

FLORIDA PUBLIC SERVICE COMMISSION
AUDIT REPORT

PROJECTED TEST PERIOD ENDING JUNE 30, 1998

FIELD WORK COMPLETED
JULY 7, 1997

HOBE SOUND WATER COMPANY
HOBE SOUND, FLORIDA
MARTIN COUNTY

RATE CASE AUDIT
DOCKET NUMBER **970164-WU**
AUDIT CONTROL NUMBER 97-119-3-1



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MINORITY OPINION

YES ___ NO EP



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07/28/97
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I. EXECUTIVE SUMMARY

AUDIT PURPOSE: We have applied the procedures described in Section II of this report to audit the schedules of Water Rate Base, Net Operating Income, and Capital Structure for the projected twelve-month period ending June 30, 1998, prepared by Hobe Sound Water Company for its petition for rate relief, FPSC Docket No. 970164-WU. This report is based on confidential information which is separately filed with the Division of Records and Reporting. The audit exit conference was held July 7, 1997.

DISCLAIM PUBLIC USE: 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.

OPINION: The Water Rate Base schedule for projected year ending June 30, 1998, represents Hobe Sound Water Company's books and records maintained in substantial compliance with Commission directives except where otherwise noted. The expressed opinions extend only to the scope of work described in Section II of this report.

SUMMARY FINDINGS:

The company incorrectly recorded \$14,161 in operations and maintenance expenses which should have been capitalized.

The company failed to reconcile its plant balances as of December 31, 1993, with prior Commission Order No. PSC-94-1452-FOF-WU resulting in understating accumulated depreciation by \$1,505.

The company failed to provide supporting documentation for \$10,122 of plant additions.

The company failed to record a \$436,875 retirement of utility plant-in-service and corresponding depreciation per NARUC Accounting Instruction 27B, (2).

The company incorrectly recorded \$63,538 for employee salaries in previously disallowed Commission Order No. PSC-94-1452-FOF-WU.

The company recorded an additional \$2,400 in computer expenses that were also included in another operations and maintenance expense account.

The company included \$3,294 for purchased electrical power which was an out-of-period charge.

The company erroneously recorded \$9,267 power generator repairs as an operations and maintenance item which was non-recurring in nature.

Revenues reported on the utility's 1995 Regulatory Assessment Fee return were understated by \$42,617 causing an underpayment of RAF fees in the amount of \$1,918.

The utility included cash as a component in its working capital allowance calculations in which this item was disallowed in prior Commission Orders 11498 and PSC-95-0574-FOF-WS.

The company included \$4,000 out-of-period charges for operations and maintenance expenses for the projected test period ending June 30, 1998.

The company failed to remove \$14,548 in accumulated depreciation for the fiscal years ending June 30, 1997, and 1998, when plant-in-service items were retired.

Included in employee salaries are substantial increases for fiscal year ended June 30, 1996, and only nominal increases for the projected fiscal years ended June 30, 1997, and 1998.

II. AUDIT SCOPE

The opinions contained in this report are based on the audit work described below. When used in this report, the following definitions shall apply.

COMPILED: The audit staff reconciled exhibit amounts with the general ledger, visually scanned accounts for error or inconsistency, disclosed any unresolved error, irregularity, or inconsistency, and except as noted, performed no other audit work.

REVIEWED: The audit staff reconciled exhibit amounts to the general ledger, traced general ledger account balances to subsidiary ledgers, applied selective analytical review procedures, and disclosed any unresolved error, irregularity, or inconsistency observed.

RATE BASE: Reconciled company plant balances established in FPSC Order No. PSC-94-1452-FOF-WU, issued November 28, 1994, to Hobe Sound Water Company's December 31, 1993 general ledger balances. Reviewed 75 percent of utility plant-in-service, land, 32 percent contributions-in-aid-of-construction (CIAC), accumulated depreciation, and amortization of CIAC for the period December 31, 1993 to June 30, 1996. Recomputed accumulated depreciation and CIAC amortization balances from July 1, 1996 to June 30, 1998. Reviewed working capital allowance balances from July 1, 1995 to June 30, 1996, and recomputed balances from July 1, 1996 to June 30, 1998.

NET OPERATING INCOME: Compiled operation and maintenance expense accounts. Judgmentally selected samples of operating expenses. Tested \$221,568 of sampled amounts for proper classification, timing, amount, and utility related. The sampled operating expenses were also traced to canceled checks for verification of payment. Sampled utility customer bills to verify that currently approved rates and charges were in effect. Recalculated revenues recorded on MFRs based on current customer types for projected test period ending June 30, 1998. Obtained and examined regulatory assessment fees for 1996. Reviewed real estate and personal property taxes for 1996.

COST OF CAPITAL: Obtained and reviewed promissory note for long-term debt. Verified interest rates. Obtained support documentation for short-debt. Recalculated weighted cost and cost of capital.

TAX RETURNS: Scanned the company's tax returns for pertinent items.

BOARD OF DIRECTORS' MINUTES: Read the company's Board of Directors' Minutes for pertinent items.

OUTSIDE AUDITORS' REPORTS: Read the company's outside auditors' reports for pertinent items.

Audit Exception No. 1

Subject: Expenses That Should be Capitalized

Facts: The company included the following items as part of its operation and maintenance expenses

Acct #	Vendor	Description	Amount
631	Bishop & Associates	Const Admin Wells	\$ 2,070
631	Bishop & Associates	Iron Compliance	1,090
631	Bishop & Associates	Iron Compliance	1,058
631	Bishop & Associates	Iron Compliance	4,438
620	Hughes Supply, Inc	Meters/Meter Supplies	716
620	Hughes Supply, Inc.	Meters/Meter Supplies	1,356
620	Hughes Supply, Inc.	Saw	795
620	Hughes Supply, Inc.	Meter Supplies	744
620	Hughes Supply, Inc.	Pipe Wrench	148
620	Elephant Repl. Co.	Jack & Bore Tools	661
620	Elephant Repl. Co.	Jack & Bore Tools	1,085

		Total:	\$14,161

The above expenses incurred within the historical period ending June 30, 1996

Per NARUC, Account No. 101,

This account shall include the original cost of utility plant, included in the plant accounts prescribed herein and in similar accounts for other utility departments, owned and used by the utility in its utility operations, and having an expected life in service of more than one year from the date of installation.

Opinion/Recommendation: The above amounts should have been capitalized to plant-in-service because they will serve more than one year. The Commission should require the company to record the following adjustments for the period ending June 30, 1998:

Increase Plant-in-Service (includes AFUDC)	\$15,197	See Schedule 1
Reduce Operations and Maintenance Expenses (includes indexing for 1997 and 1998)	\$14,883	See Schedule 1
Increase Accumulated Depreciation	\$ 1,319	See Schedule 1
Increase Depreciation Expense	\$ 734	See Schedule 1

Audit Exception No. 1 - Schedule 1

Plant in Service Adjustments

Schedule 2	2,070
Schedule 3	7,622
Schedule 4	2,072
Schedule 5	3,434

Total:	15,197
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Operation and Maintenance Expenses Adjustments

Schedule 2	2,176
Schedule 3	6,921
Schedule 4	2,177
Schedule 5	3,609

Total:	14,883
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Accumulated Depreciation Adjustments

Schedule 2	213
Schedule 3	346
Schedule 4	234
Schedule 5	525

Total:	1,319
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Depreciation Expense Adjustments

Schedule 2	69
Schedule 3	346
Schedule 4	104
Schedule 5	215

Total:	734
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Audit Exception No. 1 - Schedule 2

<i>Depreciable Amount #307</i>	<i>Period</i>	<i>Depreciation Rate - Yrs</i>	<i>Per Audit</i>
2,070.00	6/95 to 6/95	30	5.75
2,070.00	FY 1996	30	69.00
<i>Total Accum. Depr. FY 1996</i>			74.75
2,070.00	FY 1997	30	69.00
<i>Total Accum. Depr. FY 1997</i>			143.75
2,070.00	FY 1998	30	69.00
Total Accum. Depr. FY 1998			212.75

Reduction to Expenses - Account Number 631.00

<i>Year</i>	<i>Amount</i>	<i>Index</i>	<i>Proj. Amt.</i>
1997	2,070.00	1.0252	2,122.16
1998	2,122.16	1.0252	2,175.64

Audit Exception No. 1 - Schedule 3

Reduction to Expenses - Account Number 631.00

Year	Amount	Index	Proj. Amt.
	1,090.00		
	1,057.50		
	<u>4,437.50</u>		
1997	6,585.00	1.0252	6,750.94
1998	6,750.94	1.0252	6,921.07

Audit Exception No. 1 - Schedule 3

Project # DESCRIPTION ACCT #320	HOB19 Filtration Sys.	Depr. Rate	Depr Amount
Balance 10/95	0.00		
Charges 11/95	4,437.50		
Average Balance	2,218.75		
AFUDC Applied 0.815%	18.08		
Balance 11/95	<u>4,455.58</u>		
Charges 12/95	1,057.50		
Total	<u>5,513.08</u>		
Average Balance	4,984.33		
AFUDC Applied 0.815%	40.62		
Balance 12/95	<u>5,553.71</u>		
Charges 1/96	1,090.00		
Total	<u>6,643.71</u>		
Average Balance	6,098.71		
AFUDC Applied 0.815%	49.70		
Balance 1/96	<u>6,693.41</u>		
Charges 2/96	0.00		
Total	<u>6,693.41</u>		
Average Balance	6,693.41		
AFUDC Applied 0.815%	54.55		
Balance 2/96	<u>6,747.96</u>		
Charges 3/96	0.00		
Total	<u>6,747.96</u>		
Average Balance	6,747.96		
AFUDC Applied 0.815%	55.00		
Balance 3/96	<u>6,802.96</u>		
Charges 4/96	0.00		
Total	<u>6,802.96</u>		
Average Balance	6,802.96		
AFUDC Applied 0.815%	55.44		

Audit Exception No. 1 - Schedule 3

Project # DESCRIPTION ACCT #320	HOB19 Filtration Sys.	Depr. Rate	Depr Amount
Balance 4/96	6,858.40		
Charges 5/96	0.00		
Total	6,858.40		
Average Balance	6,858.40		
AFUDC Applied 0.815%	55.90		
Balance 5/96	6,914.30		
Charges 6/96	0.00		
Total	6,914.30		
Average Balance	6,914.30		
AFUDC Applied 0.815%	56.35		
Balance 6/96	6,970.65		
Charges 7/96	0.00		
Total	6,970.65		
Average Balance	6,970.65		
AFUDC Applied 0.815%	56.81		
Balance 7/96	7,027.46		
Charges 8/96	0.00		
Total	7,027.46		
Average Balance	7,027.46		
AFUDC Applied 0.815%	57.27		
Balance 8/96	7,084.73		
Charges 9/96	0.00		
Total	7,084.73		
Average Balance	7,084.73		
AFUDC Applied 0.815%	57.74		
Balance 10/96	7,142.47		
Charges 11/96	0.00		
Total	7,142.47		
Average Balance	7,142.47		
AFUDC Applied 0.815%	58.21		

Audit Exception No. 1 - Schedule 3

Project # DESCRIPTION ACCT #320	HOB19 Filtration Sys.	Depr. Rate	Depr Amount
Balance 11/96	7,200.68		
Charges 12/96	0.00		
Total	7,200.68		
Average Balance	7,200.68		
AFUDC Applied 0.815%	58.69		
Balance 12/96	7,259.37		
Charges 1/97	0.00		
Total	7,259.37		
Average Balance	7,259.37		
AFUDC Applied 0.815%	59.16		
Balance 1/97	7,318.53		
Charges 2/97	0.00		
Total	7,318.53		
Average Balance	7,318.53		
AFUDC Applied 0.815%	59.65		
Balance 2/97	7,378.18		
Charges 3/97	0.00		
Total	7,378.18		
Average Balance	7,378.18		
AFUDC Applied 0.815%	60.13		
Balance 3/97	7,438.31		
Charges 4/97	0.00		
Total	7,438.31		
Average Balance	7,438.31		
AFUDC Applied 0.815%	60.62		
Balance 4/97	7,498.93		
Charges 5/97	0.00		
Total	7,498.93		
Average Balance	7,498.93		

Audit Exception No. 1 - Schedule 3

Project #	HOB19	Depr.	Depr
DESCRIPTION ACCT #320	Filtration Sys.	Rate	Amount
AFUDC Applied 0.815%	61.12		
Balance 5/97	<u>7,560.05</u>		
Charges 6/97	0.00		
Total	<u>7,560.05</u>		
Average Balance	7,560.05		
AFUDC Applied 0.815%	61.61		
Balance 6/97	<u>7,621.67</u>	4.55%	346.44

Audit Exception No. 1 - Schedule 4

<i>Depreciable Amount #334</i>	<i>Period</i>	<i>Depreciation Rate - Yrs</i>	<i>Per Audit</i>
716.14	2/96 to 6/96	20	14.92
1,355.59	3/96 to 6/96	20	11.94
<u>2,071.73</u>			<u>26.86</u>
2,071.73	FY 1997	20	103.59
<i>Total Accum. Depr. FY 1997</i>			130.44
2,071.73	FY 1998	20	103.59
Total Accum. Depr. FY 1998			234.03

Reduction to Expenses - Account Number 631.00

<i>Year</i>	<i>Amount</i>	<i>Index</i>	<i>Proj. Amt.</i>
1997	2,071.73	1.0252	2,123.94
1998	2,123.94	1.0252	2,177.46

Audit Exception No. 1- Schedule 5

<i>Depreciable Amount #343</i>	<i>Period</i>	<i>Depreciation Rate - Yrs</i>	<i>Per Audit</i>
795.00	8/95 to 6/96	16	45.55
744.12	2/96 to 6/96	16	19.38
148.40	2/96 to 6/96	16	3.86
661.26	4/96 to 6/96	16	10.33
1,084.88	4/96 to 6/96	16	16.95
<u>3,433.66</u>			<u>96.07</u>
3,433.66	FY 1997	16	214.60
<i>Total Accum. Depr. FY 1997</i>			310.68
3,433.66	FY 1998	16	214.60
Total Accum. Depr. FY 1998			525.28

Reduction to Expenses - Account Number 620.05

<i>Year</i>	<i>Amount</i>	<i>Index</i>	<i>Proj. Amt.</i>
1997	3,433.66	1.0252	3,520.19
1998	3,520.19	1.0252	3,608.90

Audit Exception No. 2

Subject: Nonreconciliation to Prior Commission Order

Facts: The company recorded \$1,544,303 in accumulated depreciation at December 31, 1993

Per Commission Order No. PSC-94-1452-FOF-WU, accumulated depreciation was \$1,545,808 at December 31, 1993.

Opinion/Recommendation: The company failed to reconcile accumulated depreciation to the above-mentioned Commission order, resulting in understating water accumulated depreciation by \$1,505 (\$1,545,808 - \$1,544,303).

The audit staff recommends to the Commission that water accumulated depreciation be increased by \$1,505 to comply with the above Commission order

Audit Exception No. 3

Subject: Unsupported Plant

Facts: The company recorded the following \$10,122 for water utility plant-in-service at June 30, 1996.

Opinion/Recommendation: The company did not provide adequate or had no support for the plant entries referenced above. See attached Schedule 1.

The audit staff recommends to the Commission that water plant-in-service be reduced by \$10,122 to remove these unsupported entries. The audit staff further recommends to the Commission that the associated water accumulated depreciation be reduced by \$912.

AUDIT EXCEPTION NO. 3-SCHEDULE 1

	Vendor	Per Co.	Per Audit	Difference	
6/30/95	1705 JE 246	454.40		(454.40)	Insufficient support for entry
6/30/95	1705 JE 248	4,762.69		(4,762.69)	Insufficient support for entry
6/30/95	1705 JE 264	1,055.01		(1,055.01)	No support given for entry
6/30/95	1706 JE 265	800.00		(800.00)	No support given for entry
1/31/96	1706 A/P 2	3,050.47		(3,050.47)	No support given for entry
	Totals	10,122.57	0.00	(10,122.57)	

Audit Exception No. 4

Subject: Unrecorded Plant Retirement

Facts: The company has six wells that are not in use. Per the company's statement in Document Request Number Thirteen, the South Florida Water Management has mandated that these wells not be used as source wells indefinitely.

The company has recorded \$436,875 as the original cost for these wells.

Per the company's engineering consultants, the saltwater intrusion is likely to return rapidly if the wells are used as source again.

Per NARUC, Accounting Instruction Number 27B, (2), "If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to utility plant shall be charged to the accumulated depreciation applicable to such property."

Opinion/Recommendation: The audit staff believes that these wells should be retired due to the fact these wells are no longer in use and that they probably will never be used for their intended purpose again.

As a result, the audit staff recommends to the Commission that utility plant-in-service be reduced by \$436,875 to remove these wells. The audit staff further recommends to the Commission that the associated accumulated depreciation be reduced by \$436,875.

Audit Exception No. 5

Subject: Salary Expense

Facts: The company included the following salary, benefits and payroll taxes expenses in its MFRs for fiscal periods ending June 30, 1996, 1997, and 1998, as shown below for its Executive Secretary

	Salary Per MFRs	Benefits @18.45%	Payroll Taxes @8.55%
1996	\$18,512	\$ 3,415	\$ 1,583
1997	22,074	4,073	1,887
1998	22,952	4,235	1,962

In Commission Order No. 24485 the company's Executive Secretary's salary, benefits, and payroll taxes expenses were disallowed.

Also, in Commission Order No. PSC-94-1452-FOF-WU, the Executive Secretary's salary and related costs were disallowed. In this order it was stated that "normal secretarial duties for the utility were performed by the utility bookkeeper."

Per the company the "[Executive Secretary] receives 50 percent of her annual salary from the water company (reflected in the MFRs) as compensation for her duties as Corporate Secretary and her position as Executive Secretary under the Company's administrative function "

Opinion/Recommendation: The above amounts reflect 50 percent, since she works part-time for the utility company as an Executive Secretary and is the amount included in the MFRs. Per the above Commission Orders, the Executive Secretary's salary and related costs should be disallowed.

Audit Exception No. 6

Subject: Computer Expenses

Facts: The company included \$2,400, 200 x 12 months, for computer expenses in its MFRs for the fiscal periods 1996 through 1998. This amount was included in Operation and Maintenance Expense Account No. 642, Rental of Equipment.

Opinion/Recommendation: The Commission should reduce Operation and Maintenance Expenses, Account No. 642, Rental of Equipment, for \$2,400 for each period ending June 30, 1996, 1997, and 1998, for two reasons. First, the company has already projected computer-related expenses in Account No. 675, Miscellaneous Expenses, therefore, to include them in Account No. 642 would be double counting the computer expenses. Second, the company did not provide adequate supporting documentation for these expenses.

Audit Exception No. 7

Subject: Out-of-Period Purchased Power Expense

Facts: The company included thirteen billings for purchased power for its water plant in the historical period ending June 30, 1996. The historical amount was carried forward to the projected 1997 and 1998 amounts. The out-of-period amount is \$3,294.40 for Meter No. 1V53340. This amount was included in both its general ledger and MFRs, Account No. 615, Purchased Power.

Opinion/Recommendation: The Commission should reduce Operation and Maintenance Expenses, Account No. 615, for \$3,294.40 for each period ending June 30, 1996, 1997, and 1998.

Audit Exception No. 8

Subject: Generator Repair Expense

Facts: The company's generator was struck by lightning and subsequently cost \$22,993.59 to repair. The company had insurance to cover the cost except for a \$10,000 deductible. The \$10,000 was charged to Operation and Maintenance Expense Account No. 659, Insurance - Other, in its general ledger in December 1995. However, in its MFRs the amount was charged to Account No. 667, Regulatory Commission Expenses - Other, in December 1995. An offsetting entry for \$732.76 was credited to Account No. 620.01, Materials and Supplies, leaving a net of \$9,267.24 being charged to Operation and Maintenance Expenses. The net amount of \$9,267.24 was included in each period ending June 30, 1996, 1997, and 1998.

Per Commission Rule 25-30.433(8), "Non-recurring expenses shall be amortized over a 5-year period unless a shorter or longer period of time can be justified."

Opinion/Recommendation: The above net amount of \$9,267.24 should be classified as a non-recurring expense. Therefore, it should be amortized over a five-year period. The Commission should reduce operation and maintenance expenses \$7,413.79 ($9,267.24 / 5 = 1,853.45 - 9,267.24$) for each period ending June 30, 1996, 1997, and 1998.

Audit Exception No. 9

Subject: Understated Regulatory Assessment Fees

Facts: The company filed its 1995 Water System Regulatory Assessment Fee Return showing revenues of \$1,392,431 and regulatory assessment fees of \$62,659.40. However, in its general ledgers revenues are stated at \$1,435,049, a difference of \$42,617.

Opinion/Recommendation: The Commission should require the company file a Notice of Regulatory Assessment Fee Adjustment form to correct the understated revenues and regulatory assessment fees. The understated regulatory assessment fees' amount is \$1,918 ($42,617 \times 4.5\%$).

Audit Exception No. 10

Subject: Working Capital Allowance

Facts: The company recorded the following average amounts for cash \$30,259, \$59,836, and \$150,281 as of June 30, 1996, 1997, and 1998, respectively.

The accounts that the cash is placed in are interest bearing. The company uses the balance sheet method for calculating working capital allowance.

Per Commission Order No. 11498,

If the temporary cash investments earn less than the approved rate of return, the ratepayers make up the difference; conversely, if the company's return on temporary cash investment exceeds its approved rate of return, the ratepayers benefit. To prevent subsidization of the company by the ratepayers and vice versa, temporary cash investments will be excluded from working capital.

Per Commission Order No. PSC-95-0574-FOF-WS,

UIF maintains a bank account in Florida that, through a series of wire transfers, deposits all monies received into an interest bearing account in Chicago on a daily basis. Also, the balances for miscellaneous current and accrued assets are company deposits to secure electric and telephone service.

UIF is receiving interest revenues on both of the accounts illustrated above. Hence, to include them in the working capital calculation would allow the company to earn a second return on the same capital balance. Therefore, we find it appropriate to remove cash and miscellaneous current and accrued assets from the working capital calculation.

Opinion/Recommendation: The cash component of working capital is included in rate base, thus a return is given on it. If it were included in the calculation, then the utility would be receiving an additional return on the cash to the extent of the amount of the interest rate earned on it.

Therefore, the audit staff recommends to the Commission that the cash portion be removed from the calculation of working capital.

Audit Disclosure No. 1

Subject: Out-of-Period Expenses

Facts: The company included the following as part of its projected maintenance expenses in the period ending June 30, 1998.

Media Replacement (Ten-year intervals)	\$ 2,000	(\$20,000/10)
Filter Painting (Ten-year intervals)	2,000	(\$20,000/10)
Total:	<u>\$ 4,000</u>	

The above amounts came from its engineering consultants as part of an Operation and Maintenance Cost Opinion for its currently being-built catalytic filtration facilities. The amounts were included in Account Number 620, Materials and Supplies.

The above amount was indexed for 1998 as shown below in the company's MFRs:

$$\$4,000 \times 1.0252 = \$4,101$$

Opinion/Recommendation: Since the above amounts will not occur until ten years, they should not be included in the projected June 30, 1998 period. This company will probably experience another rate proceeding within that time frame and the expenses may be captured then if they have occurred. The Commission should reduce 1998 expenses for \$4,101, Account Number 620, Materials and Supplies.

Audit Disclosure No. 2

Subject: Overstatement of Accumulated Depreciation

Facts: The company recorded \$14,548 in accumulated depreciation for the periods ending June 30, 1997 and June 30, 1998. The entries are associated with unrecorded plant retirements

Opinion/Recommendation: The company failed to record the retirement of wells for the period ending June 30, 1996. If the utility had recorded the retirements, then all accumulated depreciation accruals would have stopped. As a result, the accumulated depreciation in the company's MFRs is overstated by \$14,548 in each of the periods referenced above.

The audit staff recommends to the Commission that accumulated depreciation be reduced by \$29,096 ($\$14,548 \times 2$) to remove the additional accruals. Further, the audit staff recommends that depreciation expense be reduced by \$14,548 for the periods ending June 30, 1997 and June 30, 1998

Audit Disclosure No. 3

Subject: Salaries Increase

Facts: The company increased the following personnel salaries. The amounts shown are per hour

	Before 5/11/96	After 5/11/96	Percent Change
Vice President and General Manager	\$17.85	\$28.85	61.62%
Executive Secretary	\$ 8.90	\$10.58	18.88%

In the following fiscal periods ending 1997 and 1998 their salaries increased approximately 4 percent per period as shown in the MFRs

The company gave the following explanation for the above increases on May 11, 1996.

The salary adjustment for [the Executive Secretary] and [Vice President and General Manager] occurred on May 11, 1996 and reflect the Company's change in corporate status to a 'stand-alone' entity. Prior to this time, the utility had a parent company relationship and these employees performed peripheral activities, as needed, for the parent company. The salaries of these utility employees were shared under that arrangement.

When this relationship was dissolved and utility's payroll expense was no longer subsidized by the parent company and salary's of [the Executive Secretary] and [Vice President and General Manager] were adjusted to be compensatory with levels established in the industry for utility employees holding similar positions [The Vice President and General Manager] annual salary of approximately \$60,000 is compensation for his position of Vice President-General Manager of the Hobe Sound Water Company. [The Executive Secretary] utility salary of approximately \$22,000 represent one-half of her annual compensation for her position as Corporate Secretary-Executive Secretary of the utility. [The Executive Secretary] continues to share her duties. The other half of her annual compensation is received for the time devoted to [the stockholder and Corporate President] other, outside business activities.

Opinion/Recommendation: The Commission should determine the appropriate salary for the above personnel. Salaries in the MFRs are based on 2,080 hours per year

Note: If the Executive Secretary's salary is disallowed in Audit Exception No. 5, then the above Executive Secretary portion of this audit disclosure should be omitted since this is the same person.

Schedule of Water Rate Base

Florida Public Service Commission

Company: The Hobe Sound Water Company
 Docket No. 970164-WU
 Schedule Year Ended: June 30, 1998
 Interim Final
 Historical Projected

Schedule: A-1
 Page 1 of 2

Preparer: Gary C. White
 and John F. Guastella

Explanation: Provide the calculation of average 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) Adjusted Balance 06/30/96	(3) Utility Adjustments	(4) Adjusted Balance 06/30/97	(5) Utility Adjustments	(6) Adjusted Average Balance	(7) Supporting Schedule(s)
1	Utility Plant In Service	\$8,961,803	\$1,596,847	\$8,558,650	3,373	\$8,562,023	A-5
2	Utility Land & Land Rights	3,983	0	3,983	0	3,983	A-5
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	(2,105,689)	(235,760)	(2,341,449)	(150,457)	(2,491,906)	A-9
6	Less: CIAC	(321,349)	(1,635)	(322,984)	(3,303)	(326,287)	A-12
7	Accum. Amortization of CIAC	150,991	9,983	160,973	5,081	166,054	A-14
8	Acquisition Adjustments	0	0	0	0	0	-
9	Accum. Amort. of Acq. Adjustmts	0	0	0	0	0	-
10	Advances For Construction	0	0	0	0	0	A-16
11	Working Capital Allowance	283,206	(93,424)	189,782	111,342	301,124	A-17
12	Total Rate Base	<u>\$4,972,945</u>	<u>\$1,276,011</u>	<u>\$8,248,955</u>	<u>(\$33,964)</u>	<u>\$8,214,991</u>	

Schedule of Water Net Operating Income

Florida Public Service Commission

EXHIBIT II

Company: The Hobe Sound Water Company
 Schedule Year Ended: June 30, 1998
 Interim [] Final [x]
 Historic [] and Projected [x]

Schedule: B-1
 Page 1 of 3
 Docket No. 970164-WU
 Preparer: Gary C. White
 and John F. Giustella

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) 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)	(8) %age Increase
1	OPERATING REVENUES	\$1,674,493	\$396	\$1,674,889	\$424,226	\$2,099,115	B-4	25.33%
2	Operation & Maintenance	823,755	9,836	833,591		833,591	B-5	
3	Deprec, net of CIAC Amort.	290,742	0	290,742		290,742	B-13	
4	Amortization	44,206	0	44,206		44,206	B-3	
5	Taxes Other Than Income	218,276	920	219,196	19,090	238,286	B-15	
6	Provision for Income Taxes	(33,578)	5,456	(28,122)	152,453	124,331	C-1	
7	OPERATING EXPENSES	1,343,402	16,212	1,359,614	171,543	1,531,157		
8	NET OPERATING INCOME	\$331,091	(\$16,816)	\$315,275	\$252,683	\$567,958		
9	RATE BASE	\$8,214,991		\$8,214,991		\$8,214,991		
10	RATE OF RETURN	5.33%		5.07%		9.14%		

Schedule of Requested Cost of Capital
13-Month Average Balance

Florida Public Service Commission

Company: The Hobe Sound Water Company
Docket No. 970164-WU
Schedule Year Ended: June 30, 1998
Historic [] and Projected [x]

Schedule: D-1
Page 1 of 3
Preparer: Gary C. White
and John F. Guastella
Subsidiary [] or Consolidated []

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.	Class of Capital	(1) Reconciled To Requested Rate Base	(2) Ratio	(3) Cost Rate	(4) Weighted Cost
1	Long-Term Debt	4,246,803	68.33%	8.51%	5.82%
2	Short-Term Debt	0	0.00%	10.00%	0.00%
3	Preferred Stock	0	0.00%		
4	Common Equity	1,739,045	27.98%	11.88%	3.32%
5	Customer Deposits	0	0.00%		
6	Tax Credits - Zero Cost	0	0.00%		
7	Tax Credits - Wtd. Cost	0	0.00%		
8	Accum. Deferred Income Taxes	229,143	3.69%	0.00%	0.00%
9	Other (Explain)	0	0.00%		
10	Total	<u>6,214,991</u>	<u>100.00%</u>		<u>9.14%</u>

Supporting Schedules: D-2
Recap Schedules: A-1, A-2

Debt	4,246,803	70.95%
Equity	<u>1,739,045</u>	<u>29.05%</u>
	5,985,848	100.00%

Leverage Graph =

9.05 1.131 / 0.2905 Equity Ratio = 12.94%

STATE OF FLORIDA

Commissioners:
JULIA L. JOHNSON, CHAIRMAN
J. TERRY DEASON
SUSAN F. CLARK
DIANE K. KIESLING
JOE GARCIA



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

Public Service Commission

July 16, 1997

Mr. Michael A. Carfine
Hobe Sound Water Company
Post Office Box 68
Hobe Sound, Florida 33475-0068

Re: Docket No. 970164-WU -- Hobe Sound Water Company
Rate Case Audit Report - Projected Test Period Ending June 30, 1997
Audit Control # 97-119-3-1

Dear Mr. Carfine:

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.

The Division of Records and Reporting is holding the workpapers for which you requested confidential treatment. You have 21 days from the audit exit conference, or July 28, 1997 to file a formal request for Confidential Classification with the Division of Records and Reporting.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Kay Flynn".

Kay Flynn, Chief
Records and Reporting

KF/DNV/clg

Enclosure

cc: Public Counsel
Bruce May, Esquire