

M E M O R A N D U M

March 31, 1998

TO: DIVISION OF RECORDS AND REPORTING

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

RE: DOCKET NO. 971401-WS -- BAYSIDE UTILITIES, INC.
STAFF-ASSISTED RATE CASE AUDIT REPORT
AUDIT CONTROL NO. 98-009-1-1

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 two diskettes. The diskettes 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:

Bayside Utilities, Inc.
Leonard Jeter
6325 Big Daddy Drive
Panama City Beach, FL 32407-5506

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)
Tallahassee District Office (Hicks)

Research and Regulatory Review (Harvey)
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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING*

Tallahassee District Office

BAYSIDE UTILITIES, INC.

STAFF-ASSISTED RATE CASE AUDIT

HISTORICAL YEAR ENDED DECEMBER 31, 1997

DOCKET NO. 971401-WS

AUDIT CONTROL NO. 98-009-1-1

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

MARCH 24, 1998

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

We have applied the procedures described later in this report to prepare the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the historical 12-month period ended December 31, 1997, for Bayside Utilities, Inc. These schedules were prepared by the auditor as part of the utility's petition for a staff-assisted rate case in Docket No. 971401-WS. 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 report should 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, the schedules referred to above present fairly, in all material respects, the utility's books and records, maintained in conformity with the accounting practices prescribed by the Florida Public Service Commission. The attached findings discuss all differences and other matters which were noted during our examination.

SUMMARY OF SIGNIFICANT FINDINGS

The utility does not use NARUC accounts. The utility states that all records before November 1995 were destroyed by flooding caused by Hurricane Opal. Depreciation has not been calculated using F.A.C. Rule 25-30.140. Disposition of Sewer pipe was not accounted for correctly. CIAC has not been calculated correctly and the balance has been adjusted without approval. Operating and Maintenance expenses of \$11,137 were not supported in 1997.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient 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 definitions apply 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.

Examined - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers. Selective analytical review procedures were applied, and account balances were tested to the extent further described.

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.

RATE BASE: Prepared a schedule from annual reports and examined account balances for Utility-Plant-in-Service (UPIS), Contributions-in-Aid-of-Construction (CIAC), accumulated depreciation, and accumulated amortization of CIAC from December 31, 1987. Reconciled

rate base balances authorized in Commission Order No. 20148, issued October 11, 1988, to the December 31, 1988 general ledger balance. Examined supporting documentation for CIAC additions and agreed to FPSC-approved tariff amounts. Calculated working capital using one-eighth of the utility's operation and maintenance expenses. Examined plant retirements. Calculated 1997 accumulated depreciation. Recomputed accumulated amortization of CIAC using proper rates from 1987.

NET OPERATING INCOME:

Compiled utility revenue, operating, and maintenance accounts for the year ended December 31, 1997. Recalculated customer billing register. Reviewed operation and maintenance expenses and examined the invoices and other supporting documentation. Recalculated 1997 depreciation expense. Examined support for taxes other than income.

CAPITAL STRUCTURE: Compiled components of the capital structure for the year ended December 31, 1997. Confirmed note balances at December 31, 1997. Obtained and recalculated affiliated company long-term debt.

OTHER: Reviewed external audit work papers for the twelve-month period ended December 31, 1997. Looked for items related to regulatory issues.

EXCEPTIONS

Exception No. 1

Subject: Uniform System of Accounts for Water and Wastewater

Statement of Fact: Rule 25-30.115 F.A.C. (1) states "Water and wastewater utilities shall, effective January 1, 1986, maintain its accounts and records in conformity with the 1984 NARUC Uniform System of Accounts (USOA) adopted by the National Association of Regulatory Utility Commissioners." The utility does not use the NARUC USOA.

Recommendation: The utility should maintain its accounts and records in conformity with NARUC.

Exception No. 2

Subject: Loss of Records

Statement of Facts: F.A.C. Rule 25-30.110(1)(a) 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". The utility states that all records before November 1995 were destroyed by flooding caused by Hurricane Opal.

Per the National Association of Regulatory Utility Commissioners (NARUC), Regulations to Govern the Preservation of Records of Electric, Gas and Water Utilities, General Instructions:

- C. Protection and Storage of Records,
The public utility or licensee shall provide reasonable protection for records subject to the regulations in this part from damage by fires, floods, and other hazards and, in the selection of storage spaces, safeguard the records from unnecessary exposure to deterioration from excessive humidity, dryness, or lack of proper ventilation.

- I. Premature Destruction or Loss of Records,
When any records are destroyed before the expiration of the prescribed period of retention, a certified statement listing, as far as may be determined, the records destroyed and describing the circumstances of accidental or other premature destruction shall be filed with the Commission within ninety (90) days from the date of discovery of such destruction. Discovery of loss of records is to be treated in the same manner as in the case of premature destruction.

Recommendation: The utility failed to comply with these rules. Accounting adjustments per Commission Order No. 20148 issued October 11, 1988 had to be verified indirectly because of the missing records. Failure to comply with Commission rules may result in penalties.

Exception No. 3

Subject: Depreciation Expense and Accumulated Depreciation

Statement of Facts: Bayside Utilities, Inc. has not been calculating depreciation based on Rule 25-30.140 F.A.C.

Recommendation: Depreciation and Accumulated Depreciation for 1997 has been recalculated by staff. The difference is shown below.

Depreciation Expense per Audit for Water:	\$5,843
Depreciation Expense per Company for Water:	<u>\$5,849</u>
Difference:	<u>(\$ 6)</u>

Depreciation Expense per Audit for Wastewater:	\$10,437
Depreciation Expense per Company for Wastewater:	<u>\$17,826</u>
Difference:	<u>(\$ 7,389)</u>

The utility should make the following adjustments:

	<u>DR</u>	<u>CR</u>
Accumulated Depreciation Water	\$6	
Depreciation Expense Water		\$6
Accumulated Depreciation Wastewater	\$7,389	
Depreciation Expense Wastewater		\$7,389

The above amounts are rounded to the nearest whole dollar.

Exception No. 4

Subject: Disposition of Sewer Pump

Statement of Facts: Bayside Utilities, Inc. recorded a loss on disposal of Sewer Pumps as follows:

	<u>DR</u>	<u>CR</u>
Accumulated depreciation - Wastewater	\$1,760	
Loss on disposition	\$1,757	
Depr. Expense - Sewer Pumps, Sewer		\$320
		\$3,197

NARUC Uniform System of Accounts, Accounting Instructions 5. (D) states, "When an item of plant is retired, Accumulated Depreciation shall be charged and the appropriate plant accounts shall be credited with the entire recorded original cost of plant retired regardless of the amount of depreciation which has been accumulated for this particular item of plant".

Recommendation: The utility should make the following adjustments:

	<u>DR</u>	<u>CR</u>
Accumulated Depreciation - Wastewater	\$1,757	
Loss on Disposition		\$1,757

The above amounts are rounded to the nearest whole dollar.

Exception No. 5

Subject: Contributions In Aid of Construction

Statement of Facts: Commission Order No. 20148, issued October 11, 1988, for the year ended 1987 calculated CIAC for Wastewater as \$74,026. The 1988 Annual Report shows the utility reduced the amount to \$40,344.

Recommendation: Wastewater CIAC should be increased by \$33,682. This will bring the CIAC balance for wastewater to \$74,026. This figure agrees with the Order No. 20148. There has been no additional CIAC since Order No. 20148.

The above amounts are rounded to the nearest whole dollar.

Exception No. 6

Subject: Amortization of Contributions In Aid of Construction (CIAC)

Statement of Facts: Commission Order No. 20148, issued October 11, 1988, calculated amortization of CIAC using the 1987 composite depreciation rates.

The utility did not use these rates.

Recommendation: The schedule on the following page shows the recalculation of the Accumulated Amortization of CIAC beginning in 1986 and includes the new composite depreciation rate for 1997. The amount of amortization beginning in 1997 should be \$1,704 for Water and \$2,310 for Wastewater.

The following adjustments should be made for the years 1986 through 1996:

Accumulated Amortization CIAC - Water per Auditor	\$35,691
Accumulated Amortization CIAC - Water per utility	<u>\$36,088</u>
Difference	<u>(\$ 397)</u>
Accumulated Amortization CIAC - Wastewater per Auditor	\$47,719
Accumulated Amortization CIAC - Wastewater per utility	<u>\$26,469</u>
Difference	<u>\$21,250</u>

	<u>DR</u>	<u>CR</u>
The following entries should be made to correct 1997:		
Accumulated Amortization CIAC - Water	\$ 56	
Amortization of CIAC - Water		\$ 56
Accumulated Amortization CIAC - Wastewater	\$ 1,117	
Amortization of CIAC - Wastewater		\$ 1,117

The above amounts are rounded to the nearest whole dollar.

BAYSIDE UTILITIES, INC.
Accumulated Amortization of Contributions in Aid of Construction
Per Docket No. 870093-WS Order No. 19284 and 20148

	<u>WATER</u>	<u>WASTEWATER</u>
December 31, 1986	\$18,836	\$25,472
Amortization 1987	\$ 1,429	\$ 2,591
December 31, 1987	\$20,265	\$28,063
Amortization 1988	\$ 1,714	\$ 2,184
December 31, 1988	\$21,979	\$30,247
Amortization 1989	\$ 1,714	\$ 2,184
December 31, 1989	\$23,693	\$32,431
Amortization 1990	\$ 1,714	\$ 2,184
December 31, 1990	\$25,407	\$34,615
Amortization 1991	\$ 1,714	\$ 2,184
December 31, 1991	\$27,121	\$36,799
Amortization 1992	\$ 1,714	\$ 2,184
December 31, 1992	\$28,835	\$38,983
Amortization 1993	\$ 1,714	\$ 2,184
December 31, 1993	\$30,549	\$41,167
Amortization 1994	\$ 1,714	\$ 2,184
December 31, 1994	\$32,263	\$43,351
Amortization 1995	\$ 1,714	\$ 2,184
December 31, 1995	\$33,977	\$45,535
Amortization 1996	\$ 1,714	\$ 2,184
December 31, 1996	\$35,691	\$47,719
Amortization 1997	\$ 1,704	\$ 2,310
December 31, 1997	<u>\$37,395</u>	<u>\$50,029</u>

1997 Water 3.22% * 52,911 = \$ 1,704
1997 Wastewater 3.12% * 74,026 = \$ 2,310
File: ciae

Exception No. 7

Subject: Prior Years' Depreciation Expense and Accumulated Depreciation

Statement of Facts: Commission Order No. 19284, issued May 5, 1988, ordered Bayside Utilities to record water depreciation expense at 2.7% for 1987 and 3.24% in future years. Wastewater depreciation expense should be recorded at 3.5% for 1987 and 2.95% for future years.

Recommendation: Depreciation and Accumulated Depreciation for 1987 through 1996 has been recalculated by staff. The difference is shown below:

Accumulated Depreciation per Audit (Water)	\$ 99,990
Accumulated Depreciation per Company (Water)	<u>\$ 106,653</u>
Difference	<u>(\$ 6,663)</u>

Accumulated Depreciation per Audit (Wastewater)	\$ 183,736
Accumulated Depreciation per Company (Wastewater)	<u>\$ 155,402</u>
Difference	<u>\$ 28,334</u>

The above amounts are rounded to the nearest whole dollar

DISCLOSURES

Disclosure No. 1

Subject: Operations and Maintenance Expense

Statement of Fact: The Company's reported Salary Expense, FICA/SS Employer Expense, Bad Debt Expense (Water), Bad Debt Expense (Sewer), and Miscellaneous Expense (Sewer) are as reported below:

Account No.	Account Name	Auditor's Findings	Company's Reported Amount	Amount Overstated
701000	Salary Expense:			
	<i>water</i>	5,321	6,235	(914)
	<i>sewer</i>	<u>5,321</u>	<u>6,235</u>	<u>(914)</u>
		10,642	12,470	(1,828)
701700	FICA/SS Expense:			
	<i>water</i>	405	470	(65)
	<i>sewer</i>	<u>405</u>	<u>470</u>	<u>(65)</u>
		810	940	(130)
711501	Bad Debt Expense(Sewer)	745	4697	(3,952)
711502	Bad Debt Expense(Water)	745	4513	(3,768)
712001	Misc. Expense(Sewer)	0	1461	(1,461)
TOTAL:				
<i>Water</i>		6,471	11,218	(4,746)
<i>Sewer</i>		6,471	12,863	<u>(6,392)</u>
				(11,138)

Recommendations: The company's amounts are not fully supported by the utility's books and records. The audit staff recommends the utility adjust the above accounts.

The above amounts are rounded to the nearest whole dollar.

Disclosure No. 2

Subject: Retained Earnings and Long Term Debt

Statement of Facts: The retained earnings balance of the utility is negative and 92% of long-term debt is from an affiliated company.

Recommendation: Since the retained earnings balance is negative the utility's Capital Structure is 100% debt. In 1997 the affiliated company arranged a long-term variable rate loan through a bank with a beginning rate of 10.5%. This rate can change daily and can be between 8.5% and 11%. The affiliated company average long term debt rate was 9.46% on October 15, 1997.

All of the loans made by the affiliate to the utility are at 10% fixed rate. Because the rate from the bank to the affiliate can vary between 8.5% and 11%, the auditor recommends that the fixed rate between the affiliate and the utility of 10% be used.

**BAYSIDE UTILITIES, INC.
STAFF-ASSISTED RATE CASE
RATE BASE BALANCES- WATER
TEST YEAR ENDED 12/31/97**

EXHIBIT I

DESCRIPTION	12/31/97	12/31/96	CHG	BALANCE PER AUDIT 12/31/97
Supply Main - Pumping	4,904			4,904
Pumping Equipment	211			211
Distribution Main	105,848			105,848
Services	26,067			26,067
Meters, Valves, etc.	34,144			34,144
Hydrants, etc.	1,828			1,828
Office Furniture & Equipment	1,388			1,388
Transportation Equipment	6,962			6,962
Accumulated Depreciation	(112,502)	6,663	E - 7 E - 3	(105,833)
C.T.A.C.	(52,911)			(52,911)
Accum. Amortization	37,736	(397)	E - 6 E - 6	37,395
Working Capital {1}		5,563	{1}	5,563
TOTAL	53,675	11,891		65,566

{1} FOOTNOTES: Working Capital was calculated at 1/8 O & M expense per Commission policy.

The above amounts are rounded to the nearest whole dollar.

**BAYSIDE UTILITIES, INC.
STAFF-ASSISTED RATE CASE
RATE BASE BALANCES- WASTEWATER
TEST YEAR ENDED 12/31/97**

EXHIBIT II

Pumping Station	6,010			6,010
Office Building	1,388			1,388
Transmission	6,962			6,962
Collection	51,141			51,141
Collection System	75,263			75,263
Treatment	196,560			196,560
Accumulated Depreciation	(171,788)	1,757 7,389 (28,334)	E - 4 E - 3 E - 7	(190,976)
Streams & Interconnections	12,200			12,200
C. T. A. S.	(40,344)	(33,682)	E - 5	(74,026)
Accounting	27,662	21,250 1,117	E - 6 E - 6	50,029
Working Capital		5,019	{1}	5,019
TOTALS	165,054	(25,484)		139,570

{1} FOOTNOTES: Working Capital was calculated at 1/8 O & M expense per Commission policy.

The above amounts are rounded to the nearest whole dollar.

BAYSIDE UTILITIES, INC.
STAFF-ASSISTED RATE CASE
NET OPERATING INCOME - WATER
TEST YEAR ENDED 12/31/97

EXHIBIT III

DEBIT	CREDIT	NET OPERATING INCOME	BALANCE	CHANGE
<i>Operating Revenue</i>				
Metered	20,290			20,290
RFIC	30,004			30,004
Other	1,041			1,041
<i>Operating Expenses</i>				
O & M Expense	49,248	(4,746)	D - 1	44,502
Depreciation Expense	5,849	(6)	E - 3	5,843
Fuel Expense	2,925			2,925
Income Tax Expense	0			0
Amortization Expense Water	(1,648)	(56)	E - 6	(1,704)
Net Operating Profit (Loss)				
	(5,039)	(4,808)		(231)

The above amounts are rounded to the nearest whole dollar.

{1} No income tax since utility has a net taxable loss.

BAYSIDE UTILITIES, INC.
STAFF-ASSISTED RATE CASE
NET OPERATING INCOME - WASTEWATER
TEST YEAR ENDED 12/31/97

EXHIBIT IV

Description	Amount	Adjustments	Code	Balance per Audit
Operating Revenue				
Revenue	26,450			26,450
Rate	28,263			28,263
Other	1,041			1,041
Operating Expenses				
Cost of Service	48,302	(6,392) (1,757)	D - 1 E - 4	40,153
Depreciation	17,826	(7,389)	E - 3	10,437
Revenue	3,304			3,304
Income	0			0
Amortization	(1,193)	(1,117)	E - 6	(2,310)
Net Operating Income	(12,485)	(16,655)		4,170

The above amounts are rounded to the nearest whole dollar.

{1} No income tax since utility has a net taxable loss.

BAYSIDE UTILITIES, INC.
STAFF-ASSISTED RATE CASE
CAPITAL STRUCTURE - WATER AND WASTEWATER
TEST YEAR ENDED 12/31/97

EXHIBIT V

DESCRIPTION	AMOUNT	AMOUNT	EXEMPT	AMOUNT	RATE	COST RATE	WEIGHTED AVERAGE COST OF CAPITAL
Retained Earnings	(42,935)	4,808 16,655	Ex - III Ex - IV	(21,472)	0	0%	0
Notes Payable Bayside Real Estate	9,500			9,500	3	10%	.31%
Notes Payable Bayside Park	272,820			272,820	89	10%	8.90%
Notes Payable SBA Loan	24,242			24,242	8	4%	.32%
TOTALS	263,627	21,463		285,090	100		9.53%

FOOTNOTES: Zero Cost Rate for Negative Retained Earnings

The above amounts are rounded to the nearest whole dollar.