

M E M O R A N D U M

November 4, 1996

TO: DIVISION OF RECORDS AND REPORTING

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

RE: DOCKET NO. **960984-SU** -- NORTH PENINSULA UTILITIES CORPORATION  
OVEREARNINGS INVESTIGATION AUDIT REPORT - PERIOD ENDED JUNE 30, 1996  
AUDIT CONTROL NO. 96-243-3-1

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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, including the confidential portions, to:

Robert Hillman  
North Peninsula Utilities Corporation  
Post Office Box 2803  
Ormond Beach, FL 32175-2803

DNV/sp

Attachment

cc: Chairman Clark  
Commissioner Deason  
Commissioner Johnson  
Commissioner Kiesling  
Commissioner Garcia  
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

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FPSC-RECORDS/REPORTING



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**I. EXECUTIVE SUMMARY**

**Audit Purpose:** We have applied the procedures described in Section II of this report to prepare proposed schedules of Rate Base, Net Operating Income, and Capital Structure for the twelve months ended June 30, 1996, North Peninsula Utilities Corporation and prepared pro forma adjustments which are presented as audit disclosures.

**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 schedules of Rate Base, Net Operating Income, and Capital Structure for the twelve-month period ended June 30, 1996, represent company's books and records not maintained in substantial compliance with Commission directives. The expressed opinions extend only to the scope of work described in Section II of this report.

**Summary Findings:**

Field staff excluded \$33,892.14 of interest from operating expenses.

Wastewater accumulated depreciation was reduced by \$20,738.15.

Prior period legal expenditures of \$19,890.66 charged to operations were excluded.

## II. AUDIT SCOPE

The opinions contained in this report are based on the audit work described below. When used in this report, compiled means that audit work includes:

**COMPILED:** means that 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.

**Rate Base:** Prepared North Peninsula Utilities, Inc.'s wastewater rate base at June 30, 1996. Traced seventy-five percent of all wastewater plant additions from September 1, 1989 through June 30, 1996, to supporting documentation. Recomputed the depreciation reserve and accumulated amortization at June 30, 1996, and computed the working capital allowance on staff-adjusted operation and expense. Ascertained that all rate adjustments per Commission Order No. 22345 were properly reflected via the utility's books and records.

**Net Operating Income:** Prepared Wastewater Net Operating Income Statement for the twelve-month period ended June 30, 1996. Traced approximately eighty percent of test year operating expenses to source documentation. Recalculated individual test year billings on a sample basis.

**Capital Structure:** Compiled equity and debt account balances at June 30, 1996, and obtained a copy of loan agreements funding utility investment.

**Other:** Scanned the utility's federal income tax returns for calendar years 1989 through 1995. Prepared trial balance at June 30, 1996. Ascertained that amount subject to allocation were reasonably distributed. Toured the wastewater plant facilities.

**AUDIT EXCEPTION NO. 1**

**SUBJECT: UTILITY BOOKS AND RECORDS**

**FACTS:** The books and records of the utility were not maintained in substantial compliance with NARUC Wastewater Class "C," Accounting Instructions 11A & B. The examination was compromised based on the following deficiencies:

Account descriptions and corresponding numbering for accounts differed from those designated per the Uniform System of Accounts.

The supporting documentation (invoices) in many instances did not reflect the account charged and check number in remittance.

Costs subject to allocation were arbitrarily distributed and not based on correlating factors.

There was an inadequate trail between utility records and source documentation.

**OPINIONS & CONCLUSIONS:** Utility President Tyree Wilson and Vice President Robert Hillman acknowledged the aforementioned problems and cooperatively indicated that every effort will be made to achieve full compliance with all FPSC record-keeping requirements.

**RECOMMENDATION:** Direct utility to comply with NARUC.

**AUDIT EXCEPTION NO. 2**

**SUBJECT: INTEREST EXPENSE**

**FACTS:** The utility charged \$33,892.14 of interest on promissory notes to operations via NonNARUC Accounts 5452, 5455, 5456, and 5460 during the twelve months ended June 30, 1996.

In accordance with NARUC Wastewater Class "C," Account 427, Interest Expense, all interest costs should be reflected therein.

**OPINIONS/CONCLUSIONS:** Utility was not in compliance with above-referenced instruction.

**RECOMMENDATION:** Field staff recommends that operating expense be reduced by \$33,892.14, and below the line Account 427 increased the same.

**AUDIT EXCEPTION NO. 3**

**SUBJECT: LEGAL EXPENSE**

**FACTS:** The utility charged \$19,890.66 of legal expenses to operations via NonNARUC Account 5150, Professional Services, during the twelve months ended June 30, 1996.

**OPINION/CONCLUSIONS:** Company representatives informed field staff that the utility and DEP were codefendants in a suit filed by Thomas Visconti and The Seabridge Civic Association.

The litigation revolved around the coplaintiffs' claims that normal regulatory procedures were not followed in the utility's expansion of its franchise area and wastewater treatment plant. Coplaintiff Visconti also alleged that the expansion of the treatment plant also lowered his property value.

The codefendants prevailed in the suit which began in 1993 and concluded in 1995.

The law firm of Storch, Hansen, & Morris provided all of the legal services applicable to the case.

**RECOMMENDATION:** Field staff recommends that test year operating expenses be reduced by \$19,890.66 as the charges were applicable to prior periods and nonrecurring. It is further recommended that the total amount be charged to Deferred Debits, Account 186, and amortized over a period of time as determined by the FPSC analyst.



**AUDIT EXCEPTION NO. 4**

**SUBJECT: TRAVEL AND ENTERTAINMENT EXPENSES**

**FACTS:** The utility charged travel and entertainment expense of \$4,636.62 and \$1,392.24 via NonNARUC Accounts 5720 and 5722 during the twelve months ended June 30, 1996.

In accordance with NARUC Wastewater Class "C" Account 426, Miscellaneous Nonutility Expenses, all entertainment and any travel expense not related to utility's operations should be reflected therein.

**OPINION & CONCLUSIONS:** Utility representatives informed field staff that a portion of travel expense was connected with utility business; however, documentation was not made available to substantiate.

**RECOMMENDATION:** Field staff recommends that travel and entertainment expense be reduced by \$4,636.62 and \$1,392.24, and net operating income be increased by \$6,028.86 until such time that the utility can provide support for any utility-related expenditures.

**AUDIT EXCEPTION NO. 5**

**SUBJECT: MISCLASSIFIED CAPITAL EXPENDITURES**

**FACTS:** Attachment A is a list of capital expenditures charged to operations by the utility during the twelve months ended June 30, 1996.

In accordance with NARUC Wastewater, Class "C" Instructions per Account 101, all utility capital additions should be charged to plant-in-service.

**OPINION/CONCLUSIONS:** Utility was not in compliance with above-referenced instruction.

Depreciation was computed based on Rule 25-30.140.

**RECOMMENDATION:** District staff recommends that the utility record the following journal entry to reflect the reclassification of costs:

101-370	Receiving wells	\$1,277.65	
101-354	Structures & Improvements	750.00	
101-380	T&D Equipment	442.90	
403	Depreciation	73.14	
5200	Repairs & Maintenance		\$1,720.55
5150	Professional Services		750.00
108	Accumulated Depreciation		<u>73.14</u>
		<u>\$2,543.69</u>	<u>\$2,543.69</u>

Attachment A to Audit Exception No. 5

<u>Payer</u>	<u>Description</u>	<u>Oper. Account Charged By Utility</u>	<u>NARUC Designated Account</u>	<u>Capitalized Amount</u>	<u>Dep./ Acc.Dep.</u>
Zev Cohen	Engineering work on STP Expansion Ck #2807/ 2/21/96 \$(50) Ck #2837/ 3/22/96 \$(700)	5150 (Prof. Svcs.)	101/354	\$ 750.00	\$ 10.65
Wetherell	New motor on surge tank Ck #2641-8/7/95	5200 (Repairs & Maint.)	101/380	442.90	27.04
Wetherell	Complete rebuild of lift station pump GJ 11-2/2/96	5200 (Repairs & Maint.)	101/370	<u>1,277.65</u>	<u>35.45</u>
				<u>\$2,470.55</u>	<u>\$ 73.14</u>

**AUDIT EXCEPTION NO. 6**

**SUBJECT: AMORTIZATION OF LOAN COSTS**

**FACTS:** The utility reflected loan closing costs (Non-NARUC Account 2600) and accumulated amortization of loan closing costs (NonNARUC Account 2650) of \$6,968.50 at June 30, 1996.

Income Statement Account 5482 reflected test year amortization of the closing costs of \$8,710.63.

**OPINION/CONCLUSIONS:** The loan closing costs were over-amortized by \$1,742.13 (\$8,710.63 - \$6,968.50) during the twelve months ended June 30, 1996.

The loan costs extend over more than one period and, accordingly, should be amortized over the life of the loan.

**RECOMMENDATION:** Field staff recommends that test year amortization be reduced by \$8,710.63, and net operating income be increased by the same.

**AUDIT EXCEPTION NO. 7**

**SUBJECT: WORKING CAPITAL ALLOWANCE**

**FACTS:** The working capital allowance has been computed based on the 1/8 formula method to comply with Commission Order No. 21202.

**OPINION/CONCLUSIONS:** The wastewater working capital allowance was computed as \$10,095.21 based on staff-adjusted operations and maintenance expense of \$80,761.88.

**RECOMMENDATION:** Field staff recommends that rate base be increased by \$10,095.21 to reflect said allowance.

**AUDIT EXCEPTION NO. 8**

**SUBJECT: CONTRIBUTIONS**

**FACTS:** The utility charged \$150.00 of charitable contributions to operations, via NonNARUC Account 5740, during the twelve months ended June 30, 1996.

In accordance with NARUC Wastewater Class "C" Account 426, Miscellaneous Nonutility Expenses, all charitable donations should be reflected therein.

**OPINIONS & CONCLUSIONS:** The utility was not in compliance with above-referenced instruction.

**RECOMMENDATION:** Field staff recommends that utility operating expenses be reduced by \$150.00 during the test year ended June 30, 1996.

**AUDIT EXCEPTION NO. 9**

**SUBJECT: PURCHASED POWER EXPENSES**

**FACTS:** The utility charged purchased power and water expense of \$13,257.40 via NonNARUC Account 5100 (utilities) during the twelve months ended June 30, 1996.

Purchased power expense of \$869.07, applicable to the test year, was not reflected per utility's books whereas prior period electric charges of \$744.16 were booked during the twelve months ended June 30, 1996.

**OPINIONS & CONCLUSIONS:** Purchased power expense was understated by \$124.91 during the test year (\$869.07 - \$744.16).

**RECOMMENDATION:** Field staff recommends that purchased power expense be increased by \$124.91.

**AUDIT EXCEPTION NO. 10**

**SUBJECT: INTEREST INCOME**

**FACTS:** The utility charged \$122.04 of interest income via NonNARUC Account 4100 to operating revenues during the twelve months ended June 30, 1996.

In accordance with NARUC Wastewater Class "C" Account 419, Interest and Dividend Income, all income derived from interest should be reflected therein.

**OPINION/CONCLUSIONS:** Utility was not in compliance with above-referenced instruction.

**RECOMMENDATION:** Field staff recommends that operating revenues be reduced by \$122.04, and Account 419 be increased by the same.



**AUDIT EXCEPTION NO. 11**

**SUBJECT: ORDER 22345 ADJUSTMENTS**

**FACTS:** The Commission, via Order 22345, established August 30, 1989 balances for utility plant-in-service and CIAC as \$524,287 and \$418,494.

The utility reflected plant and CIAC-adjusted balances of \$524,407 and \$419,244.

**OPINION/CONCLUSIONS:** The utility recorded thirteen-month average adjustments of \$120 and \$750 to plant and CIAC.

**RECOMMENDATION:** Field staff recommends that plant and CIAC balances be reduced by \$120 and \$750 to comply with Commission Order 22345 issued December 27, 1989.

**AUDIT EXCEPTION NO. 12**

**SUBJECT: DEPRECIATION AND AMORTIZATION**

**FACTS:** Field staff computed test year depreciation and amortization and updated the accumulated balances at June 30, 1996, as the utility was unable to provide complete schedules in support of the amounts reflected on its books.

**OPINION/CONCLUSIONS:** The differences between field staff computation, based on Rule 25-30.140, and utility's book balances are as follows:

Accumulated depreciation per staff @6-30-96	\$331,436.85
Accumulated depreciation per utility @6-30-96	<u>352,175.00</u>
	\$ 20,738.15
Accumulated amortization per staff @6-30-96	\$269,344.82
Accumulated amortization per utility @6-30-96	<u>267,797.62</u>
	\$ 1,547.20
Test year depreciation (net of amortization) per staff	\$ 6,823.02
Test year depreciation (net of amortization) per utility	<u>9,950.22</u>
	<u>\$ 3,127.20</u>

**RECOMMENDATION:** Field staff recommends that accumulated depreciation at June 30, 1996, and test year depreciation be reduced by \$20,738.15 and \$3,127.20, respectively, and that accumulated amortization be increased by \$1,547.20.

**AUDIT DISCLOSURE NO. 1**

**SUBJECT: COMMON EXPENSE**

**FACTS:** The utility charged Office Supplies (NonNARUC Account 5300), Office Expense (NonNARUC Account 5320), Office Rent (NonNARUC Account 5565), Telephone (NonNARUC Account 5725), Postage (NonNARUC Account 5735), and Automobile Lease Expense (NonNARUC Account 5750) of \$1,286.04, \$2,916.64, \$2,504.25, \$2,837.92, \$1,721.50, and \$2,681.04, respectively, during the twelve months ended June 30, 1996.

**OPINION:** The utility headquarters is located at 1460 Oceanshore Boulevard in Ormond Beach, Florida. The office is shared with development companies, Ocean Dunes, Inc., and Wellington Station, Inc., of which utility President Tyree Wilson and Vice President Robert Hillman are shareholders.

Field staff determined, upon review of the above accounts, that virtually all charges were common expenses and subject to allocation. Mr. Wilson and Mr. Hillman acknowledged the commonality of the charges. There were also three office electric bills totaling \$186.07 that were charged to NonNARUC Account 5100, Utilities, during the twelve months ended June 30, 1996.

Mr. Wilson and Mr. Hillman informed staff that they are revising their management agreement to incorporate all common expenses under overhead costs. They stated that the agreement will contain the basis for all distributions of costs and will be forwarded to Tallahassee as soon as possible.

The utility charged \$20,000 of management fees via NonNARUC Account 5160 to operations during the twelve months ended June 30, 1996.

## EXHIBIT I

**NORTH PENINSULA UTILITIES CORPORATION  
RATE BASE-WASTEWATER  
@6-30-96**

	Per Utility Books <u>@6-30-96</u>	<u>Adjustments</u>	Refer To	Staff Adjusted Balance <u>@6-30-96</u>
Utility Plant-in-Service	\$781,226.87	\$ 1,277.65	AE5	\$783,577.42
		750.00	AE5	
		442.90	AE5	
		(120.00)	AE11	
Accumulated Depreciation	(352,175.00)	( 73.14)	AE5	(331,509.99)
		20,738.15	AE5	
Land	46,800.00			46,800.00
CIAC	(630,494.00)	750.00	AE11	629,744.00
Acc. Amortization	267,797.62	1,547.20	AE12	269,344.82
Wk. Cap. Allowance	<u>-0-</u>	<u>10,095.21</u>	AE7	<u>10,095.21</u>
<b>RATE BASE</b>	<b><u>\$113,155.49</u></b>	<b><u>\$ 35,407.97</u></b>		<b><u>\$148,563.46</u></b>

**EXHIBIT II**

**NORTH PENINSULA UTILITIES CORPORATION  
NET OPERATING INCOME-WASTEWATER  
TYE 6-30-96**

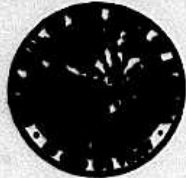
	<b>Per Utility Books @6/30/96</b>	<b>Adjustments</b>	<b>Refer To</b>	<b>Staff Adjusted Balance @6/30/96</b>
<b>Operating Revenues</b>	\$143,811.42	\$ 122.04	AE10	\$143,689.38
<b>Operating Expenses:</b>				
<b>O&amp;M Expense</b>	143,318.80	(33,892.14) (19,890.66) ( 4,636.62) ( 1,392.24) ( 1,720.55) ( 750.00) ( 150.00) ( 124.91)	AE2 AE3 AE4 AE4 AE5 AE5 AE8 AE9	80,761.68
<b>Depreciation</b>	9,950.22	73.14 (3,127.20)	AE5 AE12	6,896.16 6,896.16
<b>Amortization</b>	8,710.63	( 8,710.63)	AE6	-0-
<b>Taxes Other Than Income</b>	<u>18,866.48</u>			<u>\$ 18,866.48</u>
<b>Total Operating Income</b>	<u>\$180,846.13</u>	<u>\$ 74,321.81</u>		<u>\$106,524.32</u>
<b>Net Operating Income</b>	<u>\$ 37,034.71</u>	<u>\$ 74,199.77</u>		<u>\$ 37,165.06</u>

Exhibit III

**NORTH PENINSULA UTILITIES CORP.  
COST OF CAPITAL  
TYE 6-30-96**

	<u>Cost</u>	<u>Ratio</u>	<u>Rate</u>	<u>Weighted Cost</u>
Equity	\$(172,437.89)	-	-	-
N/P - First State Bank of Florida	<u>295,000.00</u>	<u>100%</u>	<u>10.02</u>	<u>10.02%</u>
	<u>295,000.00</u>	<u>100%</u>		<u>10.02%</u>

State of Florida



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

DIVISION OF RECORDS &  
REPORTING  
BLANCA S. BAYO  
DIRECTOR  
(904) 413-6770

## Public Service Commission

November 6, 1996

Robert Hillman, Vice President  
North Peninsula Utilities Corporation  
Post Office Box 2803  
Ormond Beach, Florida 32175-2803

RE: Docket No. 960984-SU -- North Peninsula Utilities Corporation  
Overearnings Investigation Audit Report - Period Ended June 30, 1996  
Audit Control # 96-243-3-1

Dear Mr. Hillman:

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. Bayo

BSB/mas  
Enclosure  
cc: Public Counsel  
Rachlin & Cohen Law Firm