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State of Florida



Public Service Commission

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DATE: March 24, 2004
TO: Division of Economic Regulation (Fletcher, Biggins)
FROM: Division of Auditing and Safety (Vandiver) W
RE: **Docket No.** 030444-WS; **Company Name:** Bayside Utility Services, Inc.; **Audit Purpose:** Rate case audit for the historical test year Ended December 31, 2002; **Audit Control No.** 04-036-3-3

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, it should send the response to the Division of the Commission Clerk and Administrative Services. There are no confidential work papers associated with this audit.

DNV/jcp
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
Division of the Commission Clerk and Administrative Services (2)
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

BAYSIDE UTILITY SERVICES, INC.

FILE AND SUSPEND PETITION FOR RATE RELIEF

BAY COUNTY

HISTORICAL PERIOD ENDED DECEMBER 31, 2002

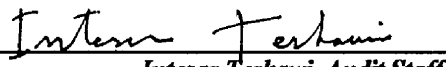
**DOCKET NO. 030444-WS
AUDIT CONTROL NO. 04-036-3-2**



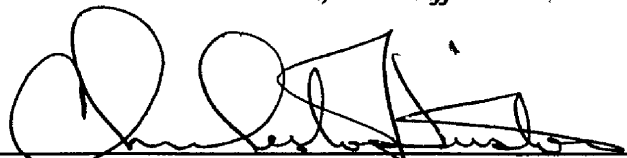
Jeffery A. Small, Audit Manager



Asst Kathy E. Welch, Audit Staff



Intesar Terkawi, Audit Staff



Charleston J. Winston, District Audit Supervisor

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**DIVISION OF AUDITING AND SAFETY
AUDITOR'S REPORT**

MARCH 19, 2004

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the historical 12-month period ended December 31, 2002, for Bayside Utility Services, Inc.'s water and wastewater operations located in Bay County, Florida. These schedules were prepared by the utility as part of its petition for rate relief in Docket No. 030444-WS.

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.

SUMMARY OF SIGNIFICANT FINDINGS

The utility did not record the prior Order adjustments to its books and records correctly.

The utility's water and wastewater utility-plant-in-service (UPIS) are overstated by \$39,365 and \$18,798, respectively, because it includes acquisition costs that should be removed for ratemaking proceedings.

The utility's water and wastewater UPIS are overstated by \$3,215 and \$1,548, respectively, because it includes costs that should have been recorded as operation and maintenance expenses (O&M) or to other utility systems.

The utility's water and wastewater UPIS are overstated by \$2,052 and understated by \$6,134, respectively, because of improper common plant allocations.

The utility's water and wastewater accumulated depreciation are understated by \$12,263 and \$37,846, respectively, because its 1999 adjustments improperly removed the 1998 and 1999 accruals and compounded the error in booking the prior Order discussed above.

The utility's wastewater accumulated depreciation is understated by \$17,555 because it used the wrong service life to depreciate Account No. 380, Treatment and Disposal Equipment.

The utility did not include the effect of the new Internal Revenue Service tax laws concerning accelerated depreciation in its deferred tax balance reported in the filing.

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.

Verified - The item was tested for accuracy and compared to substantiating documentation.

RATE BASE: Reviewed and verified account balances for UPIS, land, contributions-in-aid-of-construction (CIAC), accumulated depreciation (AD), accumulated amortization of CIAC (AAC), and working capital (WC) for Bayside Utility Services, Inc. as of December 31, 2002. Reconciled rate base balances authorized in Commission Order No. PSC-99-1818-PAA-WS, issued September 20, 1999, to the utility's general ledger.

NET OPERATING INCOME: Reviewed utility revenues and operating and maintenance accounts for the year ended December 31, 2001. Chose a judgmental sample of customer bills and recalculated using FPSC-approved rates. Verified a judgmental sample of O&M expenses. Reviewed the allocation of O&M expenses from Water Service Corporation (WSC) and Utilities, Inc. of Florida (UIF) cost centers to Bayside Utility Services, Inc. and verified the accuracy of company allocations based on company-provided allocation schedules. Tested the calculation of depreciation and CIAC amortization expense. Compiled support for taxes other than income and income taxes.

CAPITAL STRUCTURE: Reviewed the components of the capital structures for the year ended December 31, 2002. Agreed interest expense to the terms of the notes. Verified note balances at December 31, 2002.

OTHER: Scanned the utility's December 31, 2002, Regulatory Assessment Fee Returns.

Exception No. 1

Subject: Adjustment to Prior Orders

Statement of Facts: Order No. PSC-98-1269-FOF-WS, issued September 24, 1998, in Docket No. 971401-WS, Staff-Assisted Rate Case, established rate base balances for Bayside Utility Services, Inc. as of December 31, 1997.

Order No. PSC-99-1818-PAA-WS, issued September 20, 1999, Docket No. 981403-WS, Certificate of Transfer, carried forward these rate base balances for Bayside Utility Services, Inc. as of December 31, 1997. These balances are shown below.

	<u>Water Rate Base as of 12/31/97</u>	<u>Wastewater Rate Base as of 12/31/97</u>
Utility-Plant-in-Service	\$181,352	\$349,524
Land	0	0
CIAC	(52,911)	0
Accumulated Depreciation	(106,993)	(143,982)
Amortization of CIAC	<u>37,736</u>	<u>0</u>
Rate Base	\$59,184	\$205,542

The utility recorded the following acquisition journal entries in 1999 when the above Certificate of Transfer Order became final.

	<u>Water Rate Base</u>	<u>Wastewater Rate Base</u>
Utility-Plant-in-Service	\$189,702	\$341,362
Land	0	0
CIAC	(52,911)	0
Accumulated Depreciation	(111,728)	(132,568)
Amortization of CIAC	<u>36,715</u>	<u>0</u>
Rate Base	\$61,778	\$208,794

Recommendation: The utility's water utility-plant-in-service and accumulated depreciation balances are overstated by \$8,350 and 4,735, respectively, as of December 31, 2002, because it incorrectly recorded the Commission-approved transfer balance referenced above. See Schedule A that follows for details.

The utility's water amortization of the CIAC balance is understated by \$1,021 (\$37,736 - \$36,715) as of December 31, 2002, because it incorrectly recorded the Commission-approved transfer balance referenced above.

The utility's wastewater utility-plant-in-service and accumulated depreciation balances are understated by \$8,162 and \$11,414, respectively, as of December 31, 2002, because it incorrectly recorded the Commission-approved transfer balance referenced above. See Schedule B that follows for details.

Schedule A for Exception No. 1

Water- UPIS

<u>Acct#</u>	<u>Acct. Description</u>	<u>1999 Utility Acquisition Entry</u>	<u>Per Order @12/31/1997</u>	<u>Audit Adjustment</u>
309	Supply Mains	\$0	\$4,904	\$4,904
311	Pumping Equipment	211	211	0
331	Trans. Distr. Mains	110,753	105,849	(4,904)
333	Services to Customers	26,066	26,066	0
334	Meters & Meter Installations	34,144	34,144	0
335	Hydrants	1,828	1,828	0
340	Office Furniture & Equipment	2,776	1,388	(1,388)
341	Transportation Equipment	<u>13,924</u>	<u>6,962</u>	<u>(6,962)</u>
		\$189,702	\$181,352	(\$8,350)

Water-Accumulated Depreciation

<u>Acct#</u>	<u>Acct. Description</u>	<u>1999 Utility Acquisition Entry</u>	<u>Per Order @12/31/1997</u>	<u>Audit Adjustment</u>
309	Supply Mains	\$0	(\$1,543)	(\$1,543)
311	Pumping Equipment	(102)	(64)	38
331	Trans. Distr. Mains	(59,067)	(72,231)	(13,164)
333	Services to Customers	(15,647)	(16,902)	(1,255)
334	Meters & Meter Installations	(19,127)	(11,411)	7,716
335	Hydrants	(1,313)	(1,403)	(90)
340	Office Furniture & Equipment	(2,548)	(475)	2,073
341	Transportation Equipment	<u>(13,924)</u>	<u>(2,965)</u>	<u>10,959</u>
		(\$111,728)	(\$106,994)	\$4,735

Schedule B for Exception No. 1

Wastewater- UPIS

<u>Acct#</u>	<u>Acct. Description</u>	<u>1999 Utility Acquisition Entry</u>	<u>Per Order @12/31/1997</u>	<u>Audit Adjustment</u>
354	Structure & Improvements	\$12,200	\$0	(\$12,200)
360	Collection Sewers - Forced	51,141	63,341	12,200
361	Collection Sewers - Gravity	75,263	75,263	0
370	Receiving Wells	0	6,010	6,010
380	Treatment and Disposal Equipment	202,758	196,560	(6,198)
390	Office Furniture & Equipment	0	1,388	1,388
391	Transportation Equipment	<u>0</u>	<u>6,962</u>	<u>6,962</u>
		\$341,362	\$349,524	\$8,162

Wastewater-Accumulated Depreciation

<u>Acct#</u>	<u>Acct. Description</u>	<u>1999 Utility Acquisition Entry</u>	<u>Per Order @12/31/1997</u>	<u>Audit Adjustment</u>
354	Structure & Improvements	(\$452)	(\$75)	\$377
360	Collection Sewers - Forced	(26,716)	(31,013)	(4,297)
361	Collection Sewers - Gravity	(47,134)	(54,490)	(7,356)
370	Receiving Wells	0	814	814
380	Treatment and Disposal Equipment	(58,266)	(55,940)	2,326
390	Office Furniture & Equipment	0	(475)	(475)
391	Transportation Equipment	<u>0</u>	<u>(2,803)</u>	<u>(2,803)</u>
		(\$132,568)	(\$143,982)	(\$11,414)

Exception No. 2

Subject: Organization and Franchise Costs

Statement of Facts: The utility's filing reflects the following balances for the indicated accounts as of December 31, 2002.

<u>System</u>	<u>Acct. No.</u>	<u>UPIS</u>	<u>Accumulated Depreciation</u>	<u>Depreciation Expense</u>
Water	301	\$21,194	(\$1,383)	\$530
	302	<u>18,171</u>	<u>(1,186)</u>	<u>454</u>
		\$39,365	(\$2,569)	\$984
W/Water	351	\$9,500	(\$711)	\$237
	352	<u>9,298</u>	<u>(928)</u>	<u>277</u>
		\$18,798	(\$1,639)	\$514

NARUC, Utility Plant Accounts, Accounts Nos. 301 and 351 should include all fees paid to federal or state governments for the privilege of incorporation and expenditures incident to organizing the corporation, partnership or other enterprise and putting it into readiness to do business.

NARUC, Utility Plant Accounts, Accounts Nos. 302 and 352 should include amounts paid to the federal government, to a state or to a political subdivision thereof in consideration of franchises, consents or certificates, running in perpetuity or for a specified term of more than one year.

NARUC Operation and Maintenance Expense Accounts, Accounts Nos. 633 and 733 shall include the costs paid to outside legal firms to perform legal services for the utility.

Commission Orders Nos. 25821, issued February 27, 1992, and PSC-94-0739-FOF-WS, issued June 16, 1994, determined that the purchase costs of utility systems are to be charged as acquisition adjustments, not as organization costs.

Recommendation: The utility's water and wastewater UPIS are overstated by \$39,365 and \$18,798, respectively, as of December 31, 2002, because of the following audit staff determinations.

- 1) The balance of \$21,194 reflected in Account No. 301 above consists of legal and agency fees and capitalized executive time recorded in 1999 for the acquisition of Bayside Utility Services, Inc. These costs should be treated as an acquisition cost and be removed from UPIS per the Commission Orders cited above.

Exception No. 2, continued

- 2) The balance of \$18,171 reflected in Account No. 302 above consists of \$8,489 of legal fees recorded in 1999 for the acquisition of Bayside Utility Services, Inc. and \$9,682 (\$9,033 + \$649) of legal fees recorded in 2001 and 2002 for a dispute with a developer over impact fees imposed by Bay County on the utility system and its customers. The \$8,489 of legal costs referenced above should be treated as an acquisition cost and be removed from UPIS per the Commission Orders cited above. The \$9,682 of legal fees associated with the developer dispute should have been recorded in Accounts Nos. 633 and 733 per the NARUC rule cited above. The utility should reclassify \$649 of legal fees, which were incurred in 2002, and allocate them equally, \$324 to water and \$325 to wastewater in Accounts Nos. 633 and 733, respectively, for the 12-month period ended December 31, 2002.
- 3) The balance of \$9,500 reflected in Account No 351 above consists of one-half of a \$19,000 finder's fee paid to a third party as a commission for locating the Bayside utility system for Utilities, Inc. to purchase. The other half is included in Account No. 301 above. This cost should be treated as an acquisition cost and removed from UPIS per the Commission Orders cited above.
- 4) The balance of \$9,298 reflected in Account No. 352 above consists of legal fees and capitalized executive time recorded in 1999 for the acquisition of Bayside Utility Services, Inc. These costs should be treated as an acquisition cost and removed from UPIS per the Commission Orders cited above.

Additionally, the above audit staff reductions to the utility's UPIS will require corresponding reductions of \$2,569 and \$1,639 to its water and wastewater accumulated depreciation balances, respectively, as of December 31, 2002, and reductions of \$984 and \$514 to its water and wastewater depreciation expense balance, respectively, for the 12-month period ended December 31, 2002.

See Schedule D that follows for an itemized list of the organization and franchise costs to be removed.

Schedule D for Exception No. 2

Year Recorded	Acct. No.	Amount	Description
1999	301	\$498.75	Legal fees for transfer
1999	301	2,211.00	Airline tickets travel to Bay County
1999	301	9,500.00	Finder's fees for acquisition
1999	301	1,144.00	16 hrs. capitalized time for DR (acquisitions)
1999	301	<u>7,840.00</u>	49 hrs. capitalized time for CW (acquisitions)
		\$21,193.75	
1999	302	\$6,553.64	Legal fees for transfer
1999	302	371.26	Legal fees for transfer
1999	302	1,331.20	Legal fees for transfer
1999	302	90.00	Legal fees for transfer
1999	302	<u>142.95</u>	Legal fees for transfer
		\$8,489.05	
1999	351	\$9,500.00	Finder's fees for acquisition
1999	352	\$6,553.64	Legal fees for transfer
1999	352	808.53	Legal fees for transfer
1999	352	371.26	Legal fees for transfer
1999	352	1,331.20	Legal fees for transfer
1999	352	90.01	Legal fees for transfer
1999	352	<u>142.95</u>	Legal fees for transfer
		\$9,297.59	
2001	302	\$4,652.05	Legal fees for developer dispute
2001	302	527.25	Legal fees for developer dispute
2001	302	285.08	Legal fees for developer dispute
2001	302	208.90	Legal fees for developer dispute
2001	302	931.18	Legal fees for developer dispute
2001	302	883.15	Legal fees for developer dispute
2001	302	<u>1,544.86</u>	Legal fees for developer dispute
		\$9,032.47	
2002	302	\$56.30	Legal fees for developer dispute
2002	302	133.10	Legal fees for developer dispute
2002	302	385.68	Legal fees for developer dispute
2002	302	<u>74.15</u>	Legal fees for developer dispute
		\$649.23	

Exception No. 3

Subject: Miscellaneous UPIS Adjustments

Statement of Facts: The utility's filing reflects the following balances for the indicated accounts as of December 31, 2002.

<u>System</u>	<u>Acct. No.</u>	<u>Account Description</u>	<u>UPIS</u>
Water	311	Pumping Equipment	\$2,789
	333	Services	\$33,059
	334	Meters & Meter Installations	\$34,768
W/Water	380	Treatment & Disposal Equipment	\$226,553

Recommendation: The utility's water and wastewater UPIS are overstated by \$3,215 and \$1,548, respectively, as of December 31, 2002, because of the following audit staff determinations.

- 1) The balance of \$2,789 reflected in Account No. 311 above includes an invoice for \$1,048 which was for repairs performed at Sandy Creek Utilities, Inc., a sister subsidiary of Bayside Utility Services, Inc., and should be removed.
- 2) The balance of \$33,059 reflected in Account No. 333 above includes 1999 additions of \$699 and 2002 additions of \$844 for repairs to customer service lines and utility water mains, respectively. Both amounts should be removed because they are repair costs of a recurring nature. The 2002 cost of \$844 for water main repair should be transferred to Account No. 636, Contractual Services - Other for the 12-month period ended December 31, 2002.
- 3) The balance of \$34,768 reflected in Account No. 334 above includes a 2002 addition of \$624 for labor charges to change out a customer water meter. The entire amount should be removed because it is a repair cost of a recurring nature and should be transferred to Account No. 636, Contractual Services - Other for the 12-month period ended December 31, 2002.
- 4) The balance of \$226,553 reflected in Account No. 380 above includes a 2002 addition of \$1,548 for repairs to the lift station at Sandy Creek Utilities, Inc., a sister subsidiary of Bayside Utility Services, Inc., and should be removed.

Additionally, the above audit staff reductions to the utility's UPIS will require corresponding reductions of \$70 and \$43 to its water and wastewater accumulated depreciation balances, respectively, as of December 31, 2002, and reductions of \$70 and \$43 to its water and wastewater depreciation expense balances, respectively, for the 12-month period ended December 31, 2002.

See Schedule E that follows for itemized details and the audit staff's calculations.

Schedule E for Exception No. 3

Utility-Plant-in-Service Adjustment				
<u>Year Recorded</u>	<u>Acct. No.</u>	<u>Amount</u>	<u>Description</u>	
2002	311	\$1,048.00	Repair well pump at Sandy Creek	
2001	333	\$698.59	Repair leaks in 3 customer service lines	
2002	333	<u>844.08</u>	Repair break in 8" main	
		\$1,542.67		
2002	334	\$624.12	Labor to change out water meter	
Total Water Adjustment		\$3,214.79		
2002	380	\$1,548.00	Repairs to Sandy Creek lift station	
Accumulated Depreciation and Depreciation Expense Adjustment				
<u>Acct. No.</u>	<u>Amount</u>	<u>Dep. Rate</u>	<u>Acc. Dep. and Dep. Exp. Adjustment</u>	
311	\$1,048.00	5.00%	\$26.20	(2002 half year)
333	698.59	2.50%	17.46	(2001 full year)
333	844.08	2.50%	10.55	(2002 half year)
334	<u>624.12</u>	5.00%	<u>15.60</u>	(2002 half year)
	\$3,214.79		\$69.82	
380	\$1,548.00	5.56%	\$43.00	(2002 half year)

Exception No. 4

Subject: Allocated Common Cost

Statement of Facts: The utility's general ledger reflects balances of \$8,185, and \$2,001, for allocated UPIS and accumulated depreciation, respectively, from Utilities, Inc. of Florida (UIF) in its water system accounts for the 12-month period ended December 31, 2002.

The utility's general ledger does not include any allocations from Water Service Corporation (WSC), its parent operations in Northbrook, IL. However, the WSC allocation schedule provided for this audit indicates that Bayside Utility Services should have received \$4,082 in net common plant allocations as of December 31, 2002.

Recommendation: The utility's water UPIS and accumulated depreciation are overstated by \$2,052 and \$1,001, respectively, while its wastewater UPIS and accumulated depreciation are understated by \$6,134 and \$1,001, respectively, for the 12-month period ended December 31, 2002, based on the following audit staff determinations.

- 1) The utility did not allocate any of the \$8,185 from UIF to its wastewater system. The utility's water UPIS should be reduced by \$4,093 and its wastewater UPIS should be increased by \$4,093 to properly distribute the UIF allocation to Bayside Utility's customer base. Additionally, the utility's water accumulated depreciation should be reduced by \$1,001 and its wastewater UPIS should be increased by \$1,001 to properly distribute the UIF allocation to Bayside Utility's customer base.
- 2) The utility water and wastewater UPIS should be increased by \$2,041 each to properly distribute the \$4,081 of allocated common plant from WSC.

Additionally, the reallocation adjustment to UIF water and wastewater UPIS above will require a corresponding adjustment to the associated \$880 of allocated depreciation expense for the 12-month period ended December 31, 2002. See audit staff's calculations that follow.

<u>UPIS</u>	<u>UIF Water</u>	<u>UIF W/Water</u>	<u>WSC Water</u>	<u>WSC W/Water</u>	<u>Total Water</u>	<u>Total W/Water</u>
Per Utility	\$8,185	\$0	\$0	\$0	\$8,185	\$0
Per Audit	<u>4,092</u>	<u>4,093</u>	<u>2,041</u>	<u>2,041</u>	<u>6,133</u>	<u>6,134</u>
Adjustment	(\$4,093)	\$4,093	\$2,041	\$2,041	(\$2,052)	\$6,134

<u>Acc/Dep</u>	<u>UIF Water</u>	<u>UIF W/Water</u>	<u>Dep/Exp</u>	<u>UIF Water</u>	<u>UIF W/Water</u>
Per Utility	(\$2,001)	\$0	Per Utility	\$880	\$0
Per Audit	<u>(1,000)</u>	<u>(1,001)</u>	Per Audit	<u>440</u>	<u>440</u>
Adjustment	\$1,001	(\$1,001)	Adjustment	(\$440)	\$440

Exception No. 5

Subject: Adjustments to Accumulated Depreciation

Statement of Facts: The utility's filing reflects adjustments in 1999 that effectively reduce its water and wastewater accumulated depreciation balances by \$7,945 and \$58,786, respectively.

The utility stated that the adjustments were made to reduce the accumulated depreciation balances to the rate case-ordered balances.

Recommendation: The utility's water and wastewater accumulated depreciation balances should be increased by \$12,263 and \$37,846, respectively, based on the following audit staff determinations. See the audit staff's calculations that follow.

- 1) The utility's acquisition entry for water accumulated depreciation is overstated by \$4,735 and its acquisition entry for wastewater accumulated depreciation understated by \$11,414. See Exception No. 1 of this report for the audit staff's discussion of these adjustments.
- 2) The above utility adjustment effectively reduces the 1998 and 1999 accruals to water and ignores the 1998 and 1999 accruals to wastewater accumulated depreciation which the audit staff calculates to be \$12,263 and \$37,846, respectively, based on the utility's 1998 and 1999 Annual Reports.

<u>Water</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/97 (transfer)	(\$111,728)	\$4,735	(\$106,993)
1998 accruals	ignored	(7,003)	(7,003)
1999 accruals	<u>(1,743)</u>	<u>(5,260)</u>	<u>(7,003)</u>
@12/31/99	(\$113,471)	(\$7,528)	(\$120,999)
Remove adjustment in Exception No. 1 of this		<u>(4,735)</u>	
Adjustment for 1998-1999 accruals		<u>(\$12,263)</u>	
<u>Wastewater</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/97 (transfer)	(\$132,568)	(\$11,414)	(\$143,982)
1998 accruals	ignored	(18,923)	(18,923)
1999 accruals	<u>ignored</u>	<u>(18,923)</u>	<u>(18,923)</u>
@12/31/99	(\$132,568)	(\$49,260)	(\$181,828)
Remove adjustment in Exception No. 1 of this		<u>11,414</u>	
Adjustment for 1998-1999 accruals		<u>(\$37,846)</u>	

Exception No. 6

Subject: Depreciation Rates

Statement of Facts: Rule 25-30.140, Florida Administrative Code, prescribes specific depreciation rates for each NARUC subaccount balance. Specifically, the rule establishes the following rates for the indicated accounts.

<u>Acct. No.</u>	<u>Account Description</u>	<u>Service Life</u>	<u>Depreciation Rate</u>
380	Treatment & Disposal Plant	18 years	5.56%
381	Plant Sewers	35 years	2.86%

Recommendation: The utility's wastewater accumulated depreciation and test year depreciation expense are understated by \$17,555 and \$6,162, respectively, for the 12-month period ended December 31, 2002, because it used the wrong service life to depreciate Account No. 380. See audit staff's calculations that follow.

<u>Year</u>	<u>Acct. 380 Average UPIS</u>	<u>Rule Depreciation Rate(1)</u>	<u>Depreciation Accrual per Audit</u>	<u>Depreciation Accrual per Utility</u>	<u>Audit Staff Adjustment(2)</u>
2000	\$202,758	5.56%	\$11,264	\$5,791	\$5,473
2001	\$210,789	5.56%	\$11,711	\$5,791	\$5,920
2002	\$222,687	5.56%	\$12,372	\$6,210	<u>\$6,162</u>
					\$17,555

- 1) The utility depreciated Acct. No. 380 using a rate of 2.86 percent. Recalculations of the utility's accrual may slightly differ because it calculates depreciation accruals on a monthly basis. The audit staff's calculation above uses the average of the beginning and ending UPIS balances.
- 2) The depreciation expense adjustment is \$6,162 for the 12-month period ended December 31, 2002.

Exception No. 7

Subject: Adjustments to Accumulated Amortization of CIAC

Statement of Facts: The utility's filing reflects adjustments in 1999 that effectively reduce its water accumulated amortization of CIAC balance by \$2,669.

The utility stated that the adjustments were made to reduce the accumulated amortization of CIAC balances to the rate case-ordered balances.

Recommendation: The utility's water accumulated amortization of CIAC should be increased by \$3,296 based on the following audit staff determinations. See the audit staff's calculations that follow.

- 1) The utility's acquisition entry for water accumulated amortization of CIAC is overstated by \$1,021. See Exception No. 1 of this report for the audit staff's discussion of these adjustments.
- 2) The above utility adjustment effectively ignores the 1998 and 1999 accruals to accumulated amortization of CIAC which the audit staff calculates to be \$3,296 based on the utility's 1998 and 1999 Annual Reports.

<u>Water</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/97 (transfer)	\$36,715	\$1,021	\$37,736
1998 accruals	ignored	1,648	1,648
1999 accruals	ignored	<u>1,648</u>	<u>1,648</u>
@12/31/99	\$36,715	\$4,317	\$41,032
Remove adjustment in Exception No. 1 of this report.		<u>(1,021)</u>	
Adjustment for 1998-99 accruals		<u>\$3,296</u>	

Exception No. 8

Subject: Deferred Tax Change

Statement of Facts: New Internal Revenue Service regulations allow for excess depreciation to be taken on plant additions after September 10, 2001. At the time the exhibits were prepared, the utility had not calculated the effect of this change. Schedule D-1, page 1 of the MFRs shows the average balance of accumulated deferred taxes without the change. The utility provided a schedule showing additional deferred income tax to be \$8,571.

Recommendation: The beginning and ending average of the change should be added to deferred taxes. A revised cost of capital schedule follows on Schedule F and changes the cost rate from 9.18 percent to 9.10 percent.

Schedule F for Exception No. 8

Bayside Utility Services, Inc.
 Staff Revised Cost of Capital
 Test Year Ended December 31, 2002

	<u>Prorated Capital Per Utility</u>	<u>Staff Adjustment</u>	<u>Adjusted Prorated Capital</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term Debt	\$250,738	\$0	\$250,738	50.87%	7.56%	3.85%
Short-term Debt	31,489	0	31,489	6.39%	3.93%	0.25%
Customer Deposits	8,484	0	8,484	1.72%	6.00%	0.10%
Common Equity	205,212	0	205,212	41.63%	11.77%	4.90%
Accumulated Deferred Tax	<u>(7,305)</u>	<u>4,286</u>	<u>(3,020)</u>	-0.61%	0.00%	<u>0.00%</u>
	\$488,618	\$4,286	\$492,904	100.00%		9.10%
		Note A		Per Utility		9.18%
				Difference		-0.08%

Note A: The utility computed the change in deferred tax for the bonus depreciation allowed by the Internal Revenue Service in 2002. The increase calculated was \$8,571. Since the utility used beginning and ending average, one-half of the adjustment is posted to this schedule. ($\$8,571 / 2 = \$4,286$)

Disclosure No. 1

Subject: Pro Forma Additions to UPIS

Statement of Facts: The utility's filing reflects the following requested additions to UPIS, accumulated depreciation, depreciation expense, and taxes other than income for this rate proceeding.

<u>Water System Pro Forma</u>	<u>UPIS</u>	<u>Acc/Dep</u>	<u>Dep/Exp</u>	<u>Property Tax</u>
Automatic meter reading equipment	\$55,000	(\$3,667)	(\$3,667)	
Water main improvements	<u>25,000</u>	<u>(581)</u>	<u>(581)</u>	
	\$80,000	(\$4,248)	(\$4,248)	\$34
<u>Wastewater System Pro Forma</u>	<u>UPIS</u>	<u>Acc/Dep</u>	<u>Dep/Exp</u>	
Lift station improvements	\$25,000	(\$1,000)	(\$1,000)	
Gravity main improvements	<u>25,000</u>	<u>(556)</u>	<u>(556)</u>	
	\$50,000	(\$1,556)	(\$1,556)	\$17

Recommendation: The audit staff requested supporting documentation for the above pro forma additions. Specifically, we asked for invoices, contractor estimates, third-party bids, and utility designs. No information or documents were provided to the audit staff as of the date of this audit report.

The pro forma UPIS additions indicated above and all corresponding entries to accumulated depreciation, depreciation expense and taxes other than income should be removed from the utility's requested rate case filing until the projects can be adequately supported.

Disclosure No. 2

Subject: Revenues

Statement of Facts: Order No. PSC-98-1269-FOF-WS approved new rates for water and wastewater service effective for service rendered on or after the stamped approval date on its revised tariff sheets. The above-mentioned order also required that the new rates are to be reduced at the end of the four-year rate case expense amortization period.

The utility properly filed its revised tariff sheets that were approved and stamped effective by the Commission on October 21, 2002, that decreased the utility's water and wastewater rates per the Commission Order cited above for the four-year rate case amortization period.

Recommendation: During fieldwork for this proceeding, the audit staff discovered that the utility did not reduce its rates for the revised tariff mentioned above and mentioned the findings to the utility's staff at the Florida district office.

The utility, at its own initiative, calculated and refunded the difference in tariff rates that it charged its customers from October 21, 2002 through the January 27, 2004, billing cycle. The total amount of the refund was \$593.90 and was credited to approximately 254 customer bills.

Disclosure No. 3

Subject: Pro Forma Adjustments to Operation and Maintenance Expenses (O&M)

Statement of Facts: The utility's filing reflects the following requested additions to O&M expenses for this rate proceeding.

<u>Pro Forma</u>	<u>Increase</u>	<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
Adjust employee salaries.	3.00%	\$659	\$607	\$1,266
Adjust health care cost.	25.86%	1,293	1,293	1,266
Adjust other insurance cost.	36.88%	<u>534</u>	<u>749</u>	<u>2,532</u>
		\$2,486	\$2,649	\$5,064

Recommendation: The audit staff requested supporting documentation for the above pro forma adjustments. Specifically, we compared 2002 historical costs with 2003 historical costs and asked for other supporting schedules and calculations to support the utility's requested increases.

- 1) The 3.00 percent increase is supported in that the utility's 2003 historical salaries increased 6.55% over the corresponding 2002 historical salaries reported in the utility's filing.
- 2) The 25.86 percent increase to health care cost should be reduced to 9.83 percent which represents the actual increase in health care cost over the corresponding 2002 historical test year. See the audit staff calculations that follow for the recommended adjustment.
- 3) The 36.88 percent increase to other insurance cost should be increased to 42.93 percent which represents the actual increase in other insurance cost over the corresponding 2002 historical test year. See the audit staff calculations that follow for the recommended adjustment.

<u>Pro Forma Health Care Cost</u>	<u>Increase</u>	<u>Water(a)</u>	<u>Wastewater(a)</u>	<u>Total(b)</u>
Adjustment per utility	25.86%	\$1,293	\$1,293	\$2,586
Adjustment per audit	9.83%	491	491	982
Audit staff adjustment		(\$802)	(\$802)	(\$1,604)

(a) Split equally between water and wastewater O&M (b) 2002 historical cost of \$9,996 x % increase

<u>Pro Forma Other Insurance Cost</u>	<u>Increase</u>	<u>Water(a)</u>	<u>Wastewater(a)</u>	<u>Total(b)</u>
Adjustment per utility	36.88%	\$534	\$749	\$1,283
Adjustment per audit	42.93%	622	872	1,494
Audit staff adjustment		\$88	\$123	\$211

(a) 2002 allocation split 41.63% to water and 58.37% to wastewater (b) 2002 historical cost of \$3,480 x % increase

EXHIBIT I

Schedule of Water Rate Base

Florida Public Service Commission

Company: Bayside Utility Services, Inc.
 Docket No.: 030444-WS
 Schedule Year Ended: December 31, 2002
 Interim [] Final [X]
 Historic [X] Projected []

Schedule: A-1
 Page 1 of 1
 Preparer: Seidman, F.

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. If method other than formula approach (1/8 O&M) is used to determine working capital, provide additional schedule showing detail calculation.

Line No.	(1) Description	(2) Balance Per Books	(3) A-3 Utility Adjustments	(4) Adjusted Utility Balance	(5) Supporting Schedule(s)
1	Utility Plant in Service	\$ 235,308	\$ 80,000 A	\$ 315,308	A-5, A-3
2	Utility Land & Land Rights			-	A-5
3	Less: Non-Used & Useful Plant	-	- B	-	A-7, A-3
4	Construction Work in Progress	-	-		A-18, A-3
5	Less: Accumulated Depreciation	(113,161)	(4,248) C	(117,409)	A-9, A-3
6	Less: CIAC	(52,911)		(52,911)	A-12
7	Accumulated Amortization of CIAC	40,503		40,503	A-14
8	Acquisition Adjustments	(9,182)	9,182 D	-	A-18, A-3
9	Accum. Amort. of Acq. Adjustments	526	(526) D		A-18, A-3
10	Advances For Construction				A-16
11	Working Capital Allowance	-	11,773 E	11,773	A-17, A-3
12	Total Rate Base	\$ 101,083	\$ 96,180	\$ 197,263	

EXHIBIT II

Schedule of Wastewater Rate Base

Florida Public Service Commission

Company: Bayside Utility Services, Inc.
Docket No.: 030444-WS
Schedule Year Ended: December 31, 2002
Interim [] Final [X]
Historic [X] Projected []

Schedule: A-2
Page 1 of 1
Preparer: Seldman, F.

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. If method other than formula approach (1/8 O&M) is used to determine working capital, provide additional schedule showing detail calculation.

Line No.	(1) Description	(2) Balance Per Books	(3) A-3 Utility Adjustments	(4) Adjusted Utility Balance	(5) Supporting Schedule(s)
1	Utility Plant in Service	\$ 382,444	\$ 50,000	A \$ 432,444	A-6, A-3
2	Utility Land & Land Rights			-	A-6
3	Less: Non-Used & Useful Plant	-	-	B -	A-7, A-3
4	Construction Work in Progress			-	A-18
5	Less: Accumulated Depreciation	(152,932)	(1,556)	C (154,488)	A-10, A-3
6	Less: CIAC			-	A-12
7	Accumulated Amortization of CIAC			-	A-14, A-3
8	Acquisition Adjustments	(31,105)	31,105	D -	A-18, A-3
9	Accum. Amort. of Acq. Adjustments	1,738	(1,738)	D -	A-18, A-3
10	Advances For Construction				A-16
11	Working Capital Allowance	-	13,398	E 13,398	A-17, A-3
12	Total Rate Base	\$ 200,146	\$ 91,209	\$ 291,354	

EXHIBIT III

Schedule of Water Net Operating Income

Florida Public Service Commission

Company: Bayside Utility Services, Inc.
 Docket No.: 030444-WS
 Test Year Ended: December 31, 2002
 Interim [] Final [X]
 Historic [X] or Projected []

Schedule: B-1
 Page 1 of 1
 Preparer: Seidman, F.
 Revision No. 1

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) Balance Per Books	(3) Utility Test Year Adjustments	(4) Utility Adjusted Test Year	(5) Requested Revenue Adjustment	(6) Requested Annual Revenues	(7) Supporting Schedule(s)
1	OPERATING REVENUES	\$ 64,713	\$ 1,181 A	\$ 65,894	\$ 81,669 F	\$ 147,563	B-4, E-2
2	Operation & Maintenance	91,698	2,486 B	94,184	12,864 G	107,048	B-5, B-3
3	Depreciation, net of GIAC Amort.	5,985	4,248 C	10,233		10,233	B-13, B-3
4	Amortization				-	-	B-3
5	Taxes Other Than Income	4,719	201 D	4,919	3,675 H	8,594	B-15, B-3
6	Provision for Income Taxes	(14,723)	14,723 E	-	3,579 I	3,579	C-1, B-3
7	OPERATING EXPENSES	87,678	21,658	109,336	20,118	129,454	
8	NET OPERATING INCOME	\$ (22,965)	\$ (20,477)	\$ (43,442)	\$ 61,551	\$ 18,109	
9	RATE BASE	\$ 101,083		\$ 197,263		\$ 197,263	
10	RATE OF RETURN	-	%	-	%	9.18	%

EXHIBIT IV

Schedule of Wastewater Net Operating Income

Florida Public Service Commission

Company: Bayside Utility Services, Inc.
 Docket No.: 030444-WS
 Test Year Ended: December 31, 2002
 Interim [] Final [X]
 Historic [X] or Projected []

Schedule: B-2
 Page 1 of 1
 Preparer: Seldman, F.
 Revision No. 1

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) Balance Per Books	(3) Utility Test Year Adjustments	(4) Utility Adjusted Test Year	(5) Requested Revenue Adjustment	(6) Requested Annual Revenues	(7) Supporting Schedule(s)
1	OPERATING REVENUES	\$ 90,721	\$ 1,892	A \$ 92,613	\$ 81,447	F \$ 174,060	B-4, E-2
2	Operation & Maintenance	104,533	2,650	B 107,183	12,864	G 120,047	B-6, B-3
3	Depreciation, net of CIAC Amort.	10,559	1,556	C 12,114		12,114	B-14, B-3
4	Amortization				0	-	B-3
5	Taxes Other Than Income	5,920	239	D 6,159	3,665	H 9,824	B-15, B-3
6	Provision for Income Taxes	(12,203)	12,203	E -	5,329	I 5,329	C-1, B-3
7	OPERATING EXPENSES	108,809	16,647	125,456	21,858	147,314	
8	NET OPERATING INCOME	\$ (18,088)	\$ (14,755)	\$ (32,843)	\$ 59,589	\$ 26,746	
9	RATE BASE	\$ 200,146		\$ 291,354		\$ 291,354	
10	RATE OF RETURN	- %		- %		9.18 %	

EXHIBIT V

**Schedule of Requested Cost of Capital (Final Rates)
Beginning and End of Year Average**

Florida Public Service Commission

**Company: Bayside Utility Services, Inc.
Docket No.: 030444-WS
Test Year Ended: December 31, 2002
Schedule Year Ended: December 31, 2002
Historic [X] or Projected []**

**Schedule: D-1
Page 1 of 2
Preparer: Seidman, F.
Revision No. 1
Subsidiary [] or Consolidated [X]**

Explanation: Provide a schedule which calculates the requested Cost of Capital on a beginning and end of year average basis. If a year-end basis is used, submit an additional schedule reflecting year-end calculations.

Line No.	(1) Total Capital	(2) Ratio	(3) Cost Rate	(4) Weighted Cost	
1	Long-Term Debt	250,738	51.32 %	7.56 %	3.88 %
2	Short-Term Debt	31,489	6.44	3.93	0.25
3	Preferred Stock				
4	Customer Deposits	8,484	1.74	6.00	0.10
5	Common Equity	205,212	42.00	11.77	4.95
6	Tax Credits - Zero Cost				
7	Accumulated Deferred Income Tax	(7,305)	(1.50)	-	
8	Other (Explain)				
9	Total	488,618	100.00 %		9.18 %

10 Note: Cost of Equity based on Order Nos. PSC-03-0707-PAA-WS and PSC-03-0799-CO-WS