

MEMORANDUM

August 22, 1996

TO: DIVISION OF RECORDS AND REPORTING

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

RE: DOCKET NO. ~~960625~~-WU -- VIRGINIA CITY UTILITIES, INC.
RATE CASE AUDIT REPORT - 12 MONTHS ENDED DECEMBER 31, 1995
AUDIT CONTROL NO. 96-172-2-1

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 working papers are available for review on request. There are no confidential working papers associated with this audit.

Please forward a complete copy of this report to:

Virginia City Utilities, Inc.
Judson P. Potter
6319 Conniewood Square
New Port Richey, FL 34653-4804

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/
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DOCUMENT NUMBER DATE
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FPSC-RECORDS/REPORTING

FLORIDA PUBLIC SERVICE COMMISSION

AUDIT REPORT

FOR THE TWELVE MONTHS ENDED DECEMBER 31, 1995

Field Work Completed

July 11, 1996

VIRGINIA CITY UTILITIES INC.

New Port Richey, Florida

Pasco County

Rate Case Audit

Docket Number 960625-WU

Audit Control Number 96-172-2-1



Thomas E. Stambaugh
Audit Manager



Ann Bouckaert
Public Utilities Supervisor

DOCUMENT NUMBER DATE

08985 AUG 23 96

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 month period ending December 31, 1995 for the Virginia City Utilities, Inc., petition for staff assisted rate case, FPSC Docket 960625-WU.

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 ending December 31, 1995 represent Utility books and records 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 of Findings:

The predecessor utility did not post the adjustments from FPSC Order 9467, dated July 31, 1980, to its books and records. The effects of not posting these adjustments and not recording a retirement affected the rate base of Virginia City Utilities, Inc. in the amount of (\$9,545.00) at 12/31/95.

The predecessor utility did not provide general and subsidiary ledgers to Virginia City Utilities at transfer.

The Utility incurred \$574 of expense in 1994 which should have been added to plant account 309, Supply Mains.

The Utility incurred \$1,404 of expense in 1995 which should have been added to plant account 334, Supply Mains, (\$1,274) and to plant account 348, Other Tangible Plant (\$130).

The Utility added plant of \$3,650 in 1980 to Acct 348, Other Tangible Plant. This account is depreciated at 10% per year. The amount was not retired by the utility in 1990.

The Utility contemplates a meter change-out program valued at approximately \$5,376.00 and a valve replacement program valued at approximately \$12,184.00.

Utility incurred affiliated transactions during the twelve months ended 12/31/95 totaling \$2,487.50.

Utility had not applied FPSC-approved depreciation and amortization rates to plant and CIAC.

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 otherwise noted performed no other audit work.

RATE BASE:

Compiled Plant in Service and CIAC for 1994 and 1995. Scheduled Plant in Service and CIAC for preceding years from annual reports. Calculated accumulated depreciation of Plant in Service and Accumulated Amortization of CIAC. Used the amounts specified in FPSC Order 9467 for the beginning balances of plant, accumulated depreciation, CIAC and amortization of CIAC. Adjusted rate base balances according to analyses performed in various rate base and NOI work papers.

NET OPERATING INCOME:

Compiled Net Operating Income.

Reconciled revenues for a test month in the general ledger to the billing register. Recalculated selected customer bills; verified that rates and charges used in customer bills agreed to approved tariff. Reconciled other revenues to verify that the account contained the type of transactions associated with this account. Performed a reasonableness test of annual revenues.

Tested operating and maintenance (O&M) expense by tracing test year expenses to their supporting documentation and canceled utility checks. Adjusted O&M expense for: (1) capital items, (2) one-time expense which should be amortized over future periods and (3) out of period expenses.

Recalculated depreciation and amortization expense.

Compiled taxes other than income.

Compiled income tax returns for 1994 and 1995.

CAPITAL STRUCTURE:

Compiled Capital Structure. Traced capital structure balances and rates to supporting documentation.

PRO-FORMA ADJUSTMENTS: Pro-forma adjustments were calculated for certain plant and expense accounts.

AUDIT EXCEPTION No. 1

SUBJECT: Non-Compliance with FPSC Order 9467 issued 7/29/80.

STATEMENT OF FACT: The rate case audit for Virginia City, Inc., (predecessor of Virginia City Utilities, Inc) was performed in 1980 for the test year ended 12/31/79. The comparative rate base balances per Utility and FPSC (as mandated by Order 9467) are as follows:

	Utility	Staff Adjusts	FPSC
	-----	-----	-----
Plant in Service	56,247	(12,645)	43,602
Accumulated Depreciation	(22,347)	14,585	(7,852)
CIAC	(7,605)	(2,505)	(10,110)
Amortization of CIAC	-0-	612	612
Working Capital	2,927	(842)	2,095

AUDIT OPINION: The predecessor utility did not post the adjustments mandated by FPSC Order 9467 to its books and records. The effect of not posting these differences, plus other differences identified by FPSC auditor in the present rate case audit, yield the following auditor-prepared balances of rate base at 12/31/95:

	Bal per Util @ 12/31/95	Adjusts Per FPSC #9467	Adj Bal per Util 12/31/95	Net Effect Aud Adj	Audited Bal @ 12/31/95
	-----	-----	-----	-----	-----
Plant	36,504	(12,645)	23,859	5,079	28,938
A/D	(28,492)	14,585	(13,907)	(664)	(14,571)
CIAC	(1,747)	(2,505)	(3,979)	(11,009)	(14,988)
Amort	112	612	724	8,359	9,083

AUDIT CONCLUSION: Predecessor utility did not comply with FPSC order #9467.

AUDIT RECOMMENDATION: Instruct Utility to post all adjustments from FPSC Order #9467 and any future FPSC Orders to its books and records.

AUDIT EXCEPTION No. 2

SUBJECT: Non-compliance with NARUC, Class C Water, account 630, Contractual Services and account 655, Insurance Expense.

STATEMENT OF FACT: In account 630, Utility charged \$950 to accounting, \$1,210.35 to system repair and \$991.43 to system tap-in/construction. Utility charged \$953.44 to Account 655. The description of account 630 reads in part: "This account shall include the cost of operation and maintenance work not performed by utility employees." The description of account 655 reads in part: "This account shall include all insurance costs applicable to the current period."

AUDIT OPINION AND CONCLUSION: The utility incorrectly classified the following amounts associated with the indicated accounts.

	Acctg	Sys Rep	Sys Tap	Rep/Tap Total
	-----	-----	-----	-----
Per utility	\$950	\$1,210	\$991	2,201
Adjustments	(350)	(413)	(991)	(1,404)
	88	-	-	
	-----	-----	-----	-----
Per audit	688	797	0	797
	-----	-----	-----	-----
Reclassification to other accounts:				
Acct 186	(350)			
Acct 630	88			
Acct 334	0	283	991	1,274
Acct 348	0	130	0	130
	-----	-----	-----	-----
Total	(262)	413	991	1,404

The adjustment to accounting is for one-time costs to establish a Simplified Employee Pension (SEP) plan. Costs of the SEP should be re-classified to account 186, Miscellaneous Deferred Debits and then should be charged to account 630, Contractual Services, over four years at \$87.50 per year.

Amounts charged to contract services for labor and small parts associated with meters should have been charged to plant accounts. The Utility paid \$353.18 to Acct 655 which applied to 1994.

Summary of O&M expense reductions:

Plant items	(1,404)
SEP	(262)
Insurance out of period	(353)

Total	(2,019)
	=====

AUDIT RECOMMENDATION: Add \$1,274 to account 334 and \$130 to account 348. Reduce O&M expense by \$2,019 and carry to average working capital.

AUDIT EXCEPTION No. 3

SUBJECT: Retirement: Non-compliance with Rule 25-30.140 F.A.C.

STATEMENT OF FACT: Utility added \$3,650 to plant account 348, Other Tangible Plant, in 1980. Plant dollars had not been retired as of 1995. According to FPSC Rule 25.30-140, Depreciation, the service life for account 348 in Class C Water utilities is ten years, which translates to an annual depreciation rate of ten percent.

AUDIT OPINION: The plant should have been retired as of 1990. Auditor restated the balance of plant in 1990 by showing a retirement from plant in service of \$3,650 and removing the same amount from the balance of accumulated depreciation.

AUDIT CONCLUSION: Accept auditor re-statement of the ending balances of plant in service and accumulated depreciation at 12/31/95, taking into account the adjustments in 1990 to plant in service and accumulated depreciation.

AUDIT EXCEPTION No. 4

SUBJECT: Non-compliance with NARUC, Class C, account 630, Contractual Services.

STATEMENT OF FACT: In 1994, Utility classified \$1,822.86 to account 630, System Repair, and \$1,647.00 to account 630, System Maintenance. The description of account 630 reads in part: "This account shall include the cost of operation and maintenance work not performed by utility employees".

AUDIT OPINION: Audit review of Wray Enterprises invoices in 1994 revealed that four invoices for the installation or replacement of valves and for installing valve boxes and pouring concrete around them had been classified to expense account 630. The invoices total \$573.82. Auditor reclassified these dollars to plant account 309, Supply Mains and reduced O&M expense by the same amount for the purposes of calculating NOI and average working capital.

AUDIT CONCLUSION: Include the \$573.82 in plant in service. Reduce O&M expense by \$573.82 and reduce 1994 working capital by \$71.73 for the calculation of average working capital.

AUDIT EXCEPTION No. 5

SUBJECT: CIAC: Non-compliance with Rule 25-30.140 F.A.C.

STATEMENT OF FACT: The Utility provided the following information in response to document/record request #9: "CIAC is being recorded based on actual expense of a project which is based on provisions allowed in our present Tariff. It is recorded when the money is received from the customer as a credit to CIAC and a debit to cash. Amortization is calculated at a rate of 5% of the ending balance." Utility did not use a composite amortization rate to amortize CIAC based on Rule 25-30.140, paragraph 8a, page 30-32, Depreciation, FAC.

AUDIT OPINION AND CONCLUSION:

Staff analyst informed field staff auditor on July 2, 1996 that a composite depreciation rate should be calculated and used by auditor to calculate CIAC amortization. This method was used in the CIAC amortization work papers. Review of previous FPSC orders in the Tampa District Office permanent file did not yield any instruction to the Utility to calculate CIAC amortization by any particular method.

Use of the average balance of CIAC and a composite depreciation rate yielded a CIAC amortization expense for 1995 of \$1,019 or an adjustment to the "per books" expense of \$932.00.

The Utility did not carry forward any CIAC from the predecessor Utility. CIAC is usually associated with meter connections. FPSC auditor carried forward the same percentage of CIAC dollars as the associated meter account plant-in-service balance. Auditor calculations of CIAC as of 12/31/95 yield an end of year balance of (\$14,988) and an average balance of (\$14,490).

AUDIT RECOMMENDATION: Utility should be instructed to comply with Rule 25-30.140, FAC and to adjust its balance of CIAC as of 12/31/95 to equal (\$14,988) and to record a CIAC amortization expense for 1995 of \$1,019.00.

AUDIT EXCEPTION No. 6

SUBJECT: Depreciation; Non-compliance with Rule 25.30-140 F.A.C.

STATEMENT OF FACT: "Virginia City Utilities, Inc., used two different methods of accounting for depreciation in 1994, but in 1995 adopted a policy where it used the same depreciation for tax as it does for regulatory purposes." Verbal statement from Utility Secretary-Treasurer is that use of regulatory depreciation rates is more conservative than tax depreciation rates and would therefore be acceptable to the Internal Revenue Service (IRS). Utility did not use depreciation based on service lives in Rule 25-30.140, pages 30-29 and 30-30, Depreciation, FAC.

AUDIT OPINION AND CONCLUSION:

IRS Form 4562 shows use of double declining balance method of depreciation instead of straight-line. Depreciation rates derived by the double declining balance calculation method provide faster depreciation of assets than do rates derived by the straight-line method of calculating depreciation. Therefore, use of straight-line depreciation for tax purposes is more conservative than use of double declining balance method of calculating depreciation.

Use of 2.5% per year for all accounts up to March, 1984 per FPSC staff assistance instructions and use of rates based on service lives in Rule 25-30.140 FAC yields an average balance of accumulated depreciation at 12/31/95 of (\$13,986) or an adjustment to the "per books" balance of \$13,090.00. The end of year balance of accumulated depreciation calculated by auditor is \$14,571.00.

Use of the average balance of plant per year and depreciation rates from the USOA, plus including the depreciation effects of an unrecorded retirement, yielded a depreciation expense of \$1,169 for 1995 or an adjustment of (\$2,419) to the "per books" expense amount for 1995.

AUDIT RECOMMENDATION: Utility should be instructed to use Rule 25-30.140, FAC, in its calculation of depreciation rates, expense and accumulated depreciation. Utility should adjust its books and records for 1995 to show a depreciation expense of \$1,169.00 and an ending balance of accumulated depreciation of \$14,571.00.

AUDIT DISCLOSURE No. 1

SUBJECT: "Books and Records" of the Utility at time of transfer.

STATEMENT OF FACT: FPSC Order PSC-94-0084-FOF-WU, page 2, second paragraph under heading "Rate Base", reads as follows: "According to Section 367.071(5), Florida statutes, this Commission may establish rate base at the time of transfer, but it is not required to do so. According to an analysis of the annual report submitted by Virginia City, the approximate net book value of the assets purchased by VCUI is \$2,626. This amount does not justify the time and expense necessary to conduct an audit in the instant docket. VCUI has indicated that it will be filing for a staff assisted rate case in the near future. Rate base can be established at that time." VCUI, in its response to document/record request #4 in the current audit, stated that Virginia City had provided only FPSC annual reports for 1992 and 1993; Federal Tax Return Form 1120-S for 1992 and 1993; billing ledger cards for nine years and meter readings for eight years.

AUDIT OPINION: The only record available for scheduling rate base components forward from 12/31/79 to 12/31/93 (previous owner) were annual reports. Annual reports do not qualify as "books and records" because they are developed by extraction from other records and are not books of original entry. The present owner has general ledgers for the two years of its ownership, 1994 and 1995. A rate base audit at time of certificate transfer is beneficial from the standpoint of (a) having all utility records of the seller intact at the time of sale, (b) being able to properly identify balances and transactions of accounts and (c) ask clarifying questions of knowledgeable utility personnel.

AUDIT DISCLOSURE No. 2

SUBJECT: Planned additions to plant in service.

STATEMENT OF FACT: Utility plans to institute a meter change-out program and a gate valve replacement program. Estimate provided by one contractor indicates a total cost of \$5,040 and by another contractor a total cost of \$5,376 for the meter change out program. One contract estimate for gate valve replacement indicates a cost of \$12,184 to replace the gate valves.

AUDIT OPINION AND CONCLUSION: None drawn; propriety of these plans is the area of expertise of the FPSC engineer.

AUDIT DISCLOSURE No. 3

SUBJECT: Affiliated Transactions

STATEMENT OF FACT: During the twelve months ended 12/31/95, the utility incurred affiliated transactions in the amount of \$2,487.50.

AUDIT OPINION AND CONCLUSION:

The amounts, payees and services were as follows:

Amount	Payee	Service
\$687.50	Peter A. Altman, CPA	Accounting
1,200.00	Peter A. Altman, CPA	Billing
600.00	Judson F. Potter	Office Rent

2,487.50	Total	
=====		

The "affiliated" nature of the transactions stems from the fact that Mr. Matthew A. Potter, Secretary-Treasurer of the Utility, is a staff accountant employed by Mr. Altman and performs the accounting and part of the billing work for which the Utility is charged. Further, the office rental charged the utility is charged by the Utility President, Mr. Judson F. Potter, for rental of office space in Mr. Potter's private residence.

Determination of reasonableness is left to the analyst.

AUDIT DISCLOSURE No. 4

SUBJECT: Change in gallonage rates for bulk water.

STATEMENT OF FACT: Utility posted \$49,140.63 to its general ledger in 1995 for purchased water expense (account 610) at a rate of \$2.31 per thousand gallons. Utility also stated that Pasco County would charge a bulk water rate of \$2.18 per thousand gallons beginning January 1, 1996. The rate would be lowered further to \$2.15 per thousand gallons beginning October 1, 1996.

AUDIT DISCLOSURE No. 5

SUBJECT: Rate Case Expense

STATEMENT OF FACT: On July 26, 1996, Utility provided documentation of expenditure of \$959.00 in rate case expense. Utility states that the expense is applicable to the current audit. Detail of the expense is as follows:

Type Expense	Provider	Amount
-----	-----	-----
Prepare SARC application	Peter Altman, CPA	\$250.00
SARC time billing	Peter Altman, CPA	250.00
Billing for SARC	Peter Altman, CPA	459.00
	-----	-----
	Total	\$959.00

AUDIT DISCLOSURE NO. 6

SUBJECT: Increase in meter reading expense.

STATEMENT OF FACT: Utility charged \$1,440 to account 630, Contractual Services/meter reading expense, in 1995.

AUDIT OPINION AND CONCLUSION: Utility stated that it would pay the meter reading contractor \$135 per month in 1996. This amount equates to \$1,620 annually or an increase over 1995 of \$180.

AUDIT DISCLOSURE NO. 7

SUBJECT: Change in the State Unemployment Tax (SUTA) rate.

STATEMENT OF FACT: The Utility posted to its general ledger \$237.60 for SUTA expense in 1995. SUTA rate was 2.7% applied to a taxable base of \$8,800.00.

AUDIT OPINION AND CONCLUSION: Utility stated that its SUTA rate effective June, 1996 had become 2/10ths of one percent. This percent, applied to the taxable base of \$8,800 in 1995 yields a SUTA tax of \$.88 for one-half of 1996 or \$1.76 if annualized.

Virginia City Utilities, Inc. - Dkt 960625 - WU
 Staff Assisted Rate Case
 Rate Base
 Test Year Ended 12/31/95

Rate Base Component	Per FPSC Order 9467 @12/31/79	Bal per Books @ 12/31/95	Audit Excep- tions	Reference	Bal per Audit @ 12/31/95	Ave bal per Audit @ 12/31/95
Plant in Service	43,602	36,311	(9,545) 1404 574	E-1 E-2 E-4		0
Land	0	0	(7,567) 0		28,744 0	28,745 0
Const Work in Progress	0	0	0		0	0
Accum Depr of Plant	(7,856)	(28,493)	13,090	E-6	(15,403)	(13,986)
CIAC	(10,110)	(1,747)	(13,373)	E-5	(15,120)	(14,490)
Amort of CIAC	612	117	8,506	E-5	8,623	8,574
Working Capital (1)	2,095	0	0		10,819	10,454
Total	28,343	6,188	(6,911)		17,663	19,297

Required Footnotes:

- (1) Working Capital Formula: 1/8 Operating and Maintenance Expense.
- (2) Audit adjustments do not include audit disclosures.

Virginia City Utilities, Inc. – Dkt 960625–WU
 Staff Assisted Rate Case
 Net Operating Income
 Test year Ended 12/31/95

NOI Component	Per FPSC Order 9467	12/31/95 Balance per books	Audit Adjust- ments	Ref	Balance per Audit
Revenue	18,133	78,449	0		78,449
<u>Expenses</u>					
O&M Expense	23,496	88,570	(2,020)	E-2	86,550
Depreciation Expense	4,190	3,588	(2,419)	E-6	1,169
Amortization Expense	0	(87)	(932)	E-5	(1,019)
Income Tax Expense	0	0	0		0
Taxes Other Than Income	2,428	5,971	0		5,971
Total Expenses	30,114	98,042	(5,371)		92,671
Net Operating Income	(11,981)	(19,593)	5,371		(14,222)

REQUIRED FOOTNOTES:

(1) AUDIT ADJUSTMENTS DO NOT INCLUDE AUDIT DISCLOSURES.

EXHIBIT III

VIRGINIA CITY UTILITIES, INC.
 DOCKET 960625-WU
 CAPITAL STRUCTURE
 AS OF DEC. 31, 1995

DESCRIPTION	(a) BALANCE PER BOOKS @12/31/95	(b) AUDIT ADJUST- MENTS REF	(c) BALANCE PER AUDIT @12/31/95	(d) RATIO	(e) COST RATE	(f) WEIGHTED COST OF CAPITAL
COMMON EQUITY (A)	4,666	0	4,666	10.65%	13.00%	1.38%
COMMON STOCK	500		500			
RETAINED EARN.	(10,088)		(10,088)			
PD IN CAPITAL	14,253	0	14,253			
PREFERRED STOCK	0		0	0.00%	0	0.00%
L/T DEBT--F POTTER	12,775	0	12,775	29.16%	6.00%	1.75%
L/T DEBT--J POTTER	8,325		8,325	19.00%	5.00%	0.95%
L/T DEBT--J POTTER	15,000	0	15,000	34.24%	10.00%	3.42%
CUSTOMER DEPOSITS	3,040		3,040	6.94%	6.00%	0.42%
OTHER			0	0.00%	0.00%	0.00%
TOTAL	43,805	0	43,805	100.00%		7.93%

Required Footnotes:

- (1) Cost of capital is based on utility debt.
- (2) Audit adjustments do not include disclosures.
- (3) Equity cost is based on FPSC Order 9467, dated 7/29/80.

State of Florida

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



DIVISION OF RECORDS &
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BLANCA S. BAYO
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Public Service Commission

August 23, 1996

Judson F. Potter
Virginia City Utilities, Inc.
6319 Conniewood Square
New Port Richey, Florida 34653-4804

RE: Docket No. 960625-WU -- Virginia City Utilities, Inc.
Rate Case Audit Report - 12 Months Ended December 31, 1995
Audit Control #96-172-2-1

Dear Mr. Potter:

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,

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

Kay Flynn
Chief, Bureau of Records

KF/mas
Enclosure
cc: Public Counsel