

MEMORANDUM

December 29, 1997

TO: DIVISION OF RECORDS AND REPORTING

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

RE: DOCKET NO. 971182-SU -- BFF CORPORATION
STAFF-ASSISTED RATE CASE AUDIT REPORT
12 MONTHS ENDED OCTOBER 31, 1997
AUDIT CONTROL NO. 97-279-3.1

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 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 to:

BFF Corporation
Charles de Menzes
Post Office Box 5220
Ocala, FL 34478-5220

DNV/sp

Attachment

cc: Chairman Johanson
Commissioner Clark
Commissioner Deason
Commissioner Garcia
Commissioner Kiesling
Mary Andrews Bane, Deputy Executive Director/Technical
Legal Services
Division of Auditing and Financial Analysis (Devlin/Causseaux/
File Folder)
Division of Water and Wastewater (Dewberry)
Orlando District Office (Forbes)

Research and Regulatory Review (Harvey)
Office of Public Counsel

DOCUMENT NUMBER-DATE

13281 DEC 30 97

FPSC-RECORDS/REPORTING

FLORIDA PUBLIC SERVICE COMMISSION

AUDIT REPORT

12 MONTHS ENDED OCTOBER 31, 1997

FIELD WORK COMPLETED

DECEMBER 5, 1997

BFF CORPORATION

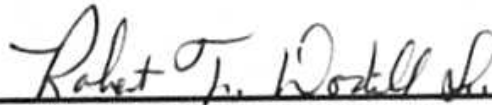
OCALA, FLORIDA

MARION COUNTY

STAFF-ASSISTED RATE CASE

DOCKET NO. 971182-SU

AUDIT CONTROL NO. 97-279-3-1



ROBERT F. DODRILL, SR.
AUDIT MANAGER



IAN J. FORBES
REGULATORY ANALYST SUPERVISOR
ORLANDO DISTRICT OFFICE

DOCUMENT NUMBER-DATE
13281 DEC 30 97
FPSC-RECORDS/REPORTING

TABLE OF CONTENTS

	<u>Page</u>
I. EXECUTIVE SUMMARY	
AUDIT PURPOSE	1
DISCLAIM PUBLIC USE	1
OPINION	1
SUMMARY FINDINGS	1
II. AUDIT SCOPE	
RATE BASE	2
GENERAL	2
III. AUDIT EXCEPTIONS	
1. PRIOR ORDER BOOKED INCORRECTLY	3
2. PRIOR PLANT ADDITIONS INCORRECT	4
3. TEST YEAR PLANT ADDITIONS INCORRECT	5
4. REVENUE ADJUSTED INCORRECTLY	6
5. MISCLASSIFICATION OF LEGAL EXPENSES	7
6. CIAC BOOKED INCORRECTLY	8
7. AMORTIZATION OF CIAC	9
8. MISCLASSIFICATION OF CONTRACT OPERATOR CHARGES	10
9. DEPRECIATION EXPENSE	11
10. ACCUMULATED DEPRECIATION	12
11. WORKING CAPITAL ALLOWANCE	13
IV. AUDIT DISCLOSURES	
1. RELATED PARTY TRANSACTIONS	14
2. TEN PERCENT CONSTRUCTION MANAGEMENT FEE	15
3. CONSTRUCTION WORK-IN-PROGRESS	16
V. EXHIBITS	
1. WASTEWATER RATE BASE	17
2. WASTEWATER OPERATING INCOME	18
3. COST OF CAPITAL	19

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 October 31, 1997, for the BFF Corporation's Petition for Staff-Assisted Rate Case, FPSC Docket 971182-SU.

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 October 31, 1997, represent BFF Corporation's 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 Findings:

Utility failed to correctly book the previous PSC rate Order No. 22570 dated February 19, 1990, requiring a net plant addition of \$4,174.96.

Utility incorrectly increased the plant subaccounts with rate case expense in the amount of \$4,628.

Utility failed to provide documentation for two DEP payments charged to franchise fees totaling \$2,400.

Utility misclassified \$5,632 of nonrecoverable legal expenses to Miscellaneous.

Utility did not credit the CIAC account with \$7,044 in hook-up fees.

Utility misclassified plant operator charges to plant of \$4,519. Of these charges, \$1,704 should have been expensed, and \$2,815 should have been deferred debits.

II. AUDIT SCOPE

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

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

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

RATE BASE: Read prior audit report and associated work papers. Computed materiality levels for plant review purposes. Verified that the adjustments from the PSC Order No. 22570 dated February 19, 1990, were made to the BFF general ledger. Scheduled plant additions from Annual Reports from 1989 to 1996 for audit. Compiled plant subaccount detail from the work papers of the previous Order No. 22570 issued February 19, 1990. Obtained and read vendor's invoice files for plant additions. Recomputed accumulated depreciation of utility plant-in-service based on depreciation rates used in the last rate case. Scanned BFF's journal entries looking for contributions not listed on the CIAC account. Scheduled customer additions and verified 1997 customer count with billing records. Recomputed amortization of CIAC amounts.

NET OPERATING INCOME: Reviewed the revenue for the test year. Scheduled legal billing detail for hours representing non-recoverable activity. Scheduled contract operator invoices, traced BFF classifications, and rescheduled per audit classifications. Calculated depreciation expense from audited plant subaccount balances. Netted depreciation expense with the current amortization of CIAC amount. Scanned the other expense accounts.

CAPITAL STRUCTURE: Obtained the loan document for the DEP-required sprayfield upgrade.

OTHER: Toured the BFF service area and treatment plant. Judgmentally selected customer billing records to verify that the rates were those authorized by the Commission.

AUDIT EXCEPTION NO. 1

SUBJECT: PRIOR ORDER BOOKED INCORRECTLY

STATEMENT OF FACT: After the last rate case, BFF Corp. made correcting entries to its December 31, 1989 general ledger. These entries did not yield the FPSC-established utility plant-in-service balances.

OPINION: In order for the BFF plant subaccounts to match the FPSC Order No. 22570 dated February 19, 1990, staff should make the following adjusting entries.

	DR(CR)
#351 Organization	\$ 2,411.00
#354 Structures	(12,308.50)
#360 Collection Sewers	(5,010.00)
#361 Gravity Sewers	9,568.00
#362 Collecting Structures	(34,800.00)
#363 Services	6,219.00
#370 Receiving Wells	(13,920.00)
#380 Trans and Dist Eq.	<u>52,015.46</u>
Total	\$ 4,174.96

AUDIT EXCEPTION NO. 2

SUBJECT: PRIOR PLANT ADDITIONS INCORRECT

STATEMENT OF FACT: BFF capitalized \$4,628 of rate case expense for Charles deMenzes after the last rate proceeding in 1989. The utility also failed to provide documentation for two 1994 DEP permits totaling \$2,400. The rate case expense and the DEP permits were charged to the Organization and the Franchise plant subaccounts, respectively.

OPINION: Staff should reduce the Organization and the Franchise plant subaccounts by \$4,628 and \$2,400, respectively.

AUDIT EXCEPTION NO. 3

SUBJECT: TEST YEAR PLANT ADDITIONS INCORRECT

STATEMENT OF FACT: BFF capitalized payments to American Pipe and Tank, its sludge hauler, for a major sewer treatment plant clean-out. "This clean-out was needed after years of accumulation of sand," stated the utility manager.

The invoice charges for pumping 30,500 gallons of sludge and delivering 3,500 of seed sludge plus related expenses for a total of \$2,432.50. The BFF manager stated that this amount was capitalized into the Structures and Improvements account as part of DEP's requirement to clean up the operation of the plant.

The manager also stated that "this problem existed prior to the purchase of the utility and that this type clean-out would only be needed every 20 years or so."

OPINION: This major plant clean-out is a periodic recurring item, and \$2,432.50 should be transferred to Account No. 186, Deferred Debits and amortized over 20 years.

AUDIT EXCEPTION NO. 4

SUBJECT: REVENUE ADJUSTED INCORRECTLY

STATEMENT OF FACT: BFF wrote off a prior year's bad debt of \$799.99 against revenue during the month of December 1996. This amount represents an uncollectible "back billing" to a property owner for actual consumption by his tenant. This tenant refused to pay the utility bills, and BFF found that it had no legal right to collect from the property owner.

When BFF reduced revenue for this write-off, it also reduced its Regulatory Assessment Fee payable by \$36.00 which was the 4.5 percent amount associated with the \$799.99.

OPINION: The write-off amount of \$799.99 should be restored to the revenue account, and the bad debt should be considered nonrecurring and disallowed from ratemaking. The associated \$36.00 of Regulatory Assessment Fee should also be restored.

AUDIT EXCEPTION NO. 6

SUBJECT: CIAC BOOKED INCORRECTLY

STATEMENT OF FACT: BFF Corp. is required to charge a connection fee of \$1,620 per customer as they are hooked to its wastewater system. Since the last rate proceeding, BFF has added fourteen (14) customers. (From 81 to 95 customers)

The October 31, 1989 CIAC total was established to be \$18,616 by FPSC Order No. 22570 dated February, 19, 1990.

The October 31, 1997 BFF general ledger CIAC total is \$34,252.

OPINION: The BFF CIAC account should be increased by \$7,044 which is the difference between the BFF \$34,252 and the imputed \$41,296. ($\$18,616 + 22,680(14 \times \$1,620)$)

AUDIT EXCEPTION NO. 7

SUBJECT: AMORTIZATION OF CIAC

STATEMENT OF FACT: BFF Corp. booked amortization of CIAC with a recurring journal entry calculated at the beginning of the year. The balance is to be adjusted at year-end.

The company's October 31, 1997 ending balance for accumulated amortization of CIAC is \$9,122.

OPINION: The PSC audit staff recomputed the amortization of CIAC balance reflecting the audited CIAC balance. This October 31, 1997 balance was determined to be \$9,687.

The difference was determined to be \$565.

AUDIT EXCEPTION NO. 8

SUBJECT: MISCLASSIFICATION OF CONTRACT OPERATOR CHARGES

STATEMENT OF FACT: BFF employed its contract operator Enviro-Masters beginning March of the test period. Enviro-Masters performs not only the DEP required monthly services but also assists with plant upgrades and communications with engineers, DEP representatives, and the utility attorney.

The utility classified the Enviro-Masters' invoices as they were scheduled for payment

OPINION: In some cases, the utility classification did not correlate with the descriptions on the invoices. An analysis of the invoices, summarized below, yielded several corrections that should be made.

Acct No.	Description	Remove BFF Classification	Add Audit Classification	Required Audit Adjustment
186	Deferred Debits	0.00	2,815.00	2,815.00
354	Structures	(1,925.00)	604.00	(1,321.00)
362	Spec Collecting Structures	(2,378.00)	1,931.00	(447.00)
380	Treat & Disposal Equip.	(2,095.00)	0.00	(2,095.00)
382	Outfall Sewer Lines	(1,616.00)	960.00	(656.00)
720	Materials and Supplies	0.00	431.00	431.00
730	Monthly Oper Contract	(3,650.00)	4,100.00	450.00
775	Miscellaneous	0.00	822.00	822.00

AUDIT EXCEPTION NO. 9

SUBJECT: DEPRECIATION EXPENSE

STATEMENT OF FACT: BFF Corp. booked depreciation expense with a recurring journal entry calculated at the beginning of the year. This entry was unadjusted for test year plant additions.

Net depreciation expense was calculated by the audit staff using BFF's book balances and FPSC's audited balances. The difference is the adjustment listed below.

OPINION: The following schedule yields the depreciation expense adjustment.

<u>DESCRIPTION</u>	<u>AMOUNT</u>	<u>TOTALS</u>
PSC RECALCULATION OF DEP EXPENSE	\$8,707.00	
AMORTIZATION OF CIAC EXPENSE	<u>(1,496.00)</u>	
PSC DEPREC EXP		7,211.00
BFF CORP DEPRECIATION EXP	7,063.00	
BFF CORP AMORT OF CIAC EXPENSE	<u>(\$1,147.00)</u>	
BFF DEPREC EXP	LESS	<u>5,916.00</u>
NET ADJUSTMENT		\$1,295.00

Staff should increase BFF depreciation expense by \$1,295.

AUDIT EXCEPTION NO. 10

SUBJECT: ACCUMULATED DEPRECIATION

STATEMENT OF FACT: BFF Corp. booked depreciation with a recurring journal entry calculated at the beginning of the year. The balance was to be adjusted at year-end.

The company's October 31, 1997 ending balance for accumulated depreciation is \$77,168.

OPINION: The PSC audit staff recomputed the accumulated depreciation balance reflecting the corrected plant subaccount balances. This October 31, 1997 accumulated depreciation balance was computed at \$87,433.

The required adjustment is \$10,265. ($\$87,433 - \$77,168$)

AUDIT EXCEPTION NO. 11

SUBJECT: WORKING CAPITAL ALLOWANCE

STATEMENT OF FACT: Working capital allowance was calculated at 1/8 O & M expenses per Commission policy.

The BFF Corporation's operation and maintenance expense total for the test year was \$34,151.

OPINION: The PSC audit adjustments to those operation and maintenance expenses totaled \$4,109.

The working capital allowance per the PSC-approved formula method is one eighth of the remaining \$30,042, ($\$34,151 - \$4,109$) or \$3,755.

AUDIT DISCLOSURE NO. 1

SUBJECT: RELATED PARTY TRANSACTIONS

STATEMENT OF FACT: Charles deMenzes is the manager or an officer of one sewer, one water, and two combined water and sewer utilities. He manages all of these utilities from Tradewinds Utilities and beginning in 1997 from MIRA International, Inc. (MIRA), a standalone management corporation.

As Accountant and General Manager of all of these utilities, he maintains their general ledgers and provides a whole list of administrative services through MIRA.

OPINIONS: During the current audit of BFF Corp., many invoices were not clearly marked as pertaining to this corporation. Most unmarked invoices mentioned Tradewinds Utilities and manually designated BFF by Mr. deMenzes. Some invoices were sent to the contract operators, who work for all of the deMenzes' utilities, and BFF was just penciled in. The net result of these pencil changes was to turn invoices, usually considered third party documentation, into management representations. Such representations usually require other corroborating evidence but in this case none was available.

The following table gives the extent of the relatedness of MIRA and its utilities.

<u>CORP.</u>	<u>OWNER</u>	<u>%</u>	<u>OFFICER</u>	<u>OFFICE</u>	<u>MANAGER</u>
BFF	other		deMenzes	Treas	deMenzes
Residential	other		deMenzes	Pres/Sec	deMenzes
CFAT H2O	other		others		deMenzes
Tradewinds	deMenzes	50%	deMenzes	Pres	deMenzes
MIRA Intl.	deMenzes	100%	deMenzes	Pres	deMenzes

It is recommended that in the next SARC or overearnings review of one of these utilities, staff should review all of the companies to verify that all of the utility activity was accounted for correctly and that there was no expense shifting or resource misallocation.

AUDIT DISCLOSURE NO. 2

SUBJECT: TEN PERCENT CONSTRUCTION MANAGEMENT FEE

STATEMENT OF FACT: MIRA's 10 percent of new construction fee in 1997 is justified by Charles deMenzes with the following statement:

All utilities managed by MIRA international, Inc. have agreed to a construction management fee of 10 percent in the event of an upgrade. The cost savings versus contracting with one firm has proven to be significant.

When asked for an authorization from the ownership of BFF to charge the 10 percent fee, the audit staff received a current confirmation of the agreement stating "MIRA International, Inc. is to receive 10% of the cost of all new construction."

MIRA also receives a \$1,120 management and maintenance fee each month for operations from BFF.

OPINION: An analysis of the plant additions yielded the following application of the MIRA 10 percent management fee.

<u>ACCOUNT</u>	<u>DESCRIPTION</u>	<u>AMOUNT</u>
101181	DEBT DISCOUNT	\$234.83
101354	STRUCTURES	435.73
101362	SPECIAL STRUCTURES	479.79
101380	T AND D EQUIPMENT	611.77
101382	OUTFALL SPRAYFIELD	5,005.96
775000	MISCELLANEOUS EXPENSE	<u>95.53</u>
	TOTAL MGT FEE	\$6,863.61

The staff should compare the costs of the BFF sprayfield with other similar projects and determine the validity of the cost savings' statement.

Due to the related parties involved with this arrangement, these transactions deserve careful analysis. (See Disclosure No. 1.) The traditional role of utility management is to control costs while providing service. This arrangement, with the manager's company having a straight percentage interest in construction costs, gives the appearance of a disincentive to perform the cost control function.

AUDIT DISCLOSURE NO. 3

SUBJECT: CONSTRUCTION WORK-IN-PROGRESS

STATEMENT OF FACT: BFF Corp. had construction underway during the last part of field work. The manager, Charles deMenzes, booked an estimate of the construction cost as of October 31, 1997. This \$7,500 entry represented his best estimate of the final costs of the sprayfield addition.

The actual invoices (unbooked) presented to the audit staff after test period-end amounted to \$17,162.85. These are as follows.

<u>Vendor</u>	<u>Amount</u>	
Davis Meter	\$545.05	Materials
Miles Anderson	245.75	Engineering
All American Site	8,087.90	Fill
Barrineau and Associates	1,765.95	Engineering
All American Site	5,895.00	Fill
Central Testing	<u>623.25</u>	Testing
TOTAL CWIP	\$17,162.85	

OPINION: The staff should consider including these invoices in CWIP and revisiting the utility upon completion of the project.

EXHIBIT I

**BFF CORP.
DOCKET NO. 971182-SU
RATE BASE
TEST YEAR ENDED OCTOBER 31, 1997**

(a) DESCRIPTION	(b) PER COMPANY 10/31/97	(c) AUDIT EXCEPTION	(d) REFER TO	(e) PER AUDIT 10/31/97
UTILITY PLANT-IN-SERVICE	\$284,167	(\$9,372)	(1)	\$284,795
LAND	\$34,800	\$0		\$34,800
PLANT HELD FOR FUTURE USE	\$0	\$0		\$0
CIAC	(\$34,252)	(\$7,044)	E-6	(\$41,296)
AMORTIZATION OF CIAC	\$9,122	\$565	E-7	\$9,687
ACCUMULATED DEFRECIATION	(\$77,168)	(\$10,265)	E-10	(\$87,433)
WORKING CAPITAL(2)	\$0	\$3,755	E-11	\$3,755
TOTAL	\$226,669	(\$22,361)		\$204,308

FOOTNOTES:

(1) See Audit Exceptions 1, 2, 3, 5 & 8.

(2) Working Capital was calculated at 1/8 O&M expense per Commission policy.

EXHIBIT II

**BFF CORP.
DOCKET NO. 971182-SU
NET OPERATING INCOME
TEST YEAR ENDED OCTOBER 31, 1997**

(a) DESCRIPTION	(b) PER COMPANY 10/31/97	(c) AUDIT EXCEPTION	(d) REFER TO	(e) PER AUDIT 10/31/97
OPERATING REVENUES	\$41,536	\$800	E-4	\$42,336
OPERATING EXPENSES:	\$34,151	(\$4,109)	(1)	\$30,042
O&M EXPENSE	\$5,916	\$1,295	E-9	\$7,211
DEPRECIATION EXPENSE	\$2,443	\$36	E-4	\$2,479
TAXES OTHER THAN INCOME	\$0	\$0		\$0
INCOME TAX EXPENSE	\$0	\$0		\$0
OTHER UTILITY EXPENSE	\$0	\$0		\$0
TOTAL OPERATING EXPENSE	\$42,510	(\$2,778)		\$39,732
NET OPERATING INCOME(LOSS)	(\$974)	\$3,578		\$2,604

FOOTNOTES:

(1) See Audit Exceptions 5 & 8.

EXHIBIT III

**BFF CORP.
DOCKET NO. 971182-SU
CAPITAL STRUCTURE
TEST YEAR ENDED OCTOBER 31, 1997**

(a)	(b)	(c)	(d)	(e)	(f)
DESCRIPTION	PER COMPANY 10/31/97	AUDIT EXCEPTION	REFER TO	PER AUDIT 10/31/97	RATIO
COMMON EQUITY	\$105,964	\$0		\$105,964	56.81%
19 PREFERRED STOCK	\$0	\$0		\$0	0.00%
LONG-TERM DEBT (1)	\$79,548	\$0		\$79,548	42.65%
SHORT-TERM DEBT	\$0	\$0		\$0	0.00%
CUSTOMER DEPOSITS	\$1,020	\$0		\$1,020	0.55%
ITC	\$0	\$0		\$0	0.00%
TOTAL	\$186,532	\$0		\$186,532	100.00%

NOTE (1) Long term debt rate is variable daily at 1.250% over the High New York Prime as published in the Wall Street Journal daily.

STATE OF FLORIDA

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



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

Public Service Commission

December 30, 1997

BFF Corporation
Mr. Charles deMenzes, President
Post Office Box 5220
Ocala, Florida 34478-5220

Re: Docket No. 971182 - SU - BFF Corporation
Staff-assisted Rate Case Audit Report - 12 months Ended September 30, 1997
Audit Control # 97-279-3-1

Dear Mr. deMenzes:

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. Bayó

BSB/clis
Enclosure
cc: Public Counsel
MIRA International