



Public Service Commission
-M-E-M-O-R-A-N-D-U-M-

DATE: September 26, 2003
TO: Division of Economic Regulation (Iwenjiora)
FROM: Division of Auditing and Safety (Vandiver) *W*
RE: **Docket No.** 030601-SU; **Company Name:** North Peninsula Utilities, Corp.; **Audit Purpose:** Investigation of Possible Overearnings;
Audit Control No. 03-195-3-1

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

Robert Hillman, Vice President
North Peninsula Utilities, Inc.
P. O. Box 2803
Ormond Beach, FL 32175-2803

Tyree F. Wilson, President
North Peninsula Utilities, Inc.
P. O. Box 2803
Ormond Beach, FL 32175-2803

DOCUMENT NUMBER 030601-SU

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FLORIDA PUBLIC SERVICE COMMISSION

***DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING***

Orlando District Office

**NORTH PENINSULA UTILITIES CORPORATION
INVESTIGATION OF POSSIBLE OVEREARNINGS
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**


**DOCKET NO. 030601-SU
AUDIT CONTROL NO. 03-195-3-1**



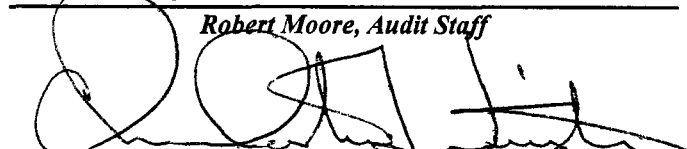
Misty B. Shepherd, Audit Manager



Intesar Terkawi, Audit Staff



Robert Moore, Audit Staff



Charleston J. Winston, District Audit Supervisor

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

September 22, 2003

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 period ended December 31, 2002, for North Peninsula Utilities Corporation. The attached schedules were assembled by the audit staff as part of our work in the utility's Investigation of Possible Overearnings, Docket No. 030601-SU.

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's contributions-in-aid-of-construction (CIAC) are understated by \$17,600, and accumulated amortization of CIAC is understated by \$2,389 as of December 31, 2002.

The utility overstated its revenues by \$10,779.

The utility's Operation and Maintenance Expenses should be reduced by \$2,723.

The utility's amortization expense is understated by \$806 for the period ended December 31, 2002.

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.

Verified - The items were tested for accuracy, and substantiating documentation was examined.

RATE BASE: Verified utility-plant-in-service (UPIS), contributions-in-aid-of-construction (CIAC), accumulated depreciation, and accumulated amortization of CIAC additions as of December 31, 2002. Reconciled rate base balances authorized in Commission Order No. PSC- 00-1676-PAA-SU, issued September 19, 2000, to the utility's general ledger. Verified contributions-in-aid-of-construction and accumulated amortization additions as of December 31, 2002. Computed working capital allowance using the one-eighth of operation and maintenance expenses. Tested additions to accumulated depreciation and accumulated amortization for proper rates and calculations.

NET OPERATING INCOME: Compiled utility revenue and operating and maintenance accounts for the year ended December 31, 2002. Chose a judgmental sample of customer bills and recalculated using FPSC-approved rates. Chose a judgmental sample of operations and maintenance expenses and reviewed the invoices and other supporting documentation. Tested the calculation of depreciation expense. Verified taxes other than income and income taxes.

CAPITAL STRUCTURE: Compiled components of the capital structure as of December 31, 2002. Agreed interest expense to the terms of the notes and bonds. Confirmed note balances as of December 31, 2002.

OTHER: Scanned the Regulatory Assessment Fees for the year 2002.

Exception No. 1

Subject: CIAC and Accumulated Amortization of CIAC

Statement of Fact: The utility reported balances of (\$623,394) and \$492,182 for CIAC and accumulated amortization of CIAC, respectively, as of December 31, 2002.

Commission Order No. 16184, issued June 4, 1986, in Docket No. 850121-SU ordered the utility to cease charging service availability charges to avoid exceeding the 75 percent maximum CIAC level established by Rule 25-30.580(1), Florida Administrative Code (F.A.C.). Commission Order No. PSC-00-1676-PAA-SU, issued September 19, 2000, approved a balance of (\$640,994) for CIAC as of December 31, 1998.

The utility's 2000 Annual Report indicates an adjustment to CIAC of \$17,600 labeled as a refund.

Recommendation: The audit staff had requested an explanation and supporting documentation for the \$17,600 adjustment to CIAC. As of the end of fieldwork, the utility had not complied with this request. Based on the audit staff's inability to determine the nature and support for this amount, we have reversed the \$17,600 adjustment made by the utility. The balance for CIAC should be (\$640,994) as of December 31, 2002. The effect of this finding increases accumulated amortization of CIAC by \$2,389. The balance of accumulated amortization of CIAC should be \$494,571 as of December 31, 2002. This finding also increases amortization expense by \$806. Amortization expense should be \$29,981 for the period ended December 31, 2002.

The Commission should require the utility to adjust its balances to reflect the findings described above.

Exception No. 2

Subject: Revenues

Statement of Fact: The utility recorded revenues of \$187,899 for the 12-month period ended December 31, 2002, in its general ledger.

The utility's billing register shows revenues of \$177,120 for the 12-month period ended December 31, 2002. The difference of \$10,779 (\$187,899 - \$177,120) is due to the following adjustments.

2001 adjustments to account receivables recorded in 2002	\$3,951
2003 revenues received in 2002	1,960
2001 account receivables recorded in 2002	937
2000 account receivables recorded in 2002	457
An interest rebate recorded as revenues	2,429
Changes in account receivables recorded as revenues	<u>1,045</u>
Total:	<u>\$10,779</u>

Recommendation: The revenues per the utility's general ledger should be reduced by \$10,779 for the 12-month period ended December 31, 2002.

The associated reduction to the Regulatory Assessment Fee is \$485 (\$10,779 x 4.5%).

Exception No. 3

Subject: Operation and Maintenance (O & M) Expense

Statement of Fact: The utility recorded O & M expense of \$133,143 for the 12-month period ended December 31, 2002.

In the above amount the utility included \$2,473 in Account No. 407-100, Amortization-Loan Closing Costs. In its closing journal entries the utility reclassified this amount to Account No. 775, Miscellaneous Expenses.

Per Commission Order No. PSC-94-1452-FOF-WU, issued November 28, 1994, Docket No. 940475-WU, loan closing costs should be a part of the Capital Structure as debt issue charges thereby increasing the effective interest rate.

Recommendation: The utility's O & M expense should be reduced by \$2,723 (\$2,473 + 250) as noted below.

The utility's effective interest rate on one of its Long-Term Debt should be increased from 5.12% to 5.90% as shown on the attached schedule.

Working Capital should be \$16,303 $((\$133,143 - \$2,723 = \$130,420)/8)$ Using the one-eighth of O & M expense method.

The above \$2,473 should be reclassified to Account No. 426, Miscellaneous Nonutility Expenses. However, it should be recognized in calculating the effective interest rate on its debt. See the attached schedule.

The utility could not provide supporting documentation for \$250 included in Account No. 732, Contractual Service-Accounting, therefore it should be removed.

Exception No. 3, continued

Schedule - Exception No. 3

Annual Loan Costs Amortization Expense	2,473.00	per G/L
Interest Expense	18,232.57	per G/L
Total:	<u>20,705.57</u>	
Divided by Principle from below	351,098.64	
Correct Effective Interest Rate:	<u>5.90%</u>	
Balance per G/L	356,333.64	
Less Unamortized Loan Closing Costs Balance	5,235.00	
Total:	<u>351,098.64</u>	
Loan Closing Costs per G/L:	18,969.00	
Accum. Amort-Loan Closing Costs per G/L:	13,734.00	
Total Unamort-Loan Closing Costs:	<u>5,235.00</u>	
Interest Expense per G/L	18,232.57	
Balance per G/L	356,333.64	
Incorrect Effective Interest Rate:	5.12%	

G/L = general ledger

Exception No. 4

Subject: Taxes Other Than Income (TOTI)

Statement of Fact: The utility recorded taxes other than income of \$19,638 for the 12-month period ended December 31, 2002.

Recommendation: The taxes other than income balance should be reduced by \$601 according to the following schedule:

Description	Amount Per Company	Audit Adjustments	Amount Per Audit
General Journal Entry	(\$108)	\$0	(\$108)
Florida Public Service Commission (1)	8,455	(485)	7,970
Real Estate Taxes (2)	7,155	(74)	7,081
Tangible Personal Property Taxes (3)	4,136	(42)	4,094
Total :	\$19,638	(\$601)	\$19,037

- (1) Adjustment to revenues per Exception No. 2
- (2) The real estate tax expense does not reflect the maximum discount.
- (3) The tangible personal property taxes do not reflect the maximum discount.

Disclosure No. 1

Subject: Pro Forma Utility-Plant-in-Service (UPIS)

Statement of Fact: The utility reported a balance of \$806,039 for UPIS as of December 31, 2002. The utility's consultant submitted an analysis of projected plant additions for consideration during this audit. The analysis projects an increase of \$71,113 for plant and an increase in expenses of \$7,565.

The audit staff requested additional documentation to support these projected amounts and as of the end of fieldwork had not received any further information regarding this matter.

Recommendation: The audit staff defers this information to the analyst for final disposition.

Audit Disclosure No. 2

Subject: Management Fees

Statement of Facts: North Peninsula Utilities, Corp. has no employees and therefore no salary expenses or benefits. The utility is managed by Peninsula Management Inc.(PMI), a related party. A contract exists between PMI and the utility regarding the services to be provided and the compensation required. The contract states a compensation of \$9.34 per connected sewer customer per month. The total amount paid to PMI was \$56,500 for the twelve month period ended December 31, 2002.

Total O&M expenses per audit for the utility amounted to \$130,420 for the twelve-month period ended December 31, 2002. Therefore, management fees represent 43% (56,500/130,420) of total O&M expenses.

Audit staff requested the utility to provide an analysis of the hours spent on management related services. The utility did not provide a response to this request.

Recommendation: Audit staff defers final disposition of this matter to FPSC analyst.

Disclosure No. 3

Subject: Interest Rates

Statement of Fact: The utility obtained a long-term debt with Peninsula Bank of Central Florida. The bank charges an effective interest rate of 5.12 percent for the period ended December 31, 2002. Comparatively, the utility holds two notes payable to Blake Hillman and Lynda Wilson, both related parties, and pays an annual interest rate of 14 percent, for the period ended December 31, 2002.

Recommendation: Audit staff defers final disposition of this matter to FPSC analyst.

EXHIBIT I

**NORTH PENINSULA UTILITIES, CORP.
WASTEWATER RATE BASE
DOCKET NO. 030601-SU
INVESTIGATION OF POSSIBLE OVERTURNINGS
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
UTILITY PLANT-IN-SERVICE	\$806,039	\$0		\$806,039
LAND & LAND RIGHTS	46,800	0		46,800
CONTRIBUTIONS-IN-AID- OF- CONSTRUCTION (CIAC)	(623,394)	(17,600)	E1	(640,994)
ACCUMULATED DEPRECIATION	(598,231)	0		(598,231)
ACCUMULATED AMORTIZATION OF CIAC	492,182	2,389	E1	494,571
WORKING CAPITAL ALLOWANCE	0	16,303	E3	16,303
TOTAL	\$123,396	\$1,092		\$124,488

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.

EXHIBIT II

**NORTH PENINSULA UTILITIES, CORP.
WASTEWATER NET OPERATING INCOME
DOCKET NO. 030601-SU
INVESTIGATION OF POSSIBLE OVERTURNINGS
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
REVENUES:				
OPERATING REVENUES	\$187,899	(\$10,779)	E2	\$177,120
EXPENSES:				
O&M EXPENSE	133,143	(2,723)	E3	130,420
DEPRECIATION EXPENSE	37,701	0		37,701
AMORTIZATION EXPENSE	(29,175)	(806)	E1	(29,981)
TAXES OTHER THAN INCOME	19,638	(601)	E4	19,037
TOTAL	\$161,307	(\$4,130)		\$157,177
NET OPERATING INCOME	\$26,592	(\$6,649)		\$19,943

FOOTNOTES:

1) Small differences can be attributed to rounding errors.

EXHIBIT III**NORTH PENINSULA UTILITIES, CORP.
DOCKET NO. 030601-SU
CAPITAL STRUCTURE
2002 EARNINGS REVIEW
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER COMPANY @12/31/02	AUDIT EXCEPTION (1)	REFER TO (1)	PER AUDIT @12/31/02	RATIO	COST RATE (2)	WEIGHTED COST OF CAPITAL
COMMON EQUITY	(\$308,311)	\$0		(\$308,311)	(531.36)%	11.96%	(63.550)%
LONG-TERM DEBT	356,334	0		356,334	614.13%	5.90%	36.233%
LONG-TERM DEBT	5,000	0		5,000	8.62%	14.00%	1.210%
LONG-TERM DEBT	5,000	0		5,000	8.62%	14.00%	1.210%
CUSTOMER DEPOSITS(1)	0			0			0.000%
TOTAL	\$58,023	\$0		\$58,023	100.00%		(24.897)%

REQUIRED FOOTNOTES:

- 1) The company does not collect a customer deposit for service connections.
- 2) Cost rate for common equity established in Order No. PSC-03-0707-PAA-WS, issued June 13, 2003