**FLORIDA PUBLIC SERVICE COMMISSION**

 **Fletcher Building**

 **101 East Gaines Street**

 **Tallahassee, Florida 32399-0850**

 **M E M O R A N D U M**

 **June 10, 1993**

**TO : DIRECTOR OF RECORDS AND REPORTING**

**FROM : DIVISION OF AUDITING AND FINANCIAL ANALYSIS (MEEKS, C. ROMIG, REVELL, SLEMKEWICZ)**

 **DIVISION OF ELECTRIC AND GAS (MILLS)**

 **DIVISION OF LEGAL SERVICES (ANQUIANO)**

**RE : DOCKET NO. 921277-GU, SOUTH FLORIDA NATURAL GAS COMPANY - 1992 DEPRECIATION STUDY**

**AGENDA : JUNE 22, 1993 - PROPOSED AGENCY ACTION - CONTROVERSIAL -PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\921277.RCM**

 **DISCUSSION OF ISSUES**

**ISSUE :** Should the current depreciation rates for South Florida Natural Gas Company (SFNG or Company) be changed?

**RECOMMENDATION:** Yes. Changes in activity and Company plans necessitate changes in the recovery provisions. (MEEKS)

**STAFF ANALYSIS:** Under Rule 25-7.045 (8), Florida Administrative Code (F.A.C.), gas companies are to file a comprehensive depreciation study at least once every five years. The Company filed the current depreciation study in keeping with this rule. Changes since the last study brought about by activity and Company planning indicate the need to revise currently prescribed depreciation rates.

**ISSUE 2:** What should be the date of implementation for new rates?

**RECOMMENDATION:** Staff recommends approval of the Company's proposed May 1, 1993 date of implementation for the new depreciation rates. (MEEKS)

**STAFF ANALYSIS:** The Company's requested implementation date of May 1, 1993 coincides with the beginning of its fiscal year. All supportive data and calculations have been made abutting this date; Staff therefore recommends its approval.

**ISSUE 3:** What are the appropriate lives, net salvages, reserve amounts, and resultant depreciation rates for each account?

**RECOMMENDATION:** The Staff recommended lives, net salvages, reserves and resultant depreciation rates are shown on Attachment A, page 11. This results in an increase in annual depreciation expense of approximately $5,100.00 based on May 1, 1993 investments as shown on Attachment B, page 12. (MEEKS)

**STAFF ANALYSIS:** Staff has worked closely with Company personnel during the course of this study review. Even though SFNG's study did not include a proposal for new rates or parameters, it did include the necessary data and information that permitted Staff to conduct a review and an analysis of the current recovery status of

each account. As a result of that analysis, Staff proposes that certain changes in the currently prescribed life and salvage parameters are warranted. The Company agrees with the Staff position for all accounts.

 The Company has successfully resolved data problems encountered during the last review and has initiated policies and procedures to ensure the proper accounting of retirements, salvage and cost of removal.

 In connection with this depreciation study, the Division of Research and Regulatory Review performed an operational review of the Company's Continuing Property Records. The review contained eight recommendations; the Company agreed with seven and disagreed with one. The recommendation SFNG disagreed with related to capitalization of overhead costs and is discussed in Issue 5.

 For each of the following listed accounts, the recommended average remaining lives simply reflect updating currently prescribed lives with accounting data since the last depreciation study. There are no changes recommended to the currently prescribed net salvage factors.

Distribution Assets:

Measuring and Regulating Station Equipment-General

 Measuring and Regulating Station Equipment-City Gate

 House Regulators

 Industrial Measuring and Regulator Station Equipment

 Other Equipment

General Support Assets:

 Structures and Improvements

 Office Furniture

 Office Machines and Equipment

 Transportation

 Small Tools

 Laboratory Equipment

 Power Operated Equipment

 Miscellaneous Equipment

 Shown below is a brief discussion for the remaining accounts that warrant a change in either the life and/or net salvage factor.

**DISTRIBUTION ASSETS**

Structures and Improvements : During the last review, Staff believed that these were leased facilities. Staff's belief is reflected in the currently prescribed life and salvage parameters. However, the Company has informed Staff that this investment consists of fences and other protective improvements. With this in mind, Staff recommends the use of a 25 year service life and SQ curve for this account. The recommended 6.3 year remaining life is based on an average age of 18.7 years. The currently prescribed salvage factor of zero is still considered appropriate for this account. The embedded portion of this account is approaching 100% recovery. For this reason, the depreciation rate being recommended for the embedded investment is not considered appropriate for new additions. With this in mind, Staff recommends a 4% whole life depreciation rate for new additions based on the 25 year average service life and zero salvage factor.

Mains-General: During the review of the submitted data, it was noted that removal costs were not incurred when a replacement main was installed at the same time the old main was removed. This results in the capitalization of the cost of digging down to and abandoning the old facility plus the cost of filling and any resurfacing. Staff is of the opinion that the costs associated with removal (i.e., labor, overhead, digging, backfilling, etc.) as well as restoration of any pavement or concrete should be equitably shared between the removal of the retired facility and installation of the replacing facility. One approach is that the cost associated with digging down to and any work associated with abandoning the retiring facility would be charged as cost of removal. The cost to install the replacing facility along with any costs associated with filling and resurfacing would then be capitalized with the new main. The Company has agreed to change its procedures to utilize this approach.

Mains and Services: The recommended average remaining lives for these accounts simply reflect updating the currently prescribed lives with the accounting data since the last depreciation study. Mains and Services are generally abandoned in place upon retirement. This involves travel time for the crew, digging down to the facility, cutting and capping, refilling the hole, and restoring the roadway. Costs for restoring the roadway can be significant if the facility is under the pavement. In the case of SFNG, less than 3% of its mains and service lines are under pavement and potentially subject to costly surface restoration upon retirement. The Staff recommended cost of removal factors are based on information received from the Company detailing labor and materials generally associated with abandonment.

Meter and Regulator Installations: These installations are only retired when the meter or regulator is removed from the location and no new one is installed, or when the service through the meter or regulator is cut off. In other words, the life of the meter or regulator installation should be very similar to the life of the services. The Staff recommended remaining life is reflective of this. The removal costs associated with this account have increased slightly over the past five years. Since the removal costs are actually labor costs and are expected to continue to increase, Staff recommends a change in the future net salvage to a negative five percent from the current (4)% salvage factor. This is in line with recent industry projections for this type of investment.

Industrial Measuring and Regulating Station Equipment: The embedded portion of this account is approaching 100% recovery. For this reason, the depreciation rate being recommended for the embedded investment is not considered appropriate for any new additions. With this in mind, Staff is recommending a whole life depreciation rate of 3.3% for any new additions. This is based on a 30 year average service life and zero salvage factor.

 GENERAL SUPPORT ASSETS

Office Machines and Equipment: The embedded portion of this account is approaching 100% recovery. For this reason, the depreciation rate being recommended for the embedded investment is not considered appropriate for any new additions. With this in mind, Staff is recommending a whole life depreciation rate of 6.7% for any new additions. This is based on a 15 year average service life and zero salvage factor

Communications Equipment: The Company now leases all of its communication equipment. However, should the Company purchase any communication equipment before the next depreciation rate review, Staff recommends the use of a whole life rate based on a 10 year average service life and zero net salvage.

**ISSUE 4:** Should the Company be required to perform a physical inventory of the Small Tools account?

**RECOMMENDATION:** Yes. Based on the results of this inventory, SFNG should make the necessary accounting adjustments on its books. (MEEKS)

**STAFF ANALYSIS:** The age distribution indicates about 78% of the surviving investment is over 15 years old with 20% over 25 years old. This type of data suggests the need for a physical inventory. The Company has agreed to perform a physical inventory and, based on its findings, make the necessary accounting adjustments. If, as a result of the inventory, it is found that equipment is not physically in service but is still reflected in the investment on the books, then the plant in service and reserve for this account should reflect an appropriate inventory adjustment to correctly remove the investment from service.

**ISSUE 5:** Is SFNG correctly capitalizing overheads directly associated with each construction project as set forth in Rule 25-7.0461 (7), Florida Administrative Code (F.A.C.)?

**RECOMMENDATION:** No. SFNG should implement a process of allocation to begin properly capitalizing those overhead costs directly associated with construction projects as set forth in Rule 25-7.0461 (7), F.A.C. (MEEKS, SLEMKEWICZ)

**STAFF ANALYSIS:** As the result of a Continuing Property Record (CPR) audit performed by the Research and Regulatory Review Staff, it has been found that SFNG does not capitalize overheads directly associated with construction projects as set forth in Rule 25-7.0461 (7), F.A.C. The audit recommended that the Company begin capitalizing overheads directly associated with each construction project, as a part of plant additions and retirements. The Company disagreed, stating that for a small company such as theirs, there is insufficient economic justification to devise an elaborate allocation basis to capitalize these costs, and the Company would welcome a waiver from Rule 25-7.0461 (7). Staff believes a waiver is not justified and that the allocation basis need not be elaborate. The allocation can be based on the actual employees' salaries and benefits and a reasonable estimate of the vehicles costs which can be updated on an annual basis. This will result in a more proper allocation of overhead costs between capital and expense.

**ISSUE 6:** Should the current amortization of investment tax credits (ITCs) and the flowback of excess deferred income taxes be revised to reflect the approved depreciation rates?

**RECOMMENDATION:** Yes. The current amortization of ITCs and the flowback of excess deferred income taxes should be revised to reflect the approved depreciation rates. Also, the utility should be required to file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes separate from, but at the same time it files its fourth quarterly Rate of Return Report for 1993. (C. ROMIG)

**STAFF ANALYSIS:** As previously addressed in Issue 3 and detailed on Attachment A, page 11, Staff recommends revisions to SFNG's depreciation rates to become effective May 1, 1993. Revising a utility's depreciation rates usually results in a change in its rate of ITC amortization and a change in its flowback of excess deferred taxes.

 SFNG is treated under Section 46(f)(1) of the Internal Revenue Code, which results in its ITCs being given a zero cost rate in its capital structure and below-the-line amortization. Section 46(f)(6) of the Internal Revenue Code (IRC) states that the amortization of ITCs should be determined by the period of time used in computing depreciation expense for purposes of reflecting regulated operating results of the utility. Rule 25-14.008(3)(b)(2) states that where an election was made under Section 46(f)(l) of the Code, restorations to rate base are allocated ratably in proportion to the ratemaking life used in the calculation of the regulated depreciation expense. Consequently, a change in depreciation rates usually results in a change in the amortization of ITCs.

 Regarding the flowback of excess deferred taxes, Section 203(e) of the Tax Reform Act of 1986 (TRA) prohibits rapid write-back of excess protected (depreciation related) deferred taxes. Moreover, Rule 25-14.013, Florida Administrative Code (F.A.C.), prohibits (without good cause shown) excess deferred income taxes (protected and unprotected) associated with temporary differences, from being reversed any faster than allowed under either the average rate assumption method of Section 203(e) of the TRA or Revenue Procedure 88-12, whichever is applicable. Consequently, the flowback of excess deferred taxes should be altered to comply with the TRA and Rule 25-14.013.

 To date, no calculations of the tax effect have been provided. Consequently, Staff recommends that the utility be ordered to submit detailed calculations of the tax impact, to include amortization of the ITCs and flowback of excess deferred taxes. The detailed calculations should be submitted separate from, but at the same time it files its fourth quarterly Rate of Return Report for 1993.

**ISSUE 7:** Should this docket be closed?

**RECOMMENDATION:** Yes, assuming no protests are filed to the Proposed Agency Action Order. (MEEKS)

**STAFF ANALYSIS:** In Staff's opinion, no further Commission action is necessary if no protests to the PAA Order are filed.

SOUTH FLORIDA NATURAL GAS COMPANY

1992 STUDY

COMPARISON OF RATES AND COMPONENTS

 CURRENT COMPANY PROPOSAL STAFF RECOMMENDATION

 AVERAGE REMAINING AVERAGE REMAINING AVERAGE REMAINING

 REMAINING NET LIFE REMAINING NET LIFE REMAINING NET LIFE

ACCOUNT LIFE SALVAGE RESERVE RATE LIFE SALVAGE RESERVE RATE LIFE SALVAGE RESERVE RATE

 (YRS.) (%) (%) (%) (YRS.) (%) (%) (%) (YRS.) (%) (%) (%)

**DISTRIBUTION ASSETS**

 375 Structures & Impr.‑Embedded 6.2 0.0 38.49 9.9 6.3 0.0 87.99 1.9 6.3 0.0 87.99 1.9

 375 Structures & Impr.‑New Adds NOT APPLICABLE 25.0 0.0 0.00 4.0 \* 25.0 0.0 0.00 4.0 \*

 376 Mains‑Other Than Plastic 22.0 (7.0) 48.83 2.6 17.9 (21.0) 65.84 3.1 17.9 (21.0) 65.84 3.1

 376.1 Mains‑Plastic 34.0 (7.0) 12.05 2.8 33.0 (14.0) 16.73 2.9 33.0 (14.0) 16.73 2.9

 378 Meas. & Reg. Sta. Eq.‑Gen. 18.9 (3.0) 49.44 2.8 14.4 (3.0) 63.73 2.7 14.4 (3.0) 63.73 2.7

 379 Meas. & Reg. Sta.‑ City Gate 15.4 (3.0) 55.5 3.1 12.3 (3.0) 71.00 2.6 12.3 (3.0) 71.00 2.6

 380 Services‑Other Than Plastic 22.0 (20.0) 48.28 3.3 17.7 (34.0) 52.32 4.6 17.7 (34.0) 52.32 4.6

 380.1 Services‑Plastic 33.0 (20.0) 10.54 3.3 31.0 (29.0) 12.67 3.8 31.0 (29.0) 12.67 3.8

 381 Meters 12.1 0.0 38.48 5.1 13.4 0.0 60.17 3.0 13.4 0.0 60.17 3.0

 382,384 Meter & Reg. Inst. 25.0 (4.0) 33.01 2.8 26.0 (5.0) 32.45 2.8 26.0 (5.0) 32.45 2.8

 383 House Regulators 16.7 0.0 36.43 3.8 19.4 0.0 32.10 3.5 19.4 0.0 32.10 3.5

 385 Indust. Meas. & Reg. Sta. Eq.‑Emb. 7.0 0.0 77.52 3.2 6.9 0.0 93.52 0.9 6.9 0.0 93.52 0.9

 385 Indust. Meas. & Reg. Sta. Eq.‑New NOT APPLICABLE 30.0 0.0 0.00 3.3 \* 30.0 0.0 0.00 3.3 \*

 387 Other Equipment 9.4 0.0 72.73 2.9 24.0 0.0 27.08 3.0 24.0 0.0 27.08 3.0

**GENERAL SUPPORT ASSETS**

 390 Stuctures & Improvements 8.9 0.0 41.63 6.6 16.7 0.0 25.83 4.4 16.7 0.0 25.83 4.4

 391.1 Office Furniture 10.9 0.0 56.40 4.0 9.2 0.0 69.83 3.3 9.2 0.0 69.83 3.3

 391.2 Ofc. Mach. & Eq.‑Embedded 6.7 0.0 57.74 6.3 4.2 0.0 99.28 0.2 4.2 0.0 99.28 0.2

 391.2 Ofc. Mach. & Eq.‑New Additions NOT APPLICABLE 15.0 0.0 0.00 6.7 \* 15.0 0.0 0.00 6.7 \*

 392 Transportation 5.6 15.0 17.24 12.1 4.9 15.0 16.80 13.9 4.9 15.0 16.80 13.9

 394 Small Tools 5.7 0.0 71.50 5.0 3.8 0.0 89.54 2.8 3.8 0.0 89.54 2.8

 395 Laboratory Equipment 14.5 0.0 65.01 2.4 9.5 0.0 77.04 2.4 9.5 0.0 77.04 2.4

 396 Power Operated Equip. 10.4 0.0 30.32 6.7 8.5 0.0 44.33 6.5 8.5 0.0 44.33 6.5

 397 Communication Eq.‑Embedded 5.1 0.0 74.51 5.0 NOT APPLICABLE NOT APPLICABLE

 397 Communication Eq.‑New Additions NOT APPLICABLE 10.0 0.0 0.00 10.0 \* 10.0 0.0 0.0 10.0 \*

 398 Miscellaneous Equip. 12.5 0.0 25.16 6.0 12.4 0.0 16.41 6.7 12.4 0.0 16.41 6.7

 \*Denotes Whole Life Rate

 SOUTH FLORIDA NATURAL GAS COMPANY

 1992 STUDY

 COMPARISON OF EXPENSES

 CURRENT COMPANY PROPOSAL STAFF RECOMMENDATION

 CHANGE CHANGE

 5/1/93 5/1/93 IN IN

ACCOUNT INVESTMENT RESERVE RATE EXPENSES RATE EXPENSES EXPENSES RATE EXPENSES EXPENSES

 ($) ($) (%) ($) (%) ($) ($) (%) ($) ($)

**DISTRIBUTION ASSETS**

 375 Structures & Impr.‑Embedded 2,790 2,455 9.9 276 1.9 53 (223) 1.9 53 (223)

 375 Structures & Impr.‑New Additions 0 0 N/A N/A 4.0 \* 0 0 4.0 \* 0 0

 376 Mains‑Other Than Plastic 718,579 473,110 2.6 18,683 3.1 22,276 3,593 3.1 22,276 3,593

 376.1 Mains‑Plastic 270,843 45,303 2.8 7,584 2.9 7,854 270 2.9 7,854 270

 378 Meas. & Reg. Sta. Eq.‑Gen. 8,035 5,121 2.8 225 2.7 217 (8) 2.7 217 (8)

 379 Meas. & Reg. Sta.‑ City Gate 11,744 8,338 3.1 364 2.6 305 (59) 2.6 305 (59)

 380 Services‑Other Than Plastic 422,936 221,260 3.3 13,957 4.6 19,455 5,498 4.6 19,455 5,498

 380.1 Services‑Plastic 140,560 17,813 3.3 4,638 3.8 5,341 703 3.8 5,341 703

 381 Meters 178,560 107,434 5.1 9,107 3.0 5,357 (3,750) 3.0 5,357 (3,750)

 382,384 Meter & Reg. Inst. 123,233 39,987 2.8 3,451 2.8 3,451 0 2.8 3,451 0

 383 House Regulators 48,756 15,650 3.8 1,853 3.5 1,706 (147) 3.5 1,706 (147)

 385 Indust. Meas. & Reg. Sta. Eq.‑Emb. 10,336 9,666 3.2 331 0.9 93 (238) 0.9 93 (238)

 385 Indust. Meas. & Reg. Sta. Eq.‑New Adds. 0 0 N/A N/A 3.3 \* 0 0 3.3 \* 0 0

 387 Other Equipment 7,863 2,129 2.9 228 3.0 236 8 3.0 236 8

 Total Distribution 1,944,235 948,266 60,697 66,344 5,647 66,344 5,647

**GENERAL SUPPORT ASSETS**

 390 Stuctures & Improvements 17,396 4,494 6.6 1,148 4.4 765 (383) 4.4 765 (383)

 391.1 Office Furniture 7,636 5,332 4.0 305 3.3 252 (53) 3.3 252 (53)

 391.2 Ofc. Mach. & Eq.‑Embedded 4,153 4,123 6.3 262 0.2 8 (254) 0.2 8 (254)

 391.2 Ofc. Mach. & Eq.‑New Additions 0 0 N/A N/A 6.7 \* 0 0 6.7 \* 0 0

 392 Transportation 29,279 4,919 12.1 3,543 13.9 4,070 527 13.9 4,070 527

 394 Small Tools 13,877 12,426 5.0 694 2.8 389 (305) 2.8 389 (305)

 395 Laboratory Equipment 823 634 2.4 20 2.4 20 0 2.4 20 0

 396 Power Operated Equip. 34,057 15,097 6.7 2,282 6.5 2,214 (68) 6.5 2,214 (68)

 397 Communication Eq.‑Embedded 0 0 5.0 0 NOT APPLICABLE NOT APPLICABLE

 397 Communication Eq.‑New Additions 0 0 N/A N/A 10.0 \* 0 0 10.0 \* 0 0

 398 Miscellaneous Equip. 3,151 517 6.0 189 6.7 211 22 6.7 211 22

 Total General Support Assets 110,372 47,542 8,443 7,929 (514) 7,929 (514)

 GRAND TOTAL 2,054,607 995,808 69,140 74,273 5,133 74,273 5,133

 \*Denotes Whole Life Rate