

State of Florida



Public Service Commission

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

DATE: January 31, 2005
TO: Stephanie Clapp, Division of Economic Regulation
FROM: Denise N. Vandiver, Chief, Bureau of Auditing *DNV*
Division of Regulatory Compliance and Consumer Assistance
RE: **Docket No.:** 040952-WS; **Company Name:** Florida Water Services Corp. ; **Audit Purpose:** Establish Rate Base; **Audit Control No.:** 04-247-3-1

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 Regulatory Compliance and Consumer Assistance (Hoppe, District Offices, File Folder)
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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF REGULATORY COMPLIANCE & CONSUMER ASSISTANCE
BUREAU OF AUDITING*

Orlando District Office

**FLORIDA WATER SERVICES CORPORATION
CHULUOTA SYSTEMS**

ESTABLISH RATE BASE

SEMINOLE COUNTY

AS OF JUNE 30, 2004

**DOCKET NO. 040952-WS
AUDIT CONTROL NO. 04-247-3-1**

Jeffery A. Small, Audit Manager

Charleston J. Winston, Audit Supervisor

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**DIVISION OF REGULATORY COMPLIANCE & CONSUMER ASSISTANCE
AUDITOR'S REPORT**

January 21, 2005

**TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED
PARTIES**

We have applied the procedures described later in this report to prepare a schedule of Rate Base as of June 30, 2004, for Florida Water Services Corporation's Chuluota water and wastewater operations located in Seminole County, Florida. These schedules were prepared by the audit staff as part of the company's application for Certificate of Transfer in Docket No. 040952-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 properly adjust its rate base balances to the authorized balances in Commission Order No. PSC-96-1320-FOF-WS, issued October 30, 1996.

The utility's wastewater land is overstated by \$9,205 as of June 30, 2004.

The utility's accumulated depreciation is understated by \$5,399 each for its water and wastewater systems as of June 30, 2004.

The utility's construction-work-in-progress is overstated by \$13,873 and understated by \$11,897, respectively, for its water and wastewater systems as of June 30, 2004.

The utility's acquisition adjustment and accumulated amortization of acquisition adjustment balances are overstated by \$45,065 and \$16,246, respectively, for its water system as of June 30, 2004.

The utility's regulatory surcharge balances are \$23,096 and \$15,853, respectively, for its water and wastewater systems as of June 30, 2004.

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: Compiled account balances for utility-plant-in-service (UPIS), contributions-in-aid-of-construction (CIAC), accumulated depreciation, accumulated amortization of CIAC, construction-work-in-progress (CWIP), acquisition adjustment (AA) and accumulated amortization of AA for Florida Water Corporation's Chuluota system as of June 30, 2004. Reconciled rate base balances authorized in Commission Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, to the utility's general ledger. Verified selected additions to UPIS and

CIAC accounts using auditor judgment. Verified selected additions to accumulated depreciation and accumulated amortization of CIAC for proper rates and calculations.

Verified the utility's other regulatory asset balance approved in Commission Order No. PSC-99-1794-FOF-WS, issued September 14, 1999.

Exception No. 1

Subject: Adjustment to Prior Order

Statement of Fact: Commission Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, established the following rate base component balances for the utility as of December 31, 1994.

Water System

Contributions-in-Aid-of-Construction (CIAC)	(\$178,161)
Amortization of CIAC	\$81,025
Authorized Acquisition Adjustment (AA)	\$23,325
Amortization of AA	(\$10,444)

Wastewater System

Contributions-in-Aid-of-Construction (CIAC)	(\$91,933)
Amortization of CIAC	\$53,268

The above balances were determined by using the December 31, 1996, projected test year balance established in the above-mentioned Order and removing all utility additions, retirements and adjustments for the projected years 1995 and 1996 that it included in its rate case filing for Docket No. 950495-WS.

Recommendation: The utility's general ledger balances do not reconcile with the Commission-approved rate base accounts in the above-mentioned Order. The audit staff has determined that the following adjustments should be made to the utility's requested transfer balances in this proceeding to reconcile the calculated differences.

<u>Water System</u>	<u>Per G/L at</u> <u>12/31/1994</u>	<u>Audit</u> <u>Adjustment</u>	<u>Per Order at</u> <u>12/31/1994</u>
Contributions-in-Aid-of-Construction (CIAC)	(\$178,161)	\$0	(\$178,161)
Amortization of CIAC	\$79,584	\$1,441	\$81,025
Authorized Acquisition Adjustment (AA)	\$23,325	\$0	\$23,325
Amortization of AA	(\$11,383)	\$939	(\$10,444)

<u>Wastewater System</u>	<u>Per G/L at</u> <u>12/31/1994</u>	<u>Audit</u> <u>Adjustment</u>	<u>Per Order at</u> <u>12/31/1994</u>
Contributions-in-Aid-of-Construction (CIAC)	(\$91,933)	\$0	(\$91,933)
Amortization of CIAC	\$51,258	\$2,010	\$53,268

Exception No. 2

Subject: Wastewater Land

Statement of Fact: The utility's transfer application reflects balances of \$33,665 and \$296,432 for its water and wastewater land, respectively, as of June 30, 2004.

The above balances include the following transactions that were recorded in its general ledger during 1999.

<u>System</u>	Per G/L at	Land Transactions Recorded in 1999			Per G/L at
	<u>12/31/1994</u>	<u>Remove Common</u>	<u>Reclass Common</u>	<u>Additions</u>	<u>12/31/2004</u>
Water Land	\$167	(\$167)	\$0	\$33,665	\$33,665
Wastewater Land	\$286,663	(\$354)	\$10,122	\$0	\$296,432
General Land	<u>\$11,485</u>	<u>(\$1,363)</u>	<u>(\$10,122)</u>	<u>\$0</u>	<u>\$0</u>
	\$298,315	(\$1,883)	\$0	\$33,665	\$330,097

Commission Order No. PSC-96-1320-FOF-WS established a total land balance of \$289,110 comprised of \$167, \$286,663, and \$2,280 for the utility's water, wastewater, and general lands, respectively, as of December 31, 1994.

Recommendation: The utility's wastewater land balance is overstated by \$9,205, because it never adjusted its general land balance to the above-mentioned Order. (\$11,485 - \$2,280)

In 1999, the utility removed \$1,363 of land associated with its parent operations from its general land balance. The remaining land balance of \$10,122 (\$11,485 - \$1,363) should be further reduced by \$9,205 as discussed above, leaving a remaining land balance of \$917 which is to be transferred to its wastewater operations. (\$11,485 - \$1,363 - \$9,205 = \$917)

<u>System</u>	Per Order at	Land Transactions Recorded in 1999			Per Audit at
	<u>12/31/1994</u>	<u>Remove Common</u>	<u>Reclass Common</u>	<u>Additions</u>	<u>12/31/2004</u>
Water Land	\$167	(\$167)	\$0	\$33,665	\$33,665
Wastewater Land	\$286,663	(\$354)	\$917	\$0	\$287,227
General Land	<u>\$2,280</u>	<u>(\$1,363)</u>	<u>(\$917)</u>	<u>\$0</u>	<u>\$0</u>
	\$289,110	(\$1,883)	\$0	\$33,665	\$320,892

Exception No. 3

Subject: Accumulated Depreciation - Adjustment for Extraordinary Abandonment

Statement of Fact: The utility's records reflect duplicate journal entries that increased accumulated depreciation by \$5,399 each to Accounts Nos. 3392 and 3892 - Other Plant and Miscellaneous Equipment as of June 30, 2003.

The above journal entry is identified as a reclassification of an extraordinary abandonment from prior years.

The utility made several adjustments in 1999 that reclassified and retired UPIS assets. The retired UPIS and its associated accumulated depreciation balances were equally retired. These adjustments are discussed in more detail in Disclosure No. 2 of this report.

The utility's adjustments discussed above reduced its UPIS for retired assets and created several debit balances in specific accumulated depreciation accounts. This occurred where the accumulated depreciation retirement exceeded the corresponding reserve account balance. The resulting debit balances in accumulated depreciation are discussed in more detail in Disclosure No. 2 of this report.

However, the utility transferred some of the resulting accumulated depreciation debit balances to an extraordinary abandonment account.

Recommendation: This utility's journal entry displayed above is a violation of the NARUC USOA and should not be included in rate base based on the following audit staff determinations.

1. The NARUC Chart of Accounts requires prior Commission approval to use this account. The utility did not receive it. In 2003, the utility transferred the balance from its extraordinary abandonment account back to its water and wastewater accumulated depreciation accounts as detailed above.
2. The resulting gain or loss from an extraordinary abandonment is an income item and the NARUC Uniform System of Accounts (USOA) directs that it be placed in either Account No. 433 or 434, depending on whether it is a gain or loss.
3. The USOA further directs that items placed in these accounts are only entered "Upon approval of the regulatory authority" The Commission has not approved or even considered this extraordinary item.

Exception No. 4

Subject: Construction-Work-in-Progress (CWIP)

Subject: The utility's transfer application reflects a balance of \$375,583 for CWIP as of June 30, 2004.

The utility's general ledger reflects balances of \$91,699 and \$263,140 totaling \$354,840 for its water and wastewater CWIP, respectively, as of June 30, 2004.

Recommendation: The utility's balances for CWIP are \$77,826 and \$295,781 for its water and wastewater systems, respectively, as of June 30, 2004, based on the following audit staff determinations.

1. The utility's general ledger balance of \$354,840 discussed above does not include \$20,744 of vendor invoices received by the utility after it prepared its June 30, 2004, closing journal entries to record the sale of its utility systems. These invoices were included in the transfer application CWIP balance.
2. The audit staff's review of the utility's CWIP projects indicates that it includes a construction project with a balance of \$2,108 that should have been recorded to System 332, a Florida Water Corporation subsidiary that was sold to the City of Altamonte Springs.
3. The utility's CWIP transaction ledger contains an unknown \$132 adjustment that is included in the transfer application balance.

See the audit staff's calculations below.

<u>Account Number</u>	<u>Water</u>	<u>Wastewater</u>	<u>Combined</u>	
335 105 260 AFUDC	\$879	\$16,259	\$17,137	<i>Per utility G/L</i>
335 105 270 Materials	\$75,392	\$204,604	\$279,996	<i>Per utility G/L</i>
335 105 285 Overhead	<u>\$15,428</u>	<u>\$42,278</u>	<u>\$57,706</u>	<i>Per utility G/L</i>
Total CWIP per G/L	\$91,699	\$263,140	\$354,840	
	<u>\$0</u>	<u>\$20,744</u>	<u>\$20,744</u>	<i>Other invoices</i>
Total CWIP per Transfer Application	\$91,699	\$283,884	\$375,583	
Total CWIP per Audit	<u>\$77,826</u>	<u>\$295,781</u>	<u>\$373,607</u>	
Audit Adjustment	<u>(\$13,873)</u>	<u>\$11,897</u>	<u>(\$1,976)</u>	

The audit adjustment of \$1,976 above corrects the unknown difference of \$132 indicated in the utility's CWIP transaction ledger which was included in the transfer application balance. (\$1,976 + \$132 = \$2,108 total audit adjustment for subsidiary system indicated in the following schedule)

See the audit staff's schedule that follows for additional details.

Exception No. 4, continued

<u>Sys#</u>	<u>Project #</u>	<u>AFUDC</u>	<u>Materials</u>	<u>Overhead</u>	<u>Total</u>	
01	03CC218	\$0.00	\$12,088.23	\$2,475.65	\$14,563.88	Replace control panel at WTP #1
01	03CC285	0.00	7,125.00	1,459.20	8,584.20	Replace gate valves at WTP #1
01	03CC707	830.47	33,000.00	6,758.40	40,588.87	Install groundwater monitor wells at WTP #'s 1&2
01	04CC707	0.00	1,749.51	358.29	2,107.80	Apple Valley WTP Well#2 (Should be removed)
01	04CO504	0.00	7,874.23	1,451.10	9,325.33	Water meter inventory accruals
01	04CO506	0.00	3,153.90	645.92	3,799.82	Intall water service extensions
01	04CO510	0.00	800.00	163.84	963.84	Install SCADA Telemetry equipment at WTP & WWTP
Total Water CWIP		\$830.47	\$65,790.87	\$13,312.40	\$79,933.74	Per CWIP Transaction Ledger
01	04CC707	0.00	(1,749.51)	(358.29)	(2,107.80)	Remove Apple Valley Project
Total Water CWIP		\$830.47	\$64,041.36	\$12,954.11	\$77,825.94	Per Audit
02	02CC734	\$2,657.50	\$15,127.52	\$3,098.11	\$20,883.13	Replace sewer latewrals under 5th Street East
02	02CC743	12,495.78	141,889.70	29,434.38	183,819.36	Design and planning fees for WWTP expansion
02	03CC286	0.00	8,232.00	1,685.91	9,917.91	Replace sand filter media at WWTP
02	04CC702	0.00	6,744.55	1,381.28	8,125.83	Renovate chlorine contact chamber
02	04CC706	0.00	32,706.00	6,698.18	39,404.18	Engineering evaluation for WWTP expansion
02	04CO510	0.00	800.00	163.84	963.84	Install SCADA Telemetry equipment at WTP & WWTP
02	00C0500	0.00	27,782.06	4,884.77	32,666.83	Legal Fees for Chuluota Land Use (Sprayfield)
Total W/Water CWIP		\$15,153.28	\$233,281.33	\$47,346.47	\$295,781.08	Per CWIP Transaction Ledger & Audit

Exception No. 5

Subject: Water Acquisition Adjustment

Statement of Fact: The utility's transfer application reflects balances of \$68,390 and \$32,229 for acquisition adjustment (AA) and accumulated amortization of AA as of June 30, 2004.

Rule 25-30.0371, Florida Administrative Code (F.A.C.), states that a positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances.

Order No. 10859, issued June 8, 1982, approved a positive acquisition adjustment of \$23,325 as of June 30, 1979, that is to be amortized over 40 years.

Order No. PSC-96-1409-FOF-WU, issued November 20, 1996, included a prior-approved acquisition adjustment balance in the rate base balance established at transfer for a utility regulated by the Commission.

The utility's general ledger reflects balances of \$23,325 and \$16,922 for the approved acquisition adjustment and accumulated amortization of AA as of June 30, 2004.

Recommendation: The difference between the utility's transfer application balances and general ledger balances for the acquisition adjustment and accumulated amortization of AA as of June 30, 2004, is an unapproved acquisition adjustment and accumulated amortization of AA. The unapproved amounts, shown below, should be removed from the transfer application balances for this proceeding per the Commission rule cited above.

<u>As of June 30, 2004</u>	<u>Approved</u>	<u>Unapproved</u>	<u>Total</u>
Water Acquisition Adjustment (AA)	\$23,325	\$45,065	\$68,390
Water Accumulated Amortization of AA	(\$16,922)	(\$15,307)	(\$32,229)

The approved balance for accumulated amortization of AA above does not include the audit staff's adjustment that decreases accumulated amortization of AA by \$939 in Exception No. 1 of this report. When included, the balance for accumulated amortization of AA is \$15,983 as of June 30, 2004. (\$16,922 - \$939) The total reduction to amortization of AA is \$16,246 (\$15,307 + \$939)

Exception No. 6

Subject: Other Regulatory Assets – FPSC Surcharge

Statement of Fact: The utility's transfer application reflects a balance of \$38,949 for a FPSC surcharge as of June 30, 2004.

Order No. PSC-99-1794-WS, issued September 14, 1999, approved a surcharge relating to a settlement agreement regarding appeals from Docket No. 950495-WS. Pertinent elements of the Commission's finding were as follows.

1. The surcharge was to be booked and treated as a regulatory asset.
2. The regulatory asset is transferable and is not subject to being revisited or reconsidered.
3. No amortization of the regulatory asset would occur until it is included in a future rate proceeding.
4. The total amount of the surcharge was calculated to be \$8,896,316 based on provisions contained in the above-mentioned Order. The utility's calculation was communicated to the Commission's Division of Water and Wastewater by letter dated December 3, 1999.
5. The above balance was to be allocated to all of the Florida Water Corporation utility systems included in Docket No. 950495-WS based on their final average Equivalent Residential Connections (ERCs) as of December 31, 1996.

The utility calculated Chuluota's regulatory surcharge to be \$23,096 and \$15,853 for its water and wastewater systems, respectively, based on its average ERCs' calculation as of October 31, 1999.

The utility provided the audit staff with a revised surcharge calculation using the final average ERCs as of December 31, 1996, as required in the above-mentioned Order.

Recommendation: The utility's regulatory surcharge balances for its water and wastewater systems are understated by \$16,406 and overstated by \$8,343, respectively, based on the following audit staff calculations.

<u>Allocation Method</u>	<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
1999 ERCs	\$23,096	\$15,853	\$38,949
1996 ERCs	<u>\$39,502</u>	<u>\$7,510</u>	<u>\$47,012</u>
Adjustment	\$16,406	(\$8,343)	\$8,063

Exception No. 7

Subject: Allowance for Funds Prudently Invested (AFPI)

Statement of Fact: The Florida Water Services Corporation tariff for its Chuluota system in Seminole County allows collection of AFPI charges from new customers. These AFPI connection charges are designed to cover the utility's costs for building utility plants and lines in economical sizes. Unless these AFPI charges are collected, the current monthly bills to the ratepayer would be much higher. Lastly, these AFPI charges are in addition to contributions-in-aid-of-construction (CIAC) charges which are also assessed to new utility customers.

The most recent tariff for AFPI connection charges became effective on June 13, 1997, and may be assessed to only a limited number of customers. These customers are measured in equivalent residential connections or ERCs. A residential customer would be considered one ERC and a large commercial customer might be considered more than one ERC based upon its expected flows.

The maximum AFPI allowable charges for the Chuluota System in Seminole County are:

<u>Type of AFPI Charge</u>	<u>No. of ERCs</u>	<u>Maximum Charge</u>	
Water Treatment Plant	994	\$20.00	Note: AFPI could be less, depending on the month it was paid. The closer to June 1997, the lower the AFPI charge.
Water Transmission and Distribution (Lines)	227	\$700.00	
Wastewater Collection System (Lines)	19	\$1,300.00	
Wastewater Treatment Plant	178	\$1,300.00	

Since January 1, 1997, Chuluota system records report 487 instances where a new connection occurred or was ordered. The utility records also report \$535,476.28 in AFPI charges for the period June 13, 1977 to June 30, 2004. The utility initially reported these AFPI monies were charged as follows:

1,155.07 ERCs	Water Plant AFPI
118.44 ERCs	Water Line AFPI
318.83 ERCs	Sewer Line AFPI
19.22 ERCs	Sewer Treatment Plant AFPI

The audit staff's review of the Chuluota System records for AFPI reveal a number of errors including ERC Counts and category of AFPI reported as collected.

Based upon discussions with utility staff, they were not aware that precise ERC calculations are critical to the collection of AFPI. As a result, the utility has not to date performed precise and detailed reconciliations between its customer connection information and AFPI payment information. Consequently, the utility's detailed records need to be researched to determine why

Exception No. 7, continued

AFPI was collected or not collected from customers for the period June 13, 1997 to the June 30, 2004, which is from the tariff approval date to the date of the sale of the Chuluota system.

The utility asserts AFPI charges were typically paid by developers and were not paid by its existing customers and that any refunds to developers would be inappropriate as a developer would have included these AFPI charges in the basis of the property and homes bought by the current ratepayer. The utility also explains it accepted certain donated offsite water and wastewater lines pursuant to agreements with developers for which it did not charge these developers either CIAC or AFPI. The utility asserts the cost of the offsite lines donated by these developers exceeded its CIAC and AFPI charges and in those instances accepting donated lines in lieu of charges is the appropriate method to follow.

The utility has agreed to research its records and explain all unusual and non-routine Chuluota System AFPI charges. This research should take approximately two weeks. As part of this research, the utility will:

- investigate ERC counts for AFPI collected;
- for each connection, determine why AFPI was collected and why AFPI was not collected;
- identify instances where AFPI was collected, but where it should not have been collected;
- identify instances where AFPI was not collected, but where AFPI should have been collected;
- explain all instances where a connection was made, but AFPI was not collected; and
- answer additional audit inquiries regarding AFPI information provided to date.

The results of this additional investigation on the part of the staff and the utility will be included in audit staff's work papers and will be provided to the Division of Economic Regulation which is responsible for the staff recommendation in this matter.

Disclosure No. 1

Subject: 1999 Rate Base Retirements

Statement of Fact: The utility's records reflect the following entries were recorded to its general ledger to record retirements of utility assets as of December 31, 1999.

<u>Water Rate Base</u>	<u>Debit</u>	<u>Credit</u>
UPIS		\$242,307
Land		\$167
CIAC	\$37,356	
Accumulated Depreciation	\$235,687	
Accumulated Amortization of CIAC		\$37,356
Extraordinary Loss on Retirement	\$6,786	
<u>Wastewater Rate Base</u>		
UPIS		\$314,330
Land	\$9,768	
CIAC	\$15,394	
Accumulated Depreciation	\$322,026	
Accumulated Amortization of CIAC		\$15,394
Extraordinary Loss on Retirement		\$7,342
<u>General Rate Base</u>		
UPIS		\$35,595
Land		\$11,485
Accumulated Depreciation	\$22,544	
Extraordinary Loss on Retirement	\$14,414	
Sum Check	\$663,975	\$663,975

In early 1996, Florida Water Services (FWS) began an effort to institute a formal Fixed Asset Management "function" within Property Accounting. Based on documents received from the utility, this effort was due, in large part, to internal auditor concerns over accurate reporting of the utility's asset base after several large utility system acquisitions (Deltona Utilities in 1989, Lehigh Utilities in 1991 and Orange-Osceola Utilities late in 1996). These acquisitions had produced extensive capital additions to the utility's books at a time when new directives from NARUC were being handed down on how assets must be classified. To help solve the auditor's concerns and to prepare for future changes, management decided to conduct a system-wide inventory and valuation of the entire plant-in-service. The utility hired outside consultants to assist in this endeavor and by letter dated November 30, 1999, the consultants delivered a report to the utility.

This report included a Plant Account Summary depicting the total assigned costs for each four-digit NARUC account grouped by plants and their respective facilities as of December 31, 1997. This report can best be described as an Original Cost Study on 61 of FWS utility systems. The utility compared this report to its general ledger accounts and made adjustments to equal the Original Cost Study. These adjustments were recorded to accomplish the following four objectives.

Disclosure No. 1, continued

1. Remove or retire general utility plant assets that should have been recorded on the utility's parent's books.
2. Reclassify utility plant assets to the proper utility system or account.
3. Correct utility account balances for unrecorded utility assets.
4. Retire utility account balances to equal a physical inventory of all utility assets as of December 31, 1997.

Recommendation: The audit staff's main concern with these adjustments is the retirement of UPIS and its accounting treatment described in Issue No. 4. The utility initially had difficulty finding this report and was only able to provide it to the audit staff on January 11, 2005. Additionally, given the limited amount of time the audit staff has had to review the report it does not address many of the questions that the audit staff has regarding whether these UPIS retirements are appropriate or prudent. It is the utility's burden to justify its actions in its application. The audit staff does not believe that the utility has met this burden.

The audit staff does not believe that it is a good general policy to adjust the utility's books to an Original Cost Study. The Commission has established UPIS balances for FWS in prior Orders, and the utility should only adjust these balances for documented corrections, additions and retirements. However, according to the FWS report, the utility's internal auditors had concerns about the asset accounting system. In addition, the physical inventory indicates that UPIS balances are significantly lower than those reported in its general ledger. This difference may be attributed to UPIS retirements that were not recorded or to differences in the valuation of the UPIS assets using actual historical invoices and the consultant's use of estimates in the Original Cost Study. The utility does not have any evidence to support either explanation.

The audit staff has reviewed the accounts that were adjusted by the retirement entry. Many of these adjustments reduced UPIS to a zero balance or a minimal amount. The audit staff believes that this may support the theory that the utility's UPIS includes assets that should have been previously retired. The audit staff believes that if it is merely a calculation difference, the UPIS balances would be closer in value.

A secondary concern for the audit staff is the utility's corresponding retirements to CIAC and accumulated amortization of CIAC which was based on the percentage of UPIS retired. Although the utility's CIAC and accumulated amortization of CIAC retirements are off-setting amounts for each system, the policy of retiring cash contributions of CIAC is questionable.

Additionally, the audit staff noted that the utility's consolidated adjusted general ledger balance equals the utility's federal tax return as of December 31, 2004, which indicates that the utility's methodology was consistently applied for federal tax reporting purposes.

Disclosure No. 2

Subject: Accumulated Depreciation Balances

Statement of Fact: The utility's records reflect the following debit balances for its accumulated depreciation accounts as of the periods indicated.

<u>Acct. No.</u>	<u>Account Description</u>	<u>12/31/1997</u>	<u>6/30/2004</u>
3112	Pumping Equipment	\$21,259	
3203	Water Treatment Equipment	\$40,388	\$6,993
3344	Meters & Meter Installations	\$1,530	
3543	Structure & Improvements	\$2,599	\$0
3804	Treatment & Disposal Equipment	\$89,828	\$15,936
	Totals	<u>\$155,604</u>	<u>\$22,929</u>

The 12/31/1997 accumulated depreciation balances above represent the affect of the utility's 1999 inventory adjustment applied to the actual unadjusted 12/31/1997 accumulated depreciation balance for each account.

The NARUC Uniform System of Accounts for Class A Utilities (USOA) states in Instruction 27H the following:

. . . the unexpected early retirement of a major unit of property, which would eliminate or seriously deplete the existing depreciation reserve, may require accounting treatment which differs from that described

NARUC Instructions further describe how an extraordinary loss should be approved by the Commission for amortization over a period of time. Commission Rule 25-30.433(9), F.A.C., describes how the amortization period should be calculated. In addition, Commission Rule 25-30.140 (8), F.A.C., states the following:

Prior to the date of retirement of major installations, the Commission may approve capital recovery where schedules to correct associated calculated deficiencies in recovery where a utility demonstrates that retirement of the installation or group of installations is prudent and the associated investment will not be recovered by the time of retirement through normal depreciation process.

Recommendation: As discussed in Disclosure No 1 of this report, the utility made numerous retirements to UPIS based on a consultant's Original Cost Study. Mostly, these entries credited UPIS and debited accumulated depreciation for equal amounts which is the standard regulatory accounting for UPIS asset retirements. However, many of the UPIS retirement entries were based on an Original Cost Study which is described in Disclosure No. 1 of this report. The resulting retirements created a debit accumulated depreciation balance for specific individual accounts as detailed above.

Disclosure No. 2, continued

The audit staff believes that if the Commission agrees to accept the retirement entries, the resulting debit balances indicate a “serious depletion” of accumulated depreciation as described in the Commission rules. The utility did not bring this adjustment to the Commission for approval or for guidance in adjusting the depreciation or amortization of the depreciation deficiencies.

As indicated in Disclosure No. 1 of this report, the utility could not provided any support that specifically identifies its UPIS retirement entries, the time frame for when the UPIS would have been retired, or what would be a reasonable amortization period for any extraordinary loss. In addition, many items that were retired were items such as communication equipment, computers, office equipment, and tools that the utility may have received salvage value for.

The utility has not been able to justify the above debit balances in its accumulated depreciation accounts. The audit staff surmises that this may be a result of (1) applying incorrect depreciation rates in the past, (2) incorrect calculations determined in the Original Cost Study, and (3) incorrectly reclassifying its accumulated depreciation balances between accounts.

The audit staff believes that if the accumulated depreciation retirements had been recorded correctly at the time of the 1997 UPIS adjustment, the current debit balances in accumulated depreciation may not exist as of June 30, 2004.

The audit staff provides the following two alternatives for the Commission to consider in addressing this issue.

1. Eliminate the debit balances in the accumulated depreciation accounts as of June 30, 2004, with the following entry.

Increase	Water Acc. Dep.	\$6,993
Increase	W/Water Acc. Dep.	\$15,936

2. Eliminate the debit balances in the accumulated depreciation accounts as of December 31, 1997, which would incorporate the cumulative effect on accumulated depreciation for the period January 1, 1998 through June 30, 2004.

Increase	Water Acc. Dep.	\$63,177
Increase	W/Water Acc. Dep.	\$92,427

Disclosure No. 3

Subject: Land & Land Rights

Statement of Fact: The utility transferred the following parcels of land to Aqua Utilities of Florida by a Special Warranty Deed which was recorded on July 7, 2004, in Seminole County OR Book 5379, pages 647-656.

<u>Property Description</u>	<u>Parcel Identification Number</u>
Water Plant No. 1 Site	21-21-32-5CF-5700-0010
Water Plant No. 1 Site	21-21-32-5CF-5700-0020
Water Plant No. 2 Site	21-21-32-300-012A-0000
Wastewater Plant Site	21-21-32-5CF7400-0010
Wastewater Plant Site	21-21-32-5CF7400-0020
Lift Station No. 1 Site	28-21-32-501-0X01-0000
Wastewater Sprayfield Site	20-21-32-300-0100-0000

The utility also owns a parcel of land which accommodates Lift Station No. 2. The property is identified as Parcel Identification No. 16-21-32-5QJ-0500-000, and it was recorded on January 25, 1991, in Seminole County OR Book 4340, page 375.

Recommendation: The utility should be required to transfer the above-mentioned property identified as Lift Station No. 2 to Aqua Utilities of Florida per the terms of the transfer agreement.

EXHIBIT I

FLORIDA WATER SERVICE CORPORATION
CHULUOTA UTILITY SYSTEM – 335
WATER RATE BASE
DOCKET NUMBER 040952-WS
ESTABLISH RATE BASE AT TRANSFER
AS OF JUNE 30, 2004

DESCRIPTION	PER UTILITY	AUDIT ADJUSTMENT	REFER TO	PER AUDIT
UTILITY-PLANT-IN-SERVICE	\$4,110,264	\$0		\$4,110,264
LAND & LAND RIGHTS	33,665	0		33,665
CONSTRUCTION-WORK-IN-PROGRESS	91,699	(13,873)	Exception No. 4	77,826
ACQUISITION ADJUSTMENT (AA)	68,390	(45,065)	Exception No. 5	23,325
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION (CIAC)	(1,193,027)	0		(1,193,027)
ACCUMULATED DEPRECIATION	(638,411)	(5,399)	Exception No. 3	(643,810)
ACCUMULATED AMORTIZATION OF CIAC	164,716	1,441	Exception No. 1	166,157
ACCUMULATED AMORTIZATION OF AA	(32,229)	16,246	Exception No. 5	(15,983)
OTHER REGULATORY ASSET	23,096	16,406	Exception No. 6	39,502
TOTAL	<u>\$2,628,163</u>	<u>(\$30,244)</u>		<u>\$2,597,918</u>

NOTES:

1. Audit adjustments do not include Audit Disclosures.
2. Small differences are due to rounding errors.

EXHIBIT II

**FLORIDA WATER SERVICE CORPORATION
CHULUOTA UTILITY SYSTEM – 335
WASTEWATER RATE BASE
DOCKET NUMBER 040952-WS
ESTABLISH RATE BASE AT TRANSFER
AS OF JUNE 30, 2004**

DESCRIPTION	PER UTILITY	AUDIT ADJUSTMENT	REFER TO	PER AUDIT
UTILITY-PLANT-IN-SERVICE	\$2,059,152	\$0		\$2,059,152
LAND & LAND RIGHTS	296,432	(9,205)	Exception No. 2	287,227
CONSTRUCTION-WORK-IN- PROGRESS	283,885	11,897	Exception No. 4	295,782
ACQUISITION ADJUSTMENT (AA)	0	0		0
CONTRIBUTIONS-IN-AID-OF- CONSTRUCTION (CIAC)	(1,257,071)	0		(1,257,071)
ACCUMULATED DEPRECIATION	(546,969)	(5,399)	Exception No. 3	(552,368)
ACCUMULATED AMORTIZATION OF CIAC	164,026	2,010	Exception No. 1	166,036
ACCUMULATED AMORTIZATION OF AA	0	0		0
OTHER REGULATORY ASSET	15,853	(8,343)	Exception No. 6	7,510
TOTAL	<u>\$1,015,308</u>	<u>(\$9,040)</u>		<u>\$1,006,268</u>

NOTES:

1. Audit adjustments do not include Audit Disclosures.
2. Small differences are due to rounding errors.