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STEVE CRISAFULLI
Speaker of the House of Representatives

March 13, 2015

Mr. Andrew Maurey
Division of Accounting and Finance
Florida Public Service Commission
2340 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket 140158-WS - Application for increase in water/wastewater rates in Highlands County by HC Waterworks, Inc. – OPC List of Concerns

Dear Mr. Maurey,

The Office of Public Counsel is actively monitoring the rate case docket for HC Waterworks, Inc. (“HCWW”, “Utility”, or “Company”). Attached is a list of issues that OPC has prepared to identify concerns we have with the MFRs and other information filed by HC in support its requested rate increase. We would like to bring these to staff’s attention to aid staff in its review of the rate case and to allow the staff sufficient time to review our concerns and ask for any additional information that might be needed. If you should have any questions, please feel free to call or e-mail me.

Sincerely,

s/ Patricia W. Merchant

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C: Division of Accounting & Finance (Bulecza-Banks, Cicchetti, Archer)
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Division of Engineering (Watts)
Division of Auditing and Performance Analysis (Deamer)
Office of the General Counsel (J. Crawford, Mapp)
HC Waterworks, Inc. (Rendell)

OPC Issues and Concerns – HC Waterworks, Inc. Docket No. 140158-WS

1) Negative Accumulated Depreciation Balances Purchased from Aqua

In the transfer audit[1] from Aqua Utilities Florida, Inc. to HCWW in Docket No. 130175-WS, Audit Finding 3 addressed accumulated depreciation balances that had no or very small plant balances. The finding stated that Lake Josephine water accumulated depreciation balance included two accounts with negative accumulated depreciation balances. The corresponding plant and accumulated depreciation balances by account are listed below as of the date of transfer:

Acct. No.	Acct. Description	Plant Balance @ 03/28/2013	Acc. Depr. Balance @ 03/28/2013
Lake Josephine Water			
341.50	Transportation Equipment	$0	($20,000)
343.50	Tools, Shop & Garage Equipment	$3,031	($20,399)
Leisure Lakes Wastewater			
382.40	Outfall Sewer Lines	$934	($6,048)

The audit finding stated that "negative balances for accumulated depreciation are not a normal occurrence…" and "negative balances create a stranded asset with an indeterminable life on the utility's books and effectively overstates a utility system's net book value." The auditors also prescribed two alternative accounting treatments from the NARUC Uniform System of Accounts as: 1) writing off the balance to current year operating expense, or 2) amortizing the balance over a prescribed future period. Despite the finding in the staff audit report, the staff recommendation or Commission order approving the transfer contained no comments or adjustments related to Staff Audit Finding 3.

OPC agrees with the audit finding language that negative accumulated depreciation balances are unusual, create a stranded asset with an indeterminable life on the utility's books, and effectively overstate a utility system's net book value. Further, negative accumulated depreciation balances should be investigated, especially those without corresponding balances of plant. OPC believes that these balances are effectively "phantom assets" which should not have been purchased by the utility unless fully substantiated by the buyer as to what physical or intangible assets were purchased. Absent substantiating support to show to what these balances relate, OPC believes that these amounts should be removed from rate base. Further, given the turn-key nature of the affiliate operating contract with U.S. Water, the utility should be required

[1] Aqua Utilities Florida, Inc./HC Waterworks, Inc. Application for Transfer of Certificate Nos. 422-W and 359-S, as of March 28, 2013, in Docket No. 130175-WS; Audit Control No. 13-199-2-3, report issued September 18, 2013.

to specifically state what assets are included in Lake Josephine Water Account 343.5 Tools, Shop & Garage Equipment totaling $3,031 and Leisure Lakes Wastewater Account 382.40 Outfall Sewer Lines totaling $934, and why those amounts are reasonable and necessary to remain on the books of the utility.

2) <u>Accumulated Amortization of Acquisition Adjustment and Amortization Expense - Staff Audit Finding 6 in Current Docket</u>

In its MFRs filed in this rate case, HCWW included the Commission approved negative acquisition adjustment and a full year of the amortization and accumulated amortization of the adjustment. In Audit Finding 6 in the current rate case docket, the staff auditors recommended, for purposes of both the general ledger and the rate case filing, that the negative acquisition adjustment and related amortization be adjusted to the amount that should be recorded on the Company's books as of June 30, 2014. Essentially, since the transfer was approved on June 14, 2014, the balances per the books and the filing should reflect only 16 days of amortization for the test year ended June 30, 2014. While the auditors are correct that the balance per books adjustments should be made, OPC strongly disagrees with the adjustment to remove the normalization of the negative acquisition adjustment and amortization for rate setting purposes for several reasons.

First, this Commission in almost every water and wastewater rate case considers pro forma plant and expense adjustments that will be in service once the new rates will be in effect. There are several post-test year proforma plant items that the Company has requested recovery of in this docket. Since the test year ended June 30, 2014, and the rates are scheduled to go into effect around June 30, 2015, a full year will have passed since the date the transfer order was issued as well as the end of the test year. Second, to not include a full year of the negative amortization will essentially remove 96% of the negative expense that will be recognized during the time the rates are in effect for at least the next 6 years. Third, by including the full year of negative amortization in its adjusted test year clearly shows that the Company believes that the adjustment to normalize this expense was the appropriate adjustment to make. As a result, OPC believes that the auditors recommended adjustments to the filing related on this issue should not be made.

3) <u>Bad Debt Expense</u>

In its MFRs, HCWW requested the following amounts for bad debt expense broken out by test year amount, proforma adjustments and total bad debt expense.

	Test Year Per Books	Proforma Adjustments	Total Bad Debt Expense Requested	Requested Revenue Requirement	% to Total Requested Revenues
Water	$10,801	$2,194	$12,995	$509,665	2.55%
Wastewater	$1,260	$(932)	$328	$73,571	0.45%

On Schedule B-3 page 3 of 3, the Company lists the amounts that it has requested for proforma bad debt expenses but does not explain the basis for the adjustment. As reflected on the balance sheet as of the end of the test year (June 30, 2014) on Schedule A-18 of its MFRs, the Company has a balance of accounts receivable of 39,269 with an allowance for bad debts of $11,749. The allowance reflected is 30% of the accounts receivable balance.

In its Second Data Request, Question 5, Staff questioned why water bad debt expense increased in November 2013 compared to other months, and requested the Company to provide all of the Utility's calculations, basis, work papers, and support documentation (i.e. invoices) for the month. In its response the Company stated that the November amount was an accrual for the months April 2013 through November 2013. The Company further stated that its bad debt practice is to (1) accrue 2% of monthly revenues; (2) adjust the accrued amount to the Aged Accounts Receivable amounts over 60 days on a semi-annual basis (twice a year); and (3) write off inactive accounts over 60 days and adjust the monthly accruals to reconcile to the difference. HCWW indicated that a sister company, Brevard, had recently adjusted this practice to accrue monthly bad debt expense to the Aged Accounts Receivable over 60 days. For HCWW, below is the analysis to this approach as of June 30, 2014:

Accrued Amount	Aged AR over 60
$11,757	$11,767

The Company's response to Staff's Question 5 appears lacking in that no information was provided to show all of the Utility's calculations, basis, work papers, and support documentation. Simply comparing the aged accounts receivable over 60 days old balance at one point in time to the bad debt accrued bad debt expense does not support a 2% expense level. Apparently, it is the owner's policy to estimate that 2% of revenues for each company owned will be considered bad debts, as there has been no analysis provided that reflects the company specific actual bad debts. Additionally, not all 60 day old receivables are uncollectible; if they are, the customers should have been shut off and the bad debt should have been offset by some or all of the customer's deposit.

OPC is also concerned that the requested 2.55% for water is unreasonable and unsupported. We would note that the requested level for wastewater bad debt expense was only 0.45%[2], which appears reasonable, not the unsupported 2% as explained by the Company's response. Additionally, OPC believes that the level requested for wastewater is more in line with levels that the Commission has allowed for other small water and wastewater companies, and generally the Commission approved higher rates when the economy was at its lowest level. We are also concerned with using an unsupported 2% level of expense without additional support showing that this a normal and recurring level to establish for rate setting purposes. Monthly data such as gross write-offs, accounts receivable, and amounts recovered should be reviewed before allowing such a high rate for uncollectibles.

[2] The water and wastewater percentages are calculated by taking the requested bad debt expense divided by the revenue requirement.

HCWW's affiliate, U.S. Water, is performing the services for all aspects of customer billing, collection, monitoring uncollectible accounts, and shut offs for non-payment of bills. Thus, the affiliate is in control of how aggressive it should be to insure the timely collection of payments or shutting off customers as needed. The Company should provide an explanation of how the company treats customer deposits, bad debt write-offs, and non-payment disconnects. Additionally, the procedures should be provided which show the adjustments made when bad debt write-offs are made when a customer's service is shut-off for non-payment but then pays what is owed and is reconnected.

OPC also has concerns with the Company's use of one data point in time to support its bad debt write-offs. The Commission historically uses a 3 to 5 year average of bad debts expense to use for prospective rates. While we recognize that the test year was the first year of operation for the new owner, another year has almost passed since the purchase. Since HCWW has only had two years of operating experience, OPC would like to see what has happened in the most recent twelve months regarding bad debt expense and write-offs. Lastly, the economy in Florida has been steadily improving and bad debt rates should be reflective of this on a going-forward basis. OPC believes that using the unusually high and unsupported 2% factor without sufficient corroborating data could overstate what the actual expense has been and will continue to be on a going-forward basis.