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Florida Power
CORPORATION

December 3, 1992

VIA HAND DELIVERY

Mr. Steven C. Tribble
Director of Records and Reporting
Florida Public Service Commission
101 E. Gaines Street
Tallahassee, FL 32399-0863

Re: Docket No. 920949-EU
Our File No. 9200264

Dear Mr. Tribble:

Enclosed please find an original and 15 copies of Sebring's Responses to the PSC Final Exit Audit Report. We are transmitting this to the Commission on behalf of the Sebring Utilities Commission . Please acknowledge receipt of filing by returning a copy of this letter.

Sincerely,

James P. Fama

James P. Fama

cc: Pat Lee
Leon Cherok
Martha C. Brown, Esquire
All Parties of Record

LAW OFFICES

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Please reply to:

Tallahassee
December 3, 1992

VIA HAND DELIVERY

Mr. James Stanfield
Florida Power Corporation
106 E. College Ave., Suite 770
Tallahassee, FL 32301

Re: Sebring Utilities Commission Response to Audit
Docket No. 920949-EU

Dear Mr. Stanfield:

On behalf of our client, Sebring Utilities Commission (Sebring), enclosed is Sebring's response to the PSC audit of Resource Management International's Sebring Utilities Commission Distribution System Valuation. It is our understanding that you will transmit the response to the appropriate persons at the Florida Public Service Commission.

Thank you for your attention to this matter.

Sincerely,

HOLLAND & KNIGHT

D. Bruce May

Enclosure
DBM/sms
cc: James Fama
Joe Calhoun
Andy Jackson

TAL-18940

EXECUTIVE SUMMARY

Company Comments:

OPINIONS:

Sebring is convinced that the valuation study conducted by RMI resulted in a reasonable and accurate valuation of the tangible electric utility assets being transferred to Florida Power Corporation. Sebring disagrees that, based on the audit disclosures, the "inconsistencies noted in Disclosures 1-6 indicate the results tend to border on the area of being unreasonable." Sebring is not surprised that the Commission's auditors, working with a very small sample of the available records and inventory, found some differences between their sample and the RMI study. The statistical unreliability of such small samples is the reason why RMI decided to perform a complete inventory of Sebring's assets at the outset of this process. Sebring is confident that, if the Commission's auditors were able to commit the time and resources that RMI expended on its thorough study of the Sebring assets, their conclusions would be the same as those reached by RMI. Sebring's specific differences with the auditors' conclusions are set forth in the point-by-point comments that follow.

AUDIT DISCLOSURE NUMBER 1

Company Comments:

STATEMENT OF FACTS:

Sebring accepts the Statement of Facts as presented.

OPINION:

Sebring does not accept the opinions drawn from the Statement of Facts for the following reasons:

(1) A judgmental sample of 32 poles out of over 7,000 poles does not represent a statistically valid sample for two reasons. First, the sample of 32 is not a random sample where every member of the population has an equal probability of being included in the sample. Second, the error range, at a 95% confidence interval, of such a small sample is so large as to make any inferences to the population virtually worthless. Therefore, Sebring believes this judgmental sample cannot be the basis for **any** conclusion.

(2) The errors identified by the Auditors do not show a consistent bias to either understating or overstating the value of the Sebring system. As expected in an inventory of this nature, there were errors on both the "plus" side and the "minus" side.

(3) The Sebring system is not stagnant. Since the field inventory in October 1991, the distribution system has undergone many changes. The Auditors did not take into account whether the "errors" were, in fact, changes to the distribution system after the field inventory. RMI and Sebring are in the process of updating the inventory for Fiscal Year 1992 which will account for these changes. In addition, RMI and Sebring will perform a final update to the inventory just after closing to reflect work done in Fiscal Year 1993.

(4) Sebring was able to identify 10 of the 12 errors claimed by the Auditors and calculated the impact (labor, vehicle, and materials) on Original Cost and Net Book Value. Assuming the sample of 32 poles is a valid sample, with which Sebring certainly disagrees, the total impact of these 10 errors, including the two improperly dated poles, would reduce Original Cost of these 32 locations by $377.21 or 1.35%. Due to the compensating effect of accumulated depreciation, the impact of the 10 errors would reduce Net Book Value by $124.09.

AUDIT DISCLOSURE NUMBER 2

<u>**Company Comments:**</u>

STATEMENT OF FACTS:

Sebring accepts the Statement of Facts as presented.

OPINION:

Sebring accepts the Opinion as presented.

AUDIT DISCLOSURE NUMBER 3

Company Comments:

STATEMENT OF FACTS:

Sebring accepts the Statement of Facts as presented.

OPINION:

Sebring strongly disagrees with the Auditors' Opinion drawn from the Statement of Facts. The Auditors continue to overlook the difference between an assumed standard crew size for use in an analytic valuation process and the reality of varying crew sizes throughout time. The Statement of Fact that the groundman position has not been filled since March 1990 is correct. What is also correct, and was discussed with the Auditors, is that there have been varying standard crew sizes at Sebring over the years. For example, during the period of high growth in the mid-70s, the standard crew size was five people.

The important point, however, is that **actual** crew sizes are completely irrelevant to RMI's valuation of the Sebring system. Based on RMI's analysis of Sebring's historical construction practices, its professional engineering judgement, and general knowledge of the industry, RMI assumed a standard four person crew size that is representative of the way Sebring normally staffed its crews. This crew size determination was the **first** step in assigning a value to the inventory of property units. The next step was to develop, based on the assumed crew size, the time necessary to construct each of the property units in the inventory. If RMI had assumed a standard crew size of three, then the amount of time necessary to construct the property units would have increased by a proportionate amount. RMI believes the resulting total dollar value would be essentially the same as that calculated by RMI in its study using a four person crew. The audit disclosure failed to acknowledge this fact.

AUDIT DISCLOSURE NUMBER 4

<u>Company Comments:</u>

STATEMENT OF FACTS:

Sebring accepts the Statement of Facts as presented.

OPINION:

The Auditors accurately represent that the unit prices used by RMI were current as of March 1992. However, the Auditors erroneously conclude that RMI erred in using March 1992 prices because the Auditors found a difference between a September Inventory Status List provided by Sebring and the RMI list of unit prices. As discussed in David Rumolo's direct testimony, RMI generally developed the reproduction cost of the Sebring system as of September 1991 and used the appropriate Handy-Whitman index to restate the reproduction cost into original cost. This method was apparently accepted by the Auditors. The use of March 1992 current prices as opposed to September 1991 prices is irrelevant because the Handy-Whitman index for total distribution plant for the first quarter of 1992 **and** the third quarter of 1991 was 267. In layman's terms, this means that prices quoted in March 1992 were the same as September 1991 prices.

The difference in unit prices noted by the Auditors is due primarily to differences between replacement cost and average inventory cost. For example, assume three 40-foot poles in inventory. Also assume that the 1991 replacement cost of the poles is $250 each. If Sebring had purchased those poles in 1991, the average inventory cost and the replacement cost would be the same, $250. However, if Sebring had purchased one pole in 1989 for $240, one pole in 1990 for $247, and one pole in 1991 for $250, then the average inventory cost in 1991 would be $245. If RMI had used the average inventory cost, as suggested by the Auditors, then for each pole installed in 1989, RMI would have assigned a material cost of $236 instead of $240. When using the reproduction cost/Handy-Whitman method, as RMI did, the use of average inventory cost for material pricing coupled with a low turnover of inventory will generally understate the value of the materials installed on the system.

The statement that average unit prices should have been used instead of current replacement costs is wrong given the analytical technique utilized by RMI. At a utility with high inventory turnover and good inventory practices, the average inventory prices reflect the average <u>for that year</u> and might be reasonable for a system valuation. This is not the case with Sebring. Because much of Sebring's inventory is older than one year, an average inventory unit price would embody lower prices from earlier years and not be an appropriate statement of materials prices in 1991. Then, when RMI used the Handy-Whitman index to restate the material prices to the year of installation, the prices would, in effect, be de-escalated twice resulting in an improper understatement of the value of the system.

AUDIT DISCLOSURE NUMBER 6

Company Comments:

STATEMENT OF FACTS:

Sebring accepts the Statement of Facts as presented, with clarification. In reference to Item Number 4, there are two entries for vehicle #79 (the rope pulling machine) in the Sebring equipment list. One entry is described as "ditch witch" and the other entry is described as "truck". RMI elected to use the entry labeled "ditch witch" because that description is closest, it is physically listed with the other line department equipment, and the hourly rate was more in line with that used by RMI for the wire pulling machines.

OPINION:

While Sebring accepts that the rates for the wire pulling machines and the rope pulling machine together are greater than those listed by Sebring, Sebring does not accept the statement that the rates used are an overstatement of reasonable hourly rates. Due to the lack of documentation in the vehicle and equipment list provided by Sebring, RMI, at the beginning of the valuation study, tested the rates listed by Sebring for reasonableness. RMI performed a telephone survey of other municipal utilities concerning their practices, contacted electrical contractors about their hourly rates for equipment and consulted Means Electrical Data 1991. RMI concluded that the rates listed by Sebring were generally reasonable but found that the hourly rates for the wire pulling machines were unreasonably low. Accordingly, RMI elected to use $12.50 per hour for these two machines.

Subsequent to the Auditors' concerns about RMI's decision, current replacement costs for each machine, including the rope pulling machine, were determined. The following table compares the various hourly rates for these machines and supports Sebring's position that the rates used were reasonable.

	Listed by Sebring	Used by RMI	1991 Means Electrical Data	Based on Current Replacement Cost
Wire Puller	$6.00	$12.50	$180.75	$13.36
Wire Tensioner	6.00	12.50	30.55	9.08
Rope Puller	6.00	11.25	15.42	14.96
Total	**$18.00**	**$36.25**	**$226.72**	**$37.39**