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DOCKET NO.: ~~960444~~WU - [Lake Utility Services, Inc.]

WITNESS: Direct Testimony Of Ian J. Forbes. Appearing On Behalf Of The Staff Of The Florida Public Service Commission, Division Of Auditing And Financial Analysis

DATE FILED: September 10, 1997

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 FPSC-RECORDS/REPORTING

1 DIRECT TESTIMONY OF IAN J. FORBES

2 Q. Please state your name and business address.

3 A. My name is Ian J. Forbes and my business address is Hurston N. Tower,  
4 Suite N512, 400 W. Robinson Street, Orlando, Florida, 32801.

5 Q. By whom are you presently employed and in what capacity?

6 A. I am employed by the Florida Public Service Commission as a Regulatory  
7 Analyst Supervisor in the Division of Auditing and Financial Analysis.

8 Q. How long have you been employed by the Commission?

9 A. I have been employed by the Florida Public Service Commission for  
10 approximately fifteen years.

11 Q. Briefly review your educational and professional background.

12 A. In 1981 I received an Accounting Degree from the University of Central  
13 Florida. I worked as a staff accountant for a CPA firm for four months prior  
14 to joining the Commission Staff. I am also a Certified Public Accountant  
15 licensed in the State of Florida. I was hired as a Public Utilities Analyst  
16 by the Florida Public Service Commission in August of 1982. I was promoted  
17 to Regulatory Analyst Supervisor in 1985.

18 Q. Please describe your current responsibilities.

19 A. Currently, I am a Regulatory Analyst Supervisor with the  
20 responsibilities of administering the Orlando district office and reviewing  
21 work load and allocating resources to complete field work and issue audit  
22 reports when due. I also supervise, plan, and conduct utility audits of  
23 manual and automated accounting systems for historical and forecasted  
24 financial statements and exhibits.

25 Q. Have you presented expert testimony before this Commission or any other

1 | regulatory agency?

2 | A. Yes. I have testified in the Sunshine Utility Company's rate case,  
3 | Docket No. 900386-WU.

4 | Q. What is the purpose of your testimony today?

5 | A. The purpose of my testimony is to sponsor the staff Rate Case Audit  
6 | Report of Lake Utility Services, Inc., Docket No. 960444-WU for the test year  
7 | ended December 31, 1995. I am sponsoring this audit report as part of my  
8 | responsibilities as the audit supervisor of the Orlando district office.  
9 | Therefore, I am sponsoring the administrative portion of the Audit Report and  
10 | Audit Exceptions 2, 3, and 4. These portions of the audit report are filed  
11 | with my testimony and are identified as IJF-1.

12 | Q. Was this audit report supervised by you?

13 | A. Yes, this audit was prepared under my supervision.

14 | Q. Please review the audit exceptions you are sponsoring.

15 | A. Audit Exception No. 2 addresses the correct balance for land and land  
16 | rights. I have attached a schedule to this exception in my exhibit which  
17 | indicates the audited cost of land for each of the water plants. This totals  
18 | \$4,086.94. The cost reflected in the Minimum Filing Requirements (MFRs) is  
19 | \$3,730. I recommend that the land and land rights account be increased by  
20 | \$356.94 to reflect the correct cost of land.

21 | Audit Exception No. 3 addresses the correct balance for utility plant-  
22 | in-service. The utility's filing indicates an amount of \$1,979,991 for  
23 | utility plant-in-service. The staff audit found some plant items  
24 | misclassified and others that lacked supporting documentation. I recommend  
25 | that the MFR balance of plant be reduced by \$47,445. In addition to this

1 adjustment, the utility incurred charges of \$57,369 in successfully defending  
2 its certificated territory from the City of Clermont in 1992. The utility  
3 capitalized these charges as organization costs. I recommend that pursuant  
4 to Rule 25-30.433, F.A.C. these charges be removed from plant-in-service and  
5 be treated as a nonrecurring expense and amortized over five years. This  
6 results in three years amortization and a remaining balance of \$22,948 in rate  
7 base at the end of 1995. Schedule A attached to this exception in my exhibit  
8 provides a breakdown of the \$104,814 amount removed from plant-in-service by  
9 NARUC account. Schedule B includes a breakdown of the \$57,369.

10         Audit Exception No. 4 addresses accumulated depreciation and  
11 depreciation expense. The utility's filing included \$157,183 for accumulated  
12 depreciation at December 31, 1995, and \$64,177 for depreciation expense for  
13 the twelve months ended December 31, 1995. The audit staff calculated  
14 accumulated depreciation at December 31, 1995. Because the utility has not  
15 had a previous rate case, we used 2.5% depreciation rate until the test year,  
16 and then used the guideline rates in Rule 25-30.140, F.A.C. This results in  
17 accumulated depreciation of \$209,413 and depreciation expense for the test  
18 year of \$49,912. Therefore, I recommend that accumulated depreciation be  
19 increased by \$52,230 and depreciation expense be reduced by \$14,765. I have  
20 attached a schedule to this exception in my exhibit which indicates the  
21 breakdown of these amounts by account number.

22 Q. Does this conclude your testimony?

23 A. Yes it does.

24

25

FLORIDA PUBLIC SERVICE COMMISSION

Audit Report

December 31, 1995

Field Work Completed

September 20, 1996

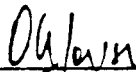
LAKE UTILITY SERVICES, INC.

Lake County Florida

Rate Case Audit

Docket Number 960444-WU

Audit Control Number 96-225-3-1

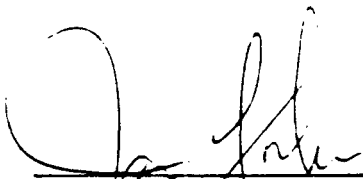
  
\_\_\_\_\_  
Orrett L. Douse  
Audit Manager

Audit Staff

Charleston J. Winston  
Elbert E. Phillips

Minority Opinion

Yes \_\_\_ No EP  
Yes \_\_\_ No EP

  
\_\_\_\_\_  
Ian J. Forbes  
Regulatory Analyst Supervisor  
Orlando District Office

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I. Executive Summary

**AUDIT PURPOSE:** We have applied the procedures described in Section II of this report to the appended exhibits as filed by Lake Utility Services, Inc. to support the Rate Case Docket Number 960444-WU for the twelve-month period ending December 31, 1995. Also, the company's books and records were examined to determine compliance with Commission directives and to disclose any transactions or events that may influence Commission decision.

**DISCLAIM PUBLIC USE:** This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this document must 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.

**OPINION:** Subject to the procedures described in Section II, the company's books and records for the twelve months ended December 31, 1995, have not been maintained in substantial compliance with Commission directives.

**SUMMARY FINDINGS:**

1. Utility plant-in-service is overstated by \$104,814 due to misclassifications and unsupported additions.
2. The utility failed to record land for all of its water treatment plants. Utility land should be increased by \$357.
3. The MFRs understated accumulated depreciation at December 31, 1994, by \$53,176. Depreciation expense for the twelve months ended December 31, 1995, is overstated by \$14,265.
4. The company recorded real estate tax for nonutility land, thereby requiring a reduction in real estate tax of \$1,481 for the twelve months ended December 31, 1995.
5. Operations and maintenance expense should be reduced by \$741 for officers' life insurance policy and \$275 for a refundable security deposit for electricity.

6. Taxes other than income (payroll taxes) should be reduced by \$1,532 due to the utility's failure to capitalize taxes associated with capitalized salaries.
7. The company recorded \$751 in unsupported operations and maintenance expenses for the twelve months ended December 31, 1995.
8. Revenues should be reduced by \$32,912 for the misclassification of AFPI.
9. In the MFRs a cost rate of eight percent was used for customer deposits. In the company's billing registers the interest paid on customer deposits was six percent. The rate used in the MFRs should be reduced to six percent.
10. Increase CIAC for \$188,478 due to improper recording. Increase advances for construction for \$405,520 due to improper recording. Increase CIAC accumulated amortization for \$8,673 and decrease CIAC amortization expense for \$6,258 due to the above adjustment.

## II. Audit Scope

The opinions contained in this report are based on the audit work described below. When used in this report, the following definition shall apply.

**COMPILED** - means that the audit staff reconciled exhibit amounts with the general ledger; visually scanned accounts for error or inconsistency; disclosed any unresolved error, irregularity, or inconsistency; and except as noted, performed no other audit work.



## **RATE BASE**

**UTILITY PLANT-IN-SERVICE:** Compiled the company's plant-in-service. Reconciled plant-in-service to prior orders. Recalculated the company's schedules of plant additions from 1976 to December 31, 1995. Sampled actual amounts for \$1,510,815 of water plant additions. Samples were tested for proper amount, classification, period, support documentation, whether nonutility-related, nonrecurring, unreasonable and imprudent. Toured plant facilities with the utility engineer.

**LAND:** Obtained supporting documentation for all utility land to determine the original cost.

**ACCUMULATED DEPRECIATION:** Reviewed prior orders and workpapers to establish proper beginning amounts. Scheduled and calculated accumulated depreciation from 1976 to December 31, 1994, using a 2.5 percent depreciation rate. For the twelve months ended December 31, 1995, depreciation rates are per Rule 25-30.140, F.A.C.

**CIAC (CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION) AND AMORTIZATION:** Reviewed prior orders and workpapers to establish proper beginning amounts. Recalculated and scheduled CIAC Amortization. Reviewed the company's CIAC ledgers and developer/purchase agreements for CIAC additions.

**WORKING CAPITAL ALLOWANCE:** Recomputed Working Capital Allowance using the 1/8 of Operation and Maintenance Expenses method for 1995.

## **NET OPERATING INCOME**

**REVENUES:** Recalculated revenues for the twelve months ended December 31, 1995. Reviewed and recomputed a sample of customer charges using approved tariffs.

**OPERATIONS AND MAINTENANCE EXPENSES:**

- 1) Compiled and determined that operation and maintenance expenses are classified in compliance with Commission Rules and the Uniform System of Accounts.
- 2) Determined that disbursements are only for authorized expenditures incurred and are properly recorded in the correct account and dollar amount.
- 3) Determined that allocated costs are consistent with prior periods, and that the basis and methodology are reasonable.
- 4) Determined that the filed exhibits of historical data agree to the company's books.
- 5) Determined the existence of related party transactions, and that they appear prudent and competitive with nonaffiliated transactions.
- 6) Judgmentally sampled 62% of O & M Expenses for the twelve months ended December 31, 1995. Items were tested for the proper period, amount classification, support documentation and whether nonutility-related, nonrecurring, unreasonable or imprudent.

**TAXES OTHER THAN INCOME:** Compiled taxes other than income. Judgmentally sampled approximately 53% of taxes other than income for the twelve months ended December 31, 1995. Items were tested for the proper period, amount classification, support documentation and whether nonutility-related, nonrecurring, unreasonable or imprudent.

**COST OF CAPITAL**

Traced debt components to the debt agreements to determine the proper rates and amounts for the twelve months ended December 31, 1995. Reviewed customer deposits for the proper amount received and returned.

**OTHER**

**OUTSIDE AUDITORS' REPORT:** The company's external auditors' report for 1995 was reviewed for items pertinent to this rate proceeding.

**BOARD OF DIRECTORS' MINUTES:** The company's Board of Directors' Minutes were reviewed for items pertinent to this audit from 1984 to May 1996.

**TAX RETURNS:** The company's tax returns were reviewed for 1994 for items pertinent to this audit.

**AUDIT EXCEPTION NUMBER 2**

**SUBJECT: LAND**

**FACTS:** The company's MFRs indicate an amount of \$3,730 for land and land rights.

The utility recorded land for only one of its twelve water treatment plants.

Accounting Instruction No. 13a,

All amounts included in the accounts for utility plant acquired as an operating unit or system, shall be stated at the cost incurred by the person who first devoted the property to utility service.

**OPINION/RECOMMENDATION:** Field audit staff has determined that the correct amount to be recorded to land and land rights should be \$4,087. (See attached schedule.) Staff has determined the amount of land for each of the twelve water treatment plants.

Staff recommends that the land be increased by \$357.

## AUDIT EXCEPTION NUMBER 2 SCHEDULE

SYSTEM NAME	O.R. BOOK PAGE # [A]	LAND PER AUDIT	LAND PER MFRs	AUDIT ADJUS	COMMENTS
AMBER HILL	892/1981	100.00			Doc. Stamps 1986 \$.50
CLERMONT I	624/1925	257.50			See Note [B]
CLERMONT II	758/1736	100.00			Doc. Stamps 1982 - \$. 45
CRESCENT BAY	987/2442	100.00			Doc. Stamps 1986 - \$. 55
CRESCENT BAY	1233/1372	100.00			Doc. Stamps 1993 - \$. 70. Easement
CRESCENT WEST	1342/2420	100.00			Purchased in 1989, Recorded in 1995
LK. CRESCENT HILLS	1164/0371	100.00			Doc. Stamps 1992 - \$. 60
HIGHLAND POINT	906/1289	1,000.00			Doc. Stamps 1986 - \$5.00
FOUR LAKES	867/1350	100.00			Doc. Stamps 1986 - \$. 50
LAKE RIDGE CLUB	1082/2042	100.00			Doc. Stamp 1990 - \$. 55
LAKE SAUNDERS	352/903	929.44			
THE ORANGES	916/1489	1,000.00			Doc. Stamps 1987 - \$5.00
THE VISTAS	1423/893	100.00			Doc. Stamps 1995 - \$. 70
TOTAL LAND		4,086.94	3,730.00	356.94	

**AUDIT EXCEPTION NUMBER 3****SUBJECT: UTILITY PLANT-IN-SERVICE**

**FACTS:** The company's filing indicates an amount of \$1,979,991 for utility plant-in-service.

**OPINION AND RECOMMENDATION:** Some of the above plant were misclassified and some lacked support. The following adjustment is recommended:

**Plant-in-Service:**

<u>Per Audit</u> <u>12/31/95</u>	<u>Per MFR</u> <u>12/31/95</u>	<u>Audit</u> <u>Adjustment</u>
\$1,875,777	\$1,979,991	(\$104,814)

See attached Schedule A for a breakdown of the \$104,814.

Included in the recommended adjustment amount of \$104,814 is an amount of \$57,369. The utility incurred these charges in successfully defending its certificated territory from the City of Clermont in 1992. The utility had incorrectly capitalized these charges as organization costs.

Field audit staff recommends that the \$57,369 be treated as a nonrecurring expense and be amortized over five years.

See attached Schedule B for breakdown of \$57,369.

UTILITY PLANT IN SERVICE - ADJUSTMENTS
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## AUDIT EXCEPTION NUMBER 3 SCHEDULE A

Acct. No.	DESCRIPTION	UPIS PER AUDIT	UPIS PER MFR'S	AUDIT ADJUSTMENT
301	ORGANIZATION	16,558	96,200	(79,642)
304	STRUCTURES & IMPROVE	45,014	345,916	(300,902)
307	WELLS & SPRINGS	179,043	13,934	165,109
311	PUMPING EQUIPMENT	110,957	19,912	91,045
320	WATER TREAT. EQUIP.	101,674	75,381	26,293
330	DISTRIBUTION RESERV.	79,017	108,993	(29,976)
331	TRANS. & DISTRIB. MAINS	1,153,588	1,240,526	(86,938)
333	SERVICES	97,482	20,597	76,885
334	METERS & METER INSTA.	23,273	0	23,273
335	HYDRANTS	32,933	22,894	10,039
343	TOOLS/SHOP/GARAGE	7,075	7,075	0
344	LABORATORY EQUIPMENT	261	261	0
346	COMMUNICATION EQUIP.	2,000	2,000	0
347	MISC. PLANT(COMP. ALLO)	4,188	4,188	0
348	OTHER PLNT (WSC R/B)	22,114	22,114	0
TOTAL		1,875,177	1,979,991	(104,814)

## AUDIT EXCEPTION NUMBER 3 SCHEDULE B

The Utility recorded the following charges as Organization Costs. These costs were incurred by the Utility defending its certificated territory from The City of Clermont.

10/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	2,554.47
09/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	5,828.72
06/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	85.00
07/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	8,339.30
06/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	966.01
05/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	101.14
04/92	MGMT. & REGULAT. CON.	LUSI vs CLERMONT	5,788.04
02/92	BEN E. GIRTMAN	LUSI vs CLERMONT	2,950.21
03/92	BEN E. GIRTMAN	LUSI vs CLERMONT	8,251.69
04/92	BEN E. GIRTMAN	LUSI vs CLERMONT	3,072.23
05/92	BEN E. GIRTMAN	LUSI vs CLERMONT	3,011.56
07/92	BEN E. GIRTMAN	LUSI vs CLERMONT	1,527.99
08/92	BEN E. GIRTMAN	LUSI vs CLERMONT	4,609.28
09/92	BEN E. GIRTMAN	LUSI vs CLERMONT	5,631.36
10/92	BEN E. GIRTMAN	LUSI vs CLERMONT	1,878.22
11/92	BEN E. GIRTMAN	LUSI vs CLERMONT	157.57
06/92	BEN E. GIRTMAN	LUSI vs CLERMONT	2,615.82
%% AUDIT ADJUSTMENT REQUIRED		1992 SAMPLE TOTAL	57,368.61



**AUDIT EXCEPTION NUMBER 4****SUBJECT: ACCUMULATED DEPRECIATION/DEPRECIATION EXPENSE**

**FACTS:** The company's filing included \$157,183 for accumulated depreciation at December 31, 1995, and \$64,177 for depreciation expense for the twelve months ended December 31, 1995.

**OPINION AND RECOMMENDATION:** Field audit staff calculated accumulated depreciation at December 31, 1995, to be \$209,413. Depreciation expense for the test was calculated to be \$49,912.

The following adjustments are recommended:

	<u>Per Audit</u> <u>12/31/95</u>	<u>Per MFR</u> <u>12/31/95</u>	<u>Audit</u> <u>Adjustment</u>
Accumulated depreciation	\$209,413	\$157,183	\$52,230
Depreciation expense	\$ 49,912	\$ 64,177	(\$14,765)

For a breakdown of the above amounts refer to attached schedule.

AUDIT EXCEPTION NUMBER 4 SCHEDULE

Acct. No.	DESCRIPTION	DEPR. RATE	UPIS ① 12/31/94	ADD	RETIRE	UPIS ② 12/31/95	DEPR. EXP. PER AUDIT	DEPR. EXP. PER MFR's	AUDIT ADJUSTMENT
301	ORGANIZATION	2.50%	16,558.23			16,558.23	413.96	2,982.00	(2,568.04)
304	STRUCTURES & IMPROV	3.03%	42,380.48	2,833.31		45,013.77	1,324.02	5,630.00	(4,305.98)
307	WELLS & SPRINGS	3.33%	155,822.14	27,720.69	(4,500.00)	179,042.83	3,400.43	0.00	3,400.43
311	PUMPING EQUIPMENT	5.00%	93,562.21	21,656.39	(4,262.00)	110,956.60	3,088.52	3,195.00	(106.48)
320	WTR. TREAT. EQUIP	10.00%	98,164.00	5,236.21	(2,140.00)	101,260.21	9,008.21	2,248.00	6,760.21
330	DISTRIBUTION RESER.	2.86%	73,804.41	9,055.28	(309.00)	82,550.69	2,085.80	2,316.00	(230.20)
331	TRANS. & DISTRIB. MAIN	2.32%	1,138,515.18	15,073.18	(3,120.00)	1,150,468.36	25,028.40	38,961.00	(13,932.60)
333	SERVICES	2.50%	78,055.52	19,426.76		97,482.28	2,194.22	2,872.00	(677.78)
334	METERS & METER INSTA	5.00%	18,654.00	7,314.28	(2,895.77)	23,272.51	(232.33)	629.00	(861.33)
335	HYDRANTS	2.22%	31,861.15	1,072.33		32,933.48	719.22	710.00	9.22
340	OFFICE FURNITURE	6.67%	0.00			0.00	0.00	517.00	(517.00)
341	TRANSPORTATION	18.67%	0.00			0.00	0.00	2,310.00	(2,310.00)
343	TOOLS/SHOP/GARAGE	6.25%	5,742.14	1,332.75		7,074.89	400.53	584.00	(183.47)
344	LABORATORY EQUIP.	6.67%	0.00	261.45		261.45	8.72	0.00	8.72
346	COMMUNICATION EQUIP	10.00%	2,000.00			2,000.00	200.00	194.00	6.00
347	MISC. PLANT	6.67%	4,188.00			4,188.00	279.34	1,049.00	(769.66)
348	OTHER TANG. PLANT	10.00%	17,752.00	4,362.00		22,114.00	1,993.30	0.00	1,993.30
DEPR. EXPENSE - 1995			1,777,059.44	115,144.63	(17,026.77)	1,875,177.30	49,912.34	64,177.00	(14,264.66)

PLANT ADDITIONS AND RETIREMENTS ARE SUBJECT TO HALF (1/2) YEAR CONVENTION  
DEPRECIATION RATES ARE PER RULE 25-30.140 F.A.C.