ORIGINAL

DOCKET NO. 991643-SU: Petition for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.

WITNESS: **Direct Testimony Of James A. McPherson,** Appearing On Behalf Of Staff

DATE FILED: August 28, 2000

DIRECT TESTIMONY OF JAMES A. MCPHERSON

Q. Please state your name and business address.

A. My name is James A. McPherson and my business address is 4950 West Kennedy Blvd., Suite 310, Tampa, Florida, 33609.

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

A. I am employed by the Florida Public Service Commission as a Regulatory Analyst Supervisor in the Division of Regulatory Oversight.

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

A. I have been employed by the Florida Public Service Commission since August, 1992.

Q. Briefly review your educational and professional background.

A. In 1975, I received a Degree in Forestry from the University of Florida and in 1978 I received an Accounting Degree from the University of South Florida. I worked as a staff accountant for a CPA firm for three years. Before joining the Commission Staff I was employed at Lykes Brothers, Inc. for nine years, the last three years as the Manager of Internal Audit.

I am a Certified Public Accountant licensed in the State of Florida. I also am a member of the Florida Institute of Certified Public Accountants and the American Institute of Certified Public Accountants.

Q. Please describe your current responsibilities.

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

Q. Have you presented expert testimony before this Commission or any other regulatory agency?
A. Yes. I testified in the Florida Cities Water Company rate case, Docket No. 950387-SU.
Q. What is the purpose of your testimony today?
A. The purpose of my testimony is to testify to Audit Disclosure Nos. 7 and 8 in the staff audit report of Aloha Utilities, Inc., the Seven Springs Wastewater system, Docket No. 991643-SU. The audit report is filed with Tom Stambaugh's testimony and is identified as TES-1. I am also testifying to the issues raised in a subsequent audit of Aloha Utilities, Inc. This subsequent audit was an undocketed earnings review audit of the other three systems: Aloha Gardens water and wastewater systems and Seven Springs water system. The audit report for this audit is attached to my testimony as Exhibit JAM-1.
Q. Did you prepare Audit Disclosures 7 and 8?
A. Yes, I was the auditor assigned to complete the audit work and write the disclosures.
Q. Was this second audit report prepared by you?
A. Yes, I was the audit manager in charge of this audit.
Q. Please review the work you and the audit staff performed in this audit.
A. We compiled Rate Base, tested the balances by reviewing capital work orders, and calculated accumulated depreciation using currently approved rates. We also tested Contributions in Aid of Construction (CIAC) and Amortization of CIAC and calculated a working capital allowance using the balance sheet method. We also compiled revenue and expenses, tested specific customer bills to verify that approved rates were in use, recomputed revenues using approved tariffs and

company-provided gallonage sales, verified Operating and Maintenance (O&M) expenses, performed audit test work of payments to vendors to verify booked expenses, calculated depreciation expense, and analyzed taxes other than income. We also compiled the capital structure of Aloha Utilities and traced the amounts and interest rates to supporting documents.

Q. Please review Audit Disclosure No. 7 from the rate case audit.

A. Audit Disclosure No. 7 discusses deferred taxes and contributed taxes. In the subsequent earnings audit I have expanded my discussion of this issue so I will address this issue further when I address Audit Disclosure No. 14 of the subsequent audit.

Q. Please review Audit Disclosure No. 8 from the rate case audit.

A. Audit Disclosure No. 8 discusses three components of the capital structure: Notes Payable, Customer Deposits, and Retained Earnings. The disclosure first addressed the notes payable. Included on the utility's long-term debt schedule (MFR Schedule D-5(c)) is a vehicle note payable showing an average balance of $17,760. The utility incorrectly used the actual balance payable at September 30, 1999 instead of the thirteen-month average. During the audit we recalculated the actual thirteen-month average as $7,203 or a difference of $10,557. The thirteen-month average balance of notes payable shown on MFR Schedule D-2(c) should be reduced $10,557.

The second component addressed was Customer Deposits. The utility included in its reconciliation of capital structure to rate base (MFR Schedule D-2(c)) an amount of customer deposits of $215,795. This amount is the total deposits of all four of the utility's operating systems. The utility did not prorate this amount to rate base as was done with the other components of capital structure.

The utility should either prorate total customer deposits to the associated rate base as is done with the other components of capital structure or include only those customer deposits that are directly attributable to the Seven Springs wastewater system. Audit Disclosure No. 13 in the subsequent audit also addresses customer deposits regarding another issue found during that audit.

The third component addressed was Retained Earnings. The utility's thirteen-month average balance of retained earnings of $1,878,373 was computed based on actual monthly general ledger activity. Many of the utility's largest journal entries are made only at the end of the year. Some of these adjustments are made to record depreciation, CIAC amortization, income tax expense, and amortization of rate case expenses. All of these expenses actually occur during the course of the entire year. I believe a better way to determine each month's balance of retained earnings is to assume that all income and expense occurs evenly throughout the year. The balance of retained earnings at December 31, 1997 was $1,556,376. The utility reported 1998 net income of $180,172 and retained earnings of $1,736,548 at December 31, 1998. Therefore, the balance at September 30, 1998 should be equal to the beginning balance plus 9/12ths of $180,172 or $1,691,504 not the $1,935,054 that the utility used in its computation. Likewise, for the nine months ended September 30, 1999, the utility reports a loss of $62,533 or $6,948 per month. However, in its MFR Schedule A-19(c) the utility shows income of $266,622 for the first eight months and then a large loss of $329,155 in the last month. This method overstates the monthly retained earnings balance every month except at the year end. We have recomputed the thirteen-month average balance starting with September 30, 1998 as computed above and have added yearly income or loss as if it were earned evenly throughout the year. Based on this method, the thirteen-month average of retained earnings is $1,705,567 or $172,806 less than is shown in the MFR schedules.

Q. Please review the audit disclosures in the undocketed audit report.

A. Audit Disclosure No. 1 discusses plant additions. This same issue was addressed in the rate case audit and the effect on the Seven Springs wastewater system is discussed in Mr. Stambaugh's testimony.

Audit Disclosure No. 2 discusses the Aloha Gardens wastewater land account. This issue was also addressed in the rate case audit and the effect on the Seven Springs wastewater system is discussed in Mr. Stambaugh's testimony.

Audit Disclosure No. 3 discusses accumulated depreciation and depreciation expense for computer equipment. Aloha Utilities, Inc. purchased new computer equipment and system software in 1998 and 1999 and capitalized these as Office Furniture using a 15-year depreciable life. Rule 25-30.140(2)(a), Florida Administrative Code, requires computer equipment to be depreciated over a six-year period. Therefore, I recommend that the accumulated depreciation for the Seven Springs wastewater system be increased by $2,151 and that the test year depreciation expense be increased by $1,727.

Audit Disclosures Nos. 4, 5, and 6 have no impact on the rate case.

Audit Disclosure No. 7 discusses payroll expense. This issue was also addressed in the rate case audit and the effect on the Seven Springs wastewater system is discussed in Mr. Stambaugh's testimony.

Audit Disclosure No. 8 discusses errors from the computer system conversion. This issue was also addressed in the rate case audit and the effect on the Seven Springs wastewater system is discussed in Mr. Stambaugh's testimony.

Audit Disclosure No. 9 discusses accounting expenses. The utility replaced its general ledger and billing software systems in July of 1999 with a new accounting software system. The utility's accounting firm, Cronin, Jackson, Nixon & Wilson, assisted the utility with the implementation of the new system by reviewing system output, balancing accounts, and testing accuracy. The replacement of billing and accounting systems is an infrequent event and expenses related to this event are non-recurring. Rule 25-30.433 (8), Florida Administrative Code, requires that non-recurring expenses be amortized over a 5-year period unless a shorter or longer period of time can be justified. Accordingly, these invoices should be deferred and amortized over a 5-year period. I recommend that the accounting expenses for the Seven Springs wastewater system be reduced by $1,113 to reflect this adjustment.

Audit Disclosure No. 10 discusses transportation expenses. A review of the utility expenses revealed that the utility had issued Shell Oil credit cards to several of its employees. We examined invoices for February and April and noted that the invoices provided a subtotal for each card in use during the month. We also noted that someone had hand written the initials PG, RS, LS, SW, and AC next to the individual card numbers. When asked to identify the users indicated by the initials, the utility responded that LS (card number 2004) and RS (card number 2003) were both Lynnda Speer. Lynnda Speer's husband is Roy Speer. As a follow-up question, we asked for all of the remaining Shell gas card invoices for 1999. Before providing them, someone erased the identifying initials next to the card numbers on these invoices. I believe card number 2003 was used by the utility vice president's husband who is not an employee or officer of the company. The audit report indicates a monthly listing of charges to this card that total $760.73. These charges are only for January through September, which are wholly within the test year. I believe that all expenses charged on card 2003 should be removed for ratemaking purposes. This would result in a reduction to transportation expense for the Seven Springs wastewater system of $280.25, plus any charges for the first quarter of the historical test year.

Audit Disclosure No. 11 discusses taxes other than income. The utility did not take all available discounts on its real estate and personal property taxes. This issue was also addressed in the rate case audit and the effect on the Seven Springs wastewater system is discussed in Mr. Stambaugh's testimony. This disclosure also addresses a difference in the methodology used to allocate these taxes. This difference does not affect the rate case as the numbers we developed for the rate case were correct.

Audit Disclosure No. 12 discusses Aloha Gardens' purchased water. This disclosure has no impact on the rate case.

Audit Disclosure No. 13 discusses customer deposits. This is in addition to the discussion reflected under Audit Disclosure No. 8 in the rate case audit. Customer deposits per the company's books total $458,716 at December 31, 1999. However, included in this amount are certain deposits totaling $41,782 which relate to the nonregulated related company street light and garbage customers. Beginning in the early part of 1999, the utility began recording its customer deposits incorrectly. The deposits were being credited directly to the accounts receivable. The utility discovered this error and corrected it in December when it was able to restate all the customer deposits. Therefore, this error was still in effect at the end of the test year and the balance of customer deposits is understated in the MFRs. We were unable to determine the appropriate level of customer deposits at the end of September 30, 1999.

Audit Disclosure No. 14 discusses deferred taxes and contributed taxes. The following discussion includes information from both audit reports. As shown in Disclosure No. 7 of the rate case audit, the utility has the following accounts listed in its general ledger:

Acct No.	Acct. Title	G/L 9-30-98	G/L 9-30-99	13 Mo. Avg.
190-00-0	Def. Tax Asset MF SIT	$5,077	$6,656	
191-00-0	Def. Tax Asset MF FIT	$29,387	$38,614	$38,639
193-00-0	Def. Tax Asset CIAC SIT	$333,016	$310,681	
194-00-0	Def. Tax Asset CIAC FIT	$1,945,417	$1,814,972	$2,203,971
	Sub-total			$2,242,610
245-00-0	Def. Tax Liability SIT	($3,475)	($3,475)	
246-00-0	Def. Tax Liability FIT	($20,313)	($20,313)	
247-00-0	Def. Tax Liab. Depr. SIT	($47,866)	($75,830)	
248-00-0	Def. Tax Liab. Depr. FIT	($343,948)	($507,403)	
	Sub-total			($475,501)
254-00-0	Contributed Taxes	($2,720,755)	($2,720,755)	
255-10-0	Amort. of Contr. Taxes	$244,301	$380,339	
	Sub-total			($2,418,898)

Rule 25-30.433(3), Florida Administrative Code, states that "used and useful debit deferred taxes shall be offset against used and useful credit deferred taxes in the capital structure. Any resulting net debit deferred taxes shall be included as a separate line item in the rate base calculation. Any net credit deferred taxes shall be included in the capital structure calculation." Order No. 23541, issued October 1, 1990, in Docket No. 860814-PU deals specifically with the accounting and regulatory treatment of Contributions-in-

aid-of-Construction (CIAC) which is grossed up to pay income taxes. This order also compares CIAC which is grossed up with CIAC which is not. Under the heading *Accounting/Regulatory Treatment - No Gross-Up, Normalization,* "witness Causseaux recommends the method required by the IRS pursuant to Notice 87-82. This notice says debit deferred taxes should be treated as the regulatory body usually treats deferred taxes. In Florida, the norm is to offset debit deferred taxes against credit deferred taxes in the capital structure. If the net of the credit and debit deferred tax amounts is a debit, the amount is included in rate base." Witness Causseaux then gives a more simplistic approach in which the entire debit deferred tax balance is included in rate base. The order continues by stating "although the proposed rate base treatment would be easier to administer, we believe that the appropriate method is the capital structure method. This would keep the treatment in total compliance with Notice 87-82."

Under the heading *Accounting/Regulatory Treatment With Gross-Up*, the order states that all witnesses who testified agreed that normalization accounting should be followed when a utility does gross-up. The order then states that "we still believe that full normalization accounting should be utilized. This would result in consistent treatment between utilities that are not grossing-up and those that are. In addition, those utilities that switch from grossing-up to not grossing-up will maintain the same normalization methodology." In the next paragraph, the order states, "as discussed above, normalization involves offsetting debit deferred taxes against credit deferred taxes in the capital structure with any net debit deferred balance included in rate base."

In addition, Order No. 11487, issued January 5, 1983, in Docket No. 820014-WS, states: " ... the utility has also reduced CIAC by the amount of income taxes paid on connection fees, which were included as income for tax purposes. We believe that connection and tap fees should be considered CIAC, not revenue. Therefore, we have increased CIAC for the water system by $26,690 and $26,199 for the sewer system."

The Uniform System of Accounts (USOA) For Class A Wastewater Utilities describes the amounts that should be recorded in Account 271 (Contributions in Aid of Construction). Item 4 in this description states "any amount of money received by a utility, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility and which is utilized to offset the federal, state or local income tax effect of taxable contributions in aid of construction . . . shall be reflected in a sub-account of this account."

The utility did not follow these procedures. It did not include the gross-up portion of CIAC with the other CIAC in its MFR rate base schedule. It did not net deferred tax assets (debits) against deferred tax liabilities (credits) in its capital structure as required by the Commission rule and the Commission orders.

I believe that all CIAC, whether grossed-up for tax or not, should be treated consistently. Among other things, this means that both should be included in a utility's rate base even if income taxes were paid on them. Second, deferred tax assets are to be offset against deferred tax credits in the utility's capital structure with any net debit being included in rate base. In Aloha's case, no distinction is made for deferred taxes relating to meter fees received that were not grossed-up and deferred taxes relating to plant capacity charges that were grossed-up. The utility appears to believe that this treatment should not apply nor does it have to include CIAC grossed up for taxes in its rate base because its deferred tax assets are less than its net contributed taxes. I believe that Order No. 11487 is very clear and that all contributions received should be considered CIAC and included in rate base even if taxes were paid on them.

The utility has a supporting schedule which specifically identifies the division to which the contributed taxes relate. I used this schedule to allocate the net deferred tax assets to the various divisions on the same basis as the contributed taxes. This schedule then calculates the net reduction which should be made to the utility's rate base. I have attached this schedule to my testimony as Exhibit JAM-2. Based on this schedule, I recommend that the Seven Springs wastewater rate base be adjusted on a thirteen-month average basis to include the following amounts: CIAC should be increased by $1,544,865 and the amortization of CIAC should be increased by $171,681. These are the thirteen-month average amounts that relate to this system. The net of these amounts is $1,373,112 or 56.8% of the total. I recommend that this percent be applied to the net deferred tax asset amount of $1,767,109 ($2,242,610 + $(475,501)). This results in an allocation to the Seven Springs wastewater system of $1,003,170, which should also be included in rate base.

I have also prepared an example of two hypothetical companies. One company does not gross-up and the other one does gross-up. I have tried to show that the regulatory and accounting treatment of these accounts should be handled consistently. If a company that does not gross-up CIAC is not allowed to offset its CIAC by the associated taxes paid, then a company that does gross-up should also not be allowed to do this. My example of the two hypothetical companies is attached to my testimony as Exhibit JAM-3.

Q. Do you have anything to add to your testimony?

A. Yes. Some of these adjustments are to the historical test year ended September 30, 1999. Any escalation factors, such as growth or inflation, that were applied to these items should also be removed.

Q. Does this conclude your testimony?

A. Yes, it does.

DOCKET NO. 991643-SU: Petition for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.

WITNESS: **Direct Testimony Of James A. McPherson,** Appearing On Behalf Of Staff

EXHIBIT: JAM-1

FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF REGULATORY OVERSIGHT
BUREAU OF AUDITING SERVICES

TAMPA DISTRICT OFFICE

ALOHA UTILITIES, INC.

EARNINGS INVESTIGATION

FOR THE TWELVE MONTHS ENDED DECEMBER 31, 1999

Docket No. 000737-WS

Vincent C. Aldridge, Audit Staff

Simon Ojada, Audit Staff

James A. McPherson, Audit Manager and
Tampa District Supervisor

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DIVISION OF REGULATORY OVERSIGHT
AUDIT REPORT

JULY 14, 2000

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to prepare and audit the accompanying schedules of Rate Base, Net Operating Income and Capital Structure for the historical twelve month period ended December 31, 1999, for Aloha Utilities, Inc. These schedules were prepared as part of an Earnings Investigation of the Aloha Gardens water and wastewater systems and the Seven Springs water system. There is no confidential information associated with this audit, and there are no audit staff minority opinions.

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 had several O & M expense accounts misstated. The total affect of these misstatements on the three audited systems was $48,596. The utility did not remove from its rate base capitalized expenses disallowed in Order No. PSC-99-1917-PAA-WS.

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:

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Verify - The item was tested for accuracy, and substantiating documentation was examined.

RATE BASE: Compiled Rate Base. Tested the balances by reviewing capital work orders on a judgmental basis. Calculated accumulated depreciation using currently approved rates. Tested Contributions in Aid of Construction (CIAC) and Amortization of CIAC. Auditors calculated a working capital allowance on the balance sheet method.

NET OPERATING INCOME : Compiled revenue and expenses. Tested specific customer bills to verify that approved rates were in use. Recomputed revenues using approved tariffs and company-provided gallonage sales. Verified Operating and Maintenance (O&M) expenses on a judgmental basis. Performed audit test work of payments to vendors to verify booked expenses. Calculated depreciation expense. Analyzed taxes other than income. Performed a test calculation of achieved rate of return to facilitate the determination of whether or not the utility was over earning.

CAPITAL STRUCTURE: Compiled the capital structure of Aloha Utilities. Traced amounts and interest rates to supporting documents.

OTHER: Performed analytical review on O&M expense. Received a copy of the utility's 1999 audited financial statements. Reviewed the independent auditor's workpapers.

Disclosure No. 1

Subject: Plant Additions Previously Capitalized

Statement of Fact: In 1997 the utility made an adjustment to capitalize certain transactions which were originally classified as Operations and Maintenance (O&M) expense between the years 1980 and 1991. The effect of this adjustment was to add $232,262 to plant accounts, $68,671 to accumulated depreciation and to increase the 1997 depreciation expense by $9,961. In our previous audit we recommended these items be removed from rate base. FPSC Order 99-1917-PAA-WS, dated September 28, 1999 agreed with us saying that the utility's adjustments were neither fair, just nor reasonable and should be disallowed . However, the FPSC recognized the Utility's disagreement with its decision, and provided that the matter could be revisited later. The utility did not make any adjustment to remove these items from rate base.

Opinion: As of December 31, 1999, the portion of the suggested plant additions relating to the Aloha Gardens Water System is $3,669 with its associated accumulated depreciation of $1,125; Aloha Gardens Wastewater System is $1,567 with its associated accumulated depreciation of $960; and Seven Springs Water system is $99,794 with its associated accumulated depreciation of $31,602.

If the Utility is permitted to recover the depreciation expense related to this capitalization of previous years expenses, it will in a sense be recovering these costs twice, using depreciation expense as the recovery vehicle this time, as compared to O&M expense used in previous years. The effect of expensing these items in previous years was to reduce the utility's NOI in those years. Whether the act of capitalizing these transactions would have caused an over earnings situation in a prior year(s) cannot be determined without detailed investigation of Utility financial statements and federal income tax returns.

Recommendation: These transactions should be removed from rate base as was previously recommended in PSC Order No. 99-1917-PAA-WS. The associated depreciation expense for the current year should also be reduced as follows: Aloha Gardens-Water $122; Aloha Gardens-Wastewater $87; and Seven Springs-Water $3077.

Disclosure No. 2

Subject: Aloha Gardens Wastewater Land Account.

Statement of Fact: The total land balance for Aloha Gardens Wastewater per utility books at December 31, 1999 is $3,220. As stated in our previous audit of the Seven Springs Wastewater division, FPSC Order No 99-1917-PAA-WS incorrectly directed the utility to remove $12,120 from the Aloha Gardens Wastewater division. This amount should have been removed from the Seven Springs Wastewater division. The above order also directed the utility to consider 75% of the Aloha Gardens Wastewater land as Non Used and Useful. The utility made this adjustment, however, because $12,120 was incorrectly removed, this computation also needs to be corrected.

Recommendation: The $12,120 should be added back to Aloha Gardens wastewater land account. The Land Account balance of $25,000 should then be reduced by $18,750 (75% non used and useful) for rate making purposes. The required corrections are summarized below:

	Aloha Gardens Wastewater	Seven Springs Wastewater
Land @ 12/31/97 per G/L	53,061	588,030
FPSC Adjustments made	(49,841)	(39,086)
Land Additions/Deletions	0	0
Balance @12/31/99 per G/L	3,220	548,944
To add back utility use & useful adjustments	9,660	0
To correct Land Adjustments	12,120	(12,120)
Actual Land at Cost	25,000	536,824
Non Used and Useful (75%)	(18,750)	0
Audited Balance @ 12/31/99	6,250	536,824
<u>Difference (Adjustments)</u>		
Increase/(Decrease) Land	3,030	(12,120)

Disclosure No. 3

Subject: Accumulated Depreciation/Depreciation Expense

Statement of Fact: Aloha Utilities, Inc. capitalized new computer equipment and system software purchased in 1998 and 1999 and classified them as Office Furniture using a 15 year depreciable life. Total computer equipment capitalized in 1998 was $8,639 for Aloha Gardens-Water, $3,295 for Aloha Gardens-Wastewater, and $22,621 for Seven Springs-Water. Computer additions for 1999 were $5,279 for Aloha Gardens-Water, $5,279 for Aloha Gardens-Wastewater, and $17,591 for Seven Springs-Water.

Recommendation: According to Rule 25-30.140 of the Florida Administrative Code computer equipment should be classified as Office Furnitue, but depreciated over six years instead of fifteen. PSC auditors recalculated the depreciation expense including the accumulated depreciation for the two years as follows:

	AGW	AGS	SSW
1998 Additions			
1998 Depreciation Exp. Per Books (½ yr convention)	432	110	754
Correct 1998 Depreciation Expense	720	275	1,885
Difference	288	165	1,131
1999 Depreciation Expense Per Books (15 yr life)	576	220	1,508
1999 Correct Depr. Expense	1,440	549	3,770
Difference	864	329	2,262
Total Dif. in Depr. for 1998 additions	1,152	494	3,393
1999 Additions			
1999 Depreciation Exp. Per Books	176	176	586
Correct 1999 Depreciation Exp.	440	440	1,466
Difference	264	264	880
Total increase in deprc exp. in 1999	1,128	593	3,142

Conclusion: The utility should increase its 1999 depreciation expense by the above adjustments. The accumulated depreciation should also be increased by $1,416(1,128+288) for Aloha Gardens-Water, $758(593+165) for Aloha Gardens Wastewater, and $4,273(3,142+1,131) for Seven Springs-Water.

Disclosure No. 4

Subject: Reallocation of Purchased Water Expense

Statement of Fact: The utility recorded expenses for water purchased from Pasco County incorrectly in November and December of 1999.

Recommendation: The utility receives one monthly bill from Pasco County for purchased water. On this bill there are generally two meters that reflect the prior months water consumption. One meter is for Aloha Gardens, the other is for Seven Springs. The utility made a mistake in recording Aloha Garden's November and December consumption as a Seven Springs expense and vice-versa. The following adjustment will correct that mistake:

Account	Debit	Credit
610.011 Purchased Water- Aloha Gardens		$15,227
610.013 Purchased Water- Seven Springs	$15,227	

Disclosure No. 5

Subject: Out of Period Expenses

Statement of Fact: During the test year, the utility recorded an expense twice in the test year and made a correcting adjustment outside of the test year.

Recommendation: The utility recorded a transportation expense of $1,102.09 twice in December, 1999. It posted a correcting credit in January of 2000. For ratemaking purposes, the transportation account affected by this mistake should be reduced to accurately reflect the actual expense incurred during the test year. An adjustment should be made as follows:

650.023	Transportation Expense- Seven Springs Water	($1,102.09)

Disclosure No. 6

Subject: Items Expensed That Should Have Been Capitalized

Statement of Fact: During the test year, the utility expensed a new pump that should have been capitalized in the Aloha Gardens Wastewater division.

Recommendation: The following item is a fixed or plant asset and should be reclassified from an expense account to plant account. Plant assets generally are acquired for use in operations and have relatively long lives. Because this asset provides benefit to future periods, it should be recorded in the appropriate plant account at historical cost and then depreciated over the service life as provided in Rule 25-30.140, Florida Administrative Code.

Item	Account	Description	Debit	Credit
Barbarian Pump	720.042	Material/Supplies		3,816
	371.xxx	Pumping Equipment	3,816	
		Total:	3,816	3,816

The utility also needs to record additional depreciation expense of $106 for 1999.

Disclosure No. 7

Subject: Payroll Expense

Statement of Fact: The payroll expense for the following officers for the test year was:

President	$118,438
Vice President	$ 68,631

The percentage of time spent as an officer of Aloha Utility was:

President	100%
Vice President	20%

Recommendation: FPSC Order 99-1917-PAA-WS, issued September 28, 1999, stated that "we do not believe that Aloha's vice president warrants a greater annualized salary than the president." It then ordered a reduction of the vice president's salary to an amount equal to 20 percent of the president's pay. The order also reduced corresponding benefit and payroll tax accounts. Similar adjustments to the Utility's Salary, Benefits and Payroll Tax accounts should be made for the test year as follows:

20% of the President's salary = $118,438 x 20% = $23,688

Vice President's Salary:	$68,631
Maximum Vice President's Salary Allowed:	23,688
Total Utility Salary Adjustment:	$44,943

Since the above amounts relate to the entire utility, an allocation of the adjustment must be made to the various systems.

AG WATER		AG WASTEWATER		SS WATER	
Salary Adj.:	$44,943	Salary Adj.:	$44,943	Salary Adj.:	$44,943
Allocation %:	14.00%	Allocation %:	14.00%	Allocation %:	36.00%
AGW Sal Adj:	**$6,292**	**AGWW Sal Adj:**	**$6,292**	**SSW Sal Adj:**	**$16,180**

The percentage of salary adjustments to total salaries can be used to make the corresponding adjustment to Payroll Taxes and Benefits:

	AG WATER	AG WASTEWATER	SS WATER
Salary Adjustment:	$ 6,292	$ 6,292	$ 16,180
Total Salaries:	$81,060	$67,170	$322,672
Factor to apply to benefits and taxes:	7.76%	9.37%	5.01%
Total Benefits:	$32,859	$28,512	$112,668
Adjustment factor:	7.76%	9.37%	5.01%
Benefits Adjustment:	**$ 2,551**	**$ 2,671**	**$ 5,649**
Total Payroll Tax:	$ 6,918	$5,307	$28,962
Adjustment factor:	7.76%	9.37%	5.01%
Payroll Tax Adjustment:	**$ 537**	**$ 497**	**$ 1,452**

Disclosure No. 8

Subject: Computer System Conversion

Statement of Fact: The utility replaced its general ledger software system in July of 1999 with a new general ledger software system. The company stated that during the mid-year conversion of accounts payable, differences arose between the detail and the general ledger. These differences were assumed related to Seven Springs and an journal entry was made to several Seven Springs expense accounts totaling $15,526.

Recommendation: Where they cannot be specifically identified and charged directly to the appropriate division of the utility, the utility policy is to allocate expenses based on ERC's. ERC allocation results in the following percentages for each of Aloha's four divisions: Aloha Gardens Water- 14%; Aloha Gardens Wastewater- 14%; Seven Springs Water- 36%; Seven Springs Wastewater- 36%.

Absent clear evidence to suggest that these expenses were attributable to Seven Springs only, the ERC allocation method should have been used. The following adjustments should be made to allocate 14% of this cost to each of the Aloha Gardens Divsions as follows:

Account	Description	Debit	Credit
618.013	Chemicals- SSW		1,087
620.013	Materials/Supplies- SSW		1,087
718.054	Chemicals- SSWW		1,087
720.054	Materials/Supplies- SSWW		1,087
675.081	Misc. Exp- AGW	2,174	
775.082	Misc. Exp- AGWW	2,174	

Disclosure No. 9

Subject: Accounting Expenses

Statement of Fact: The utility replaced its general ledger and billing software systems in July of 1999 with a new accounting software system.

Recommendation: The utility's accounting firm Cronin, Jackson, Nixon & Wilson (CJNW) assisted the utility with the implementation of the new system by reviewing system output, balancing accounts, and testing accuracy.

The replacement of billing and accounting systems is an infrequent event and expenses related to this event are non-recurring. Rule 25-30.433 (7), F.A.C. states that non-recurring expenses shall be amortized over a 5-year period unless a shorter or longer period of time can be justified. For regulatory purposes, the following amounts reflected on CJNW invoices related to this event should be deferred and amortized over a 5-year period as follows:

Remove from expense and reclassify to 186.xxx accounts:

	AGW	AGWW	SSW
Month	632.081	632.083	732.082
August	$541.10	$541.10	$1,391.40
October	764.23	764.23	1,965.15
November	258.48	258.48	664.65
	$1,563.80	$1,563.80	$4,021.20
Amortization- 1999 @ 20%:	($312.76)	($312.76)	($804.24)
Net amount to remove:	**$1,251.04**	**$1,251.04**	**$3,216.96**

Disclosure No. 10

Subject: Transportation Expenses

Statement of Fact: A review of the utility expenses revealed that the utility had issued Shell Oil credit cards to several of its employees. We examined invoices for February and April and noted that the invoices provided a subtotal for each card in use during the month. We also noted that someone had hand written the initials PG, RS, LS, SW and AC next to the individual card numbers. When asked to identify the users indicated by the initials, the utility responded that LS (card number 2004) and RS (card number 2003) were both Lynnda Speer. Lynnda Speer's husband is Roy Speer.

As a follow-up question, the FPSC auditor asked for all of the remaining Shell gas card invoices for 1999. Before providing them, someone erased the identifying initials next to the card numbers on these invoices.

Recommendation: We believe card number 2003 was used by the utility vice president's husband who is not an employee or officer of the company. The following schedule reflects all charges made to card 2003 during the year. We believe all expenses charged on card 2003 should be removed for ratemaking purposes. Modifying or altering requested utility documents prior to delivery to FPSC auditors is an unacceptable practice.

Month	RS Card 2003
January	
February	$67.40
March	$91.70
April	$211.09
May	$164.18
June	$42.70
July	$41.51
August	$112.55
September	$29.60
October	
November	
December	
Total	$760.73

Amounts should be removed from Transportation Expense allocated between the divisions as follows:

650.061	750.062	650.063	750.064
$108.99	$108.99	$280.25	$280.25

Disclosure No. 11

Subject: Taxes Other Than Income

Statement of Fact: The utility did not take all available discounts on its real estate and personal property taxes. Also, its allocation methods for regulatory assessment fees, real estate and personal property taxes among its four divisions are different from the method we used.

Recommendation: The utility allocates its real estate taxes based on land values per books. Because the tax paid on each particular piece of property is known, and we know to which system each piece of property applies, we allocated real estate taxes to the system where the particular piece of property is located.

The utility allocated the tangible personal property taxes based on plant balances. In past audits of this utility, we have allocated tangible personal property taxes based on plant balances less land and transportation equipment, net of accumulated depreciation.

For regulatory assessment fees, we simply took the revenues per books per system and multiplied them by the regulatory assessment fee of 4.5%. Adjustments should be made as follows:

Aloha Gardens Water	Account No.	PER G/L	PER AUDIT	ADJUST
Regulatory Assessment Fees	408.10	23,169	23,266	97
Property Taxes- Real Estate	408.11	236	3,655	3,418
Tangible Personal Prop Tax	408.13	6,041	3,667	(2,374)
Total Taxes Other Than Income:		**29,446**	**30,588**	**1,141**

Aloha Gardens Wastewater	Account No.	PER G/L	PER AUDIT	ADJUST
Regulatory Assessment Fees	408.10	45,320	45,418	98
Property Taxes- Real Estate	408.11	79	3,555	3,477
Tangible Personal Prop Tax	408.13	8,445	10,706	2,261
Total Taxes Other Than Income:		**53,844**	**59,679**	**5,836**

Seven Springs Water	Account No.	PER G/L	PER AUDIT	ADJUST
Regulatory Assessment Fees	408.10	78,422	77,671	(750)
Property Taxes- Real Estate	408.11	875	1,900	1,025
Tangible Personal Prop Tax	408.13	115,440	119,535	4,095
Total Taxes Other Than Income:		**194,736**	**199,106**	**4,370**

Disclosure No. 12

Subject: Aloha Gardens Purchased Water

Statement of Fact: The purchased water expense in Aloha Gardens decreased from $232,923 in 1998 to $156,376 in 1999, a decrease of $76,574.

Recommendation: Aloha Gardens has two sources of water- water pumped from its own wells and water purchased from Pasco County. The utility believes that it received more water than it was billed for from Pasco County in 1999. It believes that this can be explained by a faulty Pasco County meter incorrectly tabulating the gallons of water flowing into the Aloha Gardens system. The utility believes that this is a potential liability and that the under reporting of purchased water expense skews its earnings picture in 1999 for the Aloha Gardens Water System.

1,000s of gallons of water per 1999 annual report:	
Total water sold to customers:	151,731
Total water pumped and purchased:	116,130
Excess Water Sold:	35,601
1999 cost per 1000 gallons	$2.07
	$ 73,694

We note that in the utility's audited financial statements for 1999, there was no liability booked for this contingency, nor was there any mention of this contingency in the footnotes of the financial statements. However, the utility did address this issue in its 1999 annual report filed with the PSC on page W-2 (a) (GROUP 1).

Disclosure No. 13

Subject: Customer Deposits

Statement of Facts: Customer deposits per the company's books total $458,716 at December 31, 1999. Included in this amount are certain deposits totaling $41,782 which relate to the nonregulated related company street light and garbage customers. This money was collected when a new customer initiated service, the money was transfered to the related company but the deposit amount was not reduced. Instead a related party account receivable was recorded.

Recommendation: An adjustment needs to be made reducing both Customer Deposits and Accounts Receivable - Tahitian Development by $41,782 at December 31, 1999. Since the company did not record these deposits and corresponding receivable until December 1999, the thirteen month average correcting adjustment will be $3,214 ($41,782/13).

Disclosure No. 14

Subject: Deferred Taxes and Contributed Taxes

Statement of Facts:
The utility has the following accounts listed in its general ledger:

ACCT. NO.	TITLE	G/L BAL. 12-31-98	G/L BAL. 12-31-99	13 MONTH AVERAGE
190-00-0	Def. Tax Asset MF SIT	5,783	7,306	
191-00-0	Def.Tax Asset MF FIT	33,511	42,409	
	Sub Total	39,294	49,715	40,096
193-00-0	Def.Tax Asset CIAC SIT	319,776	307,093	
194-00-0	Def.Tax Asset CIAC FIT	1,868,076	1,793,987	
		2,187,852	2,101,080	2,203,971
	Total Def. Tax Assets	2,227,146	2,150,795	2,221,273
245-00-0	Def.Tax Liability SIT	(3,475)	(3,475)	
246-00-0	Def.Tax Liability FIT	(20,313)	(20,313)	
247-00-0	Def.Tax Liab.Depr. SIT	(57,402)	(69,839)	
248-00-0	Def.Tax Liab.Depr. FIT	(399,664)	(472,306)	
	Total Def. Tax Liability	(480,854)	(565,933)	(487,399)
254-00-0	Contributed Taxes	(2,720,755)	(2,720,755)	
255-10-0	Amort. Of Contr. Taxes	312,320	380,339	
	Net Contributed Tax	(2,476,454)	(2,340,416)	(2,418,898)

Rule 25-30.433(3) Florida Administrative Code says that debit deferred taxes shall be offset against credit deferred taxes in the capital structure. Any resulting net debit deferred tax should be included in rate base and any net credit deferred taxes should be included in the capital structure calculation.

FPSC Order No. 23541, issued October 1, 1990 regarding regulatory treatment of contributions-in - aid-of-construction (CIAC) with gross-up states, "... we still believe that full normalization accounting should be utilized. This would result in consistent treatment between utilities that are not grossing-up and those that are." The Order goes on to state: "As discussed above, normalization involves offsetting debit-deferred taxes against credit-deferred taxes in the capital structure with any net debit-deferred balance included in rate base."

FPSC Order No. 11487, issued January 5, 1983 states: " ... the utility has also reduced CIAC by the amount of income taxes paid on connection fees, which were included as income for tax purposes. We believe that connection and tap fees should be considered CIAC, not revenue. Therefore, we have increased CIAC for the water system by $26,690 and $26,199 for the sewer system."

Disclosure No. 14 (continued)

Recommendation: In the previous rate case audit of the Seven Springs Wastewater division we analyzed the above accounts to determine the appropriate regulatory treatment. We presented several alternative methods. After reading the above orders and further review of the issues it is clear as to the proper accounting treatment of these accounts for regulatory purposes. First, all contributions-in-aid-of-construction, whether grossed-up for tax or not, should be treated consistently. Among other things, this means that both should be included in a utility's rate base even if income taxes were paid on them. Second, that deferred tax assets are to be offset against deferred tax credits in the utility's capital structure with any net debit being included in rate base. In Aloha's case, no distinction is made for deferred taxes relating to meter fees received that were not grossed-up and deferred taxes relating to plant capacity charges that were grossed-up.

The utility seems to think that this treatment should not apply and that it does not have to include CIAC grossed up for taxes in its rate base because its deferred tax assets are less than its net contributed taxes. We believe that Order 11487 is very clear and that all contibutions received should be considered CIAC and included in rate base even if taxes were paid in the year received.

The following adjustment to rate base needs to be made:

	TOTAL	AG-W	AG-WW	SS-W	SS-WW
CIAC Grossed Up	$(2,720,755)			$(1,175,890)	$(1,544,865)
Amort. of CIAC	380,339			164,022	216,317
Net CIAC Grossed Up	(2,340,416)			(1,011,868)	(1,328,548)
				43%	57%
Deferred Tax Assets	2,150,795				
Deferred Tax Liabilities	(565,933)				
Net Deferred Tax Assets	1,584,862*			681,491	903,371
Net Reduction to Rate Base	$ (755,554)			$(330,377)	$(425,177)

* We have allocated the net deferred tax assets on the same basis that grossed-up CIAC was received.

ALOHA UTILITIES, INC.
DOCKET 000737-WS
EARNINGS INVESTIGATION
ALOHA GARDENS WATER NET OPERATING INCOME
TEST YEAR ENDED 12/31/99

EXHIBIT 2
P 1 of 3

Aloha Gardens Water-Twelve months ended 12/31/99.

Component	Balance per Books	Ref	Audit Adjustments	Balance per Audit
Revenue	517,032		0	517,032
O&M Expense		Disc 4	(15,227)	
		Disc 7	(8,843)	
		Disc 8	2,174	
		Disc 9	(1,251)	
		Disc 10	(109)	
O&M Expense	354,162		(23,256)	330,906
Net Depreciation Exp		Disc 1	(122)	
		Disc 3	1,128	
Depreciation Expense	25,085		1,006	26,091
Depreciation Expense	(12,928)		0	(12,928)
Taxes Other		Disc 7	(537)	
		Disc 11	1,141	
Taxes Other	36,364		604	36,969
Income Tax	6,209		0	6,209
Operating Expenses	408,892		(21,645)	387,247
Net Operating Income	108,140		21,645	129,785

ALOHA UTILITIES, INC.
DOCKET 000737-WS
EARNINGS INVESTIGATION
ALOHA GARDENS WASTEWATER NET OPERATING INCOME
TEST YEAR ENDED 12/31/99

EXHIBIT 2
P 2 of 3

Aloha Gardens Wastewater-Twelve months ended 12/31/99.

Component	Balance per Books	Ref	Audit Adjustments	Balance per Audit
Revenue	1,009,284		0	1,009,284
O&M Expense		Disc 6	(3,816)	
		Disc 7	(8,963)	
		Disc 8	2,174	
		Disc 9	(1,251)	
		Disc 10	(109)	
O&M Expense	782,268		(11,965)	770,303
Depreciation Expense		Disc 1	(87)	
		Disc 3	593	
		Disc 6	106	
Depreciation Expense	40,108		612	40,720
Amortization of CIAC	(9,092)		0	(9,092)
Taxes Other	0	Disc 7	(497)	0
	0	Disc 11	5,836	0
Taxes Other	59,151		5,339	64,489
Income Tax	6,209		0	6,209
Operating Expenses	878,644		(6,014)	872,630
Net Operating Income	130,640		6,014	136,654

ALOHA UTILITIES, INC.
DOCKET 000737-WS
EARNINGS INVESTIGATION
SEVEN SPRINGS WATER NET OPERATING INCOME
TEST YEAR ENDED 12/31/99

EXHIBIT 2
P 3 of 3

Seven Springs Water-Twelve months ended 12/31/99.

Component	Balance per Books	Ref	Audit Adjustments	Balance per Audit
Revenue	1,726,029		0	1,726,029
O&M Expense		Disc 4	15,227	
		Disc 5	(1,102)	
		Disc 7	(21,829)	
		Disc 8	(2,174)	
		Disc 9	(3,217)	
		Disc 10	(280)	
O&M Expense	1,289,953		(13,375)	1,276,577
Depreciation Expense		Disc 1	(3,077)	
		Disc 3	3,142	
Depreciation Expense	244,228		65	244,293
Amortization of CIAC	(173,944)		0	(173,944)
Amort of Cont Taxes	(29,397)		0	(29,397)
Taxes Other		Disc 6	(1,452)	
		Disc 10	4,370	
Taxes Other	223,698		2,918	226,616
Income Tax	15,966		0	15,966
Operating Expenses	1,570,504		(10,393)	1,560,111
Net Operating Income	155,526		10,393	165,918

ALOHA UTILITIES, INC.

EXHIBIT 1

DOCKET 000737-WS

P 1 of 3

EARNINGS INVESTIGATION

ALOHA GARDENS WATER 13 MONTH AVERAGE RATE BASE

TEST YEAR ENDED 12/31/99

Aloha Gardens Water-Twelve months ended 12/31/99.

Component	Per G/L 12/31/99	Ref	Audit Adjustments	Per Audit 12/31/99	Per Audit 13 Month Ave
Plant in Service	887,852	D1	(3,669)	884,183	880,347
Land	5,000		0	5,000	5,000
Const Work in Progres	0		0	0	0
Accum Depr of Plant	(763,201)	D1	1,125		
		D3	(1,416)	(763,492)	(765,918)
CIAC	(438,245)		0	(438,245)	(438,245)
Amort of CIAC	295,628		0	295,628	289,164
Working Capital	53,358		0	53,358	53,358
Total	40,392		(3,960)	36,432	23,706

ALOHA UTILITIES, INC. EXHIBIT 1

DOCKET 000737-WS P 2 of 3

EARNINGS INVESTIGATION

ALOHA GARDENS WASTEWATER 13 MONTH AVERAGE RATE BASE

TEST YEAR ENDED 12/31/99

Aloha Gardens Wastewater-Twelve months ended 12/31/99.

Component	Per G/L 12/31/99	Ref	Audit Adjustments	Per Audit 12/31/99	Per Audit 13 Month Ave
Plant in Service	1,356,359	D1	(1,567)		
		D6	3,816	1,358,608	1,346,570
Land	3,220	D2	3,030	6,250	6,250
Const Work in Progres	0		0	0	0
Accum Depr of Plant	(828,390)	D1	960		
		D3	(758)		
		D6	(106)	(828,294)	(829,960)
CIAC	(324,586)		0	(324,586)	(324,586)
Amort of CIAC	179,700		0	179,700	175,154
Working Capital	124,210		0	124,210	124,210
Total	510,513		5,375	515,888	497,638

ALOHA UTILITIES, INC. EXHIBIT 1

DOCKET 000737-WS P 3 of 3

EARNINGS INVESTIGATION

SEVEN SPRINGS WATER 13 MONTH AVERAGE RATE BASE

TEST YEAR ENDED 12/31/99

Seven Springs Water-Twelve months ended 12/31/99.

Component	Per G/L 12/31/99	Ref	Audit Adjustments	Per Audit 12/31/99	Per Audit 13 Month Ave
Plant in Service	8,495,644	D1	(99,794)	8,395,850	7,604,873
Land	21,563		0	21,563	21,563
Const Work in Progress	0		0	0	0
Accum Depr of Plant	(1,919,680)	D1	31,602		
		D3	(4,273)	(1,892,351)	(1,709,245)
CIAC	(7,029,510)		0	(7,029,510)	(6,453,513)
Amort of CIAC	1,596,018		0	1,596,018	1,676,291
Contributed Taxes, net	0	D14	(1,011,868)	(1,011,868)	(1,026,572)
Working Capital	205,846		0	205,846	205,846
Deferred Tax Assets	0	D14	685,208	685,208	720,104
Total	1,369,881		(399,125)	970,756	1,039,347

ALOHA UTILITIES, INC. EXHIBIT 3

DOCKET # 000737-WS

EARNINGS INVESTIGATION

CAPITAL STRUCTURE

AS OF DECEMBER. 31, 1999

DESCRIPTION	(b) BALANCE PER BOOKS @12/31/99	REF	(d) AUDIT ADJUST-MENTS	(e) BALANCE PER AUDIT @12/31/99	(f) 13 MONTH AVERAGE PER AUDIT	(g) RATIO	(h) COST RATE @12/31/99	(i) WTD AVG COST OF CAPITAL
COMMON STOCK	500		0	500	500			
PD IN CAPITAL	41,600		0	41,600	41,600			
RETAINED EARN.	1,820,174		0	1,820,174	1,695,773			
COMMON EQUITY (A)	1,862,274		0	1,862,274	1,737,873	27.07%	10.12%	2.74%
PREFERRED STOCK (B)	600,000		0	600,000	600,000	9.35%	10.12%	0.95%
FIRST UNION : 597938	0		0	0	113	0.00%	9.38%	0.00%
FIRST UNION: 612350	0		0	0	226	0.00%	9.21%	0.00%
NOTE PAYABLE: F150	13385			13,385	7,840	0.12%	4.90%	0.01%
NOTE PAYABLE: F150	12809			12,809	7,503	0.12%	4.90%	0.01%
NOTE PAYABLE: F150	12807			12,807	7,503	0.12%	4.90%	0.01%
NOTE PAYABLE: F150	12,809			12,809	7,503	0.12%	4.90%	0.01%
NOTE PAYABLE: EXPEDITIO	16,408			16,408	9,531	0.15%	9.25%	0.01%
L. SPEAR LINE OF CREDIT	3,009,185		0	3,009,185	3,018,496	47.02%	10.50%	4.94%
L. SPEAR N/P DOT (C)	546,606		0	546,606	548,314	8.54%	10.50%	0.90%
NOTE- SPEER	0		0	0	61,538	0.96%	0.00%	0.00%
N/P NATIONS BANK (D)	224,828		0	224,828	86,472	1.35%	7.93%	0.11%
TOTAL LONG TERM DEBT	3,848,837			3,848,837	3,755,039	58.50%		5.98%
CUSTOMER DEPOSITS	458,716	D 13	(41,782)	416,934	326,034	5.08%	6.00%	0.30%
TOTAL	6,769,827		(41,782)	6,728,045	6,418,946	100%		9.97%

NOTES:
(A) Cost rate of Common Equity is taken from PSC Order 99-1917-PAA-WS.

(B) Cost of Pref Stock was determined to be same as cost rate of other equity in PSC Order 92-0578-FOF-SU.

(C) Used Prime + 2% for the notes from L. Spear per PSC Order 97-0280-FOF-WS, Actual notes are Prime + 3%.

(D) Interest rate is LIBOR plus 1.75%

DOCKET NO. 991643-SU: Petition for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.

WITNESS: **Direct Testimony Of James A. McPherson,** Appearing On Behalf Of Staff

EXHIBIT: JAM-2

ALOHA UTILITIES, INC.
AUDIT CALCULATION OF DEFERRED ASSETS AND
DEFERRED TAX LIABILITIES
HISTORICAL TEST YEAR ENDED SEPTEMBER 30, 1999

Step 1: Allocate the Contributed Tax CIAC and its associated amortization to the specific division per the utility's schedule.

	13 Month Average Balance	Seven Springs Water	Seven Springs Wastewater
Contributed Taxes	($2,720,755)	($1,175,890)	($1,544,865)
Amortization	$301,857	$130,176	$171,681
Net Contributed Taxes	($2,418,898)	($1,045,714)	($1,373,184)
		43.231%	56.769%

Step 2: Deferred Tax Assets should be netted against Deferred Tax Liabilities in the utility's capital structure.

	Total Company	Seven Springs Water	Seven Springs Wastewater
Deferred Tax Assets	$2,242,610		
Deferred Tax Liabilities[1]	($475,501)		
Net Deferred Assets	$1,767,109		
Step 3: Allocate the Net Deferred Tax Assets to the divisions on the same basis as Step 1.		43.231%	56.769%
		$763,939	$1,003,170

[1] The deferred tax liabilities are included in the MFR capital structure schedule.

DOCKET NO. 991643-SU: Petition for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.

WITNESS: **Direct Testimony Of James A. McPherson**, Appearing On Behalf Of Staff

EXHIBIT: JAM-3

COMPARISON OF CIAC GROSSED-UP VS. NOT GROSSED-UP

Consider two companies, "A" and "B". These two companies are almost exactly alike. They are the same size, have identical rate base, income, and expenses. They pay the same amount of income taxes. The only differences are that Company A was authorized to collect a capacity fee of $150 per new connection and Company B was only authorized to collect $100. However, Company B requested approval to gross-up its CIAC and Company A did not. Both companies have income tax rates of 33.34%. Both companies use an accelerated depreciation for tax purposes. The third column contrasts Aloha's treatment of contributed taxes.

	Company A	Company B
Authorized Capacity Fee	$150	$100
Gross-Up for Taxes	$0	$50
Total CIAC Received	$150	$150
Income Tax Payable (33.34% rate)	$50	$50
Deferred Tax Asset (Debit) related to CIAC	$50	$50
Deferred Tax Liabilities (Credits) from other sources such as accelerated depreciation	$15	$15
Net Deferred Taxes	$35	$35

Question: How much does Company A record as CIAC? Can it offset the CIAC with the amount of Income Tax it paid?

Answer: It must record the entire amount received as CIAC ($150). It cannot reduce this amount by the amount of income tax paid (PSC Order No. 11487).

Question: What happens to the Deferred Tax Assets and Deferred Tax Liabilities?

Answer: According to Rule 25-30.433(3), Florida Administrative Code, and Order No. 23541, they are to be netted in the company's capital structure schedule with any net "debit" included in the company's rate base.

Question: Should Company B be treated differently?

Answer: No, it should receive the same regulatory treatment as Company A (PSC Order No. 23541). Therefore, the entire $150 of CIAC collected should be included in rate base and the deferred taxes netted in the company's capital structure.