

State of Florida



Public Service Commission

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

DATE: October 4, 2000
TO: Division of Economic Regulation (Binford)
FROM: Division of Regulatory Oversight (Vandiver)
RE: 000295-WU; Placid Lakes Utilities, Inc.
Audit Report - Rate Case
Audit Control No. 00-188-3-1 (Talla.)

A handwritten signature in dark ink, appearing to be "W".

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, they should send it to the Division of Records and Reporting. There are no confidential work papers associated with this audit.

DNV/sp

Attachment

cc: Division of Regulatory Oversight (Hoppe/Harvey/File Folder)
Tallahassee District Office (Hicks)
Orlando District Office (Winston)
✓ Division of Records and Reporting
Division of Legal Services

Roland Tobler
Placid Lakes Utilities, Inc.
2000 Jefferson Avenue, North
Lake Placid, FL 33852-9749

APP
CAF
DIP
COM
STR
EOR
LEG
OPG
PAI
RGO
SEQ
SER
OTH

A vertical bar chart with 13 bars of varying heights, corresponding to the list of departments on the left. The bars for "CAF", "COM", "STR", "EOR", "LEG", "OPG", "PAI", "RGO", "SEQ", and "SER" are significantly taller than the others, indicating they are the primary recipients or related departments.

DOCUMENT NUMBER-DATE

12663 OCT-58

FPSC-RECORDS/REPORTING



FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF REGULATORY OVERSIGHT
BUREAU OF AUDITING SERVICES*

Tallahassee District Office

PLACID LAKES UTILITIES, INC. (WU193)

RATE CASE AUDIT

HISTORICAL TEST YEAR ENDED DECEMBER 31, 1999

DOCKET NO. 000295-WU
AUDIT CONTROL NO. 00-188-3-1

Edward D. Bass II

Edward Bass II, Audit Manager

Mike Buckley

Mike Buckley, Audit Staff

Rhonda L. Hicks

Rhonda Hicks, Audit Supervisor

DOCUMENT NUMBER-DATE

12663 OCT-58

FPSC-RECORDS/REPORTING

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**DIVISION OF REGULATORY OVERSIGHT
AUDITOR'S REPORT**

August 31, 2000

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure, for the historical test year ended December 31, 1999, for Placid Lakes Utilities, Inc. The attached schedules were prepared by the audit staff as part of our work in Docket No. 000295-WU.

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 does not maintain regulated books and records; utility capitalized interest to plant in service without prior Commission approval; contributions in aid of construction (CIAC) is overstated; amortization expense is overstated and accumulated amortization of CIAC is understated; depreciation expense and accumulated depreciation are overstated; operating revenue is understated; utility owes additional regulatory assessment fee (RAF) for 1999; operation and maintenance (O&M) expense is overstated; taxes other than income is understated; utility has several large outstanding loans with its parent company.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report.

Scanned - The documents or accounts were read quickly looking for obvious errors.

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

Verify - The item was tested for accuracy and compared to the substantiating documentation.

RATE BASE: Obtained work papers for selected rate base components; verified that the beginning amounts of the rate base components are computed correctly and consistent with the utility's last rate case; compiled rate base components and adjustments; traced a judgmental sample of plant additions to supporting invoices; calculated working capital using one-eighth of O&M expense; recomputed amortization of contributions in aid of construction (CIAC); recomputed accumulated depreciation.

NET OPERATING INCOME: Scheduled net operating income for the test year; recalculated operating revenues; recalculated a judgmental sample of customer bills for the correct tariff rate; compiled operation and maintenance (O&M) expense for the historical year ended December 31, 1999; scanned and verified the components and the allocation methods used to calculate the management fee; scheduled rate case expense as available during the audit; recalculated depreciation expense for the periods ended 1995 through 1999; recomputed taxes other than income; scanned the 1998 and 1999 consolidated federal income tax returns.

CAPITAL STRUCTURE: Compiled equity and liability account balances as of December 31, 1999 for the utility's parent, Lake Placid Holding (LPH) Company, Inc. Computed the weighted average cost of capital; scanned advances from associated companies.

OTHER: Scanned LPH board of directors' minutes for the twelve-month period ended December 31, 1999; Toured the utility's water plant and warehouse facility.

EXCEPTIONS

Exception No. 1

Subject: NARUC - Uniform System of Accounts

Statement of Fact: Commission Rule 25-30.115, F.A.C. requires water utilities to maintain their accounts and records in conformity with the National Association of Regulatory Utility Commissioners (NARUC) - Uniform System of Accounts.

The utility does not maintain its books and records using the account numbers and descriptions in accordance with the NARUC - Uniform System of Accounts. In addition, the utility does not maintain its accounting records on the accrual basis of accounting

Recommendation: The utility should be required to maintain its books and records using the account numbers and descriptions in accordance with Commission Rule 25-30.115, F.A.C., NARUC - Uniform System of Accounts. Also, the utility should maintain its accounting records on the accrual method.

Exception No. 2

Subject: Allowance for Funds Used During Construction (AFUDC)

Statement of Fact: Commission Rule 25-30.116 (5), F.A.C. states, "no utility may charge or change its AFUDC rate without prior Commission approval."

During 1997 the utility acquired a loan from its parent company, Lake Placid Holding Company, Inc., for the construction of its plant expansion. The utility capitalized the interest on the construction related to the plant expansion loan. The interest rate used was based on the prime rate plus 1%. The total interest capitalized to plant in service was \$45,333. Of this amount, \$12,671 was charged to Account 307 - Wells and Springs, \$12,671 was charged to Account 311 - Pumping Equipment, \$12,671 was charged to Account 330 - Distribution Reservoirs and Standpipes, and \$7,320 was charged to Account 331 - Transmission and Distribution Mains. The Commission has not authorized an AFUDC rate for this company.

Recommendation: Since there is not a commission order authorizing AFUDC, the utility should make the following adjustments to its plant in service accounts.

Account	Debit	Credit
435 - Retained Earnings	\$45,333	
307 - Wells and Springs		\$12,671
311 - Pumping Equipment		\$12,671
330 - Distribution Reservoirs and Standpipes		\$12,671
331 - Transmission and Distribution Mains		\$7,320

In addition, the utility should make the following adjustments to accumulated depreciation and its 1999 depreciation expense.

Account	Debit	Credit
108 - Accumulated Depreciation	\$4,632	
403 - Depreciation Expense		\$1,544
435 - Retained Earnings		\$3,088

These adjustments to accumulated depreciation and depreciation expense are included in Disclosure No. 3. In addition, the audit staff's rate base and net operating income schedules reflect these adjustments.

DISCLOSURES

Disclosure No. 1

Subject: Contributions In Aid of Construction (CIAC)

Statement of Fact: The utility had the following Account 271 - Contributions In Aid of Construction (CIAC) balance per the general ledger and Minimum Filing Requirement (MFR) for the period ended December 31, 1999.

Account 271 - CIAC	Amount
General Ledger	\$1,010,604
MFR (Schedule A-12, page 14)	\$1,010,604

Recommendation: The audit staff recalculated CIAC based on the utility's supporting documentation of its CIAC. The audit staff's calculation of CIAC reflects an amount of \$1,006,582 for the period ended December 31, 1999. The utility's MFR Account 271 - CIAC should be decreased by \$4,022 (\$1,010,604 - 1,006,582). The utility's consultant calculated CIAC based on the company's annual reports. The utility made adjustments to the general ledger as of December 31, 1999 to agree the general ledger to the MFRs. Using the utility's supporting documentation the audit staff's calculation results in a CIAC audit difference of \$4,022 for the period ended December 31, 1999.

Disclosure No. 2

Subject: Amortization Expense and Accumulated Amortization of CIAC

Statement of Fact: As of December 31, 1999 the utility had the following balances in Account 407 - Amortization Expense and Account 272 - Accumulated Amortization of CIAC. The utility calculates amortization expense using a composite rate.

	407 - Amortization Expense	272 - Accumulated Amortization of CIAC
General Ledger	\$0	\$405,137
MFR (Schedule B-13 and A-13)	\$32,211	\$405,016

Recommendation: The audit staff recalculated amortization expense to be \$31,184 and accumulated amortization of CIAC to be \$405,540 using a composite rate. The utility's MFR Account 407 - Amortization Expense should be decreased by \$1,027 (\$32,211 - \$31,184), and Account 272 - Accumulated Amortization of CIAC should be increased by \$524 (\$405,016 - \$405,540). These audit differences are related to the audit staff's calculation of CIAC. See Disclosure No. 1. Also included in this difference is the audit staff's calculation of the annual composite rate.

Disclosure No. 3

Subject: Depreciation Expense and Accumulated Depreciation

Statement of Fact: As of December 31, 1999 the utility had the following balances in Account 403 - Depreciation Expense and Account 108 - Accumulated Depreciation. The utility used depreciation rates established in Commission Rule 25-30.140 (2) (a), F.A.C.

	403 - Depreciation Expense	108 - Accumulated Depreciation
General Ledger	\$42,682	\$583,685
MFR (Schedule B-13 and A-8)	\$58,842	\$583,896

Recommendation: The audit staff recalculated depreciation expense to be \$57,024 and accumulated depreciation to be \$578,325 using the rates established in Commission Rule 25-30.140 (2) (a), F.A.C. The utility's MFR Account 403 - Depreciation Expense should be decreased by \$1,818 (\$58,842 - \$57,024), and Account 108 - Accumulated Depreciation should be decreased by \$5,571 (\$583,896 - \$578,325). These audit differences are related to the audit staff's calculation of plant in service, and include the adjustments in Exception No. 2.

The audit staff's calculation of depreciation expense, net of amortization expense - CIAC and non-used and useful depreciation is as follows:

Description	Per Audit
Depreciation Expense	\$57,024
Amortization Expense - CIAC (Disclosure No. 2)	(31,184)
Non-Used and Useful Depreciation (MFR Sch. B-13, Pg 37)	(3,475)
Total	\$22,365

The audit staff's depreciation calculation reflects an amount of \$22,365 for the historical test year ended December 31, 1999. The utility's MFR schedule B-1, page 22 reflects depreciation expense of \$23,428. This results in a difference of \$1,063 (\$23,428 - \$22,365) which consists of audit differences and averaging adjustments.

Disclosure No. 4

Subject: Operating Revenue

Statement of Fact: The utility had the following Account 400 - Operating Revenue balance per the general ledger and Minimum Filing Requirement (MFR) for the period ended December 31, 1999.

Account 400 - Operating Revenue	Amount
General Ledger	\$246,460
MFR (Schedule B-1, page 22)	\$248,692

Recommendation: The audit staff recalculated water revenues based on the utility's billing register, meter size reports, and miscellaneous service revenue ledger. The auditor's calculation of operating revenue reflects an amount of \$250,832 for the period ended December 31, 1999. The utility's MFR Account 400 - Operating Revenue should be increased by \$2,140 (\$250,832 - \$248,692). This audit difference is based on the audit staff's calculation of operating revenues for the period ended December 31, 1999.

Disclosure No. 5

Subject: Regulatory Assessment Fee (RAF)

Statement of Fact: The utility's 1999 RAF return reflects total water operating revenue of \$262,966. This results in RAF due of \$11,833. The utility applied an adjustment for over payment of its 1998 RAF return to its 1999 RAF due. The utility did not file an amended return for the over payment of its 1998 RAF. The utility paid \$10,273 in RAF for the period ended December 31, 1999.

Recommendation: The audit staff recalculated water revenues based on the utility's billing register, meter size reports, and miscellaneous service revenue ledger. The audit staff's calculation of total water operating revenue reflects an amount of \$266,171 for the period ended December 31, 1999. This yields a total RAF due of \$11,978 ($\$266,171 \times .045$) for the period ended December 31, 1999. This results in an additional RAF of \$1,705 ($\$11,978 - \$10,273$) owed by the utility.

The utility should file an amended 1998 RAF return for the over payment of its 1998 RAF, and request a refund or an approved prior-period credit to be applied towards a future RAF return.

Disclosure No. 6

Subject: Operation and Maintenance (O&M) Expense

Statement of Fact: The utility's Minimum Filing Requirement (MFR) schedule B-5, page 30 reflects O&M expense of \$304,110, as of December 31, 1999. Of this amount, \$40,915 is related to rate case expense. This \$40,915 is made up of projected rate case amortization in the amount of \$38,574, and \$2,341 in management fee for additional time spent on the rate case by an employee of the utility's parent company, Lake Placid Holding Company, Inc.

Recommendation: The audit staff's calculation of O&M expense reflects an amount of \$285,882 for the period ended December 31, 1999. This difference of \$18,228 (\$304,110 - \$285,882) consists of \$13,775 in rate case expense. See Disclosure No. 8 for the audit findings related to rate case expense.

Also included in this difference of \$18,228 are expenses in the amount of \$1,521 that relate to wastewater activities. This amount of \$1,521 consists of \$1,071 related to wastewater testing and monitoring, and \$450 related to examination fees for a wastewater D license. Since this is a water rate increase, wastewater expenses should not be included in water rates.

The remaining balance of \$2,932 (\$18,228 - \$13,775 - \$1,521) is made up of non-utility expenses, averaging adjustments, and estimated amounts. The utility should reduce its MFR O&M expense by \$18,228.

Disclosure No. 7

Subject: Annual Membership Dues

Statement of Fact: The utility incurred the following annual membership dues for the historical test year ended December 31, 1999.

Description	Amount
American Water Works Association	\$55.00
Florida Rural Water Association	\$292.10

Recommendation: This information is provided for informational purposes. The audit staff has provided copies of these invoices in the audit work papers. The analyst may want to review these invoices for lobbying activities that might be associated with these membership dues.

Disclosure No. 8

Subject: Rate Case Expense

Statement of Fact: The utility's Minimum Filing Requirement (MFR) O&M expense reflects rate case expense of \$40,915. This \$40,915 is made up of projected rate case amortization in the amount of \$38,574 and \$2,341 in management fee for additional time spent on the rate case by an employee of the utility's parent company, Lake Placid Holding Company, Inc.

The utility incurred the following expenses related to its filing for a rate increase as available during the audit.

Description	Projected (MFR)	Actual	Difference
Dorrell, Hancock & Carter, CPA's	\$5,000	\$13,775	(\$8,775)
Guastella Associates, Inc.	118,100	100,578	17,522
Rutledge, Ecenia, Purnell & Hoffman	27,000	5,265	21,735
FPSC Filing Fee	2,000	2,000	0
Allocation of Parent Company Employee's Salary	9,404	9,364	40
Other Miscellaneous - Customer Notices, etc.	2,195	0	2,195
Total	\$163,699	\$130,982	\$32,717

In October 1998, the utility hired Dorrell, Hancock & Carter, CPA's to begin work on the rate case. The utility released Dorrell, Hancock & Carter, CPA's due to the fact that it was unable to meet the demands of preparing the utility for its rate case.

In June 1999, the utility hired Guastella Associates, Inc. to prepare its MFR. The utility also hired Rutledge, Ecenia, Purnell & Hoffman to represent the utility during the rate case.

During 1999 an employee of the utility's parent company devoted additional time in preparing for the rate case. The utility allocated \$9,404 (25% x \$37,618) of the employee's base salary.

Recommendation: Because Dorrell, Hancock & Carter, CPA's were unable to meet the demands of preparing the utility for its rate case, the audit staff believes the ratepayers of Placid Lakes Utilities, Inc. should not have to bear this rate case expense. Disclosure No. 6 reflects an adjustment to operation and maintenance (O&M) expense in the amount of \$13,775.

Disclosure No. 9

Subject: Taxes Other Than Income

Statement of Fact: The utility's general ledger and Minimum Filing Requirement (MFR) reflects the following taxes other than income as of December 31, 1999.

Description	General Ledger	MFR (Sch. B-15, Pg 40)
Real Estate and Tangible Personal Property Taxes	\$12,838	\$12,209
Regulatory Assessment Fee (RAF)	12,070	11,191
Payroll Taxes	11,197	11,197
Total	\$36,105	\$34,597

Recommendation: Based on supporting documentation, the audit staff calculated taxes other than income for the period ended December 31, 1999. This calculation reflects an amount of \$36,013. This amount consists of \$12,838 in real estate and tangible personal property taxes, \$11,978 in RAF, and \$11,197 in payroll taxes. The utility's MFR for taxes other than income should be increased by \$1,416 (\$36,013 - \$34,597). This audit difference is related to the audit staff's calculation of additional RAF owed by the utility. See Disclosure No. 5. Also included in this difference are adjustments made by the utility to real estate and tangible personal property taxes for a plant in service increase and non-used and useful plant.

Disclosure No. 10

Subject: Income Tax Expense

Statement of Fact: In the last rate case, the utility was allowed income tax expense. However, the utility's general ledger does not reflect any income tax expense, as of December 31, 1999.

The utility had net operating losses for the historical periods ended December 31, 1998 and 1999 of \$37,937 and \$97,222, respectively.

Recommendation: The utility files income taxes as part of its parent company's consolidated tax return. During the test year, the parent company's general ledger does not reflect income tax expense. However, it may be appropriate to include income tax expense once the utility's level of earnings is determined.

Disclosure No. 11

Subject: Advances from Associated Companies

Statement of Fact: The utility's Minimum Filing Requirement (MFR) reflects \$1,707,915 in advances from associated companies. The utility's general ledger reflects the following loans payable and interest due its parent company, Lake Placid Holding (LPH) Company, Inc. as of December 31, 1999.

Account and Description	Principal and Interest
221 - LPH Loan - Intercompany	\$823,787
222 - LPH Loan - Plant Expansion	516,948
223 - LPH Loan - Line Extension	152,018
225 - LPH Loan - Operating Expense	198,528
226 - LPH Loan - Catfish Creek Line Extension	16,634
Total	\$1,707,915

The intercompany loan is the oldest loan on the books of the utility. The purpose for this loan was to assist the utility with operating expenses. There is no formal written loan agreement with regards to this loan. There is no interest expense associated with this loan.

The plant expansion loan is a formal written mortgage loan agreement between the utility and LPH. This loan was initiated in 1996 when the Florida Department of Environmental Protection (DEP) informed the utility that it was at plant capacity and could not accept any more customers unless the plant was expanded. The interest rate associated with this loan agreement is prime plus 1%. The utility collects a plant expansion fee of \$315 per connection. In addition, the utility received approval to collect an allowance for funds prudently invested (AFPI). The utility uses these fees to make payments on the plant expansion loan every month. Due to the slow growth of the subdivision, the loan payment does not provide sufficient funds to pay the interest on the loan, therefore, the loan principal balance is increasing.

The line extension loan and the operating loan is a written line of credit between the utility and LPH. The rate of interest on this line of credit is prime plus 1%. The purpose of this loan was for line extensions and other operating expenses of the utility. This loan is currently over \$511,000, of which \$323,000 was loaned for operating costs. The utility collects a line extension fee of \$299 per connection. The utility uses these fees to make payments on this line extension loan. The loan payment does not provide sufficient funds to pay the interest on the loan, therefore, the loan principal balance is increasing. There are no funds available to make any payments on the operating portion of this line of credit.

The catfish creek line extension loan is also part of the line of credit loan but is recorded separately to account for the monies used on this line extension. Customers on catfish creek contacted the Florida Public Service Commission to be added to the utility's service area. Several customers had contaminated wells and the DEP was providing funds to connect these customers to a potable water system. After collecting the DEP funds there were still additional costs that were not covered and the utility did not have the money to pay these bills, therefore, LPH agreed to loan the money to cover the additional costs of this line extension.

Recommendation: Although the audit staff has made no adjustment, it may be appropriate to transfer the amounts of the signed loan agreements to the utility's capital structure as long term notes payable.

Rate Base Exhibit

PLACID LAKES UTILITIES, INC.
 SCHEDULE OF WATER RATE BASE
 HISTORICAL TEST YEAR ENDED DECEMBER 31, 1999

Description	Test Year Per Utility's MFR Sch. A-1, Page 2	Audit Adjustments	Reference	Balance Per Audit	Average Balance
Plant in Service	\$1,860,086	(\$45,333)	E-2	\$1,814,753	\$1,790,236
Land	1,000	0		1,000	1,000
Less: Non-Used and Useful Plant	(103,265)	0	*	(103,265)	(103,265)
Less: Accumulated Depreciation	(583,896)	5,571	D-3	(578,325)	(553,166)
Less: CIAC	(1,010,604)	4,022	D-1	(1,006,582)	(980,624)
Accumulated Amortization of CIAC	405,016	524	D-2	405,540	389,948
Working Capital Allowance	38,014	(2,279)	**	35,735	35,735
<i>Rate Base</i>	<u>\$606,351</u>	<u>(\$37,495)</u>		<u>\$568,856</u>	<u>\$579,864</u>

D - Disclosure

E - Exception

* There were no audit procedures associated with the non-used and useful plant calculation.

** See audit work papers for working capital calculation.

Net Operating Income Exhibit

PLACID LAKES UTILITIES, INC.
 SCHEDULE OF WATER NET OPERATING INCOME (LOSS)
 HISTORICAL TEST YEAR ENDED DECEMBER 31, 1999

Description	Test Year Per Utility's MFR Sch. B-1, Page 22	Audit Adjustments	Reference	Balance Per Audit
Operating Revenues	\$248,692	\$2,140	D-4	\$250,832
Operating Expenses:				
Operation and Maintenance	304,110	(18,228)	D-6	285,882
Depreciation, net of CIAC Amort.	23,428	(1,063)	D-3	22,365
Taxes Other Than Income	34,598	1,416	D-9	36,014
Income Tax Expense	(42,870)	42,870	D-10	0
Total Operating Expenses	319,266	24,995		344,261
<i>Net Operating Income (Loss)</i>	<u>(\$70,574)</u>	<u>(\$22,855)</u>		<u>(\$93,429)</u>

D - Disclosure

Capital Structure Exhibit

PLACID LAKES UTILITIES, INC.
 SCHEDULE OF CAPITAL STRUCTURE
 HISTORICAL TEST YEAR ENDED DECEMBER 31, 1999

Description	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
	12/31/98	12/31/99	(a) + (b)/2 Beg/End Average	Pro Rata	(c) - (d) Reconcile to Avg. Rate Base	% of Total	Cost Rate	(f) x (g) Weighted Cost of Capital
Preferred Stock 7% Non-Cumulative	\$1,180,000	\$1,180,000	\$1,180,000	(\$1,057,149)	\$122,851	21.19%	7.00%	1.48%
Common Equity	4,284,043	4,495,300	4,389,672	(3,932,659)	457,013	78.81%	9.14%	7.20%
Total Capital Structure	\$5,464,043	\$5,675,300	\$5,569,672	(\$4,989,808)	\$579,864	100.00%		8.69%

Common Equity

Common Stock - Class A Voting	\$53,422	\$53,422
Common Stock - Class B Non-voting	49,500	49,500
Additional Paid-In-Capital	136,349	136,349
Retained Earnings	4,044,772	4,256,029
Total Common Equity	\$4,284,043	\$4,495,300

Notes:

1. Placid Lakes Utilities, Inc. is a wholly-owned subsidiary of Lake Placid Holding Company (LPHC), Inc. Therefore, the audit staff used LPHCs capital structure.
2. Audit staff verbally confirmed with utility bookkeeper that LPHC has no short or long term debt and customer deposits were refunded to the customers.
3. The audit staff used a simple beginning/ending test year average.
4. 1999 Leverage Formula (Order No. PSC-00-1162-PAA-WS, issued June 26, 2000)
 Return on common equity = 8.14% + .789/ER = 8.14% + .789/.7881 = 9.14%
 ER (Equity Ratio) = Common equity/Total capital structure
 Range of Returns on Equity = 8.93% - 10.12%