

State of Florida



Public Service Commission
-M-E-M-O-R-A-N-D-U-M-

DATE: February 12, 2003
TO: Division of Economic Regulation (Revell)
FROM: Division of Auditing and Safety (Vandiver) *W*
RE: Docket No. 020407-WS; Company Name: Cypress Lakes Utilities, Inc.; **Audit Purpose:** Compile and audit rate base, capital structure and net operating income for the approved historic test year ended December 31, 2002; **Audit Control No.** 02-350-3-2

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, it should send the response to the Division of the Commission Clerk and Administrative Services. The Division of Economic Regulation analysts have requested that the company response be filed no later than February 28, 2003.

There are no confidential work papers associated with this audit.

DNV/jcp
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
Division of the Commission Clerk and Administrative Services (2)
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

Carl J. Wenz, Vice President - Regulatory
Cypress Lakes Utilities, Inc.
200 Weathersfield Avenue
Altamonte Springs, FL 32714-4099

Mr. Martin Friedman, Esq.
Rose Law Firm
650 S. North Lake Blvd., Suite 420
Altamonte Springs, FL 32701

Mr. Donald Rasmussen
Cypress Lakes Utilities, Inc.
200 Weathersfield Avenue
Altamonte Springs, FL 32714-4099

DOCUMENT NUMBER CASE

01454 FEB 12 8

FPSC-COMMISSION CLERK

State of Florida



Public Service Commission

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

Date : February 10, 2003
TO : DENISE VANDIVER, CHIEF OF AUDITING
DIVISION OF AUDITING AND SAFETY, TALLAHASSEE
FROM : CHARLESTON J. WINSTON, AUDIT SUPERVISOR, ORLANDO DISTRICT
RE : COMPLETED AUDIT SUMMARY REPORT

Originator JayRevell

Company Cypress Lakes Utilities, Inc.

Control No. 02-350-3-2 Docket No. 020407-WS

Compile and audit the utility's water and wastewater rate base, capital structure, and net operating income for the test year ended December 31, 2001.

Auditors Assigned: Audit Hours:

Kathy Welch 41

Audit Manager: Jeffery Small 335

Audit Supervisor Hours: 11

Estimated Hours: 340 Total Hours: 387

Number of Work Paper Binders: 2

FOR THE FOLLOWING ITEMS USE ADDITIONAL PAPER AS NECESSARY - BE SPECIFIC

RECOMMENDATIONS FOR THE NEXT AUDIT:



FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

CYPRESS LAKES UTILITIES, INC.

FILE AND SUSPEND PETITION FOR RATE RELIEF

POLK COUNTY

HISTORICAL PERIOD ENDED DECEMBER 31, 2001

**DOCKET NO. 020407-WS
AUDIT CONTROL NO. 02-350-3-2**

A handwritten signature in black ink, appearing to read "Jeffery A. Small".

Jeffery A. Small, Audit Manager

A handwritten signature in black ink, appearing to read "Kathy L. Welch".

Kathy L. Welch, Audit Staff

A handwritten signature in black ink, appearing to read "Charleston J. Winston".

Charleston J. Winston, District Audit Supervisor

TABLE OF CONTENTS

| | PAGE |
|--|------|
| I. AUDITOR'S REPORT | |
| PURPOSE | 1 |
| DISCLAIM PUBLIC USE | 1 |
| SUMMARY OF SIGNIFICANT PROCEDURES | 2 |
| II. EXCEPTIONS | |
| 1. UTILITY-PLANT-IN-SERVICE | 4 |
| 2. UPIS-COMMON PLANT ALLOCATIONS FROM WSC AND UIF | 7 |
| 3. CIAC AND ACCUMULATED AMORTIZATION OF CIAC | 9 |
| 4. WORKING CAPITAL | 13 |
| 5. COST OF CAPITAL-PARENT | 14 |
| 6. OPERATION & MAINTENANCE EXPENSE (O&M) | 18 |
| 7. O&M EXPENSE - COMMON ALLOCATIONS | 19 |
| 8. O&M EXPENSE - ADJUSTMENTS TO TEST YEAR | 20 |
| 9. DEPRECIATION & AMORTIZATION OF CIAC EXPENSE | 22 |
| 10. TAXES OTHER THAN INCOME - RAFS | 23 |
| 11. TAXES OTHER THAN INCOME - ADJUSTMENTS TO TEST YEAR | 24 |
| 12. BOOKS AND RECORDS | 25 |
| III. EXHIBITS | |
| WATER RATE BASE | 26 |
| WASTEWATER RATE BASE | 27 |
| WATER NET OPERATING INCOME | 28 |
| WASTEWATER NET OPERATING INCOME | 29 |
| COST OF CAPITAL | 30 |

**DIVISION OF AUDITING AND SAFETY
AUDITOR'S REPORT**

FEBRUARY 6, 2003

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 12-month period ended December 31, 2001, for Cypress Lakes Utilities, Inc.'s water and wastewater operations located in Polk County, Florida. These schedules were prepared by the utility as part of its petition for rate relief in Docket No. 0200407-WS.

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's water and wastewater UPIS are overstated by \$86,964 and \$90,680, and its wastewater land is understated by \$2,610, respectively, as of December 31, 2001.

The utility's combined UPIS allocation from UIF and its net rate base allocation from WSC are understated by \$18,562 as of December 31, 2001.

The utility's water CIAC balance is understated by \$18,100 and its water and wastewater accumulated amortization of CIAC balances are understated by \$9,505 and \$16,270, respectively, as of December 31, 2001.

The utility's adjusted water and wastewater working capital balances are overstated by \$2,225 and \$2,264, respectively, as of December 31, 2001.

The utility's average weighted cost of debt is 8.41 percent as of December 31, 2001.

The utility's water and wastewater O&M expenses are overstated by \$1,100.77 and \$1,942.86, respectively, for the 12-month period ended December 31, 2001.

The utility's WSC water and wastewater allocated O&M expenses are overstated by \$1,523 and \$1,475, respectively for the 12-month period ended December 31, 2001.

The utility's adjustment to water and wastewater O&M expenses in the test year is overstated by \$11,699 and \$11,328, respectively, for the 12-month period ended December 31, 2001.

The utility's net water and wastewater depreciation expenses are overstated by \$3,853 and \$5,157, respectively, for the 12-month period ended December 31, 2001.

The utility's adjustment to water and wastewater taxes other than income expense in the test year is overstated by \$4,008 and \$3,881, respectively, for the 12-month period ended December 31, 2001.

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.

Reviewed - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers, and selective analytical review procedures were applied.

Examined - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers. Selective analytical review procedures were applied, and account balances were tested to the extent further described.

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

RATE BASE: Examined account balances for utility-plant-in-service (UPIS), land, plant-held-for-future-use (PHFU), contributions-in-aid-of-construction (CIAC), accumulated depreciation (AD), accumulated amortization of CIAC (AAC), and working capital (WC) for Cypress Lakes Utilities, Inc. as of December 31, 2001. Reconciled rate base balances authorized in Commission Orders Nos. PSC-98-0993-FOF-WS, issued July 20, 1998, and PSC-00-0264-FOF-WS, issued February 8, 2000, to the respective December 31, 2001 general ledger balance.

NET OPERATING INCOME: Compiled utility revenues and operating and maintenance accounts for the year ended December 31, 2001. Chose a judgmental sample of customer bills and recalculated using FPSC-approved rates. Chose a judgmental sample of operation and maintenance expenses (O&M) and examined the invoices for supporting documentation. Reviewed the allocation of O&M expenses from Water Service Corporation (WSC) and Utilities, Inc. of Florida (UIF) cost centers to Cypress Lakes Utilities, Inc. and verified the accuracy of company allocations based on company-provided allocation schedules. Tested the calculation of depreciation and CIAC amortization expense. Examined support for taxes other than income and income taxes.

CAPITAL STRUCTURE: Compiled the components of the capital structures for the year ended December 31, 2001. Agreed interest expense to the terms of the notes and the bonds. Reconciled note balances at December 31, 2001, to supporting documentation.

OTHER: Audited the utility's December 31, 2001, Regulatory Assessment Fee Returns.

Exception No. 1

Subject: Utility-Plant-In-Service (UPIS)

Statement of Fact: Utility records reflect the following additions to UPIS for the accounts and time periods indicated.

WATER UPIS ADDITIONS

| <u>Acct#</u> | <u>Account Description</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>Totals</u> |
|--------------|----------------------------|-----------------|-----------------|----------------|-------------|-----------------|
| 301 | Organization Cost | \$54,048 | \$26,153 | \$350 | \$0 | \$80,551 |
| 311 | Pumping Equipment | 0 | 0 | 794 | 0 | 794 |
| 344 | Laboratory Equipment | 0 | 0 | 303 | 0 | 303 |
| 343 | Tools & Shop Equipment | 0 | 5,316 | 0 | 0 | 5,316 |
| | Total Additions | <u>\$54,048</u> | <u>\$31,469</u> | <u>\$1,447</u> | <u>\$0</u> | <u>\$86,964</u> |

WASTEWATER UPIS ADDITIONS

| <u>Acct#</u> | <u>Account Description</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>Totals</u> |
|--------------|--------------------------------|-----------------|-----------------|----------------|-----------------|-----------------|
| 351 | Organization Cost | \$10,115 | \$0 | \$0 | \$0 | \$10,115 |
| 352 | Franchise Cost | 5,303 | 12,554 | 350 | 0 | 18,207 |
| 353 | Land & Land Rights | 0 | 0 | 0 | 0 | 0 |
| 380 | Treatment & Disposal Equipment | 0 | 0 | 4,945 | 54,913 | 59,858 |
| | Total Additions | <u>\$15,418</u> | <u>\$12,554</u> | <u>\$5,295</u> | <u>\$54,913</u> | <u>\$88,180</u> |

(The \$4,945 addition to Acct. No. 380 in 2000 includes two entries for \$2,600 and \$2,345.)

Commission Order PSC-98-0993-FOF-WS established a balance of \$2,500 in Account No. 103, Plant Held for Future Use as of December 31, 1997.

NARUC, Utility Plant Accounts, Accounts Nos. 301 and 351 should include all fees paid to federal or state governments for the privilege of incorporation and expenditures incident to organizing the corporation, partnership or other enterprise and putting it into readiness to do business.

NARUC, Utility Plant Accounts, Account No. 352 A. should include amounts paid to the federal government, to a state or to a political subdivision thereof in consideration of franchises, consents or certificates, running in perpetuity or for a specified term of more than one year.

NARUC, Utility Plant Accounts, Accounts No. 352 A. states that if a franchise is acquired by assignment, the charge to this account in respect thereof shall not exceed the amount paid therefore by the utility to the assignor, nor shall it exceed the amount paid by the original grantee, plus the expense of acquisition to such grantee. Any excess of the amount actually paid by the utility over the amount specified shall be charged to Account 426 - Miscellaneous Nonutility Expense.

Exception No. 1, continued

NARUC Accounting Instruction 2.A. states that each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of accounts so as to be able to furnish readily full information as to any item included in any account.

Rule 25-30.116 (5), Florida Administrative Code, (F.A.C.), states that no utility may charge or change its Allowance-For-Funds-Used-During-Construction (AFUDC) rate without prior Commission approval.

Commission Orders Nos. 25821, issued February 27, 1992, and PSC-94-0739-FOF-WS, issued June 16, 1994, determined that the purchased cost of utility systems is to be charged as acquisition adjustments, not as organization cost.

Recommendation: The utility's water and wastewater UPIS are overstated by \$86,964 and \$90,680, and its wastewater land is understated by \$2,610, respectively, as of December 31, 2001, based on the following audit staff determinations.

- 1) The additions of \$80,551, \$10,115 and \$18,207 to Accounts Nos. 301, 351, and 352, respectively, represent legal and consulting fees paid by the utility to purchase and secure the transfer of Cypress Lakes Utilities Commission water and wastewater certificates and should be removed per the NARUC rules and Commission Orders cited above.
- 2) Included in the \$10,115 addition to Account No 351 referenced above is a utility acquisition entry for \$2,610 that should have been recorded in Account No. 353, Land & Land Rights per Commission Order No. PSC-98-0993-FOF-WS.
- 3) The additions of \$794 to Account No. 311 and \$2,345, and \$54,913 to Account No. 380 represent AFUDC accruals on utility construction projects that should be removed because the utility does not have an approved AFUDC rate for Cypress Lakes Utilities, Inc. per the Commission rule cited above.
- 4) The additions of \$303, \$5,316, and \$2,600 to Accounts Nos. 344, 343, and 380, respectively, represent UPIS additions with no supporting documentation and should be removed per the NARUC rule cited above.
- 5) The utility combined the \$2,500 balance in PHFU, mentioned above, with Account No. 380 in its filing. The entire balance should be removed because the utility stated that the capital items represented by this balance had been discarded and never placed in service.

The Commission should require the utility to reduce its water UPIS by \$86,964 ($\$80,551 + \$794 + \$303 + 5,316$), reduce its wastewater UPIS by \$90,680 ($\$10,115 + \$18,207 + \$2,345 + \$54,913 + \$2,600 + \$2,500$) and increase its wastewater Land & Land Rights by \$2,610 as of December 31, 2001, per the audit staff findings discussed above.

The audit staff adjustments recommended above will require corresponding adjustments to the utility's accumulated depreciation balance as of December 31, 2001, and its depreciation expense balance for the 12-month period ended December 31, 2001. See the audit staff's calculations in Schedule A that follows.

Schedule A for Exception No. 1

| Water Accumulated Depreciation | | UPIS | Depreciation | | | | | |
|--|----------------------------|-------------------|--------------|----------------|------------------|------------------|------------------|------------------|
| <u>Acct.#</u> | <u>Account Description</u> | <u>Adjustment</u> | <u>Rate</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>Total</u> |
| 301 | Organization | (\$80,551) | 2.50% | (\$451) | (\$1,371) | (\$2,025) | (\$2,030) | (\$5,877) |
| 311 | Pumping Equipment | (794) | 5.00% | 0 | 0 | (20) | (40) | (60) |
| 340 | Laboratory Equipment | (303) | 6.67% | 0 | 0 | (10) | (20) | (30) |
| 343 | Tool & Shop Equipment | <u>(5,316)</u> | 6.25% | <u>0</u> | <u>(177)</u> | <u>(354)</u> | <u>(354)</u> | <u>(886)</u> |
| | Total UPIS Adjustment | <u>(\$86,964)</u> | | <u>(\$451)</u> | <u>(\$1,548)</u> | <u>(\$2,409)</u> | <u>(\$2,444)</u> | <u>(\$6,853)</u> |
| | | | (Note 1) | | | | (Note 2) | (Note 3) |
| W/Water Accumulated Depreciation | | UPIS | Depreciation | | | | | |
| <u>Acct.#</u> | <u>Account Description</u> | <u>Adjustment</u> | <u>Rate</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>Total</u> |
| 351 | Organization | (\$10,115) | 2.50% | (\$108) | (\$253) | (\$253) | (\$253) | (\$867) |
| 352 | Franchise | (18,207) | 2.50% | (1) | (165) | (536) | (542) | (1,244) |
| 380 | Treatment & Disposal | <u>(62,358)</u> | 5.56% | <u>0</u> | <u>0</u> | <u>(137)</u> | <u>(1,800)</u> | <u>(1,937)</u> |
| | Total UPIS Adjustment | (\$90,680) | | (\$109) | (\$418) | (\$926) | (\$2,595) | (\$4,048) |
| 353 | Land & Land Rights | <u>2,610</u> | 0.00% | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| | Total Net Adjustment | <u>\$88,071</u> | | <u>(\$109)</u> | <u>(\$418)</u> | <u>(\$926)</u> | <u>(\$2,595)</u> | <u>(\$4,048)</u> |
| | | | (Note 1) | | | | (Note 2) | (Note 3) |
| <u>Summary of Acct. No. 380 adjustment</u> | | | | | | | | |
| 380 | PHFU (Note 4) | (\$2,500) | 5.56% | \$0 | \$0 | \$0 | \$0 | \$0 |
| 380 | Treatment & Disposal | (4,945) | 5.56% | 0 | 0 | (137) | (275) | (412) |
| 380 | Treatment & Disposal | <u>(54,913)</u> | 5.56% | <u>0</u> | <u>0</u> | <u>0</u> | <u>(1,525)</u> | <u>(1,525)</u> |
| | | (\$62,358) | | \$0 | \$0 | (\$137) | (\$1,800) | (\$1,937) |

Note 1 Accruals to accumulated depreciation calculated using utility rates and half year convention or the amounts posted in utility records.

Note 2 Depreciation expense adjustment for the 12-month period ended December 31, 2001

Note 3 Accumulated depreciation adjustments as of December 31, 2001.

Note 4 The utility did not depreciate PHFU in its G/L, therefore no accumulated depreciation or depreciation expense was recorded in the filing.

Exception No. 2

Subject: UPIS - Common Plant Allocations from Water Service Corporation (WSC) and Utilities, Inc. of Florida (UIF)

Statement of Fact: WSC, the service corporation for the parent company Utilities, Inc., allocates a portion of its common rate base to each subsidiary utility throughout the United States. Cypress Lakes Utilities, Inc. (CLU) received \$18,547, net of accumulated depreciation and accumulated deferred income taxes, or approximately 0.81 percent of the total WSC net rate base of \$2,300,646. The allocation is based on a calculated customer equivalent (CE) percentage that equates all customers throughout the United States in terms of single family residential equivalent units. CLU did not record any amount for WSC common rate base in its MFRs filing.

The Commission's Division of Auditing and Safety, at the request of the Division of Economic Regulation, performed an undocketed affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2001. The scope of the audit included an examination of the WSC rate base components that are allocated to all of its subsidiary operations in 2001. The audit report, issued October 23, 2001, included adjustments that increased CLU's allocated WSC net rate base allocation by \$661 to \$19,208.

UIF is the administrative and operational headquarters for all of the parent company's Florida operations. It allocates a portion of its common rate base and accumulated depreciation to all Florida operations. CLU received \$32,819 and \$7,095 of common rate base and accumulated depreciation allocations, respectively, from UIF for the 12-month period ended December 31, 2001. CLU recorded both amounts as additions to its water utility operation in its MFRs.

The Commission's Division of Auditing and Safety performed an audit of UIF in Docket No. 020071-WS for the 12-month period ended December 31, 2001. The scope of the audit included an examination of UIF's common rate base components that are allocated to all of the Florida operations in 2001. The audit report, issued November 5, 2002, included adjustments that reduced CLU's allocated UIF common rate base allocation by \$647 to \$32,172.

Recommendation: The utility's water UPIS is overstated by \$7,853 and its wastewater UPIS is understated by \$26,414, respectively, because it did not allocate any common UPIS to its wastewater operations. Its combined allocations for WSC rate base and UIF UPIS are understated by \$18,562 as of December 31, 2001.

Additionally, the utility's water accumulated depreciation allocation UIF is overstated by \$3,978, and its wastewater accumulated depreciation is understated by \$3,298, because it did not allocate any common accumulated depreciation to its wastewater operations. Its combined allocation for UIF accumulated depreciation is overstated by \$679 for the 12-month period ended December 31, 2001. See Schedule B that follows for the audit staff's calculations and proposed adjustments.

Schedule B for Exception No. 2

| Per Utility UPIS | | | Audit Adjustments | | | Per Audit UPIS | | |
|-------------------------|-------------------------|---------------------------|-------------------------|-------------------------|---------------------------|-------------------------|-------------------------|---------------------------|
| <u>WSC Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>WSC Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>WSC Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> |
| \$0 | \$0 | \$0 | \$19,209 | \$9,334 | \$9,875 | \$19,208 | \$9,334 | \$9,875 |
| <u>UIF Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>UIF Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>UIF Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> |
| \$32,819 | \$32,819 | \$0 | (\$647) | (\$17,187) | \$16,539 | \$32,172 | \$15,632 | \$16,539 |
| <u>Total Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>Total Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>Total Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> |
| \$32,819 | \$32,819 | \$0 | \$18,562 | (\$7,853) | \$26,414 | \$51,380 | \$24,966 | \$26,414 |

| Per Utility Accumulated Dep. | | | Audit Adjustments | | | Per Audit Accumulated Dep. | | |
|------------------------------|-------------------------|---------------------------|-----------------------|-------------------------|---------------------------|----------------------------|-------------------------|---------------------------|
| <u>UIF Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>UIF Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> | <u>UIF Allocation</u> | <u>Water Allocation</u> | <u>W/Water Allocation</u> |
| \$7,095 | \$7,095 | \$0 | \$679 | \$3,978 | (\$3,298) | \$6,416 | \$3,117 | \$3,298 |

- 1) WSC allocations are net of accumulated depreciation and deferred charges and require a corresponding adjustment of \$503 to allocated depreciation expense from WSC.
- 2) Water and wastewater allocations above are 48.59% and 51.41%, respectively, per the utility's filing.
- 3) Small differences due to rounding errors.

Exception No. 3

Subject: Contributions-in-Aid-of-Construction (CIAC) and Accumulated Amortization of CIAC

Statement of Fact: The utility's filing reflects balances of \$249,686 and \$711,034 for water and wastewater CIAC as of December 31, 2001, and states that no break-out of CIAC by classification is possible.

The filing also reflects balances of \$32,349 and 68,667 for water and wastewater accumulated amortization of CIAC as of December 31, 2001, respectively, with adjustments of \$5,565 and \$12,509 to accrue amortization for 1998 that was not recorded.

Rule 25-30.140 (8), F.A.C., states that adequate records to account for CIAC must be maintained by the utility. The CIAC plant shall be amortized either by account, function or bottom line depending on the availability of supporting information. The amortization rate shall be that of the appropriate account or function where supporting documentation is available to identify the account or function of the related CIAC plant. Otherwise, the composite plant amortization rate shall be used.

Utility records indicate that it used the latter method to calculate its accruals to amortization of CIAC for years 1999 through 2001.

The utility's water and wastewater CIAC balances were last established in Docket No. 971220-WS as of December 31, 1997, in Order No. PSC-98-0993-FOF-WS. The audit staff, in that docket, calculated the water and wastewater CIAC balances for each specific UPIS account.

Utility records indicate additions to water CIAC of \$5,575 for the addition of 41 new customers and \$6,375 for the addition of 51 customers in 2000 and 2001, respectively.

Order No. PSC-98-0993-FOF-WS adopted the following meter installation fees that were established by the Polk County Commission as of August 6, 1996, when CLU received its initial operating certificate.

| <u>Meter Size</u> | <u>Charge</u> |
|-------------------|---------------|
| 5/8" | \$125 |
| 1" | \$150 |
| 1-1/2" | \$300 |
| 2" | \$350 |
| Over 2" | Actual Cost |

Utility records indicate that it added 228 new water customers since December 31, 1997.

Exception No. 3, continued

Recommendation: The utility's water CIAC balance is understated by \$18,100 and its water and wastewater accumulated amortization of CIAC balances are understated by \$9,505 and \$16,270, respectively, as of December 31, 2001, because of the following audit staff's determinations and subsequent calculations.

- 1) The utility recorded additions to water CIAC for 92 (41 + 51) customers in 2000 and 2001 and should be required to record water CIAC for 37, 94, and 5 additional customers that were added in 1998, 1999, and 2000, respectively. See the table below.
- 2) The utility calculated its accruals to accumulated amortization of CIAC using a composite rate, which is discussed above. The utility should be required to calculate its accumulated amortization of CIAC accruals by specific account which was used in the prior audit referenced above and is required by the Commission rule cited above. See Schedules C and D that follow for the audit staff's calculations and proposed adjustments.
- 3) The utility's adjustment to accumulated amortization of CIAC for 1998 discussed above is no longer required because the audit staff schedules that follow correct the utility's 1998 accumulated amortization accrual oversight.

| <u>Year</u> | <u>Size</u> | <u>Meter Charge</u> | <u>Customers</u> | <u>CIAC per Utility</u> | <u>Adjustment</u> | <u>CIAC per Audit</u> |
|-------------|-------------|---------------------|------------------|-------------------------|-------------------|-----------------------|
| 1998 | 5/8" | 125 | 36 | 0 | \$4,500 | \$4,500 |
| | 3/4" | 125 | <u>1</u> | <u>0</u> | <u>125</u> | <u>125</u> |
| | | | 37 | \$0 | \$4,625 | \$4,625 |
| 1999 | 5/8" | 125 | 76 | 0 | \$9,500 | \$9,500 |
| | 1" | 150 | 14 | 0 | 2,100 | 2,100 |
| | 1-1/2" | 300 | 3 | 0 | 900 | 900 |
| | 2" | 350 | <u>1</u> | <u>0</u> | <u>350</u> | <u>300</u> |
| | | | 94 | \$0 | \$12,850 | \$12,850 |
| 2000 | 5/8" | 125 | 44 | \$4,875 | \$625 | \$5,500 |
| | 2" | 350 | <u>2</u> | <u>700</u> | <u>0</u> | <u>700</u> |
| | | | 46 | \$5,575 | \$625 | \$6,200 |
| 2001 | 5/8" | 125 | 51 | <u>\$6,375</u> | <u>\$0</u> | <u>\$6,375</u> |
| | | | | \$11,950 | \$18,100 | \$30,050 |

The utility only recorded CIAC for 39 - 5/8" and 2 - 2" customers in 2000.
 (\$125 x 39 = \$4,875 and 2 x \$350 = \$700)

Schedule C for Exception No. 3

| Acct# | Acct. Description | Year | Cost | Life | Acc/Amtz. @12/31/97 | 1998 Accrual | Acc/Amtz. @12/31/98 | 1999 Accrual | Acc/Amtz. @12/31/99 | 2000 Accrual | Acc/Amtz. @12/31/00 | 2001 Accrual | Acc/Amtz. @12/31/01 |
|-------|------------------------------|------|-----------------|------|------------------------|-----------------|------------------------|-----------------|------------------------|-----------------|------------------------|-----------------|------------------------|
| 331 | Tran. & Distribution Mains | | | | | | | | | | | | |
| | Water Distribution Phase IIA | 1990 | \$33,638 | 43 | \$5,867 | \$782 | \$6,649 | \$782 | \$7,432 | \$782 | \$8,214 | \$782 | \$8,996 |
| | Water Distribution Phase 5-1 | 1998 | 80,507 | 43 | NA | 936 | 936 | 1,872 | 2,808 | 1,872 | 4,681 | 1,872 | 6,553 |
| 333 | Services | | | | | | | | | | | | |
| | Water Distribution Phase IIA | 1990 | 11,340 | 40 | 2,126 | 284 | 2,410 | 284 | 2,693 | 284 | 2,977 | 284 | 3,260 |
| | Water Distribution Phase 5-1 | 1998 | 28,310 | 40 | NA | 354 | 354 | 708 | 1,062 | 708 | 1,769 | 708 | 2,477 |
| 334 | Meters | | | | | | | | | | | | |
| | Meters & Meter Installation | 1996 | 38,081 | 20 | 1,328 | 1,904 | 3,232 | 1,904 | 5,137 | 1,904 | 7,041 | 1,904 | 8,945 |
| | Meter Fees | 1996 | 12,118 | 20 | 423 | 606 | 1,029 | 606 | 1,634 | 606 | 2,240 | 606 | 2,846 |
| | Meters & Meter Installation | 1997 | 9,110 | 20 | 106 | 456 | 561 | 456 | 1,017 | 456 | 1,472 | 456 | 1,928 |
| | Meter Fees | 1997 | 7,232 | 20 | 84 | 362 | 446 | 362 | 807 | 362 | 1,169 | 362 | 1,530 |
| | Meter Fees | 1998 | 4,625 | 20 | NA | 116 | 116 | 231 | 347 | 231 | 578 | 231 | 809 |
| | Meter Fees | 1999 | 12,850 | 20 | NA | NA | NA | 321 | 321 | 643 | 964 | 643 | 1,606 |
| | Meter Fees | 2000 | 6,200 | 20 | NA | NA | NA | NA | NA | 155 | 155 | 310 | 465 |
| | Meter Fees | 2001 | 6,375 | 20 | NA | NA | NA | NA | NA | NA | NA | 159 | 159 |
| 335 | Hydrants | | | | | | | | | | | | |
| | Water Distribution Phase IIA | 1990 | 5,200 | 45 | 867 | 116 | 982 | 116 | 1,098 | 116 | 1,213 | 116 | 1,329 |
| | Water Distribution Phase 5-1 | 1998 | <u>12,200</u> | 45 | NA | <u>136</u> | <u>136</u> | <u>271</u> | <u>407</u> | <u>271</u> | <u>678</u> | <u>271</u> | <u>949</u> |
| | Per Audit @12/31/2001 | | \$267,786 | | \$10,801 | \$6,050 | \$16,851 | \$7,912 | \$24,763 | \$8,388 | \$33,151 | \$8,703 | \$41,854 |
| | 1998 Audit staff adjustment | | (4,625) | | | | | | | | | | |
| | 1999 Audit staff adjustment | | (12,850) | | | | | | | | | | |
| | 2000 Audit staff adjustment | | <u>(625)</u> | | | | | | | | | | |
| | Total Adjustment | | <u>(18,100)</u> | | | | | | | | | <u>(1,153)</u> | <u>(9,505)</u> |
| | Per Company @12/31/2001 | | \$249,686 | | | | | | | | | \$7,550 | \$32,349 |

- a) The above schedule incorporates the audit staff adjustments to CIAC in this exception and recalculates the water accumulated amortization of CIAC balance as of December 31, 2001, by specific account per the Commission rule previously cited.
- b) The above schedule calculates the specific amortization balance for each NARUC account using the utility's corresponding UPIS depreciation rates and the CIAC amortization expense balance for the 12-month period ended 12/31/01.
- c) Small differences due to rounding errors.

Schedule D for Exception No. 3

| <u>Acct#</u> | <u>Acct. Description</u> | <u>Year</u> | <u>Cost</u> | <u>Life</u> | <u>Acc/Amtz. @12/31/97</u> | <u>1998 Accrual</u> | <u>Acc/Amtz. @12/31/98</u> | <u>1999 Accrual</u> | <u>Acc/Amtz. @12/31/99</u> | <u>2000 Accrual</u> | <u>Acc/Amtz. @12/31/00</u> | <u>2001 Accrual</u> | <u>Acc/Amtz. @12/31/01</u> |
|--------------|----------------------------|-------------|----------------|-------------|--------------------------------|-------------------------|--------------------------------|-------------------------|--------------------------------|-------------------------|--------------------------------|-------------------------|--------------------------------|
| 360 | Forced Collection Systems | | | | | | | | | | | | |
| | W/Water Col. Phase 5-1 | 1998 | \$92,624 | 30 | NA | \$1,544 | \$1,544 | \$3,087 | \$4,631 | \$3,087 | \$7,719 | \$3,087 | \$10,806 |
| 361 | Gravity Collection Systems | | | | | | | | | | | | |
| | W/Water Dist. Phase IIA | 1990 | 31,800 | 45 | 5,300 | 707 | 6,007 | 707 | 6,713 | 707 | 7,420 | 707 | 8,127 |
| | W/Water Dist. Phase 5-1 | 1998 | 132,482 | 45 | NA | 1,472 | 1,472 | 2,944 | 4,416 | 2,944 | 7,360 | 2,944 | 10,304 |
| 362 | Manholes | | | | | | | | | | | | |
| | W/Water Dist. Phase IIA | 1990 | 23,400 | 45 | 5,850 | 520 | 6,370 | 520 | 6,890 | 520 | 7,410 | 520 | 7,930 |
| | W/Water Dist. Phase 5-1 | 1998 | 59,885 | 45 | NA | 665 | 665 | 1,331 | 1,996 | 1,331 | 3,327 | 1,331 | 4,658 |
| 363 | Services | | | | | | | | | | | | |
| | W/Water Dist. Phase IIA | 1990 | 19,115 | 38 | 3,773 | 503 | 4,276 | 503 | 4,779 | 503 | 5,282 | 503 | 5,785 |
| | Additional services | 1996 | 4,350 | 38 | 172 | 114 | 286 | 114 | 401 | 114 | 515 | 114 | 630 |
| | Tap Fees | 1996 | 647 | 38 | 26 | 17 | 43 | 17 | 60 | 17 | 77 | 17 | 94 |
| | Additional Services | 1997 | 5,175 | 38 | 68 | 136 | 204 | 136 | 340 | 136 | 477 | 136 | 613 |
| | Tap Fees | 1997 | 12,442 | 38 | 164 | 164 | 327 | 327 | 655 | 327 | 982 | 327 | 1,310 |
| | W/Water Col. Phase 5-1 | 1998 | 29,115 | 38 | NA | 383 | 383 | 766 | 1,149 | 766 | 1,915 | 766 | 2,682 |
| 380 | Treatment Plant | | | | | | | | | | | | |
| | W/Water Plant Expansion | 1998 | 50,000 | 25 | NA | 1,000 | 1,000 | 2,000 | 3,000 | 2,000 | 5,000 | 2,000 | 7,000 |
| | W/Water Plant Expansion | 1999 | <u>250,000</u> | 45 | NA | <u>NA</u> | <u>NA</u> | <u>5,000</u> | <u>5,000</u> | <u>10,000</u> | <u>15,000</u> | <u>10,000</u> | <u>25,000</u> |
| | Per Audit @12/31/2001 | | \$711,034 | | \$15,352 | \$7,225 | \$22,577 | \$17,453 | \$40,030 | \$22,453 | \$62,484 | \$22,453 | \$84,937 |
| | Total Adjustment | | 0 | | | | | | | | | (2,315) | (16,270) |
| | Per Company @12/31/2001 | | \$711,034 | | | | | | | | | \$20,138 | \$68,667 |

- a) The above schedule recalculates the wastewater accumulated amortization of CIAC balance as of December 31, 2001, by specific account per the Commission rule previously cited.
- b) The above schedule calculates the specific amortization balance for each NARUC account using the utility's corresponding UPIS depreciation rates.
- c) Small differences due to rounding errors.

Exception No. 4**Subject: Working Capital**

Statement of Fact: The utility's filing includes \$12,804 and \$21,268 for water and wastewater working capital additions to the respective rate base balances as of December 31, 2001. The additions were calculated as one-eighth of the adjusted water and wastewater operation and maintenance expenses (O&M) of \$102,430 and \$170,147 for the 12-month period ended December 31, 2001.

Recommendation: The utility's adjusted water and wastewater working capital balances are overstated by \$2,225 and \$2,264, respectively, as of December 31, 2001, based on the following recommended audit staff adjustments to the utility's O&M expenses in this report.

| <u>Issue</u> | <u>Water</u> | <u>Wastewater</u> |
|---|-----------------|-------------------|
| Exception No. 6 | (\$1,101) | (\$1,943) |
| Exception No. 7 | (1,523) | (1,475) |
| Exception No. 8 | (3,478) | (3,368) |
| Exception No. 8 | <u>(11,699)</u> | <u>(11,328)</u> |
| Total | (17,801) | (18,114) |
| Working Capital Adjustment (1/8 of total) | (\$2,225) | (\$2,264) |

Exception No. 5

Subject: Cost of Capital - Parent

Statement of Fact: The utility's filing reflects a 9.21 percent weighted average cost of capital as of December 31, 2001.

Recommendation: The Division of Auditing and Safety conducted an affiliate transaction audit of Water Service Corporation (WSC), the service operating company for UIF's parent, for the 12-month period ended December 31, 2001, Audit Control No. 02-122-3-1. The audit report was issued on October 23, 2002.

Exception No. 10 of the above-mentioned audit report recommends specific adjustments to the components of the Requested Cost of Capital for the parent, Utilities, Inc. The audit staff has incorporated these recommendations in their entirety as Schedule E that follows.

In this filing, the utility has adjusted the beginning and ending balances for short and long-term debt and equity. The utility did not correct the cost rates, and it did not include the accumulated deferred tax and investment tax credit amounts arrived at in the affiliate audit mentioned above.

The audit staff has recalculated the utility's average weighted cost of debt for CLU to be 8.41 percent based on its findings in Exception No. 10 of the affiliate audit mentioned above. See Schedule F that follows.

Schedule E, for Exception No. 5

Exception No. 10

Subject: Cost of Capital

Statement of Fact: The company included a credit for accumulated deferred taxes of \$339,113 in rate base. This is the portion of deferred taxes that relates to Water Service Corp. and is not the consolidated Utilities, Inc. balance. Order No. PSC-98-0524-FOF-SU removed these taxes in the past.

In calculating the cost of capital, the company did not include consolidated deferred taxes. In all counties except Marion, in Docket No. 020071-WS of Utilities, Inc. of Florida's Minimum Filing Requirements (MFRs) Schedule D-1 included \$2,788 for deferred taxes. This is believed to be the average of the Account 237 for one division which is accrued interest.

The company did have a regulatory asset that offset deferred taxes. The average balance for the consolidated Utilities, Inc. deferred income tax is \$16,345,859 net of the regulatory asset. The company also has unamortized investment tax credits averaging \$1,318,251.

All counties used an amount for customer deposits that did not agree with the division's general ledger. The amounts follow:

| | <u>Per Filing</u> | <u>Per Ledger</u> |
|-----------------|-------------------|-------------------|
| Orange County | \$ 4,765 | \$ 4,862 |
| Marion County | (4,865) | 5,026 |
| Seminole County | 43,948 | 43,789 |
| Pasco County | 14,973 | 15,276 |
| Pinellas County | 3,413 | 3,723 |

The notes related to short-term debt were reviewed. It was determined that the amounts in the MFRs Schedule D-4 for short-term debt did not agree to the MFRs Schedule D-1. The company corrected this in the revised filing but included an adjustment to interest that removed interest related to acquisitions.

Long-term debt in MFRs Schedule D-5 was traced to the notes. It could not be reconciled to the lead schedules. In addition, a note paid off during the year was left off of MFRs Schedule D-5.

The company used different rates of return for equity for each division. The equity ratio is the same for all companies and thus using the formula provides the same rate for all companies.

Schedule E for Exception No. 5

Recommendation: The audit staff-prepared revised cost of capital exhibits that incorporated the correct general ledger amounts and the corrected interest rates which were computed from the company's outstanding notes and bank statements. See Exhibits VI through X of this report.

The revised cost of capital exhibits also include consolidated Utilities, Inc.'s deferred taxes net of the regulatory assets.

The MFRs Schedule D-4 of short-term debt was recalculated. The actual effective rate for short-term debt calculated by the audit staff using bank statements is 5.18 percent. The 13-month average balances from the general ledger were used.

The MFRs Schedule D-5 of debt was recalculated using all notes and the 13-month average balances from the general ledger. The effective rate is 8.63 percent.

The general ledger balances for the customer deposits for the five counties are included in the revised cost of capital Exhibits VII through X of this report.

The equity rate for all companies was changed to 10.914 percent based on Order PSC-02-1252-CO-WS, issued September 11, 2002.

The weighted cost rate for Utilities, Inc. is 8.42 percent.

The weighted cost rates for the five Utilities, Inc. of Florida counties are:

| | |
|----------|-------|
| Marion | 8.39% |
| Orange | 8.29% |
| Pasco | 8.40% |
| Pinellas | 8.38% |
| Seminole | 8.39% |

Schedule F, for Exception No. 5

| Utilities, Inc. - Parent Company | | | | | | | | |
|--|---------------------------------|--------------------------|-------------------------|--|--------------------------------|---------------------------------------|------------------|------------------------------|
| Average Consolidated Cost of Capital for Cypress Lakes Utilities, Inc. | | | | | | | | |
| As of December 31, 2001 | | | | | | | | |
| <u>Account Description</u> | <u>Balance @12/31/01</u> | <u>Balance @12/31/00</u> | <u>13-Month Average</u> | <u>Total Percentage Without Deposits</u> | <u>Reconciled to Rate Base</u> | <u>Total Percentage With Deposits</u> | <u>Cost Rate</u> | <u>Weighted Average Cost</u> |
| Long-term Debt | \$70,345,623 | \$73,757,982 | \$72,690,352 | 40.91% | \$750,223 | 40.75% | 8.630% | 3.517% |
| Short-term Debt | 23,801,000 | 7,517,000 | 13,245,115 | 7.45% | 136,700 | 7.43% | 5.180% | 0.385% |
| Common Equity | 76,392,765 | 69,945,301 | 73,384,644 | 41.30% | 757,389 | 41.14% | 10.914% | 4.490% |
| Acc. Deferred FIT Net of Reg. Assets | 16,173,472 | 16,366,079 | 16,345,859 | 9.20% | 168,702 | 9.16% | 0.000% | 0.000% |
| Acc. Deferred SIT | 548,106 | 727,237 | 714,538 | 0.40% | 7,375 | 0.40% | 0.000% | 0.000% |
| Unamortized ITC | <u>1,300,000</u> | <u>1,336,501</u> | <u>1,318,251</u> | <u>0.74%</u> | <u>13,605</u> | <u>0.74%</u> | 0.000% | <u>0.000%</u> |
| Total Before Customer Deposits | \$188,560,966 | \$169,650,100 | \$177,698,759 | 100.00% | \$1,833,994 | 99.63% | | 8.390% |
| Customer Deposits | | | | | <u>6,900</u> | <u>0.37%</u> | 6.000% | <u>0.022%</u> |
| Total | | | | | \$1,840,894 | 100.00% | | <u>8.410%</u> |
| Equity Ratio | Common Equity | | \$757,389 | | | | | |
| | Equity + Long & Short-term Debt | | \$1,644,312 | 46.06% | | | | |
| Calculation of Common Equity per Order No. PSC-02-1252-CO-WS, issued September 11, 2002. | | | | | | 9.650% | | |
| 0.00582 / Equity Ratio | | | | | | <u>1.264%</u> | | |
| Cost of Common Equity | | | | | | 10.914% | | |

Exception No. 6

Subject: Operation and Maintenance Expense (O&M)

Statement of Fact: The utility's filing reflects balances of \$93,356.00 and \$161,412.00 for water and wastewater O&M expenses, respectively, for the 12-month period ended December 31, 2001.

The utility's accounting system actively records monthly accruals and reversals for internal financial reporting purposes.

NARUC Accounting Instruction 2.A. states that each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of accounts so as to be able to furnish readily full information as to any item included in any account.

Recommendation: The utility's water and wastewater O&M expenses are overstated by \$1,100.77 and \$1,942.86, respectively, for the 12-month period ended December 31, 2001.

The audit staff's analysis of the utility's O&M expense account balances identified the following adjustments to the indicated accounts because it failed to reverse the beginning and ending accruals discussed above. It also could not provide adequate supporting documentation for expense additions per the NARUC rule cited above, and it improperly recorded expenses associated with one of its other Florida affiliated utilities on CLU books.

| <u>Acct#</u> | <u>Amount</u> | <u>Water</u> | <u>W/Water</u> | <u>Action</u> |
|--------------|-------------------|-------------------|-------------------|--|
| 615 | (\$608.98) | (\$608.98) | \$0.00 | Remove beginning year reversal. |
| 615 | 680.63 | 680.63 | 0.00 | Remove ending year accrual. |
| 715 | (2,261.34) | 0.00 | (2,261.34) | Remove beginning year reversal. |
| 715 | <u>2,282.21</u> | <u>0.00</u> | <u>2,282.21</u> | Remove ending year accrual. |
| | \$92.52 | \$71.65 | \$20.87 | |
| 618/718 | 407.34 | 141.07 | 266.27 | Remove - no document support. |
| 620 | 307.84 | 0.00 | 307.84 | Charge to Mid-County Services, Inc. |
| 620 | 407.34 | 0.00 | 407.34 | Remove - no document support. |
| 620/720 | <u>253.59</u> | <u>87.82</u> | <u>165.77</u> | Remove - no document support. |
| | \$968.77 | \$87.82 | \$880.95 | |
| 633/733 | 1,575.00 | 800.22 | 774.78 | Charge to Lake Utilities Service, Inc. |
| | <u>\$3,043.63</u> | <u>\$1,100.76</u> | <u>\$1,942.87</u> | Total O&M adjustments |

Exception No. 7

Subject: Operation and Maintenance Expense - Common Allocations

Statement of Fact: The utility's records indicate that it was allocated \$23,853 of common O&M expenses from Water Service Corporation (WSC) for the 12-month period ended December 31, 2001.

The utility allocated the above amount to its water and wastewater operations based on customer ratios of 50.81 percent and 49.19 percent, respectively.

Recommendation: The utility's allocated WSC water and wastewater O&M expenses are overstated by \$1,523 and \$1,475, respectively, for the 12-month period ended December 31, 2001, based on its customer ratio allocation method.

The Division of Auditing and Safety conducted an affiliate transaction audit of Water Service Corporation (WSC), the service operating company for CLU's parent, for the 12-month period ended December 31, 2001, Audit Control No. 02-122-3-1. The audit report was issued on October 23, 2002. In Exceptions Nos. 2 through 9 of the report, the audit staff reduced the common allocations CLU receives from WSC by \$2,998.

The Commission should require the utility to reduce its O&M expense for the 12-month period ended December 31, 2001, per the audit findings discussed above.

Exception No. 8

Subject: Operation and Maintenance Expense - Adjustments to Test Year

Statement of Fact: The utility's filing includes the following adjustments to its O&M expense balances for the 12-month period ended December 31, 2001.

| <u>Account</u> | <u>Event</u> | <u>Water</u> | <u>W/Water</u> | <u>Total</u> |
|---------------------------|---|--------------|----------------|--------------|
| Salaries | Annualize salaries at current pay rates. | (\$983) | (\$952) | (\$1,935) |
| Pension and Benefits | Annualize pension and benefits to reflect salary adjustments. | 6,671 | 6,459 | 13,130 |
| WSC & UIF Allocations | Revise common expense allocation to estimated current levels. | (537) | (568) | (1,105) |
| Total revised O&M expense | | \$5,151 | \$4,939 | \$10,090 |

Recommendation: The utility's \$1,935 reduction to salary expenses is understated by \$6,846, and its increase of \$13,130 pension and benefit expenses are overstated by \$23,027 based on the following audit staff findings.

- 1) The utility incorrectly computed the salary expense adjustment above by failing to include \$6,846 of historical WSC salary expenses in its calculations.
- 2) The utility incorrectly computed the pension and benefit expense adjustment above by failing to include \$20,288 and \$2,739 of the historical operator and WSC pension and benefits, respectively, in its calculations.

The Commission should require the utility to increase its water and wastewater salary expense reduction by \$3,478 and \$3,368, respectively, to properly record the reductions in annual salary expenses projected by the utility for the 12-month period ended December 31, 2001.

The Commission should require the utility to reduce its water and wastewater pension and benefit expense increase by \$11,699 and \$11,328, respectively, to properly record the reductions in annual pension and benefits expenses projected by the utility for the 12-month period ended December 31, 2001.

See audit staff's calculations and adjustments on Schedule G that follows.

Schedule G, for Exception No. 8

| <u>Actual Test Year</u> | <u>Adjustment per Audit</u> | | <u>Adjustment per Utility</u> | |
|---------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|
| | <u>Salaries</u> | <u>Pension & Benefits</u> | <u>Salaries</u> | <u>Pension & Benefits</u> |
| Operator Salaries | \$73,935 | \$20,288 | \$73,935 | \$0 |
| Office Salaries | 12,268 | 3,648 | 12,268 | 3,648 |
| Allocated WSC Salaries | <u>6,847</u> | <u>2,739</u> | <u>0</u> | <u>0</u> |
| Totals | \$93,050 | \$26,675 | \$86,203 | \$3,648 |
| | | | | |
| <u>Adjusted Test Year</u> | <u>Adjustment per Audit</u> | | <u>Adjustment per Utility</u> | |
| Operator Salaries | \$66,827 | \$12,408 | \$66,827 | \$12,408 |
| Office Salaries | 8,856 | 1,631 | 8,856 | 1,631 |
| Allocated WSC Salaries | <u>8,586</u> | <u>2,739</u> | <u>8,586</u> | <u>2,739</u> |
| Totals | \$84,269 | \$16,778 | \$84,269 | \$16,778 |
| | | | | |
| <u>Adjustments</u> | <u>Adjustment per Audit</u> | | <u>Adjustment per Utility</u> | |
| Operator Salaries | (\$7,108) | (\$7,880) | (\$7,108) | \$12,408 |
| Office Salaries | (3,412) | (2,017) | (3,412) | (2,017) |
| Allocated WSC Salaries | <u>1,739</u> | <u>0</u> | <u>8,586</u> | <u>2,739</u> |
| Totals | (\$8,781) | (\$9,897) | (\$1,934) | \$13,130 |
| | | | | |
| <u>Allocations</u> | <u>Allocations per Audit</u> | | <u>Allocations per Utility</u> | |
| | | <u>Salaries</u> | <u>Salaries</u> | <u>Pension & Benefits</u> |
| Water Customers | 1,132 | | | |
| Percentage | 50.81% | (\$4,461) | (\$983) | \$6,671 |
| W/Water Customers | 1096 | | | |
| Percentage | 49.19% | <u>(4,320)</u> | <u>(952)</u> | <u>6,459</u> |
| Total Customers | 2,228 | | | |
| Percentage | 100.00% | (\$8,781) | (\$1,935) | \$13,130 |
| | | | | |
| | <u>Audit Staff Adjustments</u> | | | |
| | | <u>Salaries</u> | | |
| Water Customers | 1,132 | | | |
| Percentage | 50.81% | (\$3,478) | | (\$11,699) |
| W/Water Customers | 1096 | | | |
| Percentage | 49.19% | <u>(3,368)</u> | | <u>(11,328)</u> |
| Total Customers | 2,228 | | | |
| Percentage | 100.00% | (\$6,846) | | (\$23,027) |

Exception No. 9

Subject: Depreciation and Amortization of CIAC Expense

Statement of Fact: The utility's filing reflects a net balance of \$43,325 and \$35,990 for water and wastewater depreciation expense, respectively, for the 12-month period ended December 31, 2001, as displayed below.

| | <u>Water</u> | <u>Wastewater</u> |
|---------------------------|------------------|-------------------|
| Depreciation Expense | \$50,875 | \$56,128 |
| CIAC Amortization Expense | <u>(\$7,550)</u> | <u>(\$20,138)</u> |
| Net Depreciation Expense | \$43,325 | \$35,990 |

Recommendation: The utility's water and wastewater net depreciation expenses should be reduced by \$3,853 and \$5,157, respectively, for 12-month period ended December 31, 2001, based on the following audit staff determinations.

- 1) Exception No. 1 of this report recommended UPIS adjustments that effectively reduced water and wastewater depreciation expenses by \$2,444 and \$2,595, respectively, for the 12-month period ended December 31, 2001.
- 2) Exception No. 2 of this report recommended common UPIS adjustments that effectively reduced water and wastewater depreciation expenses by \$256 and \$247, respectively, for the 12-month period ended December 31, 2001.
- 3) Exception No. 3 of this report recommended CIAC and accumulated amortization of CIAC adjustments that effectively increased water and wastewater amortization of CIAC expenses by \$1,153 and \$2,315, respectively, for the 12-month period ended December 31, 2001.

| <u>Issue</u> | <u>Water</u> | <u>Wastewater</u> |
|-------------------------------------|----------------|-------------------|
| Exception No. 1 | (\$2,444) | (\$2,595) |
| Exception No. 2 | (256) | (247) |
| Exception No. 3 | <u>(1,153)</u> | <u>(2,315)</u> |
| Net Depreciation Expense Adjustment | (\$3,853) | (\$5,157) |

Exception No. 10

Subject: Taxes Other Than Income (TOTI)- Regulatory Assessment Fees (RAFTs)

Statement of Fact: The utility's filing reflects balances of \$5,024 and \$10,736 for its water and wastewater RAFTs, respectively, for the 12-month period ended December 31, 2001.

Recommendation: The above balances represent the utility's RAFT payment for the 12-month period ended December 31, 2000. Its payment to the Commission was for \$15,760. (\$5,024 + \$10,736)

The utility's actual RAFT payment for the 12-month period ended December 31, 2001, was \$15,248. (\$4,873 for water and \$10,411 for wastewater)

The utility's water and wastewater TOTI are overstated by \$151 and \$325, respectively, for the 12-month period ended December 31, 2001, because it used the year 2000 RAFTs instead of the year 2001 RAFTs in its filing. (\$5,024 - \$4,873) (\$10,736 - \$10,411)

Exception No. 11

Subject: Taxes Other Than Income - Adjustments to Test Year

Statement of Fact: The utility's filing includes adjustments that increase its payroll tax expenses by \$7,164. (\$3,640 to water and \$3,524 to wastewater)

Recommendation: The utility's adjustments that increase payroll tax expenses illustrated above are overstated by \$4,008 and \$3,881 for water and wastewater operations, respectively, based on the following audit staff determinations.

The utility incorrectly computed the payroll tax expense adjustment above by failing to include \$5,855 and \$2,034 of historical operator and WSC payroll taxes, respectively, in its calculations.

The Commission should require the utility to reduce its water and wastewater payroll tax expense adjustments by \$4,008 and \$3,881, respectively, to properly record the reductions in annual payroll tax expenses projected by the utility for the 12-month period ended December 31, 2001. See audit staff's calculations and adjustments below.

| <u>Actual Test Year</u> | <u>Per Utility</u> | <u>Payroll Tax Expense</u> | |
|-------------------------|--------------------|----------------------------|-------------------|
| | | <u>Adjustment</u> | <u>Per Audit</u> |
| Operator Salaries | \$0 | \$5,855 | \$5,855 |
| Office Salaries | 999 | 0 | 999 |
| Allocated WSC Salaries | <u>0</u> | <u>2,034</u> | <u>2,034</u> |
| Totals | \$999 | \$7,889 | \$8,888 |
| Adjusted Test Year | | | |
| Operator Salaries | \$5,412 | \$0 | \$5,412 |
| Office Salaries | 717 | 0 | 717 |
| Allocated WSC Salaries | <u>2,034</u> | <u>0</u> | <u>2,034</u> |
| Totals | \$8,163 | \$0 | \$8,163 |
| Adjustments | | | |
| Operator Salaries | \$5,412 | (\$5,845) | (\$433) |
| Office Salaries | (282) | 0 | (282) |
| Allocated WSC Salaries | <u>2,034</u> | <u>(2,034)</u> | <u>0</u> |
| Totals | \$7,164 | (\$7,889) | (\$725) |
| <u>Allocations</u> | | | |
| Payroll Tax Expense | <u>Adjustment</u> | <u>Water</u> | <u>Wastewater</u> |
| | (\$7,889) | (\$4,008) | (\$3,881) |
| Customer Allocation | 100.00% | 50.81% | 49.19% |

Exception No. 12

Subject: Books and Records

Statement of Fact: The Commission's Division of Auditing and Safety performed an audit of UIF in Docket No. 020071-WS for the 12-month period ended December 31, 2001. The audit report was issued on November 5, 2002.

Exception No. 26 of the above-mentioned audit report concluded that the utility's books and records are not in substantial compliance with the NARUC USOA, and that the utility has not complied with Orders Nos. PSC-00-1528-PAA-WU, issued August 23, 2000, and PSC-00-2388-AS-WU, issued December 31, 2000.

Recommendation: The utility's books and records continue to be not in substantial compliance with the NARUC USOA. It has not complied with Orders Nos. PSC-00-1528-PAA-WU and PSC-00-1528-PAA-WU, referenced above. See the audit staff's discussion on this issue in Exception No. 26 of the above-mentioned audit report.

EXHIBIT I

Schedule of Water Rate Base

Florida Public Service Commission

Company: Cypress Lakes Utilities, Inc.
 Docket No.: 020407-WS
 Schedule Year Ended: December 31, 2001
 Interim [] Final [X]
 Historic [X] Projected []

Schedule: A-1
 Page 1 of 1
 Preparer: Seidman, F.

Explanation: Provide the calculation of average rate base for the test year, showing all adjustments. All non-used and useful items should be reported as Plant Held For Future Use. If method other than formula approach (1/8 O&M) is used to determine working capital, provide additional schedule showing detail calculation.

| Line No. | (1) Description | (2) Balance Per Books | (3) A-3 Utility Adjustments | (4) Adjusted Utility Balance | (5) Supporting Schedule(s) |
|----------|-----------------------------------|--------------------------|-----------------------------------|---------------------------------|-------------------------------|
| 1 | Utility Plant in Service | \$ 1,329,460 | | \$ 1,329,460 | A-5 |
| 2 | Utility Land & Land Rights | 509 | | 509 | A-5 |
| 3 | Less: Non-Used & Useful Plant | - | - A | - | A-7, A-3 |
| 4 | Construction Work in Progress | - | - B | | A-18, A-3 |
| 5 | Less: Accumulated Depreciation | (288,550) | - | (288,550) | A-9 |
| 6 | Less: CIAC | (246,499) | | (246,499) | A-12 |
| 7 | Accumulated Amortization of CIAC | 28,574 | 5,565 C | 34,139 | A-14, A-3 |
| 8 | Acquisition Adjustments, Net | (267,107) | 267,107 D | - | A-18, A-3 |
| 9 | Accum. Amort. of Acq. Adjustments | incl. above | incl. above | | - |
| 10 | Advances For Construction | | | | A-16 |
| 11 | Working Capital Allowance | - | 12,804 E | 12,804 | A-17, A-3 |
| 12 | Total Rate Base | \$ 556,388 | \$ 285,476 | \$ 841,864 | |

EXHIBIT II**Schedule of Wastewater Rate Base**

Florida Public Service Commission

Company: Cypress Lakes Utilities, Inc.
Docket No.: 020407-WS
Schedule Year Ended: December 31, 2001
Interim [] Final [X]
Historic [X] Projected []

Schedule: A-2
Page 1 of 1
Preparer: Seidman, F.

Explanation: Provide the calculation of average rate base for the test year, showing all adjustments. All non-used and useful items should be reported as Plant Held For Future Use. If method other than formula approach (1/8 O&M) is used to determine working capital, provide additional schedule showing detail calculation.

| Line No. | (1) Description | (2) Balance Per Books | (3) A-3 Utility Adjustments | (4) Adjusted Utility Balance | (5) Supporting Schedule(s) |
|----------|-----------------------------------|--------------------------------|--------------------------------------|---------------------------------------|----------------------------------|
| 1 | Utility Plant in Service | \$ 2,252,159 | | \$ 2,252,159 | A-6 |
| 2 | Utility Land & Land Rights | | | - | A-6 |
| 3 | Less: Non-Used & Useful Plant | - | (131,593) A | (131,593) | A-7, A-3 |
| 4 | Construction Work in Progress | 160,381 | (160,381) B | - | A-18, A-3 |
| 5 | Less: Accumulated Depreciation | (502,877) | - | (502,877) | A-10 |
| 6 | Less: CIAC | (711,034) | | (711,034) | A-12 |
| 7 | Accumulated Amortization of CIAC | 58,598 | 12,509 C | 71,107 | A-14, A-3 |
| 8 | Acquisition Adjustments | (400,032) | 400,032 D | - | A-18, A-3 |
| 9 | Accum. Amort. of Acq. Adjustments | incl. above | incl. above | | - |
| 10 | Advances For Construction | | | | A-16 |
| 11 | Working Capital Allowance | - | 21,268 E | 21,268 | A-17, A-3 |
| 12 | Total Rate Base | \$ 857,195 | \$ 141,835 | \$ 999,030 | |

EXHIBIT III

Schedule of Water Net Operating Income

Florida Public Service Commission

Company: Cypress Lakes Utilities, Inc.
 Docket No.: 020407-WS
 Test Year Ended: December 31, 2001
 Interim [] Final [X]
 Historic [X] or Projected []

Schedule: B-1
 Page 1 of 1
 Preparer: Seidman, F.

Explanation: Provide the calculation of net operating income for the test year. If amortization (Line 4) is related to any amount other than an acquisition adjustment, submit an additional schedule showing a description and calculation of charge.

| Line No. | (1) Description | (2) Balance Per Books | (3) Utility Test Year Adjustments | (4) Utility Adjusted Test Year | (5) Requested Revenue Adjustment | (6) Requested Annual Revenues | (7) Supporting Schedule(s) |
|----------|----------------------------------|--------------------------|--------------------------------------|-----------------------------------|-------------------------------------|----------------------------------|-------------------------------|
| 1 | OPERATING REVENUES | \$ 110,204 | \$ 4,348 A | \$ 114,552 | \$ 160,939 F | \$ 275,490 | B-4, E-2 |
| 2 | Operation & Maintenance | 93,356 | 5,151 B | 98,507 | 3,923 G | 102,430 | B-5, B-3 |
| 3 | Depreciation, net of CIAC Amort. | 43,325 | - C | 43,325 | | 43,325 | B-13, B-3 |
| 4 | Amortization | | | | - | - | B-3 |
| 5 | Taxes Other Than Income | 17,268 | 3,836 D | 21,103 | 7,177 H | 28,280 | B-15, B-3 |
| 6 | Provision for Income Taxes | (28,449) | 28,449 E | - | 23,919 I | 23,919 | C-1, B-3 |
| 7 | OPERATING EXPENSES | 125,500 | 37,436 | 162,936 | 35,019 | 197,954 | |
| 8 | NET OPERATING INCOME | \$ (15,296) | \$ (33,088) | \$ (48,384) | \$ 125,920 | \$ 77,536 | |
| 9 | RATE BASE | \$ 556,388 | | \$ 841,864 | | \$ 841,864 | |
| 10 | RATE OF RETURN | -- | % | -- | % | 9.21 | % |

EXHIBIT IV

Schedule of Wastewater Net Operating Income

Florida Public Service Commission

Company: Cypress Lakes Utilities, Inc.
 Docket No.: 020407-WS
 Test Year Ended: December 31, 2001
 Interim [] Final [X]
 Historic [X] or Projected []

Schedule: B-2
 Page 1 of 1
 Preparer: Seidman, F.

Explanation: Provide the calculation of net operating income for the test year. If amortization (Line 4) is related to any amount other than an acquisition adjustment, submit an additional schedule showing a description and calculation of charge.

| Line No. | (1) Description | (2) Balance Per Books | (3) Utility Test Year Adjustments | (4) Utility Adjusted Test Year | (5) Requested Revenue Adjustment | (6) Requested Annual Revenues | (7) Supporting Schedule(s) |
|----------|----------------------------------|--------------------------|--------------------------------------|-----------------------------------|-------------------------------------|----------------------------------|-------------------------------|
| 1 | OPERATING REVENUES | \$ 229,432 | \$ 5,346 | A \$ 234,778 | \$ 126,477 | F \$ 361,255 | B-4, E-2 |
| 2 | Operation & Maintenance | 161,412 | 4,939 | B 166,351 | 3,796 | G 170,147 | B-6, B-3 |
| 3 | Depreciation, net of CIAC Amort. | 35,990 | (3,293) | C 32,697 | | 32,697 | B-14, B-3 |
| 4 | Amortization | | | | 0 | - | B-3 |
| 5 | Taxes Other Than Income | 29,745 | 2,709 | D 32,454 | 5,280 | H 37,734 | B-15, B-3 |
| 6 | Provision for Income Taxes | 780 | - | E - | 28,666 | I 28,666 | C-1, B-3 |
| 7 | OPERATING EXPENSES | 227,927 | 4,355 | 231,502 | 37,742 | 269,244 | |
| 8 | NET OPERATING INCOME | \$ 1,505 | \$ 991 | \$ 3,276 | \$ 88,735 | \$ 92,011 | |
| 9 | RATE BASE | \$ 857,195 | | \$ 999,030 | | \$ 999,030 | |
| 10 | RATE OF RETURN | 0.18 % | | 0.33 % | | 9.21 % | |

EXHIBIT V

Schedule of Requested Cost of Capital (Final Rates)
Beginning and End of Year Average

Florida Public Service Commission

Company: Cypress Lakes Utilities, Inc.
Docket No.: 020407-WS
Test Year Ended: December 31, 2001
Schedule Year Ended: December 31, 2001
Historic [X] or Projected []

Schedule: D-1
Page 1 of 2
Preparer: Seidman, F.

Subsidiary [] or Consolidated [X]

Explanation: Provide a schedule which calculates the requested Cost of Capital on a beginning and end of year average basis. If a year-end basis is used, submit an additional schedule reflecting year-end calculations.

| Line No. | | (1) | (2) | (3) | (4) |
|----------|---------------------------------|------------------|----------------|-----------|---------------|
| | | Total Capital | Ratio | Cost Rate | Weighted Cost |
| 1 | Long-Term Debt | 821,446 | 44.62 % | 8.82 % | 3.93 % |
| 2 | Short-Term Debt | 178,448 | 9.69 | 2.54 | 0.25 |
| 3 | Preferred Stock | | | | |
| 4 | Customer Deposits | 6,900 | 0.37 | 6.00 | 0.02 |
| 5 | Common Equity | 834,100 | 45.31 | 11.07 | 5.01 |
| 6 | Tax Credits - Zero Cost | | | | |
| 7 | Accumulated Deferred Income Tax | | | | |
| 8 | Other (Explain) | | | | |
| 9 | Total | <u>1,840,894</u> | <u>99.99 %</u> | | <u>9.21 %</u> |

10 Note: Cost of Equity based on Order No. PSC-01-2514-FOF-WS