

State of Florida



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

DATE: April 10, 2003
TO: Division of Economic Regulation (Fletcher)
FROM: Division of Auditing and Safety (Vandiver) *W*
RE: **Docket No.** 020408-SU; **Company Name:** Alafaya Utilities, Inc.; **Audit Purpose:** File and Suspend Petition for Rate Relief; **Audit Control No.** 02-309-3-1

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. There are no confidential work papers associated with this audit.

DNV/jcp
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
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DOCUMENT NUMBER 020408-SU

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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

ALAFAYA UTILITIES, INC.

FILE AND SUSPEND PETITION FOR RATE RELIEF

SEMINOLE COUNTY

HISTORICAL PERIOD ENDED DECEMBER 31, 2001

**DOCKET NO. 020408-SU
AUDIT CONTROL NO. 02-309-3-1**



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

APRIL 2, 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 Alafaya Utilities, Inc.'s wastewater operations located in Seminole County, Florida. These schedules were prepared by the utility as part of its petition for rate relief in Docket No. 0200408-SU.

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 adjusted wastewater UPIS is overstated by \$713,048 as of December 31, 2001.

The utility's pro forma additions to utility-plant-in-service (UPIS) and accumulated depreciation (AD) are overstated by \$317,881 and understated by \$31,509, respectively.

The utility's balance for wastewater land is understated by \$34,013 as of December 31, 2001.

The utility's adjusted accumulated depreciation is overstated by \$33,120 as of December 31, 2001.

The utility's contributions-in-aid-of-construction (CIAC) and accumulated amortization of CIAC are understated by \$769,606 and \$846,348, respectively, as of December 31, 2001.

The utility's working capital balance is understated by \$215,156 as of December 31, 2001.

The utility's average weighted cost of capital is 8.37 percent.

The utility's adjusted wastewater operation and maintenance (O&M) expenses are overstated by \$85,889 for the 12-month period ended December 31, 2001.

The utility's net adjusted depreciation expense is overstated by \$10,782 for the 12-month period ended December 31, 2001.

The utility's adjusted taxes other than income (TOTI) is overstated by \$33,676 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: Scanned and verified the Original Cost Study prepared by the utility to support its UPIS, contributions-in-aid-of-construction (CIAC), AD, and accumulated amortization of CIAC (AAC) as of December 31, 1993. Examined additions to UPIS, land, CIAC, AD, and AAC for the period January 1, 1995 through December 31, 2001. Compiled working capital (WC) balances as of December 31, 2001.

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 O&M expenses 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 Alafaya Utilities, Inc. Tested the calculation of depreciation and CIAC amortization expense. Examined support for TOTI and income taxes.

CAPITAL STRUCTURE: Compiled the components of the capital structure as of December 31, 2001. Agreed interest expense to the terms of the notes and the bonds. Reconciled note balances as of December 31, 2001, to supporting documentation.

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

Exception No. 1

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

16p1

Statement of Fact: Utility records reflect an adjusted balance of \$17,243,824 for UPIS as of December 31, 2001.

Included in the above balance are additions to the following accounts for the time periods indicated.

WASTEWATER UPIS ADDITIONS From 16A p1

Acct#	Account Description	1995	1996	1997	1998	1999	2000	2001	Totals
351	Organization Cost	\$150,085	\$0	\$343	\$0	\$0	\$0	\$0	\$150,428
352	Franchise Cost	0	0	0	49,482	0	0	0	49,482
354	Structures & Improv.	9,171	15,073	0	23,948	11,269	1,605	0	61,066
360	Col. Mains - Forced	5,742	0	3,514	690	2,239	0	0	12,185
361	Col. Mains - Gravity	2,193	0	0	0	0	9,056	17,133	28,382
380	Treatment & Disposal	199,900	1,283	13,567	1,686	968	233,077	146,083	596,564
393	Tools & Shop	0	0	0	0	0	0	3,328	3,328
394	Laboratory Equip.	<u>396</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>396</u>
	Total Additions	<u>\$367,487</u>	<u>\$16,356</u>	<u>\$17,424</u>	<u>\$75,805</u>	<u>\$14,476</u>	<u>\$243,738</u>	<u>\$166,544</u>	<u>\$901,830</u>

Columns and rows may not foot due to rounding errors.

NARUC, Utility Plant Accounts, Account No. 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, Account 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 No. 426 - Miscellaneous Nonutility Expense.

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.

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

Exception No. 1, continued

Recommendation: The utility's adjusted wastewater UPIS is overstated by \$713,048 as of December 31, 2001, based on the following audit staff determinations.

- 1) The addition of \$150,428 to Account No. 351 includes the following transactions.
 - 16AP² a) Invoices totaling \$288 for legal fees that should have been charged to O&M when they were actually incurred. Invoices and capitalized executive time totaling \$16,283 for legal fees and travel costs that should have been recorded as utility acquisition adjustments. Invoices and general ledger (G/L) journal entries totaling \$133,514 that are not supported by any utility documentation. ($\$288 + \$16,283 + \$133,514 = \$150,086$)
 - 16AP⁴ b) Invoices totaling \$343 for legal fees that should have been charged to Wedgefield Utilities, Inc.
- 2) The addition of \$49,482 to Account No. 352 includes the following transactions.
 - 16AP⁵ a) Invoices totaling \$34,686 for legal fees over a service territory dispute with the City of Oviedo, Florida. These costs should be recorded in Account No. 186 pending the Commission's determination of the proper accounting treatment of these costs. See Disclosure No. 1 for further details.
 - 16AP⁵ b) Capitalized salaries of \$14,796 that should have been recorded in Account No. 3612008.
- 3) The addition of \$61,066 to Account No. 354 includes the following transactions.
 - 16AP² a) A \$4,375 addition to rebuild a lift station pump that should have included an adjustment of \$3,282 to retire its associated UPIS and a \$4,796 G/L journal adjustment that is not supported by any utility documentation. ($\$3,282 + \$4,796 = \$8,077$)
 - 16AP³ b) Additions of \$4,546 and \$10,527 to rebuild the effluent pump at the wastewater treatment plant and to rewire the Alafaya Woods lift station that should have included adjustments of \$3,410 and \$7,895 to retire the associated UPIS that was replaced. ($\$3,410 + \$7,895 = \$11,305$)
 - 16AP⁵ c) Additions of \$6,961 and \$16,987 to rebuild Lift Stations Nos. 9 and 16 that should have included adjustments of \$5,221 and \$12,740, respectively, to retire the associated UPIS that was replaced. ($\$5,221 + \$12,740 = \$17,961$)
 - 16AP⁶ d) A \$11,269 addition to rebuild a pump and starter at Lift Station No. 16 that should have included an adjustment of \$8,452 to retire the associated UPIS that was replaced.
 - 16AP⁷ e) A \$1,605 addition for an alarm system at Lift Station No. 7 at Weathersfield Utilities, Inc. that should be removed and reclassified to the proper utility system.
- 4) The addition of \$12,185 to Account No. 360 includes the following transactions.
 - 16AP² a) A \$5,742 G/L journal entry that is not supported by any utility documentation and should be removed.
 - 16AP⁴ b) A \$2,350 addition to relocate and replace 80 feet of forced main that should have included an adjustment of \$1,762 to retire the associated UPIS that was replaced.
 - 16AP⁵ c) A \$2,652 addition and \$1,962 retirement that is not supported by any utility documentation and should be removed. ($\$2,652 - \$1,962 = \$690$)
 - 16AP⁶ d) A \$1,329 addition that is not supported by any utility documentation and an addition of \$910 for work at a Clermont, Florida, job site that is not in the utility's service territory and both should be removed. ($\$1,329 + \$910 = \$2,239$)

Exception No. 1, continued

5) The addition of \$28,382 to Account No. 361 includes the following transactions.

- 16Ap 2 a) A \$2,193 addition that is not supported by any utility documentation and should be removed.
- 16Ap 5 b) A \$14,796 transfer from Account No. 351 in Issue 2(b) above.
- 16Ap 7 c) A \$9,056 addition that is not supported by any utility documentation and should be removed.
- 16Ap 8 d) A \$17,133 addition to repair a forced main break that should be recorded as an O&M expense.

6) The addition of \$596,564 to Account No. 380 includes the following transactions.

- 16Ap 2 a) Additions of \$2,511 and \$24,217 that are not supported by any utility documentation and should be removed. A \$1,606 addition for generator repairs that should be recorded as an O&M expense. Additions of \$1,074, \$91,563, and \$6,073 for major repairs or replacements to UPIS that should have included adjustments totaling \$74,033 to retire the associated UPIS that was replaced. ($\$2,511 + \$24,217 + \$1,606 + \$74,033 = \$102,367$)
- 16Ap 3 b) The addition of \$1,283 to rebuild a blower at the wastewater treatment plant that should have included an adjustment of \$962 to retire the associated UPIS that was replaced.
- 16Ap 4 c) A \$2,143 addition for annual maintenance of the emergency generator that should have been recorded as an O&M expense. Additions of \$2,739 and \$8,686 for major repairs or replacements to UPIS that should have included adjustments totaling \$8,568 to retire the associated UPIS that was replaced. ($\$2,143 + \$8,568 = \$10,711$)
- 16Ap 5 d) Additions of \$1,036 and \$650 that are not supported by any utility documentation and should be removed. ($\$1,036 + \$650 = \$1,686$)
- 16Ap 6 e) A \$968 addition that is not supported by any utility documentation and should be removed.
- 16Ap 7 f) A \$4,967 addition that is not supported by any utility documentation and should be removed. Additions of \$73,351, \$144,654, and \$10,105 for major repairs or replacements to UPIS that should have included adjustments totaling \$171,083 to retire the associated UPIS that was replaced. ($\$4,967 + \$171,083 = \$176,050$)
- 16Ap 8 g) An \$8,551 addition that is not supported by any utility documentation and should be removed. Additions of \$66,706 and \$70,826 for major maintenance work that is nonrecurring in frequency and should be recorded in Accounts Nos. 1862048 and 1862066 and amortized to O&M expense over five years. ($\$8,551 + \$66,706 + \$70,826 = \$146,083$)

7) The addition of \$3,328 to Account No. 393 includes the following transactions.

- 16Ap 8 a) Additions of \$1,646 and \$1,682 for major repairs to a tractor that should have included adjustments totaling \$2,496 to retire the associated UPIS that was replaced.

8) The addition of \$396 to Account No. 394 for a G/L journal entry that is not supported by any utility documentation and should be removed.

16Ap 2

16Ap 1 The Commission should require the utility to reduce its wastewater UPIS by \$713,048, per the audit staff findings discussed above. See the audit staff's calculations in Schedule A that follows.

The audit staff adjustments recommended above will require corresponding adjustments that reduce its accumulated depreciation by \$317,597 as of December 31, 2001, and reduce its depreciation expense by \$17,365 for the 12-month period ended December 31, 2001. See the audit staff's calculations in Schedule B that follows.

Schedule A for Exception No. 1 *16A*

WASTEWATER UPIS ADJUSTMENT(1)									
<u>Acct#</u>	<u>Account Description</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>Totals</u>
351	Organization Cost	(\$150,085)	\$0	(\$343)	\$0	\$0	\$0	\$0	(\$150,428)
352	Franchise Cost	0	0	0	(49,482)	0	0	0	(49,482)
354	Structures & Improv.	(8,077)	(11,305)	0	(17,961)	(8,452)	(1,605)	0	(47,400)
360	Col. Mains - Forced	(5,742)	0	(1,763)	(690)	(2,239)	0	0	(10,434)
361	Col. Mains - Gravity	(2,193)	0	0	14,796	0	(9,056)	(17,133)	(13,586)
380	Treatment & Disposal	(102,367)	(962)	(10,711)	(1,686)	(968)	(176,050)	(146,083)	(438,826)
393	Tools & Shop	0	0	0	0	0	0	(2,496)	(2,496)
394	Laboratory Equip.	(396)	0	0	0	0	0	0	(396)
	Total Additions	(\$268,860)	(\$12,267)	(\$12,816)	(\$55,023)	(\$11,659)	(\$186,711)	(\$165,712)	(\$713,048)

Schedule B for Exception No. 1 *22A p 1 & 2*

WASTEWATER ACCUMULATED DEPRECIATION ADJUSTMENT(2)						
<u>Acct.#</u>	<u>Account Description</u>	<u>UPIS Adjustment</u>	<u>Depreciation Rate(2)</u>	<u>Acc./Dep. Retirement(3)</u>	<u>2001(4)</u>	<u>Total(5)</u>
351	Organization Cost	(\$150,428)	2.50%	\$0	(\$3,761)	(\$3,761)
352	Franchise Cost	(49,482)	2.50%	0	(1,237)	(1,237)
354	Structures & Improv.	(47,400)	3.13%	(40,999)	(1,481)	(42,480)
360	Col. Mains - Forced	(10,434)	3.33%	0	(348)	(348)
361	Col. Mains - Gravity	(28,382)	2.22%	0	(440)	(440)
380	Treatment & Disposal	(424,030)	2.86%	(254,646)	(10,028)	(264,674)
393	Tools & Shop	(2,496)	6.25%	(2,496)	(117)	(2,613)
394	Laboratory Equip.	(396)	6.67%	0	(26)	(26)
		(\$713,048)		(\$298,141)	(\$17,438)	(\$315,579)

Notes:

- 1) Columns and rows may not foot due to rounding errors.
- 2) Rule 24-30.146, F.A.C., depreciation rates.
- 3) Retirements calculated as 75 percent of corresponding UPIS addition per utility capitalization policy.
- 4) Accumulated depreciation and depreciation expense adjustment for the 12-month period ended December 31, 2001.
- 5) The sum of the accumulated depreciation retirement and the year 2001 depreciation expense accrual.

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. Alafaya Utilities, Inc. (ALF) received \$72,099, net of accumulated depreciation and accumulated deferred income taxes, or approximately 3.13 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.

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 ALF's allocated WSC net rate base allocation by \$1,420 to \$73,519.

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. ALF received \$85,271 and \$17,005 of common rate base and accumulated depreciation allocations, respectively, from UIF for the 12-month period ended December 31, 2001. ALF recorded both amounts as additions to its wastewater 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 ALF's allocated UIF common rate base allocation by \$1,717 to \$1,803.

16-12 Recommendation: The utility's allocation for WSC common rate base is understated by \$1,420 as of December 31, 2001.

16-13 The utility's allocations for UIF's common rate base and accumulated depreciation are overstated by \$1,717 and \$1,803, respectively, as of December 31, 2001.

Exception No. 3

Subject: UPIS - Pro Forma Adjustments to the Test Year

16p1
22p1

Statement of Fact: The utility's filing reflects pro forma additions of \$2,847,259 and \$37,333 for wastewater UPIS and accumulated depreciation (AD) as of December 31, 2001.

16-14

Recommendation: The utility's pro forma additions to UPIS and AD are overstated by \$317,881 and understated by \$31,509, respectively, based on the following audit staff determinations.

- 1) The utility provided construction project schedules and invoices totaling \$2,529,378 to support its pro forma additions to UPIS which is \$317,881 less than the amount requested above.
- 2) The utility calculated accumulated depreciation on pro forma UPIS additions using a monthly depreciation accrual for each month a construction project was placed in service. It should have included one full year of depreciation accruals for each construction project for this rate proceeding. See Schedule C that follows for details.

Additionally, the utility's adjusted depreciation expense is understated by \$31,509 for the 12-month period ended December 31, 2001, per the AD adjustment recommended above.

The audit staff adjustments do not include any used and useful calculations presented in the utility's MFRs filing.

Schedule C for Exception No. 3

16-14

<u>Per Company (Work Order No.)</u>	<u>Acct. No.</u>	<u>UPIS</u>	<u>Dep. Rate</u>	<u>Dep. Expense</u>	<u>Notes</u>
0647-116-01-01 Reuse Plant Facilities	354	\$1,170,924	3.13%	\$33,596	11 Months
0647-116-01-05 30hp Motor/Blower Assembly	380	10,168	2.86%	267	11 Months
0647-116-02-01 Reuse Water Main	375	512,228	2.33%	995	1 Month
0647-116-02-02 Gorman Pump for Reuse	371	6,718	4.00%	247	11 Months
0647-116-97-16 Reuse Mains	375	<u>1,147,221</u>	2.33%	<u>2,228</u>	1 Month
Totals		<u>\$2,847,259</u>		<u>\$37,333</u>	
<u>Per Audit (Work Order No.)</u>	<u>Acct. No.</u>	<u>UPIS</u>	<u>Dep. Rate</u>	<u>Dep. Expense</u>	<u>Notes</u>
0647-116-01-01 Reuse Plant Facilities	354	\$1,217,630	3.13%	\$38,112	12 Months
0647-116-01-05 30hp Motor/Blower Assembly	380	10,503	2.86%	300	12 Months
0647-116-02-01 Reuse Water Main	375	346,035	2.33%	8,063	12 Months
0647-116-02-02 Gorman Pump for Reuse	371	6,590	4.00%	264	12 Months
0647-116-97-16 Reuse Mains	375	<u>948,620</u>	2.33%	<u>22,103</u>	12 Months
Totals		<u>\$2,529,378</u>		<u>\$68,842</u>	
<u>Adjustment (Work Order No.)</u>	<u>Acct. No.</u>	<u>UPIS</u>		<u>Dep. Expense</u>	
0647-116-01-01 Reuse Plant Facilities	354	\$46,706		\$4,516	
0647-116-01-05 30hp Motor/Blower Assembly	380	335		33	
0647-116-02-01 Reuse Water Main	375	(166,193)		7,068	
0647-116-02-02 Gorman Pump for Reuse	371	(128)		17	
0647-116-97-16 Reuse Mains	375	<u>(198,601)</u>		<u>19,875</u>	
Totals		<u>(\$317,881)</u>		<u>\$31,509</u>	

Exception No. 4

Subject: Land and Land Rights

16 p1 **Statement of Fact:** The utility's filing reflects a balance of \$26,830 for wastewater land as of December 31, 2001.

NARUC, Class A, Accounting Instruction 18 A, requires all amounts included in the accounts for utility plant acquired as an operating unit or system, shall be stated at the cost incurred by the person who first devoted the property to utility service.

Recommendation: The utility's balance for wastewater land is understated by \$34,013 as of December 31, 2001, based on the following audit staff determinations. (\$60,843 - \$26,830)

17-2 p 1-4 On May 16, 1984, Norman A. Rossman and William J. Goodman executed a Special Warranty Deed that transferred 783 acres of undeveloped land to South Country Corp., a California corporation for \$12,000,000, or \$15,326 per acre. Included in the aforementioned acreage was land to be used to construct a wastewater treatment plant to service the planned development.

17 p 1-2 On September 17, 1992, South Country Corp. executed a Warranty Deed that transferred 3.97 acres to Alafaya Utilities, Inc., a related party. The legal description of the property being transferred coincides with the Seminole County Property Appraiser's legal description for the utility's wastewater treatment plant facility.

17 p1 The audit staff has determined that the original cost of the land now occupied by the wastewater treatment facilities is \$60,843, based on the original cost of \$15,326 per acre times 3.97 acres for the wastewater plant site.

Exception No. 5

Subject: Accumulated Depreciation (AD)

22p1
Statement of Fact: The utility's filing reflects an adjusted balance of \$4,237,226 for wastewater accumulated depreciation as of December 31, 2001. Included in the above balance is a pro forma adjustment of \$37,333 for UPIS added subsequent to year 2001.

The utility's original certificate, approved in Order No. 14841, issued September 3, 1985, projected a composite depreciation rate of 3.3 percent based on the Commission's "Sewer System Guideline Average Service Lives" found in Rule 25-10.32, Florida Administrative Code (F.A.C.), (current Rule 25-30.140, F.A.C.).

The utility used account specific rates to depreciate its UPIS from 1985 through 1994.

Order No. PSC-95-0489-FOF-SU, issued April 18, 1995, approved the transfer of the utility's assets to its present owners.

22-1
22-2
The utility's Annual Reports filed with the Commission indicate that its new owners used a composite rate of 1.5 percent to depreciate its UPIS in 1995 and 1996 and that from 1997 to the present it has used the guideline rates applied for specific accounts that is established in Rule 25-30.140, F.A.C.

Recommendation: The utility's adjusted accumulated depreciation is overstated by \$33,120 as of December 31, 2001, based on the following audit staff determinations.

- 22-1
- 1) The utility's 1995 and 1996 accumulated depreciation accruals are understated by \$130,221 and \$121,255, respectively, because it should not have used a composite rate of 1.5 percent to calculate depreciation expense. It should have continued using the current rates used by the seller or converted to the rule rates in effect at the time of transfer. The audit staff has recalculated accumulated depreciation accruals using the latter method for 1995 and 1996. ($\$130,137 + \$121,255 = \$251,476$)
 - 2) Exception No. 1 of this report recommended UPIS adjustments that effectively reduced wastewater accumulated depreciation by \$315,580 as of December 31, 2001.
 - 3) Exception No. 2 of this report recommended common UPIS adjustments that effectively reduced wastewater accumulated depreciation by \$1,803 as of December 31, 2001.
 - 4) Exception No. 3 of this report recommended pro forma UPIS adjustments that effectively increased wastewater accumulated depreciation by \$31,509 as of December 31, 2001.
 - 5) Exception No. 10 of this report reclassified \$1,278 of O&M expense that should have been recorded in accumulated depreciation as of December 31, 2001.

<u>Issue</u>	<u>Adjustment</u>	<u>Action</u>	<u>Amount</u>
1	Incorrect Depreciation Rates	Increase	\$251,476
2	Exception No. 1	Decrease	(315,580)
3	Exception No. 2	Decrease	(1,803)
4	Exception No. 3	Increase	31,509
5	Exception No. 10	Increase	<u>1,278</u>
	Net Audit Staff Adjustment	Decrease	(\$33,120)

Exception No. 6

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

20
23
Statement of Fact: The utility's filing reflects balances of \$9,226,883 and \$2,642,919 for wastewater CIAC and accumulated amortization of CIAC, respectively, as of December 31, 2001.

Order No. 14841, granting the utility's original certificate, approved a capacity fee of \$410 per Equivalent Residential Connection (ERC). Subsequently, Order No. PSC-98-0391-FOF-SU, issued March 16, 1998, increased the capacity fee to \$640.

The above Order also established the use of a composite rate in determining annual accruals to accumulated amortization of CIAC.

20-1
23-1
Recommendation: The utility's CIAC and accumulated amortization of CIAC are understated by \$769,606 and \$846,348, respectively, as of December 31, 2001, based on the following audit staff determinations.

- 20-2
20-3
1P1
- 1) The utility's Annual Reports, which tie to its MFRs filing, reflect that the \$9,226,883 CIAC balance is composed of \$7,314,048 of contributed UPIS and \$1,912,835 of capacity fees collected from customer connections. The utility's 2001 Annual Report reflects that it served 5,796 wastewater customers as of December 31, 2001.

20-3
The audit staff recalculated the amount of capacity fees that should have been collected based on the 5,796 customers indicated above and determined a balance of \$2,682,441 as of December 31, 2001. The result is an imputed increase of \$769,606 to CIAC as of December 31, 2001. (\$2,682,441 - \$1,912,835) See Schedule D that follows for details.

- 23-1
- 2) The audit staff's analytical review of utility accruals to accumulated amortization of CIAC in its Annual Reports determined that the utility used inaccurate composite rates to amortize its CIAC balance, and the audit staff's adjustment to CIAC capacity fees collected above also requires an additional increase to accumulated amortization of CIAC. The two adjustments result in an imputed increase of \$846,348 to accumulated amortization of CIAC as of December 31, 2001. See Schedule E that follows for details.

51
Additionally, the above-mentioned CIAC adjustment requires a corresponding increase of \$23,050 to CIAC amortization expense for the period ended December 31, 2001.

Schedule D for Exception No. 6

20-3

	Number of 5/8" <u>Meters(1)</u>	Number of meters ≥ 5/8"(1)	Total Meter <u>Additions</u>	CIAC Additions for 5/8" <u>Meters(2)</u>	CIAC Additions for Meters ≥ 5/8"(3)	Total Capacity Fee <u>Additions</u>	Total Contributed Plant <u>Additions(4)</u>	Total CIAC <u>Additions</u>
1985	74	0	74	\$30,340	\$0	\$30,340	\$357,491	\$387,831
1986	576	0	576	236,160	31,561	267,721	1,720,209	1,987,930
1987	461	0	461	189,010	0	189,010	442,011	631,021
1988	332	2	334	136,120	0	136,120	1,145,046	1,281,166
1989	783	5	788	321,030	0	321,030	836,624	1,157,654
1990	176	2	178	72,160	0	72,160	134,018	206,178
1991	933	2	935	382,530	0	382,530	543,321	925,851
1992	407	0	407	166,870	0	166,870	0	166,870
1993	292	0	292	119,720	0	119,720	(13,388)	106,332
1994	377	0	377	154,570	0	154,570	0	154,570
1995	144	9	153	59,040	2,753	61,793	0	61,793
1996	96	1	97	39,360	5,241	44,601	0	44,601
1997	168	3	171	68,880	21,625	90,505	857,280	947,785
1998	54	0	54	22,140	0	22,140	0	22,140
Increase in capacity fees as of March 1998(2)								
1998	208	2	210	133,120	47,137	180,257	483,497	663,754
1999	222	1	223	142,080	2,742	144,822	0	144,822
2000	178	3	181	113,920	1,932	115,852	807,939	923,791
2001	<u>285</u>	<u>0</u>	<u>285</u>	<u>182,400</u>	<u>0</u>	<u>182,400</u>	<u>0</u>	<u>182,400</u>
Totals	<u>5,766</u>	<u>30</u>	<u>5,796</u>	<u>\$2,569,450</u>	<u>\$112,991</u>	<u>\$2,682,441</u>	<u>\$7,314,048</u>	<u>\$9,996,489</u>

Notes:

- 1) Meter counts are from the utility's Annual Reports.
- 2) Additions are based on \$410 collected for each 5/8 meter connected until March 1998. Order No. PSC-98-0391-FOF-SU increased the capacity fee to \$640.
- 3) Collections made for meters greater than 5/8 are provided by the company's Annual Reports and tie to the G/L.
- 4) Contributed plant additions are per the company's Annual Report, and the audit staff has no adjustments to these balances.

Schedule E for Exception No. 6 23-1

Ending CIAC and Amort. of CIAC per Audit							
Company	Beginning Balance		CIAC	Ending Balance	Amortization	Amortization	Ending Balance
Period	CIAC	Amortz. of CIAC	Additions	CIAC	Rate	Expense	Amortz. of CIAC
12/31/85	\$0	\$0	\$387,831	\$387,831	1.80%	\$3,500	\$3,500
12/31/86	387,831	3,500	1,987,930	2,375,761	4.20%	58,039	61,539
12/31/87	2,375,761	61,539	631,021	3,006,782	3.98%	107,108	168,646
12/31/88	3,006,782	168,646	1,281,166	4,287,948	4.74%	172,817	341,463
12/31/89	4,287,948	341,463	1,157,654	5,445,602	3.36%	163,490	504,953
12/31/90	5,445,602	504,953	206,178	5,651,780	4.69%	260,386	765,339
12/31/91	5,651,780	765,339	925,851	6,577,631	4.59%	280,812	1,046,151
12/31/92	6,577,631	1,046,151	166,870	6,744,501	4.49%	299,389	1,345,539
12/31/93	6,744,501	1,345,539	106,332	6,850,833	4.49%	305,550	1,651,090
12/31/94	6,850,833	1,651,090	154,570	7,005,403	3.55%	245,885	1,896,975
12/31/95	7,005,403	1,896,975	61,793	7,067,196	2.72%	191,601	2,088,575
12/31/96	7,067,196	2,088,575	44,601	7,111,797	2.79%	197,558	2,286,133
12/31/97	7,111,797	2,286,133	947,785	8,059,582	2.77%	209,932	2,496,066
12/31/98	8,059,582	2,496,066	685,894	8,745,476	2.74%	230,143	2,726,209
12/31/99	8,745,476	2,726,209	144,822	8,890,298	2.76%	243,042	2,969,251
12/31/00	8,890,298	2,969,251	923,791	9,814,089	2.66%	248,949	3,218,200
12/31/01	9,814,089	3,218,200	182,400	9,996,489	2.74%	271,068	3,489,267
Per Utility - CIAC, Amortz. Exp., and Accumulated Amortz. of CIAC				<u>\$9,226,883</u>		<u>\$248,018</u>	<u>\$2,642,919</u>
Audit Staff Adjustments				<u>\$769,606</u>		<u>\$23,050</u>	<u>\$846,348</u>

Exception No. 7

Subject: Working Capital

Statement of Fact: The utility's filing includes an adjustment of \$112,900 for working capital as of December 31, 2001. The addition was calculated using a balance sheet method as required in Rule 25-30.433(2), F.A.C.

Recommendation: The utility's working capital balance is understated by \$215,156 as of December 31, 2001, based on the following recommended audit staff adjustments to the utility's working capital calculation.

	<u>Per Utility</u>	<u>Audit Adjustment</u>	<u>Reference</u>	<u>Per Audit</u>
Current Assets				
Cash	\$0	\$10,046	1	\$10,046
Accounts receivable	175,137	0		175,137
Deferred debits	218,319	(88,658)	2, 3, 4	129,661
Deferred rate case expense	82,875	0	5	82,875
Misc. current & accrued assets	<u>20,604</u>	0		<u>20,604</u>
Total current assets	\$496,935			\$418,323
Current Liabilities				
Accounts payable	(\$2,998)	0		(\$2,998)
Accounts payable to assoc. co.	(293,768)	293,768	1	0
Accrued taxes	(88,382)	0		(88,382)
Accrued interest	<u>1,113</u>	0		<u>1,113</u>
Total Current Liabilities	(\$384,035)			(\$90,267)
Total Working Capital Balance	<u>\$112,900</u>	<u>\$215,156</u>		<u>\$328,056</u>

Audit Adjustments

- (1) The utility is a Class A wastewater utility that must calculate working capital according to the balance sheet approach. Cash should be included under current assets. The audit staff has included the allocated piece from the parent company. Accounts payable to associated companies is not a current liability and has therefore been removed from the calculation.
- (2) (\$1,735) - This is the difference between the MFRs and the 13-month average per the G/L.
- (3) (\$196,949) - This is the unamortized balance of deferred charges related to legal and engineering fees incurred for the utility's certificate extension. See Disclosure No. 1 for details.
- (4) \$110,026 is the unamortized balance being reclassified from UPIS and amortized over five years. See Exception No. 10 for details.
- (5) This amount is related to expenses incurred during the current rate case and has not been audited at this time.

Exception No. 8

Subject: **Cost of Capital - Parent**

3/12 **Statement of Fact:** The utility's filing reflects an 8.98 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 F 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 correct balance for accumulated deferred tax and investment tax credits. Actual division balances were used for this report.

3/14 The audit staff has recalculated the utility's average weighted cost of debt for ALF to be 7.67 percent based on its findings in Exception No. 10 of the affiliate audit mentioned above. See Schedule G that follows.

Schedule F for Exception No. 8

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 F, continued, for Exception No. 8

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 G for Exception No. 8 31p4

Utilities, Inc. - Parent Company								
Average Consolidated Cost of Capital for Alafaya 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	41.38%	\$1,951,343	36.65%	8.630%	3.163%
Short-term Debt	23,801,000	7,517,000	13,245,115	7.54%	355,560	6.68%	5.180%	0.346%
Common Equity	76,392,765	69,945,301	73,384,644	41.78%	1,969,981	37.00%	10.914%	4.038%
Acc. Deferred FIT Net of Reg. Assets	<u>16,173,472</u>	<u>16,366,079</u>	<u>16,345,859</u>	9.31%	<u>438,798</u>	8.24%	0.000%	0.000%
	\$186,712,860	\$167,586,362	\$175,665,970	100.00%	\$4,715,682	88.57%		
Acc. Deferred SIT					498,163	9.36%	0.000%	0.000%
Unamortized ITC					<u>0</u>	<u>0.00%</u>	0.000%	0.000%
Total Before Customer Deposits					\$5,213,845	97.93%		
Customer Deposits					<u>110,199</u>	<u>2.07%</u>	6.000%	<u>0.124%</u>
Total					<u>\$5,324,044</u>	100.00%		<u>7.67%</u>
Equity Ratio	Common Equity		\$2,153,173					
	Equity + Long & Short-term Debt		\$4,674,599					
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. 9

Subject: Wastewater Billing Analysis

Statement of Fact: The Billing Summary (Report 143) and the Billing Analysis of Alafaya Utilities, Inc. for the 3" meter, 4" meter, and reclaimed water ended at 199,000 gallons. However, the usage for these rate classes extended beyond 199,000 gallons.

The gallons for the reclaimed water recorded in the Minimum Filing Requirements (MFRs) Schedule E-2 were correct, since they were taken from the billing system instead of multiplying the number of bills by 199,000 gallons, as calculated in the billing analysis.

41-1
2-12
3

The utility's books show revenues of \$1,809,140 for the test year ended December 31, 2001. The MFRs Schedule E-2 show total annualized revenues of \$1,811,478, based on the company's billing analysis for the test year ended December 31, 2001. The difference is \$2,338 (\$1,811,478 - \$1,809,140).

Recommendation: The total gallons for the 3" and 4" meters recorded in the MFRs Schedule 2 were based on the calculation from the Billing Analysis which understated the number of gallons and revenues.

41-1
2-12

The audit staff's recalculated MFRs Schedule E-2 shows \$1,815,690 of annualized revenue for the year ended December 31, 2001. See Schedule H that follows for details. The difference between the audit staff's test year revenues and the per books revenues is \$6,550 (\$1,815,690 - \$1,809,140). Below is the recalculation of the 3" meter, and 4" meter with the correct gallons.

<u>Rate Class</u>	<u>Per Audit Actual Gallons</u>	<u>Per Company E-2 Schedule Gallons</u>	<u>Difference</u>	<u>Rate</u>	<u>Difference In Charge *</u>
3" Meter	4,429,000	2,388,000	2,041,000	\$1.76	\$3,592
4" Meter	2,294,000	1,942,000	352,000	\$1.76	620
Total	<u>6,723,000</u>	<u>4,330,000</u>	<u>2,393,000</u>		<u>\$4,212</u>

*Per 1,000 gallons

The Commission should require the utility to increase its books revenues by \$6,550 and its annualized MFRs revenues by \$4,212 for the test year ended December 31, 2001.

The Commission should also require the utility to calculate its bills on the actual gallons used beyond 199,000.

The associated Regulatory Assessment Fee adjustment to the MFRs is \$190 (\$4,212 x 4.5%).

Schedule H for Exception No. 9

41-1
2-12/3

Revised Schedule E-2 Class/ Meter Size	Total Bills	Total Gallons	Test Year Rates	Test Year Revenue	Proposed Rates	Revenue at Proposed Rates
Residential						
5/8" x 3/4"	65,696		\$12.85	\$844,194	\$15.08	\$990,696
M Gallons		485,582	1.76	<u>854,624</u>	2.07	<u>1,005,155</u>
Total Residential				<u>\$1,698,818</u>		<u>\$1,995,850</u>
Average Bill				25.86		30.38
General Service						
5/8" x 3/4"	769		\$12.85	\$9,882	\$15.08	\$11,597
M Gallons		7,469	1.76	13,145	2.07	15,461
1"	146		32.15	4,694	37.70	5,504
M Gallons		3,473	1.76	6,112	2.07	7,189
1 1/2"			64.29	0	75.40	0
M Gallons			1.76	0	2.07	0
2"	167		102.86	17,178	120.64	20,147
M Gallons		8,892	1.76	15,650	2.07	18,406
3"	12		205.72	2,469	226.20	2,714
M Gallons		4,429	1.76	7,795	2.07	9,168
4"	12		321.45	3,857	377.00	4,524
M Gallons		2,294	1.76	4,037	2.07	4,749
6"			0.00	0		0
M Gallons			1.76	0		0
8"			0.00	0		0
M Gallons			1.76	0		0
Total Gen. Serv.	1,106	26,557		<u>\$84,820</u>		<u>\$99,459</u>
Reclaimed Water						
Availability Fee	0		5.04		5.91	
Monthly Flat Fee	0		9.07		10.64	
M Gallons	12	23,074	0.60	<u>13,844</u>	0.70	<u>16,152</u>
Total Reclaimed Water	12	23,074		<u>\$13,844</u>	=	<u>\$16,152</u>
Average Bill				1,153.70		1,345.98
Miscellaneous Service Revenues				<u>18,208</u>		<u>18,208</u>
Total Annualized Revenue				<u>\$1,815,690</u>		<u>\$2,129,669</u>
Total Revenue per books/required				<u>1,809,140</u>		<u>2,125,634</u>
Immaterial Difference				<u>\$6,550</u>		<u>\$4,035</u>

Exception No. 10

Subject: Operation and Maintenance (O&M) Expense

Statement of Fact: The utility's filing reflects an adjusted balance of \$1,167,969 for wastewater O&M expenses for the 12-month period ended December 31, 2001.

The utility included the following test year adjustments to its O&M expenses to annualize its salary and pension and benefits costs based on its current year salary information.

<u>Account</u>	<u>Event</u>	<u>Total</u>
Salaries	Annualize salaries at current pay rates.	($\$32,641$)
Pension and Benefits	Annualize pension and benefits to reflect salary adjustments.	<u>$38,259$</u>
Total adjusted O&M expense		<u>$\\$5,618$</u>

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 adjusted wastewater O&M expense balance indicated above should be reduced by \$85,889 for the 12-month period ended December 31, 2001, based on the following audit staff determinations. ($\$15,946 - \$18,662 - \$83,173$)

- 1) The utility incorrectly computed the annualized salary expense adjustment depicted above by failing to include \$18,662 of historical WSC salary expenses in its calculations. See Schedule I that follows.
- 2) The utility incorrectly computed the annualized pension and benefit expense adjustment above by failing to include \$70,531 and \$12,799 of the historical operator and Florida office pension and benefits, respectively, in its calculations and by overstating the historical WSC pension and benefits by \$157 in its calculations. ($\$70,531 + \$12,799 - \$157 = \$83,173$) See Schedule J that follows.
- 3) The audit staff's analysis of the utility's O&M expense account balances identified the following adjustments which increase test year O&M expense by \$15,946 and are detailed in Schedule K that follows.
 - a) Remove \$4,699 of unsupported O&M expenses. ($\$2,085 + \$975 + \$500 + \$613 + \$526$).
 - b) Remove the \$865 security deposit for electric service that should be recorded in NARUC Account No. 142, Other Accounts Receivable.
 - c) Remove \$21,852 of amortized legal expenses incurred for a service territory dispute with the City of Oviedo pending Commission determination of the proper accounting treatment. See Disclosure No. 1 for additional details.
 - d) Remove the \$1,278 general journal entry that should have been recorded in NARUC Account No. 108, Accumulated Depreciation.
 - e) Add \$27,507 of amortized deferred maintenance expenses to NARUC Account No. 735 for major repairs at the wastewater treatment plant that were improperly capitalized. See Exception No. 1 for additional details.
 - f) Reclassify \$112,459 of land lease expense from NARUC Account No. 720, Materials & Supplies to NARUC Account No. 741, Rental of Real Property.
 - g) Add \$17,133 of maintenance expense to NARUC Account No. 735 for repairs that were improperly capitalized. See Exception No. 1 of this report for additional details.

Schedule I, for Exception No. 10 *43-3p1*

<u>Actual Test Year</u>	<u>Per Utility</u>	<u>Salary Expense</u>	
		<u>Adjustment</u>	<u>Per Audit</u>
Operator Salaries	\$242,891	\$0	\$242,891
Office Salaries	43,044	0	43,044
Allocated WSC Salaries	<u>8,114</u>	<u>18,662</u>	<u>26,776</u>
Totals	\$294,049	\$18,662	\$312,711
Adjusted Test Year			
Operator Salaries	\$196,326	\$0	\$196,326
Office Salaries	30,192	0	30,192
Allocated WSC Salaries	<u>34,890</u>	<u>0</u>	<u>34,890</u>
Totals	\$261,408	\$0	\$261,408
Adjustments			
Operator Salaries	(\$46,565)	\$0	(\$46,565)
Office Salaries	(12,852)	0	(12,852)
Allocated WSC Salaries	<u>26,776</u>	<u>(18,662)</u>	<u>8,114</u>
Totals	(\$32,641)	(\$18,662)	(\$51,303)

Schedule J for Exception No. 10 *43-3p1*

<u>Actual Test Year</u>	<u>Per Utility</u>	<u>Pension & Benefit Expense</u>	
		<u>Adjustment</u>	<u>Per Audit</u>
Operator P&B	\$0	\$70,531	\$70,531
Office P&B	0	12,799	12,799
Allocated WSC P&B	<u>10,635</u>	<u>(157)</u>	<u>10,478</u>
Totals	\$10,635	\$83,173	\$93,808
Adjusted Test Year			
Operator P&B	\$32,699	\$0	\$32,699
Office P&B	5,560	0	5,560
Allocated WSC P&B	<u>10,635</u>	<u>0</u>	<u>10,635</u>
Totals	\$48,894	\$0	\$48,894
Adjustments			
Operator P&B	\$32,699	(\$70,531)	(\$37,832)
Office P&B	5,560	(12,799)	(7,239)
Allocated WSC P&B	<u>0</u>	<u>157</u>	<u>157</u>
Totals	\$38,259	(\$83,173)	(\$44,914)

Schedule K, for Exception No. 10 **43A**

<u>Acct.#</u>	<u>Description</u>	<u>Amount</u>	<u>Action</u>	<u>Issue</u>
711	Sludge Hauling Expense	(\$2,085)	Remove unsupported expense.	3a
715	Purchase Power	(865)	Remove electric service deposit.	3b
720	Materials & Supplies	(21,852)	Remove amortized legal fees for territory dispute.	3c
720	Materials & Supplies	(112,459)	Reclassify land lease to proper NARUC account.	3f
720	Materials & Supplies	(975)	Remove unsupported expense.	3a
720	Materials & Supplies	(500)	Remove unsupported expense.	3a
720	Materials & Supplies	(1,278)	Remove journal booking error.	3a
733	Contract Services-Legal	(613)	Remove unsupported expense.	3a
735	Contract Services-Other	44,640	Add maintenance cost	3e, 3g
741	Rental of Real Property	112,459	Reclassify land lease to proper NARUC account.	3f
750	Transportation Expense	<u>(526)</u>	Remove unsupported expense.	3a
		<u>\$15,946</u>	Total O&M adjustments	

Exception No. 11

Subject: Operation and Maintenance (O&M) Expense - Common Allocations

Statement of Fact: The utility's records indicate that it was allocated \$88,746 of common O&M expenses from Water Service Corporation (WSC) for the 12-month period ended December 31, 2001.

Recommendation: The utility's allocated WSC O&M expenses are overstated by \$10,859 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 ALF'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 ALF receives from WSC by \$10,859.

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. 12

Subject: Depreciation and Amortization of CIAC Expense

Statement of Fact: The utility's filing reflects a net adjusted balance of \$187,504 for wastewater depreciation expense for the 12-month period ended December 31, 2001.

5/1

	<u>Wastewater</u>
Depreciation expense	\$435,522
CIAC amortization expense	<u>(248,018)</u>
Net depreciation expense	<u>\$187,504</u>

Recommendation: The utility's wastewater net adjusted depreciation expense balance should be reduced by \$10,782 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 wastewater depreciation expenses by \$17,365 for the 12-month period ended December 31, 2001.
- 2) Exception No. 2 of this report recommended common UPIS adjustments that effectively reduced wastewater depreciation expenses by \$1,803 for the 12-month period ended December 31, 2001.
- 3) Exception No. 3 of this report recommended pro forma UPIS adjustments that effectively increased wastewater depreciation expenses by \$31,509 for the 12-month period ended December 31, 2001.
- 4) Exception No. 6 of this report recommended CIAC adjustments that effectively increased wastewater amortization of CIAC expenses by \$23,050 for the 12-month period ended December 31, 2001.

<u>Issue</u>	<u>Action</u>	<u>Amount</u>
1 Exception No. 1 - Depreciation Expense	Decrease	(\$17,438)
2 Exception No. 2 - Depreciation Expense	Decrease	(1,803)
3 Exception No. 3 - Depreciation Expense	Increase	31,509
4 Exception No. 6 - CIAC Amtz. Expense	Increase	<u>(23,050)</u>
Net adjustment	Decrease	<u>(\$10,782)</u>

Exception No. 13

Subject: Taxes Other Than Income (TOTI)

531 **Statement of Fact:** The utility's filing reflects an adjusted balance of \$151,514 for wastewater TOTI for the 12-month period ended December 31, 2001.

Included in the above balance is an adjustment that increases its payroll tax expenses by \$18,197.

Recommendation: The utility's adjusted TOTI balance indicated above should be reduced by \$33,676 per the audit findings discussed below.

531 1) The utility recorded Regulatory Assessment Fees (RAFTs) of \$81,743 which were paid on 2000 revenues. Actual RAFTs paid for 2001 are \$81,411, a difference of (\$311).

Additionally, the audit staff adjusted test year revenues by \$4,212. (See Audit Exception No. 9 for details.) The associated RAF adjustment is \$190 ($4,212 \times .045$).

The combined effect of the two adjustments requires a reduction in RAFTs of \$121 ($\$190 - \311).

2) A prior audit of Utilities Inc.'s Affiliate Transactions, Audit Control No. 02-122-3-1, Exception No. 7 made specific adjustments to payroll tax expense that effectively reduced Alafaya Utilities' allocation by \$5,782.

The utility incorrectly computed the payroll tax expense adjustment referenced above by failing to include \$19,233, \$3,505, and \$5,035 of historical operator, office, and WSC payroll taxes, respectively, in its calculations. This error caused it to overstate its payroll tax adjustment by \$27,773. ($\$19,233 + \$3,505 + \$5,035$) See Schedule L that follows for details.

The combined effect of the two errors above requires a reduction in payroll taxes of \$33,555. ($\$5,782 + 27,773$)

531

<u>TOTI Account</u>	<u>Per Utility Balance</u>	<u>Audit Adjustments</u>	<u>Issue</u>	<u>Per Audit Balance</u>
Regulatory Assessment Fees	\$81,848	(\$121)	1	\$81,727
Payroll Taxes	48,589	(33,555)	2	15,034
Real Estate & Personal Property	20,927	0		20,927
Other	<u>150</u>	<u>0</u>		<u>150</u>
Total	<u>\$151,514</u>	<u>(\$33,676)</u>		<u>\$117,838</u>

Schedule L for Exception No. 13

53-1
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<u>Actual Test Year</u>	<u>Per Utility</u>	<u>Payroll Tax Expense Adjustment</u>	<u>Per Audit</u>
Operator Salaries	\$0	\$19,233	\$19,233
Office Salaries	0	3,505	3,505
Allocated WSC Salaries	<u>2,619</u>	<u>5,035</u>	<u>7,654</u>
Totals	\$2,619	\$27,773	\$30,392
Adjusted Test Year			
Operator Salaries	\$15,754	\$0	\$15,754
Office Salaries	2,443	0	2,443
Allocated WSC Salaries	<u>2,619</u>	<u>0</u>	<u>2,619</u>
Totals	\$20,816	\$0	\$20,816
Adjustments			
Operator Salaries	\$15,754	(\$19,233)	(\$3,479)
Office Salaries	2,443	(3,505)	(1,062)
Allocated WSC Salaries	<u>0</u>	<u>(5,035)</u>	<u>(5,035)</u>
Totals	\$18,197	(\$27,773)	(\$9,576)

Exception No. 14

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.

Disclosure No. 1

Subject: Miscellaneous Deferred Debits

12 **Statement of Fact:** The utility's general ledger reflects balances of \$65,814 and \$218,545 in Accounts Nos. 186030, Miscellaneous Regulatory Commission Expense and 1862041, Deferred Charges Attorney Fees.

12 The utility's general ledger also reflects a corresponding balance of \$87,410 in Account No. 1865041- Amortization of Attorney Fees, which includes \$21,852 of amortized attorney fees for the 12-month period ended December 31, 2001. There is no corresponding amortization account balance in the utility's general ledger for Account No. 186030 above.

Order No. PSC-98-0391-FOF-SU, issued March 16, 1998, approved \$56,373 of legal fees, engineering fees, and in-house personnel expenses, related to the utility's reuse proceeding before the Commission.

NARUC, Class A, Balance Sheet Account, Account 186, states that this account shall include all debits not elsewhere provided for, such items the proper final disposition of which is uncertain.

Recommendation: The audit staff's analysis of the supporting invoices for these two accounts indicates that the majority of the expenses incurred were for legal and engineering fees related to the utility's extension of its service territory and an associated legal battle with the City of Oviedo, Florida, over said territory extension.

25-1 { The remaining invoices totaling \$21,335 were related to the utility's reuse case discussed in the above-mentioned Order and were recorded in Account No. 1863030. However, all of these costs were incurred after the above-mentioned Order was issued.

The audit staff defers to the analyst in Tallahassee for the proper accounting treatment of these issues.

Exception No. 7 of this report removed the unamortized balance of \$196,949 in Account No. 1865041 from the utility's working capital as of December 31, 2001, and Exception No. 10 removed its corresponding accrual of \$21,335 to O&M expenses for the 12-month period ended December 31, 2001, pending the Commission's disposition of the above issues.

Disclosure No. 2

Subject: Pro Forma Intangible Property Tax

Statement of Fact: The utility's MFRs indicated an adjusted balance of \$40,767 for real estate and personal property taxes for the 12-month period ended December 31, 2001. Included in the above balance is an adjustment that increases tangible personal property taxes by \$19,840 for pro forma plant additions of \$1,069,953. (\$1,069,953 times 18.5427 millage rate for Seminole County)

53p1

The utility's actual tangible property tax bill for year 2001 was \$6,974 and was calculated on an assessed value of \$360,000 for net UPIS assets.

53-2
2P3

The utility's net UPIS balance is \$10,196,672 as of December 31, 2001. (UPIS of \$14,396,565 less acc./dep. of \$4,199,893)

16P1
22P1

Recommendation: The audit staff is not able to determine the validity of the utility's requested tangible personal property tax adjustment based on the information provided in its filing. However, per the above-stated facts, the proposed increase to tangible property taxes appears to be inordinately high.

The audit staff defers to the analyst in Tallahassee for the proper accounting treatment of these issues.

Disclosure No. 3

Subject: Allowance-for-Funds-Used-During-Construction (AFUDC)

Statement of Fact: Order No. 21760, issued August 21, 1989, approved an AFUDC rate of 13.16 percent for all eligible projects commencing on or after January 1, 1989.

Recommendation: The utility has accrued AFUDC on its eligible construction projects using calculated rates between 9.79 percent and 10.40 percent during the years 1995 through 2001.

The utility did not request a revised AFUDC rate in this rate proceeding.

The Commission should establish a current AFUDC rate based on the utility's average cost of capital for this rate proceeding.

Disclosure No. 4

Subject: Original Cost Study

16-1
Statement of Fact: On October 17, 1994, Utilities, Inc. filed an application for transfer of majority organizational control of Alafaya Utilities, Inc. from South Country Corp. to Utilities Inc. The transfer was approved by Commission Order No. PSC-95-0489-FOF-SU, issued April 18, 1995.

Utilities, Inc. was unable to obtain sufficient documentation from the prior owner to support historical balances. Therefore, the utility hired Management & Regulatory Consultants, Inc. to conduct an Original Cost Study to support historical balances as of the date of transfer. This Original Cost Study was provided to the Commission staff.

Recommendation: The Original Cost Study discussed above includes the years 1984, the date the utility began operations, through 1993. As mentioned above, the utility transfer occurred during 1994, and the utility has informed the audit staff that its records do not include transactions occurring prior to 1995. Therefore, the Original Cost Study should have included all activity through 1994 and should not have ended at December 31, 1993.

The utility did not provide information to support the activity occurring during 1994. Therefore, the audit staff has not audited these additions to rate base. An Original Cost Study should be done to incorporate these additions.

EXHIBIT I

Schedule of Wastewater Rate Base

Florida Public Service Commission

Company: Alafaya Utilities, Inc.
 Docket No.: 020408-SU
 Schedule Year Ended: December 31, 2001
 Interim [] Final [X]
 Historic [X] Projected []

Schedule: A-2 Revised
 Page 1 of 1
 Preparer: Deborah Swain / MSA

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) Average Amount Per Books	(3) A-3 Utility Adjustments	(4) Adjusted Utility Balance	(5) Supporting Schedule(s)
1	Utility Plant In Service	\$ 14,109,471	\$ 2,847,259 (A)	\$ 16,956,730	A-6
2	Utility Land & Land Rights	26,255		26,255	A-6
3	Less: Non-Used & Useful Plant		(1,009,020) (B)	(1,009,020)	A-7
4	Construction Work In Progress	1,777,306	(1,777,306) (C)	-	-
5	Less: Accumulated Depreciation	(4,018,476)	(37,333) (D)	(4,055,809)	A-10
6	Less: CIAC	(9,225,895)		(9,225,895)	A-12
7	Accumulated Amortization of CIAC	2,518,883		2,518,883	A-14
8	Acquisition Adjustments				-
9	Accum. Amort. of Acq. Adjustments				-
10	Advances For Construction				A-16
11	Working Capital Allowance	-	112,900 (E)	112,900	A-17
12	Total Rate Base	\$ 5,187,544	\$ 136,500	\$ 5,324,044	

EXHIBIT II

Schedule of Wastewater Net Operating Income

Florida Public Service Commission

Company: Alafaya Utilities, Inc.
 Docket No.: 020408-SU
 Test Year Ended: December 31, 2001
 Interim [] Final [X]
 Historic [X] or Projected []

Schedule: B-2 Revised
 Page 1 of 1
 Preparer: Deborah Swain / MSA

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	\$ 1,809,140	\$ 2,338 (A)	\$ 1,811,478	\$ 314,156 (F)	\$ 2,125,634	B-4, E-13
2	Operation & Maintenance	1,162,351	5,616 (B)	1,167,969	27,625 (G)	1,195,594	B-6, B-3
3	Depreciation, net of CIAC Amort.	150,171	(42,783) (C)	107,388	37,333 (H)	144,721	B-14, B-3
4	Amortization			0	0 (I)		B-3
5	Taxes Other Than Income	133,212	18,302 (D)	151,514	33,646 (J)	185,160	B-15, B-3
6	Provision for Income Taxes	60,160	7,208 (E)	67,368	54,662 (K)	122,030	C-1, B-3
7	OPERATING EXPENSES	1,505,894	(11,655)	1,494,239	153,296	1,647,535	
8	NET OPERATING INCOME	\$ 303,246	\$ 13,993	\$ 317,239	\$ 160,860	\$ 478,099	
9	RATE BASE	\$ 5,187,544		\$ 5,324,044		\$ 5,324,044	
10	RATE OF RETURN	5.85 %		5.96 %		6.98 %	

EXHIBIT III

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

Florida Public Service Commission

Company: Alafaya Utilities, Inc.
Docket No.: 020408-SU
Test Year Ended: December 31, 2001
Schedule Year Ended: December 31, 2001
Historic [] or Projected [X]

Schedule: D-1 Revised
Page 1 of 1
Preparer: Deborah Swain / MSA

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) Total Capital	(2) Ratio	(3) Cost Rate	(4) Weighted Cost	
1	Long-Term Debt	2,356,658	44.26 %	8.82 %	3.90 %
2	Short-Term Debt	449,433	8.44 %	0.03 %	0.00 %
3	Preferred Stock				
4	Customer Deposits	110,199	2.07 %	8.00 %	0.12 %
5	Common Equity	2,391,591	44.92 %	11.05 %	4.96 %
6	Tax Credits - Zero Cost				
7	Accumulated Deferred Income Tax	16,163	0.30		
8	Other (Explain)				
9	Total	5,324,044	100.00 %		8.98 %