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REPLY TO ALTAMONTE SPRINGS

June 18, 2003

HAND DELIVERY

Ms. Blanca Bayo
Commission Clerk and Administrative Services Director
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

Re: Cypress Lakes Utilities, Inc.; Application for Rate Increase in Polk County
Florida; Docket No. 020407-WS
Our File No. 30057.45

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are the original and seven (7) copies of Cypress Lakes Utilities, Inc.'s Response to Order to Show Cause.

Should you have any questions concerning the enclosed, please do not hesitate to give me a call.

Very truly yours,



MARTIN S. FRIEDMAN
For the Firm

ORIGINAL

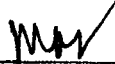
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MARTIN S. FRIEDMAN, P.A.
VALERIE L. LORD, OF COUNSEL
(LICENSED IN TEXAS ONLY)

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COMMISSION
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AUS _____ MSF/dmp
CAF _____ Enclosures
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COM _____
CTR _____ cc: Mr. Steven M. Lubertozzi (w/enclosure)
ECR _____ Mr. Patrick Flynn (w/enclosure)
GCL _____ Mr. David L. Orr, EI (w/enclosure)
OPC _____
MMS _____
SEC _____
OTH _____

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FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER DATE

05409 JUN 18 8

FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application of)
CYPRESS LAKES UTILITIES, INC.)
for a rate increase in Polk County) DOCKET NO. 020407-WS
_____)

RESPONSE TO ORDER TO SHOW CAUSE

CYPRESS LAKES UTILITIES, INC. (“Utility”), by and through its undersigned attorneys and pursuant to Order No. PSC-03-0647-PAA-WS, responds to the Show Cause Order as follows:

The Show Cause Order directed the Staff to identify the specific areas where it believed non-compliance existed. By letter dated May 21, 2003, the Staff complied with this directive. A copy of that letter has been filed in this Docket, Document No. 04671-03. Attached hereto is the response of the Utility to that letter, which incorporates a plan and schedule for addressing the Staff’s areas of concern.

While the attached response addresses the issues raised in the Staff’s letter, a response to the issues raised in the Show Cause Order itself is appropriate.

The alleged non-compliance with NARUC USOA are based upon standards that involve a certain degree of subjectivity. Accounting Instruction 2.A. requires books “so as to be able to furnish readily full information” as to any item in an account. Accounting Instruction 3.D. requires that a list of account numbers and subdivision of accounts be “readily available”. Rule 25-30-450, F.A.C. requires that work sheets supporting the schedules and data submitted must be organized in a “systematic and rational manner so as to enable Commission personnel to verify the schedules in an expedient manner and minimum amount of time.”

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These “standards” are subject to legitimate differing interpretations. That is not to say that there is not room for improvement which is already underway, and is reflected in the recent audit by the Staff in connection with the Lake Groves Utilities, Inc., overearnings investigation.

A number of the Orders referenced in the Order to Show Cause predate the 1998 modifications to the Utilities, Inc., accounting systems. In the most recent Order issued December 31, 2000, in the Wedgefield Utilities, Inc., rate case, the Staff and utility personnel were to get together so that the Utility could understand the previous concerns of the Staff. Although there were some attempts, no meeting took place to articulate the Staff’s concerns.

As set forth above, there are substantial questions of material fact regarding whether the Utility is in compliance with NARUC USOA. However, although the Utility does not believe a fine of \$3,000 (or any amount) is appropriate, it does not make economic sense to hold a formal administrative hearing on the factual issues. As shown by the response to the Staff’s letter articulating the Staff’s concerns with the Utility’s books and records, the Utility is in good faith addressing those concerns.

Respectfully submitted on this
18 day of June, 2003 by:

ROSE, SUNDSTROM & BENTLEY, LLP
600 S. North Lake Boulevard
Suite 160
Altamonte Springs, Florida 32701
(407) 830-6331
(407) 830-8522 Fax

By:

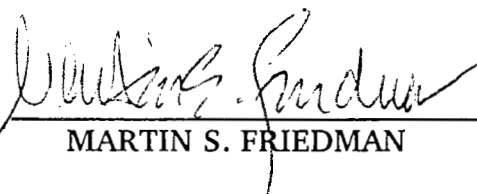

MARTIN S. FRIEDMAN

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U. S. Mail this 16 day of June, 2003, to:

Lawrence Harris, Esquire
Katherine Echternacht, Esquire
Office of General Counsel
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

Jack Shreve
Office of Public Counsel
Claude Pepper Building
111 W. Madison Street, Suite 812
Tallahassee, FL 32399

By: 
MARTIN S. FRIEDMAN

UTILITIES, INC.

2335 Sanders Road
Northbrook, Illinois 60062-6196
Telephone 847 498-6440
Facsimile 847 498-2066

June 17, 2003

Via Hand Delivery

Denise N. Vandiver
Bureau Chief of Auditing
Division of Auditing and Safety
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Patricia W. Merchant
Supervisor, File and Suspended Cases
Division of Economic Regulation
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

RE: Docket No. 020407-WS, Application for Increase Water and Wastewater in Polk County for Cypress Lakes Utilities, Inc. – Recommendation For Apparent Violation of Commission Rules Regarding Books and Records for Florida Subsidiaries of Utilities, Inc.

Dear Ms. Vandiver and Ms. Merchant:

Thank you for your correspondence of May 21, 2003, and as you are aware the Commission's Order in the above referenced docket was issued on May 28, 2003, whereby requiring Utilities, Inc. to respond, by June 18, 2003 to all alleged deficiencies noted in your letter. Below please find Utilities, Inc.'s responses and corrective measure being implemented.

No. 1

Commission

The MFRs are designed with a column titled "Balance Per Books". This column must reflect the balances on the General Ledger. The Annual Report must also reflect the same balances.

Utilities, Inc.'s Response

The Utility understand the importance of this issue and ensures the Commission that all rate cases filed in the future will comply with this requirement.

No. 2

Commission

All adjustments to the utility balances that are included in Commission orders must be booked by the utility within 60 days of the date of the order. The utility must submit documentation showing that these adjustments have been made within 90 days of the date of the order. These adjustments include the following:

- a) Transfer: when the utility purchases a system, the balances included in the Commission order setting rate base must be recorded on the utility books.
- b) Adjustments: when the Commission adjusts rate base item in an order that becomes final, these adjustments must be made on the utility books.

Utilities, Inc.'s Response

Utilities, Inc. is in the process of reviewing all prior Commission orders and comparing those orders to our books and records to assure compliance. As you are aware we have filed numerous test year approval letters earlier this year and are currently conducting a comparison analysis on an expedited basis for those companies. In addition, we anticipate that the review process for all other Florida companies will be completed prior to the filing of our 2003 Annual Reports.

No. 3

Commission

The structure of the utility's accounting system, particularly regarding O&M expenses, continues to require significant amounts of staff time to reconcile the MFR filings to the books and records. Specifically, our audit of Account 620

(Materials and Supplies-Water) and Account 720 (Material and Supplies-Wastewater) is cumbersome, difficult, and time-consuming. We would suggest that the utility add two fields to its General Ledger and accounting reports as follows:

- a) USOA account cross-reference.
- b) Allocation methodology

If these two fields are added, the Commission staff may be able to sort the General Ledger in a more efficient manner and reconcile the utility accounts to the NARUC accounts in an expeditious manner. Also, we have found some inconsistencies in how a particular account may be allocated in different methodologies for different subsidiaries. (For instance, GL Account #6355010, #3755090, and #6759503 are cross referenced to NARUC account #620. In Cypress Lake, the amounts are allocated between water and wastewater. In UIF, the amounts are allocated to water only.) The addition of an allocation field will facilitate an efficient reconciliation of the accounting records and the MFRs. We believe that it may also be an opportunity for the utility to verify the consistent application of each allocation methodology.

Utilities, Inc.'s Response

The Utility's financial software package precludes us from providing this information within a general ledger report, because our software limits text to 132 characters per line. However, in all future proceedings the Utility will provide as a separate document a detailed listing of all General Ledger account numbers, the corresponding USOA account number and the method of allocation. This allocation will include percentages and methodology from our affiliate company (Water Service Corp.) and any other affiliate relationship including Utilities, Inc. of Florida to all other Florida operating subsidiaries.

No. 4

Commission

The utility has generally done a good job at matching plant accounts to NARUC accounts. However, Account 310 (Power Generation Equipment) is included in Account 311 (Pumping Equipment).

Utilities, Inc.'s Response

The Utility is currently reviewing this allegation against its annual reports and will provide the Commission and Staff with the any required adjusting journal entries.

No. 5

Commission

The utility has a four-step policy for retirement of Utility Plant in Service (UPIS). The utility appears to be inconsistent in applying its policy. The utility should develop a method to improve its implementation of its policy, i.e. a new form procedure, internal control, etc. Two findings regarding this are found in Docket No. 020071 – WS (UIF), Exception No. 4 and the undocketed affiliate audit, Exception No. 1. In the UIF audit, staff found \$299,017.94 of additions which did not have corresponding retirements. In the affiliate audit, staff found inadequate documentation regarding the disposition of old computer that are either transferred or destroyed when new ones are purchased.

• Utilities, Inc.'s Response

The Utility has recently moved to a fully automated work order system to facilitate our work order process. The Utility is going to add the following fields to the work order form and input screen, which will allow us to better track retirements when items are moved from the CP ledger to the General Ledger:

1. New,
2. Upgrade,
3. Repair, and
4. Replace.

These additional data entry fields will allow us to sort all projects and better evaluate which projects require retirements. In addition to the above mentioned fields, will also be requiring that our operations' employees provide us the original date the asset was placed in service or the original cost, if available.

No. 6

Commission

Rule 25-30.140(8), F.A.C., states that the CIAC "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." The audit staff has found that the utility is able to identify the CIAC to specific accounts. Therefore, the utility is incorrect in using a composite amortization rate for those systems that CIAC has specifically identified by account. The utility shall begin amortizing CIAC using the corresponding depreciation rates.

Utilities, Inc.'s Response

In addition to agreeing with the comment listed above the, Utilities, Inc. is also aware that there is new rule pending at the Florida Public Service Commission and once that rule is adopted all Class A and Class B utilities will have to amortize CIAC using the corresponding depreciation rates. Utilities, Inc. intends to comply with all Commission Orders.

No. 7

Commission

The utility does not maintain adequate documentation regarding its allocation methodology. As discussed in Disclosure No. 2 of the affiliate audit, staff attempted to verify the accuracy of the customer equivalents used to allocate the expenses of Water Services Corporation. In order to complete this task, staff requested gallons of water purchased and pumped and gallons of wastewater treated to determine our own calculation of equivalent residential connection (ERCs) for each company. The company could not provide gallons of wastewater treated for states other than Florida. It claimed that operating reports were not available to provide the information. In addition, some small water plants did not have usage reports. The report of number of customers that the company did provide showed water customers and did not break down wastewater numbers by division. Therefore, we were unable to determine ERCs and unable to determine if the company's computation is reasonable.

Utilities, Inc.'s Response

The Utilities allocation methodology to distribute commons expenses and Utility Plant in Service is based upon customer equivalents and is an equitable allocation. The Utility has and will continue to communicate directly with FPSC auditor Kathy Welch to assure that information that is required is being provided. The Utility is cognizant of Staff's disagreement with using this methodology and would like to invite staff and the Office of Public Counsel to discuss this method and other allocations methods. In addition, the Utility's current allocation method has been approved in other states in which it operates.

No. 8

Commission

In a related matter to the above issue the affiliate audit found evidence that the utility does not allocate costs to systems that the utility does not own but systems for which the utility performs management and/or billing functions.

Utilities, Inc.'s Response

The Utility does not currently allocate Water Service Corporation expenses to utilities that it does not own but operates. We do not allocate expenses to these systems because they do not require the same level of attention from management as subsidiaries that are owned and operated. However, in light of the Commission's inquiry the Utility will allocate costs to systems that it does not own but operates. In addition, the Utility believes that a water or sewer customer in a system that Utilities, Inc. owns and operates is not equivalent to a water or sewer customer in a system that it operates but does not own. Utilities, Inc. will develop a methodology for allocating costs to these systems that will be implemented to allocate costs in the 2003 Annual Reports.

No. 9

Commission

As evidenced by the Cypress Lakes proceedings, the utility does not adequately document its normal "other water uses" such as line flushing and line breaks. The utility should maintain records indicating actual usage or documentation regarding estimation methodology for each individual event, with a monthly summary.

Utilities, Inc.'s Response

Each month the operators of the various water systems in Florida provide the regional office with a monthly flushing log sheet. This log identifies the estimated volume of water used in such activities as line flushing, hydrant use, water main and service line breaks, construction activities, and filling new water mains. The estimated volume is recorded and tracked internally on the system's water report to assist in determining percent of unaccounted for water. These reports are kept and are available for the Commission's review. The Utility is committed to improving this reporting mechanism by educating its field personnel of the importance of accurately estimating these flows.

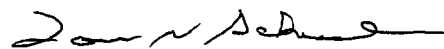
In addition to the nine concerns listed above, Florida Public Service Commission auditors (Jeff Small and Kathy Welch of the Division of Auditing and Safety) who were in Northbrook, Illinois the weeks of June 2nd and June 9th have brought two additional items to our attention. They are the following:

- 1) the Utility should keep an adjusting entry log book, and
- 2) the Utility should provide more detail in the cash book and general ledger.

The Utility has already advised its accounting staff of the additional detailed requested from the auditors and the Utility is studying the adjusting journal entry log book proposal.

In accordance with Commission Order No. PSC-03-0647-PAA-WS, issued May 5, 2003 I have attached as Exhibit A, a schedule indicating the Utility's plan to comply with this order. In closing, Utilities, Inc. would like to advise the Commission and their staff of Utilities, Inc.'s desire and commitment to have a positive working relationship with staff and our willingness to work with staff to address any concerns that staff or the Commissioners may have. In agreement with this approach I, along with our President & CFO, and Director of Regulatory Accounting had a meeting with Auditors Kathy Welch and Jeff Small to discuss any additional concerns or issues they had. I found (and I believe that Jeff and Kathy did too) this meeting to be extremely helpful and informative. If you require any further information, please feel free to contact me at (847) 498-6440.

Sincerely yours,



Lawrence N. Schumacher
President & CFO
Utilities, Inc.

cc: James Camaren

Cypress Lakes Utilities, Inc.			Exhibit A
Summarization of Response to Show Cause Order			
		Utilities, Inc.'s Response	Time Frame
Issue No. 1	MFR "Balance Per Books"	All subsequent MFR filings will adhere to this rule.	All future MFRs will adhere to this requirement.
Issue No. 2	Commission Ordered Adjustments	Currently reviewing all prior Commission Orders in a comparison analysis.	Adjusting entries will be booked and/or policy implemented prior to filing any MFRs or prior to filing 2003 Annual Reports.
Issue No. 3	Account Cross-Reference & Allocation Methodology	The requested information cannot be provided within the general ledger systems; however, UI will provide a schedule with the requested information for all subsequent MFR.	Policy implemented and schedules will be provided concurrently with future MFR filings.
Issue No. 4	Plant Account	Comparing Account 310 to Account 311 for misclassifications.	Adjusting entries booked prior to filing 2003 Annual Reports, if applicable.
Issue No. 5	Retirements	Adding new fields to better track retirements and require additional information from the filed.	Additional fields in the work order system will be added prior to month end.
Issue No. 6	CIAC Amortization Rate	On a go forward basis when the plant account is known the Utility will use the corresponding rate and will comply with the Commission's	On a go forward basis.

Cypress Lakes Utilities, Inc.			Exhibit A
Summarization of Response to Show Cause Order			
		Utilities, Inc.'s Response	Time Frame
		proposed rule if and when adopted.	
Issue No. 7	Water Service Corp. Allocation	Utilities, Inc. believes that its current methodology is equitable and will work with staff to facilitate audit process of WSC's allocations.	Will arrange a meeting or conference call to discuss different methodologies.
Issue No. 8	Systems operated not owned	Utilities, Inc. is working towards developing a methodology to allocate these costs.	Methodology developed and implemented prior to filing 2003 Annual Reports.
Issue No. 9	Document "other water uses"	Utilities, Inc. is educating is field personnel on the importance of logging this information	Currently communicating with field personnel.
Issue No. 10	Adjusting entry log book	The Utility is currently reviewing the feasibility, costs and time required to implement this procedure.	Currently reviewing feasibility.
Issue No. 11	Additional detail in cash book & general ledger	The Utility agrees that more detail can be provided in the cash book and general ledger.	Currently providing more detail in the general ledger system, where applicable.