

State of Florida



# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

COMMISSION  
CLERK

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

**DATE:** March 4, 2004

**TO:** Director, Division of the Commission Clerk & Administrative Services (Bayó)

**FROM:** Office of the General Counsel (Fleming) *LEF*  
 Division of Auditing & Safety (Vandiver) *W*  
 Division of Economic Regulation (Merchant, Willis) *W* *190*

**RE:** Docket No. 020407-WS – Application for rate increase in Polk County by Cypress Lakes Utilities, Inc.

**AGENDA:** 03/16/04 – Regular Agenda – Interested Persons May Participate

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\GCL\WP\020407.RCM.DOC

### Case Background

Cypress Lakes Utilities, Inc. (Cypress Lakes or the utility) is a Class B water and wastewater utility in Polk County. Cypress Lakes is a wholly-owned subsidiary of Utilities, Inc. (UI) and is a sister company to Utilities, Inc. of Florida (UIF) and Wedgefield Utilities, Inc. (Wedgefield). Water Services Corporation (WSC) is an affiliated service company, which provides common services to all UI subsidiaries.

On September 30, 2002, the utility filed for approval of final and interim rate increases, pursuant to Sections 367.081 and 367.082, Florida Statutes. On November 26, 2002, the utility satisfied the MFRs and this date was designated as the official filing date, pursuant to Section 367.083, Florida Statutes. By Order No. PSC-03-0647-PAA-WS (show cause order), issued on May 28, 2003, in this docket, the Commission approved proposed water and wastewater rate increases for Cypress Lakes.

In addition, the Commission ordered the utility to show cause, in writing within 21 days, why it should not be fined \$3,000 for its apparent violation of Rule 25-30.115, Florida

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Administrative Code, and Order No. PSC-00-2388-AS-WU, issued on December 13, 2000, in Docket No. 991437-WU, In re: Application for Increase in Water Rates in Orange County by Wedgefield Utilities, Inc. (Settlement Order)<sup>1</sup>, for its failure to maintain its books and records in conformance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA). Further, the Commission ordered the utility to file, along with its written response to show cause, a plan and schedule by which it intends to come into compliance with all show cause issues, including how it intends to keep its books and records in accordance with the NARUC USOA.

The show cause order also directed staff to meet with representatives of the utility to identify specific areas of non-compliance. The show cause order further directed staff to prepare a letter to communicate the specific requirements for the utility to change or implement in order to comply with the Commission's rules and orders.

On June 18, 2003, the utility filed its response to the show cause order. This recommendation addresses the disposition of the show cause proceeding. The Commission has jurisdiction pursuant to Sections 367.081, 367.121, and 367.161, Florida Statutes.

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<sup>1</sup> As part of the 2000 Settlement, Wedgefield requested that the Commission permanently suspend a \$3,000 fine for its violation of Rule 25-30.115, Florida Administrative Code. Pursuant to the Settlement Order, the Commission permanently suspended the \$3,000 fine and Wedgefield was ordered to correct any areas of noncompliance with the NARUC USOA by January 31, 2001. Further, the order required that Wedgefield and its parent, Utilities, Inc., file, in future proceedings before this Commission, MFRs which begin with utility book balances, and show all adjustments to book balances after the "per book" column in the MFRs. Additionally, Wedgefield was required to file a statement which affirms that the MFRs begin with actual book balances.

### **Discussion of Issues**

**Issue 1:** Should a fine of \$3,000 be imposed on Cypress Lakes for the utility's apparent violation of Rule 25-30.115, Florida Administrative Code, for its failure to maintain its books and records in conformance with the NARUC USOA?

**Recommendation:** No. A fine should not be imposed. The utility timely responded to the show cause and has made specific commitments to correct the deficiencies identified by staff. The utility appears to be making efforts to comply with the requirements of Rule 25-30.115, Florida Administrative Code. Attachment 1 is a summary of the deficiencies identified by staff and the utility's response. (K. FLEMING, VANDIVER, MERCHANT)

**Staff Analysis:** In Order No. PSC-03-0647-PAA-WS, in this docket, the Commission found that the utility's failure to keep its books and records in conformance with the NARUC USOA was an apparent violation of Rule 25-30.115, Florida Administrative Code, and Order No. PSC-00-2388-AS-WU. Therefore, the Commission found that a show cause proceeding was warranted and ordered the utility to show cause, in writing within 21 days, why it should not be fined \$3,000 for its apparent violation of Rule 25-30.115, Florida Administrative Code, and Order No. PSC-00-2388-AS-WU. In addition, staff was directed to meet with representatives of the utility to identify which specific areas of non-compliance existed. Staff was further directed to prepare a letter to the utility which communicated the specific requirements for the utility to change or implement in order to come into compliance with Commission rules and orders.

In addition to its response to the show cause order, the utility was ordered to file a plan and schedule by which it intended to come into compliance with all the show cause issues. These time frames included points discussed above and those which resulted from discussions and directions from staff, including how it intends to maintain its books and records in accordance with the NARUC USOA.

As directed by the Commissioners at the May 6, 2003, Agenda Conference, staff sent a letter to the utility to identify the specific areas of noncompliance. By letter dated May 21, 2003, staff detailed nine specific deficiencies that staff believed the utility should correct:

- 1) MFRs should begin with balance per books
- 2) Adjustments to rate base should be timely made
- 3) Improve account cross reference & allocation methodology
- 4) Pumping equipment account number incorrect
- 5) Retirements not made consistently
- 6) CIAC amortization rate incorrect
- 7) Water Service Corporation allocation not supported
- 8) Allocation to systems not owned, and
- 9) Document "other water uses"

By letter dated June 17, 2003, the utility timely responded to the Commission's show cause order, the nine specific deficiencies, and two additional deficiencies addressed in a meeting with the staff auditors. These additional deficiencies were:

- 10) Maintenance of adjusting entry log book, and
- 11) Lack of detail in cash book and general ledger

By letters dated July 3, 2003, August 28, 2003, and October 6, 2003, staff detailed specific areas of clarification and requested additional information and detail. The utility responded to each of these requests with letters dated August 13, 2003, October 1, 2003, and October 24, 2003. A summary of the eleven deficiencies and the company commitments is attached to this recommendation as Attachment 1.

#### Fine

Section 367.161, Florida Statutes, authorizes the Commission to assess a penalty of not more than \$5,000 for each offense, if a utility is found to have knowingly refused to comply with, or have willfully violated any Commission rule, order, or provision of Chapter 367, Florida Statutes. In failing to maintain its books and records in conformance with the USOA, the utility's act was "willful" in the sense intended by Section 367.161, Florida Statutes. In Order No. 24306, issued April 1, 1991, in Docket No. 890216-TL, In Re: Investigation Into The Proper Application of Rule 25-14.003, Florida Administrative Code, Relating To Tax Savings Refund For 1988 and 1989 For GTE Florida, Inc., the Commission having found that the company had not intended to violate the rule, nevertheless found it appropriate to order it to show cause why it should not be fined, stating that "[i]n our view, 'willful' implies an intent to do an act, and this is distinct from an intent to violate a statute or rule." Id. at 6. Additionally, "[i]t is a common maxim, familiar to all minds that 'ignorance of the law' will not excuse any person, either civilly or criminally." Barlow v. United States, 32 U.S. 404, 411 (1833).

Commission Order No. PSC-03-0647-PAA-WS found that the utility's failure to keep its books and records in conformance with the NARUC USOA was an apparent violation of Rule 25-30.115, Florida Administrative Code, and Order No. PSC-00-2388-AS-WU. It further found that a show cause proceeding was warranted and ordered the utility to show cause, in writing within 21 days, why it should not be fined \$3,000 for its apparent violation of Rule 25-30.115, Florida Administrative Code, and Order No. PSC-00-2388-AS-WU. The order stated that the utility's response to the show cause order must contain specific allegations of fact and law.

The utility's response to the show cause stated that the alleged non-compliance with NARUC USOA is based upon standards that involve a certain degree of subjectivity and that these standards are subject to legitimate differing interpretations. Therefore, the utility states, as set forth in its response, that there are substantial questions of material fact regarding whether the utility is in compliance with the NARUC USOA. In addition, the utility stated that it does not believe a fine of \$3,000, or any amount, is appropriate, and it does not make economic sense to hold a formal administrative hearing on the factual issues. The utility believes that its response to staff's letter articulating staff's concerns with the utility's books and records, is in good faith addressing those concerns.

The utility has made significant progress in addressing staff's concerns. It has committed to changes that will improve the quality of the books and records and the utility states it has

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come close to bringing them into compliance with the NARUC USOA. Based on the utility's commitments addressed in Attachment 1, staff believes that the utility's response adequately addresses the show cause issue with regard to Cypress Lakes. As such, staff recommends that a fine of \$3,000 should not be imposed on Cypress Lakes.

**Issue 2:** Should a docket be opened to address Utilities, Inc.'s plan to comply with Rule 25-30.115, Florida Administrative Code, for all Florida subsidiaries?

**Recommendation:** Yes.

**Staff Analysis:** As discussed earlier in this recommendation, this case was initiated as a rate case for Cypress Lakes Utilities, Inc., a wholly-owned subsidiary of Utilities, Inc. During the review of the MFRs, staff noted numerous deficiencies which were the basis for the show cause recommendation. The show cause order, in this docket, states that Utilities, Inc., and some of its Florida subsidiaries have been cited in prior Commission Orders for failure to comply with one or both of the above-mentioned rules. See, Order No. PSC-03-0647-PAA-WS, issued May 28, 2003, in this docket, page 43.

Staff recognizes that compliance with Rule 25-30.115, Florida Administrative Code, has been an ongoing problem with Utilities, Inc.'s Florida subsidiaries. While Utilities, Inc. has detailed a specific plan in Attachment 1 for compliance with regard to Cypress Lakes, staff believes that a separate docket is the appropriate mechanism to require that this plan be implemented for each Florida subsidiary of Utilities, Inc. The purpose of the new docket would be to analyze UI's plan and make a recommendation for UI's implementation of this plan for all Florida subsidiaries.

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**Issue 3:** Should this docket be closed?

**Recommendation:** If no party timely appeals the order, this docket shall be closed.

**Staff Analysis:** If no party timely appeals the order, this docket shall be closed.

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
1	<p><b>Balance Per Books:</b>                      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.</p>	<p>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.</p>
2	<p><b>Adjustments to Rate Base:</b>                      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:  <b>Transfers:</b> 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:</b> when the Commission adjusts rate base items in an order that becomes final, these adjustments must be made on the utility books.</p>	<p>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 Commission staff is 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.</p>



**ATTACHMENT 1**

Item No.	Staff Description	Company Response
3	<p><b>Account Cross-Reference &amp; Allocation Methodology:</b>                      The structure of the utility's accounting system, particularly regarding O&amp;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 (Materials 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: 1) USOA account cross-reference, and 2) Allocation methodology. If these two fields are added, the Commission staff should 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, #6755090, and #6759503 are cross referenced to NARUC account #620. In Cypress Lakes, 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.</p>	<p>The requested information cannot be provided within the general ledger systems; however, UI will provide a schedule in all subsequent MFR filings that is a detailed listing of all General Ledger account numbers, the corresponding USOA account number and method of allocation. This allocation will include percentages and methodology from the affiliate company (Water Service Corp.) and any other affiliate relationship including Utilities, Inc. of Florida to all other Florida operating subsidiaries.</p>

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
4	<b>Pumping Equipment:</b> 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).	The utility has reviewed this allegation and has identified the accounts and amounts in questions and will make the necessary adjusting entries. These entries will be booked within 90 days (from the August 11, 2003 letter) and will be reflected on the utilities' 2003 annual report.

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
5	<p><b>Retirements:</b>                      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 computers that are either transferred or destroyed when new ones are purchased.</p>	<p>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:</p> <ol style="list-style-type: none"> <li>1. New,</li> <li>2. Upgrade,</li> <li>3. Repair, and</li> <li>4. Replace.</li> </ol> <p>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. The utility will be reiterating to its operations personnel and accounting staff the importance of retirements to ensure that all retirements or replacements are clearly marked on all invoices and properly recorded. A memo will be distributed on or before December 15, 2003. A copy of the memo will be provided to the FPSC Staff. The memo will be created in conjunction with our Director of Corporate Accounting and Director of Operations to ensure that all divisions of the utility's personnel are involved. In addition, the memo will reiterate the company's current retirement policy so that all employees are clear as to the decisions to be made regarding retirements.</p>

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
6	<p><b>CIAC Amortization Rates:</b>                      Commission rule 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 plant 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.</p>	<p>Utilities, Inc. intends to comply with all Commission Orders and rules. As of January 2003, Utilities, Inc. and all Florida operating subsidiaries will use the appropriate amortization rate “where supporting documentation is available to identify the account or function of the related CIAC plant.” These changes will be reflected in the utilities’ 2003 annual reports.</p>

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
7	<p><b>Water Service Corp. Allocation:</b>                      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 connections (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 provided showed water customers and did not break down wastewater number of customers by division. Therefore, we were unable to determine ERCs and unable to determine if the company's computation is reasonable.</p>	<p>The allocation methodology to distribute commons expenses and Utility Plant in Service is based upon customer equivalents and is an equitable allocation. Utilities, Inc. has circulated to all operations personnel and to all branch offices, where the Single Family Equivalent (SFE) information is entered, a policy and procedure memo to ensure that the appropriate supporting documentation is being provided when an SFE is being added to the billing system. A copy was provided to staff. In addition, Utilities, Inc. does keep records of gallons pumped, purchased and treated for all operating subsidiaries and this information is available for Staff's review. Utilities, Inc. also has the capacity to generate reports that contain the numbers of gallons sold to each individual within all subdivisions and bill codes. However, we do have some limitations on content for systems where other entities control the billing data. The utility is committed to working with the FPSC's auditors prior to any subsequent audits to ensure that all requested consumption data is available. Most of the consumption is contained on Utilities, Inc.'s billing and general ledgers systems that were replaced in the second quarter of 2003. This new and improved system allows us the capacity to generate and print additional data. In addition, certain consumption data is contained in the field with operational personnel. The intent would be to work with the FPSC Staff, prior to their arrival, to ensure that all of the requested information is available.</p>

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
8	<p><b>Allocation to Systems Not Owned:</b>                      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.</p>	<p>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.</p>

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
9	<p><b>Document “other water uses”:</b>                      As evidenced by the Cypress Lakes proceeding, 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.</p>	<p>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. On July 12, 2003, Lisa Crossett, Utilities, Inc.’s Director of Operations advised all regional managers as to the importance of “other water uses” and the importance of accurately estimating this information. This information was then disseminated to all operations personnel. Within the next thirty to sixty days Utilities, Inc. will be circulating a memo to reiterate what was said on July 12th and to further elaborate on how to ensure that all future employees will be informed of these requirements. A copy will be provided to FPSC Staff.</p>

**ATTACHMENT 1**

Item No.	Staff Description	Company Response
10	<p><b>Adjusting Entry Log Book:</b>                      This issue was not included in the letter. However, in staff's meeting with you in Chicago, staff indicated that this was very important. We would like to know the results of the utility's determination on this issue before proceeding further. Specifically, we believe that each journal entry should have attached to it, or in a central filing system for all journal entries, all support for that journal entry (i.e. purpose of the entry, person making the entry, worksheets showing any calculations, and any supporting documents, reconciliations, invoices, etc.).</p>	<p>Utilities, Inc.'s Accounting Department's personnel have created a folder that will contain all manual and uploaded journal entries, this information will be sorted by month. In addition, the utility's accounting department has been advised to retroactively create these folders as of January 2003.                      The folder will contain all manual journal entries. The folder will also provide enough information that an individual can easily find source documents either within the folder or in another location.</p>
11	<p><b>Detail in Cash Book &amp; General Ledger:</b>                      The Cash Book is where all entries affecting cash are recorded. However, the book does not include the supporting documentation or a reference to where the documentation can be found. The same level of information we described for journal entries should be provided for the cash book.</p>	<p>The accounting staff will be providing as much information that is available and that the system will allow them to enter. This additional information will also be provided in the cash book.</p>