

State of Florida



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Public Service Commission

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COMMISSION  
CLERK

**DATE:** April 9, 2004

**TO:** Tiffany Joyce, Division of Economic Regulation

**FROM:** Denise N. Vandiver, Chief, Bureau of Auditing *DNV*  
Division of Auditing and Safety

**RE:** **Docket No.** 030445-WS ; **Company Name:** Utilities, Inc. of Eagle Ridge ;  
**Audit Purpose:** File and Suspend Petition for Rate Relief ; **Audit Control**  
**No.** 04-036-3-3

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)  
Division of the Commission Clerk and Administrative Services (2)  
Division of Competitive Markets and Enforcement (Harvey)  
General Counsel  
Office of Public Counsel

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**FLORIDA PUBLIC SERVICE COMMISSION**

*DIVISION OF AUDITING AND SAFETY  
BUREAU OF AUDITING*

*Orlando District Office*

**UTILITIES, INC. OF EAGLE RIDGE**

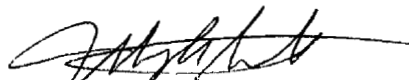
**FILE AND SUSPEND PETITION FOR RATE RELIEF**

**LEE COUNTY**

**HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

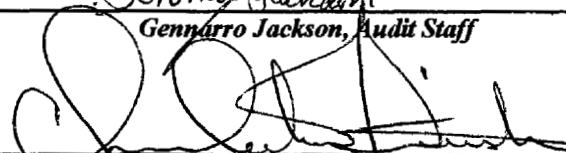
**DOCKET NO. 030445 - SU  
AUDIT CONTROL NO. 04-036-3-3**

  
\_\_\_\_\_  
*Jeffery A. Small, Audit Manager*

  
\_\_\_\_\_  
*For Kathy L. Welch, Audit Staff*

  
\_\_\_\_\_  
*Intesar Terkawi, Audit Staff*

  
\_\_\_\_\_  
*Gennarro Jackson, Audit Staff*

  
\_\_\_\_\_  
*Charleston J. Winston, District Audit Supervisor*

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

**APRIL 5, 2004**

**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, 2002, for Utilities, Inc. of Eagle Ridge's wastewater operations located in Lee County, Florida. These schedules were prepared by the utility as part of its petition for rate relief in Docket No. 030445-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 utility-plant-in-service (UPIS) and accumulated depreciation are understated by \$236,662 and \$369,339, respectively, as of December 31, 2002.

The utility's UPIS and accumulated depreciation are overstated by \$325,585 and \$34,492, respectively, as of December 31, 2002.

The utility's UPIS and accumulated depreciation are overstated by \$9,343 and \$436, respectively, as of December 31, 2002.

The utility's UPIS and accumulated depreciation are overstated by \$36,858 and \$2,048, respectively, as of December 31, 2002.

The utility's UPIS is understated by \$25,263 as of December 31, 2002.

The utility's contributions-in-aid-of-construction (CIAC) and accumulated amortization of CIAC are understated by \$252,084 and \$337,625, respectively, as of December 31, 2002.

The utility's accumulated depreciation and test year depreciation expense are understated by \$220,688 and \$85,109, respectively, as of December 31, 2002.

The utility's average weighted cost of capital is 8.85 percent

The utility's regulatory assessment fees are understated by \$1,274 for the 12-month period ended December 31, 2002.

## 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.

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

**RATE BASE:** Reviewed and verified account balances for UPIS, land, contributions-in-aid-of-construction, accumulated depreciation (AD), accumulated amortization of CIAC (AAC), and working capital (WC) for Utilities, Inc. of Eagle Ridge as of December 31, 2002. Reconciled rate base balances authorized in Commission Orders Nos. PSC-98-0514-FOF-SU, issued April 15, 1998, and PSC-01-1792-PAA-SU, issued September 5, 2001, to the utility's general ledger.

**NET OPERATING INCOME:** Reviewed utility revenues and operating and maintenance accounts for the year ended December 31, 2002. Chose a judgmental sample of customer bills and recalculated using FPSC-approved rates. Verified a judgmental sample of operating and maintenance (O&M) expenses. Reviewed the allocation of O&M expenses from Water Service Corporation (WSC) and Utilities, Inc. of Florida (UIF) cost centers to Utilities, Inc. of Eagle Ridge and verified the accuracy of company allocations based on company-provided allocation schedules. Tested the calculation of depreciation and CIAC amortization expense. Compiled support for taxes other than income and income taxes.

**CAPITAL STRUCTURE:** Reviewed the components of the capital structures for the year ended December 31, 2002. Agreed interest expense to the terms of the notes. Verified note balances at December 31, 2002.

**OTHER:** Scanned the utility's December 31, 2002, Regulatory Assessment Fee Returns.

**Exception No. 1**

**Subject: Adjustments to 1998 Utility-Plant-in-Service and Accumulated Depreciation**

**Statement of Facts:** The utility's filing reflects adjustments in 1998 that effectively increase its UPIS and reduce its accumulated depreciation balances by \$193,000 and \$313,851, respectively.

The utility stated that the adjustments were made to restate the UPIS and accumulated depreciation balances to the rate base-ordered balances.

For transfer purposes, Order No. PSC-98-0514-FOF-SU established balances of \$2,627,374 and \$674,871 for UPIS and accumulated depreciation, respectively, as of December 31, 1994. The Order also states that the Commission staff considered and determined that rate base additions for 1995 and 1996 did not have an appreciable net effect on the utility's rate base balances established above.

The utility recorded balances of \$2,864,036 and \$1,002,246 for UPIS and accumulated depreciation, respectively, as of December 31, 1997, to book the acquisition entry for the above transfer.

**Recommendation:** The utility's UPIS is understated by \$236,662, and its accumulated depreciation is understated by \$369,339 as of December 31, 2002, because of the following audit staff determinations. (\$327,375 + \$41,964)

- 1) The \$193,000 UPIS adjustment identified above, when combined with its \$30,215 of retirements, results in a net increase of \$162,785 to UPIS. The utility was not able to adequately explain the purpose for the adjustment. The audit staff has determined that the utility's adjustment effectively removes all additions to UPIS recorded in 1995 through 1997. The utility should increase its UPIS by \$236,662 to add back the 1995 through 1997 additions. (\$208,944 + \$12,086 + \$15,632 ) See the audit staff's calculations that follow.

<u>UPIS</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/94 (transfer)		\$2,627,374	\$2,627,374
1995 net additions		208,944	208,944
1996 net additions		12,086	12,086
1997 net additions		15,632	<u>15,632</u>
@12/31/97 (acquisition entry)	\$2,864,036	0	\$2,864,036
1998 net additions	(30,215)	393,329	363,114
1998 adjustment	<u>193,000</u>	(156,667)	<u>36,333</u>
@12/31/98	\$3,026,821	\$236,662	\$3,263,483

**Exception No. 1, continued**

- 2) The \$313,851 accumulated depreciation adjustment identified above, when combined with its \$56,216 of net accruals, results in a net increase of \$256,635 to accumulated depreciation. The utility was not able to adequately explain the purpose for the adjustment. The audit staff has determined that the utility's adjustment effectively removes all accruals to accumulated depreciation recorded in 1995 through 1997. The utility should increase its accumulated depreciation by \$327,375 to add back the 1995 through 1997 accruals. (\$106,133 + \$109,553 + \$111,689 ) See the audit staff's calculations that follow.

<u>Accumulated Depreciation</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/94 (transfer)		(\$674,871)	(\$674,871)
1995 accruals		(106,133)	(106,133)
1996 accruals		(109,553)	(109,553)
1997 accruals		(111,689)	<u>(111,689)</u>
@12/31/97 (acquisition entry)	(\$1,002,246)	0	(\$1,002,246)
1998 accruals	(56,216)	(5,695)	(61,911)
1998 adjustment	<u>313,851</u>	(321,680)	<u>(7,829)</u>
@12/31/98	(\$744,611)	(\$327,375)	(\$1,071,986)

- 3) The audit staff has calculated an additional \$41,964 of accruals that should be added to the utility's accumulated depreciation balance as of December 31, 2002, to record the 1998 through 2002 accruals on the \$236,662 of UPIS added back in Item No. 1 above. Additionally, the utility's depreciation expense needs to be increased by \$8,792 for the 12-month period ended December 31, 2002. See the audit staff's calculations that follow.

<u>NARUC Acct. No.</u>	<u>Utility Acct. No.</u>	<u>Audit Adjustment</u>	<u>Rule Dep. Rate</u>	<u>Yearly Accrual</u>	<u>1998 - 2002 Accrual</u>
354	3547003	\$8,925	3.70%	(\$331)	(\$1,653)
362	3804004	111,762	2.50%	(2,794)	(13,970)
363	3602006	16,535	2.86%	(472)	(2,362)
371	3542011	44,486	4.00%	(1,779)	(8,897)
380	3804005	22,284	5.56%	(1,238)	(6,190)
393	3937094	<u>32,670</u>	6.67%	<u>(2,178)</u>	<u>(10,890)</u>
		\$236,662		(\$8,792)	(\$41,964)

**Exception No. 2**

**Subject: Organization and Franchise Costs**

**Statement of Facts:** The utility's filing reflects the following balances for the indicated accounts as of December 31, 2002.

<u>Acct. No.</u>	<u>Description</u>	<u>UPIS</u>	<u>Acc. Dep.</u>	<u>Dep. Expense</u>
351	Organization Costs	\$342,543	(\$43,475)	\$8,564

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 Operation and Maintenance Expense Accounts, Account No. 732 shall include the costs paid to outside accounting companies to maintain or audit the books and records of the utility.

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 costs of utility systems are to be charged as acquisition adjustments, not as organization costs.

**Recommendation:** The utility's UPIS and accumulated depreciation balances are overstated by \$325,585 and \$34,492, respectively, as of December 31, 2002, because of the following audit staff determinations.

- 1) The utility's general ledger reflects additions of \$289,339 for 1998. The audit staff has determined that \$10,371 of these additions are acquisition costs for the Eagle Ridge system and should be removed per the Commission Orders cited above. The remaining \$278,968 of these additions should be removed because the utility could not provide any supporting documentation per the NARUC rule cited above. (\$10,371 + \$278,968 = \$289,339)
- 2) The utility's general ledger reflects an addition of \$1,583 in 1999 which was paid to an outside accounting firm to review the utility's audit procedures applicable to its 1998 acquisitions and dispositions. This cost should have been recorded in Account No. 733, Contractual Services - Accounting per the NARUC rule cited above.
- 3) The utility's general ledger reflects additions of \$20,180 for 2000. The audit staff has determined that all of these additions are acquisition costs for the Cross Creek system and should be removed per the Commission Orders cited above.



**Exception No. 2, continued**

- 4) The utility's general ledger reflects additions of \$14,483 for 2001. The audit staff has determined that \$13,585 of these additions are acquisition costs for the Cross Creek system and should be removed per the Commission Orders cited above. The remaining \$898 of these additions should be removed because the utility could not provide any supporting documentation per the NARUC rule cited above. (\$13,585 + \$898 = \$14,483)

Additionally, the above audit staff reductions to the utility's UPIS will require corresponding reductions of \$34,492 and \$8,139 to its accumulated depreciation and depreciation expense, respectively, for the 12-month period ended December 31, 2002. See the audit staff's calculations that follow.

<u>Additions</u>	<u>Dep. Rate</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>Totals</u>
\$289,339	2.50%	\$3,617	\$7,233	\$7,233	\$7,233	\$7,233	\$32,549
1,583	2.50%	-na-	20	40	40	40	139
20,180	2.50%	-na-	-na-	252	504	504	1,261
<u>14,483</u>	2.50%	-na-	-na-	-na-	181	<u>362</u>	<u>543</u>
\$325,585						\$8,139	\$34,492

### Exception No. 3

**Subject: Miscellaneous UPIS Adjustments**

**Statement of Facts:** The utility's filing reflects the following balances for the indicated accounts as of December 31, 2002.

<u>Acct. No.</u>	<u>Description</u>	<u>UPIS</u>	<u>Acc. Dep.</u>	<u>Dep. Expense</u>
361	Collection Sewers - Gravity	\$1,398,885	\$402,689	\$31,055
380	Treatment & Disposal Equipment	\$3,135,715	\$1,486,112	\$96,196

NARUC Operation and Maintenance Expense Accounts, Account No. 742 shall include costs associated with the rental of equipment, except vehicles, used in the operation of the utility.

**Recommendation:** The utility's UPIS and accumulated depreciation balances are overstated by \$9,343 and \$436, respectively, as of December 31, 2002, because of the following audit staff determinations. ( $\$2,713 + \$6,630 = \$9,343$ ) and ( $\$68 + \$368 = \$436$ )

- 1) The \$1,389,885 balance for Account No. 361 above includes a 1998 journal entry of \$1,708 that cannot be supported by the utility and should be removed per the NARUC rule cited in Exception No. 2 of this report. The utility also included a 1999 invoice of \$1,005 for blueprints of the Cypress Lakes utility system, which is an affiliated utility operation, that should also be removed and recorded on the books of Cypress Lakes. ( $\$1,708 + \$1,005 = \$2,713$ )
- 2) The \$3,135,715 balance for Account No. 380 above includes a 1998 invoice entry of \$5,024 that cannot be supported by the utility and should be removed per the NARUC rule cited in Exception No. 2 of this report. The utility also included a 1999 invoice of \$1,606 to rent an emergency generator for standby purposes for hurricane preparation. The utility should have recorded the entire amount to Account No. 742, Rental of Equipment per the NARUC rule cited above. ( $\$5,024 + \$1,606 = \$6,630$ )

Additionally, the above adjustments will require a corresponding reduction of \$436 to depreciation expenses for the 12-month period ended December 31, 2002. See the audit staff's calculations that follow. ( $\$68 + \$368 = \$436$ )

<u>Year</u>	<u>Acct. No.</u>	<u>Amount</u>	<u>Dep. Rate</u>	<u>Acc. Dep.</u>	<u>Dep. Expense</u>
1998	361	\$1,708	2.50%	\$43	\$43
1999	361	<u>1,005</u>	2.50%	<u>25</u>	<u>25</u>
		\$2,713		\$68	\$68

<u>Year</u>	<u>Acct. No.</u>	<u>Amount</u>	<u>Dep. Rate</u>	<u>Acc. Dep.</u>	<u>Dep. Expense</u>
1998	380	\$5,024	5.56%	\$279	\$279
1999	380	<u>1,606</u>	5.56%	<u>89</u>	<u>89</u>
		\$6,630		\$368	\$368

**Exception No. 4**

**Subject: UPIS Additions from Construction Projects**

**Statement of Facts:** The utility's general ledger reflects the following additions to Account No. 380, Treatment and Disposal Equipment from its construction project subsidiary ledger.

<u>Year</u>	<u>Project No.</u>	<u>UPIS Addition</u>	<u>AFUDC</u>
1998	673-116-98-01	\$10,875	\$115
1999	673-116-98-03	167,192	8,856
1999	673-116-99-05	36,593	0
2000	673-116-99-06	41,428	1,209
2000	673-116-00-01	156,422	4,721
2000	673-116-00-02	6,391	141
2000	673-116-00-04	27,467	404
2000	673-116-00-05	11,337	161
2001	673-116-01-01	5,443	41
2001	674-116-01-01	19,327	481
2001	674-116-01-02	18,348	142
2001	673-116-02-01	<u>81,816</u>	<u>1,467</u>
		\$582,640	\$17,738

Rule 25-30.116 (5), F.A.C., states that no utility may charge or change its allowance for funds used during construction (AFUDC) rate without prior Commission approval.

NARUC Operation and Maintenance Expense Accounts, Account No. 711 shall include the cost of removal of sludge if such work is performed by persons other than owners, stockholders, and employees of the utility.

**Recommendation:** The utility's UPIS and accumulated depreciation are overstated by \$36,858 and \$2,048, respectively, as of December 31, 2002, because of the following audit staff determinations. (\$17,738 + \$19,120 = \$36,858)

- 1) The utility does not have a Commission-approved AFUDC rate as of December 31, 2002. Therefore, all AFUDC accruals totaling \$17,738 reflected above should be removed from its UPIS.
- 2) The utility recorded \$19,120 of sludge hauling expense in Construction Project No. 673-116-00-01 which should have been recorded in Account No. 711 per the NARUC rule cited above.

Additionally, the above audit staff adjustments will require a corresponding reduction of \$2,048 to depreciation expense for the 12-month period ended December 31, 2002. See the audit staff calculations below.

<u>Acct. No</u>	<u>Amount</u>	<u>Dep. Rate</u>	<u>Acc. Dep.</u>	<u>Dep. Expense</u>
380	\$36,858	5.56%	\$2,048	\$2,048

**Exception No. 5**

**Subject:       Allocated Common Cost**

**Statement of Facts:** The utility's general ledger reflects balances of \$39,785 and \$9,726 for the allocated UPIS and accumulated depreciation, respectively, from Utilities, Inc. of Florida (UIF) as of December 31, 2002.

The utility's general ledger does not include any allocations from Water Service Corporation (WSC), its parent operations in Northbrook, IL. The WSC common plant allocation schedule indicates that Utilities, Inc. of Eagle Ridge should have received \$25,263 in net common plant allocations as of December 31, 2002, for this rate proceeding.

**Recommendation:** The utility's UPIS is understated by \$25,263 as of December 31, 2002, because it does not include the above-mentioned net allocated common plant from WSC.

## Exception No. 6

**Subject: Adjustments to 1998 Contributions-in-Aid-of Construction (CIAC) and Accumulated Amortization of CIAC**

**Statement of Facts:** The utility's filing reflects 1998 adjustments that reduced its CIAC and accumulated amortization of CIAC balances by \$252,084 and \$297,920, respectively.

The utility stated that the adjustments were made to restate the CIAC and accumulated amortization of CIAC balances to the rate base-ordered balances.

For transfer purposes, Order No. PSC-98-0514-FOF-SU established balances of \$2,406,355 and \$567,681 for CIAC and accumulated amortization of CIAC as of December 31, 1994. The Order also states that the Commission staff considered and determined that rate base additions for 1995 and 1996 did not have an appreciable net effect on the utility's rate base balances established above.

The utility recorded balances of \$2,661,725 and \$865,601 for CIAC and accumulated amortization of CIAC, respectively, as of December 31, 1997, to book the acquisition entry for the above transfer.

**Recommendation:** The utility's CIAC and accumulated amortization of CIAC are understated by \$252,084 and \$337,625, respectively, as of December 31, 2002, because of the following audit staff determinations. ( $\$297,920 + \$39,705 = \$337,625$ )

- 1) The utility's \$252,084 adjustment to CIAC discussed above eliminates the 1995 through 1997 CIAC additions as recorded in its Annual Reports and should be added back as of December 31, 2002.

<u>CIAC</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/94 (transfer)	\$0	(\$2,406,355)	(\$2,406,355)
1995 accruals	0	(178,213)	(178,213)
1996 accruals	0	(23,189)	(23,189)
1997 accruals	0	(53,968)	<u>(53,968)</u>
@12/31/97 (acquisition entry)	(\$2,661,725)	0	(\$2,661,725)
1998 accruals	(90,652)	0	(90,652)
1998 adjustment	<u>252,084</u>	(252,084)	<u>0</u>
@12/31/98	(\$2,500,293)	(\$252,084)	(\$2,752,377)

**Exception No. 6, continued**

- 2) The utility's \$297,920 adjustment to accumulated amortization CIAC discussed above eliminates the 1995 through 1997 CIAC additions as recorded in its Annual Reports and should be added back as of December 31, 2002.

<u>Accumulated Amtz. of CIAC</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Order/Audit</u>
@12/31/94 (transfer)		\$567,681	\$567,681
1995 accruals		93,371	93,371
1996 accruals		99,951	99,951
1997 accruals		104,598	<u>104,598</u>
@12/31/97 (acquisition entry)	\$865,601	0	\$865,601
1998 accruals	62,589	0	62,589
1998 adjustment	<u>(297,920)</u>	297,920	<u>0</u>
@12/31/98	\$630,270	\$297,920	\$928,190

- 3) The audit staff has calculated an additional \$39,705 of amortization accruals that should be added to the utility's accumulated amortization balance as of December 31, 2002, to record the 1998 through 2002 amortization accruals on the \$252,084 of CIAC added back in Item No. 1 above. Additionally, the utility's amortization expense should be increased by \$7,019 for the 12-month period ended December 31, 2002. See the audit staff's calculations that follow.

<u>Year</u>	<u>Avg. UPIS</u>	<u>Dep. Exp</u>	<u>Composite Rate</u>	<u>CIAC</u>	<u>Amtz. Amount</u>
1998	\$2,945,429	\$86,431	2.934%	\$252,084	\$7,397
1999	3,154,191	93,351	2.960%	252,084	7,461
2000	3,428,906	101,646	2.964%	252,084	7,473
2001	4,501,411	171,837	3.817%	252,084	9,623
2002	5,501,502	169,162	3.075%	252,084	<u>7,751</u>
Accumulated amortization adjustment					\$39,705

**Exception No. 7**

**Subject: Depreciation Rates**

**Statement of Facts:** Rule 25-30.140, Florida Administrative Code, prescribes specific depreciation rates for each NARUC subaccount balance. Specifically, the rule establishes the following rates for the indicated accounts.

<u>Acct. No.</u>	<u>Account Description</u>	<u>Service Life</u>	<u>Depreciation Rate</u>
380	Treatment & Disposal Plant	18 years	5.56%

**Recommendation:** The utility's wastewater accumulated depreciation and test year depreciation expense are understated by \$220,688 and \$85,109, respectively, for the 12-month period ended December 31, 2002, because it used the wrong service life to depreciate Account No. 380. See the audit staff's calculations that follow.

<u>Year</u>	<u>Acct. 380 Average UPIS</u>	<u>Rule Depreciation Rate(1)</u>	<u>Depreciation Accrual per Audit</u>	<u>Depreciation Accrual per Utility</u>	<u>Audit Staff Adjustment(2)</u>
1999	\$1,376,735	5.56%	\$76,485	\$36,380	\$40,105
2000	1,633,305	5.56%	90,739	43,422	47,317
2001	2,404,603	5.56%	133,589	85,432	48,157
2002	3,100,713	5.56%	172,262	87,153	<u>85,109</u>
					\$220,688

- 1) The utility depreciated Account No. 380 using a rate of 2.86 percent. Recalculations of the utility's accrual may slightly differ because it calculates depreciation accruals on a monthly basis. The audit staff's calculations above use the average of the beginning and ending UPIS balances.
- 2) The depreciation expense adjustment is \$85,109 for the 12-month period ended December 31, 2002.
- 3) The utility's filing reflects a balance of \$96,196 for depreciation expense in Account No. 380. The correct amount of depreciation expense is \$87,153 per the utility's 2002 general ledger. The difference of \$9,013 is recorded in Account 370, Pumping Equipment of the utility's 2002 general ledger. The net effect on total test year depreciation expense is \$0.

**Exception No. 8**

**Subject: Cost of Equity Rate**

**Statement of Facts:** The company used an equity rate of 11.92 percent on Schedule D-1 of the company filing. The weighted cost of capital is 8.91 percent on this schedule.

**Recommendation:** The utility's average weighted cost of capital is 8.85 percent as of December 31, 2002.

The utility's return on common equity (ROE) is 11.77 percent based on the leverage formula method approved in Orders Nos. PSC-03-0707-PAA-WS, issued June 13, 2003, and PSC-03-0799-CO-WS, issued July 8, 2003.

$$8.16\% + (1.518/.4210) = 11.77\%$$

See Schedule A that follows for the revised cost of capital calculations.



**Schedule A for Exception No. 8**

Utilities, Inc. of Eagle Ridge  
 Staff Revised Cost of Capital  
 Test Year Ended December 31, 2002

	<u>Prorated Capital Per Utility</u>	<u>Staff Adjustment</u>	<u>Adjusted Prorated Capital</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term Debt	\$964,333	\$0	\$964,333	49.38%	7.56%	3.73%
Short-term Debt	121,104	0	121,104	6.20%	3.93%	0.24%
Customer Deposits	39,336	0	39,336	2.01%	6.00%	0.12%
Common Equity	789,238	0	789,238	40.42%	11.77%	4.76%
Accumulated Deferred Tax	<u>38,728</u>	<u>0</u>	<u>38,728</u>	1.98%	0.00%	<u>0.00%</u>
	\$1,952,739	\$0	\$1,952,739	100.00%		8.85%
					Per Utility	<u>8.91%</u>
					Difference	-0.06%

**Exception No. 9**

**Subject: Regulatory Assessment Fees (RAFs)**

**Statement of Facts:** The utility's filing reflects \$30,155 of regulatory assessment fees for the 12-month period ended December 31, 2002.

**Recommendation:** The utility's regulatory assessment fees are understated by \$1,274 because the \$30,155 of RAFs mentioned above was calculated on its 2001 revenues of \$670,117. The 2002 RAFs should be \$31,430 which is calculated on its 2002 revenues of \$678,437. See the audit staff's calculations that follow.

<u>Year</u>	<u>Revenues</u>	<u>RAF Rate</u>	<u>RAFs</u>
2001	\$670,117	4.50%	\$30,155
2002	<u>698,437</u>	4.50%	<u>31,430</u>
Adjustment	\$28,320		\$1,274

## Disclosure No. 1

### Subject: Pro Forma Additions to UPIS

**Statement of Facts:** The utility's filing reflects the following requested additions to UPIS, accumulated depreciation and depreciation expense for this rate proceeding.

<u>Pro Forma Addition</u>	<u>UPIS</u>	<u>Acc./Dep.</u>	<u>Dep./Exp.</u>
1 WWTP aeration improvement	\$10,000	(\$556)	\$556
2 Install aqua disk filter	150,000	(8,333)	8,333
3 Increase capacity at L/S#5	25,000	(1,389)	1,389
4 Install catwalk toeboard at WWTP	5,767	(180)	180
5 Install toeboard at CL contact chamber	<u>19,013</u>	<u>(594)</u>	<u>594</u>
	\$209,780	(\$11,052)	\$11,052

The utility also requested that Construction Project No. 673-116-03-02 totaling \$7,572 also be included as pro forma UPIS for this rate proceeding.

**Recommendation:** The utility's pro forma UPIS, accumulated depreciation, depreciation expense and property taxes are overstated by \$167,769, \$8,718 and \$8,718, respectively, based on the following audit staff determinations.

- 1) The audit staff requested supporting documentation for the above pro forma additions. Specifically, we asked for invoices, contractor estimates, third-party bids, and utility designs. The utility provided supporting documentation for two of the originally requested pro forma additions and for the additional construction project mentioned above.
- 2) The utility did not provide any support for the first three projects listed above. All of the UPIS, accumulated depreciation, and depreciation expense balances for these projects should be removed.
- 3) The fourth project listed above actually cost \$7,168 based on supporting documentation. However, the utility also included \$22 of AFUDC for this project which should be removed based on the audit staff's recommendations in Exception No. 4 of this report. Revised calculations for UPIS, accumulated depreciation, and depreciation expense follow below.
- 4) The fifth project listed above actually cost 27,624 as of February 5, 2004, based on supporting documentation. However, the utility also included \$275 of AFUDC for this project which should be removed based on the audit staff's recommendations in Exception No. 4 of this report. Revised calculations for UPIS, accumulated depreciation, and depreciation expense follow below.

**Disclosure No. 1, continued**

- 5) The utility's additional request for pro forma UPIS listed above cost \$7,572 based on supporting documentation. However, the utility included \$56 of AFUDC for this project which should be removed based on the audit staff's recommendations in Exception No. 4 of this report. Revised calculations for UPIS, accumulated depreciation, and depreciation expense follow below.

	<u>UPIS (1)</u>	<u>Acc./Dep.(2)</u>	<u>Dep./Exp.(2)</u>
<u>Pro Forma Additions</u>			
1 WWTP aeration improvement	\$0	\$0	\$0
2 Install aqua disk filter	0	0	0
3 Increase capacity at L/S#5	0	0	0
4 Install catwalk toeboard at WWTP	7,146	(397)	397
5 Install toeboard at CL contact chamber	27,349	(1,519)	1,519
6 Install centrifugal process blower	<u>7,516</u>	<u>(418)</u>	<u>418</u>
Pro forma additions per audit	\$42,011	(\$2,334)	\$2,334
Pro forma additions per utility	<u>209,780</u>	<u>(11,052)</u>	<u>11,052</u>
Audit staff adjustment	(\$167,769)	\$8,718	(\$8,718)

- 1) The per audit UPIS balance displayed is the actual cost less the AFUDC amounts discussed above.  
 2) The UPIS projects were recorded in Account No. 380 - Treatment and Disposal Equipment. The corresponding accumulated depreciation and depreciation expenses were calculated at 5.56 percent which is the Commission depreciation rule rate for this account.

**Disclosure No. 2**

**Subject: Pro Forma Adjustments to Operation and Maintenance Expenses (O&M)**

**Statement of Facts:** The utility's filing reflects the following requested additions to O&M expenses for this rate proceeding.

<u>Pro Forma</u>	<u>Increase</u>	<u>Total</u>
Adjust employee salaries.	3.00%	\$4,696
Adjust health care cost.	25.86%	7,154
Adjust other insurance cost.	36.88%	<u>4,333</u>
		\$16,183

**Recommendation:** The audit staff requested supporting documentation for the above pro forma adjustments. Specifically, we compared 2002 historical costs with 2003 historical costs and asked for other supporting schedules and calculations to support the utility's requested increases.

- 1) The 3.00 percent increase is not warranted in that the utility's 2003 historical salaries actually decreased 14.55 percent over the corresponding 2002 historical salaries reported in the utility's filing. The decrease was the result of personnel reassignments and may be temporary in nature. However, the audit staff recommends that the 3.00 percent increase be removed from this rate proceeding.
- 2) The 25.86 percent increase to health care cost should be reduced to 9.83 percent which represents the actual increase in health care cost over the corresponding 2002 historical test year. See the audit staff calculations that follow for the recommended adjustment.
- 3) The 36.88 percent increase to other insurance cost should be increased to 42.93 percent which represents the actual increase in other insurance cost over the corresponding 2002 historical test year. See the audit staff calculations that follow for the recommended adjustment.

<u>Pro Forma Health Salaries</u>	<u>Increase</u>	<u>Total(a)</u>
Adjustment per utility	3.00%	\$4,696
Adjustment per audit	0.00%	<u>0</u>
Audit staff adjustment		(\$4,696)
(a) 2002 historical cost of \$156,527 x % increase		

<u>Pro Forma Health Care Cost</u>	<u>Increase</u>	<u>Total(b)</u>
Adjustment per utility	25.86%	\$7,154
Adjustment per audit	9.83%	<u>2,663</u>
Audit staff adjustment		(\$4,491)
(b) 2002 historical cost of \$27,095 x % increase		

<u>Pro Forma Other Insurance Cost</u>	<u>Increase</u>	<u>Total(c)</u>
Adjustment per utility	36.88%	\$4,333
Adjustment per audit	42.93%	<u>5,044</u>
Audit staff adjustment		\$711
(c) 2002 historical cost of \$11,749 x % increase		

**EXHIBIT II**

**Schedule of Wastewater Net Operating Income**

**Florida Public Service Commission**

Company: Utilities, Inc. of Eagle Ridge  
 Docket No.: 030445-WS  
 Test Year Ended: December 31, 2002  
 Interim [ ] Final [X]  
 Historic [X] or Projected [ ]

Schedule: B-2  
 Page 1 of 1  
 Preparer: Seidman, F.  
 Revision No. 1

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	\$ 698,437	\$ 13,899	\$ 712,336	\$ 177,832	\$ 890,168	B-4, E-2
2	Operation & Maintenance	527,028	16,183	543,211	6,477	549,688	B-6, B-3
3	Depreciation, net of CIAC Amort.	67,737	5,342	73,079		73,079	B-14, B-3
4	Amortization				0	-	B-3
5	Taxes Other Than Income	47,710	2,523	50,233	8,002	58,236	B-15, B-3
6	Provision for Income Taxes	(3,699)	3,699	-	35,176	35,176	C-1, B-3
7	OPERATING EXPENSES	638,776	27,747	666,523	49,656	716,179	
8	NET OPERATING INCOME	\$ 59,661	\$ (13,849)	\$ 45,813	\$ 128,176	\$ 173,989	
9	RATE BASE	\$ 1,921,163		\$ 1,952,739		\$ 1,952,739	
10	RATE OF RETURN	3.11 %		2.35 %		8.91 %	

**EXHIBIT III**

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

**Florida Public Service Commission**

**Company: Utilities, Inc. of Eagle Ridge  
Docket No.: 030445-WS  
Test Year Ended: December 31, 2002  
Schedule Year Ended: December 31, 2002  
Historic [X] or Projected [ ]**

**Schedule: D-1  
Page 1 of 2  
Preparer: Seldman, F.  
Revision No. 1  
Subsidiary [ ] or Consolidated [X]**

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

Line No.		(1)	(2)	(3)	(4)
		Total Capital	Ratio	Cost Rate	Weighted Cost
1	Long-Term Debt	964,333	49.38 %	7.56 %	3.73 %
2	Short-Term Debt	121,104	6.20	3.93	0.24
3	Preferred Stock				
4	Customer Deposits	39,336	2.01	6.00	0.12
5	Common Equity	789,238	40.42	11.92	4.82
6	Tax Credits - Zero Cost				
7	Accumulated Deferred Income Tax	38,728	1.98		
8	Other (Explain)				
9	<b>Total</b>	<b>1,952,739</b>	<b>99.99 %</b>		<b>8.91 %</b>

10 Note: Cost of Equity based on Order Nos. PSC-03-0707-PAA-WS and PSC-03-0799-CO-WS.

### Disclosure No. 3

#### Subject: Construction Projects - Retirements

**Statement of Facts:** NARUC, Class A, Accounting Instruction 27.B.(2) requires that, when a retirement unit is retired from utility plant with or without replacement, the book cost thereof shall be credited to the utility plant account in which it is included. The book cost shall be determined from the utility's records and if this cannot be done, it shall be estimated.

The utility's records reflect that the following construction projects were completed and recorded in its general ledger as indicated below.

<u>Project No.</u>	<u>Acct. No.</u>	<u>Year</u>	<u>Amount</u>	<u>Description of work performed</u>
673-116-98-03	380	1999	\$167,192	WWTP improvements
673-116-99-06	380	2000	\$41,428	Install 12 new diffusers at WWTP
673-116-00-01	380	2000	\$156,422	Install new 250kw generator at WWTP
673-116-00-03	354	2001	\$14,827	Install new piping, platforms, and handrails at surge tank
673-116-00-04	380	2000	\$27,467	Install 2 new blowers at WWTP
674-116-01-02	380	2001	\$18,348	Install new clarifiers at Cross Creek.
674-116-01-01	380	2001	\$19,327	Replace piping, pumps and controls at surge tank
673-116-02-01	380	2001	\$81,816	Install new catwalks, air lines, surge tanks, and piping at WWTP

The utility maintains the following policy concerning the retirement of capitalized assets.

- a) The retirement amount is the cost of the retired equipment if known.
- b) If the amount of the retired equipment is known and is less than \$250 and the year that it was placed in service is between 1990 and 1996, do not retire.
- c) If the amount of the retired equipment is known and is greater than \$100 and the year it was placed in service is prior to 1990, retire the known amount.
- d) If the amount of the retired equipment is not given, but the year it was placed in service is known, use the Handy Whitman index to determine its retirement. Multiply the percentage from the index times the total invoice cost to determine the amount of retirement.
- e) If neither the retirement amount is known nor the year it was placed in service is given, retire 75 percent of the invoice amount.



**Disclosure No. 3, continued**

**Recommendation:** The utility's records indicate that the above-mentioned capital additions were added to its general ledger without a corresponding retirement amount. The utility's response to the audit staff inquiries about the above issue indicates that retirements should have been made but it offers no suggested retirement amounts. Each of the construction projects should have been evaluated by the utility at the time of completion to determine an appropriate retirement amount per the NARUC rule cited above.

The above construction projects contain multiple components of capital assets such as capitalized labor and AFUDC in addition to the vendor invoices. The audit staff believes that the utility's retirement policy as stated above may not be the appropriate method to determine the requisite retirement amounts for the capital projects listed above because it is predicated on the purchase of individual assets additions.

The audit staff defers this issue to the staff engineer in Tallahassee to determine the appropriate retirement amounts for each of the capital projects.

**EXHIBIT I**

**Schedule of Wastewater Rate Base**

Florida Public Service Commission

Company: **Utilities, Inc. of Eagle Ridge**  
 Docket No.: **030445-WS**  
 Schedule Year Ended: **December 31, 2002**  
 Interim [ ] Final [X]  
 Historic [X] Projected [ ]

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

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

Line No.	(1) Description	(2) Balance Per Books	(3) A-3 Utility Adjustments	(4) Adjusted Utility Balance	(5) Supporting Schedule(s)
1	Utility Plant In Service	\$ 5,601,602	\$ 209,780 A	\$ 5,711,282	A-6
2	Utility Land & Land Rights	38,245		38,245	A-6
3	Less: Non-Used & Useful Plant	-	(98,476) B	(98,476)	A-7, A-3
4	Construction Work in Progress	5,194	(6,194) C	-	A-18, A-3
5	Less: Accumulated Depreciation	(2,138,666)	(11,052) D	(2,149,610)	A-10
6	Less: CIAC	(3,542,666)		(3,542,666)	A-12
7	Accumulated Amortization of CIAC	1,924,053		1,924,053	A-14, A-3
8	Acquisition Adjustments	155,479	(155,479) E	-	A-18, A-3
9	Accum. Amort. of Acq. Adjustments	(22,096)	22,096 E		
10	Advances For Construction				A-18
11	Working Capital Allowance	-	67,901 F	67,901	A-17, A-3
12	<b>Total Rate Base</b>	<b>\$ 1,921,163</b>	<b>\$ 31,578</b>	<b>\$ 1,952,739</b>	

**EXHIBIT II**

**Schedule of Wastewater Net Operating Income**

**Florida Public Service Commission**

Company: Utilities, Inc. of Eagle Ridge  
 Docket No.: 030445-WS  
 Test Year Ended: December 31, 2002  
 Interim [ ] Final [X]  
 Historic [X] or Projected [ ]

Schedule: B-2  
 Page 1 of 1  
 Preparer: Seldman, F.  
 Revision No. 1

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	\$ 698,437	\$ 13,899	A \$ 712,336	\$ 177,832	F \$ 890,168	B-4, E-2
2	Operation & Maintenance	527,028	16,183	B 543,211	6,477	G 549,688	B-6, B-3
3	Depreciation, net of CIAC Amort.	87,737	5,342	C 73,079		73,079	B-14, B-3
4	Amortization				0		B-3
5	Taxes Other Than Income	47,710	2,523	D 50,233	8,002	H 58,236	B-15, B-3
6	Provision for Income Taxes	(3,699)	3,699	E -	35,176	I 35,176	C-1, B-3
7	OPERATING EXPENSES	638,776	27,747	666,523	49,656	716,179	
8	NET OPERATING INCOME	\$ 59,661	\$ (13,849)	\$ 45,813	\$ 128,176	\$ 173,989	
9	RATE BASE	\$ 1,821,163		\$ 1,952,739		\$ 1,952,739	
10	RATE OF RETURN	3.11 %		2.35 %		8.81 %	

**EXHIBIT III**

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

**Florida Public Service Commission**

Company: Utilities, Inc. of Eagle Ridge  
Docket No.: 830445-WS  
Test Year Ended: December 31, 2002  
Schedule Year Ended: December 31, 2002  
Historic  or Projected

Schedule: D-1  
Page 1 of 2  
Preparer: Seldman, F.  
Revision No. 1  
Subsidiary  or Consolidated

**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	884,333	49.38 %	7.58 %	3.73 %
2	Short-Term Debt	121,104	6.20	3.93	0.24
3	Preferred Stock				
4	Customer Deposits	39,338	2.01	6.00	0.12
5	Common Equity	789,238	40.42	11.92	4.82
6	Tax Credits - Zero Cost				
7	Accumulated Deferred Income Tax	38,728	1.98		
8	Other (Explain)				
9	<b>Total</b>	<b>1,952,739</b>	<b>99.98 %</b>		<b>8.91 %</b>

10 Note: Cost of Equity based on Order Nos. PSC-03-0707-PAA-WS and PSC-03-0789-CO-WS.