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Public Service Commission

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**DATE:** October 18, 2006

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

**FROM:** Denise Vandiver; Bureau Chief of Auditing *W*

**RE:** **Docket No. 060260-WS; Company Name:** Lake Placid Utilities, Inc.; **Audit Purpose:** Rate Case; **Audit Control No.:** 06-209-2-4

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 Commission Clerk and Administrative Services. There are no confidential work papers associated with this audit.

Attachment

cc: Division of Regulatory Compliance and Consumer Assistance (Hoppe, District Offices, File Folder)

✓ Division of Commission Clerk and Administrative Services (2)

Division of Competitive Markets and Enforcement (Harvey)

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FLORIDA PUBLIC SERVICE COMMISSION  
DIVISION OF REGULATORY COMPLIANCE & CONSUMER ASSISTANCE  
BUREAU OF AUDITING

*Tampa District Office*

LAKE PLACID UTILITIES INC.  
FILE AND SUSPEND RATE CASE INVESTIGATION

AS OF DECEMBER 31, 2005

DOCKET NO. 060260-WS  
AUDIT CONTROL NO. 06-209-2-4

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**DIVISION OF REGULATORY COMPLIANCE & CONSUMER ASSISTANCE  
AUDITOR'S REPORT**

**October 10, 2006**

**TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES**

We have performed the procedures described later in this report to meet the agreed upon objectives set forth by the Division of Economic Regulation in its audit service request dated July 27, 2006. We have applied these procedures to the attached schedules which were prepared by Lake Placid Utilities, Inc. in support of its filing for rate relief in Docket No. 060260-WS.

This audit was performed following general standards and field work standards found in the AICPA Statements on Standards for Attestation Engagements. This report is based on agreed upon procedures which are only for internal Commission use.

## OBJECTIVES AND PROCEDURES

### RATE BASE

#### General

*Objective:* To determine that the utility's filing represents its recorded results from continuing operations.

*Procedures:* We reconciled the following individual component rate base balances to the utility's general ledger as of December 31, 2005 and verified that adjustments required in Order No. PSC-96-0910-PAA-WS, issued July 16, 1996, were recorded.

#### Utility-Plant-in-Service (UPIS)

*Objective:* To determine that property exists and is owned by the utility. To determine that additions to UPIS are authentic, recorded at original cost, and properly classified in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that the proper retirements of UPIS were made when a replacement item was put in service.

*Procedures:* We sampled UPIS additions for the period January 1, 1996 through December 31, 2005 for compliance with the stated objectives above. We verified that the utility properly recorded retirements to UPIS when a capital item was removed or replaced. We toured the utility plant sites to observe whether assets additions were completed and to ascertain if asset retirements were properly recorded. We sampled construction project additions and the corresponding source documentation. We verified that the utility used Commission approved AFUDC rates and traced the capitalized salaries to individual employee time sheets. Audit Finding No. 1 discusses our adjustments to specific UPIS accounts because the utility could not provide supporting documentation for amounts recorded to its general ledger.

#### Land and Land Rights

*Objective:* To determine that utility land is recorded at original cost and is owned or secured under a long-term lease.

*Procedures:* We verified that there has been no change to utility land since its last rate proceeding by searching the county's public records.

#### Contributions-in-Aid-of-Construction (CIAC)

*Objective:* To determine that additions to CIAC are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that CIAC additions are reflective of the utility's Commission approved service availability tariff. To verify and insure that all donated property is properly accounted for and recorded as CIAC and UPIS.

*Procedures:* We sampled CIAC additions for the period January 1, 1996 through December 31, 2005 for compliance with the stated objectives above. We scanned the utility's cash receipts records for unrecorded cash and property. We reviewed developer agreements for unrecorded CIAC. We traced utility CIAC schedules to the general ledger and the utility's authorized tariff rates. We toured the utility's authorized service territory to look for new developments that may have included contributed property. Audit Finding No. 10 provides information on the utility's 2003 CIAC adjusting journal entry that was made to allocate CIAC based on specific UPIS account balances.

### Accumulated Depreciation

*Objective:* To determine that accruals to accumulated depreciation are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that depreciation expense accruals are calculated using the Commission authorized rates and that retirements are properly recorded.

*Procedures:* We traced the accumulated depreciation schedules to the corresponding UPIS schedules. We verified that the utility used Commission authorized rates to depreciate its UPIS accounts by calculating a sample of accumulated depreciation account balances to test for calculation errors. We verified that the utility properly recorded retirements to accumulated depreciation when the corresponding UPIS was removed or replaced. We recalculated a sample of accumulated depreciation account balances as of December 31, 2005. Audit Finding No. 1 discusses our adjustments to specific UPIS accounts because the utility could not provide supporting documentation for amounts recorded to its general ledger and the corresponding effect on accumulated depreciation balances. Audit Finding No. 2 discusses our adjustments to include accumulated depreciation balances for organization cost and franchise fees that were included in the UPIS filing balance.

### Accumulated Amortization of CIAC

*Objective:* To determine that accruals to accumulated amortization of CIAC are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that CIAC amortization expense accruals are properly recorded and calculated based on the rates and method used in the utility's last rate proceeding.

*Procedures:* We traced the accumulated amortization of CIAC schedules to the corresponding CIAC schedules. We verified that the utility used Commission authorized rates to amortize its CIAC accounts by calculating a sample of accumulated amortization account balances to test for calculation errors. We recalculated a sample of accumulated amortization of CIAC account balances as of December 31, 2005.

### Working Capital

*Objective:* To determine that the utility's working capital balance is properly calculated in compliance with Commission rules.

*Procedures:* We recalculated the utility's working capital balance as of December 31, 2005. Audit Finding No. 5 discusses our adjustment to include a historical working capital balance that was left out of the utility's filing.

### Other Rate Base Items

*Objective:* To determine that other component balances affecting rate base are properly stated and authorized by Commission rules or prior orders.

*Procedures:* Determine that adjustments to include allocated rate base balances for subsidiary operations are properly reported in the filing. Audit Finding No. 3 discusses our adjustments to allocate UIF rate base balances to the utility's wastewater system. Audit Finding No. 4 discusses our adjustments to WSC allocated rate base balances based on the affiliate transaction investigation performed in Docket No. 060253-WS.

### **NET OPERATING INCOME**

## General

*Objective:* To determine that the utility's filing represents its results from continuing operations.

*Procedures:* We reconciled the following individual component net operating income balances to the utility's general ledger for the 12-month period ended December 31, 2005.

## Revenues

*Objective:* To determine that revenues are properly recorded in compliance with Commission rules and are based on the utility's Commission approved tariff rates.

*Procedures:* We traced revenues to the general ledger and utility billing registers and selected a sample of customer bills from each customer rate class on a random basis and recalculated the bills using the Commission approved tariff rates.

## Operation and Maintenance Expenses (O&M)

*Objective:* To determine that operation and maintenance expenses are properly recorded in compliance with Commission rules and were reasonable and prudent for ongoing utility operations.

*Procedures:* We sampled O&M expense items from the general ledger based on auditor judgment. We reviewed the sample for the proper utility system, water or wastewater classification, NARUC account, amount, period and recurring nature. We examined invoices and supporting documentation to determine if the above objectives are met. Audit Finding No. 6 discusses our adjustment to remove and amortize wastewater permit renewal expenses that are considered nonrecurring. Audit Finding No. 7 discusses our adjustments to WSC allocated expense balances based on the affiliate transaction investigation performed in Docket No. 060253-WS.

## Taxes-Other-Than-Income (TOTI)

*Objective:* To determine that taxes other than income tax expense is properly recorded in compliance with Commission rules and was reasonable and prudent for ongoing utility operations.

*Procedures:* We obtained the regulatory assessment fee filings and reconciled them to the general ledger. We obtained the property tax bills for review and to determine if the amount booked reflects the discount amount. Audit Finding No. 9 discusses our adjustments to the utility's regulatory assessment fee and property tax balances to record actual cost for each system where applicable.

## Depreciation Expense

*Objective:* To determine that depreciation expense is properly recorded in compliance with Commission rules and that it accurately represents the depreciation of UPIS assets and amortization of CIAC assets for ongoing utility operations.

*Procedures:* We recalculated a sample of UPIS depreciation expense and CIAC amortization expense balances for the period using Commission approved rates and we verified that CIAC amortization expense was properly netted against depreciation expense. Audit Finding No. 1 discusses our adjustments to specific UPIS accounts because the utility could not provide supporting documentation for amounts recorded to its general ledger and the corresponding effect on depreciation expense balances. Audit Finding No. 2 discusses our adjustments to

include depreciation expense balances for organization cost and franchise fees that were included in the UPIS filing balance. Audit Finding No. 3 discusses our adjustments to allocate UIF and WSC allocated depreciation expense balances to the utility's water and wastewater system. Audit Finding No. 8 discusses our adjustments to correct a 2005 journal entry posting error.

## **CAPITAL STRUCTURE**

### General

*Objective:* To determine the components of the utility's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital are properly recorded in compliance with Commission rules and that it accurately represents the ongoing utility operations.

*Procedures:* We reconciled the following individual component capital structure balances to the utility's general ledger as of December 31, 2005. Audit Finding No. 11 provides information on the utility's capital structure component balances that were determined in the affiliate audit investigation performed in Docket No. 060253-WS.

### Long-Term-Debt

*Objective:* To determine that long-term debt balances represent actual obligations of the utility's parent and that they are properly recorded in compliance with Commission rules.

*Procedures:* We traced long-term debt balances to the original documents and verified the terms and interest rate of each note payable.

### Short-Term-Debt

*Objective:* To determine that short-term debt balances represent actual obligations of the utility's parent and that they are properly recorded in compliance with Commission rules.

*Procedures:* We traced short-term debt balances to the original documents and verified the terms and interest rate and period. We recalculated test year interest expense.

### Accumulated Deferred Income Taxes

*Objective* To determine that accumulated deferred income taxes are properly stated and calculated based on the recorded differences between utility book and taxable income.

*Procedures* Recalculated a sample of deferred tax balances for the period using Commission authorized rates and federal tax rates. Audit Finding No. 12 provides information on the utility's deferred tax balances.

### Customer Deposits

*Objective:* To determine that customer deposit balances represent actual obligations of the utility and are properly recorded in compliance with Commission rules.

*Procedures:* We traced a sample of customer deposit balances to supporting documentation and verified that customer deposits were refunded and credited with interest payments in compliance with Commission rules.



**AUDIT FINDING NO. 1**

**SUBJECT: ADJUSTMENT TO UTILITY PLANT IN SERVICE**

**SUMMARY:** The utility's average water and wastewater rate base balances are overstated by \$14,150 and \$3,093, respectively, as of December 31, 2005.

**STATEMENT OF FACT:** The utility recorded the following invoices to UPIS for the periods indicated.

<u>Construction Project No.</u>		<u>Invoice Ref. No. and Vendor</u>		<u>Amount</u>	Total Project
115-94-01		05227-09128*Kenco Und		\$5,073	\$15,520
115-94-02		22215-09128*Kenco Und		\$3,324	
115-94-02		24822-09128*Kenco Und		<u>2,000</u>	
				\$5,324	\$13,093

  

<u>Period</u>	<u>Utility Acct. No.</u>	<u>NARUC Acct. No.</u>	<u>Invoice Ref. No. and Vendor</u>	<u>Amount</u>
1995	3043021	304	Close Project 115-94-02	\$5,324
1995	3305042	330	Close Project 115-94-01	\$5,073
2004	3612010	361	042726*14050*Katz Plum	\$3,200
2005	3043021	304	096622*18602*Alexande	\$6,743
2005	3043021	304	099860*18602*Alexande	\$6,743

The above invoices were requested as part of our audit sample of UPIS additions for the period 1995 through 2005. The utility was unable to provide any supporting documentation.

The NARUC Uniform System of accounts requires utility's to retain all documentation to support the original cost recorded in its accounts. Since the documentation for the above invoices could not be provided the amounts recorded should be removed along with the cumulative effect on the corresponding accumulated depreciation and depreciation expense balances. See our calculations that follow

Utility <u>Acct.No.</u>	NARUC <u>Acct. No.</u>	UPIS <u>Adjustment</u>	Avg. UPIS <u>Adjustment</u>	Rule <u>Rate</u>	Dep. Expense <u>Expense</u>	Number <u>Years</u>	Acc/Dep <u>Adjustment</u>	Avg. Acc/Dep <u>Adjustment</u>
3043021	304	(\$5,324)	(\$5,324)	3.13%	(\$166)	9.5	(\$1,581)	(\$1,581)
3043021	304	<u>(13,486)</u>	<u>(6,743)</u>	3.13%	<u>(421)</u>	0.5	<u>(211)</u>	<u>(106)</u>
		(\$18,810)	(\$12,067)		(\$588)		(\$1,792)	(\$1,687)
3305042	330	(\$5,073)	(\$5,073)	2.70%	(\$137)	9.5	(\$1,303)	(\$1,303)
Total Average Water Adjustment			(\$17,140)					(\$2,990)
3612010	361	(\$3,200)	(\$3,200)	2.22%	(\$71)	1.5	(\$107)	(\$107)
Total Average Wastewater Adjustment			(\$3,200)					(\$107)

**EFFECT ON GENERAL LEDGER:** The following journal entry should be made to correct the utility's general ledger balances.

Utility Acct. No	NARUC Acct. No.	Account Description	Debit	Credit
1083021	108	Water Acc/Dep - Structures & Improvements	\$1,791	
1083042	108	Water Acc/Dep - Dist,Resv. & Standpipes	\$1,303	
1084010	108	W/Water Acc/Dep - Manholes	\$107	
2151000	215	Retained Earnings	\$24,627	
3043021	304	Water Structures & Improvements		\$18,810
3305042	330	Water Dist,Resv. & Standpipes		\$5,073
3612010	361	W/Water Manholes		\$3,200
4032021	403	Water Dep.Exp. - Structures & Improvements		\$588
4032042	403	Water Dep. Exp. - Dist,Resv. & Standpipes		\$137
4033010	403	W/Water Dep. Exp. - Manholes		\$71

**EFFECT ON FILING:** The utility's average water and wastewater rate base balances should be reduced by \$14,150 (\$17,140 - \$2,990) and \$3,093, (\$3,200 - \$107) respectively, as of December 31, 2005. Additionally, the utility's water and wastewater depreciation expense balances should be reduced by \$725 (\$588 + \$137) and \$71, respectively, for the 12-month period ended December 31, 2005.

**AUDIT FINDING NO. 2**

**SUBJECT: ADJUSTMENT TO ACCUMULATED DEPRECIATION**

**SUMMARY:** The utility's water and wastewater average rate base balances are overstated by \$4,555 and \$4,424, respectively, as of December 31, 2005

**STATEMENT OF FACT:** In its filing, the utility included average water and wastewater balances of \$12,374 and \$10,994, respectively, for organization cost. The filing also includes average water and wastewater balances of \$1,250, each, respectively, for franchise fees. All of the above balances were approved in the utility's last rate case proceeding in Docket No. 951027-WS.

The utility, however, did not include the corresponding accumulated depreciation and depreciation expense account general ledger balances for these accounts in the filing.

The utility's general ledger reflects the following accumulated depreciation and depreciation expense balances for organization cost and franchise fees for the periods indicated.

	Utility		Balance	Balance	
<u>System</u>	<u>Acct. No.</u>	<u>Acct. Description</u>	<u>Dec-04</u>	<u>Dec-05</u>	<u>Average</u>
Water	1083001	Acc/Dep - Organization Cost	(\$3,865)	(\$4,206)	(\$4,035)
Water	1083002	Acc/Dep - Franchise Fees	(222)	(222)	(222)
			(\$4,087)	(\$4,428)	(\$4,257)
Water	4032001	Dep. Exp. - Organization Cost		\$341	
Water	4032***	Dep. Exp. - Franchise		0	
				\$341	
W/Water	1084001	Acc/Dep - Organization Cost	(\$3,285)	(\$3,560)	(\$3,422)
W/Water	1084020	Acc/Dep - Franchise Fees	(986)	(1,017)	(1,002)
			(\$4,271)	(\$4,577)	(\$4,424)
W/Water	4033001	Dep. Exp. - Organization Cost		\$275	
W/Water	4033020	Dep. Exp. - Franchise		31	
				\$306	

The balance of \$222 for accumulated depreciation of franchise fees reflected in Acct. No. 1083002 above is the same balance as that established in the utility's last rate case proceeding mentioned above. The fact that it has not changed since that time indicates that the utility has never calculated depreciation expense or the corresponding annual accruals to accumulated depreciation.

The above general ledger balances as well as an additional \$313 of accumulated depreciation for Acct. No. 1083002 (\$1,250 x 2.5% x 10 years) and \$31 (\$1,250 x 2.5%) of additional test year depreciation expense should be included in the utility's filing.

**EFFECT ON GENERAL LEDGER:** The following journal entry should be made to correct

the utility's general ledger balances.

Utility Acct. No	NARUC Acct. No.	Account Description	Debit	Credit
1083***	108	Water Acc/Dep - Franchise Fees		\$313
2151000	215	Retained Earnings	\$282	
4032***	403	Water Dep. Exp. - Franchise Fees	\$31	

**EFFECT ON FILING:** The utility's average water and wastewater accumulated depreciation balances should be increased by \$4,555 and \$4,424, respectively, as of December 31, 2005. Additionally, the utility's water and wastewater depreciation expense balances should be increased by \$372 (\$341 + \$31) and \$306, respectively, for the 12-month period ended December 31, 2005.

<u>System</u>	<u>Utility Acct. No.</u>	<u>Acct. Description</u>	Balance		<u>Average</u>
			<u>Dec-04</u>	<u>Dec-05</u>	
Water	1083001	Acc/Dep - Organization Cost	(\$3,865)	(\$4,206)	(\$4,035)
Water	1083002	Acc/Dep - Franchise Fees	<u>(504)</u>	<u>(535)</u>	<u>(520)</u>
			(\$4,369)	(\$4,741)	(\$4,555)

Acct. No. 1083002 adjusted to include additional accumulated depreciation calculated on the previous page.

Per utility at 12/31/2005	(\$222)
Audit adjustment	<u>(313)</u>
Per Audit at 12/31/2005	(\$535)
Less one year accrual	<u>31</u>
Per Audit at 12/31/2004	(\$504)

### AUDIT FINDING NO. 3

#### SUBJECT: ADJUSTMENT TO ALLOCATED UIF RATE BASE

**SUMMARY:** The utility's average water and wastewater rate base balances are overstated and understated by \$5,699, each as of December 31, 2005 and its net water and wastewater depreciation expense balances are overstated and understated by \$1,707, each, respectively, for the 12-month period ended December 31, 2005, because it did not allocate any allocated rate base or depreciation expense balances to its wastewater operations.

**STATEMENT OF FACT:** The utility's general ledger reflects the following allocated rate base and corresponding depreciation expense balances that were included in its filing for this proceeding. All of the balances were included in the water system filing only.

Utility Acct. No.	NARUC Acct. No.	Acct. Description	Balance Dec-04	Balance Dec-05	Average	Allocated to W/W
1081050	108	Acc/Dep - Office Furniture & Equip	(\$503)	(\$484)	(\$494)	(\$281)
1082050	108	Acc/Dep - Transportation	(\$14,492)	(\$14,694)	(\$14,593)	(\$8,299)
1083050	108	Acc/Dep - Other Tangible Plant	(1,334)	(1,268)	(1,301)	(740)
3406050	340	Office Furniture & Equip.	621	571	596	339
3917050	341	Transportation Equipment	19,906	20,903	20,405	11,604
3486050	348	Other Tangible Plant	<u>5,835</u>	<u>4,982</u>	<u>5,409</u>	<u>3,076</u>
			\$10,033	\$10,010	\$10,022	\$5,699
<hr/>						
UIF						
4032090	403	Dep. Exp. - Other Tangible Plant		\$81		
4032091	403	Dep. Exp. - Office Furniture & Equip.		39		
4032092	403	Dep. Exp - Transportation		2,461		
4032094	403	Dep. Exp. - Communication & Equip.		35		
4032097	403	Dep. Exp. - Communication Equip.		25		
4032098	403	Dep. Exp. - Other Tangible Plant		55		
<hr/>						
WSC						
4032090	403	Dep. Exp. - Office Structures		72		
4032091	403	Dep. Exp. - Office Furniture		106		
4032093	403	Dep. Exp. - Telephones		3		
4033001	403	Dep. Exp. - Computer Equip.		<u>125</u>		
				\$3,002		\$1,707

Transportation Equipment and its corresponding Acc/Dep and Dep. Expense balances are included in Other Tangible Plant balances in the utility's filing. No adjustment was made other than to allocate a portion to the wastewater system because the net affect on Rate Base and Net Operating income would be \$0 within each respective system.

The rate base accounts and six of the depreciation expense accounts were allocated from Utilities Inc. of Florida (UIF), the regional office for all of Utilities, Inc. (Parent) Florida systems. These balances were audited in a separate affiliate transaction audit in Docket No. 060253-WS. No adjustments were noted in the audit report dated July 15, 2005.

The rate base accounts allocated from WSC were included as an adjustment to the utility's rate base in the filing and they are addressed in a separate finding in this report along with the corresponding depreciation expense balances reflected above. That finding did not, however, determine an allocation of depreciation expenses between the utility's water and wastewater operations.

The above balances should have been allocated to the utilities water and wastewater systems. The utility's general policy is to allocate common expenses based on the percentage of water and wastewater customers for each system. The utility's customer percentages are 43.13 percent water and 56.87 percent wastewater based on its customer allocation schedule.

**EFFECT ON GENERAL LEDGER:** The water and wastewater allocation adjustments only apply to the utility's filing.

**EFFECT ON FILING:** The utility's water and wastewater average net rate base balances should be decreased and increased by \$5,699, each, respectively, as of December 31, 2005. (\$10,022 x 56.87%) The utility's net water and wastewater depreciation expense balances should be decreased and increased by \$1,707, each, respectively, for the 12-month period ended December 31, 2005. (\$3,002 x 56.87%)

**AUDIT FINDING NO. 4**

**SUBJECT: ADJUSTMENT TO ALLOCATED WSC RATE BASE**

**SUMMARY:** The utility's allocated average net rate base from Water Service Corporation (WSC) is \$2,301 as of December 31, 2005. The balance should be further allocated to water and wastewater operations for \$1,018 and \$1,283, respectively.

**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. Lake Placid Utilities, Inc. received \$1,910, which is the average amount as of December 31, 2005. The allocation is net of accumulated depreciation and accumulated deferred income taxes or approximately 0.11 percent of the total WSC average net rate base of \$1,740,155. The allocation was calculated using a customer equivalent percentage that equates all customers throughout the United States in terms of equivalent residential connections.

The Commission's Division of Regulatory Compliance and Consumer Assistance, at the request of The Division of Economic Regulation, performed an affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2005, in Docket No. 060253-WS. The scope of the audit included a review of the WSC rate base components that are allocated to all of its subsidiary operations in 2005. The audit report, issued July 15, 2006, included specific adjustments that increased Lake Placid Utilities, Inc. allocated average WSC rate base allocation by \$391 to \$2,301.

The audit staff has incorporated the findings of the above-mentioned audit report to determine the Lake Placid Utilities, Inc. allocated average WSC rate base balance of \$2,301 for this proceeding.

**EFFECT ON GENERAL LEDGER:** None, because WSC only allocates its net rate base for rate case proceedings.

**EFFECT ON FILING:** Increase Lake Placid Utilities, Inc. average water and wastewater rate base balances by \$173 and \$218, respectively, for the 12-month period ended December 31, 2005.

<u>Simple Average</u>	<u>Total Amount</u>	<u>Water</u>	<u>Allocation Percent</u>	<u>W/Water</u>	<u>Allocation Percent</u>
Per Utility Allocated Rate Base	\$1,910	\$845	44.24%	\$1,065	55.76%
Per Audit Allocated Rate Base	<u>\$2,301</u>	<u>\$1,018</u>	44.24%	<u>\$1,283</u>	55.76%
Audit Adjustment	\$391	\$173		\$218	

**AUDIT FINDING NO. 5**

**SUBJECT: ADJUSTMENT TO WORKING CAPITAL**

**SUMMARY:** The utility's working capital allowance for water and wastewater rate base is \$2,210 and \$6,622, respectively, as of December 31, 2005.

**STATEMENT OF FACT:** The utility's filing did not include a historical working capital adjustment for water and wastewater rate base.

The audit staff has calculated the working capital allowance for water and wastewater rate base to be \$2,210 and \$6,622, respectively, as of December 31, 2005.

	Water	W/Water	Total	
Total O&M Expense	\$17,676	\$52,976	\$70,652	Per MFR Schedule B1 & B-2
Adjustments (See note below)	<u>0</u>	<u>0</u>	<u>0</u>	
Total Adjusted O&M Expense	\$17,676	\$52,976	\$70,652	
Divided by 8	<u>8</u>	<u>8</u>	<u>8</u>	
Working Capital	\$2,210	\$6,622	\$8,832	

Note: Audit staff adjustments to historical O&M expense in this report include the corresponding affect on working capital in each separate finding.

**EFFECT ON GENERAL LEDGER:** None, because a working capital adjustment is only calculated for rate case proceedings.

**EFFECT ON FILING:** Increase water and wastewater rate base by \$2,210 and \$6,622, respectively, as of December 31, 2005.



**AUDIT FINDING NO. 6**

**SUBJECT: ADJUSTMENT TO OPERATION AND MAINTENANCE EXPENSE**

**SUMMARY:** The utility's operation and maintenance expense balance is overstated by \$2,602 for the 12-month period ended December 31, 2005.

**STATEMENT OF FACT:** The utility's filing reflects a balance of \$31,862 in Acct. No. 720 - Materials and Supplies for the 12-month period ended December 31, 2005.

Included in the above balance is \$3,253 that is recorded in Utility Acct. No. 7755070 - Sewer Permits for engineering studies and permit renewal fees related to the renewal of the utility's wastewater treatment permit for five years.

Costs such as these would be considered nonrecurring and should be amortized over a five year period per Rule 25-30.433 (8), F.A.C.

The amount that should be allowed for test year 2005 is \$651. (\$3,253/5 years) The unamortized balance of \$2,602 (\$3,253 - \$651) should be recorded in Acct. No 186 - Deferred Asset.

**EFFECT ON GENERAL LEDGER:** The following entry should be made to properly record the utility's miscellaneous expense balance.

<u>Utility Acct. No.</u>	<u>NARUC Acct. No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
	186	Deferred Asset - Sewer Permit Fees	\$2,602	
7755070	720	Material & Supplies		\$2,602

**EFFECT ON FILING:** The utility's wastewater operation maintenance expense balance should be reduced by \$2,602 for the 12-month period ended December 31, 2005. Additionally, the wastewater working capital balance should be reduced by \$325 as of December 31, 2005, which is 1/8<sup>th</sup> of the O&M expense reduction mentioned above.

**AUDIT FINDING NO. 7**

**SUBJECT: ADJUSTMENT TO ALLOCATED WSC EXPENSE**

**SUMMARY:** The utility's allocated common operating expense from Water Service Corporation (WSC) is \$7,112 for the 12-month period ended December 31, 2005.

**STATEMENT OF FACT:** WSC, the service corporation for the parent company Utilities, Inc., allocates a portion of its common operating expenses to each subsidiary utility throughout the United States. Lake Placid Utilities, Inc. received \$7,369 or approximately 0.10 percent of \$7,644,705 in total WSC common expenses for the 12-month period ended December 31, 2005. The allocation was calculated using a customer equivalent percentage that equates all customers throughout the United States in terms of equivalent residential connections.

The Commission's Division of Regulatory Compliance and Consumer Assistance, at the request of The Division of Economic Regulation, performed an affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2005, in Docket No. 060253-WS. The scope of the audit included a review of the WSC common expenses that are allocated to all of its subsidiary operations in 2005. The audit report, issued July 15, 2006, included specific adjustments that reduced Lake Placid Utilities, Inc. allocated common expenses by \$257 to \$7,112. Additionally, the corresponding adjustment to reduce working capital for this proceeding is \$32.

The audit staff has incorporated the findings of the above-mentioned audit report to determine that the Lake Placid Utilities Inc. allocated average WSC common expenses are \$7,112 for this proceeding. See audit staff's calculations on the following page.

**EFFECT ON GENERAL LEDGER:**

G/L Acct.	Description	Debit	Credit
2151000	Retained Earnings	\$205	
4032098	Dep. Exp. - Computer		\$1
4191010	Interest Income	\$1	
4272090	Interest Expense	\$51	
6329002	Audit Fees		\$89
6369009	Amtz. Exp. - Computer		\$13
6599090	Insurance Exp. - Other		\$102
6759005	Postage Fees		\$52

**EFFECT ON FILING:** The utility's water and wastewater O&M expense balances are overstated by \$114 and \$143, respectively, for the 12-month period ended December 31, 2005. Additionally, water and wastewater working capital balances should be reduced by \$14 and \$18, respectively, as of December 31, 2005 which is 1/8<sup>th</sup> of the O&M expense reductions mentioned above.

Lake Placid Allocation Schedules	Per Company		Adjustment		Per Audit	
	WSC Expense	Lake Placid	WSC Expense	Lake Placid	WSC Expense	Lake Placid
SE51 Allocated Computer	\$545,445	\$640	(\$12,634)	(\$14)	\$532,811	\$626
SE52 Allocated Insurance	2,114,495	1,297	(156,711)	(102)	1,957,784	1,195
SE60 Allocated General	<u>4,984,765</u>	<u>5,432</u>	<u>(74,972)</u>	<u>(89)</u>	<u>4,909,793</u>	<u>5,343</u>
Per G/L	\$7,644,705	\$7,369	(\$244,317)	(\$205)	\$7,400,388	\$7,164
Remove interest income and expense not included in the filing				<u>(\$52)</u>		<u>(\$52)</u>
Per MFR				(\$257)		\$7,112

SE51		Per Utility	Adjustment	Per Audit
Acct No.				
4032098	Dep. - Computer	\$125	(\$1)	\$124
6369009	Amtz. - Computer	<u>31</u>	<u>(13)</u>	<u>18</u>
		\$156	(\$14)	\$142

SE52		Per Utility	Adjustment	Per Audit
Acct No.				
6599090	Insurance - Other	\$1,297	(\$102)	\$1,195

SE60		Per Utility	Adjustment	Per Audit
Acct No.				
4191010	Interest Income	(\$1)	\$1	\$0
4272090	Interest Expense	(51)	51	0
6329002	Audit Fees	262	(89)	173
6759005	Postage Fees	<u>98</u>	<u>(52)</u>	<u>46</u>
		\$308	(\$89)	\$219

Acct No.		MFR Acct. No.	Adjustment	MFR B-12	MFR B-12
				44.23% Water	55.77% W/Water
4032098	Dep. - Computer	403 *	(\$1)	(\$1)	\$0
4191010	Interest Income	426 **	0	0	0
4272090	Interest Expense	419/427 **	0	0	0
6329002	Audit Fees	632/732	(89)	(39)	(50)
6369090	Amtz. - Computer	636/736	(13)	(6)	(7)
6599090	Insurance - Other	659/759	(102)	(45)	(57)
6759005	Postage Fees	675/775	<u>(52)</u>	<u>(23)</u>	<u>(29)</u>
	O&M Expense Adjustment		(\$256)	(\$113)	(\$143)
	Total WSC allocated expense adjustment		(\$257)	(\$114)	(\$143)
	Working Capital Adjustment (1/8 of O&M Expense Adjustment)		(\$32)	(\$14)	(\$18)

\* This account was only charged to water operations per the reconciliation schedule provided with the MFRs.

\*\* Per utility these two allocations from WSC are not carried forward into the MFR filing so no adjustment is needed.

**AUDIT FINDING: 8**

**SUBJECT: ADJUSTMENT TO DEPRECIATION EXPENSE**

**SUMMARY:** The utility's water and wastewater depreciation expense balances are understated by \$788 and \$1,050, respectively, for the 12-month period ended December 31, 2005.

**STATEMENT OF FACT:** In 1996 the utility posted adjustments to its water and wastewater accounts to correct its December 31, 1995 ending balances as required in Order No. PSC-96-0910-FOF-WS, issued July 15, 1996. Subsequently, in 2005, the utility posted additional adjustments to correct the 1996 journal entry and record the cumulative effect as of December 31, 2005. We have verified that the 2005 corrections were needed and calculated accurately, however, the utility posted the depreciation expense related to the correction to the wrong accounts.

The utility posted two entries that reduced Acct. No. 4032092 - Dep. Exp. Transportation Equipment by \$919. The correct journal entry posting should have been to increase depreciation expense for Water - Undistributed Water Plant by \$392 and Wastewater - Other Tangible Plant by \$527.

The utility's general ledger does not contain specific depreciation expense accounts for these two UPIS accounts. It appears that the utility records the depreciation expense for these two accounts in Acct. No. 4032092. The two accounts do, however, have specific UPIS and accumulated depreciation account titles that did not exist in 2004 but were added in 2005.

Utility		NARUC		Account Description
Acct. Nos.		Acct. Nos.		
3486096	1083010	348	108	Undistributed Water Plant
3985000	1084000	398	108	Other Tangible Sewer

The utility's transportation depreciation expense is understated by \$919 and the depreciation expense for the two accounts above are understated by \$392 and \$527, respectively, because the utility's correcting entry reduced transportation depreciation expense by \$919 rather than increasing undistributed water plant depreciation expense and other tangible sewer depreciation expense by \$327 and \$527, respectively.

The transportation depreciation expense account reflected a balance of \$1,542 (\$2,461 - \$919) for the test year which was composed of allocated UIF transportation depreciation expense of \$2,461 and the negative depreciation expense journal entry of \$919 discussed above. We ignored the negative \$919 balance when we allocated the UIF transportation depreciation expense in Audit Finding No. 3 of this report to wastewater operations.

**EFFECT ON LEDGER:** The following entry should be made to properly record the utility's miscellaneous expense balance.

Utility Acct. No	NARUC Acct. No.	Account Description	Debit	Credit
2151000	215	Retained Earnings		\$1,838
4032092	403	Water Dep. Exp. Transportation	\$919	
403****	403	Water Dep. Exp. - Undistributed Water Plant	\$392	
403****	403	W/Water Dep. Exp. - Other Tangible Sewer	\$527	

**EFFECT ON FILING:** The utility's water and wastewater depreciation expense balances should be increased by \$1,311 (\$392 + \$919) and \$527, respectively, for the 12-month period ended December 31, 2005.

**AUDIT FINDING. 9**

**SUBJECT: ADJUSTMENT TO TAXES OTHER THAN INCOME**

**SUMMARY:** The utility's water and wastewater Taxes Other Than Income (TOTI) balances are understated by \$468 and \$2,064, respectively, for the 12-month period ended December 31, 2005.

**STATEMENT OF FACT:** The utility's filing reflects the following balances for water and wastewater TOTI for the 12-month period ended December 31, 2005.

System	RAFs	Payroll Taxes	Property Taxes	TOTI Total
Water	\$1,102	\$243	\$2,041	\$3,386
Wastewater	<u>1,715</u>	<u>378</u>	<u>3,178</u>	<u>5,271</u>
Total	\$2,817	\$621	\$5,219	\$8,657

The utility's water and wastewater RAF balances are understated by \$990 and \$1,542, respectively, based on the following audit staff determinations.

1. The utility allocated its total RAF balance to water and wastewater operations based on its corresponding revenues for the period. They should have recorded the specific RAF amounts calculated to each specific system.
2. The utility's combined RAF balance above of \$2,817 includes \$2,667 of water and wastewater RAFs calculated for the period January 2004 through December 2004, which is the prior period. The utility should have included \$5,199 of water and wastewater RAFs calculated for the period the January 2005 through December 2005. The difference is \$2,532 (\$990 + \$1,542) and it should be added to the RAF filing balance.

The utility's water and wastewater property tax balances are overstated and understated by \$522, each, respectively, based on the following audit staff determinations.

1. The utility allocated its property taxes between water and wastewater operations based on revenues.
2. Real estate taxes should have been recorded to the water or wastewater system based on the actual tax invoice for each property.
3. Tangible property tax should be allocated based on gross utility plant balances because it represents a tax on tangible assets such as the utility plant assets.

See the audit staff's calculations that follow for the above adjustments.

**EFFECT ON GENERAL LEDGER:** The utility's 2005 RAF should be increased by a net \$2,532 to properly record the actual combined water and wastewater RAF for the period. There is no effect on property taxes because it is a reallocation within the same utility system.

**EFFECT ON THE FILING:** The utility's water and wastewater Taxes Other Than Income (TOTI) balances should be increased by \$468 and \$2,064, respectively, for the 12-month period ended December 31, 2005.

Adjustment to RAF	Water	W/Water	Total		
Per Audit	\$2,033	\$3,166	\$5,199	a	Add Jan-Dec 2005 per RAF filing
Per Utility	<u>(1,043)</u>	<u>(1,624)</u>	<u>(2,667)</u>	b	Remove Jan-Dec 2004 per filing
Audit Adjustment	\$990	\$1,542	\$2,532		

Adjustment to Property Tax

Per Audit	\$68	\$118	\$187	c	Tangible Property Tax Inv. Ref# - U69260
Per Audit	29	\$49	78	c	Parent property tax allocation
Per Audit	2,466	0	2,466	a	Real Estate Property Tax Inv. Ref# - U91988
Per Audit	<u>0</u>	<u>2,488</u>	<u>2,488</u>	a	Real Estate Property Tax Inv. Ref# - U91987
Per Audit	\$2,563	\$2,656	\$5,219		
Per Utility	<u>2,041</u>	<u>3,178</u>	<u>5,219</u>	b	
Audit Adjustment	<u>(\$522)</u>	\$522	\$0		

Total Audit Adjustment      \$468      \$2,064      \$2,532

UPIS MFR A-5&6	\$332,254	\$591,188	\$923,442
Less Land	<u>(2,707)</u>	<u>(21,665)</u>	<u>(24,372)</u>
Gross UPIS	\$329,547	\$569,523	\$899,070
Percentage	36.65%	63.35%	100.00%

Per Utility RAF

RAF	\$1,043	\$1,624	\$2,667	b	
Miscellaneous	<u>59</u>	<u>91</u>	<u>150</u>	b	The utility included the Fla State Corp. filing fee of \$150 in its RAF amount in the filing. Although it is a miscellaneous TOTI element an adjustment would have a \$0 effect on the filing
	\$1,102	\$1,715	\$2,817		

- a) Actual invoice
- b) Allocated based on revenues
- c) Allocated based on gross utility plant

## **AUDIT FINDING NO. 10**

### **SUBJECT: INFORMATION ON CONTRIBUTIONS IN AID OF CONSTRUCTION**

**SUMMARY:** The utility allocated its Contributions in Aid of Construction (CIAC) in 2003 in order to comply with Rule 25-30.140 F.A.C. which required CIAC for contributed property which can be specifically associated with a corresponding utility plant in service (UPIS) account to be amortized using the same depreciation rates as the UPIS account.

**STATEMENT OF FACT:** In 2003, the utility made an adjusting journal entry to re-distribute its combined CIAC account balances into several specific accounts based on the percentage of UPIS account balances excluding balances in organization, franchise, transportation and office equipment. The utility's schedule that calculates the journal entry is displayed on the following page.

The utility first determined a balance for undistributed CIAC which represented cash collections. The amount was determined by estimating the total tap fees collected for the utility system. The remaining CIAC balance was then redistributed to specific CIAC sub-accounts based on the allocation methodology described above.

However, the audit staff notes that there are two problems with the utility's calculation.

1. The utility did not book Commission adjustments from the last rate case until 2005 and therefore the plant balances used by the utility to reallocate its CIAC balance did not reflect the Commission balances.
2. The utility allocated the CIAC to all of its UPIS accounts excluding organization, franchise and transportation equipment.

Usually when the utility receives contributed plant from a developer, it consists of service lines, lift stations, and customer service extensions. The utility's allocation method redistributed a portion of its CIAC balance to accounts containing buildings and structures, treatment plant, sewer lagoons and pumping equipment. These accounts are not normally associated with contributed property for wastewater utility systems.

The audit staff defers this issue to the analyst in Tallahassee for final disposition.

**EFFECT ON GENERAL LEDGER:** If the utility's CIAC allocation is recalculated by the analyst, the accumulated amortization of CIAC and CIAC amortization expense balances will all need to be adjusted accordingly.

**EFFECT ON FILING:** The total balance for CIAC reflected in the utility's filing will not change. However, the accumulated amortization of CIAC would need to be adjusted along with the 13-month average balance for the test year. Additionally the recalculated amortization of CIAC expense balance will affect the net depreciation expense presented in the utility's filing.



Acct. Nos		UPIS	UPIS	CIAC	CIAC	CIAC	CIAC	CIAC	CIAC	CIAC	
UPIS	CIAC	Acct. Description	Balance @12/31/02	Percentage	Allocation @12/31/02	Additions Jan-Jun '03	Balance @12/31/02	Amtz. Rate	Amtz. Jan-Jun '03	Amtz. Jul-Dec '03	Amtz Total
3542011	2721011	Lift Station	\$147,776	35.28%	\$41,967	0	\$41,967	3.13%	\$656	\$656	\$1,311
3547003	2721003	Structures & Imp.	56,516	13.49%	16,050	0	16,050	3.13%	251	251	502
3547012	2721012	Spray Irrigation Facilities	0	0.00%	0	0	0	3.13%	0	0	0
3602006	2721006	Sewage Service Lines	17,787	4.25%	5,051	0	5,051	3.33%	84	84	168
3602007	2721007	Force Mains	41,790	9.98%	11,868	0	11,868	3.33%	198	198	396
3612008	2721008	Sewer Mains	66,557	15.89%	18,902	0	18,902	2.22%	210	210	420
3612010	2721098	Manholes	0	0.00%	0	0	0	2.22%	0	0	0
3804004	2721004	Sewer Lagoons	46	0.01%	13	0	13	2.86%	0	0	0
3804005	2721005	Treatment Plant	86,480	20.64%	24,560	0	24,560	2.86%	351	351	702
3824009	2721009	Outfall Lines	<u>1,940</u>	<u>0.46%</u>	<u>551</u>	<u>0</u>	<u>551</u>	3.33%	<u>9</u>	<u>9</u>	<u>18</u>
			\$418,892	100.00%	\$118,962	0	\$118,962		\$1,759	\$1,759	\$3,517
271		CIAC Balance per T/B @12/31/02	\$152,454								
		Less Tap Fee portion of CIAC	33,492								
		Less Tap Fee Refunds	0								
		Less known CIAC Sub-Acct. Balance	<u>0</u>								
		Unidentified CIAC balance	\$118,962								
271		CIAC Additions (Jan-Jun '03)	\$817								
407.6		Amtz. Of CIAC Expense @12/31/03		\$4,915							
		Less Tap Fees Amtz of CIAC (Jan-Jun '03)		538							
		Less Tap Fees Amtz of CIAC (Jul-Dec '03)		552							
		Less known Amtz. Of CIAC Sub-Acct. Balance		<u>0</u>							
		Unidentified Amtz. Of CIAC balance		\$3,825							
		Recalculated Amtz. Of CIAC balance above		<u>(3,518)</u>							
		Retained Earnings Adjustment		\$307							

## AUDIT FINDING NO. 11

### SUBJECT: INFORMATION ON CAPITAL STRUCTURE BALANCES

**SUMMARY:** The utility's average capital structure balance is \$229,292,886 as of December 31, 2005 and its cost rate for long-term debt is 6.73 percent.

**STATEMENT OF FACT:** The utility's filing reflects the following capital structure balances prior to the reconciliation with its average rate base as of December 31, 2005.

Class of Capital	Prior Year 12/31/2004	Test Year 12/31/2005	Average	Cost Rate
Long Term Debt	\$112,803,215	\$135,285,191	\$124,044,203	6.81%
Short Term Debt	18,768,000	3,926,000	11,347,000	2.00%
Common Equity	88,963,597	92,611,247	90,787,422	11.77%
Customer Deposits	0	0	0	6.00%
Acc. Deferred Income Tax	<u>20,067</u>	<u>19,243</u>	<u>19,655</u>	0.00%
Totals	\$220,554,879	\$231,841,681	\$226,198,280	

The Commission's Division of Regulatory Compliance and Consumer Assistance, at the request of The Division of Economic Regulation, performed an affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2005, in Docket No. 060253-WS. The scope of the audit included a review of the Utilities, Inc., the parent, capital structure component balances as of December 31, 2005. The audit report, issued July 15, 2006, determined the following average balances for Lake Placid's parent, Utilities Inc. as of December 31, 2005.

Class of Capital	Prior Year 12/31/2004	Test Year 12/31/2005	Average	Cost Rate
Parent Level				
Long Term Debt	\$112,803,215	\$135,285,191	\$124,044,203	6.73%
Short Term Debt	18,768,000	3,926,000	11,347,000	2.00%
* Common Equity	92,087,507	95,673,345	93,880,426	
Lake Placid Level				
** Customer Deposits	1,680	1,524	1,602	6.00%
** Acc. Deferred Income Tax	<u>20,067</u>	<u>19,243</u>	<u>19,655</u>	0.00%
Totals	\$223,680,469	\$234,905,303	\$229,292,886	

\* The cost rate for common equity to be determined after reconciliation to the utility's average rate base.

\*\* These balances do not include other audit adjustments in this report where applicable.

Based on the above affiliate audit report findings the average common equity balance should be increased by \$3,093,004 (\$93,880,426 - \$90,787,422), the long-term debt cost rate should be reduced by 0.08 percent (6.81% - 6.73%).

Additionally, the audit staff has included an average balance of \$1,602 for customer deposits that is reflected in the utility's general ledger that was not included in its filing.

**EFFECT ON GENERAL LEDGER:** None, because capital structure balances are only used in rate case proceedings

**EFFECT ON FILING:** To be determined by the analyst in Tallahassee.

## AUDIT FINDING NO. 12

### SUBJECT: INFORMATION ON DEFERRED TAXES

**SUMMARY:** The utility reports \$19,243 on its books in net deferred income taxes in 2005. This amount is reported at average as \$19,655. As a result of our testing as described below, the average balance used in this case should be changed from \$19,655 by \$8,996 to report a net deferred tax balance of \$28,651. This amount contains estimates which have been presented to the utility and are subject to adjustments based upon further findings during this case.

<u>Calculations:</u>	<u>Average</u>	<u>Year End</u>
Beginning Balance	\$19,655	\$19,243
Deferred Income Tax		
Corrections		
State Depreciation	3,564	3,564
State Intangible	1,422	1,422
Federal Intangible	4,010	4,010
Federal Depreciation	<u>Pending</u>	<u>Pending</u>
Total	\$28,651	\$28,239

**EFFECT ON FILING:** If all the findings are accepted there is no direct effect on rate base or utility income. The effect on capital structure is to reduce the provision for equity and debt by \$8,996 and increase deferred taxes by \$8,996.

#### **Deferred Taxes -- Item 1: Accelerated Depreciation - State of Florida**

When the utility takes tax benefits due to accelerated depreciation, the utility must record deferred income taxes. In this case, the utility failed to record sufficient state deferred taxes in its accounts. The estimated correction at average is \$3,563 and at year end is \$3,564.

#### **EFFECT ON GENERAL LEDGER:**

NARUC

<u>Acct. No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
215	Retained Earnings	\$3,564	
190	State Deferred Taxes -- Depreciation		\$3,564

#### **Deferred Taxes -- Item 2: Deferred Taxes Intangible Plant -- Federal and State of Florida**

Intangible plant is recorded as an asset in water and sewer plant accounts as either organization plant or as franchise plant. For income tax purposes, this intangible plant is expensed and deferred taxes are recorded. Intangible plant and deferred taxes for intangible plant during the normal course of business are not reduced unless a utility's assets are sold.

Utility intangible plant did not match the expected balance of deferred income taxes. Further the State of Florida deferred taxes had not been properly recorded. The estimated correction to Federal deferred accounts at average is \$4,010 and at year end is \$4,010. The estimated correction to state deferred account is \$1,422 at average and at year end is \$1,422.

**EFFECT ON GENERAL LEDGER:**

NARUC

<u>Acct. No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
215	Retained Earnings	\$6,432	
190	Federal Deferred Taxes – Intangible Plant		\$4,010
190	State Deferred Taxes – Intangible Plant		\$1,422

**Deferred Taxes -- Item 3: Accelerated Depreciation – Federal**

Accelerated depreciation is a difficult account for a utility to maintain and difficult for the Commission to audit. We found there was a possibility of errors and non utility effects in the account. There was not enough available audit time for staff to verify the details in this account sufficiently to comment the account was free of error, free of non utility effects and reflected necessary Commission adjustments appropriately.

Absent available audit resources, we have asked the utility to present additional information concerning its deferred taxes in this matter. Absent additional audit procedures, we recommend industry staff use reported plant additions, retirements and Commission adjustments along with known state and federal depreciation rates to determine what level for Federal Accumulated Deferred Income Tax is reasonable. Once a Federal Deferred Tax – Accelerated Depreciation level is set, it would be appropriate to revise the estimate presented in item 2: Deferred Taxes -- Accelerated Depreciation State of Florida.

Possible Accounts Affected upon General ledger:

Retained Earnings

State Deferred Income Taxes – Depreciation

Federal Deferred Income Taxes – Depreciation

State Non Utility Deferred Income Taxes – Depreciation

Federal Non Utility Deferred Income taxes -- Depreciation

**Deferred Taxes -- Item 4: Accounting for Post 2000 Tap Fees**

Treasury Regulation Section 1.118-2(b) (3) excludes customer connection fees from the definition of CIAC for tax purposes. Therefore, Commission staff has advised that subsequent to the year 2000, CIAC in the form of cash tap fees paid to the utility is taxable. This appears to be a significant item in future utility accounting and ratemaking.

The utility records the effects of (1) taxable CIAC and (2) its amortization correctly in its deferred tax accounts, but the also utility reports (3) additional book depreciation in its reports where no book depreciation exists. Further, it appears that the taxable CIAC effects are at an accelerated rate rather than the straight line rate used by the utility. This reporting does not

affect the setting of rates in this case, but it clouds the auditing and determination of deferred taxes and the utility's ongoing and future reports such as annual report schedule F-23 and MFR schedules C-1 and C-2, and C-5. Clarification on this matter is needed.

From the auditor's perspective, it appears the proper accounting for taxable CIAC is to treat the amortization of tax on CIAC as income statement amortization and not provide a corresponding provision for income taxes on this amortization in ratemaking. Treating this item entirely in deferred tax accounts on the balance sheet seems to cause long-lived problems in assessing the impact of taxable CIAC and accelerated depreciation on rates.

**Deferred Taxes -- Item 5: Error in Utility MFR**

Utility information contained in its filing schedules C-1, C-2 and C-5 that report the provision for income taxes did not match utility schedule B-1 or Annual Report Schedule F-23 or Annual Report Schedule F-3. This type of error causes audit inefficiencies. Staff has relied upon annual report schedules during this audit of deferred income taxes.

**Deferred Taxes -- Item 6: AFUDC**

Based upon a review of cash flow model, it is apparent that when setting rates for a utility receiving both an income tax allowance and AFUDC, for ratemaking, it is appropriate to adjust the final calculations for income tax expense by the tax effect of equity AFUDC depreciation.

In the past, this item could be considered immaterial but the issue grows as AFUDC is accrued by utilities year-after-year which receive allowances for federal income tax.

Due to audit time constraints, the auditor was not able to fully research this utility's AFUDC history or determine the correct amount of equity AFUDC depreciation in this case.

# EXHIBIT 1

**Water Rate Base**

Company: Lake Placid Utilities Inc  
 Docket No.: 060257-WR  
 Test Year End: December 31, 2005  
 Interim  or Final   
 Historic  or Projected

Florida Public Service Commission  
 Schedule: A-1  
 Page 1 of 1  
 Preparer: Virchow, Krause

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.

(1) Line No.	(2) Description	(3) Balance Per Books	(4) Utility Adjustments	(5) Adjusted Books Balance	(6) Proforma Adjustments	(7) Adjusted Utility Balance	(8) Supporting Schedule(s)
1	Utility Plant in Service	\$ 320,763	\$ -	\$ 320,763	\$ 39,279 A	\$ 360,032	A-5, A-3
2	Utility Land & Land Rights	2,707	-	2,707	-	2,707	A-5
3	Less: Non-Used & Useful Plant	-	-	-	-	-	A-3, A-7
4	Construction Work in Progress	14,520	(14,520) D	-	-	-	A-3, A-18
5	Less: Accumulated Depreciation	(123,370)	-	(123,370)	30,983 B	(92,386)	A-9
6	Less: CIAC	(89,440)	-	(89,440)	-	(89,440)	A-12
7	Accumulated Amortization of CIAC	39,772	-	39,772	-	39,771.5	A-14
8	Acquisition Adjustment	-	- E	-	-	-	A-3, A-18
9	Accum. Amort. Of Acq. Adjustments	9,204	- E	9,204	-	9,204	A-3, A-18
10	Advances for Construction	-	-	-	-	-	A-16
11	Working Capital Allowance	-	-	-	4,172 F	4,172	A-17, A-3
12	<b>Total Rate Base</b>	<b>\$ 174,154</b>	<b>\$ (14,520)</b>	<b>\$ 159,628</b>		<b>\$ 234,061</b>	

# EXHIBIT 2

## Sewer Rate Base

Company: Lake Placid Utilities Inc  
 Docket No.: 060257-WS  
 Test Year End: December 31, 2006  
 Interim [ ] or Final [x]  
 Historic [x] or Projected [ ]

Florida Public Service Commission

Schedule: A-2  
 Page 1 of 1  
 Preparer: Virohow, Krause

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.

Line No	(1) Description	(2) Balance Per Books	(3) Utility Adjustments	(4) Adjusted Books Balance	(5) Prorata Adjustments	(6) Adjusted Utility Balance	(7) Supporting Schedule(s)
1	Utility Plant in Service	\$ 560,019	\$ (17,900) C	\$ 542,118	\$ 2,408 A	\$ 544,527	A-6
2	Utility Land & Land Rights	21,665	-	21,665	-	21,665	A-6
3	Less: Non-Used & Useful Plant	-	(13,188) C	(13,188)	-	(13,188)	A-3, A-7
4	Construction Work in Progress	-	- D	-	-	-	A-3, A-16
5	Less: Accumulated Depreciation	(302,910)	-	(302,910)	(30) B	(302,940)	A-10, A-3
6	Less: CIAC	(154,488)	-	(154,488)	-	(154,488.00)	A-12
7	Accumulated Amortization of CIAC	103,172	-	103,172	-	103,171.50	A-14
8	Acquisition Adjustment	-	-	-	-	-	A-3, A-16
9	Accum. Amort. Of Acq. Adjustments	-	-	-	-	-	A-3, A-16
10	Advances for Construction	-	-	-	-	-	A-16
11	Working Capital Allowance	-	-	-	9,390 F	9,390	A-17, A-3
12	Total Rate Base	\$ 227,479	\$ (31,089)	\$ 196,390		\$ 208,159	



# EXHIBIT 3

## Net Operating Income Statement - Water

Florida Public Service Commission

Company: Lake Placid Utilities Inc  
 Docket No.: D60257-WS  
 Test Year End: December 31, 2005  
 Interim [ ] or Final [x]  
 Historic [x] or Projected [ ]

Schedule: B-1  
 Page 1 of 1  
 Preparer: Virchow, Krauss

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	\$ 45,173	\$ 222 A	\$ 45,395	\$ 30,017 I	\$ 75,413	B-4, E-2
2	Operation & Maintenance	17,676	-	17,676	15,711 F, G, L	33,387	B-5
3	Depreciation, net of CIAC amort.	8,722	-	8,722	1,914 D	10,636	B-13
4	Amortization	(7,894)	7,894 B	-	-	-	
5	Taxes Other Than Income	3,386	-	3,386	1,440 K, M	4,826	B-15
6	Provision for Income Taxes	(14,339)	14,339 C	-	6,529 J	6,529	C-1, B-3
7	OPERATING EXPENSES	7,551	22,233	29,784	25,593	55,377	
8	NET OPERATING INCOME	\$ 37,622	\$ (22,011)	\$ 15,611	\$ 4,424	\$ 20,036	
9	RATE BASE	\$ 174,154		\$ 159,626		\$ 234,061	A-1
10	RATE OF RETURN	21.80%		9.78%		8.56%	

# EXHIBIT 4

Net Operating Income Statement - Sewer

Company: Lake Placid Utilities Inc  
 Docket No.: 866267-W5  
 Test Year End: December 31, 2005  
 Interest [ ] or FIRM [x]  
 Historic [x] or Projected [ ]

Florida Public Service Commission

Schedule: B-2  
 Page 1 of 1  
 Preparer: Virechow, Krause

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.

(1) Line No.	(2) Description	(3) Balance For Basis	(4) Utility Test Year Adjustments	(5) Utility Adjusted Test Year	(6) Requested Revenue Adjustment	(7) Requested Annual Revenue	(8) Supporting Schedule(s)
1	OPERATING REVENUES	\$ 78,362	\$ 50 A	\$ 78,412	\$ 71,802 I	\$ 142,314	B-4, E-2
2	Operation & Maintenance	52,976	-	52,976	22,147 E, F, G, L	75,123	B-6
3	Depreciation, net of CIAC amort.	13,194	-	13,194	30 D	13,224	B-14
4	Amortization	529	(529) B	-	-	-	B-3
5	Taxes Other Than Income	5,271	-	5,271	3,348 K, M	8,839	B-15
6	Provision for Income Taxes	10,858	-	10,858	12,971 J	27,830	
7	OPERATING EXPENSES	85,528	(529)	85,000	35,495	124,495	
8	NET OPERATING INCOME	\$ 115,167	\$ 529	\$ (14,588)	\$ 32,408	\$ 17,818	
9	RATE BASE	\$ 227,478		\$ 196,360		\$ 208,158	A-2
10	RATE OF RETURN	-6.62%		-7.43%		8.56%	

Dependents:  
 Schedule A-17

EXHIBIT 5

Requested Cost of Capital

Florida Public Service Commission

Company: Lake Placid Utilities Inc  
 Docket No.: 060257-WS  
 Test Year End: December 31, 2005  
 Schedule Year End: December 31, 2005  
 Interim  or Final   
 Historic  or Projected

Schedule: D-1  
 Page 1 of 1  
 Preparer: Kirsten E. Weeks

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) Class of Capital	(2) Total Capital	(3) Ratio	(4) Cost Rate	(5) Weighted Cost
1	Long Term Debt	\$ 241,876	54.84%	6.81%	3.73%
2	Short Term Debt	22,126	5.02%	2.00%	0.10%
3	Preferred Stock	-	0.00%	0.00%	0.00%
4	Common Equity	177,028	40.14%	11.77%	4.72%
5	Customer Deposits	-	0.00%	6.00%	0.00%
6	Tax Credits - Zero Cost	-	0.00%	0.00%	0.00%
7	Tax Credits - Weighted Cost	-	0.00%	0.00%	0.00%
8	Accumulated Deferred Income Tax	1,191	0.00%	0.00%	0.00%
9	Other (Explain)	-	0.00%	0.00%	0.00%
10	Total	\$ 442,221	100%		8.56%

Note: The cost of equity is based on the leverage formula in effect pursuant to Order No. PSC-050006. Since the equity ratio is greater than 40.00%, a(n) 11.77% cost rate has been used.