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DOCKET NO. 060368-WS: Application for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

WITNESS: Direct Testimony Of DENISE N. VANDIVER, Appearing On Behalf Of Staff

DATE FILED: August 21, 2007

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DIRECT TESTIMONY OF DENISE N. VANDIVER

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Q. Please state your name and business address.

A. My name is Denise N. Vandiver and my business address is 2540 Shumard Oak Blvd., Tallahassee, Florida, 32399.

Q. By whom are you presently employed and in what capacity?

A. I am employed by the Florida Public Service Commission as the Bureau Chief of Auditing in the Division of Regulatory Compliance and Consumer Assistance.

Q. How long have you been employed by the Commission?

A. I have been employed by the Florida Public Service Commission since March, 1983.

Q. Briefly review your educational and professional background.

A. I received a Bachelor of Science degree from Jacksonville University in 1978 with a major in accounting. I received a Master of Accountancy degree from the University of North Florida in 1982. Prior to my work at the Commission I worked four years with the City of Jacksonville Beach as an Accountant and less than one year as Director of Accounting for a Hospital in Savannah, Georgia. I joined the Commission in March 1983 and worked 6½ years in the Division of Water and Wastewater as a Regulatory Analyst performing accounting analysis of water and wastewater utilities. I then spent three years in the Economic Regulatory Standards Control Section and the Division of Research and Regulatory Review as an Economic Analyst and supervisor performing various reviews in all industries regulated by the FPSC. Since January 1993, I have been the Bureau Chief of Auditing. I am responsible for managing all the financial

1 audits performed by the Commission's district offices.

2

3 Q. Please describe your current responsibilities.

4 A. As Bureau Chief of Auditing, I am responsible for establishing operational
5 guidelines for the conduct of field audits. These guidelines include policies and
6 procedures developed to ensure unbiased, factual audits conducted by independent audit
7 staff in a timely manner. I also supervise compliance with these guidelines and
8 administrative policies and procedures.

9

10 Q. Have you presented testimony before this Commission or any other regulatory
11 agency?

12 A. Yes. I have testified in two rate cases, Docket No. 830059-WS, Spring Hill
13 Utilities, a division of Deltona Utilities, Inc., and Docket No. 840315-WS, Martin Downs
14 Utilities, Inc. I also testified before an administrative law judge at the Division of
15 Administrative Hearings in 1998 in the case Aloha Utilities, Inc. and Florida Waterworks
16 Association, Inc. vs. State of Florida Public Service Commission.

17

18 Q. What is the purpose of your testimony today?

19 A. The purpose of my testimony is to sponsor specific audit findings in the staff audit
20 report of Aqua Utilities Florida, Inc. (Utility) which addresses the Company's application
21 for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee,
22 Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and
23 Washington Counties, Audit Control Number 06-347-1-1. This audit report is filed with
24 the testimony of Charleston Winston and is identified as Exhibit CJW-1. Specifically, my
25 testimony addresses Findings 5, 7-10, 16, 17, 19, and 21-24.

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Q. Were these audit findings prepared by you?

A. Yes, I was responsible for the portion of the audit that addressed the projections.

Q. Please describe the specific audit procedures you used in auditing the projection.

A. We calculated the percentage increase for rate base and net operating income components for 2006 compared to 2005 and for 2007 compared to 2006. We also compared the 2006 projections to the actual general ledger balances at December 31, 2006 and compared the actual 2006 balances to the actual 2005 balances. We also compared 2007 projections to internal capital and operating budgets for 2007. Based on these comparisons, we attempted to follow up on major differences.

We also chose a sample of capital and operating projections, focusing on line items with 25% or greater increases, and requested additional supporting documentation. We also reviewed the work order system used by the Utility.

Q. Please review the audit findings in the audit report.

A. **Audit Finding 5**

Audit Finding 5 addresses the projections of plant retirements, excluding allocated plant. For Valencia Terrace Water, Zephyr Shores Water, and Fern Terrace Water there were significant differences between the projected and actual retirements in 2006. These differences are between 5% and 10% of the year-end balance for plant in service for these systems. The audit report provides a schedule of the specific differences.

Audit Finding 7

Audit Finding 7 discusses the Utility Plant in Service (UPIS) projections. For the

1 direct plant, we compared the December 31, 2006 projected plant balances to the
2 December 31, 2006 actual plant balances. The actual plant balances were \$6,227,656 less
3 than the projected balances included in the MFRs. The Utility commented that while the
4 actual plant balances were significantly lower than the projected balances, it had a
5 substantial balance in Construction Work in Progress (CWIP) (Account 105) at December
6 31, 2006, as well as numerous budget carry forwards. The total CWIP for all systems at
7 December 31, 2006 was \$8,270,026 and the total budget carry forwards at the end of 2006
8 were \$1,764,465. While audit staff believes that the 2006 projections may be overstated,
9 the Utility has provided information that the ending balance for December 31, 2007 may
10 be reasonable. However, if the ending balance for December 31, 2006 is overstated, the
11 thirteen-month average for 2007 is overstated. The audit report provides a chart of the
12 specific systems that were significantly over- or under-budget at December 31, 2006. For
13 these systems, the Commission should consider adjusting the thirteen-month average for
14 2007.

15 We requested support for the amounts under- and over-budget. We considered the
16 pending CWIP items and Utility carry-overs and for those systems with under- or over-
17 budget amounts remaining, we requested additional documentation. The Utility
18 submitted numerous "Substitution Information" forms indicating when a project in one
19 system was deferred and the current year's budget money was moved to another system
20 or project, or a general budget fund. The Utility did not provide any additional
21 information regarding budget differences. Audit staff requested additional information
22 regarding the remaining systems that were still under-budget. By e-mail, the Utility
23 responded: "The remaining budget variances on the report . . . will not be made up by
24 spending additional amounts in 2007." The audit report also includes a summary of the
25 amounts that are under-budget, with no related justification. The table indicates the

1 amounts under-budget, adjusted for CWIP, carry-overs, and substitutions. Because these
2 amounts will not be spent for these systems, I recommend that the amounts, totaling
3 \$404,032 be removed from the ending balances.

4
5 **Audit Finding 8**

6 Audit Finding 8 discusses the supporting documentation for the projected plant
7 additions, excluding allocated plant. For systems with 2006 UPIS additions that were
8 greater than 25% of the 2005 balances, we identified specific additions and requested
9 supporting documentation (invoices, etc.). Our review of the supporting documentation
10 found that:

- 11 • Twelve of these additions appear to be charges that should have been charged to
12 Repairs and Maintenance expense.
- 13 • Five of these additions did not include the appropriate retirement or included the cost
14 of removal in the capitalization of the new addition.
- 15 • Three of these additions included errors in the retirement (one recorded the retirement
16 seven months after the fact, and two recorded the retirement in the wrong account).

17 The audit report includes a table that identifies the specific invoices.

18
19 **Audit Finding 9**

20 Audit Finding 9 discusses the 2007 UPIS projections, excluding allocated plant.
21 For the direct plant, we sampled projected 2007 UPIS additions for systems with
22 increases greater than 25%. We requested supporting documentation (invoices, etc.) that
23 should include projection basis, any bids, quotes, or invoices used to project, and the
24 method used to project. The response to this request did not provide any significant
25 support. A few items had already had money expended and these invoices were provided.

1 But of the \$1,410,100 in projections that were requested, these expenditures were only
2 \$21,204. The remaining items were explained as either a blanket work order based on
3 prior knowledge; engineer estimates based on similar items (with no tangible evidence
4 provided); or work to be done, estimate based on prior work (no copies of prior work or
5 invoices were provided). All invoices indicated replacements. I recommend that the
6 2007 projections for plant be disallowed as the Utility did not provide sufficient support
7 for its projections.

8 In addition, we reviewed the 2007 Capital Budget and compared this to the capital
9 additions, by system, in the MFRs. We found a difference in the Sunny Hills
10 (Washington County) water system. The Utility responded that the Utility inadvertently
11 duplicated a \$150,000 addition in the MFRs. The June 2007 addition was included in
12 Account 309.2 as well as 320.3. The addition in Account 320.3 should be removed. This
13 also results in a correction to the 2007 Accumulated Depreciation and Depreciation
14 Expense.

15

16 **Audit Finding 10**

17 Audit Finding 10 discusses land projections. The Utility erroneously projected a
18 land increase of \$1,000 to Piney Woods for 2007. The Utility stated that it was for
19 electrical upgrades that should have been charged to Account No. 311 - Pumping
20 Equipment. Correction of this error will also affect Accumulated Depreciation and
21 Depreciation Expense. This account should be depreciated at an annual rate of 5% per
22 Rule 25-30.140, Depreciation, Florida Administrative Code. Staff used the Utility's
23 methodology of spreading the addition over several months to calculate depreciation.
24 This results in an adjustment to the average land balance of \$423 and an adjustment to the
25 average accumulated depreciation balance of \$8.

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Audit Finding 16

Audit Finding 16 discusses CIAC projections. The Utility projected no growth for the Village Water wastewater system but inadvertently projected CIAC additions of \$2,400 for 2007. The average CIAC balance should be reduced by \$1,015 and the average accumulated amortization balance should be reduced by \$10.

Audit Finding 17

Audit Finding 17 discusses the working capital allowance projections. The ending balances for Accounts Payable for 2005-2006 differed significantly. The ending balance at December 31, 2005 was \$1,467,620 and the projected ending balance at December 31, 2006 was \$525,000. We requested an explanation for the decrease in Accounts Payable. The Utility responded that in 2005, extremely large capital projects were accrued at the end of the month, based on the contractors' invoices, and then paid in the following month. Further, the Utility stated that for purposes of the rate case, these accruals were not made. I recommend that these accruals should have been made for projecting the working capital allowance. If the Utility is unable to provide estimated monthly accruals for the projected test year, an amount based on the historical test year 2005 should be used.

In addition, Schedule A-17 of the MFRs for Haines Creek shows a zero balance for other Regulatory Assets for 2005 and 2007. However, there is a balance of \$9,314 for 2006. The Utility responded that this balance was incorrectly included in the Haines Creek MFRs. This balance should be included in the East Lake Harris MFRs.

1 **Audit Finding 19**

2 Audit Finding 19 discusses revenue projections. For the Stone Mountain water
3 system, the Utility erroneously applied incorrect rates to project the 2006 revenue. The
4 Utility projected the 2007 revenues the same as 2006. The 2007 revenues should be
5 reduced by \$1,834.

6
7 **Audit Finding 21**

8 Audit Finding 21 discusses the lab testing expense projections. We reviewed
9 adjustments listed on Schedule B-3 (Adjustments to Operating Income) of the filed MFR
10 for each system. Our review indicated that the lab testing expense for the Leisure Lakes
11 system was significant to that system. We requested additional documentation for the lab
12 testing expense for the Leisure Lakes water system for 2006. The response that the
13 company provided was a list of invoices by system for 2005. The company response did
14 not address the 2006 expense, as requested, but we compared the response to the MFRs
15 for 2005. Our review of the company response found that the numbers provided did not
16 reconcile to the MFRs for 2005. In fact, the listing for Leisure Lakes consisted of one
17 invoice for \$84. The 2005 expense included in the Leisure Lakes MFRs was \$3,217.
18 Based on the response, it appears that the 2005 expense should be reduced by \$3,133 to
19 \$84. In addition, because the company did not provide any documentation, as requested,
20 to support the projected increase in 2006, I recommend that the 2006 addition, of \$5,763
21 also be disallowed.

22
23 **Audit Finding 22**

24 Audit Finding 22 discusses O&M expense projections. We reviewed the
25 reasonableness of the 2006 and 2007 projections for O&M expenses. For 2006, we

1 compared the 2006 projections to the actual expenses recorded for 2006. In total, the
2 company MFRs projected 2006 O&M expenses of \$6,993,799. In total, the actual 2006
3 O&M expenses were \$7,186,381. The total 2006 projections were only 3% below actual.
4 However, actual 2006 O&M expenses for the individual systems ranged from 74% of the
5 projections to 157% of the projections. For rate setting purposes in the individual
6 systems, these differences may be material.

7 For 2007, we compared the 2007 projections to the 2007 budget. These numbers
8 did not reconcile and staff requested additional information. The company responded that
9 the difference between the 2007 Budget and MFR B-6 is the "Admin Alloc" charges. I
10 have concerns that this explanation is not reasonable, especially considering that these
11 charges across the board increase all O&M expenses, including expenses that we believe
12 should be direct charges (such as, sludge removal expense, chemicals, testing, etc.) and
13 should not be subject to allocations. We did not have time to follow up further on these
14 differences in the 2007 projections.

15

16 **Audit Finding 23**

17 Audit Finding 23 discusses purchased power expense projections. We reviewed
18 the adjustments listed on Schedule B-3 (Adjustments to Operating Income) of the filed
19 MFR for each system and on February 5, 2007, we requested additional information
20 regarding the purchased power expense adjustments, included in the MFRs, as listed
21 below:

- 22 1. 2006: Purchased Power and Fuel for Purchased Power; Adj. for increase in cost
23 due to storm damage recover surcharges and fuel charges;
- 24 2. 2007: Purchased Power and Fuel for Purchased Power; Adj. to '07 plan alloc'd by
25 ERC's; and

1 3. 2006: Purchased Power Rate Increase Pass-Through

2 We requested the support to include all information necessary to show the basis
3 for projection (such as internal work papers, historical amounts used, factors used to
4 increase, historical bills used to indicate increases, total amount projected, and any
5 invoices used to project.) We specifically requested that the work papers and explanation
6 should be clear as to how these adjustments are separate and do not overlap and requested
7 that the support should also include the method used to allocate between systems and
8 between water and wastewater. The company response addressed items 1 and 3.
9 However, the company did not respond to Item 2, the projected 2007 adjustment. By e-
10 mail dated February 28, 2007, audit staff informed the company that their response did
11 not adequately address the request. Staff agreed that the information provided regarding
12 Items 1 and 3 was satisfactory, but the company needed to provide information on Item 2.
13 This was followed up by another e-mail dated March 23, 2007, as well as a letter dated
14 April 5, 2007, which listed all outstanding document requests. At this point, staff was
15 sending the Utility a weekly update of outstanding document requests and this request
16 was included each week and was discussed in several of the weekly conference calls that
17 the company participated in. As of May 11, 2007, the Utility had not submitted any
18 additional information.

19 We reviewed the information provided for parts 1 and 3 and found the
20 documentation satisfactory. However, because the Utility failed to support the purchased
21 power adjustments for 2007, audit staff recommends that the 2007 adjustments be
22 disallowed. The audit report details the specific adjustments, by system, for a total
23 reduction to purchased power expense of \$37,065.

24
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1 **Audit Finding 24**

2 Audit Finding 24 discusses O&M expense projections. We reviewed adjustments
3 listed on Schedule B-3 (Adjustments to Operating Income) and picked individual and
4 group adjustments that appeared material. On February 5, 2007, we requested additional
5 information in a formal Document Request. This request addressed the following specific
6 projected expenses for 2006 and 2007 as shown on Schedule B-3, pages 2 and 4 of each
7 of the MFRs.

- 8 • 2006: Salaries & Wages - Employees; Adjustment for open positions;
- 9 • 2007: Salaries & Wages - Employees;
- 10 • 2006: Purchased Water/Sewer Treatment; Adj. for usually wet weather, plus increase
11 for growth and inflationary increases;
- 12 • 2006: Sludge Removal Expense; Adj. for upgraded plants, growth, and inflationary
13 increases;
- 14 • 2006: Contractual Services - Legal; Adj. to account for fees that were previously
15 included in the corporate charges in the past;
- 16 • 2007: Contractual Services - Legal; Adj. to '07 plan alloc'd by ERC's;
- 17 • 2006: Contractual Services - Other; Adj. for changes occurring due to moving the call
18 center from Florida to Cary, NC;
- 19 • 2007: Contractual Services - Other; Customer Call Center Conversion;
- 20 • 2007: Contractual Services - Other; Adj. to '07 plan alloc'd by ERC's;
- 21 • 2006: Miscellaneous Expense; Adj. for various additional expenses (i.e. cellular
22 phones, long distance charges, relocation charges, seminars, travel, and fines);
- 23 • 2007: Miscellaneous Expense; Adj. to '07 plan alloc'd by ERC's;
- 24 • 2006: Materials & Supplies; Adj. for increase in spending to improvement and repairs
25 that are not capital in nature;

- 1 • 2007: Materials & Supplies; Adj. to '07 plan alloc'd by ERC's;
- 2 • 2007: Contractual Services - Mgmt Fees; Adj. to '07 plan alloc'd by ERC's;
- 3 • 2006: Bad Debt Expense; Adj. for improved delinquencies; and
- 4 • 2007: Bad Debt Expense; Adj, to '07 plan, allocated by ERC's.

5 We requested the support to include all information necessary to show the basis
6 for projection (such as internal work papers, historical amounts used, factors used to
7 increase, historical bills used to indicate increases, total amount projected, and any bids,
8 quotes, or invoices used to project.) We also stated that support should include the
9 method used to allocate between systems and between water and wastewater. For
10 projections with multiple items, we asked that each item be detailed separately.

11 On February 28, 2007, the company provided a response that included:

- 12 • 2007 Budget: a listing of monthly expense balances, by account, by system;
- 13 • Customer Call Center Conversion Expenses: a schedule detailing the calculation of
14 the expense adjustment;
- 15 • Percentage Increases: a listing by expense description of the 2006 "Rate Adjusted
16 Budget," the 5-year plan budget for 2007 and a calculated percentage difference;
- 17 • A listing of the expense adjustments with a one or two sentence summary; and
- 18 • A listing of the ERC count at 12/31/05 and calculations indicating the allocation
19 percentages for all Florida systems and all Florida systems included in this rate case.

20 By e-mail dated March 15, 2007, audit staff responded that the company response
21 did not adequately address the request. Staff agreed that the information provided
22 regarding the customer call center conversion was satisfactory. However, the company
23 did not provide information on the specific calculations used to project the remaining
24 expenses, such as internal work papers, historical amounts used, factors used to increase,
25 historical bills used to indicate increases, total amount projected, and any bids, quotes, or

1 invoices used to project. This was followed up by another e-mail dated March 23, 2007,
2 as well as a letter dated April 5, 2007 which listed all outstanding document requests. At
3 this point, staff was sending the company a weekly update of outstanding document
4 requests and this specific request was included each week and was discussed in several of
5 the weekly conference calls that the company participated in. As of May 11, 2007, the
6 company had not submitted any additional information.

7 The information provided to justify the Customer Call Center Conversion
8 Expenses is sufficient. However, the company has had over three months to provide
9 support for the remaining adjustments made to the O&M expenses in its filing. I
10 recommend that the supporting documentation should have been readily available. Staff's
11 request is for the information used by the company in preparing its rate case MFRs. The
12 company should have provided the work sheets, calculations, and schedules used to
13 determine the total expenses, as well as the allocation work sheets to spread the costs
14 between the systems. Because this information was not provided to the auditors, I
15 recommend that the projected adjustments should be disallowed. The net effect to the
16 filing is to reduce the Operation and Maintenance Expense by \$454,674 for 2006 and by
17 \$1,228,239 for 2007. A detailed schedule is contained in the audit work papers.

18

19 Q. Does this conclude your testimony?

20 A. Yes.

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BEFORE THE PUBLIC SERVICE COMMISSION

In re: Application for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

DOCKET NO. 060368-WS

DATED: AUGUST 21, 2007

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the DIRECT TESTIMONY OF DENISE N. VANDIVER has been served by U.S. Mail to Kenneth A. Hoffman and Marsha E. Rule, Esquires, Rutledge, Ecenia, Purnell & Hoffman, P. A., P.O. Box 551, Tallahassee, FL 32302-0551, on behalf of AQUA UTILITIES FLORIDA, INC., and that a true and correct copy thereof has been furnished to the following by U. S. Mail, this 21st day of August, 2007:

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