

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Peoples Gas System.

DOCKET NO. 080318-GU

FILED: JANUARY 16, 2009

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Direct Testimony of Jocelyn Y. Stephens, on behalf of the Florida Public Service Commission, has been furnished to the following, by U.S. Mail, on this 16th day of January, 2009.

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DOCUMENT NUMBER-DATE

00436 JAN 16 8

FPSC-COMMISSION CLERK

DOCKET NO. 080318-GU: Petition for rate increase by Peoples Gas System.

WITNESS: Direct Testimony Of Jocelyn Y. Stephens,
Appearing On Behalf Of Staff

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FPSC-COMMISSION CLERK

DIRECT TESTIMONY OF JOCELYN Y. STEPHENS

Q. Please state your name and business address.

A. My name is Jocelyn Stephens and my business address is 4950 West Kennedy Blvd., Suite 310, Tampa, Florida, 33609.

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

A. I am employed by the Florida Public Service Commission as a Professional Accountant Specialist in the Division of Regulatory Compliance.

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

A. I have been employed by the Florida Public Service Commission since January 1977.

Q. Briefly review your educational and professional background.

A. In 1972, I received a Bachelor of Science degree from Florida State University with a major in accounting. I am also a Certified Public Accountant licensed in the State of Florida.

Q. Please describe your current responsibilities.

A. Currently, I am a Professional Accountant Specialist with the responsibilities of planning and directing the most complex investigative audits. Some of my past audits include cross-subsidization issues, anti-competitive behavior, and predatory pricing. I am also responsible for creating audit work programs to meet a specific audit purpose and integrating EDP applications into these programs.

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FPSC-COMMISSION CLERK

1 **Q. Have you presented expert testimony before this Commission or any other**
2 **regulatory agency?**

3 **A.** Yes. I testified in the Florida Cities Water Co., (South Fort Myers) transfer of
4 certificate, Docket No. 910447-SU; the fuel and purchased power cost recovery clause
5 proceedings, Docket No. 030001-EI; and the petition for approval of storm cost
6 recovery clause for recovery of extraordinary expenditures related to hurricanes
7 Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc., Docket No.
8 041272-EI.

9
10 **Q. What is the purpose of your testimony today?**

11 **A.** The purpose of my testimony is to sponsor the staff audit report of Peoples Gas
12 System (utility) which addresses the utility's petition for a rate increase. This audit
13 report is filed with my testimony and is identified as Exhibit JYS-1.

14
15 **Q. Did you prepare this audit report?**

16 **A.** Yes, I was the audit manager in charge of the audit.

17
18 **Q. Please describe the work performed in this audit.**

19 **A.** We reconciled the individual rate base component balances to the utility's
20 general ledger as of December 31, 2007. We determined that the utility adjustments to
21 the rate base balances were properly calculated and consistent with prior approved
22 Commission rate case adjustments. For Plant in Service, we analyzed plant additions,
23 reclassifications and retirements for the period of January 2002 through December
24 2007, and selected a sample for further verification. We verified the general ledger
25 balance for Plant Held for Future Use (PHFU) at December 31, 2007, and determined

1 that the utility removed PHFU in its entirety from rate base consideration. We verified
2 the utility's compliance with Commission Rule 25-12.045, Florida Administrative
3 Code, regarding inactive gas lines. On a test basis, we recalculated the 13-month
4 average balance of plant accounts. For Common Plant Allocated, we determined the
5 applicable plant accounts and the procedures for allocating common plant as recorded
6 in the prior rate case. We also verified the data that supports this allocation basis and
7 recalculated the computation. For Acquisition Adjustment, we determined all
8 acquisition adjustments that were recorded on the utility books at December 31, 2007.
9 We verified the 13-month average calculation for the unapproved acquisition
10 adjustment and its related accumulated amortization and determined that the utility
11 made an adjustment to remove these amounts. For Construction Work in Progress
12 (CWIP), we selected a sample of open work orders charged to CWIP at December 31,
13 2007. We verified that the work orders pertained to an authorized and approved
14 construction project and reviewed supporting source documents for authenticity. We
15 determined that AFUDC was not charged to any work orders. We recalculated the 13-
16 month average balances for CWIP. For Customer Advances for Construction, we
17 chose a sample of additions and traced to customer documentation to verify the amount
18 and purpose of the advances. We determined the plant account to which the customer
19 advances were applied and verified the entry used to post the advance amount. We
20 recalculated the 13-month average balance recorded in rate base. For Accumulated
21 Depreciation and Amortization, we verified, on a sample basis, that accumulated
22 depreciation and amortization at December 31, 2007, are properly recorded and use
23 rates and calculations approved by the Commission for the period January 1, 2002,
24 through December 31, 2007. For Working Capital, we reviewed the Commission
25 order for the prior rate case and determined the prior treatment of working capital

1 items. We determined that the utility's adjustments for the current working capital
2 were consistent with the adjustments in the prior Commission order. We reviewed a
3 sample of the transactions for the following accounts: Plant Operation Materials and
4 Supplies, Other Accounts Receivable, and Customer Accounts Receivable to
5 determine if non-utility items were posted therein. We determined that no interest
6 bearing accounts were included in the calculation of working capital. We recalculated
7 the 13-month average balances for all accounts included in the working capital
8 computation.

9
10 For Net Operating Income, we reconciled the individual net operating income
11 component balances to the utility's general ledger as of December 31, 2007. We
12 verified utility adjustments to net operating income balances and reconciled the
13 adjustments to the utility's other Commission filings during the test year or to prior
14 orders that required the specific adjustment. We determined that revenues for all clause
15 audits were removed in the proper amounts from the historical base year and we
16 verified the calculation of unbilled revenues. We tested customer bills to determine
17 that customers were charged rates in accordance with the Commission-approved rate
18 tariff sheets. For Operation and Maintenance (O&M) Expenses, we verified a sample
19 of utility transactions for select O&M expense accounts. We verified that utility
20 O&M expense balances were adequately supported by source documentation, prudent,
21 and did not include non-utility items. We reviewed additional samples of utility
22 advertising expenses, legal fees, outside services, sales expenses, customer service
23 expenses, and administrative and general service expenses to ensure that amounts
24 supporting non-utility operations were removed. We reviewed inter-company
25 allocations and charges between affiliated companies and non-utility operations to

1 determine if expenses were properly allocated. For Depreciation Expense, we verified,
2 based on a sample of depreciation expense accruals, that the utility is using correct
3 depreciation rates as authorized in Commission Order No. PSC-07-0125-PAA-GU.
4 For Taxes Other Than Income (TOTI), we verified, based on a sample of utility
5 transactions for select TOTI accounts, that utility TOTI expense balances are
6 adequately supported by source documentation.

7
8 For Capital Structure, we reconciled the individual capital structure component
9 balances to the utility's general ledger as of December 31, 2007. We verified that non-
10 utility assets supported by the utility's capital structure were removed and that the
11 capital structure adjustments reconciled with the rate base adjustments in the filing.
12 We recalculated the 13-month average balances and the weighted average cost of
13 capital for the utility's historical test year capital structure. For Long-Term Debt, we
14 traced the long-term debt and reacquired debt acquisition costs balances to the original
15 documents and verified the terms, conditions, redemption provisions and interest rates
16 for each bond or note payable. We recalculated the weighted average cost of long-
17 term debt. For Short Term Debt, we traced the short-term debt balances to supporting
18 documents and verified the terms, conditions, and interest rates. We traced the
19 computation of the average cost of short-term debt to utility documentation. For
20 Customer Deposits, we verified that customer deposits are charged in accordance with
21 the tariff rates. We verified that interest is credited to customer bills, at the
22 Commission approved rate at dates designated in the tariff. For Accumulated Deferred
23 Taxes, we reconciled the deferred tax balances to the utility's federal tax returns. We
24 verified that the deferred tax balances include the capture of bonus depreciation that
25 was available in the applicable tax years. For Investment Tax Credits, we reconciled

1 the ending balance of Investment Tax Credits in the prior audit to the beginning
2 balance in the current balance. We verified the calculation of the annual amortization
3 of investment tax credit.

4
5 **Q. Please review the audit findings in the audit report.**

6 **A. Audit Finding No. 1**

7 Audit Finding No. 1 discusses O&M expenses. Based upon our analysis of
8 O&M expense for the 12-month test period ending December 31, 2007, we observed
9 the following items and amounts included in the filing and the general ledger:

10 1) The utility accrued expenses for Information Technology of \$250,000. We
11 determined that the actual true-up amount for this expense is \$180,678. This results in
12 Information Technology Expense being overstated in the amount of \$69,322.

13 2) An invoice in the amount of \$10,000 and dated December 20, 2006, was recorded
14 in Office Supplies and Expenses. This item is a prior year expense and should be
15 removed from rate case consideration.

16 3) Legal Expenses of \$7,812 were included in Outside Services but appear to be rate
17 case related and as such should be reclassified from Legal Expense to Rate Case
18 Expense.

19 4) The utility made a contribution to the American Gas Foundation towards Research
20 and Development. The utility included this as a Dues Expense. Commission Order
21 No. PSC-03-0038-FOF-GU, issued January 6, 2003, in Docket No. 020384-GU,
22 limited Research and Development expenses to \$500,000, annually. The utility has
23 already included \$500,000 in its expense in the filing. Therefore, this \$10,000
24 contribution, made to the Foundation sponsored by the American Gas, should be
25 disallowed for rate making purposes and recorded below-the-line.

1 **Audit Finding No. 2**

2 Audit Finding No. 2 discusses Net Operating Income. We analyzed the Net
3 Operating Income adjustments for the 12-month test period ending December 31,
4 2007. We observed that the utility used projected numbers when calculating some of
5 the adjustments. Staff recalculated the adjustments based on actual amounts.

6 Fuel Revenue Adjustment: The utility removed \$390,764,997 in Purchased Gas Cost
7 Recovery Revenues to determine test year revenues related to base rates. We
8 determined that the Revenues removed should have been \$391,091,648 and that the
9 utility did not include the net true-up amount in the adjustment. Our adjustment
10 decreases test year revenues by an additional \$326,651.

11 Employee Activities Adjustment: We determined that the utility used 2006 amounts
12 and projected them by an inflation factor of three percentage points. We determined
13 that the 2007 actual costs were available during our audit, and therefore, we used the
14 actual costs. This action increased the utility adjustment from (\$114,000) to
15 (\$122,723). This decreases O&M Expenses by an additional \$8,723.

16 AGA Lobbying Dues: The utility estimated the 2007 expense based upon amounts
17 that were previously expended for this item in the years 2004 through 2006, and then
18 applied a disallowance factor. We applied the disallowance to the actual 2007 expense
19 in order to determine the 2007 adjustment. This action decreased the utility adjustment
20 from (\$7,000) to (\$6,483). This increases O&M Expenses by \$517.

21 Civic and Social Club Dues: The utility estimated the 2007 expense based upon
22 amounts that were previously expended for this item in the years 2004 through 2006,
23 and then applied a disallowance factor. We applied the disallowance to the actual
24 2007 expense in order to determine the 2007 adjustment. This action decreased the
25 utility adjustment from (\$4,000) to (\$3,055). This increases O&M Expenses by \$945.

1 Economic Development: The utility estimated the 2007 expense based upon amounts
2 that were previously expended for this item in the years 2004 through 2006 and then
3 applied a disallowance factor. We applied the disallowance to the actual 2007 expense
4 in order to determine the 2007 adjustment. This action decreased the utility adjustment
5 from (\$8,500) to (\$8,000). This increases O&M Expenses by \$500.

6 Maintenance of General Plant: The utility reduced this expense by \$32,004 to reflect
7 the non-utility portion. The adjustment was based on 2006 expenses multiplied by a
8 non-utility percentage. Using the actual 2007 expense, the adjustment should be
9 \$25,000. This results in an increase to the 2007 O&M Expenses of \$7,004.

10 Maintenance of Structures and General Plant: The utility reduced this expense by
11 \$11,000 to reflect the non-utility portion. The adjustment was based on 2006 expenses
12 multiplied by a non-utility percentage. Using the actual 2007 expense, the adjustment
13 should be \$6,000. This results in an increase to the O&M Expenses of \$5,000.

14
15 **Q. Does this conclude your testimony?**

16 **A.** Yes, it does.
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DOCKET NO. 080318-GU: Petition for rate increase by Peoples Gas System.

*WITNESS: Direct Testimony Of Jocelyn Y. Stephens,
Appearing On Behalf Of Staff*

EXHIBIT JYS-1: Staff Audit Report



FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF REGULATORY COMPLIANCE
BUREAU OF AUDITING*

TAMPA DISTRICT OFFICE

PEOPLES GAS SYSTEM

FILE AND SUSPEND RATE CASE AUDIT

HISTORICAL YEAR ENDED DECEMBER 31, 2007

DOCKET NO. 080318-GU

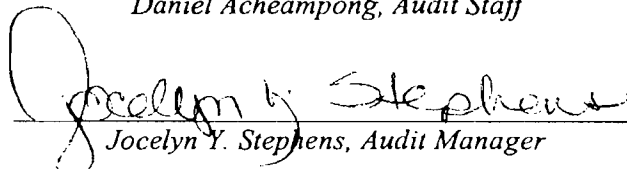
AUDIT CONTROL NO. 08-234-2-2



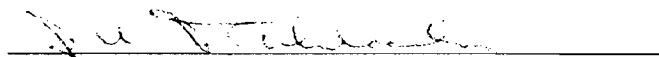
Ronald Mavrides, Audit Staff



Daniel Acheampong, Audit Staff



Jocelyn Y. Stephens, Audit Manager



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**DIVISION OF REGULATORY COMPLIANCE
AUDITOR'S REPORT**

NOVEMBER 4, 2008

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 August 15, 2008. We have applied these procedures to the attached schedules prepared by Peoples Gas System in support of its Petition for Rate Increase in Docket No. 080318-GU.

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 and the report is intended 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, 2007. We determined that the company made adjustments to its rate base balances that were properly calculated and consistent with prior approved Commission rate case adjustments.

Plant in Service

Objective: To determine that property exists and is owned by the utility. To determine that additions to Plant have adequate supporting documentation, are recorded at original costs and are properly classified in accordance with Commission Rule 25-7.014, Florida Administrative Code and the FERC Uniform System of Accounts. To determine that the proper retirements of Plant were made when a replacement item was put in service. To determine that the treatment of Plant Held for Future Use is consistent with the treatment in the prior rate case. To verify that the company has complied with Rule 25-12.045, Inactive Gas Service Lines, for all gas service lines that have been used but are now inactive. To determine that the 13-month average balance for each plant account was properly computed.

Procedures: Based on the above objectives, we analyzed plant additions, reclassifications and retirements for the period January 2002 through December 2007 and selected a sample for further verification. Prior to 2006, verification was performed using documentation stored on electronic data retrieval systems. Subsequent to 2005, we examined original third party documentation. Determined that Plant Held for Future Use (PHFU) was removed from Rate Base consideration in the prior rate case. Verified general ledger balance for PHFU at December 31, 2007. Determined that the company removed PHFU in its entirety from rate base consideration. Verified company's compliance with Commission Rule regarding Inactive Gas Lines. On a test basis, we recalculated 13-month average balance of plant accounts.

Common Plant Allocated

Objective: To determine if allocation of common plant is consistent with the last rate case. Analyze updated allocation factors. To determine if company is complying with its stated procedures for allocating common plant.

Procedures: We determined the applicable plant accounts and the procedures for allocating common plant as recorded in the prior rate case. For the current rate case, we verified the plant accounts and balances at December 31, 2007 and verified the

calculations of the allocations used. We also verified the data that supports this allocation basis and recalculated the computation. We determined that the company is complying with its stated procedures for the allocation of common plant between utility and non-utility amounts.

Acquisition Adjustment

Objective: To verify that plant acquisition adjustments, at December 31, 2007, have been properly recorded. To determine that the company has removed any acquisition adjustments that have not been approved by the Commission on a basis consistent with the prior rate case. To determine that the calculation for the removal of the acquisition adjustment and any related accumulated amortization is proper and correct.

Procedures: We determined all acquisition adjustments that were recorded on the company books at December 31, 2007. We determined and verified the acquisition adjustment amount that was not approved by the Commission. We verified the 13-month average calculation for this acquisition adjustment and its related accumulated amortization. We determined that the company made an adjustment to remove the unapproved acquisition adjustment and its related accumulated amortization.

Construction Work in Progress (CWIP)

Objective: To determine the nature and purpose of utility projects recorded as CWIP. To determine that the company has included in rate base only those projects on which no AFUDC has been charged.

Procedures: We selected a sample of open workorders charged to CWIP at December 31, 2007. We verified that the work order pertained to an authorized and approved construction project. We reviewed supporting source documents for authenticity. We determined that AFUDC was not charged to any workorders. We recalculated the 13-month average balances for CWIP.

Customer Advances for Construction

Objectives: To verify the amount of customer advances included in rate base and determine whether all customer advances have been properly recorded for the historical base year.

Procedures: Traced Customer Advances as recorded in the filing to the general ledger at December 31, 2007. Obtained database of all additions to Customer Advances for the period January 1, 2002 through December 31, 2007. Prepared a sample of these additions and traced to customer documentation as to amount and purpose of advance. Determined plant account to which the customer advances were applied and verified the entry used to post the advance amount. Recalculated the 13-month average balance recorded in rate base.

Accumulated Depreciation/Amortization

Objective: To determine that accruals, retirements and adjustments to accumulated depreciation and accumulated amortization are properly recorded in compliance with Commission Rule 25-07.045, Florida Administrative Code and the FERC Uniform System of Accounts.

Procedures: On a sample basis, we verified that accumulated depreciation and amortization at December 31, 2007, are properly recorded, using rates and calculations approved by the Commission for the period January 1, 2002 through December 31, 2007.

Working Capital

Objective: To verify that the working capital calculation is consistent with the last rate case. To determine if any working capital accounts (WCA) are interest bearing. To review transactions in selected WCA for non-utility items.

Procedures: We reviewed the Commission order for the prior rate case and determined the treatment of working capital items. We determined that the company's adjustments for the current working capital were consistent with the adjustments in the prior Commission order. Reviewed a sample of the transactions for the accounts: Plant Operation Materials and Supplies; Other Accounts Receivable and Customer Accounts Receivable to determine if non-utility items were posted therein. Determined that no interest bearing accounts were included in the calculation of working capital. Recalculated 13-month average balances for all accounts included in the working capital computation.

NET OPERATING INCOME

General

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

Procedures: We reconciled the following individual component net operating income balances to the utility's general ledger as of December 31, 2007. We verified utility adjustments to net operating income balances and reconciled the adjustments to the utility's other Commission filings during the test year or to prior orders that required the specific adjustment. Audit Finding No. 2 further addresses this issue.

Revenues

Objective: To determine that revenues are properly calculated and are based on the utility's commission approved tariff rates.

Procedures: We reconciled utility revenues for the 12-month period ended December 31, 2007 to the general ledger. We determined that revenues for all clause audits were removed in the proper amounts from the historical base year. We verified the calculation of unbilled revenues. We tested customer bills to determine that customers were charged rates in accordance with the Commission approved rate tariff sheets.

Operation and Maintenance Expenses (O&M)

Objective: To determine that operation and maintenance expenses are properly recorded in compliance with the Uniform System of Accounts, were reasonable, prudent for ongoing utility operations and adequately supported by documentation. Determine that advertising charged to O&M is not image enhancing in nature, recoverable through the Energy Conservation Cost Recovery Clause or related to non-utility operations. Determine that the allocation of common expense is consistent with the last rate case. Determine that adjustments to O&M expense are consistent with the Commission approved adjustments in the prior rate case.

Procedures: We verified, based on a sample of utility transactions for select O&M expense accounts, that utility O&M expense balances are adequately supported by source documentation, prudent, utility in nature and do not include non-utility items. Audit Finding No. 1 further addresses this issue. We reviewed additional samples of utility advertising expenses, legal fees, outside services, sales expenses, customer service expenses and administrative and general service expenses to ensure that amounts supporting non-utility operations were removed. We reviewed intercompany allocations and charges between affiliated companies and non-utility operations to determine if expenses were properly allocated.

Depreciation Expense

Objective: To determine that depreciation expense is properly recorded in compliance with Commission Rule 25-7.045, Florida Administrative Code and that it accurately represents the depreciation of Plant assets verified in rate base. To determine that historical test year depreciation expense accruals are calculated using the Commission authorized rates in Order No. PSC-07-0125-PAA-GU issued February 12, 2007, in the latest depreciation docket.

Procedures: We verified, based on a sample of depreciation expense accruals, that the company is using correct depreciation rates as authorized in Commission Order No. PSC-07-0125-PAA-GU.

Taxes Other Than Income (TOTI)

Objective: To determine that Taxes Other Than Income is properly recorded and supported by adequate documentation.

Procedures: We verified, based on a sample of utility transactions for select TOTI accounts, that utility TOTI expense balances are adequately supported by source documentation.

CAPITAL STRUCTURE

General

Objective: To determine the components of the utility's capital structure and that the respective costs rates used to arrive at the overall weighted cost of capital are properly recorded and that they accurately represent the ongoing utility operations. To determine that utility's capital structure adjustments are appropriate and correspond to the utility's rate base adjustments in the filing.

Procedures: we reconciled the following individual component capital structure balances to the utility's general ledger as of December 31, 2007. We verified that non-utility assets supported by the utility's capital structure were removed and that the capital structure adjustments reconciled with the rate base adjustments in the filing. We recalculated the 13-month average balances and the weighted average cost of capital for the utility's historical test year capital structure.

Equity:

Objective: To determine that owner's equity balances represent actual equity of the utility.

Procedures: We traced equity balances to the general ledger.

Long-Term Debt

Objective: To determine that long-term debt balances represent actual obligations of the utility and that they are properly recorded.

Procedures: We traced the long-term debt and reacquired debt acquisition costs balances to the original documents and verified the terms, conditions, redemption provisions and interest rates for each bond or note payable. We recalculated the weighted average cost of long-term debt.

Short Term Debt

Objective: To determine that short-term debt balances represent actual obligations of the utility and that they are properly recorded.

Procedures: We traced the short-term debt balances to supporting documents and verified the terms, conditions and interest rates. We traced the computation of the average cost of short-term debt to utility documentation.

Customer Deposits

Objective: To determine that customer deposit transactions represent actual obligations of the utility and are properly recorded.

Procedures: We reconciled the customer deposit balances to the general ledger. We verified that customer deposits are charged in accordance with the tariff rates. We verified that interest is credited to customer bills, at the Commission approved rate at dates designated in the tariff.

Accumulated Deferred 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: We reconciled the deferred tax balances to the general ledger and to the utility's federal tax returns. We verified that the deferred tax balances include the capture of bonus depreciation that was available in the applicable tax years.

Investment Tax Credit

Objective: To determine that Investment Tax Credits balances are properly stated and are being properly amortized.

Procedures: We reconciled net Investment Tax Credits to the General Ledger. We reconciled ending balance of Investment Tax Credits in prior audit to beginning balance in the current balance. We verified the calculation of the annual amortization of investment tax credit.

AUDIT FINDING NO. 1

SUBJECT: OPERATION AND MAINTENANCE EXPENSE (O&M)

AUDIT ANALYSIS:

Based upon staff analysis of O&M expense for the 12-month test period ending December 31, 2007, we observed the following items and amounts included in the filing and the general ledger:

- 1) Accrued expenses for Information Technology (A/C 921) of \$250,000. We determined that the actual true-up amount for this expense is \$180,678. This results in Information Technology expenses being overstated in the amount of \$69,322
- 2) An invoice in the amount of \$10,000 and dated December 20, 2006, was recorded in A/C 921 – Office Supplies and Expenses. This item is a prior year expense and should be removed from rate case consideration.
- 3) Legal Expenses of \$7,812 included in A/C 923 – Outside Services appear to be rate case related and as such should be reclassified from Legal Expense to Rate Case expense.
- 4) The company made a contribution to the American Gas Foundation towards Research and Development. The company included this as a Dues Expense. Commission Order No. PSC-03-0038-FOF-GU limited Research and Development expenses to \$500,000, annually. The company has already included \$500,000 in its expense in the filing. Therefore, this \$10,000 contribution, made to the Foundation sponsored by the American Gas, should be disallowed for rate making purposes and recorded below-the-line.

EFFECT ON GENERAL LEDGER:

Retained Earnings	89,322	
Office Supplies and Expenses (A/C 921)		79,322
Miscellaneous General Expense (A/C 930)		10,000

EFFECT UPON FILING:

If finding is accepted, 2007 Office Supplies and Expenses (A/C 921) should be decreased by \$79,322; and Miscellaneous Expense should be decreased by \$10,000

AUDIT FINDING NO. 2

SUBJECT: NET OPERATING INCOME.

AUDIT ANALYSIS: We analyzed the Net Operating Income adjustments for the 12-month test period ending December 31, 2007. We observed that the utility used projected numbers when calculating some of the adjustments. Staff recalculated the adjustments based on actual amounts.

Fuel Revenue Adjustment – The utility removed \$390,764,997 in Purchased Gas Cost Recovery Revenues to determine test year revenues related to base rates. We determined that the Revenues removed should have been \$391,091,648 and that the company did not include the net true-up amount in the adjustment. Our adjustment decreases test year revenues by an additional \$326,651.

Employee Activities Adjustment - We determined that the company used 2006 amounts and projected them by an inflation factor of three percentage points. We determined that the 2007 actual costs were available during our audit, and we therefore used the actual. This action increased the company adjustment from (\$114,000) to (\$122,723). This decreases O&M Expenses by an additional \$8,723.

AGA Lobbying Dues - The company estimated the 2007 expense based upon amounts that were previously expended for this item in the years 2004 through 2006 and then applied a disallowance factor. We applied the disallowance to the actual 2007 expense in order to determine the 2007 adjustment. This action decreased the company adjustment from (\$7,000) to (\$6,483). This increases O&M Expenses by \$517.

Civic and Social Club Dues - The company estimated the 2007 expense based upon amounts that were previously expended for this item in the years 2004 through 2006 and then applied a disallowance factor. We applied the disallowance to the actual 2007 expense in order to determine the 2007 adjustment. This action decreased the company adjustment from (\$4,000) to (\$3,055). This increases O&M Expenses by \$945.

Economic Development – The company estimated the 2007 expense based upon amounts that were previously expended for this item in the years 2004 through 2006 and then applied a disallowance factor. We applied the disallowance to the actual 2007 expense in order to determine the 2007 adjustment. This action decreased the company adjustment from (\$8,500) to (\$8,000). This increases O&M Expenses by \$500.

Maintenance of General Plant - The company used a projected adjustment amount of \$32,004. The actual adjustment was \$25,000. Using the actual amounts results in a decrease to the company adjustment of \$7,004. This increases 2007 O&M Expenses by 7,004.

Maintenance of Structures and General plant – The company estimated the 2007 expense based upon amounts that were previously expended for this item in the years 2004 through 2006 and then applied a disallowance factor. We applied the disallowance to the actual 2007 expense in

order to determine the 2007 adjustment. This action decreased the company adjustment from (\$11,500) to (\$6,000) . This increases O&M Expenses by \$5,000.

As a result of the above adjustments, Federal and State income taxes and Taxes Other Than Income will also need to be adjusted. The net income taxes adjustments is \$5,089. The Taxes Other than Income adjustment is \$1,812.

DESCRIPTION	UTILITY ADJUSTMENTS (\$)	STAFF CALCULATED ADJUSTMENT (\$)	DIFFERENCE (\$)
TAXES OTHER THAN INCOME			
FUEL TAXES	(843,951)	(845,763)	1,812
<u>INCOME TAXES</u>			
FEDERAL INCOME TAXES	378,382	383,760	(5,378)
STATE INCOME TAXES	62,921	62,632	289
SUBTOTAL INCOME TAXES	441,303	446,392	(5,089)

EFFECT ON GENERAL LEDGER

Retained Earnings	\$314,507
O&M Adjustments (Miscellaneous General Expense account 930)	5,243
Income Taxes	5,089
Taxes Other Than Income	1,812
Fuel Revenue (480,481, & 483)	\$326,651

EFFECT ON FILING

If finding is accepted, the Fuel Revenue adjustment will increase by \$326,651. Additionally, O&M expenses (A/C 930) will increase by \$5,243; Income taxes expense will increase by \$5,089; and Taxes Other Than Income will increase by \$1,812.

FLORIDA PUBLIC SERVICE COMMISSION

EXPLANATION: PROVIDE A SCHEDULE CALCULATING A 13-MONTH AVERAGE RATE BASE AS ADJUSTED FOR THE HISTORIC BASE YEAR.

TYPE OF DATA SHOWN:
HISTORIC BASE YEAR DATA: 12/31/07
WITNESS: J.P. HIGGINS

COMPANY: PEOPLES GAS SYSTEM

DOCKET NO.: 080318-GU

LINE NO.	UTILITY PLANT	AVERAGE PER BOOKS	ADJUSTMENT	ADJUSTED AVERAGE
1	PLANT IN SERVICE	\$889,840,977	\$0	\$889,840,977
2	COMMON PLANT ALLOCATED	\$0	(\$1,301,285)	(\$1,301,285)
3	ACQUISITION ADJUSTMENT	\$5,248,671	(\$2,946,879)	\$2,301,792
4	PROPERTY HELD FOR FUTURE USE	\$228,955	(\$228,955)	\$0
5	CONSTRUCTION WORK IN PROGRESS	\$20,636,659	(\$87,027)	\$20,539,632
6	TOTAL PLANT	\$915,955,261	(\$4,574,145)	\$911,381,115
	DEDUCTIONS			
7	CUSTOMER ADVANCES FOR CONST.	(\$5,953,944)	\$0	(\$5,953,944)
8	ACCUM. DEPR. - UTILITY PLANT	(\$347,921,661)	\$0	(\$347,921,661)
9	ACCUM. DEPR. - COMMON PLANT	\$0	\$280,568	\$280,568
10	ACCUM. AMORT - ACQ. ADJ.	(\$3,192,161)	\$1,825,205	(\$1,366,956)
11	ACCUM. AMORT. - LEASEHOLD/OTHER	(\$13,927,228)	\$0	(\$13,927,228)
12				\$0
13				\$0
14	TOTAL DEDUCTIONS	(\$370,994,994)	\$2,105,773	(\$368,889,221)
15	PLANT NET	\$544,960,267	(\$2,468,373)	\$542,491,894
	ALLOWANCE FOR WORKING CAPITAL			
16	BALANCE SHEET METHOD	(\$8,367,605)	(\$20,345,806)	(\$28,713,411)
17	TOTAL RATE BASE	\$536,592,662	(\$22,814,179)	\$513,778,483
18	NET OPERATING INCOME	\$40,921,148	\$124,335	\$41,045,483
19	RATE OF RETURN	7.63%		7.99%

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Docket No. 080318-GU
Exhibit JYS-1 (Page 13 of 15)
Staff Audit Report

SCHEDULE C-1

NET OPERATING INCOME

PAGE 1 OF 1

FLORIDA PUBLIC SERVICE COMMISSION

EXPLANATION: PROVIDE THE CALCULATION OF NET OPERATING
 INCOME PER BOOKS FOR THE HISTORIC BASE YEAR
 AND THE PRIOR YEAR.

TYPE OF DATA SHOWN:
 HISTORIC BASE YEAR DATA: 12/31/07
 HISTORIC BASE YR - 1: 12/31/06
 WITNESS: J.P. HIGGINS

COMPANY: PEOPLES GAS SYSTEM

DOCKET NO.: 080318-GU

NET OPERATING INCOME - HISTORIC BASE YEAR ENDED 12/31/2007

LINE NO.		(1)	(2)	(3)	(4)	(5)	(6)
		PRIOR YEAR ENDED TOTAL COMPANY PER BOOKS (BASE YEAR - 1) 12/31/06	CURRENT HISTORIC BASE YEAR ENDED TOTAL COMPANY PER BOOKS 12/31/07	ADJUSTMENTS	COMPANY ADJUSTED (2) - (3)	REVENUE ADJUSTMENT	JURISDICTIONAL AMOUNT PROPOSED RATES
1	OPERATING REVENUES	\$571,907,223	\$593,029,854	(\$421,853,678)	\$171,176,175	\$0	\$171,176,175
	OPERATING EXPENSES:						
2	GAS EXPENSE	\$365,277,412	\$389,921,046	(\$389,921,046)	\$0	\$0	\$0
3	OPERATION & MAINTENANCE	\$74,984,804	\$73,323,607	(\$7,594,990)	\$65,728,617	\$0	\$65,728,617
4	DEPRECIATION & AMORTIZATION	\$36,420,579	\$39,954,263	(\$112,910)	\$39,841,353	\$0	\$39,841,353
5	TAXES OTHER THAN INCOME TAXES	\$34,284,151	\$34,256,471	(\$24,599,413)	\$9,657,058	\$0	\$9,657,058
	INCOME TAXES:						
6	- FEDERAL	\$20,560,242	\$13,306,833	\$378,382	\$13,685,215	\$0	\$13,685,215
7	- STATE	\$3,401,230	\$2,231,055	\$62,921	\$2,293,976	\$0	\$2,293,976
	DEFERRED INCOME TAXES						
8	- FEDERAL	(\$5,472,292)	(\$721,248)	\$0	(\$721,248)	\$0	(\$721,248)
9	- STATE	(\$909,975)	(\$119,935)	\$0	(\$119,935)	\$0	(\$119,935)
10	INVESTMENT TAX CREDIT - NET	(\$43,387)	(\$43,387)	\$43,387	\$0	\$0	\$0
11	GAIN ON SALE OF PROPERTY	\$0	\$0	(\$234,343)	(\$234,343)	\$0	(\$234,343)
12	TOTAL OPERATING EXPENSES	\$528,502,764	\$552,108,705	(\$421,978,013)	\$130,130,692	\$0	\$130,130,692
13	OPERATING INCOME	\$43,404,459	\$40,921,148	\$124,335	\$41,045,483	\$0	\$41,045,483

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SCHEDULE D-1

COST OF CAPITAL - 13-MONTH AVERAGE

PAGE 1 OF 2

FLORIDA PUBLIC SERVICE COMMISSION

EXPLANATION: PROVIDE THE COMPANY'S 13-MONTH AVERAGE RECONCILED JURISDICTIONAL CAPITAL STRUCTURE AND COST RATES FOR EACH CLASS OF CAPITAL FOR THE HISTORIC BASE YEAR OF THE CURRENT CASE AND THE HISTORIC BASE YEAR OR TEST YEAR OF THE LAST RATE CASE.

TYPE OF DATA SHOWN:
 HISTORIC BASE YEAR DATA: 12/31/07
 PRIOR RATE CASE YEAR: 12/31/01
 WITNESS: J.P. HIGGINS

COMPANY: PEOPLES GAS SYSTEM

DOCKET NO.: 080318-GU

LAST RATE CASE - TEST YEAR ENDED 12/31/2003						PRESENT RATE CASE - HISTORIC BASE YEAR ENDED 12/31/2007							
LINE NO.	CLASS OF CAPITAL (1)	DOLLARS (2)	COST RATE		WEIGHTED COST		AMOUNT PER BOOKS (6)	ADJUSTMENTS			RATIO (10)	COST RATE (11)	WEIGHTED COST (12)
			RATIO (3)	APPROVED (4)	APPROVED (5)	SPECIFIC (7)		PRORATA (8)	NET (9)				
1	COMMON EQUITY	\$266,519,023	52.68%	11.25%	5.93%	\$266,067,746	(\$7,207,788)	(\$6,722,014)	\$255,137,944	49.66%	11.25%	5.68%	
2	LONG TERM DEBT	181,627,372	35.90%	7.83%	2.81%	186,719,228	(3,773,678)	(4,696,260)	178,249,290	34.69%	7.29%	2.53%	
3	SHORT TERM DEBT	(30,728)	-0.01%	1.80%	0.00%	20,291,154	0	(520,879)	19,770,275	3.85%	5.02%	0.19%	
4	CUST. DEPOSITS RESID.	6,420,061	1.27%	6.00%	0.08%	9,589,252	0	0	9,589,252	1.87%	6.00%	0.11%	
5	CUST. DEPOSITS COMM'L	22,976,625	4.54%	7.00%	0.32%	24,963,828	0	0	24,963,828	4.86%	7.00%	0.34%	
6	INACTIVE DEPOSITS	160,699	0.03%	0.00%	0.00%	308,926	0	0	308,926	0.06%	0.00%	0.00%	
7	DEFERRED INCOME TAXES	28,262,912	5.59%	0.00%	0.00%	25,654,528	0	0	25,654,528	4.99%	0.00%	0.00%	
8	TAX CREDITS	0	0.00%	0.00%	0.00%	0	106,440	0	106,440	0.02%	0.00%	0.00%	
9	OTHER (EXPLAIN)	0	0.00%	0.00%	0.00%	0	0	0	0	0.00%	0.00%	0.00%	
10	TOTAL	\$505,935,964	100.00%		9.13%	\$538,592,682	(\$10,875,028)	(\$11,939,153)	\$513,778,482	100.00%		8.76%	

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SUPPORTING SCHEDULES: B-1 p.2, D-2 p.1, D-3, D-4, D-5, D-6

RECAP SCHEDULES: A-1, A-2, C-22