

State of Florida



Public Service Commission

Office of Auditing and Performance Analysis
Bureau of Auditing
Tampa District Office

Auditor's Report

Lake Placid Utilities, Inc. (WS709)
Staff Assisted Rate Case

Twelve Months Ended December 31, 2012

Docket No. 130243-WS
Audit Control No. 13-301-2-1
December 24, 2013

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Purpose

To: Florida Public Service Commission

We have performed the procedures described later in this report to meet the agreed-upon objectives set forth by the Division of Accounting and Finance in its audit service request dated October 25, 2013. We have applied these procedures to the attached schedules prepared by the audit staff in support of Lake Placid Utilities Inc.'s request for a Staff Assisted Rate Case in Docket No.130243-WS.

This audit was performed following General Standards and Fieldwork Standards found in the AICPA Statements on Standards for Attestation Engagements. Our report is based on agreed-upon procedures. The report is intended only for internal Commission use.

Objectives and Procedures

Background

Definitions

Utility or LP refers to Lake Placid Utilities, Inc.

Parent or UI refers to Utilities, Inc.

Service Company or WSC refers to Water Service Corporation.

Test Year refers to the 12-months ended December 31, 2012.

ERC refers to Equivalent Residential Connections as defined by Commission Rule 25-30-055 – Systems with a Capacity or Proposed Capacity to Serve 100 or Fewer Persons, Florida Administrative Code. (F.A.C.)

NARUC refers to the National Association of Regulatory Utility Commissioners.

USOA refers to the NARUC Uniform System of Accounts as adopted by Commission Rule 25-30.115 – Uniform System of Accounts for Water and Wastewater Utilities, F.A.C.

Utility Information

Lake Placid Utilities, Inc. is a Class C utility providing water and wastewater service to approximately 121 water and 192 wastewater customers in Polk County. LP was granted Certificate Nos. 414-W and 347-S in 1993. LP certificates were subsequently amended to include additional territory to serve up to 52 potential connections in the Village Del Mar development in 2010. LP rate base was last established in its 2009 staff-assisted rate case (SARC) by Order No. PSC-11-0015-PAA-WS, issued January 5, 2011.

LP is a wholly owned subsidiary of UI, an Illinois corporation which owns approximately 75 utilities throughout 15 states including 15 water and wastewater utilities within the State of Florida.

Other Information

Our procedures pertain only to the direct costs incurred by LP. All allocated costs and the Parent's capital structure were reviewed in a separate audit engagement for Utilities, Inc. - Audit of Affiliate Transactions, Docket No.130212-WS, Audit Control No. 13-296-4-2.

General

Objectives: The objectives were to determine LP's Rate Base, Net Operating Income, and Capital Structure for the test year, and verify that LP's books and records are maintained in compliance with NARUC USOA.

Procedures: We completed the following objectives and procedures that follow to satisfy the objectives identified above. We reviewed LP's accounting system and determined that they are in compliance with the NARUC USOA. Our recommended adjustment to Rate Base is discussed in Finding 1.

Rate Base

Utility Plant in Service

Objectives: The objectives were to determine whether Utility Plant in Service (UPIS): 1) Consists of property that exists and is owned by the Utility, 2) Additions are recorded at original cost, 3) Retirements are made when a replacement asset was put in service, 4) Adjustments required in the Utility's last rate proceeding were recorded in its books and records, and is 5) Recorded in compliance with the NARUC USOA.

Procedures: We reconciled the beginning balances for water and wastewater UPIS as of December 31, 2008, established in Docket No. 090531-WS with the general ledger. We scheduled water and wastewater UPIS activity from January 1, 2009, through December 31, 2012. We traced asset additions and retirements to supporting documentation. We determined the year end and simple average UPIS balances as of December 31, 2012. No exceptions were noted.

Land & Land Rights

Objectives: The objectives were to determine whether utility land is: 1) Recorded at original cost, 2) Owned or secured under a long-term lease agreement, that 3) Recorded in compliance with the NARUC USOA, and that 4) Adjustments required in the Utility's last rate proceeding were recorded in its books and records.

Procedures: We reconciled the beginning balances for water and wastewater Land as of December 31, 2008, established in Docket No. 090531-WS, with the general ledger. We searched the Highlands County Clerk of the Courts' official records for any activity related to utility land and none was found. We determined the year end and simple average Land balance as of December 31, 2012. No exceptions were noted.

Contributions in Aid of Construction

Objectives: The objectives were to determine whether Contributions in Aid of Construction (CIAC): 1) Consist of cash or property contributions that exist and are owned by the Utility, 2) Additions are recorded using Commission approved tariffs, 3) Retirements are recorded when a contributed asset was replaced, 4) Adjustments required in the Utility's last rate proceeding were recorded to its books and records, and is 5) Recorded in compliance with the NARUC USOA.

Procedures: We reconciled the beginning balances for water and wastewater CIAC as of December 31, 2008, established in Docket No. 090531-WS with the general ledger. We scanned LP's records and inquired about cash and property contributions since the last rate proceeding. We determined the year end and simple average CIAC balances as of December 31, 2012. No exceptions were noted.

Accumulated Depreciation

Objectives: The objectives were to determine whether Accumulated Depreciation: 1) Accruals are properly calculated and recorded based on Rule 25-30.140 – Depreciation, F.A.C., 2) Retirements are recorded when an asset was replaced, 3) Adjustments required in the Utility's last rate proceeding were recorded to its books and records, and is 4) Recorded in compliance with the NARUC USOA.

Procedures: We reconciled the beginning balances for water and wastewater Accumulated Depreciation as of December 31, 2008, established in Docket No. 090531-WS, with the general ledger. We recalculated a sample of depreciation accruals to verify that the correct depreciation rates were used. We traced Accumulated Depreciation retirements to corresponding UPIS retirements and verified that retirements were made when a capital asset was removed or replaced. We determined the year end and simple average Accumulated Depreciation balances as of December 31, 2012. No exceptions were noted.

Accumulated Amortization of CIAC

Objectives: The objectives were to determine whether Accumulated Amortization of CIAC: 1) Accruals are properly calculated and recorded based on Rule 25-30.140 – Depreciation, F.A.C., 2) Retirements are recorded when a contributed asset was replaced, 3) Adjustments required in the Utility's last rate proceeding were recorded to its books and records, and is 4) Recorded in compliance with the NARUC USOA.

Procedures: We reconciled the beginning balances for water and wastewater Accumulated Amortization of CIAC as of December 31, 2008, established in Docket No. 090531-WS, with the general ledger. We recalculated a sample of amortization accruals for CIAC to verify that the correct depreciation rates were used. We determined the year end and simple average Accumulated Amortization of CIAC balances as of December 31, 2012. No exceptions were noted.

Working Capital

Objective: The objective was to determine the working capital adjustment to be included in rate base per Rule 25-30.433 – Rate Case Proceedings, F.A.C.

Procedure: We calculated the working capital adjustment for the test year using one-eighth of Operation and Maintenance (O&M) Expense as required by Commission rule.

Capital Structure

Objectives: The objectives were to determine the: 1) Components of the Utility's capital structure, 2) Cost rate for each class of capital, 3) Overall weighted cost of capital, and that 4) Components are properly recorded in compliance with the NARUC USOA.

Procedures: We compiled the LP's Capital Structure using information extracted from the general ledger, and Commission filed annual reports. We determined that LP's Capital Structure is composed of the Parent's common equity, long-term debt, and LP's customer deposits, and deferred income taxes. The Parent's common equity and long-term debt balances were reviewed in the Affiliate Transaction audit. We determined the year end and simple average Capital Structure balances and its weighted average cost as of December 31, 2012. Our recommended adjustments to Capital Structure and its corresponding cost rates are discussed in Finding 2.

Net Operating Income

Operating Revenue

Objectives: The objectives were to determine whether Revenues are: 1) Representative of the Utility's operations for the test year, 2) Calculated using Commission approved tariff rates, and 3) Recorded in compliance with the NARUC USOA.

Procedures: We acquired revenues for the test year from LP's 2012 detailed general ledger. We recalculated and tested the reasonableness of the Utility's test year revenues using customer billing information and its Commission approved tariff rates. No exceptions were noted.

Operation and Maintenance Expense

Objectives: The objectives were to determine whether O&M Expense is: 1) Representative of the Utility's ongoing operations for the test year, 2) Recorded in the appropriate period for the correct amount, 3) Required for the provision of utility services, and 4) Recorded in compliance with the NARUC USOA.

Procedures: We acquired O&M Expense for the test year from the LP's 2012 detailed general ledger. We examined a sample of vendor invoices for the test year period, confirmed their utility classification, verified their recurring nature and traced them to original source documentation. Our recommended adjustments to O&M Expense are discussed in Finding 3.

Depreciation and CIAC Amortization Expense

Objective: The objective was to determine whether Depreciation and CIAC Amortization Expense are properly calculated and recorded in compliance with the NARUC USOA.

Procedure: We acquired Depreciation and CIAC Amortization Expense for the test year from the LP's 2012 detailed general ledger. We recalculated a sample of LP's Depreciation and CIAC Amortization Expense for the test year using the rates established by Rule 25-30.140, F.A.C. No exceptions were noted.

Taxes Other than Income

Objectives: The objectives were to determine whether Taxes Other Than Income Expense (TOTI) is: 1) Representative of the Utility's ongoing operations for the test year, 2) Recorded in the appropriate period for the correct amount, 3) Required for the provision of utility services, and 4) Recorded in compliance with the NARUC USOA.

Procedures: We acquired TOTI Expense for the test year from LP's 2012 detailed general. We examined property taxes and corporate franchise fees for the test year, confirmed their utility classification, verified their recurring nature and traced them to original source documentation. We recalculated regulatory assessment fees (RAF) based on the test year revenues. Our recommended adjustment to TOTI Expense is discussed in Finding 4.

Income Taxes

Objective: The objective was to determine whether the Utility's income tax calculation is accurate.

Procedures: We determined that income taxes were allocated from the Parent. The Parent's 2012 federal income tax return was reviewed in the Affiliate Transaction audit. No exceptions were noted.

Audit Findings

Finding 1: Rate Base

Audit Analysis: The Utility’s records reflect the following Rate Base balances as of December 31, 2012.

Component	Water	Wastewater
Utility Plant in Service	\$495,095	\$798,135
Land	\$2,796	\$21,665
Contributions in Aid of Construction	(\$235,199)	(\$335,881)
Accumulated Depreciation	(\$184,889)	(\$575,669)
Accumulated Amortization of CIAC	\$78,650	\$155,911
Total	\$156,453	\$64,161

We increased water and wastewater rate base by \$4,343 and \$5,614, respectively, as of December 31,2012, to include a working capital adjustment for rate setting purposes.

Effect on the General Ledger: None

Effect on the Staff’s Exhibit: LP’s combined average rate base is \$242,333 (\$163,383+\$78,948), as displayed below. The Rate Base balances may change based on adjustments in the Audit of Affiliate Transactions, Docket No.130212-WS, Audit Control No. 13-296-4-2.

Water System	@12/31/11	@12/31/12	Simple Average
Utility Plant in Service	\$486,866	\$495,095	\$490,981
Land	2,796	2,796	2,796
Contributions in Aid of Construction	(235,199)	(235,199)	(235,199)
Accumulated Depreciation	(163,575)	(184,889)	(174,232)
Accumulated Amortization of CIAC	70,744	78,650	74,697
Working Capital			4,343
Total	\$161,632	\$156,453	\$163,386

Wastewater System	@12/31/11	@12/31/12	Simple Average
Utility Plant in Service	\$797,951	\$798,135	\$798,043
Land	21,665	21,665	21,665
Contributions in Aid of Construction	(335,881)	(335,881)	(335,881)
Accumulated Depreciation	(546,929)	(575,669)	(561,299)
Accumulated Amortization of CIAC	145,700	155,911	150,806
Working Capital			5,614
Total	\$82,506	\$64,161	\$78,948

TOTAL AVERAGE RATE BASE	\$242,333
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Finding 2: Capital Structure

Audit Analysis: The Utility's records reflect the following Capital Structure balances and cost rates as of December 31, 2012.

<u>Class of Capital</u>	<u>Amount</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Common Equity	\$119,837	52.06%	11.56%	6.01%
Long Term Debt	132,127	57.40%	6.60%	3.78%
Customer Deposits	770	0.33%	6.00%	0.02%
Deferred Income Taxes	(22,559)	-9.80%	0.00%	0.00%
Total	\$230,175	100.00%		9.81%

Common Equity and Long Term Debt balances are allocated from the Parent.

Order No. PSC-13-0241-PAA-WS. Issued June 3, 2013, established a maximum return on equity (ROE) of 11.16 percent for water and wastewater utilities with a maximum equity ratio of 40 percent. LP's equity ratio is 47.56 percent ($\$119,837/(\$119,837+\$132,127)$). Therefore, we reduced LP's ROE by 0.40 percent to 11.16 percent.

Order No. PSC-12-0358-FOF-PU, issued July 11, 2012, adopted an amendment to Rule 25-30.311 – Customer Deposits, F.A.C., that reduced the required annual interest rate paid on customer deposits from 6.00 to 2.00 percent. This SARC is setting prospective rates for LP's customers. Therefore, we reduced the cost rate for customer deposits from 6.00 to 2.00 percent in accordance with Commission rule.

Effect on the General Ledger: To be determined by the Utility.

Effect on the Staff's Exhibit: LP's Capital Structure has been reconciled with the average rate base displayed in Exhibit 1. The average Cost of Capital and its corresponding cost rates are included in Exhibit 2. The Capital Structure balances may change based on adjustments in the Audit of Affiliate Transactions, Docket No.130212-WS, Audit Control No. 13-296-4-2.

Finding 3: Operations and Maintenance Expense

Audit Analysis: The Utility's records reflect the following amounts for Operations and Maintenance Expense (O&M), for the test year.

Acct.	Acct. Description	Direct	Allocated	Total	Water	W/Water
601 701	Salaries & Wages - Employees	\$0	\$12,556	\$12,556	\$6,253	\$6,303
603 703	Salaries & Wages - Officers	0	1,528	1,528	761	767
604 704	Employee Pension & Benefits	0	4,044	4,044	2,014	2,030
na 711	Sludge Removal	1,848	0	1,848	0	1,848
615 715	Purchased Power	6,201	0	6,201	2,413	3,789
618 718	Chemicals	1,658	14	1,671	832	839
620 720	Materials & Supplies	3,073	0	3,073	1,566	1,507
631 731	Contract Services - Engineering	0	2	2	1	1
632 732	Contract Services - Accounting	0	492	492	245	247
633 733	Contract Services - Legal	0	14	14	7	7
635 735	Contract Services - Testing	0	0	0	0	0
636 736	Contract Services - Other	27,452	1,839	29,291	14,587	14,704
641 741	Rents	0	24	24	12	12
650 750	Transportation Expense	0	1,590	1,590	792	798
659 759	Insurance	0	2,087	2,087	1,039	1,048
660 760	Advertising Expense	0	4	4	2	2
666 766	Reg. Commission-Rate Case	9,986	51	10,036	4,998	5,038
667 767	Reg. Commission-Other	0	4	4	2	2
670 770	Bad Debt Expense	664	21	685	341	344
675 775	Miscellaneous Expense	1,494	2,780	4,274	2,030	2,244
Totals		\$52,376	\$27,050	\$79,425	\$37,896	\$41,530

Small differences are due to rounding.

We have made several adjustments to O&M Expenses that reduce water expenses by \$3,148 to \$34,747 and increase wastewater expenses by \$3,382 to \$44,912, respectively for the test year as summarized below.

Account No. 618/718 – Chemicals: We reduced water and increased wastewater chemical expense by \$460 and \$694, respectively. LP allocated chemical expense to water and wastewater operations based on ERCs. We scheduled chemical expense based on direct deliveries to the respective utility plants. We reduced water and increased wastewater expenses by \$499, each, for the test year. We increased chemical expense to include two chemical invoices totaling \$39 for water and \$195 for wastewater that were not included by LP in the test year.

Account No. 636/736 – Contract Services Other: We reduced water and increased wastewater contact service expenses by \$2,987 each. LP allocated contract service expense to water and wastewater operations based on ERCs. We scheduled contract service expense based on direct services performed at the respective utility plants. We reduced water and increased wastewater expenses by \$2,987 each, for the test year.

Finding 3, continued

Account No. 666/766 – Rate Case Expense: LP included water and wastewater rate case expense of \$4,998 and \$5,038, respectively, in this account. They include direct water and wastewater rate case expense of \$4,973 and \$5,013, respectively. The direct amounts represent one-fourth of the total rate case expense that was approved for each system in its last rate proceeding. The test year for this rate proceeding is the fourth and final period that includes rate case expense from the prior rate proceeding. Assuming that a similar level of rate case expense will be approved in this rate proceeding, we have not made any adjustments to this account for presentation purposes.

Account No. 675/775 – Miscellaneous Expense: We increased water and reduced wastewater miscellaneous expenses by \$298 each. LP allocated contract service expense to water and wastewater operations based on ERCs. We scheduled some specific miscellaneous expenses based on direct services performed at the respective utility plants. We increased water and reduced wastewater expenses by \$298 each, for the test year.

Effect on the General Ledger: To be determined by the Utility.

Effect on the Staff's Exhibit: Reduce water and increase wastewater O&M Expenses by \$3,148 and \$3,382, respectively, for the test year. The O&M Expense balances may change based on adjustments in the Audit of Affiliate Transactions, Docket No.130212-WS, Audit Control No. 13-296-4-2.

Finding 4: Taxes Other Than Income

Audit Analysis: The Utility's records reflect the following amounts for Taxes Other Than Income (TOTI) for the test year.

Description	Direct	Allocated	Total	Water	Wastewater
Regulatory Assessment Fees (RAF)	\$5,641	\$0	\$5,641	\$2,809	\$2,832
Property Taxes	5,867	52	5,919	2,948	2,971
Payroll Taxes	0	1,767	1,767	880	887
Other Taxes	150	11	161	80	81
Total	\$11,658	\$1,830	\$13,488	\$6,717	\$6,771

The total was allocated between water and wastewater by ERC's.

Water and wastewater TOTI Expenses are overstated by \$1,000 and understated by \$1,132, respectively, based on the following.

RAF LP allocated \$5,641 of direct RAF based on ERCs. The actual RAF filings reflected direct water and wastewater RAF's of \$2,589 and \$3,184, respectively, for the test year. We reduced water and increased wastewater RAF's by \$220 and \$352, to remove the LP allocation and record the actual amount of RAF's paid to the Commission based on test year revenues.

Property Taxes LP allocated \$5,867 of direct property taxes based on ERCs. Actual property tax bills reflect direct water and wastewater property taxes of \$2,142 and \$3,751, respectively. We reduced water and increased wastewater property taxes by \$780 each, to remove the LP allocation.

RAF	Total	Water	Wastewater
Per Utility	\$5,641	\$2,809	\$2,832
Per Audit	<u>5,773</u>	<u>2,589</u>	<u>3,184</u>
Adjustment	\$132	(\$220)	\$352
Property Taxes	Total	Water	Wastewater
Per Utility	\$5,867	\$2,922	\$2,945
Per Audit	<u>5,867</u>	<u>2,142</u>	<u>3,725</u>
Adjustment	\$0	(\$780)	\$780
Total Adjustment	\$132	(\$1,000)	\$1,132

Effect on the General Ledger: To be determined by the Utility.

Effect on the Staff's Exhibit: Reduce water and increase wastewater TOTI by \$1,000 to \$5,717 and by \$1,132 to \$7,903, respectively, for the test year. The TOTI Expense balances may change based on adjustments in the Audit of Affiliate Transactions, Docket No.130212-WS, Audit Control No. 13-296-4-2.

Exhibits

Exhibit 1: Rate Base

**Lake Placid Utilities, Inc.
Twelve Months Ended December 31, 2012
Docket No. 130243-WS**

Water System				
Description	Per Utility	Audit Adjustments	Per Audit	Simple Average
Plant in Service	\$495,095	\$0	\$495,095	\$490,981
Land & Land Rights	2,796	0	2,796	2,796
Contributions in Aid of Construction	(235,199)	0	(235,199)	(235,199)
Accumulated Depreciation	(184,889)	0	(184,889)	(174,232)
Accumulated Amortization of CIAC	78,650	0	78,650	74,697
Working Capital	0	4,343	4,343	4,343
Total	\$156,453	\$4,343	\$160,796	\$163,386

Wastewater System				
Description	Per Utility	Audit Adjustments	Per Audit	Simple Average
Plant in Service	\$798,135	\$0	\$798,135	\$798,043
Land & Land Rights	21,665	0	21,665	21,665
Contributions in Aid of Construction	(335,881)	0	(335,881)	(335,881)
Accumulated Depreciation	(575,669)	0	(575,669)	(561,299)
Accumulated Amortization of CIAC	155,911	0	155,911	150,806
Working Capital	0	5,614	5,614	5,614
Total	\$64,161	\$5,614	\$69,775	\$78,948

Total Average Rate Base \$242,334

(Small differences are due to rounding)

Exhibit 2: Capital Structure

Lake Placid Utilities, Inc.
Twelve Months Ended December 31, 2012
Docket No. 130243-WS

Capital Component	Per Utility	Adjustment	Per Audit	Pro Rata			Ratio	Cost	Weighted Cost
				Ratio	Adjustment	Simple Avg.			
Common Equity	\$119,837	\$0	\$119,837	47.56%	\$6,058	\$125,895	51.95%	11.16%	5.80%
Long Term Debt	132,127	0	132,127	52.44%	6,680	138,807	57.28%	6.60%	3.78%
Short Term Debt	0	0	0	0.00%	0	0	0.00%	0.00%	0.00%
Customer Deposits	770	0	770		(144)	626	0.26%	2.00%	0.01%
Deferred Taxes	(22,175)	0	(22,175)		(820)	(22,995)	-9.49%	0.00%	0.00%
Total Capital	\$230,559	\$0	\$230,559	100.00%	\$11,774	\$242,333	100.00%		9.58%

Common Equity and Long Term Debt balances are allocated from the Parent.
The cost rate for Common Equity is 11.16 percent based on the Commission's latest leverage graph calculation approved in Order No. PSC-13-0241-WS, issued June 3, 2013.
(Small differences are due to rounding)

Exhibit 3: Net Operating Income

Lake Placid Utilities, Inc.
Twelve Months Ended December 31, 2012
Docket No. 130243-WS

Water System			
Description	Per Utility	Audit Adjustments	Per Audit
Operating Revenues	\$57,538	\$0	\$57,538
Operating Expenses:			
Operation & Maintenance	37,896	(\$3,148)	34,747
Depreciation	18,565	\$0	18,565
Amortization of CIAC	(7,906)	\$0	(7,906)
Taxes Other Than Income	6,717	(\$1,000)	5,717
Income Taxes	<u>426</u>	<u>0</u>	<u>426</u>
Total Operating Expenses	\$55,698	(\$4,148)	\$51,549
Operating Income(Loss)	\$1,840	\$4,148	\$5,989

Wastewater System			
Description	Per Utility	Audit Adjustments	Per Audit
Operating Revenues	\$70,751	\$0	\$70,751
Operating Expenses:			
Operation & Maintenance	41,531	3,382	44,912
Depreciation	26,893	0	26,893
Amortization of CIAC	(10,210)	0	(10,210)
Taxes Other Than Income	6,771	1,132	7,903
Income Taxes	<u>429</u>	<u>0</u>	<u>429</u>
Total Operating Expenses	\$65,414	\$4,514	\$69,927
Operating Income(Loss)	\$5,337	(\$4,514)	\$824

The income tax amount presented is allocated from the Parent's consolidated tax return and is subject to change based on audit adjustments in the Parent's affiliate operations and LP's associated Florida utility operations in pending Commission dockets.

(Small differences are due to rounding)