

State of Florida



Public Service Commission

-M-E-M-O-R-A-N-D-U-M-

DATE: August 21, 2003
TO: Division of Economic Regulation (Greene)
FROM: Division of Auditing and Safety (Vandiver) *W*
RE: **Docket No.** 020567-WU; **Company Name:** Lake Utility Services, Inc.; **Audit Purpose:** Potential Overearnings Investigation; **Audit Control No.** 02-350-3-1

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 confidential work papers associated with this audit.

Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
Division of Commission Clerk and Administrative Services (2)
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

LAKE UTILITY SERVICES, INC.

POTENTIAL OVERTURNINGS INVESTIGATION

LAKE COUNTY

HISTORICAL PERIOD ENDED DECEMBER 31, 2002

**DOCKET NO. 020567-WS
AUDIT CONTROL NO. 02-350-3-1**

Handwritten signature of Jeffery A. Small in black ink.

Jeffery A. Small, Audit Manager

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Kathy L. Welch, Audit Staff

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Misty B. Shepherd, Audit Staff

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Charleston J. Winston, District Audit Supervisor

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

AUGUST 15, 2003

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the Annual Report for the historical 12-month period ended December 31, 2002, for Lake Utility Services, Inc. for its water and wastewater operations located in Lake County, Florida. The attached schedules were prepared by the auditors as part of their work in Docket No. 020567-WS.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use. There is confidential information associated with this audit.

SUMMARY OF SIGNIFICANT FINDINGS

The utility's water and wastewater rate base are overstated by \$2,849,198 and \$893,794, respectively, as of December 31, 2002.

The utility's water and wastewater net operating income before federal income taxes are understated by \$191,580 and overstated by \$127,858, respectively, for the 12-month period ended December 31, 2002.

The utility's average weighted cost of debt is 8.596 percent as of December 31, 2002.

HISTORICAL UTILITY INFORMATION

Lake Utility Services, Inc. (LUSI) is a Class A utility located in Lake County that operates under Certificate No. 496-W. The utility's Annual Report used in this docket indicates that its service area contains a total of 5,684 and 1,953 water and wastewater customers, respectively.

On May 9, 1997, LUSI was granted rate relief and the Commission established rate base balances for LUSI's water and wastewater systems as of December 31, 1995, by Order No. PSC-97-0531-FOF-WU in Docket No. 960444-WU. On April 5, 1999, in response to a protest of the above-mentioned Order, the Commission approved an offer of settlement between LUSI and the Office of Public Counsel (OPC) which modified the rate base balances approved in the prior Order.

On January 26, 1999, Commission Order No. PSC-99-0164-FOF-WS approved the transfer of majority organizational control of Lake Groves Utilities, Inc. (LGU) to Utilities, Inc. LGU operated under original Certificates Nos. 534-W and 465-S which were approved in Commission Order No. 24283, issued March 25, 1991. LGU has never had rate base established by the Commission.

On November 26, 2002, Commission Order No. PSC-02-1658-FOF-WS approved the corporate merger and name change of LGU and LUSI. As a result of the merger, Certificate No. 534-W was canceled, and Certificate No. 496-W was amended to include the LGU service area.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report.

Scanned - The documents or accounts were read quickly looking for obvious errors.

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Reviewed - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers, and selective analytical review procedures were applied.

Examined - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers. Selective analytical review procedures were applied, and account balances were tested to the extent further described.

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

RATE BASE: Examined account balances for utility-plant-in-service (UPIS), land, contributions-in-aid-of-construction (CIAC), accumulated depreciation (AD), accumulated amortization of CIAC (AAC), and working capital (WC) as of December 31, 2002. Compiled construction-work-in-progress as of December 31, 2002. Reconciled rate base balances authorized in Commission Orders Nos. PSC-97-0531-FOF-WS, issued May 9, 1997, and PSC-99-0635-FOF-WS, issued April 5, 1999, to the respective December 31, 1995, general ledger balance.

NET OPERATING INCOME: Compiled utility revenues and operating and maintenance accounts for the 12-month period ended December 31, 2002. Chose a judgmental sample of customer bills and recalculated using FPSC-approved rates. Chose a judgmental sample of operation and maintenance expenses (O&M) and examined the invoices for supporting documentation. Reviewed the allocation of O&M expenses from Water Service Corporation (WSC) and Utilities, Inc. of Florida (UIF) cost centers to LUSI and verified the accuracy of company allocations based on company-provided allocation schedules. Tested the calculation of depreciation and CIAC amortization expense. Examined support for taxes other than income.

CAPITAL STRUCTURE: Compiled the components of the capital structure as of December 31, 2002. Agreed interest expense to the terms of the notes and the bonds. Reconciled note balances at December 31, 2002, to supporting documentation.

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

Exception No. 1

Subject: Rate Base - Adjustment to Prior Orders

Statement of Fact: Commission Orders Nos. PSC-97-0531-FOF-WS and PSC-99-0635-FOF-WS required the following adjustments to the LUSI water rate base balances as of December 31, 1995.

<u>Account</u>	<u>Adjustment</u>
UPIS	(\$55,114)
Land	357
CIAC	(184,949)
Acc. Dep.	(63,266)
Acc. Amtz.	<u>15,309</u>
Total	(\$287,663)

Recommendation: The utility's water rate base balance is overstated by \$287,791 as of December 31, 2002, based on the following audit staff determinations. (\$287,663 + \$1,128)

- 1) The utility's rate base balances are understated by \$287,663 as illustrated in the table above because it never recorded the adjustments in the Commission Order cited above.
- 2) The utility's accumulated depreciation is overstated by an additional \$1,128, which is the cumulative effect of seven years of additional depreciation expense accruals on the \$55,114 of UPIS that should have been removed as of December 31, 1995.

Additionally, the utility's depreciation expense is overstated by \$161 for the 12-month period ended December 31, 2002, which represents one year of depreciation expense on the \$55,114 of UPIS that should have been removed as of December 31, 1995.

See Schedules A and B that follow for additional details

The cumulative effect on the amortization of CIAC for this issue will be incorporated in Exception No. 11 of this report.

Schedule A for Exception No. 1

Utility-Plant-in-Service

Account Number	Account Description	Per Utility @12/31/95	Adjustment to Order	Per Order @12/31/95	Depreciation Rate	Dep. Expense Adjustment(1)
301	Organization	\$96,200	(\$79,642)	\$16,558	2.50%	(\$1,991)
304	Structures & Improvements	35,378	9,636	45,014	3.03%	292
307	Wells & Springs	157,858	47,137	204,995	3.33%	1,571
311	Pumping Equipment	113,382	875	114,257	5.00%	44
320	Water Treatment Equipment	73,144	28,116	101,260	4.55%	1,278
330	Dist. Reservoirs & Standpipes	75,381	7,350	82,731	2.70%	199
331	Transmission & Distribution Mains	1,240,526	(77,934)	1,162,592	2.33%	(1,812)
333	Services	108,993	(3,029)	105,964	2.50%	(76)
334	Meters & Meter Installations	20,597	2,676	23,273	5.00%	134
335	Hydrants	22,894	10,039	32,933	2.22%	223
341	Transportation Equipment	0	0	0	16.67%	0
343	Tools, Shop, & Garage Equipment	<u>7,075</u>	<u>(338)</u>	<u>6,737</u>	6.67%	<u>(23)</u>
	Total UPIS (2)	\$1,951,428	(\$55,114)	\$1,896,314		(\$161)

- 1) The depreciation expense adjustment is calculated based on multiplying the adjustment to the Order balance times the depreciation rate.
- 2) Order adjustments to the utility's common plant accounts were ignored because UIF and WSC common plant allocations are subject to staff audit procedures in every Commission proceeding.

Schedule B for Exception No. 1

Accumulated Depreciation

Account Number	Account Description	Per Utility @12/31/95	Adjustment to Order	Per Order @12/31/95	Cumulative Acc. Dep.(1)	Total Acc. Dep. Adjustment(2)
301	Organization	(\$8,136)	\$5,936	(\$2,200)	\$13,937	\$19,873
304	Structures & Improvements	1,572	(9,500)	(7,928)	(2,044)	(11,544)
307	Wells & Springs	(16,338)	(18,990)	(35,328)	(10,999)	(29,989)
311	Pumping Equipment	(10,706)	922	(9,784)	(306)	616
320	Water Treatment Equipment	(5,452)	(9,124)	(14,576)	(8,946)	(18,070)
330	Dist. Reservoirs & Standpipes	(10,877)	(4,669)	(15,546)	(1,391)	(6,060)
331	Transmission & Distribution Mains	(93,015)	(13,297)	(106,312)	12,687	(610)
333	Services	(7,760)	(8,045)	(15,805)	530	(7,515)
334	Meters & Meter Installations	(1,285)	(1,585)	(2,870)	(937)	(2,522)
335	Hydrants	(1,922)	(4,980)	(6,902)	(1,562)	(6,542)
341	Transportation Equipment	0	0	0	0	0
343	Tools, Shop, & Garage Equipment	<u>(436)</u>	<u>66</u>	<u>(370)</u>	<u>158</u>	<u>224</u>
	Total Accumulated Depreciation(3)	(\$154,355)	(\$63,266)	(\$217,621)	\$1,128	(\$62,137)

- 1) The cumulative Acc. Dep. adjustment is calculated as seven times the depreciation expense adjustment in Schedule A.
- 2) The total Acc. Dep. adjustment is calculated as the sum of the Order Acc. Dep. adjustment plus the cumulative Acc. Dep. adjustment.
- 3) Order adjustments to the utility's common accumulated depreciation accounts were ignored because UIF and WSC common accumulated depreciation allocations are subject to staff audit procedures in every Commission proceeding.

Exception No. 2

Subject: Lake Groves Utilities, Inc. - Transfer Balance

Statement of Fact: On January 26, 1999, Commission Order No. PSC-99-0164-FOF-WS approved the transfer of majority organizational control of Lake Groves Utilities, Inc.(LGU) to Utilities, Inc. LGU operated under original Certificates Nos. 534-W and 465-S which were approved in Commission Order No. 24283, issued March 25, 1991. LGU has never had rate base established by the Commission.

Recommendation: The utility's water UPIS balance is overstated by \$1,335, and its wastewater UIPS balance is understated by \$1,335, respectively. Its water and wastewater accumulated depreciation balances are understated by \$502 and \$23,677, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The audit staff examined the prior utility owner's books and records since it began operations in 1990 through December 31, 1998, when Utilities, Inc. purchased LGU as discussed in the Commission Order above.
- 2) The audit staff has determined that no material adjustments are required of the LGU books and records at the time of transfer except for some retirements of utility assets not transferred which are addressed later in this report.
- 3) The audit staff has determined that Utilities, Inc. reclassified several UPIS account balances when it merged LGU into its books. The new account balances do not accurately reflect the UPIS balance as of December 31, 1998. Additionally, the utility's account reclassifications have had a material effect on the subsequent years' depreciation expense and the corresponding accumulated depreciation accruals.

Additionally, the utility's water and wastewater depreciation expenses are understated by \$167 and \$7,892, respectively, for the 12-month period ended December 31, 2002, which represents one year of depreciation expense on the adjusted UPIS discussed above.

See Schedules C and D that follow for additional details.

The Commission should require the utility to reverse the UPIS reclassifications it made when it recorded the purchase of LGU and the subsequent effect of its actions on its accumulated depreciation balance.

Schedule C for Exception No. 2

Transferred Utility-Plant-in-Service - Selected Accounts

Account Number	Account Description	Per LGU @12/31/98	Reclassified Amount	Per UINC @12/31/98	Depreciation Rate	Dep. Expense Adjustment
304	Structures & Improvements	\$121,703	(\$1,335)	\$123,038	3.03%	(\$40)
309	Supply Mains	39,121	39,121	0	2.86%	1,118
310	Power Generated Equipment	40,219	40,219	0	5.00%	2,011
311	Pumping Equipment	18,028	(40,219)	58,247	5.00%	(2,011)
331	Transmission & Distribution Mains	1,007,463	<u>(39,121)</u>	1,046,584	2.33%	<u>(910)</u>
	Water adjustment		(\$1,335)			\$167
354	Structures & Improvements	\$234,920	\$1,335	\$233,585	3.13%	\$42
360	Collection - Sewers Forced	337,776	(54,404)	392,180	3.33%	(1,813)
361	Collection - Sewers Gravity	951,626	54,404	897,222	2.22%	1,209
371	Pumping Equipment	0	0	0	5.00%	0
380	Treatment & Disposal Equipment	313,118	313,118	0	5.56%	17,395
381	Plant Sewers	25,411	(313,340)	338,751	2.86%	(8,953)
389	Other Plant & Misc. Equipment	222	<u>222</u>	0	5.56%	<u>12</u>
	Wastewater adjustment		\$1,335			\$7,892

1) The depreciation expense adjustment is calculated based on multiplying the reclassified balance times the depreciation rate.

Schedule D for Exception No. 2

Transferred Accumulated Depreciation Balance - Selected Accounts

Account Number	Account Description	Reverse Transfer Acc. Dep. Adjustment	Cumulative Acc. Dep. Adjustment	Total Acc. Dep. Adjustment
304	Structures & Improvements	\$0	\$121	\$121
309	Supply Mains	(6,725)	(3,353)	(10,078)
310	Power Generated Equipment	(13,013)	(6,033)	(19,046)
311	Pumping Equipment	13,013	6,033	19,046
331	Transmission & Distribution Mains	<u>6,725</u>	<u>2,729</u>	<u>9,454</u>
	Water adjustment	\$0	(\$502)	(\$502)
354	Structures & Improvements	\$0	(\$125)	(\$125)
360	Collection - Sewers Forced	0	5,440	5,440
361	Collection - Sewers Gravity	0	(3,627)	(3,627)
371	Pumping Equipment	(49,476)	0	(49,476)
380	Treatment & Disposal Equipment	(27,649)	(52,186)	(79,835)
381	Plant Sewers	77,125	26,858	103,983
389	Other Plant & Misc. Equipment	<u>0</u>	<u>(37)</u>	<u>(37)</u>
	Wastewater adjustment	\$0	(\$23,677)	(\$23,677)

- 1) The cumulative Acc. Dep. adjustment is calculated as three times the depreciation expense adjustment in Schedule A. (2002-1999)
- 2) The total Acc. Dep. adjustment is calculated as the sum of the reversed Acc. Dep. adjustment plus the cumulative Acc. Dep. adjustment.

Exception No. 3

Subject: Lake Grove Utilities, Inc.-Retirements at Transfer

Statement of Fact: On January 26, 1999, Commission Order No. PSC-99-0164-FOF-WS approved the transfer of majority organizational control of Lake Groves Utilities, Inc. (LGU) to Utilities, Inc.

Utilities, Inc. had assumed operations of LGU in 1998 pending the approval of the above transfer application.

NARUC, Class A, Accounting Instruction 27 B(2), states that when a retirement unit is retired from utility plant, with or without replacement, the book cost thereof shall be credited to the utility plant account in which it is included. If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to the utility plant shall be charged to the accumulated depreciation applicable to such property.

Recommendation: The utility’s water UPIS and accumulated depreciation balances are overstated by \$11,779, respectively, and its wastewater UPIS and accumulated depreciation balances are overstated by \$2,088, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The audit staff conducted a tour of the LGU water and wastewater plant operations site on June 17, 2003, with the utility’s Regional Director of Operations who oversees plant operations for the LUSI and LGU systems. During the tour, the auditor compiled an inventory of general plant equipment noted at the water and wastewater plant sites. Employees stated that all of the equipment and tools were the property of Utilities, Inc. prior to the transfer from Greater Groves Corporation (seller) in 1998. Additionally, the audit staff’s review of the books and records of LGU and LUSI indicates the installation of new laboratory facilities in 2000 and a new office and storage facility in 2002.
- 2) The audit staff’s review of the books and records of LGU indicates a transfer balance of \$13,867 (\$11,779 + \$2,088) of tools, office equipment and storage facilities that are no longer in service at LGU and should be retired from its utility plant and accumulated depreciation accounts.

<u>Acct. No.</u>	<u>Amount</u>	<u>Acct. No.</u>	<u>Amount</u>
304	(\$1,513)	354	(\$1,513)
340	(575)	393	(575)
343	(4,520)		(\$2,088)
344	(1,989)		
346	(460)		
348	(2,722)		
	(\$11,779)		

Additionally, the utility’s water and wastewater depreciation expense are overstated by \$817 and \$85, respectively, for the 12-month period ended December 31, 2002, which represents one year of depreciation expense on the above retirement amounts.

Exception No. 4

Subject: UPIS - Adjustments to Invoiced Additions

Statement of Fact: The utility's books and records reflect invoiced water and wastewater additions of \$196,003 and \$5,766, respectively, for utility plant during the period 1996 through 2002.

NARUC, Class A, Accounting Instruction 2. A., requires that all books of accounts, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to fully support the facts pertaining to such entries.

Per Rule 25-30.433 (8), Florida Administrative Code (F.A.C.), non-recurring expenses shall be amortized over a five-year period unless a shorter time can be justified.

Commission Orders Nos. 25821, issued February 27, 1992, and PSC-94-0739-FOF-WS, issued June 16, 1994, determined that the purchased cost of utility systems is to be charged as acquisition adjustments, not as organization cost.

Recommendation: The utility's water and wastewater UPIS are overstated by \$191,791 and \$5,766, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The utility improperly recorded a retirement in 1997 that overstated its water UPIS by \$1,800.
- 2) The utility improperly recorded \$77,521 of water and \$1,082 of wastewater UPIS additions that should have been deferred and amortized per the rule cited above.
- 3) The utility improperly recorded \$7,307 of water and \$1,583 of wastewater acquisition and merger costs for the transfer of LGU that should have been recorded as an acquisition adjustment at the time of transfer or merger per the Commission Order cited above.
- 4) The utility failed to provide supporting documentation for \$66,278 of water UPIS invoices which should be removed per the Commission rule cited above.
- 5) The utility's Annual Report which is the filing used in this overearnings investigation contains an unknown addition of \$5,325 of water UPIS that should be removed because it is not recorded in its general ledger.
- 6) The utility improperly recorded \$36,432 of water and \$229 of wastewater invoiced and capitalized the operators' time to UPIS that should have been recorded as operating and maintenance (O&M) expense in the year incurred.
- 7) The utility improperly recorded \$2,872 of wastewater UPIS that should be recorded in water UPIS.

Water adjustments of \$2,872 - \$1,800 - \$77,521 - 7,307 - \$66,278 - \$5,325 - \$36,432 = -\$191,791
Wastewater adjustments of -\$1,082 - \$1,583 - \$229 - \$2,872 = -\$5,766

Additionally, the utility's water and wastewater accumulated depreciation balances are overstated by \$7,689 and \$271, respectively, as of December 31, 2002. Its water and wastewater depreciation expenses are overstated by \$7,739 and \$158 for the 12-month period ended December 31, 2002, for the above retirement amounts.

See Schedule E that follows for additional details.

Schedule E for Exception No. 4

Acct. No.	Account Description	UPIS Adjustment	Depreciation Rate	Acc. Dep./Dep. Exp. Adjustment
301	Organization	(\$17,729)	2.50%	(\$443)
304	Structures & Improvements	(4,501)	3.03%	(136)
307	Wells & Springs	(22,139)	3.33%	(738)
311	Pumping Equipment	(79,063)	5.00%	(3,953)
320	Water Treatment Equipment	(8,197)	4.55%	(373)
330	Dist. Reservoirs & Standpipes	(5,171)	2.70%	(140)
331	Transmission & Distribution Mains	(27,021)	2.33%	(628)
333	Services	(14,922)	2.50%	(373)
334	Meters & Meter Installations	(8,005)	5.00%	(400)
344	Laboratory Equipment	0	6.67%	0
346	Communication Equipment	<u>(5,044)</u>	10.00%	<u>(504)</u>
	Total water adjustment	(\$191,791)		(\$7,689)

Acct. No.	Account Description	UPIS Adjustment	Depreciation Rate	Acc. Dep./Dep. Exp. Adjustment
353	Franchise (1)	(\$1,813)	2.50%	(\$158)
381	Plant Sewers	<u>(3,954)</u>	2.86%	<u>(113)</u>
	Total wastewater adjustment	(\$5,767)		(\$271)

(1) The entire wastewater UPIS balance of \$1,813 is being removed. Therefore, the entire accumulated depreciation balance of \$158 is being removed as well. However, the adjustment to depreciation expense is limited to the accrual of \$45 in year 2002. Therefore, the total reduction to wastewater depreciation expense is \$158 for the 12-month period ended December 31, 2002. (\$45 + \$113)

Exception No. 5

Subject: UPIS - Construction Project Account Additions

Statement of Fact: The utility uses a construction project account system to record accruals for major utility projects which are subsequently closed out to UPIS upon completion.

Rule 25-30.116 1(d)3, F.A.C., states that when a project is completed and ready for service, it shall be immediately transferred to the appropriate plant account(s) and may no longer accrue AFUDC.

Recommendation: The utility's water and wastewater UPIS and accumulated depreciation are overstated by \$193,871 and \$261,198 and \$72,201 and \$88,353, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The audit staff conducted a tour of utility operations on July 22, 2003, and determined the following.
 - a) The utility retired several plant items that were not recorded in its books and records.
 - b) The utility abandoned three package wastewater plant systems at Lake Groves when a new wastewater treatment facility was constructed and brought on line in year 2000. The new wastewater plant included two clarifiers of which only one is presently in service.
 - c) The utility changed its pumps and turbines at the Amber Hill water plant, and no retirement was recorded in its books and records.
 - d) The utility removed a hydropneumatic tank from the Vistas water plant and transferred it to related utility system on the west coast of Florida.
- 2) The audit staff's review of the utility's construction projects account system determined the following.
 - e) The utility continued to accrue AFUDC on several projects after the last invoice date, and the project should have been transferred to a UPIS account per the Commission rule cited above.
 - f) The utility could not provide any supporting documentation for several of the construction projects sampled.
 - g) The utility failed to make the proper retirements for several of the construction projects that involved replacements of existing utility systems.

The Commission should require the utility to reduce its water and wastewater UPIS and accumulated depreciation by \$193,871 and \$261,198 and \$72,201 and \$88,353, respectively, as of December 31, 2002.

Additionally, the utility's water and wastewater accumulated depreciation balance and depreciation expenses are overstated by \$6,159 and \$53,443, respectively, for the 12-month period ended December 31, 2002, which is one year's accrual of depreciation expense on the above retirement amounts.

See Schedules F and G that follow for additional details.

Schedule F for Exception No. 5

Plant Addition	Year Closed	Work Order Number	Reason for Adjustment	Account	UPIS	Years in Service	Dep. Rate	Dep/Exp Water	Acc/Dep Water
Adjustments to UPIS to remove improper AFUDC accruals:									
Highland Point	1997	115-96-02	Remove two months of accruals recorded after placed in service. (\$219+\$221)	307	(\$440)	5.50	3.00%	(\$15.00)	\$80
South Clermont	1997	115-96-04	Remove one month of accruals recorded after place in service.	331	(401)	3.50	2.33%	(9)	33
Vistas/Oranges	1999	115-99-03	Remove two months of accruals recorded after reimbursement by the Fla. DOT. (\$773+\$555)	331	(1,228)	3.50	2.33%	(29)	100
Lake Saunders	2000	115-98-01	Remove four months of accruals recorded after placed in service. (\$565+\$570+\$574+\$579)	307	(2,288)	2.50	3.30%	(76)	189
Amber Hill	2000	115-99-01	Remove twelve months of accruals after work was completed and project canceled.	330	(7,026)	2.50	2.70%	(190)	474
Lake Groves WTP	2001	115-99-02	Remove three months of accruals recorded after DEP permit issued. (\$5,993+\$6,504+\$6,588)	304	(19,085)	1.50	3.03%	(578)	867
Vistas/Oranges	2001	115-99-04	Remove ten months of accruals recorded after placed in service.	330	(73,999)	1.50	2.70%	(1,998)	2,997
LUSI Water Main	2002	115-2-1	Remove six months of accruals recorded after placed in service. (\$627+\$720+\$726+\$732+\$738+\$744)	331	(4,287)	1.50	2.33%	(100)	150
Adjustments to UPIS to retire UPIS removed from service:									
Vistas	2000		Move Hydro Tank to Ft. Myers.	304	(5,000)		3.13%	(157)	5,000
Amber Hill	2000		Retire UPIS additions @ 75%.	307	(59,767)		3.33%	(1,990)	59,767
Adjustments to UPIS for invoices that lacked supporting documentation:									
	2000	89-661-115-00-01	AFUDC	311	(169)	2.50	5.00%	(8)	21
	2000	89-661-115-00-01		311	<u>(20,181)</u>	2.50	5.00%	<u>(1,009)</u>	<u>2,523</u>
Total audit staff adjustment						(\$193,871)		(\$6,159)	\$72,201

Acct. No	Summary of UPIS Adjustments					Summary of Acc/Dep Adjustments					Summary of Dep. Expense Adjustments				
304	(\$19,085)	(\$5,000)	-na-	=	(\$24,085)	\$867	\$5,000	-na-	=	\$5,867	(\$578)	(\$157)	-na-	=	(\$735)
307	(440)	(2,288)	(59,767)	=	(62,495)	80	189	59,767	=	60,036	(15)	(76)	(1,990)	=	(2,081)
311	(169)	(20,181)	-na-	=	(20,350)	21	2,523	-na-	=	2,544	(8)	(1,009)	-na-	=	(1,017)
330	(7,026)	(73,999)	-na-	=	(81,025)	474	2,997	-na-	=	3,471	(190)	(1,998)	-na-	=	(2,188)
331	<u>(401)</u>	<u>(1,228)</u>	<u>(4,287)</u>	=	<u>(5,916)</u>	<u>33</u>	<u>100</u>	<u>150</u>	=	<u>283</u>	<u>(9)</u>	<u>(29)</u>	<u>(100)</u>	=	<u>(138)</u>
Total	(\$27,121)	(\$102,696)	(\$64,054)	=	(\$193,871)	\$1,475	\$10,809	\$59,917	=	\$72,201	(\$800)	(\$3,269)	(\$2,090)	=	(\$6,159)

Schedule G for Exception No. 5

Plant Addition	Year Closed	Work Order Number	Reason for Adjustment	Account	UPIS	Years in Service	Dep. Rate	Dep/Exp Water	Acc/Dep Water
Adjustments to correct CWIP addition:									
Lake Groves	2000	116-99-01	Reclassify CWIP addition for WWTP.	380	2,381,020	2	5.56%	132,279	(264,558)
Lake Groves	2001	116-99-01	Remove three months of accruals recorded after placed in service. (\$16,226+\$16,761+\$16,901).	380	(49,888)	2	5.56%	(\$2,772)	\$5,543
Lake Groves	2000	116-99-01	Reclassify CWIP addition for WWTP.	381	(2,381,020)	2	2.86%	(68,029)	136,058
Adjustment to UPIS to retire WWTP removed from service									
Lake Groves	2000		Retire Phase 1 WWTP.	354	(54,833)		3.13%	(1,714)	54,833
Lake Groves	2000		Retire Phase 1 WWTP.	380	(41,244)		5.56%	(2,291)	41,244
Lake Groves	2000		Retire Phase 1 WWTP.	382	(10,651)		3.33%	(355)	10,651
Lake Groves	2000		Retire Phase 2 WWTP.	354	(80,546)		3.13%	(2,517)	80,546
Lake Groves	2000		Retire Phase 2 WWTP.	380	(982)		5.56%	(55)	982
Lake Groves	2000		Retire Phase 2 WWTP.	382	(6,067)		3.33%	(202)	6,067
Lake Groves	2000		Retire additions to Phase 1&2 WWTP.	354	(1,740)		3.13%	(54)	1,740
Lake Groves	2000		Retire additions to Phase 1&2 WWTP.	380	(15,025)		5.56%	(835)	15,025
Lake Groves	2000		Retire additions to Phase 1&2 WWTP.	389	(222)		5.56%	(12)	222
Total audit staff adjustment						(\$261,198)		\$53,443	\$88,353

Acct. No	Summary of UPIS Adjustments						Summary of Acc/Dep Adjustments					
354	(\$54,833)	(\$80,546)	(\$1,740)	-na-	-na-	= (\$137,119)	\$54,833	\$80,546	\$1,740	-na-	-na-	= \$137,119
380	2,381,020	(49,888)	(41,244)	(982)	(15,025)	= 2,273,881	(264,558)	5,543	41,244	982	15,025	= (201,764)
381	(2,381,020)	-na-	-na-	-na-	-na-	= (2,381,020)	136,058	-na-	-na-	-na-	-na-	= 136,058
382	(10,651)	(6,067)	-na-	-na-	-na-	= (16,718)	10,651	6,067	-na-	-na-	-na-	= 16,718
389	(222)	-na-	-na-	-na-	-na-	= (222)	222	-na-	-na-	-na-	-na-	= 222
Total	(\$65,706)	(\$136,501)	(\$42,984)	(\$982)	(\$15,025)	= (\$261,198)	(\$62,794)	\$92,156	\$42,984	\$982	\$15,025	= \$88,353

Acct. No	Summary of Dep. Expense Adjustments					
354	(\$1,714)	(\$2,517)	(\$54)	-na-	-na-	= (\$4,285)
380	132,279	(2,772)	(2,291)	(55)	(835)	= 126,326
381	(68,029)	-na-	-na-	-na-	-na-	= (68,029)
382	(355)	(202)	-na-	-na-	-na-	= (557)
389	(12)	-na-	-na-	-na-	-na-	= (12)
Total	\$62,169	(\$5,491)	(\$2,345)	(\$55)	(\$835)	= \$53,443

Exception No. 6

Subject: UPIS - Transportation Equipment

Statement of Fact: The utility’s records reflect balances of \$132,969, \$54,354, and \$21,291, respectively, for its water UPIS transportation account.

Recommendation: The utility’s water UPIS, accumulated depreciation, and depreciation expenses are overstated by \$74,767, \$47,302 and \$14,731, respectively, while its wastewater UPIS accumulated depreciation is understated by \$21,654, \$2,624 and \$2,441, respectively, for the 12-month period ended December 31, 2002, based on the following audit staff determinations.

- 1) The audit staff conducted a tour of the LGU water and wastewater plant operations site on June 17, 2003, with the utility’s Regional Director of Operations who oversees plant operations for the LUSI and LGU systems. During the tour, the auditor compiled an inventory of the transportation vehicles that are assigned to LUSI. It was determined that five pick-up trucks were assigned to LUSI in 2002.
- 2) The audit staff requested invoices for the five pick-up trucks mentioned above and determined that they have a total invoice cost of \$79,856. Four of the five trucks were purchased in 2002, and one was purchased in 2001.
- 3) The utility did not allocate any of the transportation account to its wastewater system. The audit staff’s allocation is based on the number of water and wastewater customers reported in its allocation manual. See the table below for the audit staff’s recommended adjustments.

	Allocation Ratio	Amount	Dep. Exp. @12/31/2001	Dep. Exp. @12/31/2002	Acc. Dep. @12/31/2002
Per Audit Balance:	100.00%	\$79,856	\$674	\$9,001	(\$9,675)
Acct. No. 341 - Transportation Equip.	72.88%	\$58,202		\$6,560	(\$7,052)
Acct. No. 391 - Transportation Equip.	27.12%	\$21,654		\$2,441	(\$2,624)
Per Utility Balance:	100.00%	\$132,960		\$21,291	(\$54,354)
Acct. No. 341 - Transportation Equip.	100.00%	\$132,960		\$1,291	(\$54,354)
Acct. No. 391 - Transportation Equip.	0.00%	\$0		\$0	\$0
Audit Adjustment:		(\$53,113)		(\$12,290)	\$44,679
Acct. No. 341 - Transportation Equip.		(\$74,767)		(\$14,731)	\$47,302
Acct. No. 391 - Transportation Equip.		\$21,654		\$2,441	(\$2,624)

Depreciation expense was calculated consistent with utility policy based on the month each truck was placed in service at a rate of 16.67 percent.

Exception No. 7

Subject: Allocated Common Plant-UIF

Statement of Fact: The utility's Annual Report reflects balances of \$117,651, and \$28,762, for allocated UPIS and accumulated depreciation, respectively, from Utilities, Inc. of Florida (UIF) in its water system accounts for the 12-month period ended December 31, 2002.

Recommendation: The utility's water UPIS and accumulated depreciation are overstated by \$33,594 and \$9,659, respectively, while its wastewater UPIS and accumulated depreciation is understated by \$31,274 and \$7,107, respectively, for the 12-month period ended December 31, 2002, based on the following audit staff determinations.

- 1) The utility did not allocate any of the UIF allocated cost to its wastewater system. The audit staff's allocation is based on the number of water and wastewater customers reported in its allocation manual.
- 2) The audit staff, in Docket No. 020071-WS, made specific adjustments to UIF's allocated rate base that effectively reduces LUSI allocated UPIS, and accumulated depreciation by \$2,320 and \$2,552, respectively, for the 12-month period ended December 31, 2002.

	Per Utility		Adjustment		Per Audit(1)	
	<u>Water</u>	<u>Wastewater</u>	<u>Water</u>	<u>Wastewater</u>	<u>Water</u>	<u>Wastewater</u>
UPIS	\$117,651	\$0	(\$33,594)	\$31,274	\$84,057	\$31,274
Acc. Dep.	(\$28,762)	\$0	\$9,659	(\$7,107)	(\$19,103)	(\$7,107)

UPIS combined adjustment of \$2,320 (\$31,274-\$33,594)
Accumulated depreciation combined adjustment of \$2,552 (\$9,659-\$7,107)
Allocated based on customer percentages identified above.
(Example: \$117,651 - \$2,320 x 72.33% = \$84,057)

Exception No. 8

Subject: Allocated Common Plant - WSC

Statement of Fact: The 2002 Water Service Corporation (WSC) allocation manual calculated a net rate base allocation amount of \$61,979 for LUSI as of December 31, 2002.

The utility did not include the above allocated net rate base amount from WSC in its financial records or its 2002 Annual Report.

Recommendation: The utility's UPIS is understated by \$63,521 or by \$46,296 and \$17,225, for its water and wastewater UPIS, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The utility did not include the WSC rate base allocation in its 2002 Annual Report.
- 2) Deferred taxes included in the WSC rate base calculation should be removed because they are included as a component of the utility's cost of capital.
- 3) The mainframe computer system costs, micro system costs along with the corresponding accumulated depreciation and amortization account balances should be removed per Commission Order No. PSC-03-0647-PAA-WS, issued May 28, 2003, which removed these items from the WSC allocated rate base to Cypress Lakes Utilities, Inc., which is a related utility system.
- 4) The mini-computer and its corresponding accumulated depreciation account balances are \$125,018 and \$61,572, respectively, as of December 31, 2002, based on the balances determined in the Commission Order mentioned in Item No. 3 and year 2002 additions that the audit staff sampled for this investigation. See Schedule H that follows for details.
- 5) An addition in 2002 to the WSC furniture and fixtures account includes an invoiced item that should have been charged to Carolina Water Service, Inc., which is a related utility system. The work order amounted to \$27,500 and its corresponding depreciation accrual is \$1,375.
- 6) The audit staff's allocation of WSC net rate base is based on the number of water and wastewater customers reported in its allocation manual.

Based on the above-mentioned audit staff determinations, the WSC allocation manual's total net rate base to be allocated to LUSI should be increased by \$43,855 which results in a net increase of \$1,542 to LUSI from WSC for its common rate base allocation.

See Schedule I that follows for additional details.

Schedule H for Exception No. 8

Microcomputers per utility inventory:

Year	UPIS	Acc/Dep	Dep. Expense
1999	\$25,405.25	(\$25,405.25)	\$4,234.21
2000	22,608.96	(18,840.80)	7,536.21
2001	13,475.50	(6,737.76)	4,491.84
2002	<u>63,528.26</u>	<u>(10,588.08)</u>	<u>10,588.08</u>
	\$125,017.97	(\$61,571.89)	\$26,850.34

The audit staff used the 1999-2001 inventory additions approved in the previously mentioned Cypress Lakes Order and increased the computer inventory by \$63,528 for additions sampled in year 2002. Additionally, the audit staff has increased accumulated depreciation and depreciation expense for the year 2002 by \$10,588 to reflect balances of \$61,572 and \$26,850, respectively. WSC also has router equipment that is recorded in Account No. 105 - Construction-Work-in-Progress (CWIP) as of December 31, 2001, that is not included in the above inventory amounts.

Schedule I for Exception No. 8

WSC Account	Balance per Utility	Audit Adjustment	Balance per Audit	Allocation Code	LUSI %	LUSI Amount
Land and Land Rights	\$95,000		\$95,000	5	2.758%	\$2,620
Office Structures	2,677,206		2,677,206	5	2.758%	73,837
Office Furniture	1,140,777	(27,500)	1,113,277	5	2.758%	30,704
Telephone	120,696		120,696	5	2.758%	3,329
Tools Shop and Misc. Equipment	20,139		20,139	3	0.000%	0
Communication Equipment	<u>256,945</u>		<u>256,945</u>	5	2.758%	7,087
Total Plant	4,310,763	(27,500)	4,283,263		13.790%	117,577
Acc/Dep Office Structures	(917,462)		(917,462)	5	2.758%	(25,304)
Acc/Dep Office Furniture	(893,874)	1,375	(892,499)	5	2.758%	(24,615)
Acc/Dep Telephone	(93,294)		(93,294)	5	2.758%	(2,573)
Acc/Dep Tools Shop and Misc. Equipment	(20,170)		(20,170)	3	0.000%	0
Communication Equipment	<u>(161,926)</u>		<u>(161,926)</u>	5	2.758%	(4,466)
Total Acc/Dep	(2,086,726)	1,375	(2,085,351)			(56,958)
Plant in Progress	17,929		17,929	5	2.758%	494
Deferred Charges Employee Finder Fees	22,005		22,005	1	3.387%	745
Mainframe Computer	377,085	(377,085)	0	4	2.620%	0
Mini-Computers	725,319	(600,301)	125,018	4	2.620%	3,275
Acc/Dep Mainframe Computer	(353,247)	353,247	0	4	2.620%	0
Acc/Dep Mini-Computers	(549,863)	488,291	(61,572)	4	2.620%	(1,613)
Computer System Cost	822,748	(822,748)	0	4	2.620%	0
Micro System Cost	115,738	(115,738)	0	4	2.620%	0
Computer System - Amortization	(738,763)	738,763	0	4	2.620%	0
Micro System Amortization	<u>(94,620)</u>	<u>94,620</u>	<u>0</u>	4	2.620%	<u>0</u>
	304,397	(240,951)	63,446			1,662
Deferred Taxes	(310,931)	310,931	0	5	2.758%	0
Total Net Rate Base	<u>\$2,257,437</u>	<u>\$43,855</u>	<u>\$2,301,292</u>			<u>\$63,521</u>
Allocation per Utility						<u>\$61,979</u>
Audit Staff Adjustment						<u>\$1,542</u>

Exception No. 9

Subject: Land and Land Rights

Statement of Facts: The utility's records reflect balances of \$443,476 and \$468,355 for its water and wastewater land as of December 31, 2003.

Recommendation: The utility's water and wastewater land balances are overstated by \$327,313 and \$392,497, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The utility failed to record the prior Order adjustment that increased water land by \$357 as discussed in Exception No. 1 of this report.
- 2) The utility recorded invoiced additions that increased its water and wastewater land accounts by \$16,444 and \$984, respectively, from 1999 through 2002.
 - a) Of the above amounts, \$1,437 and \$547 should be removed from the water and wastewater land account balances because the utility did not provide any supporting documentation for the entries.
 - b) Of the above amounts, \$4,456 should be removed from the water land account balance because it relates to professional fees for possible land lease assessments, land appraisals, and land use assessments that should be charged to O&M expense in the year incurred.
- 3) The utility's Annual Report, which is the filing used in this overearnings investigation, includes an unknown addition of \$2,667 for water land that should be removed because it is not recorded in its general ledger.
- 4) The utility's transfer balances for water and wastewater land from its merger with LGU should be reduced by \$319,110 and \$391,950 to properly reflect the actual land that is being used to provide utility services. See the discussion that follows.

Water adjustments of \$357 - \$1,437 - \$4,456 - \$2,667 - \$319,110 = -\$327,313

Wastewater adjustments of -\$547 - \$391,950 = -\$392,497

LGU purchased 95.35 acres of property in 1990 for \$861,242 which was used to construct its water and wastewater utility plant systems. In 1991, LGU records recorded an additional \$26,763 to its land accounts. At the time of transfer to Utilities, Inc., its records reflected land account balances of \$420,634 and \$467,370 for the water and wastewater systems, respectively, as of December 31, 1998.

The audit staff determined from a property survey obtained during this proceeding that approximately 19.59 acres or 20.55 percent of the original 95.35 acres are presently being used to provide utility services. Of the 20.55 percent, approximately 11.24 acres or 57.38 percent are used by the water system and 8.35 acres or 42.62 percent are used by the wastewater system. The balance of 75.76 acres or 79.45 percent is not presently needed to provide utility services.

Exception No. 9, continued

The audit staff recommends the following adjustments to the LGU transfer land account balances.

- 1) Remove the \$26,763 addition in 1991 because no supporting documentation could be found to support its inclusion.
- 2) Remove 79.45 percent of the \$861,242 purchase price and record it in land held for future use.
- 3) Allocate the remaining utility balance of \$176,945 to the respective water and wastewater land per the ratios determined above. See the audit staff's calculations below.

Original Cost of Land		Remove Nonutility @ 79.45 %		Utility Cost of Land	
\$861,242		(\$684,296)		\$176,945	
Per Utility		Audit Adjustment		Per Audit	
Water	Wastewater	Water	Wastewater	Water	Wastewater
\$420,634	\$467,370	(\$319,110)	(\$391,950)	\$101,524	\$75,421
47.37%	52.63%			57.38%	42.62%

Exception No. 10

Subject: Construction-Work-in-Progress (CWIP)

Statement of Facts: The utility's records reflect balances of \$2,108,799 and \$311,084 for its water and wastewater CWIP as of December 31, 2002.

The utility included the above balances in its 2002 Annual Report as a part of its net rate base as of December 31, 2002.

Per Rule 25-30.116 (1), F.A.C., CWIP that is not included in rate base may accrue allowance-for-funds-used-during-construction (AFUDC).

Order No. PSC 95-1490-FOF-WS, issued November 30, 1995, approved an AFUDC rate of 10.03 percent for LUSI effective January 1, 1995.

Recommendation: The utility's net rate base balances are overstated by \$2,108,799 and \$311,084 for its water and wastewater systems as of December 31, 2002.

Utility records indicate that it has accrued monthly AFUDC charges on its CWIP since the above-mentioned Order was issued.

Per the Commission rule cited above, the CWIP balances stated above should be removed from rate base calculations.

Additionally, the Commission should revisit the utility's approved AFUDC rate and calculate a new AFUDC rate based on the utility's current cost of capital which is discussed later in this report.

Exception No. 11

Subject: Contributions-in Aid-of-Construction (CIAC) and Accumulated Amortization of CIAC

Statement of Fact: The utility's records reflect balances of \$8,341,036 and \$2,783,587 and balances of \$993,168 and \$334,146 for its water and wastewater CIAC and accumulated amortization of CIAC as of December 31, 2002.

Rule 25-30.140(8)(a), F.A.C., requires the amortization of CIAC using a composite plant amortization rate when supporting documentation is not available to identify the account or function of the related CIAC balances.

Recommendation: The utility's water and wastewater CIAC balances are understated by \$84,159 and \$3,725, respectively as of December 31, 2002. Additionally, its water and wastewater accumulated amortization of CIAC balances are understated by \$117,592 and \$80,462, respectively, as of December 31, 2002, based on the following audit staff determinations.

- 1) The utility failed to record the prior Order adjustment that increased its water CIAC and accumulated amortization of CIAC by \$184,949 and \$15,309 respectively as discussed in Exception No. 1 of this report. The audit staff's actions discussed below incorporate the cumulative effect of this adjustment on the accumulated amortization balance as of December 31, 2002.
- 2) The utility's December 31, 1995, water CIAC Annual Report balance of \$1,155,180 exceeds its December 31, 1995, general ledger balance of \$1,058,113 by \$97,065. The \$97,065 represents the difference between the utility's general ledger December 31, 1995, ending CIAC balance and its general ledger January 1, 1996, beginning CIAC balance and should be removed.
- 3) The utility improperly recorded a \$3,725 water CIAC addition to its wastewater CIAC account which should be reversed.
- 4) The utility recorded adjustments that reduced its 1998 water and wastewater accumulated amortization accounts by \$23,367 and \$19,863 as acquisition adjustments. No supporting documentation was provided when requested to explain the utility's position. Therefore, the audit staff has removed the aforementioned utility adjustments.
- 5) The audit staff's analytical review of the utility's yearly accumulated amortization of CIAC accruals for its water plant indicates that it used an average composite amortization rate of 1.16 percent for LGU and 1.22 percent for LUSI. The average composite amortization rate for its wastewater plant was 1.17 percent. In no year did the utility's average composite amortization rates exceed 1.6 percent for any of its water or wastewater systems. The audit staff's analytical review indicates that the actual average composite rates for each of the systems were approximately 3.27 percent for LGU water, 2.88 percent for LUSI water, and 3.42 percent for LGU wastewater systems. The audit staff has recalculated the accruals to LGU and LUSI accumulated amortization of CIAC and incorporated the adjustments discussed in Item Nos. 1-5 above. The audit staff's calculation increases the utility's water and wastewater accumulated amortization of CIAC balances by \$78,916 and \$60,599, respectively, as of December 31, 2002.

Exception No. 11, continued

Summary of Adjustments

Water CIAC calculated as $\$97,065 + \$3,725 - \$184,949$

Water AAC calculated as $\$23,367 + \$78,916$ and

Wastewater AAC calculated as $\$60,599 + \$19,860$

Additionally, the above adjustments will require an increase of \$9,023 and \$33,275 to amortization of CIAC expense for the 12-month period ended December 31, 2002.

Exception No. 12

Subject: Accumulated Depreciation

Statement of Facts: The utility's records reflect balances of \$1,332,292 and \$654,686 for its water and wastewater accumulated depreciation as of December 31, 2002.

NARUC, Class A, Balance Sheet, Account 186 A. (8) includes other debit balances, the proper final disposition of which is uncertain, and unusual or extraordinary expenses, not included in other accounts which are in the process of being written off.

NARUC, Class A, Accounting Instruction 27 B(2), states that when a retirement unit is retired from utility plant, with or without replacement, the book cost thereof shall be credited to the utility plant account in which it is included. If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to the utility plant shall be charged to the accumulated depreciation applicable to such property.

Recommendation: The utility's water accumulated depreciation balance is overstated by \$83,468, and its wastewater accumulated depreciation balance is understated by \$76,034 respectively, as of December 31, 2002, based on the following audit staff determinations.

Exceptions Nos. 1 through 7 of this report reduced water and wastewater accumulated depreciation balances by \$85,991 and \$57,304, respectively, as of December 31, 2002.

The above audit staff adjustments result in a combined water and wastewater over-retirement of \$2,519 and \$133,338, respectively, to selected plant accounts as of December 31, 2002. See Schedule J that follows for details.

Per the NARUC rule cited above, the balances determined in Item No. 3 should be transferred to Account No. 186 pending Commission disposition on this issue.

Alternatively, the audit staff proposes that the entire balance of \$135,857 (\$133,338 + \$2,519) be offset against the audit staff's adjustment in Exception No. 11 of this report which resulted in an increase of \$139,515 (\$78,916 + \$60,599) to the utility's accumulated amortization of CIAC balance. The offsetting of these two amounts will result in a net regulatory asset of \$3,658 that can be recorded in Account No. 186, Miscellaneous Deferred Debits per the NARUC rule cited above pending the Commission's disposition on this issue.

Schedule J for Exception No. 12

<u>Acct#</u>	<u>Acct. Description</u>	<u>Per Utility</u>	<u>E-1</u>	<u>E-2</u>	<u>E-3</u>	<u>E-4</u>	<u>E-5</u>	<u>E-6&7</u>	<u>E-12</u>	<u>Per Audit</u>
301	Organization	(\$32,907)	\$19,873	\$0	\$0	\$443	\$0	\$0	\$0	(\$12,591)
304	Structures & Improvements	(72,561)	(11,544)	121	1,513	136	5,867	0	0	(76,468)
307	Wells & Springs	(158,338)	(29,989)	0	0	738	60,036	0	0	(127,553)
309	Supply Mains	0	0	(10,078)	0	0	0	0	0	(10,078)
311	Pumping Equipment	(41,341)	616	(19,046)	0	3,953	2,544	0	0	(53,274)
320	Water Treatment Equipment	(39,478)	(18,070)	19,046	0	373	0	0	0	(38,129)
330	Dist. Reservoirs & Standpipes	(71,056)	(6,060)	0	0	140	3,471	0	0	(73,505)
331	Trans. & Distribution Mains	(652,538)	(610)	9,454	0	628	283	0	0	(642,783)
333	Services	(104,567)	(7,515)	0	0	373	0	0	0	(111,709)
334	Meters & Meter Installations	(48,098)	(2,522)	0	0	400	0	0	0	(50,220)
335	Hydrants	(18,951)	(6,542)	0	0	0	0	0	0	(25,493)
340	Office Furniture & Equipment	(1,039)	0	0	575	0	0	0	0	(464)
341	Transportation Equipment	(54,354)	0	0	0	0	0	47,302	0	(7,052)
343	Tools, Shop, & Garage Equip.	(7,724)	224	0	4,520	0	0	0	0	(2,980)
344	Laboratory Equipment	(2,133)	0	0	1,989	0	0	0	0	(144)
346	Communication Equipment	1,555	0	0	460	504	0	0	(2,519)	0
348	Other Tangible Plant	(28,764)	0	0	2,722	0	0	9,659	0	(16,383)
	Total UPIS	(\$1,332,295)	(\$62,137)	(\$502)	\$11,779	\$7,689	\$72,201	\$56,961	(\$2,519)	(\$1,248,827)
<u>Acct#</u>	<u>Acct. Description</u>	<u>Per Utility</u>	<u>E-1</u>	<u>E-2</u>	<u>E-3</u>	<u>E-4</u>	<u>E-5</u>	<u>E-6&7</u>	<u>E-12</u>	<u>Per Audit</u>
351	Organization	(\$895)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	(\$895)
352	Franchise	(158)	0	0	0	158	0	0	0	0
354	Structures & Improvements	(69,061)	0	(125)	1,513	0	137,119	0	(69,446)	0
360	Collection - Sewers Forced	(108,295)	0	5,440	0	0	0	0	0	(102,855)
361	Collection - Sewers Gravity	(171,926)	0	(3,627)	0	0	0	0	0	(175,553)
363	Services	(4,439)	0	0	0	0	0	0	0	(4,439)
371	Pumping Equipment	(105,366)	0	(49,476)	0	0	0	0	0	(154,842)
380	Treatment & Disposal Equip.	0	0	(79,835)	0	0	(201,764)	0	0	(281,599)
381	Plant Sewers	(187,794)	0	103,983	0	113	136,058	0	(52,360)	0
382	Outfall Sewer Lines	(5,371)	0	0	0	0	16,718	0	(11,347)	0
389	Other Plant	0	0	(37)	0	0	222	0	(185)	0
390	Office Furniture & Equipment	(154)	0	0	0	0	0	0	0	(154)
391	Transportation Equipment	0	0	0	0	0	0	(2,624)	0	(2,624)
393	Tools, Shop & Garage	(1,226)	0	0	575	0	0	0	0	(651)
398	Other Tangible Plant	0	0	0	0	0	0	(7,107)	0	(7,107)
	Total Acc/Dep	(\$654,686)	\$0	(\$23,677)	\$2,088	\$271	\$88,353	(\$9,731)	(\$133,338)	(730,720)

Exception No. 13

Subject: Working Capital

Statement of Fact: The utility's records reflect balances of \$96,650 and \$33,392 for its water and wastewater working capital of December 31, 2002, which are one-eighth of its operating and maintenance (O&M) expense balances of \$773,200 and \$267,134, respectively, for the 12-month period ended December 31, 2002.

Recommendation: The utility's water and wastewater working capital balances are overstated by \$13,895 and understated by \$6,648, respectively, as of December 31, 2002, based on the effects of Exceptions Nos 16 and 17 of this report which reduced the utility's water O&M expenses by \$111,160 and increased its wastewater O&M expense by \$53,183 to \$662,040 and \$320,317, respectively, for the 12-month period ended December 31, 2002. See the table below.

<u>Working Capital</u>	<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
Per Utility	\$96,650	\$33,392	\$130,042
Adjustment	(13,895)	6,648	(7,247)
Per Audit	\$82,755	\$40,040	\$122,795
	<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
Per Audit O&M Expense	\$662,040	\$320,317	\$982,357
Working Capital Calculated As 1/8 of O&M Expense (1)	\$82,755	\$40,040	\$121,892

- (1) Per the Annual Report instructions, working capital is to be calculated consistent with the utility's last rate proceeding. LUSI was considered a Class B utility in Docket No. 960444-WU, its last rate proceeding. Rule 25-30.433 (2), F.A.C., requires Class B utilities to calculate working capital using the formula method of 1/8 of O&M expense.

Exception No. 14

Subject: Cost of Capital

Statement of Facts: The utility's 2002 Annual Report, Schedule F-5, reflects a weighted cost of capital of 8.78 percent as of December 31, 2002, which was calculated based on the adjusted balances listed below.

<u>Class of Capital</u>	<u>Per Book Balance</u>	<u>Utility Adjusted Balance</u>
Common Equity	\$77,650,144	\$3,514,837
Long -term Debt	115,319,616	5,219,947
Customer Deposits	150,205	6,799
Tax-Credits - Weighted	19,016	861
Deferred Income Taxes	<u>158,312</u>	<u>7,166</u>
Totals	\$193,297,293	\$8,749,610

The company used a 11.10 percent return on equity and a cost rate of 7.24 percent for its long-term debt.

Recommendation: The utility's average weighted cost of capital is 8.596 percent as of December 31, 2002, based on the following audit staff determinations.

- 1) The utility's long-term debt balance was understated by \$2,514,922 and its associated average cost rate was understated by 0.584 percent based on the utility's 2002 general ledger and the audit staff's calculations in Schedule K that follows.
- 2) The utility's tax credit balance of \$19,016 was further defined in its Annual Report on Schedule F-2b, in Account No. 255, Accumulated Deferred Investment Tax Credits. According to the utility's general ledger and the utility's representative, this account balance actually represents an account payable balance due to developers. The audit staff has removed it from its cost of capital calculation.
- 3) The utility's cost of capital calculation included weighted balances for its customer deposits and deferred income taxes. These balances should be included after the parent's debt structure is reconciled to the utility's rate base for the cost of capital calculation.

Exhibit IV of this report calculates the utility's average weighted cost of capital based on the audit staff determinations above using the average long-term debt cost calculated in Schedule L and the utility's cost of equity which is calculated to be 11.149 percent based on the leverage formula approved in Order No. PSC-02-1252-CO-WS, issued on September 11, 2002.

Schedule K for Exception No. 14

Average Short-term Debt (Balances are actual.)

	Bank One		Bank of America				Total			Average			Cost Rate	
Interest Expense	\$334,394		\$321,519				\$655,913			\$16,709,846			3.925%	
Obligation (in 000's)	Dec 2001	Jan 2002	Feb 2002	Mar 2002	Apr 2002	May 2002	Jun 2002	Jul 2002	Aug 2002	Sep 2002	Oct 2002	Nov 2002	Dec 2002	Avg.
American National Bank One	\$12,649	\$12,275	\$12,322	\$15,686	\$16,106	\$16,190	\$16,267	\$17,733	\$0	\$0	\$0	\$0	\$0	\$9,171
Bank of America	<u>11,000</u>	<u>11,000</u>	<u>11,000</u>	<u>11,000</u>	<u>13,500</u>	<u>13,500</u>	<u>13,500</u>	<u>13,500</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>7,538</u>
Total ST Debt	\$23,649	\$23,275	\$23,322	\$26,686	\$29,606	\$29,690	\$29,767	\$31,233	\$0	\$0	\$0	\$0	\$0	\$16,710

Average Long-term Debt (Balances are actual.)

Obligation Interest Rate -- Maturity Date	Balance Outstanding @12/31/2002	Average	Amortiz. of Issuance Cost	Interest Cost	Total Interest & Issuance Cost	Effective Cost Rate
9.16% Note Due April 30, 2006	\$4,000,000	\$4,307,692	\$9,428	\$396,933	\$406,361	9.433%
9.01% Note Due November 30, 2007	7,500,000	8,769,231	16,970	799,638	816,608	9.312%
8.42% Note Due January 20, 2015	41,000,000	41,000,000	77,308	3,452,200	3,529,508	8.609%
7.87% Note Due June 1, 2005	15,000,000	15,000,000	28,283	1,180,500	1,208,783	8.059%
5.41% Note Due August 30, 2012	50,000,000	19,230,769	33,714	909,181	942,895	4.903%
Other Miscellaneous Variable Debt	<u>334,538</u>	<u>339,314</u>	<u>0</u>	<u>Note A</u>	<u>31,941</u>	9.413%
	\$117,834,538	\$88,647,006	\$165,703	\$6,738,452	\$6,936,096	7.824%

Note A - Interest on Bermuda Note is included as other short-term interest expense above.

Exception No. 15

Subject: Water Revenues

Statement of Fact: The utility's records reflect water revenues of \$1,627,914 for the 12-month period ended December 31, 2002.

The utility's Commission water tariff, Twelfth Revised Sheet No. 19.0, effective November 4, 2002, and all previous revisions indicate that the utility is to bill its customers bimonthly for water service.

Rule 25-30.135 (2), F.A.C., states that no utility may modify or revise its rules or regulations or its schedules of rates and charges until the utility files and receives approval from the Commission for any such modification or revision.

Recommendation: The utility's water revenues are overstated by \$7,185 for the 12-month period ended December 31, 2002.

The utility's customer base consists of 15 distinct subdivisions that were all billed on the same two-month billing cycle ending approximately on the 15th day of January, March, May, July, September, and October of each calendar year. At the end of the year, the utility calculates an accrued revenue for the period October 16 through December 31 as 75 percent of the October billing period. The utility then reverses the accrual at the beginning of the new calendar year.

In February 2002, the utility, in an effort to re-balance its billing system, moved 8 of the 15 subdivisions customers to the subsequent month's billing cycle. It accomplished this task by billing the subdivisions' customers for one month's usage and then subsequent billings followed the new billing cycles. The utility calculated the one month bill as one-half the base facility charge plus the gallon usage for each customer in the affected subdivisions.

The utility's methodology violates the Commission rule cited above and resulted in an overcharge to each affected customer by an amount equal to the one-half base facility charge.

For example, the base facility charge (BFC) for a 5/8"x3/4" meter is \$11.94 per bimonthly period. The utility billed the affected customers an extra seventh period in 2002 when it switched their billing cycle to the subsequent month. The extra billing period results in an overcharge of one-half of each customer's BFC or \$5.97 in the example above.

The audit staff calculated the effect of the above billing error for the customers of the eight subdivisions involved and determined that the utility revenues are overstated by \$7,185 and that a refund with interest as calculated per Rule 25-30.360, F.A.C., is owed to the affected customers.

The Commission should require the utility to reduce its water revenues by \$7,185 and refund the excess revenues collected with interest for the 12-month period ended December 31, 2002.

Exception No. 16

Subject: Operating and Maintenance Expenses (O&M)

Statement of Fact: The utility's records reflect balances of \$773,200 and \$267,134 for its water and wastewater O&M expenses for the 12-month period ended December 31, 2002.

The utility allocated its common O&M expense accounts based on the following six methods.

<u>Allocation Method</u>	<u>Account Numbers</u>	<u>Water</u>	<u>Wastewater</u>
Actual Cost	601/701(capitalized salaries), 615/715, 620/720 (16 sub-accounts), and 711	100.00%	100.00%
Revenues 1	604/704, 618/718, 620/720 (1 sub-account), 632/732, 633/733, 636/736, 650/750, 659/759, and 675/775	90.00%	10.00%
Revenues 2	670/770	74.03%	25.91%
Customers 1	601/701	80.00%	20.00%
Customers 2	666/766	73.47%	26.53%
Gross Plant	620/720 (10 sub-accounts)	68.05%	31.95%

Recommendation: The utility's water and wastewater O&M expenses are overstated by \$111,160 and understated by \$53,183, respectively, for the 12-month period ended December 31, 2002, based on the following audit staff determinations.

- 1) The utility's salary expenses are overstated by \$1,278 because it failed to remove retention bonuses paid to some of the Florida office and operations employees in 2002. The bonuses should be considered nonutility expenses because they are merger-related costs paid to key employees as a result of the merger of Utilities, Inc. with Nueon Corporation in 2001. Utilities, Inc. treated all such costs as nonutility expenses in its parent's books and records. The adjustment should be allocated by the customer ratio determined below.
- 2) The utility's salary expenses are overstated by \$871 because the salaries reported in its allocation schedule SE60 did not tie directly to the utility's salary expenses in its general ledger for WSC office salaries. The audit staff has reduced WSC office salaries and LUSI's subsequent allocation to the actual salary expenses recorded in its general ledger. The adjustment should be allocated by the customer ratio determined below.
- 3) The utility's materials and supplies should be decreased by \$445 because it represents LUSI's allocated portion of a sales tax penalty assessed against Utilities, Inc. of Florida (UIF). The adjustment should be allocated by the customer ratio determined below.

Exception No. 16, continued

- 4) The utility's legal fees should be increased by \$4,843 which represents the amount of legal fees removed from its UPIS in Exception No. 4 of this report. The adjustment should be allocated by the customer ratio determined below.
- 5) The utility's contractual services account should be decreased by \$1,092 which represents the WSC allocated computer amortization and program fees that should be removed per the Commission Order cited in Exception No. 8 of this report. The adjustment should be allocated by the customer ratio determined below.
- 6) The utility's water and wastewater contractual services accounts should be increased by \$13,404 and \$216, respectively, to record the amortized portion of non-recurring expenses that were removed from UPIS in Exception No. 4 of this report.
- 7) The utility's rate case expense of \$71,611 should be removed from O&M expenses per the audit staff's findings discussed below.
- 8) The utility's miscellaneous expense account should be reduced by \$620 which records the audit staff's reduction to WSC common expenses discussed in Exception No. 17 of this report. The adjustment should be allocated by the customer ratio determined below.
- 9) The utility's miscellaneous expense account should be reduced by \$522 which records the audit staff's reduction to UIF common expense because the utility could not provide the supporting documentation for the invoices sampled. The adjustment should be allocated by the customer ratio determined below.

The utility's records reflect water and wastewater balances of \$52,613 and \$18,998 for rate case expense charges for the year 2002.

The audit staff's analysis of the utility's deferred rate case expense accounts determined that the utility incurred \$291,843 of rate case expenses in seven separate deferred rate case accounts since its last rate proceeding in Docket No. 96044-WU. The utility began amortizing the balance to O&M Accounts Nos. 666 and 677 in 1998 with the final accrual of \$71,611 (\$52,613 + \$18,998) occurring in the year 2002.

Order No. PSC-97-0531-WU, issued May 9, 1997, approved \$57,351 of rate case expenses through the PAA process. The Order was subsequently protested and a final disposition of the issues was approved in Order No. PSC-99-0635-WS, issued April 5, 1999. The utility never requested an increase in its rate case allowance throughout any of the protest period.

The audit staff's review of a sample of the additional invoices determined that many were related to the rate case and the protest period involved. However, there were also many invoices that had nothing to do with the above-mentioned rate case proceeding. Among the invoices noted were transfer costs associated with the purchase of LGU in 1998 and legal fees associated with Lake County and the City of Clermont over zoning issues.

The audit staff has removed all rate case expenses for the year 2002 pending the Commission's disposition on this issue.

Exception No. 16, continued

The utility's allocation methodology between water and wastewater services, as illustrated above, is inappropriate because it uses arbitrary rates to allocate the predominant amount of its O&M expenses. The Revenues 1 rate is defined as the "UI designated split for proper return on investment" and the Customers 2 rate is the number of customers on Schedules W/S 9 of its 2002 Annual Report. All other customer allocations to LUSI from UIF and WSC are based on the number of customers in the WSC allocation schedule which uses the utility's June 2002 customer count as the basis for developing allocation ratios.

The audit staff has recalculated the utility's O&M expense account balances for all accounts that the utility allocated using the Revenues 1 or Customer - 1 ratio. The audit staff used the customer allocation ratios of 5,725 or 72.88 percent and 2,130 or 27.12 percent for LUSI water and wastewater customers that were reflected in the 2002 WSC allocation manual as of June 30, 2002.

Schedules L and M that follow incorporate the audit staff's adjustments illustrated in Items Nos. 1-9 above as well as the WSC customer allocation ratios for water and wastewater customers discussed above.

Schedule L for Exception No. 16

**WATER O&M EXPENSES
FOR THE 12-MONTH PERIOD ENDED DECEMBER 31, 2002**

<u>Acct. No.</u>	<u>Account Description</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Audit</u>
601	Salaries & Wages - Employees	\$261,414	(\$31,078)	\$230,336
603	Salaries & Wages - Officers	0	0	0
604	Employee Pensions & Benefits	91,581	(17,417)	74,164
610	Purchased Power	0	0	0
615	Purchased Power	130,229	0	130,229
616	Fuel for Power Production	0	0	0
618	Chemicals	16,482	0	16,482
620	Materials & Supplies	86,920	(683)	86,237
631	Contractual Services - Engineering	0	0	0
632	Contractual Services - Accounting	7,266	(1,382)	5,884
633	Contractual Services - Legal	1,267	3,289	4,556
634	Contractual Services - Management	0	0	0
635	Contractual Services - Testing	0	0	0
636	Contractual Services - Other	8,544	10,982	19,526
641	Rental of Building - Real Property	0	0	0
642	Rental of Equipment	0	0	0
650	Transportation Expense	33,560	(6,382)	27,178
656	Insurance - Vehicle	0	0	0
657	Insurance - General Liability	0	0	0
658	Insurance - Workman's Compensation	0	0	0
659	Insurance - Other	26,257	(4,994)	21,263
660	Advertising Expense	0	0	0
666	Regulatory Commission Exp. - Rate Case	52,613	(52,613)	0
667	Regulatory Expense - Other	0	0	0
670	Bad Debt Expense	4,236	0	4,236
675	Miscellaneous Expense	<u>52,831</u>	<u>(10,883)</u>	<u>41,948</u>
	Total Water Utility Expenses	<u>\$773,200</u>	<u>(\$111,160)</u>	<u>\$662,040</u>

Small differences attributed to rounding errors

Schedule M for Exception No. 16

**WASTEWATER O&M EXPENSES
FOR THE 12-MONTH PERIOD ENDED DECEMBER 31, 2002**

<u>Acct. No.</u>	<u>Account Description</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Audit</u>
701	Salaries & Wages - Employees	\$74,398	\$28,929	\$103,327
703	Salaries & Wages - Officers	0	0	0
704	Employee Pensions & Benefits	10,176	17,417	27,593
710	Purchased Power	0	0	0
711	Sludge Removal Expense	45,565	0	45,565
715	Purchased Power	73,000	0	73,000
716	Fuel for Power Production	0	0	0
718	Chemicals	1,832	0	1,832
720	Materials & Supplies	27,274	237	27,511
731	Contractual Services - Engineering	0	0	0
732	Contractual Services - Accounting	807	1,382	2,189
733	Contractual Services - Legal	141	1,554	1,695
734	Contractual Services - Management	0	0	0
735	Contractual Services - Testing	0	0	0
736	Contractual Services - Other	948	1,546	2,494
741	Rental of Building - Real Property	0	0	0
742	Rental of Equipment	0	0	0
750	Transportation Expense	3,729	6,383	10,112
756	Insurance - Vehicle	0	0	0
757	Insurance - General Liability	0	0	0
758	Insurance - Workman's Compensation	0	0	0
759	Insurance - Other	2,917	4,994	7,911
760	Advertising Expense	0	0	0
766	Regulatory Commission Exp. - Rate Case	18,998	(18,998)	0
767	Regulatory Expense - Other	0	0	0
770	Bad Debt Expense	1,481	0	1,481
775	Miscellaneous Expense	<u>5,868</u>	<u>9,739</u>	<u>15,607</u>
	Total Wastewater Utility Expenses	<u>\$267,134</u>	<u>\$53,183</u>	<u>\$320,317</u>

Small differences attributed to rounding errors.

Exception No. 17

Subject: Allocated Common O&M Expense

Statement of Fact: The utility's records reflect Water Service Corporation (WSC) incurred \$4,993,537 of common expenses of which LUSI was allocated \$140,964 for the 12-month period ended December 31, 2002.

The utility's records also reflect Utilities Inc. of Florida (UIF) incurred \$365,244 of common expenses of which LUSI was allocated \$19,381 for the 12-month period ended December 31, 2002.

Recommendation: The WSC and UIF common costs are overstated by \$504,945 and \$10,156, respectively, and LUSI's allocations are overstated by \$14,102 and \$1,083, respectively, for the 12-month period ended December 31, 2002, based on the following audit staff determinations.

- 1) The WSC salary expense is overstated by \$25,861 because the salaries reported in its allocation schedule SE60 did not tie directly to the utility's salary expenses in its general ledger for WSC office salaries. The reduction to LUSI's allocation is \$871 and is addressed in Item No. 2 of Exception No. 16 of this report.
- 2) The WSC contractual services expense is overstated by \$41,680 because it contains computer amortization and programming costs that should be removed per the Commission Order cited in Exception No. 8 of this report. The reduction to LUSI's allocation is \$1,092 and is addressed in Item No. 5 of Exception No. 16 of this report.
- 3) The WSC miscellaneous expenses are overstated by \$18,566 because they contain \$6,066 of invoiced charges for services that can be charged directly to other state utility systems and a \$12,500 banking fee that was double-booked. The reduction to LUSI's allocation is \$620 and is addressed in Item No. 8 of Exception No. 16 of this report.
- 4) The WSC depreciation expenses are overstated by \$25,720 based on specific audit staff adjustments to WSC's corresponding rate base accounts in Exception No. 8 of this report. The reduction to LUSI's allocation is \$709 and is addressed in Exception No. 18 of this report.
- 5) The WSC FICA payroll tax expense is overstated by \$13,839 because of the issues discussed in Item No. 1 above. The reduction to LUSI's allocated portion is \$382 and is addressed in Exception No. 19 of this report.
- 6) The WSC interest expense amounts of \$379,280 were eliminated because interest expense is captured in the utility's cost of capital. The reduction to LUSI's allocated portion is \$10,428.

$$(\$25,861 + \$41,680 + \$18,566 + \$25,720 + \$13,839 + \$379,280 = \$504,945)$$

$$(\$871 + \$1,092 + \$620 + \$709 + \$382 + \$10,428 = \$14,102)$$

- 7) The UIF material and supplies expense is overstated by \$4,162 because it was for a penalty paid as the result of a sales tax audit and should be removed. LUSI's allocated portion is \$445 and is addressed in Item No. 3 in Exception No. 16 of this report.
- 8) The UIF miscellaneous expenses are overstated by \$4,876 because the utility could not provide the supporting documentation for the invoices sampled. LUSI's allocated portion is \$522 and is addressed in Item No. 9 of Exception No. 16 of this report.

Exception No. 17, continued

- 9) The UIF depreciation expense is overstated by \$1,118 based on the effects of the audit staff's adjustments in Docket No. 020071-WS. LUSI's allocated portion is \$116 and is addressed in Exception No. 18 of this report.

$$(\$4,162 + \$4,876 + \$1,118 = \$10,156)$$
$$(\$445 + \$522 + \$116 = \$1,083)$$

Additionally, the utility's WSC and UIF allocations were only recorded in its water system accounts. The audit staff has redistributed the adjusted balances for WSC and UIF allocations to both water and wastewater operations using the customer ratios determined in Exception No. 16 of this report.

See Schedules N and O that follow for additional details.

Schedule N for Exception No. 17

UIF Common Cost Allocations with Audit Staff Adjustments

<u>Account Description</u>	<u>UIF Amount</u>	<u>Adjustment</u>	<u>Audit Amount</u>	<u>Allocation Factor</u>	<u>LUSI Amount</u>
Depreciation-Office Structure	\$20,508		\$20,508	10.70%	\$2,194
Depreciation Office-Furniture	8,659		8,659	10.70%	927
Depreciation-Transportation	74,499		74,499	0.00%	0
Depreciation-Tools & Shop	8,937		8,937	10.70%	956
Depreciation-Lab. Equip.	160		160	10.70%	17
Depreciation-Communication Equipment	6,573	(1,118)	5,455	10.70%	587
Depreciation-Computer	2,956		2,956	10.70%	316
Personnel Property & ITC Tax	3,529		3,529	10.70%	378
Operator Expense	1,097		1,097	10.70%	117
Gasoline	48,473		48,473	0.00%	0
Auto Repairs	57,727		57,727	0.00%	0
Auto Licensee	3,029		3,029	0.00%	0
Other Transportation	376		376	0.00%	0
Publications & Subscriptions	5,470	(2,000)	3,470	10.70%	371
Answering Service	7,839		7,839	10.70%	839
Computer Supplies	4,769		4,769	10.70%	510
Postage	12,155	(1,000)	11,155	10.70%	1,194
UPS & Air Freight	6,318		6,318	10.70%	676
Xerox	3,431		3,431	10.70%	367
Office Supplies	17,831		17,831	10.70%	1,908
Cleaning Supplies	328		328	10.70%	35
Memberships	108		108	10.70%	12
Operators-Other Office	1,469		1,469	10.70%	157
Operators-Publication	821		821	10.70%	88
Other Office Expenses	6,227		6,227	10.70%	666
Office Telephone	10,855		10,855	10.70%	1,161
Operators Telephones-LD	837		837	10.70%	90
Office Cleaning	10,815		10,815	10.70%	1,157
Landscaping/Mowing	540		540	10.70%	58
Other Office Maintenance	10,168		10,168	10.70%	1,088
Operators-Memberships	3,669		3,669	10.70%	393
Sales/Use Tax	5,004	(4,162)	842	10.70%	90
Office Education/Training	1,544		1,544	10.70%	165
Meals & Related Expenses	7,139		7,139	10.70%	764
Other Misc. General	<u>11,384</u>	<u>(1,876)</u>	<u>9,508</u>	10.70%	<u>1,017</u>
	\$365,243	(\$10,156)	\$355,087		\$18,298

Schedule O for Exception No. 17

WSC Common Cost Allocations with Audit Staff Adjustments

<u>Account Description</u>	<u>WSC Amount</u>	<u>Adjustment</u>	<u>Audit Amount</u>	<u>Allocation Factor</u>	<u>LUSI Amount</u>
Salaries Office	\$1,354,111		\$1,328,850	3.387%	\$45,008
Salaries Customer Serv.	196,233		196,233	0.000%	0
Agency Expense	6,021		6,021	3.387%	204
Audit Fees	145,910		145,910	3.387%	4,942
Temp. Employees	15,369		15,369	3.387%	521
Employ. Finder Fees	80,056		80,056	3.387%	2,711
Directors Fees	17,500		17,500	3.387%	593
Tax Return Review	92,400		92,400	3.387%	3,130
Other Outside Services	9,977		9,977	3.387%	338
Health Ins. Reimbursement	161,848		161,848	2.758%	4,464
Employee Ins. Deduction	(31,289)		(31,289)	2.758%	(863)
Health Costs and Other	4,028		4,028	2.758%	111
Dental Ins. Reimb.	10,696		10,696	2.758%	295
Pension	63,728		63,728	2.918%	1,860
Health Ins. Premiums	25,844		25,844	2.758%	713
Dental Premiums	1,230		1,230	2.758%	34
Term Life Ins.	4,719		4,719	2.758%	130
ESOP	86,179		86,179	2.918%	2,515
Disability Insurance	2,210		2,210	2.758%	61
Other Emp. Pens. and Ben.	2,246		2,246	2.758%	62
Publ. Subscriptions	5,768		5,768	3.387%	195
Answering Service	7,739		7,739	0.000%	0
Printing and Blueprints	24,418	(1,472)	22,946	2.758%	633
Xerox	6,165		6,165	2.758%	170
Off Supply Stores	35,363		35,363	2.758%	975
Office Emp. Exp.	2,357		2,357	2.758%	65
Cleaning Supplies	3,915		3,915	2.758%	108
Memberships	1,568		1,568	2.758%	43
Other Office Expense	2,054		2,054	2.758%	57
Office Telephone	8,710		8,710	2.758%	240
Office Electric	26,577		26,577	2.758%	733
Office Gas	4,272		4,272	2.758%	118
Office Utilities Other	2,671		2,671	2.758%	74
Office Cleaning	26,579		26,579	2.758%	733
Landscaping, Mowing, Snow	23,538		23,538	2.758%	649
Office Garbage Removal	1,394		1,394	2.758%	38
Repair off Mach and Heat.	5,148		5,148	2.758%	142
Other Office Maint.	43,566		43,566	2.758%	1,202
Office Education/Training	3,899		3,899	2.758%	108
Meals	4,893		4,893	3.387%	166
Bank Service Charges	181,726		181,726	3.387%	6,155
Other Misc. Gen.	26,053	(17,094)	8,959	3.387%	303
Depreciation Office	65,666		65,666	2.758%	1,811
Depreciation Furn.	59,445	(1,375)	58,070	2.758%	1,602
Depreciation Telephone	2,724		2,724	2.758%	75
Real Estate Tax	58,476		58,476	2.758%	1,613
FICA Tax	141,694	(13,839)	127,855	2.758%	3,526
SUTA	10,660		10,660	2.758%	294
FUTA	2,004		2,004	2.758%	55
Interest Expense	401,463	(401,463)	0	2.750%	0
Misc. Income	(8,702)		(8,702)	2.758%	(240)
Short-term Interest Exp.	(22,183)	22,183	0	2.758%	0
Total with Adjustments	\$3,408,636	(\$438,320)	\$2,970,316		\$88,470
Insurance	\$1,167,898		\$1,167,898	2.498%	\$29,174
Computer Allocation:					
Computer Salaries	211,488	(600)	210,888	2.620%	5,525
Outside Computer Cons.	31,862		31,862	2.620%	835
Computer Maint.	70,276		70,276	2.620%	1,841
Computer Amort. & Prog.	41,680	(41,680)	0	2.620%	0
Microfilming	10,502		10,502	2.620%	275
Depreciation Computer	51,195	(24,345)	26,850	2.758%	741
	\$417,003	(\$66,625)	\$350,378		\$9,217
Total All Costs	<u>\$4,993,537</u>	<u>(\$504,945)</u>	<u>\$4,488,592</u>		<u>\$126,862</u>

Exception No. 18

Subject: Depreciation Expense

Statement of Fact: The utility's records reflect balances of \$317,767 and \$159,402 for water and wastewater depreciation expense, respectively, for the 12-month period ended December 31, 2002.

Recommendation: The utility's water and wastewater depreciation are overstated by \$31,715 and understated by \$66,034, respectively, based on the following audit staff determinations.

- 1) Exceptions Nos. 1 through 5 of this report reduced water and increased wastewater depreciation expense balances by \$14,659 and \$61,092 respectively, for the 12-month period ended of December 31, 2002.
- 2) Exception No. 17 of this report reduced the WSC and UIF allocated depreciation expense balances by \$709 and \$116, respectively, and redistributed the adjusted LUSI allocated depreciation expense based on the customer ratios determined in Exception No. 16 of this report.

See Schedule P that follows for a summary of the audit staff's adjustments.

Schedule P for Exception No. 18

<u>Acct#</u>	<u>Acct. Description</u>	<u>Per Utility</u>	<u>E-1</u>	<u>E-2</u>	<u>E-3</u>	<u>E-4</u>	<u>E-5</u>	<u>E-6&17</u>	<u>E-17</u>	<u>Per Audit</u>
301	Organization	\$2,938	(\$1,991)	\$0	\$0	(\$443)	\$0	\$0	\$0	\$504
304	Structures & Improvements	29,702	292	(40)	(46)	(136)	(735)	0	0	29,037
307	Wells & Springs	25,230	1,571	0	0	(738)	(2,081)	0	0	23,982
309	Supply Mains	0	0	1,118	0	0	0	0	0	1,118
310	Power Generating Equipment	0	0	2,011	0	0	0	0	0	2,011
311	Pumping Equipment	17,873	44	(2,011)	0	(3,953)	(1,017)	0	0	10,936
320	Water Treatment Equipment	7,395	1,278	0	0	(373)	0	0	0	8,300
330	Dist. Reservoirs & Standpipes	38,957	199	0	0	(140)	(2,188)	0	0	36,828
331	Trans. & Distribution Mains	121,581	(1,812)	(910)	0	(628)	(138)	0	0	118,093
333	Services	22,829	(76)	0	0	(373)	0	0	0	22,380
334	Meters & Meter Installations	9,518	134	0	0	(400)	0	0	0	9,252
335	Hydrants	6,508	223	0	0	0	0	0	0	6,731
340	Office Furniture & Equipment	2,648	0	0	(38)	0	0	(251)	(471)	1,888
341	Transportation Equipment	21,291	0	0	0	0	0	(14,731)	0	6,560
343	Tools, Shop, & Garage Equip.	2,887	(23)	0	(282)	0	0	(259)	0	2,323
344	Laboratory Equipment	200	0	0	(133)	0	0	(5)	0	62
346	Communication Equipment	1,004	0	0	(46)	(504)	0	(275)	0	179
348	Other Tangible Plant	6,207	0	0	(272)	0	0	(681)	(1,384)	3,870
	Total UPIS	\$316,767	(\$161)	\$167	(\$817)	(\$7,689)	(\$6,159)	(\$16,202)	(\$1,855)	\$284,053
<u>Acct#</u>	<u>Acct. Description</u>	<u>Per Utility</u>	<u>E-1</u>	<u>E-2</u>	<u>E-3</u>	<u>E-4</u>	<u>E-5</u>	<u>E-6&17</u>	<u>E-17</u>	<u>Per Audit</u>
351	Organization	\$224	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$224
352	Franchise	45	0	0	0	(45)	0	0	0	0
354	Structures & Improvements	7,319	0	42	(47)	0	(4,285)	0	0	3,029
360	Collection - Sewers Forced	18,449	0	(1,813)	0	0	0	0	0	16,636
361	Collection - Sewers Gravity	29,478	0	1,209	0	0	0	0	0	30,687
363	Services	1,671	0	0	0	0	0	0	0	1,671
371	Pumping Equipment	20,253	0	0	0	0	0	0	0	20,253
380	Treatment & Disposal Equip.	0	0	17,395	0	0	126,326	0	0	143,721
381	Plant Sewers	81,287	0	(8,953)	0	(113)	(68,029)	0	0	4,192
382	Outfall Sewer Lines	557	0	0	0	0	(557)	0	0	0
389	Other Plant	0	0	12	0	0	(12)	0	0	0
390	Office Furniture & Equipment	39	0	0	0	0	0	251	434	724
391	Transportation Equipment	0	0	0	0	0	0	2,441	0	2,441
393	Tools, Shop & Garage	79	0	0	(38)	0	0	259	0	300
394	Laboratory Equipment	0	0	0	0	0	0	5	0	5
396	Communication Equipment	0	0	0	0	0	0	159	0	159
398	Other Tangible Plant	0	0	0	0	0	0	681	713	1,394
	Total Acc/Dep	\$159,401	\$0	\$7,892	(\$85)	(\$158)	\$53,443	\$3,796	\$1,147	\$225,436

Exception No. 19

Subject: Taxes Other Than Income (TOTI)

Statement of Fact: The utility records reflect balances of \$310,495 and \$51,445 for its water and wastewater taxes other than income, respectively, for the 12-month period ended December 31, 2002, as detailed below.

	<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
Regulatory Assessment Fees	\$71,614	\$24,903	\$96,517
Property Taxes	209,331	23,259	232,590
Payroll Taxes	29,550	3,283	32,833
Other Taxes and Licenses	<u>0</u>	<u>0</u>	<u>0</u>
Total TOTI	\$310,495	\$51,445	\$361,940

Recommendation: The utility's water and wastewater TOTI are overstated by \$45,868 and understated by \$41,915, respectively, for the 12-month period ended December 31, 2002, based on the following audit staff determinations.

- 1) The utility recorded its 2001 Regulatory Assessment Fees (RAFs) instead of accruing its 2002 RAF. The NARUC Chart of Accounts Instructions require accrual accounting. The 2002 RAFs were \$73,256.13 and \$25,606.27 for its water and wastewater systems. This requires an increase of \$1,642.13 for water and \$703.27 for wastewater RAFs. Additionally, the water RAF should be reduced by \$323 based on the water revenue adjustment of \$7,185 in Exception No. 15 of this report. ($\$7,185 \times 4.5\% = \323) ($\$1,642 - \$323 = \$1,319$)
- 2) The utility's water and wastewater property taxes were reduced by \$40,517 and increased by \$35,897 based on the following details.
 - a) The utility's allocated its total property tax amount of \$232,590 based on the Revenue 1 factor of 90 percent water and 10 percent wastewater that was discussed in Exception No. 16 of this report. The audit staff reviewed all of the utility's property tax bills and allocated each bill to the specific utility system that it served except where noted below.
 - b) The WSC and UIF property taxes were allocated by the customer ratio determined in Exception No. 16 of this report.
 - c) The LGU tangible tax bill was allocated by the ratio of water and wastewater customers served within the LGU system.
 - d) The property tax bills where the LGU water and wastewater plants are located were reduced by 79.45 percent and allocated 57.38 percent to water and 42.62 percent to wastewater as determined in Exception No. 9 of this report.

See Schedule Q that follows for additional details.

Exception No. 19, continued

- 3) The utility's payroll tax expenses were reduced by \$1,955 (\$5,090 - \$7,045) as detailed below. Additionally the utility's adjusted payroll tax balance was allocated by the customer ratio determined in Exception No. 16 of this report to be consistent with the corresponding allocation of the utility's salary expenses.
- e) The audit staff made two adjustments that reduced UIF operator and office staff salaries by \$1,278 in Exception No. 16 of this report that require a corresponding reduction in associated payroll taxes. Additionally, it was determined that the payroll tax on the operators' salaries was not allocated using the same method that was used to allocate the corresponding operators' salaries. Operators' salaries were allocated to LUSI at 5.84 percent and to LGU at 5.71 percent while corresponding payroll taxes were allocated at 6.22 percent and 6.08 percent, respectively. Furthermore, the Regional Vice President's payroll tax was calculated incorrectly because the utility did not use the correct maximum for its FICA tax calculations on his salary. The net effect of the above adjustments is a reduction in payroll taxes of \$1,573 (\$1,535 + \$38) for the year 2002.
- f) The audit staff reduced WSC allocated payroll taxes by \$382 in Exception No. 17 of this report.

<u>Payroll Tax</u>	<u>Per Utility</u>	<u>Adjustment</u>	<u>Per Audit</u>
Fla. Operator Payroll Tax	\$24,272	(\$1,535)	\$22,737
Fla. Office Payroll Tax	4,304	(38)	4,266
WSC Payroll Tax	<u>4,257</u>	<u>(382)</u>	<u>3,875</u>
	\$32,833	(\$1,955)	\$30,878
Allocation ratio		72.88%	27.12%
	<u>Total</u>	<u>Water</u>	<u>W/Water</u>
Per Audit Payroll Tax	\$30,878	\$22,505	\$8,373
Per Utility Payroll Tax	<u>32,833</u>	<u>29,550</u>	<u>3,283</u>
	(\$1,955)	(\$7,045)	\$5,090

- 4) The utility's records reflect \$600 of other taxes and licenses expense that it did not include in its 2002 Annual Report. The audit staff allocated \$375 to water and \$225 to wastewater per customer ratio determined in Exception No. 16 of this report.

$$\begin{aligned} &(\text{Water } \$1,319 - \$40,517 - \$7,045 + \$375 = \$45,868) \\ &(\text{Wastewater } \$703 + \$35,897 + \$5,090 + \$225 = \$41,919) \end{aligned}$$

Schedule Q for Exception No. 19

Real Property and Intangible Property Tax for 12-Month Period Ended December 31, 2002

Parcel ID#	Parcel Description	Note	Water	W/Water	Land Held for	Total
32-22-26-0300	Clermont 1 Water Plant Property Tax		\$55.99	\$0.00	\$0.00	\$55.99
50060	Clermont 1 Intangible Tax		63,704.58	0.00	0.00	63,704.58
07-23-26-0001	Clermont 2 Water Plant Property Tax		35.13	0.00	0.00	35.13
06540	Clermont 2 Intangible Tax		39,144.27	0.00	0.00	39,144.27
	Lake Groves Water and W/Water Plant Property Tax	A	685.70	509.32	4,620.17	5,815.19
67216	Lake Groves Intangible Property Tax	B	60,781.33	58,081.76	0.00	118,863.09
31-22-26	Oranges Water Plant Property Tax		233.42	0.00	0.00	233.42
07-23-26-0200	Oranges - Water Plant Property Tax - (vacant land)		194.01	0.00	0.00	194.01
23-24-26-0300	Lake Groves Water and W/Water Property Tax (vacant land)		16.50	0.00	0.00	16.50
23-24-26-0300	Citrus Highlands Lift Station Property Tax		0.00	16.50	0.00	16.50
22-24-25-1505	Orange Tree Lift Station Property Tax		0.00	8.25	0.00	8.25
08-23-26-0410	Vistas Water Plant Property Tax		108.88	0.00	0.00	108.88
02-22-26-0150	Four Lakes Water Plant Property Tax		89.71	0.00	0.00	89.71
02-23-25-0100	Highland Point Water Plant Property Tax		129.93	0.00	0.00	129.93
31-22-26-0060	Amber Hill Water Plant Property Tax		23.67	0.00	0.00	23.67
08-23-26-0004	Vistas Water Plant Property Tax (vacant land)		1,189.54	0.00	0.00	1,189.54
01-23-25-0250	Lake Crescent Water Plant Property Tax		125.23	0.00	0.00	125.23
01-23-25-0170	Crescent Bat Water Plant Property Tax		73.97	0.00	0.00	73.97
27-19-26-0350	Lake Saunders Water Plant Property Tax		408.80	0.00	0.00	408.80
31-22-26-0355	Lake Ridge Water Plant Property Tax		362.94	0.00	0.00	362.94
	Water Service Allocated Property Tax	C	1,175.44	437.33	0.00	1,612.77
	UIF Allocated Property Tax	C	<u>275.50</u>	<u>102.50</u>	<u>0.00</u>	<u>378.00</u>
Per Audit Real and Intangible Property Tax			\$168,814.54	\$59,155.66	\$4,620.17	\$232,590.37
Note A	Property tax is adjusted to remove nonutility land determined in Exception No. 9 of this report with the remaining balance allocated as follows. 57.38% for water and 42.62% for wastewater					
Note B	Property tax is allocated by the number of Lake Groves customers -51.14% for water and 48.86% for wastewater.					
Note C	Property taxes are allocated by customers - 72.88% water and 27.12% wastewater.					

Audit Disclosure No. 1

Subject: Chemical Expense

Statement: of Fact: The utility's records reflect water and wastewater balances of \$16,482 and \$1,832, respectively, for the 12-month period ended December 31, 2002.

The utility allocated its total chemical expense balance of \$18,314 based on the Revenue 1 factor of 90 percent water and 10 percent wastewater that was discussed in Exception No. 16 of this report.

Recommendation: The audit staff sampled all invoices exceeding \$500 in the chemical account for the proper period, account, and amount per Commission rules. Nine invoices totaling \$4,508 or 24.6% of the total chemical expense were examined. The utility, on average, paid \$64 for a 150-lb. gas chlorine cylinder. The invoices examined identified the quantity and delivery point for the chlorine gas purchased. In some cases, there were multiple deliveries to the water and wastewater systems on the same invoice.

The audit staff believes that the utility has the ability and means to record its chemical expenses as direct cost to each of its water and wastewater systems.

Due to time constraints and the large number of invoices involved the audit staff was not able to determine the actual chemical expenses for each system. However, in discussions with the Commission staff engineer, it was determined that an engineering allocation is feasible.

The auditor defers this issue to the staff engineer in Tallahassee.

For all future proceedings, the Commission should require the utility to account for its chemical expenses based on the actual cost incurred for each water and wastewater system.

Disclosure No. 2

Subject: WSC Allocation Factors

Statement of Fact: WSC uses several factors to allocate its common expenses to its subsidiary utilities. Most of the factors are based on the customer equivalents which are classified as Code 1 in the WSC allocation manual. During an affiliate transaction audit performed in 2002, the audit staff determined that WSC did not include utilities that it manages or performs billing services for in its customer equivalent calculations. Additionally, the audit staff attempted to determine the reasonableness of the customer equivalent calculations by comparing the gallons of water used and the gallons of water sold for each division. The company has still not provided an analysis of its customer consumption patterns to support its customer equivalent calculations.

Recommendation: The company should be required to provide alternative calculations using gallons or ERCs to support its position that customer equivalents are reasonable. In addition, the company should establish written procedures that provide a methodology of how to record single family equivalents, which are the basis of the customer equivalents, so that each division is computed using the same methodology.

Disclosure No. 3

Subject: Utility Books and Records

Statement of Fact: The utility's books and records have been an on-going issue for the audit staff in its rate proceedings.

Recommendation: This issue is the subject of a Commission show cause proceeding in the Utilities Inc. of Florida (UIF) rate proceeding in Docket No. 0200471-WS.

The utility, in this investigation, has been more forthcoming in its responses to audit staff's inquiries of its accounting system and its books and records. However, the issues and problems with the utility's allocation schedules and supporting documentation that are illustrated in the previous audit staff's reports for the UIF, Alafaya Utilities, Cypress Lakes Utilities and Wedgefield Utilities rate proceedings continue to require extensive use of the audit staff's time to adequately evaluate and form an opinion on their accuracy and usefulness.

The above statements are proffered as an update on the books and record issue, and no recommendation is proposed at this time pending resolution of the UIF docket.

EXHIBIT I

**LAKE UTILITY SERVICES, INC.
WATER RATE BASE
DOCKET NUMBER 020567-WS
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO(2)	PER AUDIT(1)
UTILITY PLANT-IN-SERVICE	\$11,384,983	(\$515,954)	(5)	\$10,869,029
LAND & LAND RIGHTS	443,476	(327,314)	E-9	116,162
CONTRIBUTIONS-IN-AID- OF-CONSTRUCTION (CIAC)	(8,341,036)	(84,159)	E-11	(8,425,195)
ACCUMULATED DEPRECIATION	(1,332,292)	83,331	E-12	(1,248,961)
ACCUMULATED AMORTIZATION OF CIAC	993,168	117,592	E-11	1,110,760
CONSTRUCTION-WORK-IN- PROGRESS	2,108,799	(2,108,799)	E-10	0
WORKING CAPITAL(3)	<u>96,650</u>	<u>(13,895)</u>	E-13	<u>82,755</u>
TOTAL NET RATE BASE(4)	\$5,353,748	(\$2,849,198)		\$2,504,550

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.
- 2) Audit adjustments do not include Audit Disclosures.
- 3) Calculated as 1/8 of O&M Expense.
- 4) Does not include anticipated used and useful adjustments.
- 5) Adjustment to Utility-Plant-in-Service

E-1	+	E-2	+	E-3	+	E-4	+	E-5	+	E-6	+	E-7	+	E-8	=	TOTAL
(55,114)		(1,335)		(11,779)		(191,791)		(193,871)		(74,767)		(33,594)		46,296		(515,954)

EXHIBIT II

**LAKE UTILITY SERVICES, INC.
WASTEWATER RATE BASE
DOCKET NUMBER 020567-WS
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO(2)	PER AUDIT(1)
UTILITY PLANT-IN-SERVICE	\$5,763,958	(\$197,564)	(5)	\$5,566,394
LAND & LAND RIGHTS	468,355	(392,497)	E-9	75,858
CONTRIBUTIONS-IN-AID- OF-CONSTRUCTION (CIAC)	(2,783,587)	(3,725)	E-11	(2,787,312)
ACCUMULATED DEPRECIATION	(654,686)	(76,034)	E-12	(730,720)
ACCUMULATED AMORTIZATION OF CIAC	334,146	80,462	E-11	414,608
CONSTRUCTION-WORK-IN- PROGRESS	311,084	(311,084)	E-10	0
WORKING CAPITAL(3)	<u>33,392</u>	<u>6,648</u>	E-13	<u>40,040</u>
TOTAL NET RATE BASE(4)	\$3,472,662	(\$893,794)		\$2,578,868

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.
- 2) Audit adjustments do not include Audit Disclosures.
- 3) Calculated as 1/8 of O&M Expense.
- 4) Does not include anticipated used and useful adjustments.
- 5) Adjustment to Utility-Plant-in-Service

E-2	+	E-3	+	E-4	+	E-5	+	E-6	+	E-7	+	E-8	=	TOTAL
1,335		(2,088)		(5,767)		(261,198)		21,654		31,274		17,225		(197,564)

EXHIBIT III

**LAKE UTILITY SERVICES, INC.
WATER NET OPERATING INCOME
DOCKET NUMBER 020567-WS
12-MONTH PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)(2)	AUDIT EXCEPTION(1)	REFER TO(3)	PER AUDIT(1)
REVENUES	\$1,627,914	(\$7,185)	E-15	\$1,620,729
EXPENSES:				
O&M EXPENSE	(773,200)	111,160	E-16	(662,040)
DEPRECIATION EXPENSE	(316,767)	32,714	E-18	(284,053)
AMORTIZATION EXPENSE	193,800	9,023	E-11	202,823
TAXES OTHER THAN INCOME	<u>(310,495)</u>	<u>45,868</u>	E-19	<u>(264,627)</u>
TOTAL EXPENSES	<u>(\$1,206,662)</u>	<u>\$198,765</u>		<u>(\$1,007,897)</u>
NET OPERATING INCOME(3)	\$421,252	\$191,580		\$612,832

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.
- 2) Audit adjustments do not include Audit Disclosures.
- 3) Does not include Federal Income Taxes because of anticipated used and useful adjustments.

EXHIBIT IV

**LAKE UTILITY SERVICES, INC.
WASTEWATER NET OPERATING INCOME
DOCKET NUMBER 020567-WS
12-MONTH PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)(2)	AUDIT EXCEPTION(1)	REFER TO(3)	PER AUDIT(1)
REVENUES	\$569,028	\$0		\$569,028
EXPENSES:				
O&M EXPENSE	(267,134)	(53,183)	E-16	(320,317)
DEPRECIATION EXPENSE	(159,401)	(66,035)	E-18	(225,436)
AMORTIZATION EXPENSE	75,337	33,275	E-11	108,612
TAXES OTHER THAN INCOME	(51,445)	(41,915)	E-19	(93,360)
TOTAL EXPENSES	<u>(\$402,643)</u>	<u>(\$127,858)</u>		<u>(\$530,501)</u>
NET OPERATING INCOME(3)	\$166,385	(\$127,858)		\$38,527

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.
- 2) Audit adjustments do not include Audit Disclosures.
- 3) Does not include Federal Income Taxes because of anticipated used and useful adjustments.

EXHIBIT VI

**LAKE UTILITY SERVICES, INC.
AVERAGE WEIGHTED COST OF CAPITAL
DOCKET NUMBER 020567-WS
AS OF DECEMBER 31, 2002**

	Per Utility @12/31/2002	Audit Exception	Refer to	Per Audit @12/31/2002	Ratio	Reconciled to Rate Base(2)	Ratio	Cost Rate (1)	Weighted Cost
Long-term Debt	\$115,319,616	\$2,514,922	E-14	\$117,834,538	58.928%	\$2,995,568	55.556%	7.824%	4.347%
Short-term Debt	0	0		0	0.000%	0	0.000%	3.925%	0.000%
Common Equity	77,650,144	0		<u>77,650,144</u>	<u>38.832%</u>	<u>1,974,008</u>	<u>36.610%</u>	11.149%	<u>4.082%</u>
Total before customer deposits and deferred taxes				\$199,962,797	100.000%	\$5,083,418	94.278%		8.428%
Customer Deposits	150,205	0				150,205	2.786%	6.000%	0.167%
Tax Credits-Weighted	19,016	(19,016)	E-14			0	0.000%	0.000%	0.000%
Deferred Taxes	<u>158,312</u>	<u>0</u>				<u>158,312</u>	<u>2.936%</u>	0.000%	<u>0.000%</u>
Total after customer deposits and deferred taxes	\$193,297,293	\$2,495,906				\$5,391,935	100.000%		8.596%

Notes:

- (1) Equity Ratio as a percentage of total debt and equity 38.832%
- Equity Rate per Order No. 02-1252-CO-WS, issued September 11, 2002 9.650%
- 0.00582/Equity Ratio of 38.832 % 1.499%
- Common Equity Cost Rate 11.149%
- (2) Rate base does not include anticipated used and useful adjustments