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July 17, 2007

Ms. Ann Cole, Director  
Office of Commission Clerk  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Betty Easley Conference Center, Room 110  
Tallahassee, Florida 32399-0850

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CLERK

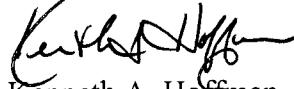
Re: Docket No. 060368-WS  
In re: Application for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.

Dear Ms. Cole:

Enclosed for filing on behalf of Aqua Utilities, Florida, Inc. ("AUF"), in the above-referenced docket are an original and seven copies of AUF's Response to Staff Audit Report.

This filing includes a CD-ROM as well as paper documents. Parties to this docket are being served by hand delivery as indicated on the certificate of service. As always, thank you for your assistance with this filing and please do not hesitate to contact me if you have any questions.

Sincerely,

  
Kenneth A. Hoffman

- CMP \_\_\_\_\_
- COM \_\_\_\_\_
- CTR \_\_\_\_\_
- ECR** \_\_\_\_\_
- GCL 1 \_\_\_\_\_
- OPC \_\_\_\_\_
- RCA 1 \_\_\_\_\_
- SCR \_\_\_\_\_
- SGA \_\_\_\_\_
- SEC \_\_\_\_\_
- OTH \_\_\_\_\_

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*COs to RCA, GCL, and ECR.*

DOCUMENT NUMBER-DATE

05999 JUL 17 08

FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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

Docket No. 060368-WS

Dated: July 17, 2007

**AQUA UTILITIES FLORIDA, INC.'S  
RESPONSE TO STAFF AUDIT REPORT**

Aqua Utilities Florida, Inc. ("AUF"), hereby files its Response to Staff's Audit

Report dated June 1, 2007.

**RESPONSE**

Audit Finding No. 1 Jasmine Lakes Reclassification

Response: AUF agrees with this finding and suggests that the entry shown below be made at the conclusion of the instant rate case.

Acct. 108	A/D-Jasmine Lakes Water	\$19,522
Acct. 304	Structures & Improvements-Jasmine Lakes Water	(\$1,172,514)
Acct. 354	Structures & Improvements-Jasmine Lakes WW	\$1,172,514
Acct. 108	A/D-Jasmine Lakes WW	(\$19,522)

Audit Finding No. 2 Original Cost Study

Response: The Rosalie Oaks water and wastewater original cost studies are attached hereto. The Company requests the additional rate base from the studies be included in rate base in the instant rate filings. AUF has already provided the Village Water water and wastewater original cost studies to the audit staff. It should be noted that Company has requested rate base treatment of the entire Village Water water and wastewater depreciated original cost, i.e. much higher than purchase price, in its response to Audit Document Request No. 95. In addition, in its response to Audit Document Request No. 95, the Company has requested rate base treatment in the instant rate filing for the \$541,000 unbudgeted TTHM capital project at the Chuluota water plant for DEP compliance reasons.

DOCUMENT NUMBER-DATE

05999 JUL 17 07

FPSC-COMMISSION CLERK

Audit Finding No. 3 Rate Base Adjustment to Prior Orders

Response: AUF acknowledges that prior Commission Orders issued prior to closing should be booked, regardless of whether the seller disregarded the Order, and suggests that the entry be made at the conclusion of the instant rate case.

In its response to Audit Document Request No. 94, a copy of which attached hereto on CD-ROM, the Company provided the Audit staff with its Excel file that summarized the prior Commission Orders that are known. There are two discrepancies between the Company's file and the Audit Finding No. 3. First, the Lake Josephine Order at Docket No. 991001WU, entered 6/30/99, should be included as part of the prior Orders not booked in Audit Finding No. 3. Second, the Jasmine Lakes water and wastewater adjustments were derived from Schedules 1-A, 1-B, and 1-C to Order No. PSC-93-1675-FOF-WS. AUF has a copy of the Order, but not the schedules. AUF is in the process of reviewing the key schedules so that the Company can determine whether the retirements in question were ever made.

Audit Finding No. 4 Plant Retirement

Response: AUF suggests moving the Oakwood retirement that caused a negative A/D balance to a similar A/D account where money is booked. Prior to filing, the Company had made several corrections of this nature to avoid negative A/D balances.

Audit Finding No. 5 Projections of Plant Retirements

Response: This finding is for informational purposes only.

Audit Finding No. 6 Re-organization Costs

Response: The term Re-organization costs does not adequately describe this allocated capital expenditure. When the Company changed its corporate name to Aqua America and state name to Aqua Utilities Florida, Inc., it had incurred costs to change the signage on buildings and vehicles and to alert its customers of the name change through letters and newspaper notices. It was important to both the Company and to its customers that the customers understood the name on the next water billing. The Company believes that this finding is not necessary, as the cost in question is not in

any way connected to reorganization costs. The Company requests that the Commission allow these customer-friendly costs.

Audit Finding No. 7 UPIS In-Service Projections

Response: The Company believes that the section of the finding entitled “Differences Greater Than 25%” is confusing because it does not take into account the actual amount of rate base being requested in the instant rate case nor the material (carry-overs, CWIP) that was provided to the Audit staff. For example, the Company’s rate base request for the Chuluota Sewer system was \$2,215,896. The 2006 capital budget for the same project was \$3,950,000 and the job was closed to UPIS in January 2007 in the amount of \$4,299,900. The 2006 under-budget variance comes into play only if the Company were requesting the \$3,950,000 in rate base, which is not the case.

Additional under and over budgeted amounts wash out to zero, as AUF spent and closed to UPIS an amount equivalent to the entire 2006 Florida capital budget. The Company’s capital budget trade-off mechanism means that there are hundreds of times each year when a project operator knows that capital projects are delayed, canceled or changed in scope. The trade-off allows the Company to give control of the budget spending to the state president and not to an individual local operator. For example, when a Chuluota WW pump is removed from the capital budget via trade-off, the Company president and engineer decides what project(s) replaces the pump. Location is not a factor. So, for example, the Chuluota WW pump can be replaced by a Sunny Hills fence, if the fence were the next highest state priority. This mechanism was explained to the Commission staff during discovery. Yet, the schedule on page 18 of the report denies the existence of the Company’s trade-off mechanism that the capital budget for a particular location can be under budget, while the capital budget state-wide may be on budget.

Audit Finding No. 8 Projected Plant Additions

Response: It is difficult to determine from an inspection of the report’s attached chart whether the Audit Report is suggesting a decrease in rate base and an increase in O&M Expense allowed in the instant rate filings as a result of the twelve Repairs & Maintenance findings or simply a reduction in rate base alone. The Company believes that the fall-back position to its response on the issue should be the former.

The Company disputes the report’s contention that all twelve of the capital jobs should be Repairs & Maintenance. Below is further information

regarding these twelve jobs and reasons why the Company believes the jobs should remain in rate base.

200'-4" water main \$21,217.35 Line replacements, hurricane damage  
The report's conclusion is that this job is Repairs & Maintenance. The confusing part of the job is the notation marked "hurricane damage". The Company believes that the 200' of pipe replaced should be capitalized. In this case, the hurricane damage description is secondary to the main replacement.

Replace damaged water mains \$3,131.08. There were approximately two lengths of pipe installed on this job. The Company believes that the 40' of pipe replaced should be capitalized. The damaged water mains description in this case is secondary to the main replacement.

Replace damaged water mains \$15,610.66. There was approximately 120' of pipe installed on this job. The Company believes that this main replacement job should be capitalized.

Replace water mains \$63,990.99. There is nothing in the Company's capitalization criteria policy or in this job that would indicate that this should be a Repairs & Maintenance O&M expense. The Company believes that this main replacement job should be capitalized.

Clean/inspect replace sewer lines \$23,506.40 I&I work, line replacement post-hurricane. The Company believes that the replacement of sewer line, even in a post-hurricane environment, should be considered capitalized work

I&I study & improvements \$331,522.87. To reduce infiltration and inflow at the Company's sewer plant, suspect collection pipe is often replaced and manholes rehabilitated. This particular job at Jasmine Lakes required substantial collection pipe replacement. The Company believes that this should be considered capitalized work.

79' of 8" sewer pipe \$21,6756.12 Collection system repair & replacements. This job entailed the replacement of 79' of 8" collection piping. The Company believes that this collection pipe replacement job should be capitalized.

I&I rehab & improvements \$266,186.26. To reduce infiltration and inflow at the Company's sewer plant, suspect collection pipe is often replaced and manholes rehabilitated. This particular job at Palm Terrace required substantial collection pipe replacement. The Company believes that this should be considered capitalized work.

Effluent disposal site \$131,653.96 Cleared & rebuilt berms around ponds. There was vegetation growing on the banks of the Village Water WW perc ponds. This job rehabilitated the perc ponds by re-working the banks of the pond to improve its percolating performance. The Company believes that this work should be capitalized.

I&I study & improvements \$82,190.19. To reduce infiltration and inflow at the Company's sewer plant, suspect collection pipe is often replaced and manholes rehabilitated. This particular job at Village Water required substantial collection pipe replacement. The Company believes that this should be considered capitalized work.

Replaced 8" sewer with CIPP liner \$43,500.00. This is a pipe lining & manhole rehabilitation job, similar to the jobs shown as I&I study & improvements. The Company believes that this should be considered capitalized work.

Well #1 rehabilitation \$66,021.64. The Sunny Hills well had a hole in the casing and a side stream of iron concentrated water was entering into the well. The Company installed a new casing to a lower elevation to plug the sidestream from entering into the well. The Company believes that this work should remain in rate base and would have explained the situation to the Commission Audit staff, had the question been raised.

Regarding the retirements made in the wrong accounts or made much later than the addition, the Company believes that there is little rate base impact to making the corrections.

Audit Finding No. 9 UPIS 2007 Projections

Response: The Company agrees that the duplicate \$150,000 Sunny Hills addition should be eliminated from the MFR.

The Commission Audit Staff requests that all unsupported 2007 capital budgeted projects be eliminated from the rate base in these instant rate filings. The Company makes two requests with regard to this finding. First, more and more actual results become known during the pendency of these rate cases. The first request is to allow actual 2007 capital expenditures through the latest month available. Second, the Company requests that the Commission understand that the majority of 2007 unsubstantiated capital projections at this time of the year are related to blanket projects, like main replacements, meter replacements, and collection pipe replacements. The blanket work, while incomplete, is based on well known unit costs of pipe, services, meters, and hydrants that the Company's operators know so well. While no tangible proof of bid

was provided during the audit, it is understandable why the Company does not bid out every blanket project.

Audit Finding No. 10 Land Projections

Response: AUF agrees with this finding.

Audit Finding No. 11 Depreciation Rates – ASI Systems

Response: AUF agrees with this finding.

Audit Finding No. 12 Depreciation Rates – FWS Systems

Response: AUF agrees with this finding.

Audit Finding No. 13 Accumulated Depreciation Balances

Response: AUF agrees with this finding.

Audit Finding No. 14 CIAC Amort. Rates – ASI Systems

Response: AUF agrees with this finding.

Audit Finding No. 15 Ocala Oaks Water Amort. of CIAC

Response: AUF agrees with this finding.

Audit Finding No. 16 CIAC Projections

Response: AUF agrees with this finding.

Audit Finding No. 17 Working Capital Allowance Projections

Response: AUF agrees with this finding.

Audit Finding No. 18 Capital Structure

Response: The Company believes that the capital structure and cost rates as filed are appropriate for the combination of systems included in the filing

Audit Finding No. 19 Revenue Projections

Response: The error that occurred was in projecting the 2006 revenues at current rates. This has no effect on the revenue requirement or proposed rates, only on the amount of increase from 2006 revenues at current rates to the revenue at proposed rates. There is no adjustment to be made to the 2007 operating revenues and retained earnings as Audit Staff suggests.

Audit Finding No. 20 Operation and Maintenance Expense

Response: Please see response to Audit Finding No. 24. The Company notes that Aqua America does not have the ability to open up the books and records for prior years for adjustments. The adjustments are recorded in the year discovered and normalized for ratemaking purposes

Audit Finding No. 21 Lab Testing Expenses

Response: Please see response to Audit Finding No. 24. The Company notes that Aqua America does not have the ability to open up the books and records for prior years for adjustments. The adjustments are recorded in the year discovered and normalized for ratemaking purposes.

Audit Finding No. 22 Operation and maintenance (O&M) Expense Projections

Response: Please see response to Audit Finding No. 24.

Audit Finding No. 23 Purchased Power Expense Projections

Response: Please see response to Audit Finding No. 24.

Audit Finding No. 24 Operating and Maintenance (O&M) Expense Projections

Response: During the course of the post-filing analysis, the Company became aware of several unintended results within the filed expense data. These discoveries led to disconnects between the Company's intended and supportable expense trends and results, and the data represented in the MFRs. This resulted in the

inability to present to the audit team a clear, comprehensible, detailed analysis of expense development in total or by system. The Company responded with any and all available detail regarding the results of actual operations in 2005 and 2006 to assist the auditors in the development of their analysis.

Concurrently, the Company commenced with preparation a revised and refreshed expense development analysis for the years 2006 and 2007 that is presented in the attached excel file in response to this audit finding.

Audit Finding No. 25 Allocated Plant Depreciation Incorrectly Classified

Response: AUF agrees with this finding.

Audit Finding No. 26 Unsupported Allocations

Response: During the normal course of business accruals are made to record expenses that are paid in subsequent time periods. This finding has no impact on the test year or the first year of rates

Audit Finding No. 27 Electric Allocated Through Division 6958 That Should Be Direct

Response: The Company notes that Aqua America does not have the ability to open up the books and records for prior years for adjustments. The adjustments are recorded in the year discovered and normalized for ratemaking purposes.

Audit Finding No. 28 Radio/Sponsorship

Response: There are no advertising expenses in the Company's revised O&M expense filing.

Audit Finding No. 29 Benefits and Adjustments in Salary Overhead Rate From Bryn Mawr

Response: Under the new allocation process which is in effect for 2006 and 2007, actual billing rates remain consistent throughout the year.

Audit Finding No. 30 Rent Overhead on Bryn Mawr Salaries

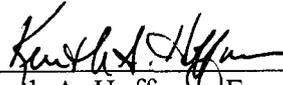
Response: The Company notes that Aqua America does not have the ability to open

up the books and records for prior years for adjustments. The adjustments are recorded in the year discovered and normalized for ratemaking purposes

Audit Finding No. 31 Taxes Other Than Income

Response: The Company notes that Aqua America does not have the ability to open up the books and records for prior years for adjustments. The adjustments are recorded in the year discovered and normalized for ratemaking purposes

Respectfully submitted this 17<sup>th</sup> day of July, 2007.



\_\_\_\_\_  
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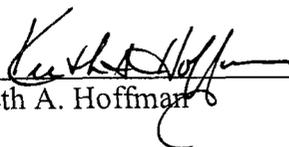
ATTORNEYS FOR AQUA UTILITIES  
FLORIDA, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing Notice was served by hand delivery this 17<sup>th</sup> day of July, 2007, to the following:

Florida Public Service Commission  
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\_\_\_\_\_  
Kenneth A. Hoffman