

RECEIVED-FPSC
07 AUG 21 AM 11:10
COMMISSION
CLERK

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

WITNESS: Direct Testimony Of Kathy L. Welch, Appearing On Behalf Of Staff

CMP _____
COM 5
CTR 1
ECR _____
GCL _____
OPC _____
RCA _____
SCR _____
SGA _____
SEC _____
OTH _____

DATE FILED: August 21, 2007

DOCUMENT NUMBER-DATE

07398 AUG 21 06

FPSC-COMMISSION CLERK

DIRECT TESTIMONY OF KATHY L. WELCH

1
2 Q. Please state your name and business address.

3 A. My name is Kathy L. Welch and my business address is 3625 N.W. 82nd Ave.,
4 Suite 400, Miami, Florida, 33166.

5
6 Q. By whom are you presently employed and in what capacity?

7 A. I am employed by the Florida Public Service Commission as a Public Utilities
8 Supervisor in the Division of Regulatory Compliance and Consumer Assistance.

9
10 Q. How long have you been employed by the Commission?

11 A. I have been employed by the Florida Public Service Commission since June, 1979.

12
13 Q. Briefly review your educational and professional background.

14 A. I have a Bachelor of Business Administration degree with a major in accounting
15 from Florida Atlantic University and a Masters of Adult Education and Human Resource
16 Development from Florida International University. I have a Certified Public Manager
17 certificate from Florida State University. I am also a Certified Public Accountant licensed
18 in the State of Florida, and I am a member of the American and Florida Institutes of
19 Certified Public Accountants. I was hired as a Public Utilities Analyst I by the Florida
20 Public Service Commission in June of 1979. I was promoted to Public Utilities
21 Supervisor on June 1, 2001.

22
23 Q. Please describe your current responsibilities.

24 A. Currently, I am a Public Utilities Supervisor with the responsibilities of
25 administering the District Office and reviewing work load and allocating resources to

1 complete field work and issue audit reports when due. I also supervise, plan, and conduct
2 utility audits of manual and automated accounting systems for historical and forecasted
3 financial statements and exhibits.

4
5 Q. Have you presented expert testimony before this Commission or any other
6 regulatory agency?

7 A. Yes. I have testified in several cases before the Florida Public Service
8 Commission. Exhibit KLW-1 lists these cases.

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

11 A. The purpose of my testimony is to sponsor specific audit findings in the staff audit
12 report of Aqua Utilities Florida, Inc. (Utility) which addresses the Company's application
13 for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee,
14 Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and
15 Washington Counties, Audit Control Number 06-347-1-1. This audit report is filed with
16 the testimony of Charleston Winston and is identified as Exhibit CJW-1. Specifically, my
17 testimony addresses Findings 6 and 25-30.

18
19 Q. Were these audit findings prepared by you?

20 A. Yes, I was responsible for the portion of the audit that addressed the corporate
21 allocations.

22
23 Q. Please describe the specific audit procedures you used in auditing the corporate
24 allocations.

25 A. The only rate base items that were allocated were for information technology plant

1 additions and leasehold improvements made when a Florida office was relocated. We
2 traced the "number of customers" methodology used to the billing reports for one month
3 and tested the allocation calculation. We sampled the projects added in 2005 and traced
4 to source documentation to determine if the timing, amount, classification, relationship to
5 the Utility, reasonableness and re-occurring nature of the charges was correct. We also
6 sampled 2006 invoices and reviewed support for how the Utility determined the numbers
7 for its 2007 projection. We recomputed depreciation on these allocated items.

8 We also identified the costs allocated from Aqua Utilities Florida in 2005 for its
9 Sarasota office and three Florida field offices. We reviewed the allocation methodology
10 and traced one month to billing reports. We sampled these costs and traced the costs to
11 source documentation to determine if the timing, amount, classification, relationship to
12 the Utility, reasonableness and re-occurring nature of the charges was correct. We
13 identified the costs allocated from Aqua Utilities, Inc. for 2005 and reviewed the
14 allocation methodology. We sampled these costs and traced the costs to source
15 documentation to determine if the timing, amount, classification, relationship to the
16 Utility, reasonableness and re-occurring nature of the charges was correct.

17
18 Q. Please review the audit findings in the audit report that are you are testifying on.

19 A. **Audit Finding 6**

20 Audit Finding 6 discusses re-organization costs. In November 2006, the Utility
21 recorded \$34,058.83 in Florida plant, Account 340500 - Office Furniture and Equipment,
22 for costs related to the corporate name change. Although the Utility indicated most of the
23 costs were for signage, the majority of the costs were paid to an identity consultant.
24 According to the National Association of Regulatory Utility Commissioners (NARUC)
25 Uniform System of Accounts (USOA), Class A, Balance Sheet, Account 340 should

1 include the cost of office furniture and equipment owned by the Utility and devoted to
2 utility service, and not permanently attached to the buildings. FPSC Order No. PSC-03-
3 O647-PAA-WS, issued May 28, 2003, in Docket No. 020407-WS, for Cypress Lakes
4 Utilities, interpreted the term "cost of acquisition" to include any consideration paid, plus
5 any other costs incurred related to or given for the purchase of the assets. The name
6 change would not have been necessary if the acquisition did not occur. Therefore,
7 according to the Cypress Lakes Order, the cost should have been recorded in the
8 acquisition adjustment account. The Utility computed depreciation expense using the
9 information technology rate of 16.67% a year.

10 In the 2006 filing for plant additions, the Utility understated its projection of
11 actual expenditures by \$149,417. Therefore, removal of the \$34,058.83 costs would be
12 offset by the \$149,417. If this adjustment is not made, depreciation expense is still
13 overstated because the Utility depreciated this plant at the information technology rate of
14 16.67% per annum or six years. The additions made have a longer useful life.

15

16 **Audit Finding 25**

17 Audit Finding 25 discusses allocated plant depreciation. The Utility depreciated
18 its allocated plant at 16.67% per annum or 1.39% per month. Our review of invoices
19 showed that the December 2005 additions of \$93,945.24 related to leasehold
20 improvements for moving the Sarasota office. Rule 25-30.140, Florida Administrative
21 Code, provides a depreciation rate for Account 304, General Building and Structures, of
22 2.5% per annum or .21 % per month. Using the correct rates would decrease depreciation
23 expense and accumulated depreciation. The audit report includes a schedule detailing the
24 audit calculations for the monthly depreciation and the 13-month average effect for all
25 three years. The net effect in 2007 is a reduction of depreciation expense of \$13,302.61

1 and a decrease (debit) to the 13-month average accumulated depreciation of \$21,062.47.

2
3 **Audit Finding 26**

4 Audit Finding 26 discusses unsupported allocations. The Utility provided the
5 2005 Corporate Charges that were allocated from the Pennsylvania office, in its response
6 to MFR Accounting Deficiency No. 33, Part 1, as listed in Mr. Tim Devlin's letter dated
7 January 2, 2007. We reconciled these costs to the allocations for each division. We
8 asked the Pennsylvania office to provide supporting documentation including any
9 accruals for costs included on this schedule. The Utility did not provide enough
10 supporting documentation to justify the full amounts. The audit report includes a listing
11 of each of the accounts that were not supported. I recommend that the 2005 expenses
12 should be reduced by \$55,712.76 for those expenses that were not supported.

13
14 **Audit Finding 27**

15 Audit Finding 27 discusses electric expense that was allocated, but should have
16 been a direct expense. Our audit found that invoices for electric service for 57 S. 7th
17 Street and 168 E. 8th Street were allocated through division 6958-Central. According to
18 the Utility representative, the 7th Street address actually relates to electric service in
19 Division 6456 (Chuluota water) and the 8th Street address relates to Division 6457
20 (Chuluota wastewater). Based on a review of the account detail, \$5,844.89 relates to
21 division 6456 and \$13,366.52 to division 6457. These costs were allocated to the
22 companies that report to the Central Florida Division. I recommend that the 2005 actual
23 expenses should be decreased for Division 6456 and increased for Division 6457, by
24 \$5,844.89 and \$13,366.52, respectively.

1 **Audit Finding 28**

2 Audit Finding 28 discusses radio/sponsorship costs. The Utility allocations
3 included three invoices from its Bryn Mawr operations in 2005 for:

- 4 1. Public service announcements and advertising;
- 5 2. Promotional and public service advertising; and
- 6 3. Advertisement in race program.

7 We were not able to determine from the Utility information whether these
8 promotions benefit the customers of Aqua Utilities of Florida. If the Commission
9 determines that these costs do not benefit the customers, the 2005 expenses in the filing
10 should be reduced by \$6,104.

11
12 **Audit Finding 29**

13 Audit Finding 29 discusses the benefits and salary overhead rate from Bryn Mawr.
14 Aqua America includes an overhead rate on each person's salary that is allocated monthly
15 to the individual states. The overhead includes payroll taxes, rent, employee benefits and
16 an amount for "adjustments/timing." We did not receive supporting documentation for the
17 benefits overhead for the employees selected in the staff sample. Aqua America provided
18 the following information related to benefits:

19 The "Benefits" column of the company schedule provided in answer to an audit
20 request includes the budgeted benefits expense for 2005 for each employee. The
21 level of benefits coverage available depends on their position, date of hire, and
22 chosen benefit package. Each of these benefit packages has different eligibility
23 requirements for benefits such as pension, post-retirement health care, and
24 vacation. In addition to the different plans that employees may be eligible for,
25 the "Benefits" expense may vary depending on their elections for coverage, such

1 as family coverage for dependents and choosing to opt out of having company
2 benefits altogether.

3 In order to adequately audit these benefits, staff needed to obtain the detail of each
4 type of benefit for each employee in the sample and the supporting documentation that
5 shows that these are the actual costs paid such as the health insurance invoice, any car
6 leases, life insurance invoices, and pension costs charges.

7 In the staff test of May salaries allocated, we also determined that adjustments
8 were made for "timing" that increased the salaries by almost 50%. The Utility provided
9 the following information on this adjustment:

10 The difference (adjustment) is due to the fact that monthly billing rates represent
11 actual service company costs in the month divided by reported billable hours in
12 that month, and fluctuate from normalized billing rates due to unplanned events
13 and transactions and the timing of events until adjusted on an annual basis. In
14 effect, this column of the schedule will fluctuate between positive and negative
15 adjustments based on the amount of billing hours and actual costs occurring each
16 month. At the conclusion of the fiscal year, Aqua completes a reconciliation of
17 budgeted billing rates and actual billing rates and the variances are charged or
18 credited to the states in the next fiscal year. For the 2005 fiscal year there was
19 not a true up reconciliation performed because Aqua was converting to a new
20 allocations process/system, thereby making the old system obsolete. It was the
21 opinion of the company that the true-up for fiscal year 2005 would not yield
22 material differences and therefore was not done. Under the new allocation
23 process, there is no need for a reconciliation of budgeted and actual billing rates
24 because the billing rates remain consistent throughout the year.

25 Since the annualized salaries for the May sample were approximately the same as

1 the W-2 wages, the increase for timing adjustments appeared excessive. Therefore, we
2 asked for the adjustments for all twelve months for the sample of employees to determine
3 if the adjustments offset. Aqua America was not able to provide this information in time
4 for the completion of the audit. We did receive two months with negative adjustments.
5 In order to determine if the adjustments actually offset, twelve months would be needed.
6 Expenses allocated from Aqua America may need to be decreased based on additional
7 information needed from Aqua America. Rate Case Expenses would also be affected.

8
9 **Audit Finding 30**

10 Audit Finding 30 discusses the rent overhead charged on Bryn Mawr salaries.
11 Aqua America charges monthly salaries to the individual states based on hours worked.
12 The employee rate per hour per employee includes an overhead component for rent.
13 Aqua Pennsylvania calculated the cost of rent, phones, heating oil, electric, and
14 depreciation on furniture, computer and printer per employee and multiplied that cost by
15 the eighty-eight service company employees. This cost, divided by the total service
16 company labor, amounts to 12.89% of the total service company labor salaries. This
17 agrees with the percent of rent charged on the salaries we tested in this audit.

18 To arrive at the rent portion of the above percent, the parent used the cost of one
19 building and the estimated cost of renovations to that building and the estimated cost of a
20 second new building. These were multiplied by a 15.15% return on investment. The
21 parent determined that these estimates amounted to \$22.91 per square foot and used the
22 market rate of \$24 per square foot to compute the cost per employee for rent. When costs
23 are allocated from affiliate companies, the Commission generally allows the lower of cost
24 or market. Rule 25-6.1351, Cost Allocation and Affiliate Transactions, Florida
25 Administrative Code, describes the methodology for electric utilities.

1 For the overheads added to 2005 wages, the rent should have been computed on
2 actual plant in service and should not have included estimated construction costs for 2006
3 additions. In addition, the rate of return in the MFRs are unique to each system. By
4 Order No. PSC-07-0325-FOF-WS, issued April 16, 2007, the Commission established,
5 for interim rates, a 7.51% rate of return for 2005.

6 The audit report incorporates these factors and computes a rent of \$46,295.92.
7 Compared to the Utility calculation of \$79,155.53, this results in a reduction of
8 \$32,859.61. The rent overhead was also included in Rate Case Expense.

9

10 Q. Does that conclude your testimony?

11 A. Yes.

12

13

14

15

16

17

18

19

20

21

22

23

24

25

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

WITNESS: **Direct Testimony Of Kathy L. Welch**, Appearing On Behalf Of Staff

EXHIBIT KLW-1: History of Testimony Provided by Kathy L. Welch

- In re: Application for approval of rate increase in Lee County by Tamiami Village Utility, Inc., Docket No. 910560-WS
- In re: Application for transfer of territory served by Tamiami Village Utility, Inc. in Lee County to North Fort Myers Utility, Inc., cancellation of Certificate No. 332-S and amendment of Certificate 247-S; and for a limited proceeding to impose current rates, charges, classifications, rules and regulations, and service availability policies, Docket No. 940963-SU
- In re: Application for a rate increase by General Development Utilities, Inc. (Port Malabar Division) in Brevard County, Docket No. 911030-WS
- In re: Dade County Circuit Court referral of certain issues in Case No. 92-11654 (Transcall America, Inc. d/b/a ATC Long Distance vs. Telecommunications Services, Inc., and Telecommunications Services, Inc. vs. Transcall America, Inc. d/b/a ATC Long Distance) that are within the Commission's jurisdiction, Docket No. 951232-TI
- In re: Application for transfer of Certificates Nos. 404-W and 341-S in Orange County from Econ Utilities Corporation to Wedgefield Utilities, Inc., Docket No. 960235-WS
- In re: Application for increase in rates and service availability charges in Lee County by Gulf Utility Company, Docket No. 960329-WS
- In re: Fuel and purchased power cost recovery clause and generating performance incentive factor, Docket No. 010001-EI
- In re: Application for staff-assisted rate case in Highlands County by The Woodlands of Lake Placid, L.P., Docket No. 020010-WS
- In re: Application for rate increase in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida, Docket No. 020071-WS
- In re: Petition for issuance of a storm recovery financing order, by Florida Power & Light Company, Docket No. 060038-EI

BEFORE THE PUBLIC SERVICE COMMISSION

In re: Application for increase in water and wastewater rates in Alachua, Brevard, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.	DOCKET NO. 060368-WS DATED: AUGUST 21, 2007
--	--

CERTIFICATE OF SERVICE

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

Stephen Burgess & Stephen Reilly, Esquires
Office of Public Counsel
c/o The Florida Legislature
111 W. Madison Street, Room 812
Tallahassee, FL 32399-1400

Cecilia Bradley, Esquire
Office of the Attorney General
The Capitol – PL01
Tallahassee, FL 32399-1050



ROSANNE GERVASI
SENIOR ATTORNEY
FLORIDA PUBLIC SERVICE COMMISSION
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850
(850) 413-6224