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May 26, 2017

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Florida Public Service Commission

Re: Docket No. 160195-WS - Application for staff-assisted rate case in Lake County by Lakeside Waterworks, Inc. – OPC Letter of Concerns

Attached are issues that OPC has prepared to identify concerns we have with the utility filing. We are bringing these to staff's attention to aid staff in its review of the rates and to allow staff sufficient time to review our concerns and ask for additional information or documentation that might be needed. If you should have any questions, please feel free to call or e-mail me.

Respectfully submitted,
s/Patricia W. Merchant

Patricia W. Merchant
Chief Legislative Analyst

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OPC Issues and Concerns

1. Issue 1 – Quality of Service

OPC requests that a copy of all complaints and information requests from the Commission's Consumer Activity Tracking System related to this utility from January 2014 to date be placed into the docket file for review.

2. Issue 3 – Year-End Rate Base.

As addressed on pages 7-10 in the Staff Report, the Utility has requested and Staff has recommended using a year-end rate base for the water system and an average rate base with year-end pro forma adjustments for the wastewater system. OPC agrees that using a year-end rate base is appropriate for both water and wastewater. By using a year-end rate base for one system and an average rate base for the other is inconsistent with the test year concept, it can violate the matching principle, and is akin to an apples and oranges analysis. When applying the test year concept, one should consider and match all aspects of the test year: rate base, cost of capital, revenues, expenses and rates. In this case, no test year additions were made to plant or CIAC for the wastewater system, therefore, there is no income statement impact in a change from an average to a year-end test year. Other than the cost of capital, the only adjustments necessary are to accumulated depreciation, accumulated amortization of CIAC and non-used and useful.

OPC notes that the Utility cited four orders where the Commission has previously used a year-end test year. Of those cases, two were water only systems, one was a wastewater only system, and the last case was water and wastewater and the Commission used a year-end test year for both systems.[1] Of those four cases, the only one with both a water and wastewater system used year-end for both systems.

[1] See Order No. PSC-98-0763-FOF-SU, issued June 3, 1998, in Docket No. 971182-SU, In re: Application for staff assisted rate case in Marion County by BFF Corp., pages 9-10; Order No. PSC-00-1774-PAA-WU, issued September 27, 2000, in Docket No. 991627-WU, In re: Application for rate increase in Polk County by Park Water Company Inc., page 5; Order No. PSC-01-0323-PAA-SU, issued February 5, 2001. Docket No. 000580-WU, In re: Application for staff assisted rate case in Polk County by Keen Sales, Rentals and Utilities, Inc. (Alturas Water Works), page 5-6; and Order No. PSC-02-1449-PAA-WS, issued October 21, 2002, in Docket No. 011451-WS, In re: Investigation of water and wastewater rates for possible overearnings by Plantation Bay Utility Co. in Volusia County, page 3.

3. Issue 3 – Plant in Service and Accumulated Depreciation

According to documents included in the Staff audit workpapers, U.S. Water Services Corporation (USWSC) billed Lakeside $2,085.05 for services incurred on June 16, 2015, to replace a 4" broken water valve at the well[2]. On the June 16th invoice, the USWSC provided a breakdown of the labor by position with a total number for the materials spent on the project, with a Unit description of LS. OPC needs to know if this valve replacement was retired when the new well was placed into service.

USWSC also billed the Utility $17,067.50, for well collapsed work[3] performed on June 18, 2015. This was based on an invoice USWSC received from an outside contractor for the same amount and provided a detailed description of the project and combined the labor and materials into one item. According to the Utility, the attempt to rehabilitate the old well failed. According to Issue 1 in the Staff report, the replacement well was completed on September 24, 2015 and approved by DEP on April 15, 2016.

OPC does not believe that it was appropriate to record the June 16th and June 18th invoices discussed above into plant in service, as those costs incurred were not capital assets that provided service for longer than a year to the Utility. The Uniform System of Accounts for Class B Water Utilities (USOA), page 58, states the following:

> 186. Miscellaneous Deferred Debits
> A. This account shall include the following classes of items:
> (1) Expenditures for preliminary surveys, plans, investigations, etc., made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited with the amount applicable thereto and the appropriate plant accounts shall be charged with an amount which does not exceed the expenditures which may reasonable be determined to contribute directly and immediately and without duplication to plant. If the work is abandoned, the charge shall be to account 426 - Miscellaneous Nonutility Expenses, or to the appropriate operating expense accounts (See account 675 – Miscellaneous Expenses).

While the Class C water Uniform system of accounts is silent on the treatment of determining the feasibility of construction projects or projects that are abandoned and not placed into operation, OPC believes that is reasonable to look at the next higher level for guidance on

[2] Staff Audit Workpaper 16-2.8, Invoice 814528
[3] Staff Audit Workpaper 16-2.6, Invoice 814525

more complicated accounting matters[4]. Additionally, the Class C USOA does address, in Accounting Instruction 5E, the implications of a retirement that would eliminate or seriously deplete the depreciation reserve, and states that the Commission should either require the loss to be expensed or transferred to Miscellaneous Deferred Debits and amortized in future periods.

While OPC is not challenging whether the work performed was reasonable, we believe that the appropriate treatment should have been to defer these costs pending the outcome of this proceeding and to amortize those costs over a reasonable time frame. It is not reasonable to capitalize these costs which have no long-term future benefit to customer service, and then retire them less than a year later. The effect of this is to decrease accumulated depreciation on an asset that was incorrectly but minimally depreciated and then remove the full cost of the capitalized repair from accumulated depreciation. This accounting treatment overstates rate base by removing accumulated depreciation that was never recorded. As discussed below, OPC believes that an appropriate amortization period is 10 years.

4. Issue 3 – Plant in Service – Miscellaneous Water Plant Additions

OPC reviewed Invoice 794567 dated May 28, 2014, which was included in Lakeside's Supplemental Response to Staff's First Data Request, page 9, filed with the Commission on October 10, 2016. This was a USWSC invoice to install chlorine pumps at the water treatment plant. The date of the service was December 17, 2012, but the Utility was not billed until May 28, 2014. OPC is concerned with such a long delay in billing and would like to see the back-up support to verify that this plant addition was added after the end of the last test year and that it was appropriately billed to Lakeside. Also, on Invoice 787751 dated December 2, 2013, there is no date of service on this invoice. OPC would also like to see the back-up support for this plant addition.

5. Issue 3 – Plant in Service – Pro forma Wastewater Plant Additions

Lakeside submitted invoice 845721 which totaled 91,485.50 for services provided by USWSC related to the wastewater treatment plant upgrades. Included in this invoice is $59,179.03 in materials and $10,652.23 for an 18% markup on the materials. The invoice also reflects 197 hours for tradesmen and 197 hour for maintenance technicians related to the plant upgrade. OPC would like to see all of the invoices that support this invoice. We are also concerned about the policy of including an 18% markup on materials. OPC has noted in several other instances that this markup is applied to services as well as materials. Further, the Utility should be required to demonstrate why an 18% markup on materials from a related party servicing company is reasonable and prudent.

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[4] In the Class A Water USOA, these costs are referred to as Preliminary Survey and Investigation Charges and the accounting is the same as described above in the Class B USOA.

Also, in its response to Staff's 2nd Data Request, the Utility stated that Lakeside obtained an estimate (quote) from Marolf and USWSC determined that it could construct and install the treatment plant installation at less cost. There was no document provided in that response that contained a quote from this outside vendor to show that the plant cost per USWSC was less than an outside vendor. If the estimate or quote is somewhere else in the docket file, OPC has not been able to find if. OPC believes that relying solely on the Utility's statement that its affiliate's cost is less than an independent vendor is not sufficient.

6. Issue 3 – Beginning Balances of Plant, Accumulated Depreciation and Accumulated Amortization of Contributions in Aid of Construction (CIAC)

In calculating the proper amount of rate base for this rate case, Staff started with the balances of plant, accumulated depreciation, CIAC, and accumulated amortization of CIAC approved in the last rate case order. The adjusted balance in the last order included several types of adjustments which are not appropriate to record on the Utility's books. These adjustments included averaging and pro forma plant adjustments, which are used for setting rates only. Only the actual plant additions and retirements should be recorded on a Utility's books and records. By starting with the total balance from the order, the rate base included in the Staff report is overstated. Further, including the pro forma plant in the beginning balance of plant double counts those additions when they are capitalized as actual plant additions in the first year. OPC notes that the beginning balance of CIAC is not impacted as there were no additions to CIAC in the last case and the year-end and the average balances were equal. The following adjustments should be made:

Adjustments to Beginning Balance as of June 30, 2013

	Water	Wastewater
Plant		
Remove Average Adjustment	$0	$93
Remove Pro forma Adjustment	($3,512)	($923)
Total	($3,512)	($830)
Accumulated Depreciation		
Remove Average Adjustment	($2,396)	($266)
Remove Pro forma Adjustment	($5,277)	($2,522)
Total	($7,673)	($2,788)
Accumulated Amortization of CIAC		
Remove Average Adjustment	$245	$139

Note: Adjustments are shown for the impact on rate base.

Also, OPC is unclear as to how the adjustments to plant to reflect the Commission ordered adjustments from the last case were calculated in the Staff report and how those amounts reconcile with the Staff audit adjustments (increases of $1,985 to water and $20 to wastewater).

7. Issue 4 – Cost of Capital

On page 11 of the Staff report, it states that "The Utility's capital structure has been reconciled with Staff's recommended rate base." Upon review of Schedule 2, the total capital shown is $181,804. If you combine the Staff recommended rate bases of $111,193 for water and $137,680 for wastewater, the total is $248,873. Further, Staff's report reflected no reconciling adjustments on Schedule 2. Thus, it does not appear that the Staff considered the additional source(s) of capital that the Utility plans to use to support its investment in rate base.

Also, reviewing Lakeside's 2016 annual report, the Utility reflects a balance of $26,410 in Other Liabilities Account 241.6 entitled Officers' Salaries. There is no other detail or explanation in the annual report regarding the terms of this debt, when it will be repaid, and what interest rate is charged, if any. OPC believes that more information should be provided to determine whether this debt should be considered in the in the cost of capital calculation.

8. Issue 6 – Operating Expenses: Contractual Services - Other.

On page 14 of its report, the Staff has recommended a $3,699 increase for water based on a preliminary estimate to reflect a possible pro forma increase in the contract amounts for the water operations pending additional information from the Utility. OPC has not seen any documentation in the docket file or audit workpapers showing that the Utility has requested this increase or a justification for this increase. At a minimum, the Utility should be required to provide any supporting documents to show why this 9.4% increase in its monthly operating contract is necessary.

9. Issue 6 – Operating Expenses: Contractual Services - Other.

Also on page 14, the Staff report states:

> The USWSC contract fees include certain repairs that do not exceed $400. During the test year, the Utility experienced a water line repair and a wastewater lift station repair that exceeded the $400 limit. Both repairs were recorded to wastewater expense, therefore, Staff reclassified the water line repair to water expenses, resulting in an increase to water of $1,165 and a corresponding decrease to wastewater of $1,165. Neither repair involved the replacement of plant. Staff believes it is reasonable to allow this level of recurring repair expense on a going-forward basis and that no further adjustment is necessary.

Please provide the basis and justification to show that these levels of repairs are recurring on an annual basis. OPC would like to know how many and in what amounts by system of these types of repairs that exceed the $400 per the operating contract have been made since 2013 when the certificate was transferred to the current owner of the Utility. Based on OPC's analysis has shown that most major line repairs prior to the test year were capitalized to plant.

Finding 5 in the Staff audit report stated that the water line repair was expensed in wastewater Account 736, Contractual Services – Other and also capitalized into plant, account 331, and the proper treatment was to capitalize the amount. In its response to the audit, the Utility disputed that the amount was capitalized and agreed that the amount should have been capitalized into water plant account 331. Upon review of the invoice, a hand-written note does state that the invoice should have gone into Account 331. In the Staff report, technical Staff has recommended that this amount be expensed as a normal recurring water line repair. OPC would like to point out several concerns regarding this repair. First, the invoice shows that the date of the repair was June 15, 2015, but the invoice from U.S. Water, the Utility's affiliate, was dated July 28, 2015. For accrual accounting purposes, the date of the repair should be the date that an accrual is made not the invoice date, which is 6 weeks after the repair. Thus, the repair, if not capitalized, is outside of the test year which began on July 1, 2015. Second, a major repair such as this is properly capitalized not expensed, which is consistent with the Utility's position in its response to the audit and consistent with the Commission's treatment of similar major line repairs in Lakeside's prior rate case[5]. If the 4" water line is not properly capitalized, it should be amortized over a 5-year period, unless the Utility can show that a repair of this magnitude is annually recurring.

10. Issue 6 – Operating Expenses: Sludge Removal Expense

In the Utility's annual reports, it reflected sludge removal expense of $975 for 2016 and $3,315 for 2015. The total per the Utility in the Staff Report on Schedule 3-E is $2,275 for sludge removal. OPC would like to know why sludge removal expense decreased between 2015 and 2016 and what is the monthly sludge removal cost that is being incurred since the new treatment plant was placed into service.

11. Issue 6 – Operating Expenses: Bad Debt Expense

The Utility's requested (and Staff recommended) balance of bad debt expense is significantly higher than the amounts reported in the annual reports for 2014 to 2016. Below is a chart compiled from the amounts reported in the Utility's annual reports, the last Commission order and the current Staff report:

[5] Order No. PSC-15-0013-PAA-WS, page 8, in Docket No. 130194-WS

Bad Debt Expense	2013	Prior Case TYE 6/30/13	2014	2015	2016	5-year Average	Current TYE 6/30/16
Water	2900	403	-2924	285	309	194.6	414
Wastewater	106	447	0	140	67	152	375
Total	3006	850	-2924	425	376		789

The Commission regularly uses an averaging method to determine the amount of bad debt expense. OPC believes that further analysis should be performed to determine what the appropriate balance of bad debt expense should be.

12. Issue 6 – Operating Expenses: Amortization of Loss on Abandonment of Plant

In its SARC application, the Utility requested a 10-year amortization period for the loss on abandonment for both the water and wastewater systems based on the Commission decisions in Dockets 140239-WS and 150102-SU. In Order No. PSC-15-0569-PAA-WS[6], as well as Order No. PSC-16-0013-PAA-SU[7], the Commission stated that since the plant was fully depreciated, there was no loss other than the cost of removal. In both cases, the Commission stated that there was no accounting guidance related to the determination of the appropriate amortization period for an incurred expense, and using professional judgement found that a reasonable amortization period was 10 years.

It appears that in calculating the loss on wastewater abandonment, Staff used the June 30, 2016, balance as the unrecovered balance. Since the agenda for this case is currently set for August 3, 2017, more than a year has elapsed since the end of the test year and rates in effect included depreciation on the retired plant. OPC believes that the accumulated depreciation balances should be updated to allow the amount of depreciation that customers have paid through rates until the new rates go into effect to be considered in determining the amount of the net loss. If one assumes that the abandoned plant was physically retired in February 2017, the depreciation account should be updated to that date and the calculated loss will be less since the depreciation expense was already recovered in rates. Further, OPC believes that a 3-year amortization period is too short and will result in a material impact on customer bills. OPC is also concerned with allowing a 3-year amortization period for such a material expense with no requirement that rates be reduced at the end of the 3-year period since that expense would no longer be incurred.

As discussed earlier in item number 3, the costs to replace the water valve and the failed attempt to rehabilitate the well should not be considered part of the loss on abandonment. Those costs should be deferred and amortized over an appropriate period. OPC believes that a 10-year

[6] Order No. PSC-15-0569-PAA-WS, issued December 16, 2015, in Docket No. 140239-WS In re: Application for staff-assisted rate case in Polk County by Orchid Springs Development Corporation, page 16
[7] Order No. PSC-16-0013-PAA-SU, issued January 6, 2016, in Docket No. 150102-SU, In re: Application for increase in wastewater rates in Charlotte County by Utilities, Inc. of Sandalhaven, page 11-12.

amortization period for these costs is reasonable given the magnitude of the expense. This amortization period is also consistent with Commission practice, as outlined above, and because the Utility requested a 10-year amortization.