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January 24, 2018

Carlotta S. Stauffer, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 20170147-WS -- Application for staff-assisted rate case in Levy County by FIMC Hideaway, Inc.

Dear Ms. Stauffer:

Attached is a list of issues that the Office of Public Counsel has prepared to identify concerns we have with the Staff Report issued on January 16, 2018. 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

c: Division of Accounting & Finance (C. Bulecza-Banks, T. Brown, K. Wilson)
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Office of Public Counsel (V. Ponder, J.R. Kelly)

OPC List of Issues and Concerns
Docket No. 20170147-WS
Application for staff-assisted rate case in
Levy County by FIMC Hideaway, Inc.

1. Excessive Unaccounted for Water (EUW) (Issue 2). On pages 11-12 of the Staff Report dated January 16, 2018, Staff addresses the Utility's EUW. Staff explains that FIMC's monthly operating reports (MORs) show that the Utility produced 8,837,742 gallons of water during the test year, while the billing records show the Utility sold 5,322,340 gallons of water during the test year. Staff further explains that the Utility's monthly operating reports (MORs) do not reflect any gallons categorized under other uses for water, so Staff instead relies upon the Utility's 2016 Annual Report, which indicated 2,628,000 gallons were used for other uses. This amount of other uses is 49 percent of the amount of water gallons sold, and a self-reported amount from an annual report does not constitute adequate support. Staff nevertheless accepts this extremely high level of undocumented other uses as reasonable for calculating the amount of EUW. Rule 25-30.4325(10) Florida Administrative Code (FAC), states that the Commission will consider all relevant factors, including whether the reason for excessive unaccounted for water during the test period has been identified, whether a solution to correct the problem has been implemented, or whether a proposed solution is economically feasible to determine whether an adjustment to plant and operating expenses for excessive unaccounted for water will be included in the used and useful calculation. It is OPC's position that more investigation is required to determine why the flushing and other uses of water are almost half of the amount of water billed. Additionally, Staff should determine if there are records of other water usage, and if there are no records, then the Utility must provide an explanation for the lack of records. Finally, if the amount of water categorized under other uses is not properly documented, then there should be a detailed explanation of the reasons the amount deemed to have been incurred is reasonable.

2. Used and Useful (Issue 2). In its Staff Report, Staff states that in the last rate case in 1991, the Hideaway WTP and WWTP were found to be 100% used and useful. In 2013, the Hideaway and Springside water systems and wastewater systems were interconnected, and the Hideaway systems were abandoned. Staff does not reflect any information in its report regarding the combined water and wastewater used and useful calculations. It would be helpful to see this information prior to receiving the staff recommendation, so that OPC will have sufficient time to review the supporting data and provide input into the calculations, if required.

3. Land and Land Rights and Plant in Service (Issue 3). In staff's workpapers and the staff audit, the staff reflects $3,858 in water and $4,961 in wastewater land for the Hideaway water and wastewater systems. As discussed in Comment 2 above, the Hideaway systems were abandoned in 2013. The audit report, on page 7, shows water plant for wells, supply mains, pumping equipment, and water treatment equipment. On page 9 of the Staff's Audit Report issued October

13, 2017, wastewater plant for the Hideaway system includes balances for treatment and disposal equipment. Since both of these treatment plants were abandoned, OPC questions why it is reasonable to retain land and plant balances for these plants in Staff's Report, and whether any retirements must be made to plant, accumulated depreciation and depreciation expense.

4. Accumulated Depreciation (Issue 3). On page 14 of its report, Staff retired a WWTP line from plant. However, Staff's workpapers do not show a corresponding retirement to accumulated depreciation or depreciation expense related to the retired line replacement, as required in the NARUC[1] Uniform System of Accounts for Class C Wastewater Utilities Accounting Instruction 5.D.[2]

5. Cost of Debt (Issue 4). The staff report reflects a 10.88% overall rate of return and a 9.01 cost of equity. There is no other discussion as to why the overall cost of capital is higher than the cost of equity. Our review of Schedule 2 in the Staff Report, which reflects Staff's calculation of the cost of capital, shows that Staff included $10,371 for credit card debt at a cost rate of 22%. OPC asserts that this cost of debt is unreasonable, and should not be used in the process for setting rates that customers must pay. While the calculated rate of return is not used in determining the revenue requirement because of the use of an operating ratio, allowing such an extremely high cost of debt in setting rates could set a dangerous precedent and should not be allowed.

6. Salaries (Issue 6). On page 18 of the Staff Report, Staff stated the Utility did not record any salaries and wages-officers expense during the test year, and that the owners of the Utility have requested pro forma salaries totaling $18,000. Staff also stated that the owners are responsible for a variety of tasks from billing to tree trimming, and that the requested increase equates to $12.50 per hour. Dividing the $18,000 by $12.50 equals a total of 1,440 hours per year. Staff then referred to another recent SARC, where the Commission approved officer salaries for a wastewater-only utility that averaged $26.75 per hour. Staff multiplied the $26.75 per hour rate by 1,560 (30 hours per week times 52 weeks) and calculated total pro forma salaries of $41,727. Staff's workpapers do not show how either the 1,560 or 1,440 hours were calculated. The Audit Report provides a more detailed description of work that the two owners contribute to the Utility, but this description does not reflect the method by which the number of hours per week were calculated. Clear delineation of work performed should be provided by the owners, especially since the Two Fold Water Engineering, Inc. operates and maintains the systems, including replacement of meters. Billing, meter reading and revenue collection for 183 water customers should only take several hours per month; there are very few monthly checks that the Utility pays, so book keeping is also minimal. Communication with DEP occurs on an "as needed" basis, and is not a monthly job function, especially since the monthly operating reports are submitted by the operator, not the

[1] National Association of Regulatory Utility Commissioners
[2] Pursuant to Rule 25-30.115, FAC, all water and wastewater utilities are required to maintain their accounts and records in conformity with the NARUC Uniform System of Accounts for Water and Wastewater Utilities.

owner. OPC asserts that Staff's description of the owners' job functions, without further documentation or justification, is unreasonable, considering the size of the Utility and the facts that it has a full time operator and does not require 30 hours per week in work requirements. If Staff does have further documentary support of the work performed, then it has not been disclosed in the official docket file of the Commission. Further, OPC asserts that using an hourly rate of $26.75 as the salary for meter reading, billing, book keeping, and tree trimming is excessive. A more reasonable hourly rate for these types of services ranges from $16 to $18 per hour. Accordingly, OPC believes that the Utility's requested salary of $18,000 per year should be allowed. On a conservative basis, if you take the Utility's requested total salary of $18,000 and divide that by $18 an hour, this would equate to 1,000 hours per year or 20 hours a week. OPC contends that this is a more reasonable officer salary allowance for a very small utility.

7. Payroll Taxes (Issue 6). In its Staff Report, Staff made a pro forma adjustment to increase salaries by $20,146 for water and $21,581 for wastewater. Staff then made a corresponding adjustment to increase taxes other than income by $3,083 and $3,904 for water and wastewater, respectively, to reflect the amount of payroll taxes on the increased payroll. Current payroll taxes are 7.65% for the employer according to the IRS website (6.2% for Social Security and 1.45% for Medicare). If you divide the adjustment for payroll taxes by the amount of the pro forma salary increase, the result is 15.3%. OPC assert that the payroll tax adjustment calculated by Staff is incorrect. We request an explanation as to why a payroll tax pro forma adjustment that is exactly double the amount required by the federal government is reasonable. If any additional adjustments are made to officer salaries, a corresponding adjustment to payroll taxes of 7.65% should also be made.

8. Contractual Services Other (Issue 6). On pages 19 and 20 of its Staff Report, Staff addresses adjustments to reclassify amounts from other expense accounts. For the amounts that are reclassified into "contractual services other," Staff failed to identify the items to which these costs relate. Similarly, in the other accounts where these amounts are removed, there is no description in the report to identify these costs. While Staff included the descriptions of the adjustments in Audit Finding 8 in the Audit Report, it would be helpful and clearer if Staff also provided a brief explanation in the Staff Report.

9. Rent Expense (Issue 6). On paged 20 of the Staff Report, Staff preliminarily recommended allowing the requested $11,000 in rent expense, of which $5,311 and $5,689 were allocated to water and wastewater, respectively. Staff stated that that additional information was needed in order to determine the Utility's appropriate rent expense going-forward. In Audit Finding 8 on page 21 of the Audit Report, Staff stated that the McBrides are charging rent of $1,000 per month for rent for the water systems. The Utility's office is in the McBride's home, and the office space is 170 square feet, or 10 percent of the size of the home. The auditors stated that the total monthly cost of the home is $1,229, and so the $1,000 monthly rent expense for the office alone, at 81 percent of the home's cost, appeared excessive. The auditors also stated that the office furniture

and equipment had been capitalized and are now fully depreciated. While the Audit Report does not delineate how the monthly cost of the home was calculated, OPC submits that, in order to be consistent with the IRS requirements for allowing a home office deduction, the office rent should be based on the square footage of the office space, as compared to the total home space. Thus, total rent expense should be no more than $123 per month or $1,476 per year, which should then be allocated between water and wastewater.

10. Self-Insurance expenses (Issue 6). On pages 20-21 of the Staff Report, Staff stated that while the Utility did not incur any insurance expense during the test year, the Utility expensed $1,200 for self-insurance accruals in its 2016 annual report. Staff noted that prior to 2016, the Utility's 2012-2015 annual reports reflected insurance expense of $1,200 for water and $1,200 for wastewater. While the Utility did not provide an explanation as to why it decreased its self-insurance expense, Staff expressed the opinion that it would be beneficial for the Utility to maintain a higher level of self-insurance. Staff stated that for purposes of the Staff Report, a five-year average of the expense reflected in the Utility's 2012-2016 Annual Reports should be used to reflect appropriate insurance expense, resulting in insurance expense of $1,080 for water and $1,080 for wastewater. OPC asserts that Staff's analysis is incorrect for multiple reasons. First, none of the amounts in the 2012-2016 Annual reports have been verified with documentary evidence or evaluated for reasonableness. An unsubstantiated, self-serving statement by a company in its own annual report is not generally considered an objective source. Second, self-insurance funding and expenses should not be recognized for ratesetting purposes except in rare exceptions, such as a storm reserve. Further, self-insurance costs are disallowed by the IRS, even if a company can't get insurance for certain types of risks, although the IRS may allow actual losses to be incurred. (See IRS Publication 547). Third, a self-insurance mechanism for such a small utility is extremely risky. One claim for damages could completely deplete the assets of a small business, not to mention the assets of the owners. Fourth, for a self-insurance reserve to work, the Utility must account for the amount of funds that have been accrued and show what types of costs could be or have been expensed; this involves a large amount of paperwork that may be untenable for a utility of this size. Finally, in this case, FIMC has not provided any estimates, quotes or invoices to show that the prior amounts included in its Annual Reports are reasonable for a utility of this size. OPC agrees that the Utility should have a reasonable amount of liability insurance. If a material accident occurred, OPC doubts that this Utility would have sufficient funds to pay out a claim. We strongly urge the staff to require the Utility to provide corroborating evidence of the cost for a reasonable amount of insurance before allowing the Utility to include a blanket, unsupported amount in the revenue requirement calculation.

11. Bad Debt Expense (Issue 6). The Staff Report, on page 21, stated that FIMC did not record any bad debt expense in its general ledger for the test year; however, the Utility included bad debt expense of $2,696 for water and $2,995 for wastewater in its 2016 Annual Report, based on a schedule generated from the billing system. Staff further noted that no bad debt expense was included in the Utility's 2014 or 2015 Annual Reports, and that only nominal amounts of bad debt

expense were reported in the Utility's 2011, 2012, and 2013 Annual Reports. Staff stated that because a 3-year historical average was not available, it would be more appropriate to use the expense reflected in FIMC's 2016 Annual Report in this case. Further, Staff added that additional information was needed in order to determine the Utility's appropriate bad debt expense going-forward. OPC has several concerns with Staff's analysis. First, as stated previously, amounts included in a Utility's Annual Report do not constitute objective, reliable support. Figures listed in an annual report cannot be considered properly supported unless documentation is provided to justify the reasonableness of each particular cost. However, one were to accept the premise that the amounts listed in an annual report support the level of costs, then the fact that the Utility reported no bad debt expense in 2014 and 2015 should be factored into the analysis of the levels of bad debt incurred. Second, in the Staff Report, the Staff incorrectly stated the balances of bad debt expense reflected in the Utility's 2016 Annual Report. The Utility reflected bad debt expense of $2,108 and $2,299 for water and wastewater, respectively, not the amounts included in the Staff Report. Regardless, Staff should investigate further how the bad debt expense was determined in the 2016 Annual Report, as well as why no bad debt expense was recorded in the test year. This expense should be disallowed until the Utility is able to provide sufficient documentation that a reasonable level of bad debt expense should be allowed. As discussed in Issue 11 of Staff's Report, OPC agrees that implementing a customer deposit will assist the Utility in minimizing the exposure to bad debts.