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March 20, 1997

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Ms. Bianca Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Utilities, Inc. of Florida - Affiliate Transaction Review, Audit Control No. 96-003-3-4

Dear Ms. Bayo:

Please find enclosed for filing, Utilities, Inc. of Florida's response to the Staff audit report regarding the affiliate transaction review.

If you have any questions, please call.

Thank you.

Sincerely,

Patricia M. Cuddie

Patricia M. Cuddie
Manager, Regulatory Accounting

enclosure

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UTILITIES, INC. OF FLORIDA
Affiliate Transaction Review
Response to Florida Public Service Commission Staff Audit Report
Audit Control #96-003-3-4

Audit Exceptions

Audit Exception No. 1:

Subject: AFUDC

The Auditor indicates that adjustments should be made to reduce Water Service Corp. plant-in-service, accumulated depreciation and depreciation expense since the parent company did not receive an approved AFUDC rate.

The Company disagrees with the Auditor's recommendation. The disputed AFUDC is based on the parent company's general construction projects, rather than its Florida companies' construction projects. The Company previously received permission from the Florida Commission to charge AFUDC for its Florida companies, but those approved rates were specific to those companies and did not extend to the parent company. However, since the parent company is a holding company which operates in various jurisdictions, it is cost prohibitive and unreasonable for it to go to each jurisdiction to receive prior approval regarding an AFUDC rate for general parent company construction projects.

The most reasonable method to determine an AFUDC rate for parent company projects is to use the parent company's capitalization. The company has consistently used this methodology year after year.

The Commission rule does not require parent company application for an AFUDC rate. Furthermore, the Commission has previously accepted the parent company's capitalization for use in determining the cost of capital to be used in various rate cases. It, therefore, only makes sense, that the Commission allow the parent company AFUDC rate to be based on the parent company's capitalization. An alternative to the Auditor's recommendation is to allow AFUDC based on one of the previously approved rates for the Florida companies as opposed to disallowing all parent company AFUDC.

Audit Disclosures

Audit Disclosure No. 1:

Subject: Allocation of Common Cost to Non-Regulated Affiliated Operations

The Auditor feels that the Company's allocation to its two non-regulated affiliated operations is flawed, and proposes an alternative method. The Company understands that there will always be various alternatives available in allocating expenses, all of which can withstand the reasonableness test. It is, however, unreasonable for the Company to be asked to change its allocation methods to suit a particular auditor when the Company operates in various jurisdictions. The WSC methodology has been tested over and over again by all jurisdictions throughout the history of the Company.

The auditor indicated that the company's allocation method regarding the indirect allocation of general office expenses represents a circular calculation which will always approximate the amount of the direct allocation. The Company's method is not a circular calculation, however, it is based on the amount of the direct allocation. This

methodology is reasonable and has been accepted in the various jurisdictions in which the company operates including Florida.

The auditor also indicated that the Company did not allocate computer and insurance costs to the non-regulated operations. This is not true. The total general office expenses of $1,188,031, which includes computer costs, were allocated to the two non-regulated entities. The computer costs are included in the amounts of $15,843 for Land & Lab and $8,167 for ICT. The full amount of computer costs is also allocated through the SE.51 computer allocation to the regulated companies. This means the computer costs were actually over allocated.

In addition, insurance costs were allocated to the non-regulated operations through the SE.52 insurance allocation. Land & Lab was allocated $33,166 and ICT was allocated $5,939.

The Auditor proposes an alternative method for the indirect allocation of general office expenses to the non-regulated operations. The Auditor feels that this particular allocation should be based on all non-executive corporate employees. The Company disagrees with this. There are only a limited number of employees who perform any work for the two non-regulated entities, and those employees are listed on page 27 of the audit report. In addition, executive time is also allocated based on time sheets. To allocate general office expenses based on twenty-six non-executive employees is inappropriate because they do not provide the administrative support for the non-regulated operations.

The Auditor's alternative method creates a very small adjustment of $575. The Company does not wish to dispute a $575 adjustment, however, it does not believe a change to its allocation methodology is appropriate regarding the indirect allocation of general office common expenses. As shown above, the employees who perform work for the non-regulated companies are allocated to them, and the general office expenses are also allocated which includes computer costs. In addition, insurance costs are allocated to the two non-regulated operations through the SE.53 insurance allocation.

The Auditor's proposal should be rejected.