

**CAROLINA WATER SERVICE, INC. OF NORTH CAROLINA
DOCKET NO. W-354, SUB 344**

**TESTIMONY OF KATHERINE A. FERNALD
ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION**

October 15, 2015

1 Q. PLEASE STATE FOR THE RECORD YOUR NAME, ADDRESS,
2 AND PRESENT POSITION.

3 A. My name is Katherine A. Fernald. My business address is 430 North
4 Salisbury Street, Raleigh, North Carolina. I am an Assistant Director
5 of the Public Staff – Accounting Division.

6 Q. HOW LONG HAVE YOU BEEN EMPLOYED BY THE PUBLIC
7 STAFF?

8 A. I have been employed by the Public Staff since 1988.

9 Q. PLEASE BRIEFLY DISCUSS YOUR EDUCATION AND
10 EXPERIENCE.

11 A. I am a graduate of North Carolina State University with a Bachelor of
12 Arts degree in Accounting. I am a Certified Public Accountant. Since
13 joining the Public Staff, I have presented testimony and exhibits in
14 general rate cases for Virginia Electric and Power Company (Docket
15 No. E-22, Sub 314), North Carolina Natural Gas Corporation (Docket
16 No. G-21, Sub 293), Ellerbe Telephone Company (Docket No. P-21,
17 Sub 54), Duke Energy Carolinas, LLC (Docket No. E-7, Sub 1026),
18 and Dominion North Carolina Power (Docket No. E-22, Sub 479). I

1 have also filed testimony and exhibits in numerous water and sewer
2 utility general rate cases, including LaGrange Waterworks
3 Corporation (Docket No. W-200, Sub 20), Bald Head Utilities, Inc.
4 (Docket No. W-798, Sub 8), Carolina Water Service, Inc. of NC
5 (Docket No. W-354, Sub 266), Heater Utilities, Inc. (Docket No. W-
6 274, Sub 478), Aqua North Carolina, Inc. (Docket No. W-218, Sub
7 274), and Aqua North Carolina, Inc. (Docket No. W-218, Sub 319). I
8 have also filed testimony or affidavits in various other water and
9 sewer utility proceedings.

10 Q. WHAT ARE YOUR DUTIES?

11 A. I am responsible for the performance and/or supervision of the
12 following activities: (1) the examination and analysis of testimony,
13 exhibits, books and records, and other data presented by utilities and
14 other parties involved in Commission proceedings; and (2) the
15 preparation and presentation to the Commission of testimony,
16 exhibits, and other documents in those proceedings.

17 Q. WHAT IS THE NATURE OF THE APPLICATION IN THIS CASE?

18 A. On March 31, 2015, Carolina Water Service, Inc. of North Carolina
19 (CWSNC or Company) filed an application with the Commission
20 seeking authority to increase rates for its water and sewer
21 operations.

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS
2 PROCEEDING?

3 A. The purpose of my testimony is to support the Stipulation between
4 the Public Staff, Corolla Light Community Association, Inc., and
5 CWSNC (Stipulating Parties) filed on October 15, 2015. My
6 testimony also discusses the adjustments agreed to by the
7 Stipulating Parties related to (1) the treatment of excess deferred
8 income taxes and (2) accumulated deferred income taxes. I also
9 assisted Public Staff Engineer Casselberry in the review of service
10 revenues.

11 Q. PLEASE DESCRIBE THE SCOPE OF YOUR INVESTIGATION
12 INTO THE COMPANY'S FILING.

13 A. My investigation included a review of the Company's application and
14 other data filed by the Company, an examination of the books and
15 records for the test year ended December 31, 2014, and a review of
16 the Company's accounting, end-of-period, and after period
17 adjustments to test year rate base and expenses.

18 Q. PLEASE COMMENT ON THE STIPULATION.

19 A. The Stipulation is the product of extensive give-and-take
20 negotiations between the parties. The Public Staff believes that the
21 Stipulation represents a just and reasonable resolution of the issues
22 that it covers. As stated in the Stipulation, the issues as they are
23 agreed upon do not necessarily reflect any position asserted by the

1 parties, but are a compromise of a complex set of issues. From the
2 perspective of the Public Staff on behalf of customers, based on the
3 overall reasonableness of the items included in the cost of service,
4 as well as the other provisions of the Stipulation, the Stipulation is in
5 the public interest and should be approved.

6 Q. HAVE YOU PREPARED EXHIBITS FOR USE IN THIS
7 PROCEEDING?

8 A. Yes. Fernald Exhibit I sets forth the stipulated adjustments which I
9 support.

10 **EXCESS DEFERRED INCOME TAXES**

11 Q. MS. FERNALD, WHAT ARE EXCESS DEFERRED INCOME
12 TAXES AND HOW DO THEY ARISE?

13 A. Deferred income taxes (DIT) arise when income tax amounts
14 collected in utility rates differ from the amount of taxes currently due
15 and payable by a utility. The primary cause of the tax differences is
16 the straight-line depreciation rates used for ratemaking purposes as
17 opposed to the accelerated depreciation rates used for income tax
18 purposes. The accumulated balance of DIT (ADIT) is available to the
19 utility to invest until it is needed to fund the taxes due and payable in
20 later years. Excess deferred income taxes (EDIT) arise as a result
21 of an income tax rate reduction. In this case, the state income tax
22 rate was initially reduced from 6.9% to 5% as a result of North
23 Carolina Session Law 2013-316 (House Bill (HB) 998), An Act to

1 Simplify the North Carolina Tax Structure and to Reduce Individual
2 and Business Tax Rates, which was signed into law on July 23, 2013.
3 HB 998 also added a new section, G.S. 105-130.3C, to the general
4 statutes concerning possible future rate reduction triggers. On
5 August 6, 2015, the North Carolina Department of Revenue
6 announced that pursuant to this new section, the target for the fiscal
7 year 2014-2015 had been met, and the state corporate tax rate will
8 decrease to 4% effective January 1, 2016. Prior to the enactment of
9 HB 998, rates of North Carolina regulated utilities, including CWSNC,
10 were set based on the assumption that the utility would pay a 6.9%
11 state income tax rate. The reduction of the tax rate from 6.9% to 4%
12 resulted in EDIT for these utilities.

13 Under generally accepted accounting principles (GAAP), when a
14 reduction in tax rates is enacted, ADIT is adjusted to reflect the new
15 enacted tax rate, and the resulting EDIT is credited to income tax
16 expense, which in effect flows the EDIT to the company's
17 shareholders. However, for regulated utilities, the EDIT is generally
18 flowed back to ratepayers.

19 Q. HAS THE COMMISSION ADDRESSED THE TREATMENT OF THE
20 EDIT RESULTING FROM HB 998 FOR NORTH CAROLINA
21 PUBLIC UTILITIES?

22 A. Yes. In its Order Addressing the Impacts of HB 998 on North
23 Carolina Public Utilities issued on May 13, 2014 in Docket No. M-

1 100, Sub 138 (May 13, 2014 Tax Docket Order), the Commission
2 ordered that EDIT for all utilities be held in a deferred tax regulatory
3 liability account until they can be amortized as credits (i.e.,
4 reductions) to income tax expense for ratemaking purposes in each
5 utility's next general rate case proceeding. The Commission further
6 ordered that all utilities are required to establish a deferred tax
7 regulatory liability account and shall not begin amortization of
8 amounts recorded in such accounts pending further order of the
9 Commission.

10 Q. DID CWSNC ESTABLISH A DEFERRED TAX REGULATORY
11 LIABILITY ACCOUNT ON ITS BOOKS?

12 A. No. CWSNC did not establish a deferred tax regulatory liability
13 account on its books. Instead, when the state corporate tax rate was
14 reduced from 6.9% to 5% in 2013, CWSNC recorded an entry on its
15 books to reduce income tax expense by the EDIT.

16 Q. WHAT IS THE PUBLIC STAFF'S RECOMMENDATION
17 CONCERNING THE TREATMENT OF EDIT IN THIS CASE?

18 A. The Public Staff recommends that the EDIT be flowed back to
19 ratepayers by amortizing the EDIT as a credit to expenses, as
20 required by the Commission in its May 13, 2014, Tax Docket Order.
21 The ratepayers have paid rates based on the higher state income tax
22 rate of 6.9%, and should be refunded the excess deferred taxes that

1 have been collected at this higher rate, which the utility will no longer
2 have to pay due to the reduction in the state income tax rate.

3 Q. ARE THERE ANY RESTRICTIONS ON HOW THE EDIT SHOULD
4 BE REFUNDED TO RATEPAYERS?

5 A. No. There are no restrictions on how the EDIT should be refunded
6 to ratepayers.¹ The Public Staff believes that the manner in which
7 EDIT should be refunded to ratepayers, including the period over
8 which the EDIT is amortized, should be determined on a case by
9 case basis in each utility's next general rate case.

10 Q. WHAT AMORTIZATION PERIOD DOES THE PUBLIC STAFF
11 RECOMMEND FOR CWSNC'S EDIT?

12 A. The Public Staff recommends that CWSNC's EDIT be refunded to
13 ratepayers over a three year period. This is the period of time that
14 the Commission has generally used to amortize rate case expense
15 for water and sewer companies, on the basis that, on average, water
16 and sewer companies file for rate increases every three years.

17 Q. WHAT IS THE AMOUNT OF EDIT TO BE AMORTIZED IN THIS
18 PROCEEDING?

¹ Under the Tax Reform Act of 1986, where the excess deferred taxes were related to federal income taxes on depreciation, the excess deferred taxes related to depreciation were protected and the period over which the excess deferred taxes could be flowed back to ratepayers was restricted, due to the normalization rules. In this case, the excess deferred taxes are related to a state income tax change and there are no restrictions on the period over which these excess deferred taxes can be flowed back to ratepayers.

1 A. During 2013, CWSNC removed \$29,262 of EDIT from ADIT by
 2 debiting ADIT and crediting income tax expense by this amount.
 3 CWSNC calculated this amount based on the accumulated deferred
 4 state income tax amounts as of December 31, 2012, and the change
 5 in the state income tax rate from 6.9% to 5%. In response to a Public
 6 Staff data request, the Company provided an updated calculation
 7 based on the accumulated deferred state income tax amounts as of
 8 December 31, 2013, as follows:

9	Accumulated state deferred taxes at 12-31-13	\$ 169,859
10	Divided by 6.9%	<u>6.9%</u>
11	Grossed up amount based on 6.9% rate	2,461,721
12	Decrease in state income tax	<u>1.9%</u>
13	Effect of state tax rate change	46,773
14	Less: federal effect of rate change at 34%	<u>15,903</u>
15	Excess deferred income taxes	<u>\$ 30,870</u>

16 In determining the amount of EDIT to be amortized in this
 17 proceeding, I have begun with the \$30,870 of EDIT calculated by
 18 CWSNC.

19 To this amount, I have made several adjustments. First, I have
 20 decreased this amount by \$2,627 to reflect additional 2013 activity
 21 at 6.9% that was not included in the Company's calculation. Second,
 22 I have increased this amount by \$28,029 to include excess deferred
 23 taxes for the 2014 ADIT activity, based on the difference between
 24 the 2014 state corporate tax rate of 6% for 2014, and the 5% state
 25 corporate tax rate effective January 1, 2015. Third, I have included

1 an additional \$26,791 of excess deferred taxes related to the
2 decrease in the state corporate income tax rate from 5% to 4%
3 effective January 1, 2016. These three adjustments resulted in an
4 increase in EDIT of \$52,193.

5 Finally, I have grossed up my adjusted level of EDIT of \$83,063
6 (\$30,870 plus \$52,193) to a pre-tax amount based on the combined
7 income tax rate of 36.64% to determine the revenue requirement of
8 \$131,097, which should be established as a regulatory liability.

9 Finally, I have amortized the deferred tax regulatory liability over
10 three years, resulting in an annual credit to expenses of \$43,699. I
11 have also deducted the unamortized regulatory liability of \$87,398
12 (\$131,097 minus \$43,699) from rate base. I have allocated these
13 amounts between uniform water, uniform sewer, Corolla Light &
14 Monterey Shores (Corolla/Monteray), and Nags Head based on
15 plant, net of depreciation.

16 **ACCUMULATED DEFERRED INCOME TAXES**

17 Q. DO YOU AGREE WITH THE COMPANY'S PRO FORMA
18 ADJUSTMENTS TO ADIT?

19 A. No, I do not. In general, the Company either made errors in its pro
20 forma adjustments, or was unable to explain the basis for the
21 adjustment. Specifically, my issues with the Company's pro forma
22 adjustments are as follows:

- 1 (1) In its application, the Company included adjustments to ADIT
2 based on adjustments made in prior Commission orders.
3 ADIT is based on the timing differences between the book and
4 tax treatment of items, and over time, these timing differences
5 will reverse. In making its adjustments based on prior
6 proceedings, the Company generally made them at the same
7 amounts as made in previous proceedings, without any
8 adjustment to update the amounts to reflect the reversal of the
9 ADIT timing differences since those proceedings. Also, the
10 Company included an adjustment related to ADIT for
11 Corolla/Monteray twice, once under CWSNC uniform sewer
12 operations, and again under Corolla/Monteray sewer
13 operations.
- 14 (2) The Company made pro forma adjustments to ADIT related
15 to depreciation for which it was unable to provide an
16 explanation of why the adjustments were made.
- 17 (3) The Company made an adjustment to ADIT related to rate
18 case expense, which contained several errors. First, the
19 Company did not deduct state income taxes in calculating the
20 federal ADIT amount. Second, the Company made an error
21 in applying the adjustment to the per books amount of ADIT.
22

1 Q. WHAT ADJUSTMENTS HAVE YOU MADE TO ACCUMULATED
2 DEFERRED INCOME TAXES?

3 A. I have made the following adjustments to ADIT.

- 4 (1) Remove Company's pro forma adjustments
- 5 (2) Reflect Company corrections
- 6 (3) Reclassify ADIT related to Cabarrus Woods gain
- 7 (4) Reclassify state portion of ADIT
- 8 (5) Remove additional excess deferred taxes
- 9 (6) Reflect adjustment based on prior Commission orders
- 10 (7) Adjust ADIT related to unamortized balances

11 Q. WHY HAVE YOU MADE AN ADJUSTMENT TO REVERSE THE
12 COMPANY'S PRO FORMA ADJUSTMENTS TO ADIT?

13 A. I have made an adjustment to reverse most of the Company's pro
14 forma adjustments to ADIT due to the errors in the Company's pro
15 forma adjustments and the Company's inability to explain the
16 purpose of some of the adjustments. The only adjustment that I did
17 not remove was the Company's adjustment to allocate the ADIT from
18 WSC, since this amount is appropriate and should be included. This
19 resulted in a debit to ADIT of \$3,435,623.

20 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO REFLECT COMPANY
21 CORRECTIONS.

22 A. The Public Staff made three corrections to ADIT based on
23 information provided by the Company. First, during my investigation

1 Company personnel indicated that the \$475,093 debit recorded to
2 ADIT in 2013 should have been reversed in 2014, and an entry
3 crediting ADIT by \$475,093 would be made on the books in 2015 to
4 do so. Second, in 2014, the Company recorded all of the ADIT
5 activity, including both state and federal amounts, in federal ADIT
6 related to depreciation. In response to data request, the Company
7 provided the journal entry that will be recorded in 2015 to reclassify
8 and correct the amounts for the 2014 ADIT activity, resulting in a net
9 debit to ADIT of \$36,582. Third, in response to a data request, the
10 Company provided an updated calculation of the entry for the state
11 tax rate change from 6.9% to 5%, resulting in a debit to ADIT of
12 \$1,609. These three corrections to the Company's per books
13 amounts resulted in a credit to ADIT of \$436,902 (\$475,093 less
14 \$36,582 less \$1,609).

15 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO RECLASSIFY THE
16 ADIT RELATED TO THE CABARRUS WOODS GAIN ON SALE TO
17 A SEPARATE LINE ITEM.

18 A. The Company included the ADIT related to the Cabarrus Woods gain
19 on sale in ADIT – depreciation. I have reclassified this ADIT to a
20 separate line item since it is related to a regulatory liability and not
21 depreciation.

1 Q. WHY HAVE YOU MADE AN ADJUSTMENT TO RECLASSIFY A
2 PORTION OF A 2013 ENTRY FROM FEDERAL ADIT TO STATE
3 ADIT?

4 A. In 2013, the Company recorded an entry to reflect adjustments on its
5 books based on prior Commission orders, along with a
6 corresponding adjustment to ADIT. Based on supporting
7 workpapers provided by the Company, the Company recorded both
8 the state and federal components of ADIT to federal ADIT in error.
9 The Company should have recorded the state portion to state ADIT,
10 instead of recording a combined state and federal amount to federal
11 ADIT. I have made an adjustment to reclassify the state portion of
12 this entry to state ADIT. While this adjustment does not impact ADIT
13 in total, it is necessary in order to have a correct calculation of excess
14 deferred taxes.

15 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO REMOVE
16 ADDITIONAL EDIT FROM ADIT.

17 A. As discussed previously in my testimony under EDIT, I have made
18 several adjustments to the EDIT calculated by CWSNC, resulting in
19 an increase in EDIT of \$52,193. I have made a corresponding
20 adjustment to ADIT to remove this additional amount of EDIT.

21 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO ADIT BASED ON
22 PRIOR COMMISSON ORDERS.

1 A. As previously discussed, the Company included in its application
2 adjustments to ADIT based on prior Commission orders. However,
3 the amounts included by the Company were incorrect, because the
4 Company failed to update the amounts to reflect the reversal of the
5 ADIT timing differences since those proceedings. Due to this error,
6 I have reversed the Company's adjustments related to prior
7 Commission orders as part of my adjustment to reverse the
8 Company's pro forma adjustments to ADIT.

9 In order to determine if any of the adjustments made to ADIT in prior
10 Commission orders should still be made, and if so, at what amounts,
11 I reviewed the reasons for the adjustments in the prior orders, the
12 changes in accounting made by the Company on its tax returns,
13 other activity on the tax returns in recent years, and the entries made
14 to clean up the amount of ADIT on the Company's books. Based on
15 this review, I have determined that most of these entries should no
16 longer be made. However, there is one adjustment that was made
17 in the Sub 327 rate case that should still be made in part. In that
18 proceeding, the Company indicated that it had reported \$4,778,460
19 of reservation of capacity fees collected from the Corolla Bay
20 developer as taxable income in error. Therefore, an adjustment was
21 made to remove the ADIT related to this CIAC, which should never
22 have been paid. Since then, the Company has changed its
23 accounting for this CIAC on its tax return, so that the amounts

1 collected in 2008 and 2009 of \$3,778,460 were no longer reported
2 and taxes were no longer paid on these amounts. This change in
3 accounting was reflected in the Company's ADIT for that year,
4 resulting in the removal of this portion of the taxes paid on CIAC from
5 ADIT on the books. However, the Company has not changed the
6 treatment of the \$1,000,000 that was reported as taxable income in
7 2006 and 2007 in error, and the taxes paid on this CIAC are still
8 included in ADIT. I have made an adjustment to remove the taxes
9 paid on this CIAC from ADIT. Since the Company reported this CIAC
10 as taxable income on its tax returns, it is able to depreciate the plant
11 paid for by this CIAC for tax purposes, and the Public Staff has
12 recognized this offset in its calculation of the ADIT related to the
13 CIAC reported in error. This adjustment resulted in a credit to ADIT
14 of \$252,816.

15 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO ADIT RELATED TO
16 UNAMORTIZED BALANCES.

17 A. I have adjusted ADIT related to rate case expense, deferred
18 maintenance, and the Cabarrus Woods gain on sale to reflect the
19 Public Staff's adjusted level of unamortized balances for these items.

20 Q. HOW HAVE YOU ALLOCATED YOUR ADJUSTED LEVEL OF ADIT
21 FOR CWSNC BETWEEN UNIFORM WATER, UNIFORM SEWER,
22 COROLLA/MONTERAY, AND NAGS HEAD?

1 A. I have allocated my adjusted level of ADIT for CWSNC to uniform
2 water, uniform sewer, Corolla/Monteray, and Nags Head based on
3 several allocation factors. First, I have allocated ADIT related to
4 CIAC based on CIAC, net of accumulated amortization. Second, I
5 have allocated ADIT related to rate case expense, deferred
6 maintenance, and the Cabarrus Woods gain on sale based on the
7 unamortized balances for those items. Third, I have allocated ADIT
8 related to organization costs and bad debts based on the number of
9 customers. Finally, I have allocated ADIT related to depreciation and
10 the NOL deferred asset based on plant, net of accumulated
11 depreciation.

12 **WATER AND SEWER SYSTEM IMPROVEMENT CHARGES**

13 Q. DO YOU HAVE ANY COMMENTS CONCERNING THE WATER
14 SYSTEM IMPROVEMENT CHARGE (WSIC) AND SEWER
15 SYSTEM IMPROVEMENT CHARGE (SSIC) MECHANISM THAT
16 WAS APPROVED BY THE COMMISSION FOR THE COMPANY IN
17 ITS LAST GENERAL RATE CASE, DOCKET NO. W-354, SUB 336?

18 A. Yes. First, consistent with Rules R7-39(k) and R10-26(k), CWSNC's
19 WSIC and SSIC surcharges will be reset to zero as of the effective
20 date of the rates in this proceeding.

21 Second, the WSIC and SSIC does not currently apply to the Nags
22 Head and Linville Ridge service areas since they were not part of the
23 Sub 336 rate case. Since these two service areas are included in

1 this proceeding, the WSIC and SSIC will apply to those customers
2 once the order is issued in this case.

3 Third, by law, the cumulative maximum charges that the Company
4 can recover between rate cases cannot exceed five percent of the
5 total service revenues approved by the Commission in this rate case.

6 Based on the agreed upon service revenues set forth in the
7 stipulation, the WSIC and SSIC caps after this rate case will be:

8		Service		WSIC &
9		<u>Revenues</u>		<u>SSIC Cap</u>
10				
11	Uniform water	\$10,727,674	x 5% =	\$536,384
12	Uniform sewer	1,117,239	x 5% =	55,862
13	Corolla/Monteray	693,575	x 5% =	34,679
14	Nags Head	7,097,654	x 5% =	354,883

15 Q. DOES THIS COMPLETE YOUR TESTIMONY?

16 A. Yes, it does.

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CAROLINA WATER SERVICE, INC. OF NC

Docket No. W-354, Sub 344

ADJUSTMENT TO ACCUMULATED

DEFERRED INCOME TAXES

For the Test Year Ended December 31, 2014

Femald Exhibit I

Schedule 1

Line No.	Item	Total Amount per Company [1]	Public Staff Adjustments [2]	Amount per Public Staff [3]	Allocation of Total to Rate Divisions			
					CWSNC Water	CWSNC Sewer	CL & MS Sewer	Nags Head Sewer
		(a)	(b)	(c)	(d)	(e)	(f)	(g)
<u>State ADIT</u>								
1	Acc def tax state (4417)	\$475,093	(\$475,093)	\$0	\$0	\$0	\$0	\$0
2	Tap fees pre 1987	354,259	0	354,259	152,752 [4]	143,740 [4]	56,970 [4]	797 [4]
3	Post-2000 tap fees	338,516	310,664	649,180	279,918 [4]	263,404 [4]	104,398 [4]	1,460 [4]
4	Rate case expense	(35,633)	23,672	(11,961)	(7,269) [5]	(4,124) [5]	(374) [5]	(194) [5]
5	Deferred maintenance	(191,589)	169,080	(22,509)	(20,055) [6]	(2,454) [6]	0 [6]	0 [6]
6	Organization costs	(145,139)	2,156	(142,983)	(86,214) [7]	(48,915) [7]	(4,431) [7]	(3,423) [7]
7	Bad debt	6,719	2,319	9,038	5,450 [7]	3,092 [7]	280 [7]	216 [7]
8	Cabarrus Woods gain on sale	0	30,205	30,205	20,011 [8]	9,371 [8]	823 [8]	0 [8]
9	Depreciation	(1,334,340)	260,224	(1,074,116)	(548,627) [9]	(367,701) [9]	(131,739) [9]	(26,049) [9]
10	NOL asset	192,843	51,016	243,859	124,556 [9]	83,480 [9]	29,909 [9]	5,914 [9]
11	Total state ADIT	(339,271)	374,243	34,972	(79,478)	79,893	55,836	(21,279)
<u>Federal ADIT</u>								
12	Tap fees pre 1987	396,029	0	396,029	170,762 [4]	160,689 [4]	63,687 [4]	891 [4]
13	Post-2000 tap fees	1,535,122	1,284,451	2,819,573	1,215,762 [4]	1,144,040 [4]	453,428 [4]	6,343 [4]
14	Rate case expense	(192,438)	94,838	(97,600)	(59,314) [10]	(33,653) [10]	(3,050) [10]	(1,583) [10]
15	Deferred maintenance	(878,905)	695,230	(183,675)	(163,650) [11]	(20,025) [11]	0 [11]	0 [11]
16	Organization costs	(327,157)	10,493	(316,664)	(190,938) [7]	(108,331) [7]	(9,814) [7]	(7,581) [7]
17	Bad debt	61,041	11,285	72,326	43,610 [7]	24,743 [7]	2,242 [7]	1,731 [7]
18	Cabarrus Woods gain on sale	0	246,468	246,468	163,286 [12]	76,466 [12]	6,716 [12]	0 [12]
19	Depreciation	(8,638,269)	160,726	(8,477,543)	(4,330,080) [9]	(2,902,106) [9]	(1,039,760) [9]	(205,598) [9]
20	NOL asset	2,088,919	593,778	2,682,697	1,370,243 [9]	918,364 [9]	329,029 [9]	65,061 [9]
21	Total federal ADIT	(5,955,658)	3,097,269	(2,858,389)	(1,780,319)	(739,813)	(197,522)	(140,736)
22	ADIT allocated from WSC	(56,954)	0	(56,954)	(34,341) [7]	(19,484) [7]	(1,765) [7]	(1,363) [7]
23	Total ADIT per Public Staff	(\$6,351,883)	\$3,471,512	(2,880,371)	(1,894,138)	(679,404)	(143,451)	(163,378)
24	Amount per Company			(6,351,883) [1]	(2,999,825) [1]	(2,483,899) [1]	(845,414) [1]	(22,745) [1]
25	Public Staff adjustment			\$3,471,512	\$1,105,687	\$1,804,495	\$701,963	(\$140,633)

[1] Based on review of Company Item 10 workpapers.

[2] Femald Exhibit I, Schedule 1-1, Column (i).

[3] Column (a) plus Column (b).

[4] Column (c) allocated based on CIAC, net of accumulated amortization.

[5] Femald Exhibit I, Schedule 1-1(c), Line 2.

[6] Femald Exhibit I, Schedule 1-1(c), Line 5.

[7] Column (c) allocated based on number of customers.

[8] Femald Exhibit I, Schedule 1-1(c), Line 8.

[9] Column (c) allocated based on plant in service, net of accumulated depreciation.

[10] Femald Exhibit I, Schedule 1-1(c), Line 3.

[11] Femald Exhibit I, Schedule 1-1(c), Line 6.

[12] Femald Exhibit I, Schedule 1-1(c), Line 9.

CAROLINA WATER SERVICE, INC. OF NC
Docket No. W-354, Sub 344
SUMMARY OF PUBLIC STAFF ADJUSTMENTS
TO ACCUMULATED DEFERRED INCOME TAXES
For the Test Year Ended December 31, 2014

Fernald Exhibit I
Schedule 1-1

Line No.	Item	Total Amount per Application [1]	Remove Company Adjustments [2]	Reflect Company Corrections [3]	Reclassify ADIT for Cabarrus Woods Gain [3]	Reclassify State ADIT [4]	Remove Additional Excess Deferred Taxes [5]	Reflect Adjustment Based on Prior Orders [6]	Adjust ADIT Related to Unamortized Balances [7]	Total Public Staff Adjustment [8]	Amount Per Public Staff [i]
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
State ADIT											
1	Acc def tax state (4417)	\$475,093	\$0	(\$475,093)	\$0	\$0	\$0	\$0	\$0	(\$475,093)	\$0
2	Tap fees pre 1987	354,259	0	0	0	0	0	0	0	0	354,259
3	Post-2000 tap fees	338,516	338,264	0	0	0	0	(27,600)	0	310,664	649,180
4	Rate case expense	(35,633)	13,097	4,772	0	0	0	0	5,803	23,672	(11,961)
5	Deferred maintenance	(191,589)	0	(34,766)	0	0	0	0	203,846	169,080	(22,509)
6	Organization costs	(145,139)	0	2,156	0	0	0	0	0	2,156	(142,983)
7	Bad debt	6,719	0	2,319	0	0	0	0	0	2,319	9,038
8	Cabarrus Woods gain on sale	0	0	0	14,911	0	0	0	15,294	30,205	30,205
9	Depreciation	(1,334,340)	294,602	(157,853)	(14,911)	59,306	79,080	0	0	260,224	(1,074,116)
10	NOL asset	192,843	0	51,016	0	0	0	0	0	51,016	243,859
11	Total state ADIT	(339,271)	645,963	(607,449)	0	59,306	79,080	(27,600)	224,943	374,243	34,972
Federal ADIT											
12	Tap fees pre 1987	396,029	0	0	0	0	0	0	0	0	396,029
13	Post-2000 tap fees	1,535,122	1,509,667	0	0	0	0	(225,216)	0	1,284,451	2,819,573
14	Rate case expense	(192,438)	89,054	23,220	0	0	0	0	(17,436)	94,838	(97,600)
15	Deferred maintenance	(878,905)	0	(169,185)	0	0	0	0	864,415	695,230	(183,675)
16	Organization costs	(327,157)	0	10,493	0	0	0	0	0	10,493	(316,664)
17	Bad debt	61,041	0	11,285	0	0	0	0	0	11,285	72,326
18	Cabarrus Woods gain on sale	0	0	0	644,976	0	0	0	(398,508)	246,468	246,468
19	Depreciation	(8,638,269)	1,190,939	(299,044)	(644,976)	(59,306)	(26,887)	0	0	160,726	(8,477,543)
20	NOL asset	2,088,919	0	593,778	0	0	0	0	0	593,778	2,682,697
21	Total federal ADIT	(5,955,658)	2,789,660	170,547	0	(59,306)	(26,887)	(225,216)	448,471	3,097,269	(2,858,389)
22	ADIT allocated from WSC	(56,954)	0	0	0	0	0	0	0	0	(56,954)
23	Total ADIT	(\$6,351,883)	\$3,435,623	(\$436,902)	\$0	\$0	\$52,193	(\$252,816)	\$673,414	\$3,471,512	(\$2,880,371)

[1] Based on review of Company Item 10 workpapers.

[2] Based on review of Company Item 10 workpapers and discussions with Company personnel.

[3] Based on information provided by Company and discussions with Company personnel.

[4] Fernald Exhibit I, Schedule 1-1(a), Line 5.

[5] Fernald Exhibit I, Schedule 2-1, Line 4.

[6] Fernald Exhibit I, Schedule 1-1(b).

[7] Amount per Public Staff from Fernald Exhibit I, Schedule 1-1(c) less sum of Columns (a) through (g).

[8] Sum of Columns (b) through (h).

[9] Column (a) plus Column (i).

CAROLINA WATER SERVICE, INC. OF NC

Docket No. W-354, Sub 344

ADJUSTMENT TO RECLASSIFY STATE ADIT

For the Test Year Ended December 31, 2014

Fernald Exhibit I

Schedule 1-1(a)

<u>Line No.</u>	<u>Item</u>	<u>Amount</u>
1	2013 revision entry	\$331,373 [1]
2	2013 composite tax rate	<u>38.554% [2]</u>
3	Grossed up amount (Line 1 / Line 2)	859,504
4	State corporate income tax rate	<u>6.90% [2]</u>
5	State portion of 2013 revision entry	<u><u>\$59,306</u></u>

[1] Based on review of Company books and records.

[2] Based on state corporate income tax rate for 2013 of 6.9% and federal tax rate of 34%.

CAROLINA WATER SERVICE, INC. OF NC

Docket No. W-354, Sub 344

ADJUSTMENT TO ADIT RELATED TO CIAC

For the Test Year Ended December 31, 2014

Fernald Exhibit I

Schedule 1-1(b)

	Amount
1 Corolla Bay CIAC reported as taxable income in error:	
2 2006	(\$250,000) [1]
3 2007	(750,000) [2]
4 Total Corolla Bay CIAC reported as taxable in error (L2 + L3)	<u>(1,000,000)</u>
5 Tax depreciation related to CIAC property:	
6 2006	85,000 [3]
7 2007	225,000 [4]
8 Total tax depreciation (L6 + L7)	<u>310,000</u>
9 Timing difference related CIAC reported as taxable in error (L4 + L8)	<u>(\$690,000)</u>
10 Adjustment to state ADIT	<u>(\$27,600) [5]</u>
11 Adjustment to federal ADIT	<u>(\$225,216) [6]</u>

[1] Per Fernald Exhibit I, Schedule 2-1, Line 2 from Docket No. W-354, Sub 327.

[2] Per Fernald Exhibit I, Schedule 2-1, Line 3 from Docket No. W-354, Sub 327.

[3] Line 2 times tax depreciation rate of 4% times 8.5 years in service.

[4] Line 3 times tax depreciation rate of 4% times 7.5 years in service.

[5] Line 9 times state corporate income tax rate of 4%.

[6] (Line 9 - Line 10) times federal corporate income tax rate of 34%.

CAROLINA WATER SERVICE, INC. OF NC
Docket No. W-354, Sub 344
ADJUSTMENT TO ACCUMULATED DEFERRED INCOME
TAXES RELATED TO DEFERRED CHARGES AND GAIN ON SALE
For the Test Year Ended December 31, 2014

Fernald Exhibit I
Schedule 1-1(c)

	CWSNC Water (a)	CWSNC Sewer (b)	CL & MS Sewer (c)	Nags Head Sewer (d)	Total (e) [2]
<u>Rate case expense</u>					
1 Unamortized balance per Public Staff	\$181,721 [1]	\$103,102 [1]	\$9,345 [1]	\$4,850 [1]	\$299,018
2 State ADIT per Public Staff (-L1 x 4%)	(7,269)	(4,124)	(374)	(194)	(11,961)
3 Federal ADIT per Public Staff -((L1 + L2) x 34%)	(59,314)	(33,653)	(3,050)	(1,583)	(97,600)
<u>Deferred maintenance</u>					
4 Unamortized balance per Public Staff	501,379 [1]	61,352 [1]	0 [1]	0 [1]	562,731
5 State ADIT per Public Staff (-L4 x 4%)	(20,055)	(2,454)	0	0	(22,509)
6 Federal ADIT per Public Staff -((L4 + L5) x 34%)	(163,650)	(20,025)	0	0	(183,675)
<u>Cabarrus Woods gain on sale</u>					
7 Unamortized balance per Public Staff	(500,264) [1]	(234,272) [1]	(20,577) [1]	0 [1]	(755,113)
8 State ADIT per Public Staff (-L7 x 4%)	20,011	9,371	823	0	30,205
9 Federal ADIT per Public Staff -((L7 + L8) x 34%)	163,286	76,466	6,716	0	246,468

[1] Amount recommended by Public Staff witness Henry.

[2] Sum of Column (a) through Column (d).

CAROLINA WATER SERVICE, INC. OF NC
Docket No. W-354, Sub 344
ADJUSTMENT FOR EXCESS DEFERRED TAXES
For the Test Year Ended December 31, 2014

Fernald Exhibit I
Schedule 2

Line No.	Item	Total Company (a)	CWSNC Water (b)	CWSNC Sewer (c)	CL & MS Sewer (d)	Nags Head Sewer (e)
1	Regulatory liability for excess deferred taxes	(\$131,097) [1]	(\$66,961) [3]	(\$44,878) [3]	(\$16,079) [3]	(\$3,179) [3]
2	Amortization period recommended by Public Staff	<u>3 [2]</u>	<u>3 [2]</u>	<u>3 [2]</u>	<u>3 [2]</u>	<u>3 [2]</u>
3	Amortization of excess deferred taxes (L1 / L2)	<u>(43,699)</u>	<u>(22,320)</u>	<u>(14,959)</u>	<u>(5,360)</u>	<u>(1,060)</u>
4	Unamortized balance to be included in rate base (L1 - L3)	<u><u>(\$87,398)</u></u>	<u><u>(\$44,640)</u></u>	<u><u>(\$29,919)</u></u>	<u><u>(\$10,719)</u></u>	<u><u>(\$2,120)</u></u>

[1] Fernald Exhibit I, Schedule 2-1, Line 7.

[2] Amortization period recommended by Public Staff.

[3] Column (a) allocated based on plant in service, net of accumulated depreciation.

CAROLINA WATER SERVICE, INC. OF NC
Docket No. W-354, Sub 344
**CALCULATION OF REGULATORY LIABILITY
FOR EXCESS DEFERRED TAXES**
For the Test Year Ended December 31, 2014

Fernald Exhibit I
Schedule 2-1

Line No.	Item	State ADIT (a)	Federal ADIT (b)	Total (c)
1	Excess deferred taxes through 12-31-13 per Company	(\$46,773) [1]	\$15,903 [1]	(\$30,870) [6]
2	Include additional excess deferred taxes at 5%	(38,487) [2]	13,085 [4]	(25,402) [6]
3	Include excess deferred taxes for tax change from 5% to 4%	(40,593) [3]	13,802 [5]	(26,791) [6]
4	Additional excess deferred taxes (L1 + L2)	(79,080)	26,887	(52,193)
5	Excess deferred taxes per Public Staff (L1 + L4)	(\$125,853)	\$42,790	(83,063)
6	Gross up for taxes			0.6336 [7]
7	Regulatory liability (L5 / L6)			(\$131,097)

- [1] Based on Company response to Public Staff data request.
[2] Fernald Exhibit I, Schedule 2-1(a), Line 19.
[3] Fernald Exhibit I, Schedule 2-1(b), Line 10.
[4] Fernald Exhibit I, Schedule 2-1(a), Line 20.
[5] Fernald Exhibit I, Schedule 2-1(b), Line 12.
[6] Column (a) plus Column (b).
[7] Based on state income tax rate of 4% and federal income tax rate of 34%.

CAROLINA WATER SERVICE, INC. OF NC

Docket No. W-354, Sub 344

**CALCULATION OF ADDITIONAL
EXCESS DEFERRED TAXES AT 5% TAX RATE**

For the Test Year Ended December 31, 2014

Fernald Exhibit I

Schedule 2-1(a)

<u>Line No.</u>	<u>Item</u>	<u>Amount</u>
	<u>Additional 2013 excess deferred taxes</u>	
1	2013 state ADIT reclassified from federal	\$59,306 [1]
2	2013 state ADIT activity not included in Company calculation	(44,848) [2]
3	Additional 2013 state ADIT activity	14,458
4	State income tax rate reflected in entry	6.90% [2]
5	Grossed-up amount (L1 / L2)	209,536
6	Change in state tax rate from 6.9% to 5%	1.90%
7	Effect of change in state tax rate (L3 x L4)	3,981
8	Federal tax rate	34.00%
9	Federal effect of state tax rate change (-L5 x L6)	(1,354)
10	Adjustment to excess deferred taxes (L7 + L9)	\$2,627
	<u>2014 excess deferred taxes</u>	
11	2014 state ADIT entries	(\$134,111) [2]
12	State income tax rate reflected in entry	6.00% [2]
13	Grossed-up amount (L11 / L12)	(2,235,183)
14	Change in state tax rate from 6.9% to 5%	1.90%
15	Effect of change in state tax rate (L13 x L14)	(42,468)
16	Federal tax rate	34.00%
17	Federal effect of state tax rate change (-L15 x L16)	14,439
18	Adjustment to excess deferred taxes (L15 + L17)	(\$28,029)
19	Additional excess deferred taxes - state tax effect (L7 + L18)	(\$38,487)
20	Additional excess deferred taxes - federal effect (L9 + L17)	13,085
21	Total additional excess deferred taxes (L19 + L20)	(\$25,402)

[1] Fernald Exhibit I, Schedule 1-1(a), Line 5.

[2] Based on review of information provided by Company.

CAROLINA WATER SERVICE, INC. OF NC
Docket No. W-354, Sub 344
CALCULATION OF EXCESS DEFERRED TAXES
FOR TAX RATE CHANGE FROM 5% TO 4%
For the Test Year Ended December 31, 2014

Fernald Exhibit I
Schedule 2-1(b)

<u>Line No.</u>	<u>Item</u>	<u>Amount</u>
1	Total State ADIT per application	(\$339,271) [1]
2	Remove Company pro forma adjustments	645,963 [2]
3	Reflect Company corrections	(607,449) [3]
4	Reclassify State ADIT	59,306 [4]
5	Remove additional state excess deferred taxes from 6.9% to 5%	38,487 [5]
6	State tax benefit at 5% state tax rate (Sum of L1 thru L5)	(202,964)
7	State tax rate	5.00%
8	Grossed up amount (L6 / L7)	(4,059,280)
9	State tax rate change from 5% to 4%	1.00%
10	Effect of change in state tax rate (L8 x L9)	(40,593)
11	Federal tax rate	34.00%
12	Federal effect of state tax rate change (-L5 x L6)	13,802
13	Excess deferred taxes for tax change from 5% to 4% (L5 + L7)	(\$26,791)

- [1] Fernald Exhibit I, Schedule 1-1, Line 11, Column (a).
[2] Fernald Exhibit I, Schedule 1-1, Line 11, Column (b).
[3] Fernald Exhibit I, Schedule 1-1, Line 11, Column (c).
[4] Fernald Exhibit I, Schedule 1-1, Line 11, Column (e).
[5] Fernald Exhibit I, Schedule 2-1(a), Line 19.