

Honorable Mayor and City Commissioners
City of Gainesville, Florida

We have audited the financial statements of Gainesville Regional Utilities (GRU or the Utility) of the City of Gainesville, Florida (the City) for the year ended September 30, 2014, and have issued our report thereon dated February 17, 2015. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our original engagement letter to you dated May 21, 2014. Professional standards also require that we communicate to you the following information related to our audit:

Qualitative Aspects of Accounting Practices

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Utility are described in Note 1 to the financial statements. We noted no transactions entered into by the Utility during the year for which there is a lack of authoritative guidance or consensus.

Adoption of New Accounting Standards

As described in Note 1 to the financial statements, in 2014, the Utility adopted Governmental Accounting Standard Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes standards for measuring and recognizing assets, liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures, effectively reclassifying certain assets as deferred outflows of resources and certain liabilities as deferred inflows of resources on the statement of net position. Pursuant to GASB Statement No. 65, the Utility has reclassified unamortized debt issuance costs and recorded the unamortized debt issuance costs as a regulatory asset on the statement of net position, as permitted by GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 476-500, Regulated Operations.

As described in Note 1 to the financial statements, the Utility anticipates adopting GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, which is effective for the Utility's fiscal year ending September 30, 2015. In addition to improving the disclosures regarding pension plans in the notes to the financial statements, GASB Statement No. 68 will require the Utility to retroactively record the unfunded actuarial liability (UAL) as a net pension liability in its statement of net position, which will decrease the Utility's net position. The effect of the application of GASB Statement No. 68 has not yet been determined.

Certified Public Accountants

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Qualitative Aspects of Accounting Practices (Continued)

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Utility's financial statements were:

■ **Allowance for Doubtful Accounts and Bad Debt Expense**

Management's estimate of the allowance for doubtful accounts reduces the Utility's accounts receivable balances to the net realizable value in the statement of net position and increases the bad debt expense in the statement of revenues, expenses, and changes in net position in accordance with generally accepted accounting principles. Management's estimate is based on historical revenues, loss levels, and analysis of the collectability of accounts. We evaluated the key factors and assumptions used to develop the allowance for doubtful accounts and bad debt expense in determining that it is reasonable in relation to the financial statements taken as a whole.

■ **Costs Recoverable in Future Years**

As discussed in Note 1 to the financial statements, the Utility prepares its financial statements in accordance with GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This accounting treatment results in costs and revenues being recognized in different periods for financial reporting purposes in order to reflect the economics of rate regulation. For the Utility to report under GASB Statement No. 62, its rates must be designed to recover the cost of services and the Utility must be able to collect those rates from its customers. If through competition, regulation or other actions it was determined the Utility no longer met these criteria, it could be required to write-off its regulatory assets and liabilities. We evaluated the key factors and assumptions used by management to develop the costs to be recovered in future years in determining that it is reasonable in relation to the financial statements taken as a whole.

■ **Unbilled Revenue Receivable and Revenues**

Management's estimate of the unbilled revenue receivable on the statement of net position consists of actual cycle billings that are billed subsequent to year end for consumption prior to September 30, 2014, multiplied by the average daily usage for the meter read period. We evaluated the key factors and assumptions used to develop the unbilled revenue receivable in determining that it is reasonable in relation to the financial statements taken as a whole.

■ **Accumulated Depreciation and Depreciation Expense**

Management estimates accumulated depreciation and depreciation expense for capital assets using the straight-line method of depreciation and by determining estimated useful lives based on the classes of depreciable property described in the notes to the financial statements. We evaluated the key factors and assumptions used to develop the capital asset and depreciation expense in determining that it is reasonable in relation to the financial statements taken as a whole.

Qualitative Aspects of Accounting Practices (Continued)

Accounting Estimates (Concluded)

■ **Fair Market Value of Financial and Derivative Instruments**

As discussed in the notes to the financial statements, the Utility uses third party valuations for determining the fair market value of its financial and derivative instruments. We evaluated the key assumptions embodied in these valuations and determined that they are reasonable.

Financial Statement Disclosures

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

■ **Fuel and Purchased Gas Adjustment Levelization**

A fuel and purchased gas adjustment levelization fund is used to stabilize the monthly impact of the cost of fuel and purchased gas. The fuel and purchased gas adjustment charge is based on ordinances approved by the City Commission. Note 7 to the financial statements describes the total revenues and expenses associated with the fuel and purchased gas adjustment and the subsequent impact on the fuel and purchased gas levelization balance as of September 30, 2014.

■ **Jointly Owned Electric Plant**

As more fully described in Note 5 to the financial statements, the Utility had a minority ownership interest in the Crystal River Unit 3 (CR3) nuclear powered electric generating plant. The plant has been permanently retired by the majority owner and operator, Duke Energy. During 2013, Duke Energy provided GRU with insurance proceeds for settlement for damages related to the plant and entitlement funds. The Utility wrote off its net investment in the CR3 plant and nuclear fuel inventory as of September 30, 2013.

During 2014, the Utility and other minority owners reached an agreement with Duke Energy, pending regulatory approval from the Nuclear Regulatory Commission, which would result in the transfer of the Utility's ownership interest in CR3 to Duke Energy, along with its decommissioning funds. In return, the Utility would receive certain cash settlements and Duke Energy would be responsible for all costs and liabilities relating to CR3, including decommissioning costs. The effects of this settlement will be reflected in the financial statements upon approval from the Nuclear Regulatory Commission.

■ **Commitments and Contingencies**

As more fully described in Note 13 to the financial statements, various environmental and other regulations could result in increased future costs.

The financial statement disclosures are neutral, consistent, and clear.

Other Matters

The Gainesville Renewable Energy Center (GREC) Biomass-Fired Power Production Facility (the Facility) began commercial operations on December 17, 2013. It was determined that appropriate accounting presentation of the related Power Purchase Agreement (PPA) included recognition of an embedded capital lease of the Facility to GRU. As a result, the following significant items were recorded in the current year. We consider this transaction and related disclosures to be both a significant estimate and a significant disclosure to financial statement users.

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Qualitative Aspects of Accounting Practices (Concluded)

Other Matters (Concluded)

Capitalization of Leased Asset and Related Liability

As required under Generally Accepted Accounting Principles (GAAP), upon determination that the PPA contained an embedded capital lease, GRU recorded the Facility as a capital lease asset and recorded the related long-term obligation to GREC. The basis for determination of the initial carrying amount of the Facility and related capital lease obligation was a present value analysis of anticipated payments to GREC under the PPA. For purposes of that analysis, the Non-Fuel Energy Charge and the Fixed O&M Charge were deemed to be payments for the Facility and related products and form the basis for calculating the lease asset and related obligation while the Variable O&M Charge was deemed to be executory in nature and not capitalized. Future payments were estimated based upon Available Energy levels realized at the Facility during fiscal 2014. As a result of these calculations, GRU recorded a capital asset and related lease obligation of \$1,006,808,754; the asset will be amortized and the lease obligation, including interest, will be repaid over the 30 year term of the PPA. As permitted under regulatory accounting, GRU has also recognized a related future recoveries revenue and an asset for net cost recoverable in future years.

Presentation of Capital Lease Interest

As required under GAAP, GRU has recorded imputed interest expense on the capital lease obligation related to the GREC PPA. As allowed under regulatory accounting and industry practice, GRU has presented interest expense related to the GREC capital lease obligation as O&M Expense in the Statement of Revenues, Expenses, and Changes in Net Position rather than as Non-Operating Interest Expense.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 17, 2015.

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Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. GRU retained Baker Tilly Virchow Krause, LLP (Baker Tilly) to evaluate whether the Power Purchase Agreement between GREC and GRU should be accounted for as a capital lease, and whether the proposed accounting for the capital lease was appropriate. Baker Tilly’s opinion agrees with our assessment of the transaction.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Utility’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to management’s discussion and analysis information, which is required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the schedules of net revenues in accordance with bond resolution, combining statements, and schedules of utility plant properties and accumulated depreciation and amortization, which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Restriction on Use

This information is intended solely for the use of City Commission and management of the Utility, and is not intended to be and should not be used by anyone other than these specified parties.

Purvis, Gray and Company, LLP

February 17, 2015
Gainesville, Florida