

State of Florida



## Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

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**DATE:** September 17, 2015  
**TO:** Office of Commission Clerk  
**FROM:** Lynn M. Deamer, Chief of Auditing, Office of Auditing and Performance Analysis  
**RE:** Docket No.: 150102-SU  
Company Name: Utilities, Inc. of Sandalhaven  
Company Code: SU959  
Audit Purpose: Affiliated Transactions Audit  
Audit Control No.: 15-175-1-2

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Attached is the final audit report for the Utility stated above. I am sending the Utility a copy of this memo and the audit report. If the Utility desires to file a response to the audit report, it should send a response to the Office of Commission Clerk. There is confidential work papers associated with this audit.

LMD/cp

Attachment: Audit Report

cc: Office of Auditing and Performance Analysis File

State of Florida



**Public Service Commission**

Office of Auditing and Performance Analysis  
Bureau of Auditing  
Tallahassee District Office

**Auditor's Report**

Utilities, Inc.

Audit of Affiliate Transactions for Utilities, Inc. of Sandalhaven

**Twelve Months Ended December 31, 2014**

Docket No. 150102-SU

Audit Control No. 15-175-1-2

**August 31, 2015**

A handwritten signature in black ink that reads "Donna D. Brown".

Donna D. Brown  
Audit Manager

A handwritten signature in blue ink that reads "Lynn M. Deamer".

Lynn M. Deamer  
Reviewer

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## Purpose

To: Florida Public Service Commission

We have performed the procedures described later in this report to meet the agreed-upon objectives set forth by the Division of Accounting and Finance in its audit service request dated June 23, 2015. We have applied these procedures to the schedules prepared by Utilities, Inc. in support of its filing for rate relief for Utilities, Inc. of Sandalhaven in Docket No. 150102-SU.

This audit was performed following General Standards and Fieldwork Standards found in the AICPA Statements on Standards for Attestation Engagements. Our report is based on agreed-upon procedures. The report is intended only for internal Commission use.

## Objectives and Procedures

### **General**

#### Definitions

The term “Company” refers to Utilities, Inc., the parent of Utilities, Inc. of Sandalhaven (Sandalhaven).

Prior rate case refers to prior Utilities, Inc. subsidiary rate cases.

Corporate refers to the Northbrook, Illinois headquarters.

Regional refers to the Altamonte Springs, Florida headquarters.

ERC refers to Equivalent Residential Connections as defined by Commission Rule 25-30.055, Florida Administrative Code. (F.A.C.)

NARUC refers to the National Association of Regulatory Utility Commissioners.

USOA refers to the NARUC Uniform System of Accounts as adopted by Commission Rule 25-30.115 – Uniform System of Accounts for Water and Wastewater Utilities, F.A.C.

#### Background

Allocated costs were last audited in Docket No. 140060-WS. This audit addresses the costs allocated to Sandalhaven. Sandalhaven used the test year ended December 31, 2014 in its application for rate relief in Docket No. 150102-SU.

The Company allocates its costs to each of its utility subsidiaries based on ERCs. Each subsidiary receives costs based on the ratio of its ERC per system to the total ERCs at the corporate level for the Northbrook, Illinois costs. Each Florida subsidiary also receives costs based on the ratio of its ERC per system to the total ERCs at the regional level for the Altamonte Springs, Florida costs.

Any adjustments recommended in this report are in addition to any adjustments recommended in the Sandalhaven Auditor’s Report, Audit Control No. (ACN) 15-175-1-1.

#### Utility Books and Records

**Objectives:** The objective was to determine whether the Company maintains its accounts and records in conformity with the NARUC USOA.

**Procedures:** Based on our review, the Company appears to be in substantial compliance with the NARUC USOA.

## **Rate Base**

### Utility Plant in Service

**Objectives:** The objectives were to determine whether: 1) Plant additions that are allocated to subsidiaries are authentic, recorded at original cost, and properly classified in compliance with Commission rules and the NARUC USOA, 2) Proper retirements were made when a replacement item was put into service, and 3) The allocation basis was reasonable for the assets allocated.

**Procedures:** We determined the corporate and regional plant balances as of December 31, 2013, that were established in Docket No. 140060-WS. We reviewed and sampled the corporate and regional additions for the period January 1, 2014, through December 31, 2014, and verified the ledger to the Company's allocation worksheets. We ensured that retirements were made when a capital item was removed or replaced. We reconciled the differences between the Company's allocated balances in its allocation worksheets and the Sandalhaven allocation ledgers to the rate base adjustments in Sandalhaven's filing. Findings 1 and 2 discuss plant in service.

### Accumulated Depreciation and Amortization

**Objectives:** The objectives were to determine whether: 1) Commission ordered adjustments to accumulated depreciation were included in the beginning balances, 2) Accruals to accumulated depreciation accounts that are allocated to subsidiaries are properly recorded in compliance with Commission rules and the NARUC USOA, 3) Depreciation Expense accruals for accounts that are allocated are calculated using previously authorized rates, and 4) Retirements are properly recorded.

**Procedures:** We determined the corporate and regional accumulated depreciation balances as of December 31, 2013, that were established in Docket No. 140060-WS. We recalculated the corporate and regional accruals to accumulated depreciation for the period January 1, 2014, through December 31, 2014, using rates from prior audits and the verified Company's allocation worksheets. We ensured that retirements to accumulated depreciation were made when a capital item was removed or replaced. We reconciled the differences between the Company's allocation worksheets and the Sandalhaven allocation ledger to the rate base adjustments in Sandalhaven's filing. Findings 1 and 2 discuss accumulated depreciation.

### Working Capital

**Objectives:** The objectives were to determine whether the adjustments made in the Sandalhaven filing for working capital were based on the correct ledger balances of the affiliate companies and that correct allocation factors were used.

**Procedures:** Sandalhaven uses the 1/8 of operation and maintenance (O&M) expense method to determine working capital pursuant to Rule 25-30.433 – Rate Case Proceedings, F.A.C. The Total O&M expenses may change for Sandalhaven based on adjustments in the Sandalhaven Auditor's Report, Docket No. 150102-SU, ACN 15-175-1-1. Finding 3 discusses working capital.

## **Net Operating Income**

### Operation and Maintenance Expense

**Objectives:** The objectives were to determine whether O&M expense allocated to subsidiaries are properly recorded in compliance with NARUC USOA and Commission rules, and that they are representative of its subsidiary's ongoing utility operations.

**Procedures:** We verified O&M expense accounts allocated for the 12-months ended December 31, 2014, by tracing a sample of invoices selected to the original source documentation. We reviewed invoices for proper amount, period, classification, NARUC account, and recurring nature. We reconciled the ledger to the Company's allocation worksheets. We reconciled the differences between the Company's allocation worksheets and the Sandalhaven allocation ledger to the net operating income (NOI) adjustments in the Sandalhaven filing.

Salaries, benefits, and transportation expenses from the corporate office, regional office, call center locations, and Florida offices were recalculated at the employee level and reconciled to payroll department data. The allocation factors were reviewed for applicability to the type of job. We tested the benefit and tax calculations. We reconciled the differences between the audited allocated balances and the Sandalhaven allocation ledgers to the NOI adjustments in Sandalhaven's filing. Findings 3 and 4 discuss O&M expenses.

### Depreciation and Amortization

**Objectives:** The objectives were to determine whether the depreciation expense allocated is properly recorded in compliance with Commission rules and that they accurately represent the depreciation of the Company's asset used to manage ongoing utility operations.

**Procedures:** We determined that the Company's calculation of depreciation expense was consistent with the balances in the ledger and the rates used in prior audits. We reconciled the differences between the Company's allocation worksheets and the Sandalhaven allocation ledgers to the NOI adjustments in Sandalhaven's filing. Finding 2 discusses depreciation expense.

### Taxes Other than Income

**Objectives:** The objectives were to determine whether the Company's allocation of taxes represented the actual taxes recorded in the ledger and that they were allocated using the appropriate ERC factors.

**Procedures:** We determined the real estate taxes for the Company and the ERC factors used. We recalculated payroll taxes based on allocated payroll and compared it to the amounts included in the Sandalhaven allocation ledger. We reconciled the ledger to the Company's allocation worksheets. We reconciled the differences between the Company's allocation worksheets and the Sandalhaven allocation ledgers to the NOI adjustments in Sandalhaven's filing. Finding 3 discusses payroll taxes.

## **Capital Structure**

**Objectives:** The objectives were to determine whether the equity and debt components of the Company's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital are based on the weighted percent of the Company's financial statements audited by Ernst and Young LLP and the Commission's authorized rate of return.

**Procedures:** We verified the Company's long-term debt, short-term debt, and common equity to the 2014 audited financial statements and the general ledger. We traced the long-term and short-term debt to the prior audit. The equity rate filed was compared to Order No. PSC-15-0259-PAA-WS. No exceptions were noted.

## Audit Findings

### **Finding 1: Transportation**

**Audit Analysis:** In prior rate cases, each Utilities Inc. Class B Utility in Florida has taken the simple average of the cost of the vehicles and its accumulated depreciation, the depreciation expense, and the associated transportation costs, and allocated each vehicle based on the payroll allocation used for the employee assigned to the vehicle. Each Florida Utility uses the ratio of its ERC per the system to the total ERCs for the State of Florida for pool vehicles and special equipment.

The Company's vehicle schedules did not support the adjustments made in its filing. In MFR Schedules A-6 and A-10, the plant adjusted balance was \$56,443 and the accumulated depreciation adjusted balance was \$44,857. Audit staff determined the correct plant balance to be \$49,154 and accumulated depreciation balance to be \$22,168 as shown in Table 1-1 following this finding.

**Effect on the General Ledger:** For affiliate adjustments, the Utility adjusts the filings but not the Company's ledger.

**Effect on the Filing:** The effect on Sandalhaven's filing, is a decrease of \$7,289 to the simple average wastewater plant balance and a decrease of \$22,689 to the simple average wastewater accumulated depreciation balance.

**Table 1-1**

Utilities, Inc. of Sandalhaven	Simple Average Per Filing	Simple Average Audit Adjusted Utility Schedules			Audit Adj.
<u>Vehicles - Simple Average</u>		Add. Vehicle	Staff Vehicle	Total	
<u>NARUC 341.5/391.7 (JDE account 1555)</u>	\$ 56,443	\$ 359	\$ 48,795	\$ 49,154	\$ (7,289)
<u>Vehicle Accumulated Depreciation - Simple Average</u>					
<u>NARUC 108.1 (JDE account 2300)</u>	\$ (44,857)	\$ (359)	\$ (21,809)	\$ (22,168)	\$ 22,689

## **Finding 2: Allocated Plant, Accumulated Depreciation and Depreciation Expense**

**Audit Analysis:** The Sandalhaven adjustments for the rate base allocations from the corporate and regional levels, MFR Schedule A-3, did not reflect the Commission Ordered Adjustments for plant, accumulated depreciation, and depreciation expense. These adjustments from prior orders have not been recorded on the Company's books. Therefore, audit staff calculated the adjustments by utilizing the restatement schedules provided by the Company.

We verified that the Phoenix Project depreciation life was ten years, as per Commission Order No. PSC-10-0407-PAA-SU.

The Utility recorded the wastewater plant balance in the UA ledger as \$200,243. Audit staff determined the plant balance to be \$172,825. The Utility made an MFR adjustment to decrease plant in the amount of \$16,450. We recommend that an additional decrease in the amount of \$10,968 ( $\$172,825 - \$200,243 + \$16,450$ ) be made to plant.

The Utility recorded the wastewater accumulated depreciation balance in the UA ledger as \$135,746. Audit staff determined accumulated depreciation balance to be \$111,876. The Utility made an MFR adjustment to decrease accumulated depreciation in the amount of \$20,292. We recommend that an additional decrease in the amount of \$3,578 ( $(\$111,876) - (\$135,746) - \$20,292$ ) be made to accumulated depreciation.

The Utility recorded the wastewater depreciation expense balance in the UA ledger as \$16,116. Audit staff determined depreciation expense to be \$12,887. The Utility made an MFR adjustment to decrease depreciation expense in the amount of \$22,610. We recommend that an increase in the amount of \$19,381 ( $\$12,887 - \$16,116 + \$22,610$ ) be made to depreciation expense.

Table 2-1 following this Finding details the adjustments to plant and accumulated depreciation.

Table 2-2 following this Finding details the adjustment to depreciation expense.

**Effect on the General Ledger:** These adjustments are allocations from Illinois and Florida Headquarters for ratemaking purposes. The Utility should determine the effect these adjustments have on its general ledgers.

**Effect on the Filing:** The effect on the filing is a decrease of \$10,968 to the simple average wastewater plant balance. The decrease to the simple average wastewater accumulated depreciation balance is \$3,578. The increase to depreciation expense is \$19,381.

**Table 2-1**

**SANDALHAVEN SUMMARY RATE BASE ADJUSTMENT**

Obj Acct	NARUC	Account Description	Simple Avg.	Simple Avg.	Audit	Simple Avg.	MFR Adj		Audit Adj
			WSC	Regional	Balance	UA Ledger	Variance	WW	WW
1025	352	FRANCHISES	\$ -	\$ 36	\$ 36	\$ 38	\$ (2)	\$ -	\$ (2)
1045	353	LAND & LAND RIGHTS GEN PLT	\$ 418	\$ -	\$ 418	\$ 425	\$ (7)	\$ 209	\$ (216)
1175	354	OFFICE STRUCT & IMPRV	\$ 13,142	\$ 17,291	\$ 30,433	\$ 30,837	\$ (404)	\$ (47)	\$ (357)
1180	390	OFFICE FURN & EQPT	\$ 6,120	\$ 4,051	\$ 10,171	\$ 10,423	\$ (252)	\$ (919)	\$ 667
1190	393	TOOL SHOP & MISC EQPT	\$ 92	\$ 4,000	\$ 4,092	\$ 4,230	\$ (138)	\$ 10	\$ (148)
1205	396	COMMUNICATION EQPT	\$ 1,561	\$ -	\$ 1,561	\$ 1,587	\$ (26)	\$ (12)	\$ (14)
1470	343/393	TOOL SHOP & MISC EQPT	\$ -	\$ -	\$ -	\$ 8	\$ (8)	\$ -	\$ (8)
1495	398	SEWER PLANT ALLOCATED	\$ -	\$ -	\$ -	\$ 15,691	\$ (15,691)	\$ (15,691)	\$ -
1580	340	MAINFRAME COMPUTER WTR	\$ 883	\$ 379	\$ 1,262	\$ 5,254	\$ (3,992)	\$ -	\$ (3,992)
1585	340	MINI COMPUTERS WTR	\$ 8,777	\$ 8,119	\$ 16,896	\$ 19,823	\$ (2,927)	\$ -	\$ (2,927)
1590	340	COMP SYS COST WTR	\$ 104,894	\$ 688	\$ 105,582	\$ 109,066	\$ (3,484)	\$ -	\$ (3,484)
1595	340	MICRO SYS COST WTR	\$ 2,040	\$ 334	\$ 2,374	\$ 2,861	\$ (487)	\$ -	\$ (487)
		<b>TOTAL PLANT</b>	<b>\$ 137,927</b>	<b>\$ 34,898</b>	<b>\$ 172,825</b>	<b>\$ 200,243</b>	<b>\$ (27,418)</b>	<b>\$ (16,450)</b>	<b>\$ (10,968)</b>
1840	108.1	ACC DEPR-FRANCHISES	\$ -	\$ (6)	\$ (6)	\$ 6	\$ (12)	\$ -	\$ (12)
1970	108.1	ACC DEPR-OFFICE STRUCTURE	\$ (7,513)	\$ (6,148)	\$ (13,661)	\$ (12,960)	\$ (701)	\$ 2,142	\$ (2,843)
1975	108.1	ACC DEPR-OFFICE FURN/EQPT	\$ (5,710)	\$ (3,256)	\$ (8,966)	\$ (8,871)	\$ (95)	\$ 18,155	\$ (18,250)
1985	108.1	ACC DEPR-TOOL SHOP & MISC EQPT	\$ (92)	\$ (4,092)	\$ (4,184)	\$ (4,409)	\$ 225	\$ (10)	\$ 235
2000	108.1	ACC DEPR-COMMUNICATION EQPT	\$ (615)	\$ -	\$ (615)	\$ (690)	\$ 75	\$ 5	\$ 70
2230	108.1	ACC DEPR-TOOL SHOP & MISC EQPT	\$ -	\$ -	\$ -	\$ (905)	\$ 905	\$ -	\$ 905
2320	108.1	ACC DEPR-MAINFRAME COMP WTR	\$ (869)	\$ (379)	\$ (1,248)	\$ (5,074)	\$ 3,826	\$ -	\$ 3,826
2325	108.1	ACC DEPR-MINI COMP WTR	\$ (5,030)	\$ (8,092)	\$ (13,122)	\$ (16,308)	\$ 3,186	\$ -	\$ 3,186
2330	108.1	COMP SYS AMORTIZATION WTR	\$ (67,002)	\$ (688)	\$ (67,690)	\$ (83,674)	\$ 15,984	\$ -	\$ 15,984
2335	108.1	MICRO SYS AMORTIZATION WTR	\$ (2,040)	\$ (344)	\$ (2,384)	\$ (2,861)	\$ 477	\$ -	\$ 477
		<b>TOTAL ACCUMULATED DEPRECIATION</b>	<b>\$ (88,871)</b>	<b>\$ (23,005)</b>	<b>\$ (111,876)</b>	<b>\$ (135,746)</b>	<b>\$ 23,870</b>	<b>\$ 20,292</b>	<b>\$ 3,578</b>

**Table 2-2**

Obj Acct	NARUC	Account Description	12/31/2014 WSC	12/31/2014 Regional	Audit Balance	12/31/2014 UA Ledger	Variance	MFR Adj WW	Audit Adj WW
6450	403	Dep - Franchises	\$ -	\$ 1	\$ 1	\$ -	\$ 1	\$ 1	\$ (0)
6580	403	Dep - Office Structure	\$ 328	\$ 1	\$ 329	\$ -	\$ 329	\$ 635	\$ (306)
6585	403	Dep - Office Furn/Eqpt	\$ 122	\$ 430	\$ 552	\$ -	\$ 552	\$ (23,656)	\$ 24,208
6595	403	Dep - Tool Shop & Misc Eqpt	\$ 0	\$ 265	\$ 266	\$ -	\$ 266	\$ 254	\$ 12
6610	403	Dep - Communication Equipment	\$ 167	\$ 198	\$ 364	\$ -	\$ 364	\$ 156	\$ 208
6835	403	Dep - Tool Shop & Misc Eqpt	\$ -	\$ -	\$ -	\$ 0	\$ (0)	\$ -	\$ (0)
6920	403	Dep - Computer	\$ 11,345	\$ 30	\$ 11,375	\$ 16,116	\$ (4,741)	\$ -	\$ (4,741)
		<b>TOTAL DEPRECIATION</b>	<b>\$ 11,962</b>	<b>\$ 925</b>	<b>\$ 12,887</b>	<b>\$ 16,116</b>	<b>\$ (3,229)</b>	<b>\$ (22,610)</b>	<b>\$ 19,381</b>

### **Finding 3: Payroll, Benefits, and Taxes**

**Audit Analysis:** The Company provided schedules that allocated the most current annualized salary and allocated the salary, benefits, and taxes using the appropriate ERC allocation factor based on the employees' duties. The schedule was then compared to the costs recorded in the ledger by division.

Audit staff requested support for each employee, their most current annualized salary and the allocated salary, benefits, and taxes using the ERC allocation factor based on the employee's duties. The Company provided schedules using the salaries at the end of April 2015 with the overtime earned in 2014, and the ERC factors at the end of April 2015. Some employees' aggregate salary was then increased by 2%, 2.5%, 3%, or 4% in preparation for the 2016 expenses. No adjustment is recommended by audit staff.

One employee received approximately a 35% percent increase from the last rate case. This employee resigned from the Company effective August 19, 2015 and was replaced by another employee, who started in July 2015. Audit staff obtained a current pay stub for the new employee and calculated the annualized salary. We determined that the annualized salary difference between the former and current employee was less than 1%. No adjustment is recommended by audit staff, but we request the analyst evaluate the costs for regulatory purposes.

Audit staff noted the following differences, in which adjustments are recommended.

1. One employee's salary calculation did not use the correct salary amount based on the employee's pay stub. This same employee also received an extra 3% increase to their salary.
2. The Company included overtime pay in the calculation of several employees' annualized salaries.
3. The Company schedule was compared to the total adjusted amounts in the filing and variances were noted and adjusted.

Table 3-1 following this Finding show the details of our adjustments.

**Effect on the General Ledger:** None

**Effect on the Filing:** The effect on Sandalhaven's filing is a decrease of \$5,343 (\$4,964 + \$379) to wastewater O&M expenses, a decrease of \$10 to wastewater payroll taxes (Taxes Other Than Income). The effect on working capital is a decrease of \$668 (\$5,343/8).

**Table 3-1**

<b>Salaries</b>	<b>Sandalhaven</b>	
NARUC 601/701 (JDE account 6110)	\$ 4,485	
NARUC 601/701 (JDE account 6115)	\$ 678	
NARUC 603/703 (JDE account 6120)	\$ 4,720	
NARUC 601/701 (JDE account 6125)	\$ 664	
NARUC 601/701 (JDE account 6130)	\$ 1,641	
NARUC 601/701 (JDE account 6135)	\$ 10,139	
NARUC 601/701 (JDE account 6140)	\$ 2,055	
NARUC 601/701 (JDE account 6145)	\$ 4,594	
NARUC 601/701 (JDE account 6146)	\$ 2,042	
NARUC 601/701 (JDE account 6147)	\$ -	
NARUC 601/701 (JDE account 6150)	\$ 115,476	
NARUC 601/701 (JDE account 6155)	\$ 1,316	
NARUC 601/701 (JDE account 6165)	\$ (4,269)	
<b>Per Books and Schedules B-5</b>	\$ 143,541	\$ 143,541
<b>Schedule B-3, pg 1 of 2, salary adjustment</b>		\$ (10,131)
		\$ 133,410
<b>Per Audited Salary Detail for Annualized 2015</b>		\$ 128,446
<b>Total Audit Payroll Adjustment</b>		\$ (4,964)

  

<b>Payroll Taxes</b>		
<b>NARUC 408.12 (JDE account 7510-7520) Schedule B-15</b>		\$ 11,359
<b>Per Audited Salary Detail for Annualized 2015</b>		\$ 11,349
<b>Total Audit Payroll Tax Adjustment</b>		\$ (10)

  

<b>Benefits</b>		
<b>NARUC 604/704 (JDE account 5625-5690)</b>		\$ 35,868
<b>Per Audited Salary Detail for Annualized 2015</b>		\$ 35,489
<b>Total Audit Benefits Adjustment</b>		\$ (379)

  

<b>Total Audit Adjustment to Payroll, Benefit, and Taxes</b>		\$ (5,353)
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**Finding 4: Operator’s Salary and the Decommissioning of Sandalhaven’s Wastewater Plant.**

**Audit Analysis:** We reviewed salaries on MFR Schedule B-6. It should be noted that there are 5 positions allocated in full or partially to the operation of the Wastewater Treatment Plant. The positions and allocations are as follows.

1. Lead Operator – 100% allocated to Sandalhaven.
2. Operator I – 30.20% allocated to Sandalhaven.
3. Operator II – 81.91% allocated to Sandalhaven.
4. Cross Connection Tech – 6.75% allocated to Sandalhaven.
5. Regional Manager – 6.75% allocated to Sandalhaven.

With the decommissioning of Sandalhaven’s Wastewater Treatment Plant taking place at the end of 2015, the Utility plans to employ one full-time operator and one part-time employee. The analyst needs to determine the appropriate adjustment for the test year.

**Effect on the General Ledger:** None.

**Effect on the Filing:** None.

This Finding is for informational purposes only.