

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:** October 102006  
**TO:** Shannon J. Hudson, Regulatory Analyst IV, Division of Economic Regulation  
**FROM:** Denise N. Vandiver, Chief of Auditing, Division of Regulatory Compliance & Consumer Assistance  
**RE:** **Docket No.** 060285-SU **Company Name:** Utilities, Inc. of Sandalhaven  
**Audit Purpose:** File & Suspend Rate Case  
**Audit Control No:** 06-209-2-9

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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 the response to the Division of Commission Clerk and Administrative Services. There are no confidential work papers associated with this audit.

DNV:sbj  
Attachments

Copy: Division of Regulatory Compliance and Consumer Assistance (Hoppe, District Offices, File Folder)  
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FLORIDA PUBLIC SERVICE COMMISSION  
DIVISION OF REGULATORY COMPLIANCE & CONSUMER ASSISTANCE  
BUREAU OF AUDITING

*Tampa District Office*

UTILITIES INC. OF SANDALHAVEN  
FILE AND SUSPEND RATE CASE INVESTIGATION

AS OF DECEMBER 31, 2005

DOCKET NO. 060258-SU  
AUDIT CONTROL NO. 06-209-2-9

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**DIVISION OF REGULATORY COMPLIANCE & CONSUMER ASSISTANCE  
AUDITOR'S REPORT**

**October 4, 2006**

**TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES**

We have performed the procedures described later in this report to meet the agreed upon objectives set forth by the Division of Economic Regulation in its audit service request dated July 27, 2006. We have applied these procedures to the attached schedules which were prepared by Utilities, Inc. of Sandalhaven in support of its filing for rate relief in Docket No. 060285-SU.

This audit was performed following general standards and field work standards found in the AICPA Statements on Standards for Attestation Engagements. This report is based on agreed upon procedures which are only for internal Commission use.

## OBJECTIVES AND PROCEDURES

### RATE BASE

#### General

*Objective:* To determine that the utility's filing represents its recorded results from continuing operations.

*Procedures:* We reconciled the following individual component rate base balances to the utility's general ledger as of December 31, 2005 and verified that adjustments required in Order No. PSC-03-0602-PAA-SU, issued May 13, 2003, were recorded.

#### Utility-Plant-in-Service (UPIS)

*Objective:* To determine that property exists and is owned by the utility. To determine that additions to UPIS are authentic, recorded at original cost, and properly classified in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that the proper retirements of UPIS were made when a replacement item was put in service.

*Procedures:* We sampled UPIS additions for the period January 1, 2002 through December 31, 2004 for compliance with the stated objectives above. We verified that the utility properly recorded retirements to UPIS when a capital item was removed or replaced. We toured the utility plant sites to observe whether assets additions were completed and to ascertain if asset retirements were properly recorded. We sampled construction project additions and the corresponding source documentation. We verified that the utility used Commission approved AFUDC rates and traced the capitalized salaries to individual employee time sheets. Audit Finding No. 2 discusses our adjustment to reclassify organization costs to a deferred asset account pending disposition by Commission staff. Audit Finding No. 3 discusses our adjustment to reduce UPIS for an invoiced amount that was recorded twice to the utility's books. Audit Finding No. 4 discusses our adjustment to remove a third pick-up truck from the utility's books because it is no longer in service.

#### Land and Land Rights

*Objective:* To determine that utility land is recorded at original cost and is owned or secured under a long-term lease.

*Procedures:* We verified the changes to utility land since its last rate proceeding by searching the county's public records. We obtained the deeds for land additions and verified that they were recorded at original cost. We examined other additions to land to determine if they were properly recorded in the land account. Audit Finding No. 1 discusses our adjustments to reclassify unused land to plant held for future use.

#### Contributions-in-Aid-of-Construction (CIAC)

*Objective:* To determine that additions to CIAC are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that CIAC additions are reflective of the utility's Commission approved service availability tariff. To verify and insure that all donated property is properly accounted for and recorded as CIAC and UPIS.

*Procedures:* We sampled CIAC additions for the period January 1, 2002 through December

31, 2005 for compliance with the stated objectives above. We scanned the utility's cash receipts records for unrecorded cash and property. We reviewed developer agreements for unrecorded CIAC. We traced utility CIAC schedules to the general ledger and the utility's authorized tariff rates. We toured the utility's authorized service territory to look for new developments that may have included contributed property. Audit Finding No. 10 provides information on a 2003 journal entry that was made to allocate CIAC based on specific UPIS account balances. Audit Finding No. 11 provides information on potentially unrecorded utility infrastructure that may have been contributed to the utility by developers.

#### Accumulated Depreciation

*Objective:* To determine that accruals to accumulated depreciation are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that depreciation expense accruals are calculated using the Commission authorized rates and that retirements are properly recorded.

*Procedures:* We traced the accumulated depreciation schedules to the corresponding UPIS schedules. We verified that the utility used Commission authorized rates to depreciate its UPIS accounts by calculating a sample of accumulated depreciation account balances to test for calculation errors. We verified that the utility properly recorded retirements to accumulated depreciation when the corresponding UPIS was removed or replaced. We recalculated a sample of accumulated depreciation account balances as of December 31, 2005.

#### Accumulated Amortization of CIAC

*Objective:* To determine that accruals to accumulated amortization of CIAC are properly recorded in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that CIAC amortization expense accruals are properly recorded and calculated based on the rates and method used in the utility's last rate proceeding.

*Procedures:* We traced the accumulated amortization of CIAC schedules to the corresponding CIAC schedules. We verified that the utility used Commission authorized rates to amortize its CIAC accounts by calculating a sample of accumulated amortization account balances to test for calculation errors. We recalculated a sample of accumulated amortization of CIAC account balances as of December 31, 2005.

#### Working Capital

*Objective:* To determine that the utility's working capital balance is properly calculated in compliance with Commission rules.

*Procedures:* We recalculated the utility's working capital balance as of December 31, 2005. Audit Finding No. 5 discusses our adjustment to include a historical working capital allowance.

#### Other Rate Base Items

*Objective:* To determine that other component balances affecting rate base are properly stated and authorized by Commission rules or prior orders.

*Procedures:* Determine that adjustments to include allocated rate base balances for subsidiary operations are properly reported in the filing. Audit Finding No. 6 discusses our adjustments to WSC allocated rate base balances based on the affiliate transaction investigation performed

in Docket No. 060253-WS.

## **NET OPERATING INCOME**

### General

*Objective:* To determine that the utility's filing represents its results from continuing operations.

*Procedures:* We reconciled the following individual component net operating income balances to the utility's general ledger for the 12-month period ended December 31, 2005.

### Revenues

*Objective:* To determine that revenues are properly recorded in compliance with Commission rules and are based on the utility's Commission approved tariff rates.

*Procedures:* We traced revenues to the general ledger and utility billing registers and selected a sample of customer bills from each customer rate class on a random basis and recalculated the bills using the Commission approved tariff rates.

### Operation and Maintenance Expenses (O&M)

*Objective:* To determine that operation and maintenance expenses are properly recorded in compliance with Commission rules and were reasonable and prudent for ongoing utility operations.

*Procedures:* We sampled O&M expense items from the general ledger based on auditor judgment. We reviewed the sample for the proper utility system, classification, NARUC account, amount, period and recurring nature. We examined invoices and supporting documentation to determine if the above objectives were met. Audit Finding No. 7 discusses our adjustment to the utility's prior rate case expense balance. Audit Finding No. 9 discusses our adjustments to WSC allocated expense balances based on the affiliate transaction investigation performed in Docket No. 060253-WS. Audit Finding No. 12 provides information on the utility's transportation expense balances.

### Taxes-Other-Than-Income (TOTI)

*Objective:* To determine that taxes other than income tax expense is properly recorded in compliance with Commission rules and were reasonable and prudent for ongoing utility operations.

*Procedures:* We obtained the regulatory assessment fee filings and reconciled them to the general ledger. We obtained the property tax bills for review and to determine if the amount booked reflects the discount amount.

### Depreciation Expense

*Objective:* To determine that depreciation expense is properly recorded in compliance with Commission rules and that it accurately represents the depreciation of UPIS assets and amortization of CIAC assets for ongoing utility operations.

*Procedures:* We recalculated a sample of UPIS depreciation expense and CIAC amortization expense balances for the period using Commission approved rates and we verified that CIAC amortization expense was properly netted against depreciation expense. Audit Finding No. 8

discusses our adjustment to CIAC amortization expense balances because the balance in the utility's filing does not reconcile to its general ledger balance.

## **CAPITAL STRUCTURE**

### General

*Objective:* To determine the components of the utility's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital are properly recorded in compliance with Commission rules and that it accurately represents the ongoing utility operations.

*Procedures:* We reconciled the following individual component capital structure balances to the utility's general ledger as of December 31, 2005. Audit Finding No. 13 provides information on the utility's capital structure component balances that were determined in the affiliate audit investigation performed in Docket No. 060253-WS.

### Long-Term-Debt

*Objective:* To determine that long-term debt balances represent actual obligations of the utility's parent and that they are properly recorded in compliance with Commission rules.

*Procedures:* We traced long-term debt balances to the original documents and verified the terms and interest rate of each note payable.

### Short-Term-Debt

*Objective:* To determine that short-term debt balances represent actual obligations of the utility's parent and that they are properly recorded in compliance with Commission rules.

*Procedures:* We traced short-term debt balances to the original documents and verified the terms and interest rate and period. We recalculated test year interest expense.

### Accumulated Deferred Income Taxes

*Objective:* To determine that accumulated deferred income taxes are properly stated and calculated based on the recorded differences between utility book and taxable income.

*Procedures:* Recalculated a sample of deferred tax balances for the period using Commission authorized rates and federal tax rates. Audit Finding No. 14 provides information on the utility's deferred tax balances.

### Customer Deposits

*Objective:* To determine that customer deposit balances represent actual obligations of the utility and are properly recorded in compliance with Commission rules.

*Procedures:* We traced a sample of customer deposit balances to supporting documentation and verified that customer deposits were refunded and credited with interest payments in compliance with Commission rules.



**AUDIT FINDING NO. 1**

**SUBJECT: ADJUSTMENT TO LAND**

**SUMMARY:** The utility's average rate base should be reduced by \$46,794 as of December 31, 2005.

**STATEMENT OF FACT:** The utility's filing reflects \$93,588 of additions to Acct. No. 353 - Land and Land Rights during the test year 2005 for a proposed treatment plant expansion. The utility purchased a parcel of land adjacent to the wastewater treatment plant for \$100,000. The warranty deed was executed on August 15, 2005.

The closing statement for the above transaction indicates that there was a \$10,000 deposit placed at the time when the sales contract was signed. The land balance of \$93,588 does not include this deposit. We could not determine what utility account the deposit was posted in.

Subsequent to the land purchase the utility has decided to interconnect its wastewater system with the City of Englewood.

Since the land now has no intended use the entire balance should be removed from rate base and reclassified to Acct. No. 103 - Property Held for Future Use pending final disposition.

**EFFECT ON GENERAL LEDGER:** Reclassify \$93,588 from Utility Acct. No. 3537002 - Land to Acct. No. 104100 - Utility Plant Acquired/Disposed

**EFFECT ON FILING:** The utility's balance for land should be reduced by \$93,588 as of December 31, 2005. The average rate base should be reduced by \$46,794 which is the amount reflected in the filing after the simple average calculation.

	<u>Dec-04</u>	<u>Dec-05</u>	<u>Average</u>
G/L Balance	\$225,000	\$318,588	\$271,794
Audit Adjustment	<u>0</u>	<u>(93,588)</u>	<u>(46,794)</u>
Adjusted G/L Balance	\$225,000	\$225,000	\$225,000

**AUDIT FINDING NO. 2**

**SUBJECT: ADJUSTMENT TO ORGANIZATION COST**

**SUMMARY:** The utility's average rate base is overstated by \$14,237 as of December 31, 2005.

**STATEMENT OF FACT:** The utility's filing reflects a year end balance of \$27,106 in Acct. No. 351 - Organization Cost with an average balance of \$14,237 as of December 31, 2005.

The utility's general ledger indicates \$1,587 of legal fees were recorded to this account in 2004, with the balance of \$25,519, also legal fees, recorded in 2005.

Our testing of additions to land indicates that these legal costs may have been incurred in association with the land purchase discussed in the previous finding of this report. We were not, however, able to examine all the invoices involved. Some of the fees may involve other areas of the utility's business.

None of the legal fees, however, should have been recorded to Acct. 351. This account is for the recording of the original cost incident to organizing the utility per the NARUC Uniform System of Accounts.

The entire balance should be transferred to Acct. No. 186 - Deferred Assets pending final disposition of what the legal fees actually were for and what account they should be posted in.

**EFFECT ON GENERAL LEDGER:** The following general ledger entries are needed to correct the utility's general ledger balances.

<u>Utility</u> <u>Acct No</u>	<u>NARUC</u> <u>Acct No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
1084001	108	Acc/Dep - Organization Cost	\$215	
186****	186	Deferred Asset	\$27,106	
2151000	215	Retained Earnings	\$10	
3511001	363	Organization Cost		\$27,106
4033001	403	Dep. Exp. - Organization Cost		\$225

**EFFECT ON FILING:** The utility's average rate base should be reduced by \$14,237 to remove all organization cost as reported in its filing. No adjustment is required for accumulated depreciation and depreciation expense because the utility did not include the general ledger balances in its filing.

**AUDIT FINDING NO. 3**

**SUBJECT: ADJUSTMENT TO WASTEWATER SERVICE LINES**

**SUMMARY:** The utility's average rate base is overstated by \$5,993 as of December 31, 2005.

**STATEMENT OF FACT:** The utility has recorded two invoices for Katz Plumbing for \$6,200. One is dated June 10, 2004 and the other is dated June 22, 2004. Both of the invoices explain that it was to run a new sewer line for the same property address. The utility indicated that Katz Plumbing has been asked for a refund.

**EFFECT ON GENERAL LEDGER:** The following general ledger entries are needed to correct the utility's general ledger balances.

Utility <u>Acct No</u>	NARUC <u>Acct No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
1084006	108	Accum Depreciation	\$310	
2311050	231	A/P - Trade	\$6,097	
3602006	363	Service Lines		\$6,200
4033006	403	Depreciation Expense		\$207

**Calculations:**

Acct. No. 108  $\$310 = \$6,200 \times 3.33\% \times 1.5 \text{ years}$

Acct. No. 403  $\$207 = \$6,200 \times 3.33\%$

**EFFECT ON FILING:** The utility's average rate base and depreciation expense balances should be reduced by \$5,993 and \$207, respectively, for the 12-month period ended December 31, 2005.

Utility <u>Acct No.</u>	NARUC <u>Acct No.</u>	<u>Acct. Description</u>	<u>Balance Dec 04</u>	<u>Balance Dec 05</u>	<u>Average</u>
1084006	108	Accum Depreciation	(\$103)	(\$310)	(\$207)
3602006	363	Sewage Service Lines	<u>6,200</u>	<u>6,200</u>	<u>6,200</u>
Adjustment to average rate base			\$6,097	\$5,890	\$5,993

**Calculations:**

Acct. No. 108  $\$103 = (\$6,200 \times 3.33\%) / 2$

Acct. No. 108  $\$310 = \$6,200 \times 3.33\% \times 1.5 \text{ years}$

**AUDIT FINDING NO. 4**

**SUBJECT: ADJUSTMENT TO TRANSPORTATION EQUIPMENT**

**SUMMARY:** The utility's average rate base is overstated by \$4,799 as of December 31, 2005.

**STATEMENT OF FACT:** The utility has the following three vehicles recorded in Utility Acct. No. 3917000 - Transportation equipment.

<u>Year</u>	<u>Month</u>	<u>Invoice Ref# and Vendor</u>	<u>Amount</u>	<u>Description</u>
2002	AUG	99698*11320*KIRBY CH	\$18,519.00	2003 Chevrolet C15 pick-up
2002	OCT	02567*13980	534.10	Bed Liner for above pick-up
2004	MAR	48239*11320*ALL AMER	17,763.05	2004 Chevrolet C15 pick-up
2004	AUG	MOVE VEHICLE 9928	<u>15,493.25</u>	1999 Dodge Dakota pick-up
			<u>\$52,309.40</u>	

During our plant tour of the utility's facilities it appeared that there were only two field employees, a lead operator and an operator. This was confirmed when we reviewed Document 06153-06 which was filed by the utility with the Commission Clerk on July 13, 2006 in response to MFR deficiencies. Additionally, when we reviewed a sample of GE Capital Fleet invoices, the utility's fuel and transportation maintenance service provider, we determine that the 2003 Chevrolet was not being used by the utility during 2005.

The 2003 Chevrolet C15 and its bed liner totaling \$19,053 (\$18,519 + \$534) should be removed from the utility's books.

**EFFECT ON GENERAL LEDGER:** The following general ledger entries are needed to correct the utility's general ledger balances.

<u>Utility</u>	<u>NARUC</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
1082000	108	Acc/Dep - Transportation Equip.	\$15,730	
2334055	233	A/P - Intercompany	\$6,193	
3917000	371	Transportation Equipment		\$19,053
4032092	403	Dep. Exp. - Transportation Equip.		\$2,870

**Calculations:**

<u>Period End</u>	<u>Transportation</u>	<u>Annual</u>	<u>Estimated</u>	<u>Amount</u>	<u>Acc/Dep</u>	<u>Acc/Dep</u>
	<u>Acct. Balance</u>	<u>Dep. Exp.</u>	<u>Dep. Rate</u>	<u>Removed</u>	<u>Accrual</u>	<u>Year End</u>
Dec-02	\$19,053	\$3,811	20.00%	\$19,053	\$3,811	
Dec-03	\$19,053	\$6,097	32.00%	\$19,053	6,097	
Dec-04	\$52,309	\$8,104	15.49%	\$19,053	2,952	\$12,778
Dec-05	\$52,309	\$7,879	15.06%	\$19,053	2,870	\$15,730

Dec 04-05                      \$19,053    (Removed for entire year)                      Average UPIS & Acc/Dep                      \$14,254

The audit staff used an estimated annual depreciation rate to determine our adjustment to accumulated depreciation. The rate was determined by dividing the annual G/L depreciation expense by the corresponding asset account balance. The rate is above 16.6% in 2002 and 2003 because it appears from reviewing the utility's annual reports that it was not depreciated when first purchased and that the first two years were an attempt to make up the difference.

**EFFECT ON FILING:** The utility's average rate base and depreciation expense balances should be reduced by \$4,799 (\$19,053 - \$14,254) and \$2,870, respectively, for the 12-month period ended December 31, 2005.

**AUDIT FINDING NO. 5**

**SUBJECT: ADJUSTMENT TO WORKING CAPITAL**

**SUMMARY:** The utility's working capital allowance for wastewater rate base is \$39,156 as of December 31, 2005.

**STATEMENT OF FACT:** The utility's filing did not include a historical working capital allowance for wastewater rate base.

The audit staff has calculated a working capital allowance for wastewater rate base to be \$39,156 as of December 31, 2005.

	Water	W/Water	Total	
Total O&M Expense	\$0	\$313,245	\$313,245	Per MFR Schedule B-2
Adjustments (See note below)	<u>0</u>	<u>0</u>	<u>0</u>	
Total Adjusted O&M Expense	\$0	\$313,245	\$313,245	
Divided by 8	<u>8</u>	<u>8</u>	<u>8</u>	
Working Capital	\$0	\$39,156	\$39,156	

Note: Audit staff adjustments to historical O&M expense in this report include the corresponding affect on working capital in each separate finding.

**EFFECT ON GENERAL LEDGER:** None, because a working capital adjustment is only calculated for rate case proceedings.

**EFFECT ON FILING:** Increase net historical rate base by \$39,156 as of December 31, 2005.

## **AUDIT FINDING NO. 6**

### **SUBJECT: ADJUSTMENT TO ALLOCATED WSC RATE BASE**

**SUMMARY:** The utility's allocated average net rate base from Water Service Corporation (WSC) is \$8,977 as of December 31, 2005.

**STATEMENT OF FACT:** WSC, the service corporation for the parent company Utilities, Inc., allocates a portion of its common rate base to each subsidiary utility throughout the United States. Utilities Inc. of Sandalhaven received \$7,458, which is the average amount as of December 31, 2005. The allocation is net of accumulated depreciation and accumulated deferred income taxes or approximately 0.43 percent of the total WSC average net rate base of \$1,740,155. The allocation was calculated using a customer equivalent percentage that equates all customers throughout the United States in terms of equivalent residential connections.

The Commission's Division of Regulatory Compliance and Consumer Assistance, at the request of The Division of Economic Regulation, performed an affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2005, in Docket No. 060253-WS. The scope of the audit included a review of the WSC rate base components that are allocated to all of its subsidiary operations in 2005. The audit report, issued July 15, 2006, included specific adjustments that increased the Utilities Inc. of Sandalhaven allocated average WSC rate base allocation by \$1,519 to \$8,977.

The audit staff has incorporated the findings of the above-mentioned audit report to determine the utility's allocated average WSC rate base balance of \$8,977 for this proceeding.

**EFFECT ON GENERAL LEDGER:** None, because WSC only allocates its net rate base for rate case proceedings.

**EFFECT ON FILING:** Increase the utility's average wastewater rate base by \$1,519 for the 12-month period ended December 31, 2005. (\$8,977 - \$7,458)

## AUDIT FINDING NO. 7

### SUBJECT: ADJUSTMENT TO PRIOR RATE CASE EXPENSE

**SUMMARY:** The utility's wastewater operation and maintenance expense (O&M) balance is overstated by \$1,842 for the 12-month period ended December 31, 2005, because the rate case expense reflected in the filing is above the amount approved in its last rate case proceeding in Docket No. 020409-SU.

**STATEMENT OF FACT:** Order PSC-03-0602-PAA-SU, issued May 13, 2003, authorized \$49,750 of rate case expenses to be amortized over four years or \$12,438 per year. The utility's new tariffs were approved on June 18, 2003, which is the beginning of the four year amortization period for rate case expense recovery. The unamortized remaining balance is \$18,655 as of December 31, 2005.

Period	Balance Approved	Yearly Amtz.	Accrued Amtz	Un-Amtz. Balance
Jun-03 to Dec-03	\$49,750	(\$6,219)	(\$6,219)	
Dec-04 to Dec-04	\$49,750	(\$12,438)	(\$18,657)	\$31,093
Jan-05 to Dec-05	\$49,750	(\$12,438)	(\$31,095)	\$18,655

The utility has included \$14,280 of annual rate case expense in the filing for the 12-month period ended December 31, 2005. The above amount was included in Acct. Nos. 766 - Regulatory Commission Expense.

The utility's rate case expense is overstated by \$1,842 (\$14,280 - \$12,438)

**EFFECT ON GENERAL LEDGER:** There is no adjustment required to the utility's general ledger because rate case expense is determined for rate proceeding purposes. The utility, however, should review the balances for deferred rate case expense in its general ledger to ensure that they properly reflect the approved rate case expense balance discussed above

**EFFECT ON FILING:** The utility's rate case expense balance should be decreased by \$1,842 for the 12-month period ended December 31, 2005.

**AUDIT FINDING NO. 8**

**SUBJECT: ADJUSTMENT TO CIAC AMORTIZATION EXPENSE**

**SUMMARY:** The utility's net depreciation expense balance is understated by \$35,128 for the 12-month period ended December 31, 2005.

**STATEMENT OF FACT:** The utility's filing reflects a balance of \$104,665 for CIAC amortization expense for the 12-month period ended December 31, 2005.

The utility's general ledger reflects a balance of \$69,537 for CIAC amortization expense for the 12-month period ended December 31, 2005.

The utility's CIAC amortization expense is overstated by \$35,128 ( $\$104,665 - \$69,537$ ) in its MFR filing.

**EFFECT ON GENERAL LEDGER:** There is no effect on the ledger since the general ledger balance is correct.

**EFFECT ON FILING:** The utility's net depreciation expense balance should be increased by \$35,128 for the 12-month period ended December 31, 2005.



## AUDIT FINDING NO. 9

### SUBJECT: ADJUSTMENT TO ALLOCATED WSC EXPENSE

**SUMMARY:** The utility's allocated common operating expense from Water Service Corporation (WSC) is \$33,207 for the 12-month period ended December 31, 2005.

**STATEMENT OF FACT:** WSC, the service corporation for the parent company Utilities, Inc., allocates a portion of its common operating expenses to each subsidiary utility throughout the United States. Utilities, Inc. of Sandalhaven received \$34,670 or approximately 0.45 percent of \$7,644,705 in total WSC common expenses for the 12-month period ended December 31, 2005. The allocation was calculated using a customer equivalent percentage that equates all customers throughout the United States in terms of equivalent residential connections.

The Commission's Division of Regulatory Compliance and Consumer Assistance, at the request of The Division of Economic Regulation, performed an affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2005, in Docket No. 060253-WS. The scope of the audit included a review of the WSC common expenses that are allocated to all of its subsidiary operations in 2005. The audit report, issued July 15, 2006, included specific adjustments that reduced Utilities, Inc of Sandalhaven's allocated common expenses by \$1,463 to \$33,207. Additionally, the corresponding adjustment to reduce working capital for this proceeding is \$183.

The audit staff has incorporated the findings of the above-mentioned audit report to determine Utilities, Inc of Sandalhaven's allocated average WSC common expenses is \$33,207 for this proceeding. See audit staff's calculations on the following page.

### EFFECT ON GENERAL LEDGER:

G/L Acct.	Description	Debit	Credit
2151000	Retained Earnings	\$1,262	
4032098	Dep. Exp. - Computer	\$3	
4191010	Interest Income	\$1	
4272090	Interest Expense	\$200	
6329002	Audit Fees		\$344
6369009	Amtz. Exp. - Computer		\$51
6599090	Insurance Exp. - Other		\$860
6759005	Postage Fees		\$211

**EFFECT ON FILING:** The utility's wastewater O&M expense balance is overstated by \$1,463 for the 12-month period ended December 31, 2005 and its wastewater working capital balance should be reduced by \$183, as of December 31, 2005 which is 1/8<sup>th</sup> of the O&M expense reduction mentioned above.

Sandalhaven Allocation Schedules		Per Company		Adjustment		Per Audit	
		WSC Expense	Sandalhaven	WSC Expense	Sandalhaven	WSC Expense	Sandalhaven
SE51	Allocated Computer	\$545,445	\$2,556	(\$12,634)	(\$48)	\$532,811	\$2,508
SE52	Allocated Insurance	2,114,495	11,456	(156,711)	(860)	1,957,784	10,596
SE60	Allocated General	<u>4,984,765</u>	<u>20,658</u>	<u>(74,972)</u>	<u>(354)</u>	<u>4,909,793</u>	<u>20,304</u>
	Per G/L	\$7,644,705	\$34,670	(\$244,317)	(\$1,262)	\$7,400,388	\$33,408
	Remove interest income and expense not included in the filing				<u>(201)</u>		<u>(201)</u>
	Per MFR				(\$1,463)		\$33,207

SE51

Acct No.		Per Utility	Adjustment	Per Audit
4032098	Dep. - Computer	\$479	\$3	\$482
6369009	Amtz. - Computer	<u>126</u>	<u>(51)</u>	<u>75</u>
		\$605	(\$48)	\$557

SE52

Acct No.		Per Utility	Adjustment	Per Audit
6599090	Insurance - Other	\$11,456	(\$860)	\$10,596

SE60

Acct No.		Per Utility	Adjustment	Per Audit
4191010	Interest Income	(\$1)	\$1	\$0
4272090	Interest Expense	(200)	200	0
6329002	Audit Fees	996	(344)	652
6759005	Postage Fees	<u>392</u>	<u>(211)</u>	<u>181</u>
		\$1,187	(\$354)	\$833

Acct No.		MFR Acct. No.	Adjustment	MFR B-12	MFR B-12
				0.00% Water	100.00% W/Water
4032098	Dep. - Computer	403	\$3	\$0	\$3
4191010	Interest Income	426 **	0	0	0
4272090	Interest Expense	419/427 **	0	0	0
6329002	Audit Fees	632/732	(344)	0	(344)
6369090	Amtz. - Computer	636/736	(51)	0	(51)
6599090	Insurance - Other	659/759	(860)	0	(860)
6759005	Postage Fees	675/775	<u>(211)</u>	<u>0</u>	<u>(211)</u>
	O&M Expense Adjustment		(\$1,466)	\$0	(\$1,466)
	Total WSC allocated expense adjustment		(\$1,463)	\$0	(\$1,463)
	Working Capital Adjustment (1/8 of O&M Expense Adjustment)		(\$183)	\$0	(\$183)

\*\* Per utility these two allocations from WSC are not carried forward into the MFR filing so no adjustment is needed.

## **AUDIT FINDING NO. 10**

### **SUBJECT: INFORMATION ON CONTRIBUTIONS IN AID OF CONSTRUCTION**

**SUMMARY:** The utility allocated its Contributions in Aid of Construction (CIAC) in 2003 in order to comply with Rule 25-30.140 F.A.C., which required CIAC for contributed property which can be specifically associated with a corresponding utility plant in service (UPIS) account to be amortized using the same depreciation rates as the UPIS account.

**STATEMENT OF FACTS:** In 2003, the utility made an adjusting entry to re-distribute its combined CIAC account balances into several specific accounts based on the percentage of plant balances excluding organization, franchise, transportation and office equipment account balances. The utility's calculations are displayed on the following page.

The utility first determined a balance for undistributed CIAC which represented cash collections. The amount was determined by estimating the total tap fees collected for the utility system. The remaining CIAC balance was then redistributed to specific CIAC sub-accounts based on the allocation methodology described above.

However, the audit staff notes there are two problems with the utility's calculation.

1. The utility did not book Commission adjustments from the last rate case until 2005 and therefore the plant balances used by the utility to reallocate its CIAC balance did not reflect the Commission balances.
2. The utility allocated the CIAC to all its UPIS accounts excluding organization, franchise, and transportation.

Usually when the utility receives contributed plant from a developer, it consists of service lines, lift stations, customer service extensions. The utility's allocation method redistributed a portion of its CIAC balance to accounts containing building and structures, wells, pumping equipment, treatment plant and sewer lagoons. These accounts are not normally associated with contributed property for wastewater utility systems.

The audit staff defers this issue to the analyst in Tallahassee for final disposition.

**EFFECT ON THE GENERAL LEDGER:** If the utility's CIAC allocation is recalculated by the analyst, the accumulated amortization of CIAC and CIAC amortization expense balances will all need to be adjusted accordingly.

**EFFECT ON THE FILING:** The total balance for CIAC reflected in the utility's filing will not change. However, the accumulated amortization of CIAC would need to be adjusted along with the beginning and ending average balance for the test year. Additionally, the recalculated amortization of CIAC expense balance will affect the net depreciation expense presented in the filing.

Sandalhaven-Wastewater

Recalculation of CIAC and Amortization of CIAC

Acct. Nos			UPIS	UPIS	CIAC	CIAC	CIAC	CIAC	CIAC	CIAC	CIAC
UPIS	CIAC	Acct. Description	Balance @12/31/02	Balance Percentage	Allocation @12/31/02	Additions Jan-Jun '03	Balance @12/31/02	Amtz. Rate	Amtz. Jan-Jun '03	Amtz. Jul-Dec '03	Amtz. Total
3542011	2721011	Lift Station	\$428,316	25.57%	\$340,846	0	\$340,846	3.13%	\$5,326	\$5,326	\$10,651
3547003	2721003	Structures & Imp.	249,455	14.89%	198,511	0	198,511	3.13%	3,102	3,102	6,203
3547012	2721012	Spray Irrigation Facilities	0	0.00%	0	0	0	3.13%	0	0	0
3602006	2721006	Sewage Service Lines	77,953	4.65%	62,033	0	62,033	3.33%	1,034	1,034	2,068
3602007	2721007	Force Mains	95,843	5.72%	76,270	0	76,270	3.33%	1,271	1,271	2,542
3612008	2721008	Sewer Mains	422,722	25.24%	336,394	0	336,394	2.22%	3,738	3,738	7,475
3612010	2721098	Manholes	122,884	7.34%	97,788	0	97,788	2.22%	1,087	1,087	2,173
3804004	2721004	Sewer Lagoons	232	0.01%	185	0	185	2.86%	3	3	5
3804005	2721005	Treatment Plant	277,714	16.58%	220,999	0	220,999	2.86%	3,157	3,157	6,314
3824009	2721009	Outfall Lines	0	0.00%	0	0	0	3.33%	0	0	0
			\$1,675,118	100.00%	\$1,333,026	0	\$1,333,026				\$37,433
271		CIAC Balance per T/B @12/31/02	\$1,689,170								
		Less Tap Fee portion of CIAC	(356,144)								
		Less Tap Fee Refunds	0								
		Less known CIAC Sub-Acct. Balance	0								
		Unidentified CIAC balance	\$1,333,026								
271		CIAC Additions (Jan-Jun '03)	\$5,000								
407.6		Amtz. Of CIAC Expense @12/31/03		\$52,171							
		Less Tap Fees Amtz of CIAC (Jan-Jun '03)		(5,485)							
		Less Tap Fees Amtz of CIAC (Jul-Dec '03)		(5,562)							
		Less known Amtz. Of CIAC Sub-Acct. Balance		0							
		Unidentified Amtz. Of CIAC balance		\$41,124							
		Recalculated Amtz. Of CIAC balance above		(37,433)							
		Retained Earnings Adjustment		\$3,691							

## **AUDIT FINDING NO. 11**

### **SUBJECT: INFORMATION ON POTENTIAL UNRECORDED CIAC INFRASTRUCTURE**

**SUMMARY:** The utility has had several new developments added since its last rate case in Docket No. 020409-SU. The utility's records, however, do not reflect any new additions to utility plant in service (UPIS) or contributions in aid of construction (CIAC) for wastewater mains or lift stations that you would expect to find.

**STATEMENT OF FACTS:** The utility provided the audit staff with a detailed schedule of tap fee connections to support its recorded CIAC additions for the years 2002 through 2005.

The audit staff recognizes that some developers may have retained ownership of the utility infrastructure once connected to the utility's system. However, without an agreement or other documentation, we cannot determine if this is the case.

The recording of contributed property would have no net effect on the utility's net rate base, and O&M expenses because the asset and expense accounts would offset each other. The NARUC Uniform System of Accounts, however, requires recording all UPIS and CIAC additions to the general ledger.

The utility did not record contributed property from Heartstone Developer, Hacienda Del Mar and Hammocks Cape Haze. These developer agreements state that, "All of the off-site Facilities installed by Developer pursuant to this Agreement shall become the property of Utility as installed." The utility was asked to explain if this related Plant in Service and CIAC were recorded. The utility indicated in its response that there has been no contributed property for any of the above-mentioned developments.

According to the National Association of Regulatory Utility Commissioners (NARUC), Account 271 Contribution in Aid of Construction should include any amount or item of money, services and property received by a utility, from any person or governmental agency.

**EFFECT ON GENERAL LEDGER:** When an amount of contributed assets is determined, UPIS and CIAC should be increased and the corresponding additions should then be depreciated and amortized at the same rates as prescribed in Rule 25-30.140, F.A.C. and recorded in the appropriate rate base accounts.

**EFFECT ON FILING:** All of the above balances, when determined, would be offsetting so that there is no effect on the utility's filing.

**AUDIT FINDING NO. 12**

**SUBJECT: INFORMATION ON TRANSPORTATION EXPENSE**

**SUMMARY:** The support supplied by the utility for transportation expense was not sufficient to determine that the charges relate to the specific vehicles used in each system.

**STATEMENT OF FACT:** The utility uses GE Capital Fleet to manage its fleet of vehicles. GE Capital provides gas cards for the employees to buy fuel for their vehicles and oversees the maintenance of the fleet. The utility provided the total invoice and its internal allocations of those invoices to each utility system. This did not provide us the information necessary to determine that the charges allocated by the utility actually related to vehicles for that system or whether the repairs were reasonable.

**EFFECT ON GENERAL LEDGER:** Expenses may need to be re-allocated among systems.

**EFFECT ON FILING:** Expenses may need to be reduced.

### AUDIT FINDING NO. 13

**SUMMARY:** The utility's average capital structure balance is \$229,434,007 as of December 31, 2005 and its cost rate for long-term is 6.73 percent.

**STATEMENT OF FACTS:** The utility's filing reflects the following capital structure balances prior to the reconciliation with rate base as of December 31, 2005.

Class of Capital	Prior Year 12/31/2004	Test Year 12/31/2005	Average	Cost Rate
Long Term Debt	\$112,803,215	\$135,285,191	\$124,044,203	6.81%
Short Term Debt	18,768,000	3,926,000	11,347,000	2.00%
Common Equity	88,963,597	92,611,247	90,787,422	11.77%
Customer Deposits	16,500	16,500	16,500	6.00%
Acc. Deferred Income Tax	<u>142,890</u>	<u>148,865</u>	<u>145,878</u>	0.00%
Totals	\$220,694,202	\$231,987,803	\$226,341,003	

The Commission's Division of Regulatory Compliance and Consumer Assistance, at the request of The Division of Economic Regulation, performed an affiliate transaction audit of Utilities, Inc. and its subsidiary WSC for the 12-month period ended December 31, 2005, in Docket No. 060253-WS. The scope of the audit included a review of the Utilities, Inc., the parent, capital structure component balances as of December 31, 2005. The audit report, issued July 15, 2006, determined the following average balances for Sandalhaven's parent, Utilities Inc. as of December 31, 2005.

Class of Capital	Prior Year 12/31/2004	Test Year 12/31/2005	Average	Cost Rate
Parent Level				
Long Term Debt	\$112,803,215	\$135,285,191	\$124,044,203	6.73%
Short Term Debt	18,768,000	3,926,000	11,347,000	2.00%
* Common Equity	92,087,507	95,673,345	93,880,426	
Sandalhaven Level				
** Customer Deposits	16,500	16,500	16,500	6.00%
** Acc. Deferred Income Tax	<u>142,890</u>	<u>148,865</u>	<u>145,878</u>	0.00%
Totals	\$223,818,112	\$235,049,901	\$229,434,007	

\* The cost rate for common equity to be determined after reconciliation to the utility's average rate base.

\*\* These balances do not include other audit adjustments in this report where applicable.

Based on the above-mentioned affiliate audit report findings the average common equity balance should be increased by \$3,093,004 (\$93,880,426 - \$90,787,422), the long-term debt cost rate should be reduced by 0.08 percent (6.81% - 6.73%) as of December 31, 2005.

**EFFECT ON GENERAL LEDGER:** None, because capital structure balances are only used in rate case proceedings

**EFFECT ON FILING:** To be determined by the analyst in Tallahassee.



## AUDIT FINDING NO. 14

### SUBJECT: INFORMATION ON DEFERRED TAXES

**SUMMARY:** The utility reports a debit balance of \$99,410 upon its books in net deferred income taxes in 2005. This amount is reported within the utility's cost of capital schedule as an average liability of \$145,878. This reporting is in error

As a result of our testing as described below, the average balance used in this case should be changed from a net liability of \$145,878 to a report balance of \$0. Thus, there should be no deferred taxes in the utility's capital structure presentation for this rate case proceeding. Also, as a result of our testing as described below the utility's 2005 year end net asset balance for deferred taxes recorded on its books should be changed from \$99,410 by \$494 to report \$99,904. These amounts should be corrected. Lastly, the utility's average asset balance of deferred income taxes of \$100,270 will have no effect upon this case because this asset balance is part of the working capital of the utility and, in cases for Class B utilities, working capital is set at a figure equal to 1/8<sup>th</sup> of operation and maintenance expenses.

<u>Calculations:</u>	<u>Average</u>	<u>Year End</u>
Beginning Balance	(\$145,878)	\$99,410
Deferred Income Tax		
Remove Liability Balance	145,878	
Report Asset Balance at Average	95,694	
Corrections		
State Depreciation	(16,321)	(16,321)
State Intangible	(784)	(1,381)
Federal Intangible	21,681	18,196
Federal Depreciation	Pending	Pending
Remove Asset from Capital Structure	(100,270)	
Total	\$0	\$99,904 Net Asset

**EFFECT ON FILING:** If all the findings are accepted there is no direct effect on rate base or utility income. Capital structure effect is to increase the provision for equity and debt by \$145,878 and increase deferred taxes by \$145,878.

#### **Deferred Taxes -- Item 1: Accelerated Depreciation -- State of Florida**

When the utility takes tax benefits due to accelerated depreciation, the utility must record deferred income taxes. In this case, the utility failed to record sufficient state deferred taxes in its accounts. The estimated correction at average is (\$16,321) and at year end (\$16,321).

**EFFECT ON GENERAL LEDGER:**

NARUC

<u>Acct. No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
215	Retained Earnings	\$16,321	
190	State Deferred Taxes – Depreciation		\$16,321

**Deferred Taxes -- Item 2: Deferred Taxes Intangible Plant – Federal and State of Florida**

Intangible plant is recorded as an asset in water and sewer plant accounts as either organization plant or as franchise plant. For income tax purposes, this intangible plant is expensed and deferred taxes are recorded. Intangible plant and deferred taxes for intangible plant during the normal course of business are not reduced unless a utility's assets are sold.

Utility intangible plant did not match the expected balance of deferred income taxes. Further the State of Florida deferred taxes had not been properly recorded. The estimated correction to Federal deferred accounts at average is \$21,681 and at year end is \$18,196. The estimated correction to state deferred account is (\$784) at average and at year end is (\$1,381).

**EFFECT ON GENERAL LEDGER:**

NARUC

<u>Acct. No.</u>	<u>Acct. Description</u>	<u>Debit</u>	<u>Credit</u>
215	Retained Earnings		\$16,815
190	Federal Deferred Taxes – Intangible Plant	\$18,196	
190	State Deferred Taxes – Intangible Plant		\$1,381

**Deferred Taxes -- Item 3: Accelerated Depreciation – Federal**

Accelerated depreciation is a difficult account for a utility to maintain and difficult for the Commission to audit. We found there was a possibility of errors and non utility effects in the account. There was not enough available audit time for staff to verify the details in this account sufficiently to comment the account was free of error, free of non utility effects and reflected necessary Commission adjustments appropriately.

Absent available audit resources, we have asked the utility to present additional information concerning its deferred taxes in this matter. Absent additional audit procedures, we recommend industry staff use reported plant additions, retirements and Commission adjustments along with known state and federal depreciation rates to determine what level for Federal Accumulated Deferred Income Tax is reasonable. Once a Federal Deferred Tax – Accelerated Depreciation level is set, it would be appropriate to revise the estimate presented in item 2: Deferred Taxes -- Accelerated Depreciation State of Florida.

Possible Accounts Affected upon General ledger:

Retained Earnings

State Deferred Income Taxes – Depreciation

Federal Deferred Income Taxes – Depreciation

State Non Utility Deferred Income Taxes – Depreciation

Federal Non Utility Deferred Income taxes -- Depreciation

**Deferred Taxes -- Item 4: Accounting for Post 2000 Tap Fees**

Treasury Regulation Section 1.118-2(b) (3) excludes customer connection fees from the definition of CIAC for tax purposes. Therefore, Commission staff has advised that subsequent to the year 2000, CIAC in the form of cash tap fees paid to the utility is taxable. This appears to be a significant item in future utility accounting and ratemaking.

The utility records the effects of (1) taxable CIAC and (2) its amortization correctly in its deferred tax accounts, but the also utility reports (3) additional book depreciation in its reports where no book depreciation exists. Further, it appears that the taxable CIAC effects are at an accelerated rate rather than the straight line rate used by the utility. This reporting does not affect the setting of rates in this case, but it clouds the auditing and determination of deferred taxes and the utility's ongoing and future reports such as annual report schedule F-23 and MFR schedules C-1 and C-2, and C-5. Clarification on this matter is needed.

From the auditor's perspective, it appears the proper accounting for taxable CIAC is to treat the amortization of tax on CIAC as income statement amortization and not provide a corresponding provision for income taxes on this amortization in ratemaking. Treating this item entirely in deferred tax accounts on the balance sheet seems to cause long-lived problems in assessing the impact of taxable CIAC and accelerated depreciation on rates.

**Deferred Taxes -- Item 5: Error in Utility MFR**

Utility information contained in its filing schedules C-1, C-2 and C-5 that report the provision for income taxes did not match utility schedule B-1 or Annual Report Schedule F-23 or Annual Report Schedule F-3. This type of error causes audit inefficiencies. The audit staff has relied upon annual report schedules during this audit of deferred income taxes.

**Deferred Taxes -- Item 6: AFUDC**

Based upon a review of cash flow model, it is apparent that when setting rates for a utility receiving both an income tax allowance and AFUDC, for ratemaking, it is appropriate to adjust the final calculations for income tax expense by the tax effect of equity AFUDC depreciation.

In the past, this item could be considered immaterial but the issue grows as AFUDC is accrued by utilities year-after-year which receive allowances for federal income tax.

Due to audit time constraints, the auditor was not able to fully research this utility's AFUDC history or determine the correct amount of equity AFUDC depreciation in this case.

# EXHIBIT 1

**Sewer Rate Base**

Company: Utilities Inc. of Sandalhaven  
 Docket No.: 060258-SU  
 Test Year End: December 31, 2005  
 Interim  or Final   
 Historic  or Projected

Florida Public Service Commission

Schedule: A-2  
 Page 1 of 1  
 Preparer: Virchow, Krause

Explanation: Provide the calculation of average rate base for the test year, showing all adjustments. All non-used and useful items should be reported as Plant Held For Future Use.

Line No.	(1) Description	(2) Balance Per Books	(3) Utility Adjustments	(4) Adjusted Books Balance	(5) Proforma Adjustments	(6) Adjusted Utility Balance	(7) Supporting Schedule(s)
1	Utility Plant in Service	\$ 2,076,274	\$ -	\$ 2,076,274	\$ 3,276,272 A	\$ 5,352,546	A-6
2	Utility Land & Land Rights	81,794	-	81,794	-	81,794	A-6
3	Less: Non-Used & Useful Plant	-	-	-	- C	-	A-3, A-7
4	Construction Work in Progress	59,410	(59,410) D	-	-	-	A-3, A-18
5	Less: Accumulated Depreciation	(839,983)	-	(839,983)	140,323 B	(699,650)	A-10, A-3
6	Less: CIAC	(2,268,445)	-	(2,268,445)	935,733	(1,330,712)	A-12
7	Accumulated Amortization of CIAC	794,500	-	794,500	(678,441)	116,059	A-14
8	Acquisition Adjustment	441,304	(441,304) E	-	-	-	A-3, A-18
9	Accum. Amort. Of Acq. Adjustments	-	-	-	-	-	A-3, A-18
10	Advances for Construction	-	-	-	-	-	A-18
11	Working Capital Allowance	-	-	-	62,554 F	62,554	A-17, A-3
12	Total Rate Base	\$ 346,855	\$ (500,714)	\$ (153,860)		\$ 3,582,582	

**EXHIBIT 2**

**Net Operating Income Statement - Sewer**

Florida Public Service Commission

Company: Utilities Inc. of Sandalhaven  
 Docket No.: 060258-SU  
 Test Year End: December 31, 2005  
 Interim [ ] or Final [x]  
 Historic [x] or Projected [ ]

Schedule: B-2  
 Page 1 of 1  
 Preparer: Virchow, Krause

Explanation: Provide the calculation of net operating income for the test year. If amortization (Line 4) is related to any amount other than an acquisition adjustment, submit an additional schedule showing a description and calculation of charge.

(1) Line No.	(2) Balance Per Books	(3) Utility Test Year Adjustments	(4) Utility Adjusted Test Year	(5) Requested Revenue Adjustment	(6) Requested Annual Revenues	(7) Supporting Schedule(s)
1 OPERATING REVENUES	\$ 270,518	\$ 6,044 A	\$ 276,562	\$ 981,066 I	\$ 1,257,628	B-4, E-2
2 Operation & Maintenance	313,245	-	313,245	187,186 E, F, G, L, N	500,431	B-6
3 Depreciation, net of CIAC amort.	(32,207)	-	(32,297)	293,876 D	261,570	B-14
4 Amortization	529	(529) B	-	-	-	B-3
5 Taxes Other Than Income	43,280	-	43,280	43,823 K, M	87,083	B-15
6 Provision for Income Taxes	(44,051)	44,051 C	-	101,866 J	101,866	
7 OPERATING EXPENSES	280,686	43,522	324,208	626,751	950,859	
8 NET OPERATING INCOME	\$ (10,168)	\$ (37,476)	\$ (47,646)	\$ 354,315	\$ 306,669	
9 RATE BASE	\$ 346,855		\$ (153,860)		\$ 3,582,582	A-2
10 RATE OF RETURN	-2.93%		30.97%		8.56%	

# EXHIBIT 3

**Requested Cost of Capital**

**Florida Public Service Commission**

Company: Utilities Inc. of Sandalhaven  
 Docket No.: 060258-SU  
 Test Year End: December 31, 2005  
 Schedule Year End: December 31, 2005  
 Interim  or Final   
 Historic  or Projected

Schedule: D-1  
 Page 1 of 1  
 Preparer: Kirsten E. Weeks

Explanation: Provide a schedule which calculates the requested Cost of Capital on a beginning and end of year average basis. If a year-end basis is used, submit an additional schedule reflecting year-end calculations.

Line No.	(1) Class of Capital	(2) Total Capital	(3) Ratio	(4) Cost Rate	(5) Weighted Cost
1	Long Term Debt	\$ 1,875,759	54.84%	6.81%	3.73%
2	Short Term Debt	171,586	5.02%	2.00%	0.10%
3	Preferred Stock	-	0.00%	0.00%	0.00%
4	Common Equity	1,372,860	40.14%	11.77%	4.72%
5	Customer Deposits	18,500	0.01%	6.00%	0.00%
6	Tax Credits - Zero Cost	-	0.00%	0.00%	0.00%
7	Tax Credits - Weighted Cost	-	0.00%	0.00%	0.00%
8	Accumulated Deferred Income Tax	145,878	0.06%	0.00%	0.00%
9	Other (Explain)	-	0.00%	0.00%	0.00%
10	Total	\$ 3,582,582	100%		8.56%

Note: The cost of equity is based on the leverage formula in effect pursuant to Order No. PSC-050006. Since the equity ratio is greater than 40.00%, a(n) 11.77% cost rate has been used.