

State of Florida



## Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD  
TALLAHASSEE, FLORIDA 32399-0850

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

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**DATE:** March 22, 2011  
**TO:** Bart Fletcher, Public Utilities Supervisor, Division of Economic Regulation  
**FROM:** Clarence J. Prestwood<sup>CJP</sup>, Chief of Auditing, Office of Auditing and Performance Analysis  
**RE:** Docket No.: 100426-WS  
Company Name: Utilities, Inc.  
Company Code: SU640  
Audit Purpose: Headquarters Audit of Affiliated Transactions  
Audit Control No: 11-004-4-2

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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 were confidential work papers associated with this audit.

CJP/ip

Attachment: Audit Report\*

cc: (With Attachment)  
Office of Auditing and Performance Analysis  
Office of Commission Clerk  
Office of the General Counsel  
Dale Mailhot, Office of Auditing and Performance Analysis  
Clarence Prestwood, Office of Auditing Performance Analysis  
Lisa Harvey, Office of Auditing and Performance Analysis  
Lynn Deamer, Office of Auditing and Performance Analysis  
Linda Hill-Slaughter, Office of Auditing and Performance Analysis

DOCUMENT NUMBER-DATE  
01908 MAR 22 =  
FPSC-COMMISSION CLERK

State of Florida



**Public Service Commission**

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

**Auditor's Report**

Utilities, Inc.  
Affiliate Audit

Twelve Months Ended June 30, 2010

Docket No. 100426-WS  
Audit Control No. 11-004-4-2  
March 21, 2011

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FPSC-COMMISSION CLERK

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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 Economic Regulation in its audit service request dated January 5, 2011. We have applied these procedures to the attached exhibits submitted in support of Utilities, Inc.'s request for Lake Utility Services, Inc. Rate Case Relief in Docket No. 100426-WS.

This audit was performed following general standards and field work 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” or holding company of Lake Utility Services, Inc. (LUSI). This Utility uses the test year ended June 30, 2010.

#### Affiliate Allocations

The Company allocates its costs to each of its utility subsidiaries based on Equivalent Residential Customers (ERCs). The Utility in this case, LUSI, receives costs based on its ERC ratio to the total ERCs at the corporate level for the Northbrook, Illinois costs. The Utility allocates costs using the same method for its Regional and Florida Altamonte Springs offices based on the total ERCs for the Region and the State of Florida, respectively.

#### Company Books and Records

**Objective:** To determine that the Company maintains its accounts and records in conformity with the National Association of Regulatory Utility Commissioners’ (NARUC) Uniform System of Accounts (USOA).

**Procedures:** We reviewed the Company’s accounting systems. The Company does not use NARUC account numbers in its ledgers but maintains a conversion table and converts its filings into NARUC accounts.

### **Rate Base**

**Objectives:** Our objective was to determine that the adjustments to rate base were correct and supported by adequate audit evidence.

**Procedures:** We obtained supporting documentation for the adjustments to rate base and verified the assumptions used. We traced any test year data used to the test year general ledger.

#### Utility Plant in Service

**Objectives:** Our objectives were to: 1) Determine whether the 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) Verify that the proper retirements of plants were made when a replacement item was put in service, and 3) Verify that the adjustments to plant in the Company’s books from the rate case proceeding of a subsidiary were recorded in its general ledger.

**Procedures:** We determined the plant balance as of December 31, 2008 that was established in Docket No. 090381-SU.<sup>1</sup> We reviewed and sampled the Illinois and Florida headquarters additions for the period January 1, 2009 through June 30, 2010 and verified the allocated plant balance for this proceeding. We ensured that retirements were made when a capital item was removed or replaced. Finding 1 discusses our findings and recommended adjustments to plant for an expense recorded as plant. Finding 2 discusses our finding and recommended adjustments to plant for an ordered adjustment that was not booked. Finding 7 discusses an adjustment to capitalized labor.

### Accumulated Depreciation

**Objectives:** Our objectives were to: 1) Verify that the adjustments to accumulated depreciation in the Company's books ordered by the Commission were recorded in its general ledger, 2) Determine that accruals to accumulated depreciation accounts that are allocated to subsidiaries are properly recorded in compliance with Commission rules and the NARUC USOA, 3) Verify that depreciation expense accruals for accounts that are allocated are calculated using the Commission's authorized rates, and 4) Verify that retirements are properly recorded.

**Procedures:** We determined the accumulated depreciation balances as of December 31, 2008 that were established in Docket No. 090381-SU. We recalculated the Illinois and Florida headquarters accrual to accumulated depreciation for the period January 1, 2009 through June 30, 2010 and verified the Company's allocated accumulated depreciation balances for this proceeding. We ensured that retirements to accumulated depreciation were made when a capital item was removed or replaced. Finding 1 and 2 discuss our recommended adjustments to accumulated depreciation. Finding 3 discusses our findings and recommended adjustments to accumulated depreciation for the ordered change of the depreciation life of Project Phoenix.

## **Net Operating Income**

### Operation and Maintenance Expense

**Objective:** Our objective was to determine that operation and maintenance expenses allocated to subsidiaries are properly recorded in compliance with NARUC USOA and Commission rules and are representative of its subsidiary's ongoing utility operations.

**Procedures:** We verified operation and maintenance expense accounts allocated for the 12-month period ending June 30, 2010, by tracing a sample of invoices to the original source documentation. We reviewed invoices for proper amount, period, classification, NARUC account, and recurring nature. Salaries, benefits, and transportation expenses from the Illinois and Florida offices were evaluated and recalculated. Finding 4, 6, 8 and 9 discuss adjustments that affect expenses.

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<sup>1</sup> See Order No. PSC-11-0015-PAA-WS, issued January 5, 2011, Docket No. 090531-WS, In Re: Application for staff-assisted rate case in Highlands County by Lake Placid Utilities, Inc.

## Depreciation Expense

**Objective:** Our objective was to determine that 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.

**Procedure:** We verified the Company's calculations of depreciation expense. Findings 1, 2 and 3 discuss our findings and recommended adjustments to depreciation expense for the 12-month period ending June 30, 2010.

## **Capital Structure**

**Objective:** Our objective was to determine that the components of the Company's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital are properly reported in compliance with Commission requirements.

**Procedure:** We verified the Company's long-term debt, short-term debt, and common equity to the audited financial statements and general ledger. We traced the long-term debt to the prior audit and traced short term debt to the bank statements. The Utility's capital structure components: customer deposits and deferred taxes were reviewed in the rate case audit (ACN 11-004-4-1) under this same docket. Finding 5 discusses the short-term cost rate.

## Audit Findings

### **Audit Finding 1**

#### **Subject: Expense Recorded As Plant**

**Audit Analysis:** The sample of plant additions in the Illinois Headquarters books contained an out of period expense transaction that the Company agreed should have been expensed.

At the end of December 2009, the Company recorded the taxes on the Company's annual Microsoft Licenses for its Enterprise Servers and Product in the amount of \$9,357 to Account 1590 – Computer System Cost, NARUC Account 340.5. Per the invoice, the licenses were effective from January to December 2008. Since the item is out of period and the invoice for 2009 was properly recorded, there is no increase to the test year's expenses. However, because the item has been depreciated, accumulated depreciation and depreciation expense should be adjusted for the test year.

The amount of allocated cost received by Lake Utility Services, Inc. is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates 4.51% of its cost to Lake Utility Services, Inc. Lake Utility then allocates the cost from headquarters between its water and wastewater systems by each system's ERC ratio to Lake Utility Services, Inc. total ERCs. The ERC percentage is 75.19% for water and 24.81% for wastewater for the Utility.

The schedule following this finding provides the transaction detail, depreciation calculation, and the allocated amounts to Lake Utility Services, Inc.

**Effect on the General Ledger:** The following adjustment is recommended to correct the Illinois ledger. Since the test year is already closed in the ledger, the depreciation expense should be recorded to retained earnings:

Co. No.	Co. Acct.	NARUC Acct.	Account Description	Debit	Credit
102	1590	340.5	Computer System Cost		\$ 9,357
102	2330	108.1	Computer System Acc. Dep	\$ 468	
102	4998	215	Retained Earnings	\$ 8,889	
			<b>Total</b>	<b>\$ 9,357</b>	<b>\$ 9,357</b>

**Effect on the Filing:** 13-Month Average Headquarter Plant should be reduced by \$5,039. 13-Month Average Headquarter Accumulated Depreciation should be reduced by \$234. Headquarter depreciation expense should be reduced by \$468. Lake Utility Services, Inc.'s 13-Month Average water and wastewater plant should be decreased by \$171 and \$56 and accumulated depreciation by \$8 and \$3, respectively. Lake Utility Services, Inc. depreciation expense should also be reduced by \$16 for water and \$5 for wastewater.



**Computation of Depreciation**

Co. No.	Co. Acc.	Description	Date	Invoice Amt.	Explanation	Plant Adj.	Plant Acct.	Ret. Earn.	Acct. 215	Life (Years)	Dep. Exp./R.E.	Months	Acc. Dep.	Acct. 108.1
102	1590	Correcting PPV, OVS, PVS, T2	12/29/2009	\$ 9,357	Out of Period Expense - Taxes on Microsoft License for Enterprise Server and Products - Jan to Dec 2008	\$ (9,357)	340.5	\$ 9,357	4998	10	\$ (468)	6	\$ 468	1900

**Computation of 13-Month Average**

Date	Plant Adj.	Acc. Dep. Adj.
June 30, 2009	\$ -	\$ -
July 31, 2009	\$ -	\$ 39
August 31, 2009	\$ -	\$ 78
September 30, 2009	\$ -	\$ 117
October 31, 2009	\$ -	\$ 156
November 30, 2009	\$ -	\$ 195
December 31, 2009	\$ (9,357)	\$ 234
January 31, 2010	\$ (9,357)	\$ 273
February 28, 2010	\$ (9,357)	\$ 312
March 31, 2010	\$ (9,357)	\$ 351
April 30, 2010	\$ (9,357)	\$ 390
May 31, 2010	\$ (9,357)	\$ 429
June 30, 2010	\$ (9,357)	\$ 468
<b>13-Month Average</b>	<b>\$ (5,039)</b>	<b>\$ 234</b>

**Computation of Allocation to LUSI**

LUSI Allocation	Rate	Plant Adj.	Acc. Dep. Adj.	Exp. Adj.
Illinois Allocation	4.51%	\$ (227)	\$ 11	\$ (21)
Water Allocation	75.19%	\$ (171)	\$ 8	\$ (16)
Wastewater Allocation	24.81%	\$ (56)	\$ 3	\$ (5)

Company used 1/2 year depreciation on this account and began depreciating in July 2009.

## Audit Finding 2

### Subject: Ordered Adjustments for Project Phoenix Not Booked

**Audit Analysis:** Project Phoenix is the Company's financial, customer care, and billing system, which became operational in December 2008. In Order PSC-10-0407-PAA-SU, the Commission established that the total cost for Project Phoenix at December 31, 2008 was \$21,617,487 and required the Company to deduct \$1,724,166 from the total cost of Project Phoenix, reducing it to \$19,893,321, before allocating costs to the remaining UI subsidiaries. The Company provided a restatement schedule for all computer balances on its books to take into account the ordered adjustments of the past. The Company did not make the adjustment ordered for Project Phoenix. The Company's restatement schedule shows the Project Phoenix balance at December 31, 2008 to be \$21,545,555. The difference between the Company's balance and the ordered amount is \$1,652,234.

The amount of allocated cost received by Lake Utility Services, Inc. is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates 4.51% of its cost to Lake Utility Services, Inc. Lake Utility then allocates the cost from headquarters between its water and wastewater systems by each system's ERC ratio to Lake Utility Services, Inc. total ERCs. The ERC percentage is 75.19% for water and 24.81% for wastewater for the Utility.

The schedule following this finding shows the calculation of the adjustment to plant, accumulated depreciation, and depreciation expense needed to comply with the Order and the adjustment to Lake Utility Services, Inc. allocated rate base and expense accounts. In the Order stated above, Project Phoenix's depreciation rate was changed from eight to 10 years. However, the Company has been depreciating the project over eight years beginning January 1, 2009. In Finding 3, we adjusted the accumulated depreciation and depreciation expense on Project Phoenix from eight to 10 years to comply with the Order. However, the schedule below removes depreciation for the reduction in plant using the 10 year depreciation rate to avoid duplicating the adjustment.

**Effect on the General Ledger:** The following adjustment corrects the Company's ledger. Since the test year is already closed in the ledger, the depreciation expense should be recorded to retained earnings:

Co. No.	Co. Acct.	NARUC Acct.	Account Description	Debit	Credit
102	1590	340.5	Computer System Cost		\$ 1,652,234
102	2330	108.1	Computer System Acc. De	\$ 247,835	
102	4998	215	Retained Earnings	\$ 1,404,399	
			<b>Total</b>	<b>\$ 1,652,234</b>	<b>\$ 1,652,234</b>

**Effect on the Filing:** 13-Month Average for Headquarters plant and accumulated depreciation should be reduced by \$1,652,234 and \$165,233, respectively. Depreciation expense should be reduced by \$165,223. The effect on Lake Utility Services, Inc.'s filing is a 13-Month Average decrease to water and waste water plant by \$56,028 and \$18,487 and accumulated depreciation by \$5,603 and \$1,849, respectively. Lake Utility Services, Inc.'s depreciation expense should also be reduced by \$5,603 for water and \$1,849 for wastewater.

**Project Phoenix Reconciliation**

Description	Amount
Project Phoenix Total Cost Per Order	\$ 21,617,487
Ordered Adjustments Per Order	\$ (1,724,166)
Difference	\$ 19,893,321
Project Phoenix Total Cost Per Company	\$ (21,545,555)
<b>Adjustment to Correct Beginning Balance</b>	<b>\$ (1,652,234)</b>

**Calculation of Depreciation**

C0. No.	C0. Acct.	Description	Beg. Bal. Adjustment	Retained Earnings	Acct.	Life (Year)	Dep. Exp/RE	Acct.	Months	Acc. Dep.	Acct.
102	1590	Project Phoenix	\$ (1,652,234)	\$ 1,652,234	4998	10	\$ (165,223)	6920	18	\$ 247,835	2330

**13-Month Average Calculation**

Date	Plant Adjustment	Acc. Dep. Adjustment
June 30, 2009	\$ (1,652,234)	\$ 82,612
July 31, 2009	\$ (1,652,234)	\$ 96,380
August 31, 2009	\$ (1,652,234)	\$ 110,149
September 30, 2009	\$ (1,652,234)	\$ 123,918
October 31, 2009	\$ (1,652,234)	\$ 137,686
November 30, 2009	\$ (1,652,234)	\$ 151,455
December 31, 2009	\$ (1,652,234)	\$ 165,223
January 31, 2010	\$ (1,652,234)	\$ 178,992
February 28, 2010	\$ (1,652,234)	\$ 192,761
March 31, 2010	\$ (1,652,234)	\$ 206,529
April 30, 2010	\$ (1,652,234)	\$ 220,298
May 31, 2010	\$ (1,652,234)	\$ 234,066
June 30, 2010	\$ (1,652,234)	\$ 247,835
<b>13-MONTH AVERAGE</b>	<b>\$ (1,652,234)</b>	<b>\$ 165,223</b>

**Utility Allocation**

LUSI Allocation	Rate	13-Mo. Plant Adj.	13-Mo. Acc. Dep. Adj.	Dep. Exp.
Illinois Allocation	4.51%	\$ (74,516)	\$ 7,452	\$(7,452)
Water Allocations	75.19%	\$ (56,028)	\$ 5,603	\$(5,603)
Wastewater Allocation	24.81%	\$ (18,487)	\$ 1,849	\$(1,849)

### Audit Finding 3

#### Subject: Depreciation Life of Project Phoenix

**Audit Analysis:** In Order PSC-10-0407-PAA-SU, the Company was directed to change the depreciation life for Project Phoenix from eight years to 10 years.

The Company provided a restatement schedule for its computer balance on its books to account for depreciation rate changes. The Company did not change the rate at which the software is being depreciated.

The amount of allocated cost received by Lake Utility Services, Inc. is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates 4.51% of its cost to Lake Utility Services, Inc. Lake Utility then allocates the cost from headquarters between its water and wastewater systems by each system's ERC ratio to Lake Utility Services, Inc. total ERCs. The ERC percentage is 75.19% for water and 24.81% for wastewater for the Utility.

The schedule following this finding shows the calculation for accumulated depreciation and depreciation expense adjustments to correct the accrual balances for Headquarters and Lake Utility Services, Inc.

**Effect on the General Ledger:** The following adjustment is recommended to correct the Headquarters ledger balance. Since the test year is already closed in the ledger, the depreciation expense should be recorded to retained earnings:

Co. No.	Co. Acct.	NARUC Acct.	Account Description	Debit	Credit
102	330	108.1	Computer System Acc. De	\$ 1,099,067	
102	4998	215	Retained Earnings		\$ 1,099,067
			<b>Total</b>	<b>\$ 1,099,067</b>	<b>\$ 1,099,067</b>

**Effect on the Filing:** The 13-Month Average accumulated depreciation and depreciation expense should be reduced by \$821,520 and \$555,094, respectively. The effect on Lake Utility Services, Inc.'s filing is a 13-Month Average decrease to water and wastewater accumulated depreciation by \$27,867 and \$9,194, respectively. Lake Utility Services, Inc.'s test year depreciation expense should also be reduced by \$18,829 for water and \$6,213 for wastewater.

**Computation of Depreciation**

Period	Additions	Depr Rate	2002 Dep. Exp.	2003 Dep. Exp.	2004 Dep. Exp.	2005 Dep. Exp.	2006 Dep. Exp.	2007 Dep. Exp.	2008 Dep. Exp.	Jan 09 - 9-Jun Dep. Exp.	Jul 09 - Jun-10 Dep. Exp.	Per Staff Jun-10 Acc. Dep.
2002	\$ 5,912.31	10.00%	\$ 296	\$ 591	\$ 591	\$ 591	\$ 591	\$ 591	\$ 591	\$ 296	\$ 591	\$ 1,478
2003	\$ 14,240.00	10.00%		\$ 712	\$ 1,424	\$ 1,424	\$ 1,424	\$ 1,424	\$ 1,424	\$ 712	\$ 1,424	\$ 3,560
2004	\$ -	10.00%										
2005	\$ -	10.00%										
2006	\$ 508,722.09	10.00%					\$ 25,436	\$ 50,872	\$ 50,872	\$ 25,436	\$ 50,872	\$ 127,181
2007	\$ (508,722.09)	10.00%						\$ (76,308)	\$ (50,872)	\$ (25,436)	\$ (50,872)	\$ (127,181)
2008	\$ 21,525,402.85	10.00%							\$ 1,076,270	\$ 1,076,270	\$ 2,152,540	\$ 4,305,081
Jan - Jun 09	\$ 279,722.11	10.00%								\$ 6,993	\$ 27,972	\$ 34,965
Jul 09 - Jun 10	\$ 394,105.31	10.00%									\$ 19,705	\$ 19,705
<b>Total</b>	<b>\$ 22,219,382.58</b>		<b>\$ 296</b>	<b>\$ 1,303</b>	<b>\$ 2,015</b>	<b>\$ 2,015</b>	<b>\$ 27,451</b>	<b>\$ (23,421)</b>	<b>\$ 1,078,285</b>	<b>\$ 1,084,271</b>	<b>\$ 2,202,233</b>	<b>\$ 4,364,789</b>

**Comparison of 8 to 10 Years**

Co. No.	Description	Plant Balance	Life (Year)	Dep. Exp./RE	Acct.	Acc. Dep.	Acct.
102	2008 Balance with Restated Dep. Per Staff	\$ 21,545,555	10	\$ 2,154,556	6920	\$ 4,310,119	2330
	At Jun 2009	\$ 279,722		\$ 27,972		\$ 34,965	
	At Jun 2010	\$ 394,105		\$ 19,705		\$ 19,705	
	<b>Total @ 10 Yrs. Per Staff</b>	<b>\$ 22,219,383</b>		<b>\$ 2,202,233</b>		<b>\$ 4,364,789</b>	
	2008 Balance Per Co.	\$ 21,545,555	8	\$ 2,693,194		\$ 5,399,723	
	At Dec 2009	\$ 513,062		\$ 64,133		\$ 64,133	
	At Jun 2010	\$ 160,765		\$ -		\$ -	
	<b>Total @ 8 Yrs. Per Co.</b>	<b>\$ 22,219,383</b>		<b>\$ 2,757,327</b>		<b>\$ 5,463,856</b>	
	<b>Adjustments</b>			<b>\$ (555,094)</b>		<b>\$ (1,099,067)</b>	

**Computation of 13-Month Average**

Date	Acc. Dep. Adj.
June 30, 2009	\$ (543,973)
July 31, 2009	\$ (590,231)
August 31, 2009	\$ (636,489)
September 30, 2009	\$ (682,747)
October 31, 2009	\$ (729,004)
November 30, 2009	\$ (775,262)
December 31, 2009	\$ (821,520)
January 31, 2010	\$ (867,778)
February 28, 2010	\$ (914,036)
March 31, 2010	\$ (960,294)
April 30, 2010	\$ (1,006,551)
May 31, 2010	\$ (1,052,809)
June 30, 2010	\$ (1,099,067)
<b>13-Month Average</b>	<b>\$ (821,520)</b>

**Utility Allocation**

LUST Allocation	Rate	13-Mo. Acc. Dep.	Dep. Exp.
Illinois Allocation	4.51%	\$ (37,061)	\$ (25,042)
Water Allocations	75.19%	\$ (27,867)	\$ (18,829)
Wastewater Allocation	24.81%	\$ (9,194)	\$ (6,213)

## Audit Finding 4

### Subject: Prepaid-Other Expenses

**Audit Analysis:** We analyzed the Prepaid-Other expense adjustment schedule provided by the Company. It restated the amount of prepaid expenses included in the test year expenses in the filing. For Headquarters Account 5735 - Computer Maintenance Expense, NARUC Account 636/736, the Company calculated a deficiency in the amount of \$54,038 and increased the filing by this amount.

Our test of the Company's support revealed the following discrepancies in the Company's prepaid schedule adjustment to its filing to correct headquarter allocations during the test year:

Schedule Adjusting Prepaid Amortization

Date	Acct.	Prepays Per Co.	Adj. Per Staff	Notes	Prepays Per Staff	Prior Amtz.	Months	Amtz. Exp.
December 2008	5735	\$ 7,414			\$ 7,414	\$ (4,325)	5	\$ 3,089
December 2008	5735	\$ 67,861			\$ 67,861	\$ (39,586)	5	\$ 28,275
December 2008	5735	\$ 3,451			\$ 3,451	\$ (2,013)	5	\$ 1,438
December 2008	5735	\$ 6,448			\$ 6,448	\$ (3,761)	5	\$ 2,687
January 2009	5735	\$ 51,998	\$ (51,998)	(1)	\$ -	\$ -		\$ -
September 2009	5735	\$ 28,853	\$ (28,853)	(2)	\$ -	\$ -		\$ -
November 2009	5735	\$ 214,913	\$ (46,004)	(3)	\$ 168,909	\$ -	8	\$ 112,606
December 2009	5735	\$ 242,019	\$ 31,476	(2)	\$ 273,495	\$ -	7	\$ 159,539
January 2010	5735	\$ 8,550	\$ (8,550)	(4)	\$ -	\$ -		\$ -
February 2010	5735	\$ -	\$ (96,920)	(5)	\$ (96,920)	\$ -	5	\$ (40,383)
February 2010	5735	\$ 28,884			\$ 28,884	\$ -	5	\$ 12,035
March 2010	5735	\$ 4,980	\$ (4,980)	(6)	\$ -	\$ -		\$ -
April 2010	5735	\$ 25,900	\$ (11,203)	(6)	\$ 14,697	\$ -	3	\$ 3,674
May 2010	5735	\$ 26,255	\$ (26,255)	(6)	\$ -	\$ -		\$ -
June 2010	5735	\$ 13,058			\$ 13,058	\$ -	1	\$ 1,088
<b>Total</b>		<b>\$ 730,584</b>	<b>\$ (243,286)</b>		<b>\$ 487,297</b>	<b>\$ (49,685)</b>		<b>\$ 284,048</b>

- 1) The Company added \$51,998 in prepayment additions for January 2009. This amount was for accounting expense paid to Thomson Reuters, which we discovered was already being amortized in a different ledger account, Account 6040 – Tax Return Review, NARUC 632/732. Account 6040 is in the Company's allocated expense accounts. We removed the amount in our recalculation because the amount should not be recovered twice.
- 2) We reclassified a \$31,476 entry from September to December. In addition, we removed an entry of \$2,623 that was for amortization expense instead of an addition to the prepaid account. This resulted in a credit to September prepays for \$28,853 and a debit to December prepays for \$31,476.
- 3) The \$46,004 included in the November 2009 additions was included in error on the schedule; therefore, we removed it in our recalculation schedule of prepaid expenses.
- 4) The Company did not provide supporting documentation for the January additions totaling \$8,550 on the Company's schedule. Therefore, we removed the amount from prepayment additions for that month in our recalculation of prepaid expenses.
- 5) The Company received a refund for an overpayment from Oracle in February 2010 for \$96,920 that it did not include in the prepayment schedule. Therefore, we have included a reduction of the duplication.

- 6) The Company included \$42,438 (\$4980+\$11,203+26,255) in items that were directly related to subsidiaries of the Company. We made an adjustment to remove the non-headquarter related expenses.

The amount of allocated cost received by Lake Utility Services, Inc. is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates 4.51% of its cost to Lake Utility Services, Inc. Lake Utility then allocates the cost from headquarters between its water and wastewater systems by each system's ERC ratio to Lake Utility Services, Inc. total ERCs. The ERC percentage is 75.19% for water and 24.81% for wastewater for the Utility.

The following are the adjustments to the expenses for the Company's Prepaid-Other schedule errors, and Lake Utility Services, Inc. expense adjustment on Schedule B-3.

**Calculation of Adjustment**

Description	Amount
Restated Amtz Exp Per Staff	\$ -
Amount in Acc 5735 - Prepays	\$ 345,857
Adjustment Per Staff to books	(345,857)
Adjustment Per Co. in filing	\$ 54,038
<b>Prepaid Expense Adjustment to filing</b>	<b>\$ 399,894</b>

**Utility Allocation**

LUSI Allocation	Rate	Allocation Adjustment
Illinois Allocation	4.51%	\$ 18,040
Water Allocations	75.19%	\$ 13,565
Wastewater Allocation	24.81%	\$ 4,476

**Effect on the General Ledger:** The following entry is recommended to correct the Company's ledger. Since the test year is already closed in the ledger, the adjustment to Computer Maintenance expense should be recorded to retained earnings:

Co. No.	Co. Acct.	NARU C Acct.	Account Description	Debit	Credit
102	5735	636/736	Computer Maintenance		\$ 61,809
102	4998	215	Retained Earnings	\$ 61,809	
			<b>Total</b>	<b>\$ 61,809</b>	<b>\$ 61,809</b>

**Effect on the Filing:** The Headquarters' expenses should be decreased by \$115,846. Lake Utility Services, Inc. test year expenses should be reduced by \$3,930 for water and \$1,297 for wastewater.

## Audit Finding 5

### Subject: Short-Term Debt Cost Rate

**Audit Analysis:** In its filings, the Company provided its supporting schedules for its requested Cost of Capital. The filing included a 4.28% rate for short term debt.

The company could not provide supporting documentation for the total interest expense to substantiate the cost rate listed on the short-term debt schedule. Instead the company provided a recalculation, based on the ledger detail, showing the total interest expense and cost rate to be \$1,014,325 and 3.42% respectively. Our reconciliation between the ledger and bank issued interest statement revealed that two of the interest entries were out of period. We recalculated the total interest cost and cost rate removing the out of period items. The proper short-term total interest expense and cost rate is \$940,641 and 3.17% for test year.

**Re-calculation of Short-Term Debt Rate**

Description	Amount	Total
Test Year Interest Exp. Per Ledger	\$1,014,325	
Out of Period Transaction	\$ (73,684)	
Test Year Actual Interest Exp.		\$ 940,641
13-Mo. Avg. Outstanding Amount		\$29,629,231
Cost Rate		3.17%

**Effect on the General Ledger:** There is no effect on the general ledger.

**Effect on the Filing:** The cost rate for short-term debt should be reduced to 3.17%.



## **Audit Finding 6**

### **Subject: Salary Increase and 401K Contribution**

**Audit Analysis:** The Company annualized the salary data as of August 2010 to prepare the filing. It added a 3.50% salary increase for April 2011 to arrive at the pro-forma salary in the test year expenses. The allocated portion for Lake Utility Services, Inc. is \$31,914 of the \$322,948 total salary increase.

In addition, the Company determined the 401K contribution by multiplying each full time employee's pro-forma salary by seven percent. This is based on a four percent profit sharing contribution that will begin in 2011 and matching a maximum of three percent of each full time employee's salary. Not all employees participate in the 401K program, but everyone is eligible to receive the 4% profit sharing. Of the \$665,052 in associated 401K cost, the Company has allocated \$66,062 to Lake Utility Services, Inc.

Salaries and the associated costs for each employee are allocated based on the ERC ratio that best describes their duties.

**Effect on the General Ledger:** This finding is included for informational purposes only.

**Effect on the Filing:** This finding is included for informational purposes only.

## Audit Finding 7

### Subject: Salaries - Capitalized Time Charged to Plant

**Audit Analysis:** We analyzed the annualized salary schedule for Lake Utility Services, Inc. with adjustments provided for the test year. Salary adjustments are based on each employee's pro-forma salary, which is the employee's total salary plus a 3.5% increase scheduled for April 2011.

In the filing adjustments the Company increased Account 6165, Salaries – Capitalized Time Charge to Plant by \$41,044 but did not include a corresponding decreasing entry to plant for capitalized labor. We reviewed the Lake Utility Services, Inc. test year additions and determined that the following four accounts included projects with capitalized time. We applied the adjustment based on the ratio of the account year end balance to total.

The amount of allocated cost received by Lake Utility Services, Inc. is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates 4.51% of its cost to Lake Utility Services, Inc. Lake Utility then allocates the cost from headquarters between its water and wastewater systems by each system's ERC ratio to Lake Utility Services, Inc. total ERCs. The ERC percentage is 75.19% for water and 24.81% for wastewater for the Utility.

#### Computation of Depreciation

Co. No.	Co. Acc.	NARUC	Description	2010 Additions	Ratio	Plant Adj.	Years	Rate	Acc. Dep./ Dep. Exp.
251	1095	310.2	Power Generation Equip	\$ 111,804	1.205%	\$ (495)	1	5.00%	\$ (25)
251	1400	380.4	Treat/Disp Equip Trt Plt	\$ 2,420,443	26.095%	\$ (10,711)	1	5.56%	\$ (595)
251	1405	371.5	Treat/Dis Eq. Recalimed Wat	\$ 5,051,947	54.466%	\$ (22,355)	1	5.56%	\$ (1,242)
251	1540	375.6	Reuse Transmission & Dist Sy	\$ 1,691,177	18.233%	\$ (7,484)	1	2.33%	\$ (174)
			<b>Total</b>	<b>\$ 9,275,371</b>		<b>\$ (41,044)</b>			<b>\$ (2,036)</b>

#### Computation of 13-Month Average

Date	Plant Adj.	Acc. Dep. Adj.
June 30, 2009	\$ -	\$ -
July 31, 2009	\$ (41,044)	\$ (170)
August 31, 2009	\$ (41,044)	\$ (339)
September 30, 2009	\$ (41,044)	\$ (509)
October 31, 2009	\$ (41,044)	\$ (679)
November 30, 2009	\$ (41,044)	\$ (848)
December 31, 2009	\$ (41,044)	\$ (1,018)
January 31, 2010	\$ (41,044)	\$ (1,188)
February 28, 2010	\$ (41,044)	\$ (1,357)
March 31, 2010	\$ (41,044)	\$ (1,527)
April 30, 2010	\$ (41,044)	\$ (1,696)
May 31, 2010	\$ (41,044)	\$ (1,866)
June 30, 2010	\$ (41,044)	\$ (2,036)
<b>13-Month Average</b>	<b>\$ (37,887)</b>	<b>\$ (1,018)</b>

#### Utility Allocation

LUSI Allocation	Rate	13-Mo. Plant Adj.	13-Mo. Acc. Dep. Adj.	Dep. Exp. Adj.
Water Allocation	75.19%	\$ (28,487)	\$ (765)	\$ (1,531)
Wastewater Allocation	24.81%	\$ (9,399)	\$ (253)	\$ (505)

**Effect on the General Ledger:** The following entry is recommended to correct the ledger. Since the test year is already closed in the ledger, the Salaries- Charged Time to Plant expense should be recorded to retained earnings:

Co. No.	Co. Acc.	NARUC	Description	Debit	Credit
251	10953	10.2	Power Generation Equip		\$ 495
251	14003	80.4	Treat/Disp Equip Trt Plt		\$ 10,711
251	14053	71.5	Treat/Dis Eq. Recalimed Water		\$ 22,355
251	15403	75.6	Reuse Tranmission & Dist Sys		\$ 7,484
251	18901	08.1	Acc Depr-Power Generation Equip	\$ 25	
251	21601	08.1	Acc Depr-Reuse Trans & Dist	\$ 595	
251	21451	08.1	Acc Depr-Pump Eqp Rclm Wtp	\$ 1,242	
251	22851	08.1	Acc Depr-Reuse Trans/Dist Sys	\$ 174	
251	4998	215	Retained Earnings	\$ 39,009	
			<b>Total</b>	<b>\$ 41,045</b>	<b>\$ 41,045</b>

**Effect on the Filing:** The effect on the filing is a decrease to Lake Utility Services, Inc. 13-Month Average water and wastewater plant by \$28,487 and \$9,399 13-Month Average water and wastewater accumulated depreciation by \$765 and \$253, and test year depreciation expense by \$1,531 and \$505, respectively.

## **Audit Finding 8**

### **Subject: Prepaid Insurance-Other**

**Audit Analysis:** The Company expensed premiums for Directors and Officers insurance in Account 5715 – Other Insurance. In past orders, such as PSC-03-1440-FOF-WS<sup>2</sup>, insurance cost for fiduciary policies protecting directors and officers have been removed because they were for the benefit of the company's shareholders. The Company expensed \$107,769 for the test year ending June 30, 2010 for Directors and Officers insurance premiums.

The amount of allocated cost received by Lake Utility Services, Inc. is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates 4.51% of its cost to Lake Utility Services, Inc. Lake Utility then allocates the cost from headquarters between its water and wastewater systems by each system's ERC ratio to Lake Utility Services, Inc. total ERCs. The ERC percentage is 75.19% for water and 24.81% for wastewater for the Utility.

**Effect on the General Ledger:** Since the test year is already closed in the ledger, there is no effect on the ledger.

**Effect on the Filing:** Headquarter expense would be reduced by \$107,769. Lake Utility Services, Inc. receives a 4.51% decrease to test year expenses, resulting in a reduction to water and wastewater expenses of \$3,655 and \$1,206, respectively.

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<sup>2</sup> See Order No. PSC-03-1440-FOF-WS, issued December 22, 2003, Docket No. 020071-WS5, In re: Application for rate increase in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida.

## Audit Finding 9

### Subject: Removal of Operating Expenses

**Audit Analysis:** Illinois Headquarters expensed certain charges that were either charged incorrectly, were non-recurring, or did not have proper source documentation.

Item 1	Company Account	NARUC Account	Amount	Allocation to LUSI	Allocation to Water	Allocation to Wastewater
				4.51%	75.19%	24.81%
1	102.100.5825	6757775	\$ (5,000.00)	\$ (225.50)	\$ (169.55)	\$ (55.95)
2	102.100.6025	6337733	\$ (3,789.25)	\$ (170.90)	\$ (128.50)	\$ (42.40)
3	102.107.5945	6757775	\$ (1,309.63)	\$ (59.06)	\$ (44.41)	\$ (14.65)
4	102.107.6190	6757775	\$ (1,137.20)	\$ (51.29)	\$ (38.56)	\$ (12.72)
5	102.109.5810	6757775	\$ (3,142.80)	\$ (141.74)	\$ (106.57)	\$ (35.17)
6	102.102.6070	6671161	\$ (3,787.76)	\$ (170.83)	\$ (128.45)	\$ (42.38)
7	102.109.5785	6757775	\$ (5,385.00)	\$ (242.86)	\$ (182.61)	\$ (60.25)
8	102.100.5825	6757775	\$ (5,791.96)	\$ (261.22)	\$ (196.41)	\$ (64.81)
9	102.107.6050	6367736	\$ (44,972.40)	\$ (2,028.26)	\$ (1,525.05)	\$ (503.21)
10	102.109.5930	6757775	\$ (3,731.78)	\$ (168.30)	\$ (126.55)	\$ (41.76)
11	102.100.7535	408.13	\$ (3,973.77)	\$ (179.22)	\$ (134.75)	\$ (44.46)
12	102.100.5825	6757775	\$ (25,000.00)	\$ (1,127.50)	\$ (847.77)	\$ (279.73)
		Total	\$ (107,021.55)	\$ (4,826.67)	\$ (3,629.17)	\$ (1,197.50)

Item 1-The Company expensed this invoice from Rose, Sundstrom, and Bentley on September 30, 2009 related to legal fees for an investigation of whether the company could operate the Martin County Correctional Institution's water/wastewater facilities. This acquisition never took place; this expense is not a recurring expense and should be removed from expenses.

Item 2-The Company expensed this invoice from Rose, Sundstrom, and Bentley on October 9, 2009. These legal fees related to the Myrtle Lake Hills Road preliminary survey. These charges should have been expensed to Sanlando Utility.

Item 3-The Company expensed this employee's business expense report on October 25, 2009 and could not provide the proper supporting documentation.

Item 4- The Company expensed this employee's business expense report on September 25, 2009 for airfare charges, but could not provide proper documentation as to the purpose of the trip.

Item 5-The Company expensed a membership fee to the National Association of Water Companies (NAWC) on January 31, 2010. According to the Company this is a specific fee for the Utilities Inc. of Central Nevada.

Item 6-The Company expensed an invoice from Lionel, Sawyer, and Collins on September 21, 2009 for legal fees related to Rate Case Rulemaking related to another state.

Item 7-The Company expensed an invoice from Integrated Resource Management, LLC on December 31, 2009. These charges pertain to the Utilities Inc. of Central Nevada.

Item 8-The Company expensed an adjustment between the bank deposits and the books and no explanation was provided for the reason for this adjustment. The adjustments appear to correct deposits. The adjustment should have been made to the offsetting account when the deposit was recorded and not just written off to an expense account.

Item 9-The Company expensed three payments for consulting fees related to the services of Mr. Lawrence Schumacher, a former employee, on different dates in the year 2010. These charges appear to be non-recurring.

Item 10-An invoice from Valley Electric Assn., Inc. was expensed for energy service to Utilities Inc. of Central Nevada.

Item 11-The Company expensed taxes paid to the Nevada Department of Taxation on April 30, 2010. Item 12- The Company expensed the difference between the bank and the books. It did not provide a reason for this difference. See item number 8.

**Effect on the General Ledger:** No entry is needed to the general ledger since this will not affect future rate cases.

**Effect on the Filing:** The Company operating expenses should be reduced by \$107,021.55. Lake Utility Services Inc. expenses should be reduced by \$3,629.17 for Water and by \$1,197.50 for Wastewater.