State of Florida

Public Service Commission

RECEIVED--FPSC

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

11 SEP -6 PM 4:05

COMMISSION CLERK

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

DATE: September 6, 2011

TO: Office of Commission Clerk

FROM: Clarence J. Prestwood, Chief of Auditing, Office of Auditing and Performance Analysis CJP

RE: Docket No.: 110153-SU
Company Name: Utilities, Inc
Audit Purpose: Affiliated Transactions
Audit Control No: 11-192-4-2

Attached is the final audit report and Volume 3 of the audit work papers for the Company stated above. Volume 3 of the audit working papers is forwarded for confidential treatment pursuant to Rule 25-22.006, Florida Administrative Code. Volumes 1, and 2 of the work papers are public and held by the Bureau of Auditing.

I am sending the Company a copy of this memo and the audit report. If the Company desires to file a response to the audit report, it should send a response to the Office of Commission Clerk.

CJP/kby
Attachments: Audit Report
Confidential Binder Listed Above

cc: Office of Auditing and Performance Analysis File

Diamond Wili
Received By

9/6/11
Date

DOCUMENT NUMBER-DATE
06403 SEP -6 =
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.
Affiliated Transactions Audit

Twelve Months Ended December 31, 2010

Docket No. 110153-SU
Audit Control No. 11-192-4-2
September 1, 2011

Iliana H. Piedra
Audit Manager

Kathy L. Welch
Reviewer

Table of Contents

Purpose 2

Objectives and Procedures 3

Audit Findings
- 1: Retirement of Telephone Equipment 6
- 2: Ordered Adjustments for Project Phoenix Not Booked 7
- 3: Depreciation Life of Project Phoenix 9
- 4: Employee Benefits 13
- 5: Vehicle Differences 14
- 6: Removal of Operating Expenses 15
- 7: Prepaid – Other Expenses 16

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 July 6, 2011. We have applied these procedures to the schedules prepared by Utilities, Inc. in support of its filing for the Utilities, Inc. of Eagle Ridge rate case in Docket 110153-SU.

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

Objectives and Procedures

General

Definitions

The term "Company" refers to Utilities, Inc., the parent or holding company of Utilities, Inc. of Eagle Ridge or Utility. The Utility has filed a rate case with the test year ended December 31, 2010. The data obtained in this audit will also be used in two future Utilities, Inc. filings: Labrador Utilities, Inc. and Sanlando Utilities Corporation. The last rate case order that affected the parent allocation PSC-11-0015-PAA-WS was issued January 5, 2011 in Docket 090531-WS.

Affiliate Allocations

The Company allocates its costs to each of its utility subsidiaries based on Equivalent Residential Connections (ERCs). The Utility, in this case Eagle Ridge, receives costs based on its ERC ratio to the total ERCs at the corporate level for the Northbrook, Illinois costs. The Company 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 it accounts and records in conformity with the National Association of Regulatory Utility Commissioners' (NARUC) Uniform System of Accounts (USOA).

Procedure: 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 prior proceedings before the Commission have been included in the current filings.

Procedures: We determined the plant balance as of June 30, 2010 that was established in the workpapers for Docket No. 100426-WS. No order has been issued for this docket at the time of issuance of this report. We reviewed and sampled the Illinois and Florida headquarters additions for the period July 1, 2010 through December 31, 2010 and verified the allocated plant balance for this proceeding. We determined that retirements were made when a capital item was removed or replaced. Findings 1, 2, and 5 discuss adjustments to plant.

Accumulated Depreciation

Objectives: Our objectives were to 1) Verify that the adjustments to accumulated depreciation in the Company's books as adjusted by the Commission were used in the filing, 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 the depreciation rates used in the filing calculations, and 4) Verify that retirements are properly recorded.

Procedures: We determined the accumulated depreciation balances as of June 30, 2010 from the last audit workpapers. We recalculated the Illinois and Florida headquarters accrual to accumulated depreciation for the period June 30, 2010 through December 31, 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. Findings 2, 3, and 5 discuss adjustments to accumulated depreciation.

Net Operating Income

Operation and Maintenance Expense

Objectives: Our objective was to determine that the 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 6-month period ending December 31, 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. Findings 5, 6, and 7 discuss adjustments to expenses.

Depreciation Expense

Objectives: 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 assets.

Procedures: We verified the Company's calculations of depreciation expense.

Capital Structure

Objectives: Or 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.

Procedures: 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.

Audit Findings

Finding 1: Retirement of Telephone Equipment

Audit Analysis: In July 2010, the Company recorded additions for the new phone system of $338,651.98 for Illinois (Division 102) and $66,110.31 for Altamonte Springs (Division 855). In November 2010 the Company recorded retirement entries related to these additions. A summary of the entries follows:

Co. No.	Co. Acct.	NARUC Account	Account Description	Debit	Credit
102	1205	396	Communication Equipment		$360,358.40
102	2000	108.1	Acc. Dep. - Comm Equipment	$376,697.60	
102	7691		Net Book Value Disposal		$16,339.20
			Total	$376,697.60	$376,697.60

Co. No.	Co. Acct.	NARUC Account	Account Description	Debit	Credit
855	1205	396	Communication Equipment		$66,110.31
855	2000	108.1	Acc. Dep. - Comm Equipment	$68,363.30	
855	7691		Net Book Value Disposal		$2,252.99
			Total	$68,363.30	$68,363.30

The Company explained the calculations for the retirement entries could not be located. Therefore, we could not determine if the appropriate amount was retired.

Effect on the General Ledger: This is provided for informational purposes.

Effect on the Filing: This is provided for informational purposes.

Finding 2: 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 schedule showed that 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 Utilities, Inc. of Eagle Ridge is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates .95% of its cost to 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 Utilities, Inc. of Eagle Ridge 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 continued to depreciate the project over eight years. 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. Dep.	$ 330,447	
102	4998	215	Retained Earnings	$ 1,321,787	
			Total	**$ 1,652,234**	**$ 1,652,234**

Effect on the Filing: The 13-month average for Headquarters plant and accumulated depreciation should be reduced by $1,652,234 and $247,835, respectively. Depreciation Expense should be reduced by $165,223. Utilities, Inc. of Eagle Ridge 13-month average decrease to wastewater plant and accumulated depreciation should be $15,696 and $2,354, respectively. Utilities, Inc. of Eagle Ridge decrease to depreciation expense should be $1,570.

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)
Adjustment to Correct Beginning Balance	**$ (1,652,234)**

Calculation of Depreciation

Co. Acct. No.	Date	Debit	Explanation	Beg. Bal. Adjustment	Life (Year)	Adjustment to Dep. Exp/RE	Depreciation Exp. Acct.	Months	Adjustment to Acc. Dep.	Acc. Dep. Acct.
1590	12/31/2008	1,724,166	Ordered Adjustment	$ (1,652,234)	10	$ (165,223)	6920	24	$ (330,447)	2330

13-Month Average Calculation

Date	Plant Adjustment	Acc. Dep. Adjustment
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)
July 31, 2010	$ (1,652,234)	$ (261,604)
August 30, 2010	$ (1,652,234)	$ (275,372)
September 30, 2010	$ (1,652,234)	$ (289,141)
October 30, 2010	$ (1,652,234)	$ (302,910)
November 30, 2010	$ (1,652,234)	$ (316,678)
December 30, 2010	$ (1,652,234)	$ (330,447)
13-MONTH AVERAGE	**$ (1,652,234)**	**$ (247,835)**

Utility Allocation

Eagle Ridge	Rate	13-Mo. Plant Adj.	13-Mo. Acc. Dep. Adj.	Dep. Exp.
Illinois Allocation	0.95%	($15,696.22)	($2,354.43)	($1,569.62)

Finding 3: 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 is still using 8 years.

The Company has also overstated the depreciation expense for this account by $3,527. This was included in the depreciation expense account in June, but it was not included in the accumulated depreciation account. The difference in the total depreciation expense amount for this account when compared to the total depreciation expense amount from the workpapers in the prior audit as of June 30, 2010 is $3,527. The amount of allocated cost received by Utilities, Inc. of Eagle Ridge is based on its ERC ratio to the total ERCs at the corporate level. The Illinois office allocates .95% of its cost to 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 Utilities, Inc. of Eagle Ridge.

Effect on the General Ledger: The following adjustment is recommended to correct the Illinois general 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	2330	108.1	Computer System Acc. Dep.	$ 1,372,368	
102	4998	215	Retained Earnings		$ 1,372,368
			Total	**$ 1,372,368**	**$ 1,372,368**

Effect on the Filing: The Illinois 13-month average accumulated depreciation should be reduced by $1,094,703 and the depreciation expense should be reduced by $555,330. The effect on Utilities, Inc. of Eagle Ridge is a 13-month average decrease to accumulated depreciation of $10,400 and a decrease to depreciation expense of $5,276.

Also, the Illinois depreciation expense should be reduced by $3,527, the effect on Utilities, Inc. of Eagle Ridge is a decrease to depreciation expense of $33.51.

Recalculation of Accumulated Depreciation

Period	Additions	Staff Acc. Dep. At 12/08	Staff 2009 Dep. Exp.	Staff 2010 Dep. Exp.	Per Staff Acc. Dep. At 12/10	Company Acc. Dep. At 12/10	Difference
2002	$ 5,912.31	$ 3,843	$ 591	$ 591	$ 5,025	5,912	(887)
2003	$ 14,240.00	$ 7,832	$ 1,424	$ 1,424	$ 10,680	13,350	(2,670)
2004	$ -	$ -	$ -	$ -	$ -		-
2005	$ -	$ -	$ -	$ -	$ -		-
2006	$ 508,722.09	$ 127,181	$ 50,872	$ 50,872	$ 228,925	(286,156)	515,081
2007	$ (508,722.09)	$ (127,181)	$ (50,872)	$ (50,872)	$ (228,925)	286,156	(515,081)
2008	$ 21,525,402.85	$ 1,076,270	$ 2,152,540	$ 2,152,540	$ 5,381,351	6,726,688	(1,345,338)
Jan - Dec 09	$ 513,062.00	$ -	$ 25,653	$ 51,306	$ 76,959	96,199	(19,240)
Jan - Dec 10	$ 338,666.00	$ -	$ -	$ 16,933	$ 16,933	21,167	(4,233)
		$ -					
	$ 22,397,283.16	**$ 1,087,945**	**$ 2,180,209**	**$ 2,222,795**	**$ 5,490,949**	**$ 6,863,316**	**(1,372,368)**
	Acc. Dep. 12/09		**$ 3,268,154**				

Depreciation at 10 Years Vs. 8 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	$ 5,397,056	2330
	2009	$ 513,062		$ 51,306		$ 76,959	
	2010	$ 338,666		$ 16,933		$ 16,933	
	Total @ 10 Yrs. Per Staff	**$ 22,397,283**		**$ 2,222,795**		**$ 5,490,949**	
	2008 Balance Per Co.	$ 21,545,555	8	$ 2,692,825		$ 6,745,951	
	2009	$ 513,062		$ 64,133		$ 96,199	
	2010	$ 338,666		$ 21,167		$ 21,167	
	Total @ 8 Yrs. Per Co.	**$ 22,397,283**		**$ 2,778,125**		**$ 6,863,316**	
	Adjustments			**$ (555,330)**		**$ (1,372,368)**	

Utility Allocation

Eagle Ridge	**Rate**	**13-Mo. Acc. Dep.**	**Dep. Exp.**
Illinois Allocation	0.95%	$ (10,400)	$ (5,276)

13-Month Average

Date	Acc. Dep. Adj.
Dec. 2009	$ (817,038)
Jan. 2010	$ (863,316)
Feb. 2010	$ (909,593)
Mar. 2010	$ (955,871)
Apr. 2010	$ (1,002,148)
May 2010	$ (1,048,426)
June 2010	$ (1,094,703)
July 2010	$ (1,140,981)
Aug. 2010	$ (1,187,258)
Sept. 2010	$ (1,233,535)
Oct. 2010	$ (1,279,813)
Nov. 2010	$ (1,326,090)
Dec. 2010	$ (1,372,368)
13-Month Average	**$ (1,094,703)**

Finding 4: Employee Benefits

Audit Analysis: The Utility made an adjustment to increase employee benefits by $11,418 in the filing. In its calculation of benefits per employee, the Utility included one of the 401K accounts "5665-401K Match". They already had a separate column for the estimated 401K costs. When this account is removed from the calculation it reduces the benefit adjustment to $8,819 or a decrease of $2,599.

Effect on the General Ledger: There is no effect on the ledger since this adjustment is made to the filing only.

Effect on the Filing: Operation and Maintenance Expense should be reduced by $2,599.

Finding 5: Vehicle Differences

Audit Analysis: The supporting documentation for the vehicle plant, accumulated depreciation, depreciation expense, and transportation expense do not agree with the amounts in the filing. The supporting documentation was audited and appears to be correct. The differences follow:

Account	Adjustment to Debit (Credit) Per Support	Adjustment to Debit (Credit) Per Filing	Difference
13-Month Average Vehicles	$ (21,447)	$ (22,883)	$ 1,436
13-Month Average Accumulated Depreciation	$ 14,297	$ (54,488)	$ 68,785
Depreciation Expense	$ 258	$ 19	$ 239
Transportation Expense	$ 1,911	$ 1,692	$ 219

Effect on the General Ledger: There is no effect on the ledger since the adjustments are made to the filing only.

Effect on the Filing: Plant should be increased by $1,436. Accumulated Depreciation should be decreased (credited) by $68,785. Depreciation expense should be increased by $239 and transportation expense increased by $219.

Finding 6: Removal of Operating Expenses

Audit Analysis: Illinois Headquarters and Altamonte Springs Headquarters expensed certain charges incorrectly to expense accounts that were allocated to Utilities, Inc. of Eagle Ridge.

Item #	Company Account	NARUC Account	Amount	Allocation % to Eagle Ridge	Allocation Amount to Eagle Ridge
1	102.101.6010	732	$29,000.00	0.95%	$275.50
2	102.100.7535	408	$16,928.46	0.95%	$160.82
3	855.100.5810	775	$1,000.00	4.04%	$40.40
4	855.100.5890	775	$1,000.00	4.04%	$40.40
			$47,928.46		**$517.12**

Item 1 - The Company accrued monthly entries for their fees paid to Price Waterhouse Coopers. The accruals included an amount of $29,000 for Utilities, Inc. of Georgia. This is a direct expense and should not be included in the Florida allocations.

Item 2 – The Company included payments totaling $16,928.46 to the Nevada Department of Taxation. This is a direct expense and should not be included in the Florida allocations.

Items 3 and 4 - The Company included $1,000 in account 5810 and $1,000 in account 5890; however, they were ultimately removed during 2011. The Company explained these items should not have been recorded in this account.

The amount of allocated costs received by Utilities, Inc. of Eagle Ridge is based on its ERC ratio to total ERCs at the corporate level. The Illinois office allocates .95% of its cost to this utility. The Altamonte Springs office allocates 4.04% of its cost to this utility.

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

Effect on the Filing: The Company operating expenses should be reduced by $47,928.46. Utilities, Inc. of Eagle Ridge operating expenses should be reduced by $517.12.

Finding 7: Prepaid – Other Expenses

Audit Analysis: We analyzed the Prepaid-Other expense adjustment schedule provided by the Company. Our test of the Company's support revealed the following discrepancies.

Item No.	Company Acct.	Prepaid per Company	Adj. Per Staff	Prepaid Per Staff	Amtz. Per Company	Months	Amtz. Per Staff	Adj. Per Staff
1	102.101.5735	$25,900.13	($11,203.00)	$14,697.13	$19,425.10	9	$11,022.85	($8,402.25)
2	102.101.5735	$30,918.60	($30,918.60)	$0.00	$15,459.30	6	$0.00	($15,459.30)
3	102.101.5735	$30,796.49	$0.00	$30,796.49	$2,566.37	1	$1,283.19	($1,283.19)
		$87,615.22	**($42,121.60)**	**$45,493.62**	**$37,450.77**		**$12,306.03**	**(25,144.74)**
							Allocation %	0.95%
							Naruc Acct. 736	**($238.88)**

Item 1 - The Company included $11,203 in items that were directly related to subsidiaries. This was reported in the last affiliate audit, Audit Control Number 11-004-4-2, of Lake Utility Services, Inc.

Item 2 – The Company included $30,918.60 in July 2010 for an item related to a Carolina subsidiary.

Item 3 – The Company included $30,796.49 in December 2010 for an item paid to Microsoft Licensing, LP. The Company amortized this item over 12 months; however, the invoice indicates the period should be 2 years or 24 months.

The amount of allocated costs received by Utilities, Inc. of Eagle Ridge is based on its ERC ratio to total ERCs at the corporate level. The Illinois office allocates .95% of its cost to this utility.

Effect on the General Ledger: The following entry is recommended to correct the Company's ledger.

NARUC Account	Account Description		Debit	Credit
186	Prepaid Expense - Other			$42,121.60
215	Retained Earnings		$42,121.60	

Effect on the Filing: The Company amortization expenses should be reduced by $25,145. Utilities, Inc. of Eagle Ridge amortization expenses should be reduced by $239.