

State of Florida



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# Public Service Commission

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

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**DATE:** February 24, 2009  
**TO:** Shannon J. Hudson, Regulatory Analyst IV, Division of Economic Regulation  
**FROM:** Denise N. Vandiver, Chief of Auditing, Division of Regulatory Compliance  
**RE:** Docket No: 080669-SU; Company Name: Sebring Ridge Utilities, Inc.;  
Audit Purpose: Staff-assisted rate case; Company Code: WS345;  
Audit Control No: 08-346-2-2;

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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 the Commission Clerk. There are no confidential work papers associated with this audit.

DNV/tbm

Attachment: Audit Report

CC: Division of Regulatory Compliance (Salak, Mailhot, Harvey,  
District Offices, File Folder)  
Office of Commission Clerk (2)  
General Counsel  
Office of Public Counsel

Mr. Christopher F. Miller  
Sebring Ridge Utilities, Inc.  
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Sebring, FL 33870-7814

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**FLORIDA PUBLIC SERVICE COMMISSION  
DIVISION OF REGULATORY COMPLIANCE  
BUREAU OF AUDITING**

*Tampa District Office*

**SEBRING RIDGE UTILITIES, INC.**

**STAFF ASSISTED RATE CASE**

**AS OF SEPTEMBER 30, 2008**

**DOCKET NO. 080669-SU  
AUDIT CONTROL NO. 08-346-2-2**

Handwritten signature of Jeffery A. Small.

*Jeffery A. Small, Audit Manager*

Handwritten signature of Ronald Mavrides.

*Ronald Mavrides, Staff*

Handwritten signature of Joseph W. Rohrbacher.

*Joseph W. Rohrbacher, District  
Supervisor*

DOCUMENT NUMBER-DATE

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TABLE OF CONTENTS

AUDITOR'S REPORT	PAGE
I. PURPOSE .....	1
II. OBJECTIVES AND PROCEDURES .....	2
III. AUDIT FINDINGS	
1. UTILITY BOOKS AND RECORDS .....	6
2. PLANT IN SERVICE AND ACCUMULATED DEPRECIATION .....	7
3. LAND AND LAND RIGHTS.....	9
4. CONTRIBUTIONS IN AID OF CONSTRUCTION AND ACCUMULATED AMORTIZATION OF CIAC .....	10
5. REVENUES .....	12
6. OPERATION AND MAINTENANCE EXPENSE .....	14
7. TAXES OTHER THAN INCOME .....	19
8. CAPITAL STRUCTURE.....	22
9. INFORMATION ON PRO FORMA PLANT IN SERVICE.....	23
10. INFORMATION ON UNPAID VENDOR INVOICES .....	24
IV. EXHIBITS	
1. RATE BASE.....	25
2. NET OPERATING INCOME .....	26
3. COST OF CAPITAL.....	27

DOCUMENT NUMBER-DATE

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**DIVISION OF REGULATORY COMPLIANCE  
AUDITOR'S REPORT**

**FEBRUARY 13, 2009**

**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 December 10, 2008. We have applied these procedures to the attached schedules prepared by the audit staff in support of Sebring Ridge Utilities, Inc. request for a Staff Assisted Rate Case in Docket No. 080669-SU.

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 and the report is intended only for internal Commission use.

## OBJECTIVES AND PROCEDURES

### GENERAL

#### Utility Books and Records

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

*Procedures:* We reviewed the utility's accounting system. Audit Finding No. 1 discusses our findings and recommendations for improvements to the utility's accounting system.

### RATE BASE

#### 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 USOA. To verify that the proper retirements of UPIS were made when a replacement item was put in service.

*Procedures:* We determined the UPIS balance that was established in Docket No. 950966-WS, the company's last staff assisted rate case.<sup>1</sup> We compiled UPIS additions for the period January 1, 1995 through September 30, 2008 to determine the UPIS balance for this proceeding. We recorded retirements to UPIS when a capital item was removed or replaced. We toured the utility plant sites to observe whether asset additions were completed and to ascertain if asset retirements were needed. Audit Finding No. 2 discusses our findings and recommended UPIS balance as of September 30, 2008. Audit Finding No. 9 provides information on the company's request for pro forma plant.

#### Land

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

*Procedures:* We verified that there has been no change to utility's land balance or ownership since its last staff assisted rate case. We determined the utility's land balance that was reaffirmed in Docket No. 950966-WS. Audit Finding No. 3 discusses our findings and recommended land balance as of September 30, 2008.

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

*Objective:* To determine that additions to CIAC are properly recorded in compliance with Commission rules and the NARUC USOA. To verify and insure that all donated property is properly accounted for and recorded as CIAC.

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<sup>1</sup> See Order No. PSC-96-0869-FOF-WS, issued July 2, 1996, Docket No. 950966-WS.

*Procedures:* We determined the utility's CIAC balance that was established in Docket No. 950966-WS. We compiled additions to CIAC for the period January 1, 1995 through September 30, 2008 to determine the utility's CIAC balance for this rate case proceeding. We scanned the utility's 1995 through 2007 Federal Income Tax returns for unrecorded cash and property contributions. Audit Finding No. 4 discusses our findings and recommended CIAC balance as of September 30, 2008.

#### Accumulated Depreciation

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

*Procedures:* We determined the utility's accumulated depreciation balance that was established in Docket No. 950966-WS. We compiled accumulated depreciation accruals for the period January 1, 1995 through September 30, 2008 to determine the utility's accumulated depreciation balance for this proceeding. We recorded retirements to accumulated depreciation when a capital item was removed or replaced. Audit Finding No. 2 discusses our findings and recommended balance for accumulated depreciation as of September 30, 2008.

#### 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 USOA.

*Procedures:* We determined the utility's accumulated amortization of CIAC balance that was established in Docket No. 950966-WS. We compiled accumulated amortization of CIAC accruals for the period January 1, 1995 through September 30, 2008 to determine the utility's accumulated amortization of CIAC balance for this proceeding. Audit Finding No. 4 discusses our findings and recommended balance for accumulated amortization of CIAC as of September 30, 2008.

#### Working Capital

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

*Procedures:* We calculated the utility's working capital balance as of September, 2008 using one-eighth of operation and maintenance expense as required by Commission rule.<sup>2</sup> Audit Finding No. 6 discusses our recommended working capital balance as of September 30, 2008.

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<sup>2</sup> See Rule 25-30.433 (2), Florida Administrative Code.

## NET OPERATING INCOME

### 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 compiled utility revenues for the 12-month period ending September 30, 2008 from the utility's billing register records. Audit Finding No. 5 discusses our findings and recommended revenue balance.

### Operation and Maintenance Expense

*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 compiled operation and maintenance expense items from the utility's general ledger and vendor invoice file. We reviewed all utility invoices for proper amount, period, classification, NARUC account and recurring nature. We determined the proper allocation of invoices and expenses that included services for non-utility operations. Audit Finding No. 6 discusses our findings and recommended operation and maintenance expense balance for the 12-month period ending September 30, 2008. Audit Finding No. 10 provides information on a number of unpaid invoices.

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

*Objective:* To determine that TOTI tax expense is properly recorded in compliance with Commission rules and was reasonable and prudent for ongoing utility operations.

*Procedures:* We compiled TOTI expense items from the utility's general ledger and vendor invoice file. We reviewed all utility tax invoices for proper amount, period, classification, NARUC account and recurring nature. We determined the proper allocation of all tax expenses that included services for non-utility operations. Audit Finding No. 7 discusses our findings and recommended TOTI expense balance for the 12-month period ending September 30, 2008.

### Depreciation Expense

*Objective:* To determine that depreciation expense is properly recorded in compliance with Commission rules and that it accurately represents the depreciation of utility plant in service assets and the amortization of utility contributions-in-aid-of-construction assets from ongoing utility operations.

*Procedures:* We calculated depreciation expense and amortization of CIAC expense balances using the UPIS and CIAC balances determined above. Audit Finding Nos. 2 and 4 discuss our findings and recommended depreciation and amortization of CIAC expense balances for the 12-month period ending September 30, 2008.

## **CAPITAL STRUCTURE**

### General

*Objective:* To determine that 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.

*Procedures:* We determined the utility's capital structure and reconciled that balance to the net rate base balance we determined in our procedures listed above. Audit Finding No. 8 discusses our findings and recommended capital structure balance as of September 30, 2008.



## **AUDIT FINDING NO. 1**

### **SUBJECT: UTILITY BOOKS AND RECORDS**

**AUDIT ANALYSIS:** Sebring Ridge Utilities, Inc.'s. (company) last application for a staff-assisted rate case was reviewed in Docket No. 950966-WS. Order No. PSC-96-0869-FOF-WS, put the company on notice that it would be required to maintain its books in accordance with the NARUC USOA as required by Commission rules.<sup>3</sup>

The company uses a cash basis accounting system that is maintained by an outside accounting firm on a calendar year basis. The firm, with the help of company officials, compiles the company's general ledger and prepares the annual report which is filed with the Commission. Additionally, the accounting firm provides federal and state tax reporting services with a September 30 fiscal year end.

The company's current accounting system is not in full compliance with the Commission order referenced above and was not conducive to our requirements or needs for this rate proceeding. The fact that its records are maintained on a cash basis and that the test year we chose does not equate to a calendar year made it difficult for us to use the information compiled in the company's general ledger. Additionally, little or no source documentation was preserved for years 1995 through 1998.<sup>4</sup>

Our review of the company's annual reports and federal tax returns for that time period reflected that there was limited or no rate base account activity in those years. Therefore, the impact on our findings should be minimal. The company's underlying records since 1998 were made accessible and deemed sufficient for us to substantially complete our assigned objectives in this proceeding.

During our field work, the company was receptive to suggested improvements to its accounting systems. However, we recommend that the company be reminded of its obligation to maintain its books in accordance with the NARUC USOA and be required to convert from its present cash basis method to an accrual basis method of accounting for future reporting periods.

Subsequent to the 1995 rate case, the company has implemented a price index in 1999, 2001, 2002, 2004, 2006, 2007 and 2008.

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<sup>3</sup> See Rule 25-30.115, Florida Administrative Code.

<sup>4</sup> Rule 25-30.110(1)(a), Florida Administrative Code, states that each utility shall preserve its records in accordance with the "Regulations to Govern the Preservation of Records of Electric, Gas and Water Utilities" as issued by the National Association of Regulatory Utility Commissions, as revised May 1985. This rule generally requires plant records to be kept until after the plant is retired.

## **AUDIT FINDING NO. 2**

### **SUBJECT: UTILITY PLANT IN SERVICE AND ACCUMULATED DEPRECIATION**

**AUDIT ANALYSIS:** The company's annual report reflects UPIS and accumulated depreciation balances of \$537,875 and \$244,799, respectively, for calendar year end 2007.

Order No. PSC-96-0869-FOF-WS required the company to reduce UPIS by \$10,158 and increase accumulated depreciation by \$49,997 as of December 31, 1994. We found no evidence in the company's records that the adjustments were ever posted to its general ledger.

Based on our adjustments and findings discussed below, the company's UPIS and accumulated depreciation balances are \$502,575 and \$311,525 respectively, as of September 30, 2008.

We compiled UPIS additions from 1995 through the test year to determine the company's UPIS balance as of September 30, 2008. We started with the UPIS balances established in the company's last rate case proceeding. We then posted additions and retirements to UPIS in succeeding years when capital items were added or replaced. We toured the utility wastewater plant site and lift stations to observe and ascertain the condition and existence of utility assets discussed above.

We calculated depreciation expense and compiled accumulated depreciation accruals since its last rate case proceeding in 1994 through the test year to determine the company's accumulated depreciation balance as of September 30, 2008. We recorded retirements to accumulated depreciation when a capital item was removed or replaced. We depreciated the plant in service asset balances we compiled above using the depreciation rates prescribed in Commission rules.<sup>5</sup>

We calculated a depreciation expense balance of \$22,886 for the 12-month period ending September 30, 2008.

The company's UPIS, accumulated depreciation and depreciation expense balances, by NARUC sub-account, are displayed on the following schedule.

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<sup>5</sup> See Rule 25-30.140 (1), Florida Administrative Code.

Acct. No.	Account Description	Plant in Service	Accumulated Depreciation	Depreciation Expense
351.00	Organization	\$0	\$0	\$0
352.00	Franchises	0	0	0
354.00	Structures & Improvements	5,396	(2,211)	154
355.00	Power Generating Equipment	0	0	0
360.00	Collection - Sewers forced	18,604	0	682
361.00	Collection - Sewers gravity	160,220	(97,143)	4,006
362.00	Special Collecting Structures	76,537	(50,145)	2,069
363.00	Services to customers	450	(55)	13
364.00	Flow Measuring Devices	0	0	0
365.00	Flow Measuring Installations	0	0	0
370.00	Receiving Wells	0	0	0
380.00	Treatment & Disposal Equipment	234,863	(160,800)	15,658
381.00	Plant Sewers	660	(382)	21
382.00	Outfall Sewer Lines	0	0	0
389.00	Other Plant & Miscellaneous Equipment	3,200	(107)	107
390.00	Office Furniture & Equipment	1,445	(264)	96
391.00	Transportation Equipment	0	0	0
393.00	Tools, Shop, & Garage Equipment	1,200	(420)	80
395.00	Power Operated Equipment	0	0	0
398.00	Other Tangible Plant	0	0	0
	Totals	<u>\$502,575</u>	<u>(\$311,525)</u>	<u>\$22,886</u>

**EFFECT ON THE FILING:** The company's UPIS and accumulated depreciation balances are \$502,575 and \$311,525, respectively, and test year depreciation expense is \$22,886 as of September 30, 2008.

**EFFECT ON THE GENERAL LEDGER:** The company should adjust its general ledger to the UPIS balances determined above once it converts to an accrual basis of accounting using the NARUC USOA that we discuss in Audit Finding No. 1 of this report.

**AUDIT FINDING NO. 3**

**SUBJECT: LAND AND LAND RIGHTS**

**AUDIT ANALYSIS:** The company's annual report reflects a land balance of \$19,712 for calendar year end 2007.

Order No. PSC-96-0869-FOF-WS required the company to increase its land balance by \$26,004 to \$45,716 as of December 31, 1994. We found no evidence in company records that the adjustments were ever posted to its general ledger. Additionally, we found no change in the company's land or land rights since its last rate case proceeding in our review of the public records for Highlands County, Florida.

The company's land balance is \$45,716 as of September 30, 2008, based on the prior Commission order discussed above.

**EFFECT ON THE FILING:** The company's land balance is \$45,716 as of September 30, 2008.

**EFFECT ON THE GENERAL LEDGER:** The company should adjust its general ledger to the balances determined above once it converts to an accrual basis of accounting using the NARUC USOA that we discuss in Audit Finding No. 1 of this report.

#### **AUDIT FINDING NO. 4**

#### **SUBJECT: CONTRIBUTIONS IN AID OF CONSTRUCTION AND ACCUMULATED AMORTIZATION OF CIAC**

**AUDIT ANALYSIS:** The company's annual report reflects CIAC and accumulated amortization of CIAC balances of \$570,943 and \$263,519, respectively, for calendar year end 2007.

Order No. PSC-96-0869-FOF-WS required the company to reduce CIAC by \$266,370 and increase accumulated amortization of CIAC by \$45,383 as of December 31, 1994. We found no evidence in company records that the adjustments were ever posted to its general ledger.

Based on our findings discussed below, the company's CIAC and accumulated amortization of CIAC balances are \$327,623 and \$157,472, respectively, as of September 30, 2008.

We compiled CIAC additions for the period January 1995 through September 2008 to determine the utility's CIAC balance as of September 30, 2008. We used information from the company's 1995-2008 annual reports, company customer service connection records and its authorized service availability tariff to determine the number of new customers connected and to calculate the annual additions to CIAC since its last rate case proceeding. There were no capital asset contributions found during our investigation.

We compiled accumulated amortization of CIAC accruals for the period January 1995 through September 2008 to determine the utility's accumulated amortization of CIAC balance as of September 30, 2008. We amortized contributed capital asset balances at the corresponding capital asset depreciation rates and the contributed cash balances at the annual composite depreciation rate as prescribed in Commission rules.<sup>6</sup>

Additionally, we calculated a balance of \$11,802 for amortization expense for the 12-month period ending September 30, 2008.

The company's CIAC, accumulated amortization of CIAC and amortization expense balances by NARUC sub-account are displayed on the following schedule.

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<sup>6</sup> See Rule 25-30.140 (9), Florida Administrative Code.

Acct. No.	Account Description	Contributions in Aid of Construction	Accumulated Amortization of CIAC	Amortization Expense
271	Cash Service availability fees	(\$173,650)	\$51,691	\$7,261
271	361 Collecting Sewers - Gravity	(123,451)	75,259	3,086
271	380 Treatment and Disposal Equipment	<u>(30,522)</u>	<u>30,522</u>	<u>1,455</u>
Totals as of September 30, 2008		(\$327,623)	\$157,472	\$11,802

**EFFECT ON THE FILING:** The company's CIAC and accumulated amortization of CIAC balances are \$327,623 and \$157,472, respectively and the test year amortization expense is \$11,802 as of September 30, 2008.

**EFFECT ON THE GENERAL LEDGER:** The company should adjust its general ledger to the balances determined above once it converts to an accrual basis of accounting using the NARUC USOA that we discuss in Audit Finding No. 1 of this report.

## AUDIT FINDING NO. 5

### SUBJECT: REVENUES

**AUDIT ANALYSIS:** The company provided wastewater service to 1 general service, 252 multi-family service and 262 residential service customer's during the 12-month period ending September 30, 2008, as described below.

- The company has one general service customer that is served by a two inch meter.
- The company's multi-residential customers consist of one condominium complex with 252 units that are served by a 4 inch water meter. The company bills the condominium complex each month for 252 base facility charges and a total gallon rate for the complex.
- The company's residential service territory contains 450 lots located within Sebring Ridge Phase II. Of these 450 lots, we have determined that thirteen lots are combined with adjoining lots and counted as one service connection, two lots are used for green space and not available for service, one lot contains the water well site and 168 lots were available but not connected to the wastewater system. The company's active customer base is 262 billable accounts and four accounts that were vacant and not billed. (262+4+168+1+2+13=450)

The company's general ledger reflects revenues of \$162,933 which was compiled from the transaction activity posted to the general ledger for the test year period of October 2007 through September 2008. The company's general ledger activity is posted using a cash basis of accounting (cash collected). It does not reflect the actual billed revenue amount for the test year period. Therefore, we recalculated the company's revenues for the test period using the customer consumption information that the company provided.

We calculated the company's wastewater revenues to be \$171,434 for the 12-month period ending September 30, 2008, based on the following.

Customer Base	Revenue Amount
Residential	\$94,046
Multi-residential	73,588
General Service	<u>3,640</u>
Total billable service	\$171,274
Miscellaneous service charges	<u>160</u>
Total Revenues	<u>\$171,434</u>

See our calculations on the following page.

**EFFECT ON THE FILING:** The company's wastewater revenues are \$171,434 for the 12-month period ending September 30, 2008.

**EFFECT ON THE GENERAL LEDGER:** None

Sebring Ridge - Residential Tariff				
Gallons	Customers Bills	Tariff Rate		Totals
	3,132	\$14.71	BFC	\$46,071.72
0	312	\$3.19	Per K/Gal	\$0.00
1,000	159	\$3.19	Per K/Gal	\$507.21
2,000	285	\$3.19	Per K/Gal	\$1,818.30
3,000	377	\$3.19	Per K/Gal	\$3,607.89
4,000	384	\$3.19	Per K/Gal	\$4,899.84
5,000	401	\$3.19	Per K/Gal	\$6,395.95
6,000	340	\$3.19	Per K/Gal	\$6,507.60
7,000	214	\$3.19	Per K/Gal	\$4,778.62
8,000	193	\$3.19	Per K/Gal	\$4,925.36
9,000	114	\$3.19	Per K/Gal	\$3,272.94
10,000	94	\$3.19	Per K/Gal	\$2,998.60
+10,000	<u>259</u>	\$3.19	Per K/Gal	\$8,262.10
	3,132			
			Residential	\$94,046.13

Sebring Bluffs - Multi-Residential Tariff				
Gallons	Customers Bills	Tariff Rate		Totals
	3,024	\$14.71	BFC	\$44,483.04
7,619,000		\$3.82	Per K/Gal	\$29,104.58
			Multi-Residential	\$73,587.62

Kegal Bowling Alley - General Service Tariff				
Gallons	Customers Bills	Tariff Rate		Totals
	12	\$117.75	BFC	\$1,413.00
583,000		\$3.82	Per K/Gal	\$2,227.06
			General Service	\$3,640.06
Total Calculated Revenue				<u>\$171,273.81</u>

Miscellaneous Service Fees

Month	New Customer	Bad Check	Total
Jan-08	\$45.00	\$0.00	\$45.00
Feb-08	\$15.00	\$0.00	\$15.00
Apr-08	\$15.00	\$40.00	\$55.00
May-08	\$15.00	\$0.00	\$15.00
Jun-08	\$15.00	\$0.00	\$15.00
Sep-08	<u>\$15.00</u>	<u>\$0.00</u>	<u>\$15.00</u>
	\$120.00	\$40.00	\$160.00



## AUDIT FINDING NO. 6

### SUBJECT: OPERATION AND MAINTENANCE EXPENSE

**AUDIT ANALYSIS:** The company's general ledger reflects an operation and maintenance expense balance of \$222,693 for the 12-month period ending September 30, 2008. (unadjusted)

We determined this balance using the detailed transaction activity for the three-month period ending December 31, 2007 and the nine-month period ending September 30, 2008 to estimate the company's test year operation and maintenance expense balance. The balance above does not include adjustments that would normally be made by the company's accountant in preparation of the company's calendar year end financial statements and annual reports and its fiscal year end, September 30, 2008 federal tax returns. We used these balances to ensure that we would capture all the relevant operation and maintenance expense transactions applicable to our 12-month test year which ended on September 30, 2008.

Based on our adjustments and findings discussed below, the company's operation and maintenance expense balance is \$140,577 for the 12-month period ending September 30, 2008.

We compiled this balance using the company's transaction activities identified above. Our compilation included general adjustments that converted the individual account balances to an accrual basis of accounting, and removed late payment fees, penalties and interest charges on outstanding vendor balances. Our more specific adjustments are discussed below.

#### Account No. 701. Salaries and Wages - Employees

The company's general ledger reflects a balance of \$39,178 for this account. We reduced this balance by \$15,062 to remove a bonus that was paid to the company's office manager from the proceeds of the water company's sale in 2005.<sup>7</sup> The company stated that it was a non-utility transaction. The company's office manager and one part-time assistant operator are included in this account.

#### Account No. 703. Salaries and Wages - Officers

The company's general ledger reflects a balance of \$96,678 for this account. We reduced this balance by \$62,188 to remove two bonuses that were paid to the company's officers from the proceeds of the water company's sale. The company stated that it was a non-utility transaction. Additionally, one of the two officers included in this account serves as the operations manager. The company posted both of his salaries as officer and employee totaling \$24,431 (after removing the bonus) to this account.

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<sup>7</sup> See Order No. PSC-05-0953-FOF-WU, issued October 6, 2005.

Account No. 704. Employee Pension and Benefits

The company's general ledger reflects a balance of \$6,375 for this account. We reduced this balance by \$1,647 to reflect an annualized health insurance premium that is based on two health insurance policies that we reviewed. The two policies overlapped the test year in this rate proceeding and covered the operation and office manager employees and their immediate family.

Account No. 711 Sludge Removal Expense

The company's general ledger reflects a balance of \$8,050 for this account. We increased this balance by \$1,050. Our adjustment includes two invoices totaling \$1,400 that were not included in the compilation of the general ledger balance discussed above. We also reduced one included transaction by \$350 to equal the amount shown on the vendor invoice that we reviewed.

Account No. 715 Purchased Power

The company's general ledger reflects a balance of \$9,189 for this account. We reduced this balance by \$626. We removed \$115 of non-utility expenses from this account. The remaining reduction of \$511 is attributed to the general adjustments that we discuss above.

Account No. 718 Chemicals

The company's general ledger reflects a balance of \$5,430 for this account. We increased this amount by \$3,388. We removed a \$230 transaction that was not supported by company documentation. The remaining adjustment, that increases this account by \$3,618, is attributed to the general adjustments that we discuss above and includes \$5,437 of unpaid chemical invoices that are discussed in more detail in Audit Finding No. 10 of this report.

Account No. 720 Materials and Supplies

The company's general ledger reflects a balance of \$7,415 for this account. We reduced this amount by \$875. We removed a \$349 transaction that was posted twice to the company general ledger in 2007 and 2008. The remaining adjustment, that reduces this account by \$526, is attributed to the general adjustments that we discuss above and includes \$984 of unpaid materials and supplies invoices that are discussed in more detail in Audit Finding No. 10 of this report.

Account No. 730 Contractual Services - Testing

The company's general ledger reflects a balance of \$2,640 for this account. We increased this amount by \$265. We reduced one transaction by \$100 to remove an overpayment of a vendor invoice that we reviewed. The remaining adjustment, that increases this account by \$365, is attributed to the general adjustments that we discuss above.

Account No. 736 Contractual Services - Others

The company's general ledger reflects a balance of \$3,100 for this account. We increase this amount by \$6,705. The entire adjustment is attributed to the general

adjustments that we discuss above and includes \$6,625 of unpaid contractual service invoices that are discussed in more detail in Audit Finding No. 10 of this report.

Account No. 740 Rent Expense

The company's general ledger reflects a balance of \$6,955 for this account. Order No. PSC-96-0869-FOF-WS included \$3,852 for this account in the company's last rate proceeding. The company stated that it increased this allocation periodically for inflation and increased annual operating costs. We tested the reasonableness of the company's balance and assertions by increasing the order approved amount using the Commission's price index adjustments for the subsequent 14 year period since the company's last rate case. Our calculations reflect an approved indexed amount of \$5,150. We believe that the difference of \$1,805 is not significant given the increased costs for property taxes and utilities services in the intervening years. The company states that there have been no changes in the allocation of office space that was determined in its last rate case other than the sale of its water company in 2005. That alone would not affect the company's use and requirements for office space in this rate proceeding. We propose no adjustments to this account.

Account No. 750 Transportation Expenses

The company's general ledger reflects a balance of \$4,130 for this account. We increased this amount by \$2,211. Order No. PSC-96-0869-FOF-WS included \$3,536 for 12,194 estimated miles at \$0.29 per mile. The company states that there has been no significant reduction to the total mileage requirement that was determined in its last rate case. The sale of the water company in 2005 removed the mileage required to service its water operations, however, the significant amount of customer growth in its wastewater operations has more than offset the water company mileage reduction.<sup>8</sup> We tested the reasonableness of the company's balance and assertions by multiplying the approved 12,194 estimated miles in its last rate case times the Internal Revenue Service (IRS) approved mileage rates during the test year.<sup>9</sup> The resulting balance was \$6,341. We have increased the company's test year transportation expense by \$2,211 to incorporate the IRS approved mileage rates discussed above.

Account No. 755 Insurance Expenses

The company's general ledger did not reflect any insurance expense in this account. We increased this account by \$2,994. The company posted four transactions for general liability and workman compensation insurance to Acct. No. 775 Miscellaneous Expenses. We have removed transactions totaling \$1,612 from that account. The \$2,994 balance that we propose reflects the annualized general liability and workman compensation insurance expense obligations for the two policies that we reviewed. The two policies coverage cycles overlapped during the test year. Therefore we apportioned the cost for each policy based on the periods included for test year purposes.

<sup>8</sup> The company's wastewater customer base increased from 47 residential customers in 1994 to 266 residential customers at the end of our test year in 2008.

<sup>9</sup> The IRS approved mileage rate during the test year was \$0.49 for Oct-Dec 2007, \$0.51 for Jan-Jun 2008 and \$0.59 for Jul-Sep 2008. We used 1,016 average monthly miles times the IRS mileage rate to calculate the \$6,341 balance. Beginning on January 1, 2009, the IRS standard mileage rate changed to \$0.55.

Account No. 765 Regulatory Commission Expenses

The company's general ledger reflects a balance of \$325 for this account. We propose no adjustments to this account at this time because the final balance will be determined by the staff analyst in this rate case proceeding.

Account No. 775 Miscellaneous Expenses

The company's general ledger reflects a balance of \$33,228. We reduced this balance by \$18,331 to remove the following amounts.

- We removed \$1,612 of general liability and workman compensation insurance transactions that are reclassified and adjusted in Acct. No. 755 Insurance Expense above.
- We removed \$3,893 of transportation related expenses that would be included in the transportation allocation that is reflected in Acct. No. 750 Transportation Expenses above.
- We removed \$297 of expenses associated with office utilities that was included in this account. The company's office location now includes a non-utility construction company that occupies approximately 24 percent of the office space available. Our adjustment removes a portion of the recorded office utilities expense attributable to the non-utility company.
- We removed \$851 of cellular telephone expenses that were included in this account. The company contracts for four cellular telephones. Two phones are used by the operation and office managers for utility business. The remaining two phones are used for non-utility business. We have removed half of the monthly service fees and overage charges associated with the two extra cellular phones.
- We removed \$680 of bank charges that were included in this account. The bank charges included \$530 for returned customer checks that were subsequently collected but not reversed from this account. The bank charges also included \$150 of bank service fees for account overdraft charges of \$50 and an electronic fund transfer for \$100 to pay for a non-utility obligation.
- We have increased this amount by \$2,706 for the amortized loss on early retirement of plant assets. We calculated a total unrecovered loss of \$13,532 as of September 30, 2008, based on the instructions found in the NARUC USOA.<sup>10</sup> We amortized this balance over five years as required by Commission rules.<sup>11</sup> The unrecovered loss resulted from multiple asset retirements that we recorded to UPIS Acct No. 360 Collection - Sewers Forced. The company's lift-station pumps and motors have experienced above normal equipment failure rates since 2003. The company's pro forma UPIS addition request, included as Audit Finding No. 9 of this report, discusses the company's efforts to address this problem.
- We have removed two transactions totaling \$12,676 that were for interest expense on the company's debt balances. Expenses such as these are recovered by the company within the weighted average cost of capital calculation that is discussed in Audit Finding No. 8 of this report.
- We removed four transactions totaling \$1,667 that were expenses associated with the company's pension that was established from proceeds of the water company's sale in 2005. The company stated that these are non-utility transactions.
- The remaining adjustment, that increases this account by \$639, is attributed to the general adjustments that we discuss above.

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<sup>10</sup> See NARUC, Class C, Accounting Instruction 5E.

<sup>11</sup> See Rule 25-30.433 (8), Florida Administrative Code.

The company's operating and maintenance expense balances by NARUC sub-account are displayed on the following schedule.

The company's working capital balance for rate base purposes is \$17,572 which is calculated as one-eighth of the company's operating and maintenance expense balance for the test year per Commission rule.<sup>12</sup>

**EFFECT ON THE FILING:** The company's operation and maintenance expense balance is \$140,577 for the 12-month period ending September 30, 2008.

**EFFECT ON THE GENERAL LEDGER:** None

Operation and Maintenance Expense

Acct. No.	Per Company G/L (unadjusted)	Adjustment	Per Audit Compilation
701	\$39,178	(\$15,062)	\$24,117
702	96,678	(62,188)	34,491
704	6,375	(1,647)	4,728
711	8,050	1,050	9,100
715	9,189	(626)	8,562
718	5,430	4,123	8,818
720	7,415	(875)	6,540
730	2,640	265	2,905
736	3,100	6,705	9,805
740	6,955	0	6,955
750	4,130	2,211	6,341
755	0	2,994	2,994
765	325	0	325
775	<u>33,228</u>	<u>(18,331)</u>	<u>14,897</u>
	\$222,693	(\$81,381)	\$140,577
	Working Capital (one-eighth of O&M)		\$17,572

<sup>12</sup> See Rule 25-30.433 (2), Florida Administrative Code.

## AUDIT FINDING NO. 7

### SUBJECT: TAXES OTHER THAN INCOME

**AUDIT ANALYSIS:** The company's general ledger reflects a TOTI tax balance of \$92,316 for the 12-month period ending September 30, 2008. (unadjusted)

We determined this balance using the detailed transaction activity for the three-month period ending December 31, 2007 and the nine-month period ending September 30, 2008 to estimate the company's test year TOTI tax expense balance. The balance above does not include adjustments that would normally be made by the company's accountant in preparation of the company's calendar year end financial statements and annual reports and its fiscal year end, September 30, federal tax returns. We used these balances to ensure that we would capture all the relevant operation and maintenance expense transactions applicable to our 12-month test year which ended on September 30, 2008.

Our calculation of the company's TOTI tax expense is \$17,677 for the 12-month period ending September 30, 2008. We compiled our balance using the company's transaction activities identified above. Our more specific adjustments are detailed below.

#### Payroll Tax

The company's general ledger reflects a balance of \$76,952 for this account. We have reduced this balance by \$71,486. We recalculated payroll taxes based on the company's actual salary expense reflected in Audit Finding No. 6 of this report. Our calculation removes all payroll taxes withheld from company employees that should not have been included in this account and any non-utility payroll taxes associated with the salary bonuses removed in the same audit finding above.

#### Property Tax

The company's general ledger reflects a balance of \$7,970 for this account. We reduced this balance by \$3,474 to remove the following amounts.

- We reduced real estate taxes on the wastewater plant site by \$2,057 to remove property taxes associated with non-utility acreage as determined in the prior rate case and to take advantage of the maximum discount available for the early payment of the property tax balance.
- We removed \$1,243 of real estate taxes associated with the company's office location because the company pays an annual rent of \$6,955 for office space as discussed in Audit Finding No. 6 of this report. The company shares this office space with another utility company, Fairmount Utilities, The 2nd, Inc., and a non-utility construction and development company. Real estate taxes would normally be incorporated in the individual annual lease payment for each tenant.
- We removed a \$174 payment to the Florida Department of Revenue that relates to state unemployment taxes that was posted to this account in error. We included unemployment taxes in our discussion of the company's payroll tax above.

Regulatory Assessment Fees

The company's general ledger reflects a balance of \$7,394 for this account. We have increased this balance by \$321 to \$7,715. Our balance was calculated as 4.5 percent of the \$171,434 revenue amount displayed in Audit Finding No. 5 of this report.

Our calculations for the payroll and property tax balances discussed above are displayed in the schedules that follow and the company's TOTI tax balance by NARUC sub-account is displayed below.

<u>Description</u>	<u>Per Company</u>	<u>Adjustments</u>	<u>Per Audit</u>
Payroll Tax	\$76,952	(\$71,486)	\$5,466
Property Tax	7,970	(3,474)	4,496
Regulatory Assessment Fee	<u>7,394</u>	<u>321</u>	<u>7,715</u>
Total	\$92,316	(\$74,639)	\$17,677

**EFFECT ON THE FILING:** The company's TOTI tax balance is \$17,677 for the 12-month period ending September 30, 2008.

**EFFECT ON THE GENERAL LEDGER:** None

## Payroll Tax Expense

Salary Description	Per Company			Adjustments	Per Audit
	G/L	Adjustments(a)	Adjusted G/L		
Salary - Officers	96,678	(62,188)	34,491	(24,431)	10,060
Salary - Operators	0	0	0	24,431	24,431
Salary - Other	<u>39,178</u>	<u>(15,062)</u>	<u>24,117</u>	<u>0</u>	<u>24,117</u>
Total	135,857	(77,249)	58,608	0	58,608

a) Remove company bonus to share holders related to the sale of the water company to Avon Park

Description of Tax	Per Company			Adjustments	Per Audit
	G/L	Adjustments(a)	Adjusted G/L		
FICA/MED	76,952	-	76,952	(72,468)	4,484
FUTA	-	-	-	224	224
SUTA	-	-	-	<u>759</u>	<u>759</u>
Totals	76,952	-	76,952	(71,486)	5,466

FICA/Med = \$58,608 x ((0.124 Social Security Rate + 0.029 Medicare Rate) / 2)

FUTA = 4 employees x \$7,000 maximum salary x 0.0080 FUTA rate

SUTA = 4 employees x \$7,000 maximum salary x 0.0271 FUTA rate

## Property Tax Expense

Description	Per Company	Adjustment	Per Audit
Land - Wastewater Plant	6,553	(2,057)	4,496
Land - Office	1,243	(1,243)	0
Department Revenue	<u>174</u>	<u>(174)</u>	<u>0</u>
	7,970	(3,474)	4,496

Land - Wastewater Plant		
Utility	6.500	35.872%
Non Utility	<u>11.620</u>	<u>64.128%</u>
Total	18.120	100.000%

2007	Assessed Value		(Maximum Discount)		
	Property Tax	Utility	Non Utility		
Land	200,144	46.723%	2,999	1,076	1,924
Equipment	<u>228,216</u>	<u>53.277%</u>	<u>3,420</u>	<u>3,420</u>	<u>0</u>
Total	428,360	100.000%	6,420	4,496	1,924

6,553 Per Utility  
(2,057) Adjustment

### Additional Information

Land - Wastewater Plant					
2008	Assessed Value		Property Tax	Utility	Non Utility
Land	190,212	46.723%	2,809	1,008	1,801
Equipment	<u>216,890</u>	<u>53.277%</u>	<u>3,203</u>	<u>3,203</u>	<u>0</u>
Total	407,102	100.000%	6,011	4,210	1,801

*Our property tax calculation above uses the company's 2007 tax year liability which was included in our test year balance. We have also included a property tax calculation based on the company's 2008 tax year liability which became due in November 2008 for comparison purposes.*



## AUDIT FINDING NO. 8

### SUBJECT: CAPITAL STRUCTURE

**AUDIT ANALYSIS:** The company's capital structure was composed of the following debt and equity component balances which are reflected in its 2007 annual report.

Class of Capital	Balance @12/31/2007
Long Term Debt	\$145,601
Customer Deposits	3,353
Equity (a)	<u>1,018,976</u>
Total	\$1,167,930

a) Includes the undistributed proceeds from the sale of the water company in 2005 and other non-utility accounts.

We have determined that the company's total capital structure for utility operations, when reconciled to rate base, is \$80,457 and its weighted average cost of capital is 7.91 percent as of September 30, 2008.

We compiled the above capital structure balance using loan documents and transaction activities affecting the company's long term debt and customer deposit accounts. The equity balance was adjusted so that the company's net capital structure equals its net rate base. Our findings are discussed below and our calculations are found in Exhibit 3 of this report.

#### Long Term Debt

The company's long term debt balance consist of two 15-year promissory notes paying 7.95 percent that were executed with a local bank on June 22, 2006 and February 27, 2007, for \$50,970 and \$101,750, respectively. (The closing cost for each note was included in the corresponding principal balance). The notes were collateralized by the company's real property and utility assets. We calculated an outstanding loan balance of \$47,839 and \$92,792, respectively, totaling \$140,630 as of September 30, 2008, based on the respective loan amortization schedules and the company's transaction records.

#### Customer Deposits

The customer deposit balance was compiled using the company's customer deposit log. We computed a balance of \$3,104 as of September 31, 2008 based on our compilation of records displayed in the company's customer deposit log. We found five customer accounts where the deposit had been refunded but was not posted to the general ledger totaling \$250.

**EFFECT ON THE FILING:** The company's weighted average cost of capital is 7.91 percent.

**EFFECT ON THE GENERAL LEDGER:** Reduce customer deposits by \$250.

**AUDIT FINDING NO. 9**

**SUBJECT: INFORMATION ON PRO FORMA PLANT IN SERVICE**

**AUDIT ANALYSIS:** The company provided an estimate for labor and materials to refurbish and rebuild its four wastewater lift stations totaling \$57,557.

Proforma Plant Request

	Shad L/S	Clam L/S	Star L/S	Sturgeon L/S	Total all L/S
Hudson Pump	\$6,388	\$6,934	\$6,934	\$6,388	\$26,644
Pugh Utilities Services	<u>7,489</u>	<u>7,489</u>	<u>7,489</u>	<u>8,446</u>	<u>30,913</u>
	\$13,877	\$14,423	\$14,423	\$14,834	\$57,557

The scope of work involves replacing all eight lift station pumps and motors with above ground grinder pumps and new motors, control boxes, transfer switches, and to upgrade the existing audio and visual alarm systems.

The operations manager and officer of the company stated that the upgrade is needed to provide its customers with better service and to reduce the annual operating cost of maintaining and servicing the existing lift station pumping system.

The above information is provided to the analyst and engineer for further consideration.

**AUDIT FINDING NO. 10**

**SUBJECT: INFORMATION ON UNPAID VENDOR INVOICES**

**AUDIT ANALYSIS:** The company stated that it has been experiencing cash flow problems for the past several years. They provided copies of vendor invoices totaling \$19,544 that have not been paid as of September 30, 2008.

We have included the following invoice amounts in the indicated account because they were for labor and materials provided during the test year for this rate case proceeding,

<u>Acct. No.</u>	<u>Account Description</u>	<u>Amount</u>
718	Chemicals	\$5,437
720	Materials and Supplies	984
736	Contractual Services - Other	<u>6,625</u>
Total unpaid invoices		\$13,046

The remaining invoices totaling \$6,498 were for labor and materials provided prior to the test year. They include capital additions of \$5,710 and operating expenses of \$788. The capital addition amounts would have been recorded in Acct. No. 380 Treatment Plant.

All of the invoices referenced above were from Highlands Utility Construction, a related party vendor. The owner/operator of this company is also the operations manager and an officer of Sebring Ridge Utilities, Inc. He stated that Highlands Utility Construction was set up after the company's last rate case at the request of then Commission staff. He provided a price list of services that Highlands Utility Construction provides the company and a third-party vendor quotation for comparable services. It appears that the fees charged by Highlands Utility Construction are competitively priced.

The above information is provided to the analyst and engineer for further consideration.

**EXHIBIT 1**

**SEBRING RIDGE UTILITIES, INC.  
WASTEWATER RATE BASE  
AS OF SEPTEMBER 30, 2008  
DOCKET NO. 080669-SU**

DESCRIPTION	PER UTILITY @09/30/2008 (a)	AUDIT ADJUSTMENTS	REFER TO	PER AUDIT @09/30/2008
UTILITY PLANT IN SERVICE		\$502,575	AF-2	\$502,575
LAND AND LAND RIGHTS		\$45,716	AF-3	\$45,716
CONTRIBUTIONS IN AID OF CONSTRUCTION		(\$327,623)	AF-4	(\$327,623)
AMORTIZATION OF CIAC		\$157,472	AF-4	\$157,472
ACCUMULATED DEPRECIATION		(\$311,525)	AF-2	(\$311,525)
WORKING CAPITAL (b)		\$17,572	AF-6	\$17,572
		-----		-----
NET RATE BASE (c)		\$84,187		\$84,187

Notes to above schedule:

- a) The company's books are maintained on a cash basis for income tax purposes. Amounts posted in the general ledger are not comparable to the audited test year and were not included.
- b) Working Capital is calculated as 1/8th of the test year operating and maintenance expense balance displayed in Exhibit 2 of this report.
- c) All amounts are rounded to the nearest whole dollar.

**EXHIBIT 2**

**SEBRING RIDGE UTILITIES, INC.  
WASTEWATER NET OPERATING INCOME  
FOR THE 12-MONTH PERIOD ENDING SEPTEMBER 30, 2008  
DOCKET NO. 080669-SU**

DESCRIPTION	PER UTILITY @09/30/2008 (a)	AUDIT ADJUSTMENTS	REFER TO	PER AUDIT @09/30/2008
REVENUES		\$171,434	AF-5	\$171,434
OPERATION AND MAINTENANCE EXPENSE		\$140,577	AF-6	\$140,577
DEPRECIATION EXPENSE		\$22,886	AF-2	\$22,886
CIAC AMORTIZATION EXPENSE		(\$11,802)	AF-4	(\$11,802)
TAXES OTHER THAN INCOME TAX EXPENSE		\$17,677	AF-7	\$17,677
PROVISION FOR INCOME TAX EXPENSE (b)		\$0		\$0
		-----		-----
OPERATING EXPENSE		\$169,338		\$169,338
		-----		-----
NET OPERATING INCOME (c)		\$2,096		\$2,096

Notes to above schedule:

- a) The company's books are maintained on a cash basis for income tax purposes. Amounts posted in the general ledger are not comparable to the audited test year and were not included.
- b) The company's 2006 Federal tax return, for the 12-month tax period ending September 30, 2007, reflects a net operation loss carry forward of \$260,194. this loss will offset any federal income tax liability for the 12-month test year and future tax liabilities in subsequent years.
- c) All amounts are rounded to the nearest whole dollar.

**EXHIBIT 3**

**SEBRING RIDGE UTILITIES, INC.  
WASTEWATER CAPITAL STRUCTURE  
AS OF SEPTEMBER 30, 2008  
DOCKET NO. 080669-SU**

CLASS OF CAPITAL	BALANCE	ADJUSTMENTS	ADJUSTED BALANCE (a)	RATIO	COST RATE	WEIGHTED COST
LONG-TERM DEBT	\$140,630	(\$58,261)	\$82,369	97.84%	7.95%	7.78%
SHORT-TERM DEBT	0	0	0	0.00%	0.00%	0.00%
COMMON EQUITY (b)	(59,547)	59,547	0	0.00%	0.00%	0.00%
CUSTOMER DEPOSITS	3,104	(1,286)	1,818	2.16%	6.00%	0.13%
ACC. DEFERRED INCOME TAXES	0	0	0	0.00%	0.00%	0.00%
<b>TOTALS(c)</b>	<b>\$84,187</b>	<b>\$0</b>	<b>\$84,187</b>	<b>100.00%</b>		<b>7.91%</b>

Notes to above schedule:

a) Adjusted balance calculations:

Long-term Debt of \$82,369 =  $(\$140,630 / (\$140,630 + \$3,104)) \times \$84,187$ .

Common Equity of \$0 is the result of removing the negative equity balance of \$59,547 for this rate case proceeding.

Customer Deposits of \$1,818 =  $(\$3,104 / (\$140,630 + \$3,104)) \times \$84,187$ .

b) The negative common equity balance was determined by reconciling the company's capital structure to the net rate base amount displayed in Exhibit 1 of this report. (Net rate base of \$84,187 less Total debt of \$143,734 = Negative equity of \$59,547)

c) All amounts are rounded to the nearest whole dollar.