

State of Florida



Public Service Commission

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

DATE: March 27, 2003
TO: Division of Economic Regulation (Fitch)
FROM: Division of Auditing and Safety (Vandiver) *SVK*
RE: **Docket No.** 021228-WS; **Company Name:** Service Management Systems, Inc.;
Audit Purpose: Staff Assisted Rate Case; **Audit Control No.** 03-006-3-1

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, it should send the response to the Division of the Commission Clerk and Administrative Services. There are no confidential work papers associated with this audit.

DNV/jcp
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
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Division of Competitive Markets and Enforcement (Harvey)
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DOCUMENT NUMBER-DATE

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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

SERVICE MANAGEMENT SYSTEMS, INC.

STAFF-ASSISTED RATE CASE

HISTORICAL PERIOD ENDED DECEMBER 31, 2002

**DOCKET NO. 021228-WS
AUDIT CONTROL NO. 03-006-3-1**

Handwritten signature of Richard F. Brown in cursive.

Richard F. Brown, Audit Manager

Handwritten signature of Intesar Terkawi in cursive.

Intesar Terkawi, Audit Staff

Handwritten signature of Charleston J. Winston in cursive.

Charleston J. Winston, Audit Staff/Supervisor

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**DIVISION OF AUDITING AND SAFETY
AUDITOR'S REPORT**

March 11, 2002

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of rate base, net operating income and capital structure for the historical period ended December 31, 2002, for Service Management Systems, Inc. The attached schedules were prepared by the audit staff as part of our work in Docket No. 021228-WS.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

SUMMARY OF SIGNIFICANT FINDINGS

The books and records of the utility were not maintained in substantial compliance with NARUC Water and Wastewater Class "C" Instruction 2B.

The audit staff recommends that water and wastewater utility plant-in-service (UPIS) be reduced by \$14,807 and \$5,702, respectively, and nonpotable be increased by \$6,277.

The audit staff recommends that water, nonpotable, and wastewater contributions-in-aid-of construction (CIAC) be increased by \$22,100, \$4,350, and \$37,000, respectively.

The utility's long-term debt should be increased by \$5,313.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Scanned - The documents or accounts were read quickly looking for obvious errors.

Verified - The item was tested for accuracy and compared to the substantiating documentation.

RATE BASE: Reconciled rate base balances authorized in Commission Order PSC-97-0918-FOF-WS, issued August 4, 1997, to the January 1, 1997, beginning balances. Verified approximately 95 percent of all plant additions acquired from January 1, 1997 through December 31, 2002. Computed accumulated depreciation as of December 31, 2002. Verified and scanned the utility's records for CIAC additions. Recalculated accumulated amortization of CIAC. Prepared water, nonpotable water, and wastewater rate bases as of December 31, 2002.

NET OPERATING INCOME: Compiled utility revenue and operating and maintenance accounts for the year ended December 31, 2002. Verified a judgmental sample of customer bills and recalculated using FPSC-approved rates. Verified a judgmental sample of operation and maintenance expenses. Verified taxes other than income.

CAPITAL STRUCTURE: Compiled components of the capital structures as of December 31, 2002. Agreed interest expense to the terms of the debt agreements.

OTHER: Read the tax returns for 2000 and 2001 for items related to regulatory issues.

Exception No. 1

Subject: Books and Records

Statement of Fact: The books and records of Service Management Systems, Inc. (SMSI) were not maintained in compliance with NARUC Water and Wastewater Class "C" Accounting Instruction 2.B., which states as follows:

All books of accounts, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, invoices, memoranda and information useful in determining the facts regarding a transaction.

Recommendation: The utility did not maintain transaction general ledgers for the years 1997 through 2000. The general ledgers that were made available were summary in nature with monthly gaps in activity. In many instances, the preceding months' ending balance did not reconcile to the following month's beginning balance.

The utility could not support contributions-in-aid-of-construction collected based on the amounts compiled on the summarized schedules from December 31, 1997 through December 31, 2001.

The Commission should require the utility to maintain its books and record in compliance with NARUC.

Exception No. 2

Subject: Utility-Plant-in-Service (UPIS)

Statement of Fact: The utility reflected water, nonpotable water, and wastewater utility-plant-in-service balances, per general ledger, of \$927,272, \$936,334, and \$2,132,510, respectively, as of December 31, 2002.

Recommendation: The audit staff recommends that water and wastewater UPIS be reduced by \$14,807 and \$5,702, respectively, and nonpotable be increased by \$6,277 based on the adjustments on the following pages.

Exception No. 2, continued

	Account	Description		
(1)	333 309	Services/Water Supply Mains/Water	4,580.00	4,580.00
(2)	363 309	Services/Wastewater Supply Mains/Water	1,038.90	1,038.90
(3)	363 361	Services/Wastewater Gravity Sewers/Wastewater	1,038.89	1,038.89
(4)	380 360	Treatment & Disposal Equipment/Wastewater Collection System/Wastewater	5,566.88	5,566.88
(5)	335 331	Hydrants/Nonpotable Water Transmission & Distribution Mains/Nonpotable Water	3,750.00	3,750.00
(6)	380 331	Transmission & Disposal Equipment/Wastewater Transmission & Distribution Mains/Water	2,566.87	2,566.87
(7)	363 309	Services/Wastewater Supply Mains/Wastewater	4,596.00	4,596.00
(8)	363 331	Services/Wastewater Transmission & Distribution Mains/Wastewater	15,992.00	15,992.00
(9)	215 360	Retained Earnings Collection System/Wastewater	15,911.00	15,911.00
(10)	426 330	Miscellaneous Nonutility Expense Distribution Reservoirs/Water	607.40	607.40
(11)	426 330	Miscellaneous Nonutility Expense Distribution Reservoirs/Water	1,402.00	1,402.00
(12)	108-330 330	Accumulated Depreciation/Distribution Reservoir/Water Distribution Reservoirs/Water	3,000.00	3,000.00
(13)	331 334 307 339 309 347	Transmission & Distribution Mains/Water Meter & Meter Installs/Water Wells & Springs/Water Reject Line/Water Supply Mains/Water Miscellaneous Equipment/Water	19,736.79 1,116.32 1,076.00 61.00	21,929.11 61.00

Exception No. 2, continued

	Account	Description		
(14)	331	Treatment & Disposal Equipment/Nonpotable Water	60,317.96	
	334	Meter & Meter Installs/Nonpotable Water	22,705.89	
	330	Storage Tank/Nonpotable Water	400.00	
	309	Supply Mains/Nonpotable Water		67,100.00
	311	Pumping Equipment/Nonpotable Water		16,324.00
	(Rounding)		0.15	
(15)	361	Gravity Sewers/Wastewater	19,782.73	
	389	Other Plant & Miscellaneous Equipment/Wastewater	211.00	
	382	Outfall Lines/Wastewater		12,984.00
	363	Services/Wastewater		5,480.00
	334	Meter & Meter Installation/Wastewater		1,318.73
	398	Miscellaneous Equipment/Wastewater		211.00
(16)	215	Retained Earnings	245.91	
	334	Meters-Wastewater		245.91

Journal Entries 1 through 8 are applicable to plant misclassified by the utility among functional accounts.

Journal Entry 9 adjusts for the double-booking of PSC-97-0918-FOF-WS Order adjustments.

Journal Entry 10 adjusted for the Documentary Stamps on a loan (\$582.40) and a loan filing fee (\$25.00).

Journal Entry 11 was capitalized interest of which support was not available.

Journal Entry 12 was for the cost of removing a storage tank that should have been charged to accumulated depreciation.

Journal Entries 13 through 15 adjusted the utility's erroneous recording of PSC-97-0918-FOF-WS Order adjustments.

Journal Entry 16 excludes the balance in this account that is applicable to water, not wastewater, and the amount could not be supported by the utility.

The foregoing Journal Entries 1 through 16 were applicable to the transfer audit as of December 31, 2001, per Docket No. 020091-WS. Journal Entries 17 through 23 are related to the adjustments made per Docket No. 021228-WS, the current audit in progress.

Exception No. 2, continued

	Account	Description		
(17)	380	Treatment & Disposal Equipment-Wastewater	1,037.00	
	720	Materials & Supplies - Wastewater		1,037.00
	(Util. Acct. 607)			
(18)	311	Pumping Equipment - Nonpotable	200.11	
	620	Materials & Supplies - Nonpotable		200.11
	(Util. Acct. 607)			
(19)	311	Pumping Equipment - Nonpotable	4,743.50	
	636	Contractual Services - Other - Nonpotable		4,743.50
	(Util. Acct. 612)			
(20)	361	Collection Sewers - Gravity - Wastewater	5,667.00	
	331	Nonpotable Transmission & Distribution Mains	955.10	
		(\$2,500.50 - \$1,545.40)		
	331	Transmission & Distribution Mains - Water		6,620.10
(21)	215	Retained Earnings	1,955.00	
	334	Meters - Wastewater	144.64	
	330	Distribution Reservoirs & Standpipes - Water		2,099.64
(22)	331	Transmission Distribution Mains - Nonpotable	21,888.00	
	309	Supply Mains - Nonpotable		21,888.00
(23)	334	Meters-Water	2,530.01	
	334	Meters - Nonpotable	378.84	
	607	Materials & Supplies-Water		2,530.01
	607	Materials & Supplies-Nonpotable		378.84

Journal Entries 17 through 19 are adjustments to recognize plant additions expensed by the utility (bridge wheel, pump and pump overall).

Journal Entry 20 is applicable to plant misclassified by the utility among functional accounts.

Journal Entry 21 represents unreconcilable and unsupported differences of \$2,100.00 and \$144.64 in the adjusted accounts between the balances at December 31 2001, and January 1, 2002.

Journal Entry 22 adjusts for differences in utility account balances between December 31, 2001, and January 1, 2002.

Journal Entry 23 relates to the capitalization of meters expensed by the utility.

Exception No. 2, continued

The following schedules reflect the adjustments to water, nonpotable water, and wastewater plant accounts.

WATER

Account	Description	Balance As of 12/31/02 Per Utility	Adjustments	Balance As of 12/31/02 Per Audit
301	Organization	\$1,050.00	\$0.00	\$1,050.00
302	Land	30,160.00	0.00	30,160.00
304	Structures & Improvements	15,765.00	0.00	15,765.00
307	Wells & Springs	115,431.00	1,076.00	116,507.00
309	Supply Mains	27,548.01	(4,580.00)	0.00
			(1,038.90)	
			(21,929.11)	
311	Pumping Equipment	3,805.00	0.00	3,805.00
320	Water Treatment Equipment	356,506.00	0.00	356,506.00
330	Distribution Reservoirs	157,219.00	(607.40)	150,109.60
			(1,402.00)	
			(2,100.00)	
			(3,000.00)	
331	Transmission & Distribution Mains	145,397.00	19,736.79	155,944.82
			(2,566.87)	
			(2,500.50)	
			(4,121.60)	
333	Services	67,057.00	4,580.00	71,637.00
334	Meters	6,073.00	1,116.32	9,719.33
			2,530.01	
339	Other Plant & Miscellaneous Equipment	1,200.00	61.00	1,261.00
347	Miscellaneous Equipment	61.00	(61.00)	0.00
		\$927,272.01	(\$14,807.26)	\$912,464.75

Exception No. 2, continued

NONPOTABLE WATER

Account	Description	Balance As of 12/31/02 Per Utility	Adjustments	Balance As of 12/31/02 Per Audit
303	Land & Land Rights	\$31,920.00	\$0.00	\$31,920.00
304	Structures & Improvements	650.00	0.00	650.00
307	Wells & Springs	115,430.00	0.00	115,430.00
309	Supply Mains	114,188.00	(67,100.00)	25,200.00
			(21,888.00)	
311	Pumping Equipment	63,553.00	(16,324.00)	52,172.61
			200.11	
			4,743.50	
330	Storage Tank	471,964.00	400.00	472,364.00
331	Transmission & Distribution Mains	66,867.00	(3,750.00)	146,278.06
			2,500.50	
			60,317.96	
			(1,545.40)	
			21,888.00	
333	Services - Water	52,710.00	0.00	52,710.00
334	Meter & Meter Installs	12,752.00	22,705.89	35,836.73
			378.84	
335	Hydrants	6,300.00	3,750.00	10,050.00
		\$936,334.00	\$6,277.40	\$942,611.40

Exception No. 2, continued

WASTEWATER

Account	Description	Balance As of 12/31/02 Per Utility	Adjustments	Balance As of 12/31/02 Per Audit
351	Organization	\$1,050.00	\$0.00	\$1,050.00
353	Land & Land Rights	33,680.00	0.00	33,680.00
354	Structures & Improvements	18,769.00	0.00	18,769.00
360	Collection System	206,148.00	(5,566.88)	184,670.12
			(15,911.00)	
361	Gravity System	280,669.16	(1,038.89)	305,080.00
			5,667.00	
			19,782.73	
363	Services	163,975.00	1,038.90	181,160.79
			1,038.89	
			4,596.00	
			15,992.00	
			(5,480.00)	
309	Supply Mains	4,596.00	(4,596.00)	0.00
371	Pumping Equipment	50,256.00	0.00	50,256.00
380	Treatment Equipment	1,193,560.22	5,566.88	1,202,730.97
			1,037.00	
			2,566.87	
382	Outfall Lines	157,892.00	(12,984.00)	144,908.00
389	Other Plant & Miscellaneous Equip.	698.00	211.00	909.00
331	Transmission & Distribution Mains	15,992.00	(15,992.00)	0.00
334	Meter & Meter Installation	1,420.00	(1,318.73)	0.00
			144.64	
			(245.91)	
398	Miscellaneous Equipment	3,805.00	(211.00)	3,594.00
		\$2,132,510.38	(\$5,702.50)	\$2,126,807.88

Exception No. 3

Subject: Accumulated Depreciation

Statement of Fact: The utility's records indicated accumulated depreciation balances of \$460,950, 486,303, and \$1,585,569 for water, nonpotable water, and wastewater respectively, as of December 31, 2002.

The utility's records indicated depreciation expense of \$24,956, \$24,347, and \$85,082 for water, nonpotable water, and wastewater, respectively, for the period ended December 31, 2002.

The utility supplied the audit staff with a per account depreciation schedule that does not agree with the general ledger.

Recommendation: Due to the numerous plant adjustments reflected via Exception No. 1 and incomplete depreciation records, the audit staff recomputed the balances as of December 31, 2002, in accordance with Rule 25-30.140, Florida Administrative Code. Based on the audit staff's computation, the utility understated water, nonpotable water, and wastewater accumulated depreciation by \$28,733, \$10,344, and \$94,406, respectively.

The utility understated depreciation expense by \$11,930, \$4,772, and \$24,966 for water, nonpotable water, and wastewater, respectively, for the period ended December 31, 2002.

The audit staff used the total amount of the depreciation expense and accumulated depreciation for each account for water, nonpotable water, and wastewater stated in the general ledger. The utility failed to supply the audit staff with the detailed depreciation schedule by account that agrees with the general ledger.

The audit staff accumulated adjustments by functional accounts are on the following pages.

Exception No. 3, continued

WATER

Account	Description	Total Accumulated Depreciation Per Audit As of 12/31/02	Total Accumulated Depreciation Per Utility As of 12/31/02	Adjustment
301	Organization	\$524.00		
302	Land & Land Rights	0.00		
304	Structures & Improvements	11,480.00		
307	Wells & Springs	77,409.00		
309	Supply Mains	0.00		
311	Pumping Equipment	\$1,631.00		
320	Treatment Equipment	331,065.00		
330	Storage Tank	14,642.00		
331	Transmission & Distribution Equipment	27,500.00		
333	Services - Water	22,584.00		
334	Meters & Meter Installs	2,311.00		
339	Reject Line	537.00		
	Totals	\$489,683.00	\$460,950.00	\$28,733.00

Exception No. 3, continued

NONPOTABLE WATER

Account	Description	Total Accumulated Depreciation Per Audit As of 12/31/02	Total Accumulated Depreciation Per Utility As of 12/31/02	Adjustment
303	Land & Land Rights	\$0.00		
304	Structures & Improvements	174.00		
307	Wells & Springs	77,150.00		
309	Supply Mains	4,219.00		
311	Pumping Equipment	21,989.00		
330	Storage Tank	330,053.00		
331	Transmission & Distribution Equip.	21,720.00		
333	Services - Water	20,011.00		
334	Meters & Meter Installs	20,295.00		
335	Hydrants	1,036.00		
	Totals	\$496,647.00	\$486,303.00	\$10,344.00

Exception No. 3, continued

WASTEWATER

Account	Description	Total Accumulated Depreciation Per Audit As of 12/31/02	Total Accumulated Depreciation Per Utility As of 12/31/02	Adjustment
351	Organization	617.00		
353	Land & Land Rights	0.00		
354	Structures & Improvements	14,034.00		
360	Collection System	88,416.00		
361	Gravity Sewers	80,914.00		
363	Services	69,375.00		
371	Pumping Equipment	2,215.00		
380	Treatment Equipment	1,300,247.00		
382	Outfall Lines	123,104.00		
389	Other Plant & Misc. Equipment	578.00		
390	Office Furniture & Equipment	0.00		
398	Miscellaneous Equipment	475.00		
	Totals	\$1,679,975.00	\$1,585,569.00	\$94,406.00

Exception No. 4

Subject: Contributions-in-Aid-of-Construction (CIAC) and Amortization Expense

Statement of Fact: Water, nonpotable water, and wastewater contributions-in-aid-of-construction balances as of December 31, 2002, per utility records, were \$351,245, \$95,822, and \$567,330, respectively. The related accumulated amortization was \$128,840, \$35,300, and \$219,520, respectively.

Recommendation: The utility could not provide meaningful supporting documentation to substantiate CIAC additions from January 1, 1997 through December 31, 2001, of \$58,768, \$10,017, and \$55,525 for the respective water, nonpotable water, and wastewater systems.

The company did offer copies of \$30.00 checks from approximately 40 customers for water and wastewater connections. Staff could not determine whether the fees collected were properly recorded via revenues or charged as CIAC. The fees, however, were collected in accordance with the company's tariff.

Additionally provided were billings and checks totaling \$19,850 from Certified Builders Corporation for plant and system capacity fees, along with meter installation charges that were collected in accordance with the utility's tariff. It appears that these fees are included in the CIAC account additions balance.

Representatives of SMSI informed the audit staff that they did not maintain CIAC records as was noted in the previous audit report dated May 16, 1997 (Docket No. 970093-WS).

The audit staff reviewed the audit report and work papers of SMSI's external auditors but was unable to establish the validity of the CIAC balances in question.

SMSI booked CIAC of \$75,868 in calendar year 2002. The amount was applicable to wastewater plant willed to the utility by Vistar Realty, Inc. and was verified by the audit staff.

The audit staff has included the utility's CIAC balances as of December 31, 2002, however, defers to the Tallahassee analyst for final disposition.

Exception No. 5

Subject: CIAC Amortization Expense and Accumulated Amortization

Statement of Fact: SMSI reflected booked water, nonpotable, and wastewater CIAC amortization expense of \$8,177, \$2,945, and \$11,732 for the 12-month period ended December 31, 2002. Water, nonpotable, and wastewater accumulated amortization as of December 31, 2002, per utility was \$128,840, \$35,300, and \$219,520, respectively.

Recommendation: The utility could not support its calculation of amortization expense or the accumulated amortization requested by the audit staff. It is recommended that the adjustment on the following page be made to the effected accounts based on the audit staff's recalculation of the amortization expense and accumulated amortization.

Exception No. 5, continued

Water accumulated amortization as of 12/31/02 per audit staff	\$130,455	
Water accumulated amortization as of 12/31/02 per utility	<u>128,840</u>	
Difference		\$1,615
Nonpotable accumulated amortization as of 12/31/02 per audit staff	\$35,662	
Nonpotable accumulated amortization as of 12/31/02 per utility	<u>35,300</u>	
Difference		\$362
Wastewater accumulated amortization as of 12/31/02 per audit staff	\$222,825	
Wastewater accumulated amortization as of 12/31/02 per utility	<u>219,520</u>	
Difference		\$3,305
Water amortization expense for the 12 months ended 12/31/02 per audit staff	\$9,793	
Water amortization expense for the 12 months ended 12/31/02 per utility	<u>8,177</u>	
Difference		\$1,616
Nonpotable amortization expense for the 12 months ended 12/31/02 per audit staff	\$3,307	
Nonpotable amortization expense for the 12 months ended 12/31/02 per utility	<u>2,945</u>	
Difference		\$362
Wastewater amortization expense for the 12 months ended 12/31/02 per audit staff	\$15,037	
Wastewater amortization expense for the 12 months ended 12/31/02 per utility	<u>11,732</u>	
Difference		\$3,305

Exception No. 6

Subject: Interest Income

Statement of Fact: SMSI recorded \$5,086.20 of water interest income in Operating Revenue Account 406.5 during the 12-month period ended December 31, 2002.

In accordance with NARUC Water, Class C Instructions, all interest income should be recorded in Account 419, Interest and Dividend Income.

Recommendation: The audit staff recommends that the following journal entry be recorded by the utility in correction.

Account 406.5 Interest Income - Water	5,086.20	
Account 419 - Interest and Dividend Income		5,086.20

Exception No. 7

Subject: Salaries & Wages

Statement of Fact: SMSI recorded water, nonpotable, and wastewater salaries of \$18,254.85, 18,254.80, and \$18,254.81 for a total of \$54,764.46 during the 12-month period ended December 31, 2002. The wages were distributed equally among the three systems.

Recommendation: The utility's combined W-2s for four employees totaling \$48,254.73 reconciled to its 2002 W-3. The utility was unable to reconcile the difference of \$6,509.73 between the tax and book amount. Therefore, the audit staff recommends that the amount be adjusted as follows.

	Water	Nonpotable	Wastewater	Total
Total per audit staff	\$16,084.91	\$16,084.91	\$16,084.91	\$48,254.73
Total per utility	18,254.85	18,254.80	18,254.81	54,764.46
Audit Staff Adjustments	\$2,169.94	\$2,169.89	\$2,169.90	\$6,509.73

Exception No. 8

Subject: Employee Pensions & Benefits

Statement of Fact: The utility charged \$1,728.41 applicable to insurance benefits to Account 604, Nonpotable Pensions & Benefits during the 12-month period ended December 31, 2002.

Recommendation: The utility has allocated all costs not applicable to a given operation equally among water, nonpotable, and wastewater operations. The salaries of the individuals accorded these benefits are distributed as aforesaid. Therefore, to be appropriate and consistent the benefits should receive similar treatment. The audit staff recommends that nonpotable benefits should be reduced by \$1,152.28 and both water and wastewater be increased by \$576.14.

Exception No. 9

Subject: Miscellaneous Expense

Statement of Fact: SMSI reflected \$21,253.31, \$21,322.99 and \$21,719.23 of water, nonpotable, and wastewater miscellaneous expense, respectively, for the 12-month period ended December 31, 2002, in utility Account 608 (NARUC Accounts 675 and 775).

Recommendation: The audit staff recommends that legal costs applicable to the prior year transfer of \$9,125.16, distributed equally among the three operating systems, be excluded from operating expenses. The utility did not provide any information to suggest that the prior year's legal costs related to the transfer were beneficial to SMSI's customers.

It is also recommended that the SARC application fee of \$1,500.00 that was distributed to water, nonpotable, and wastewater miscellaneous expense be amortized over a four-year period in accordance with Florida Statutes 367.0816.

The correcting journal entry is as follows:

211	Retained Earnings	9,125.16	
186	Deferred Debits	1,125.00	
665	Regulatory Commission Expense - Water	125.00	
665	Regulatory Commission Expense - Nonpotable	125.00	
665	Regulatory Commission Expense - Wastewater	125.00	
608	Miscellaneous Expense - Water		3,416.72
608	Miscellaneous Expense - Nonpotable		3,416.72
608	Miscellaneous Expense - Wastewater		3,791.72

Water	Nonpotable	Wastewater	Total
\$3,041.72	\$3,041.72	\$3,041.72	\$9,125.16
375.00	375.00	750.00	1,500.00
\$3,416.72	\$3,416.72	\$3,791.72	\$10,625.16

Exception No. 10

Subject: Operating Revenues

Statement of Fact: SMSI did not record water, nonpotable, and wastewater operating revenues of \$7,447.60, \$6,708.46, and \$6,708.26 per its general ledger for August 2002.

Recommendation: The audit staff recommends that the operating revenue accounts be increased by the foregoing amounts applicable to the 12-month period ended December 31, 2002.

Exception No. 11

Subject: Service Availability Charges

Statement of Fact: The utility recorded the following service availability charges as operating revenue during the 12-month period ended December 31, 2002.

Account	Description	Amount
402	Meter Installations - Water	\$3,900
402	Meter Installations - Nonpotable	1,350
404	Plant Capacity Charges - Water	18,200
404	Plant Capacity Charges - Nonpotable	3,000
404	Plant Capacity Charges - Wastewater	37,000
		<hr/>
		\$63,450

In accordance with NARUC, Class "C" Instructions per Account No. 271, Contributions-in-Aid-of-Construction, all service availability fees and charges should be reflected therein.

Recommendation: The audit staff recommends that the following journal entries be recorded by the utility in correction. Amortization expense and accumulated amortization have been computed on the misclassified CIAC.

Account	Description	
402	Meter Installations - Water	3,900
402	Meter Installations - Nonpotable	1,350
404	Plant Capacity Charges - Water	18,200
404	Plant Capacity Charges - Nonpotable	3,000
404	Plant Capacity Charges - Wastewater	37,000
271	CIAC- Water	22,100
271	CIAC - Nonpotable	4,350
271	CIAC - Wastewater	37,000
		<hr/>
		63,450
		63,450

Exception No. 11, continued

Account	Description		
272	Acc. Amortization. of CIAC- Water	363	
272	Acc. Amortization. of CIAC- Nonpotable	82	
272	Acc. Amortization of CIAC- Wastewater	685	
403	Amortization Expense - Water		363
403	Amortization Expense - Nonpotable		82
403	Amortization Expense - Wastewater		685
		1,130	1,130

Exception No. 12

Subject: Insurance Expense

Statement of Fact: SMSI recorded water, nonpotable, and wastewater insurance expense of \$3,120.36, \$3,120.35 and \$3,120.36, respectively, for the 12-month period ended December 31, 2002, in Account 606 (NARUC Accounts 655 and 755).

Recommendation: The utility was unable to provide supporting documentation for insurance totaling \$3,543.95 that was paid by the former owner, Petrus, L.P. The audit staff recommends that water, nonpotable, and wastewater insurance expense of \$1,182.32, \$1,182.32, and \$1,182.31, respectively, be excluded from operating expenses until such time that SMSI can substantiate the charges.

Exception No. 13

Subject: Contractual Services - Professional

Statement of Fact: SMSI reflected \$3,725.18, \$17,208.49, and \$3,691.84 of water, nonpotable, and wastewater Contractual Services-Professional, respectively, for the test year ended December 31, 2002, via utility Account 603.1 (NARUC Accounts 631 and 731).

Recommendation: The audit staff recommends that legal costs applicable to the prior year stock transfer of \$2,285.59, \$2,285.60, and \$2,285.60 be excluded from respective water, nonpotable, and wastewater operations. The utility did not provide any information to suggest that the prior year's legal costs related to the transfer were beneficial to SMSI's customers.

Exception No. 14

Subject: Regulatory Assessment Fees

Statement of Fact: SMSI did not reflect Regulatory Assessment Fees (RAFs) per its books and records for the 12-month period ended December 31, 2002.

Recommendation: The audit staff recommends that Taxes Other Than Income, Account 408, be increased by \$4,604.98, \$3,668.65, and \$3,968.55 for water, nonpotable, and wastewater operations, based on respective 2002 operating revenues.

	Revenues Per Audit	RAFs Per Audit
Water	\$102,332.80 x 4.5%	\$4,604.98
Nonpotable	\$81,525.64 x 4.5%	\$3,668.65
Wastewater	\$88,189.99 x 4.5%	\$3,968.55

Exception No. 15

Subject: Repairs & Maintenance

Statement of Fact: SMSI recorded (\$13,663.83) in wastewater repairs and maintenance expense for the 12-month period ended December 31, 2002, in utility Account 612 (NARUC Account 736).

Recommendation: The audit staff recommends that the repairs and maintenance account be increased by \$15,129.82 applicable to the utility's double-booking of an accrued payable at January 1, 2002.

A Loftus Electric, Inc. invoice totaling \$15,129.82 that the utility accrued at December 31, 2001, was reversed twice on January 1, 2002. The audit staff recommends that the account balance be increased by \$15,129.82 to correct the double-booking.

Exception No. 16

Subject: Long-Term Debt

Statement of Fact: The utility recorded long-term debts of \$149,849 and \$8,639 for a total of \$158,488 as of December 31, 2002, in its general ledger. The interest recorded for 2002 was \$4,985 and \$328, respectively, for a total of \$5,313.

The above long-term debts were through the Department of Environmental Protection State Revolving Fund loan program.

Recommendation: The above long-term debts should be increased to \$154,834 ($\$149,849 + \$4,985$) and \$8,967 ($\$8,639 + \328) for a total of \$163,801 as of December 31, 2002. The amounts recorded on the utility's general ledger were reduced by the interest paid of \$5,313. The long-term debts should have only been reduced by the principal paid.

The Commission should require the utility to increase its long-term debt by \$5,313.

Exception No. 17

Subject: Materials and Supplies

Statement of Fact: The utility recorded water, nonpotable, and wastewater materials and supplies expense of \$2,933.18, \$2,004.49, and \$2,579.52, respectively, during the 12-month period ended December 31, 2002, in Account 607 (NARUC Accounts 620 and 720).

Recommendation: For water materials and supplies, \$2,530.01 of the \$2,933.18 was applicable to meters and accessories. For nonpotable materials and supplies, \$378.84 of the \$2,579.52 was also applicable to meters.

The audit staff recommends that water and nonpotable materials and supplies expense be reduced by \$2,530.01 and \$378.84, respectively. Account 334, Meters and Meter Installation should be increased by \$2,530.01 and \$378.84 for water and nonpotable, respectively. (See Exception No. 2 for the plant adjustments.)

Disclosure No. 1

Subject: 2003 Utility Salaries & Wages

Statement of Fact: Utility representatives have requested a pro forma adjustment to reflect 2003 annualized utility salaries and wages.

Recommendation: The utility hired a part-time accounting assistant in 2003 and hired a full-time maintenance employee in 2002 to assist the licensed operator who went from full to part-time.

The annualized 2003 salaries for all utility employees, according to the information provided by SMSI, would be \$77,443.

Disclosure No. 2

Subject: Monthly Operations

Statement of Fact: Water and wastewater monthly operation expense charged to the utility by Accurate Utilities, Inc. was \$1,396.64 and \$115.93, respectively.

Recommendation: The audit staff recommends that the FPSC engineer review the distribution as wastewater is the more labor intensive operation to maintain.

Disclosure No. 3

Subject: Lift Station

Statement of Fact: SMSI received its first electric bill for a newly constructed lift station for the November 26, 2002 through December 20, 2002 period.

Lift station consumption was 580 KWH, and the billing was \$70.14.

Recommendation: The audit staff requests that the FPSC engineer determine the pro forma amount to be included in wastewater purchased power expense applicable to the year-end 2002 addition.

Disclosure No. 4

Subject: Allocations

Statement of Fact: All amounts subject to allocation were distributed by the utility equally among water, nonpotable, and wastewater operations.

Recommendation: Those amounts would be more accurately and precisely distributed by a methodology that employs correlating indicators to various costs as opposed to one arbitrary all-purpose application.

Disclosure No. 5

Subject: Tariff Rates

Statement of Fact: SMSI's water, nonpotable, and wastewater revenue base facility charge and gallonage rate changed effective October 12, 2002, due to the 2002 price index.

Recommendation: The utility did not prorate the billing for October 2002 instead it elected to implement the revised tariff rate commencing November 1, 2002.

SERVICE MANAGEMENT SYSTEMS, INC.
WATER RATE BASE
DOCKET NO. 021228-WS
STAFF-ASSISTED RATE CASE
AS OF DECEMBER 31, 2002

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
UTILITY PLANT-IN-SERVICE	\$897,112	(\$14,807)	E2	\$882,305
LAND & LAND RIGHTS	30,160	0		30,160
CONTRIBUTIONS-IN-AID-OF- CONSTRUCTION	(351,245)	(22,100)	E11	(373,345)
ACCUMULATED DEPRECIATION	(460,950)	(28,733)	E3	(489,683)
ACCUMULATED AMORTIZATION OF CIAC	128,840	363 1,615	E11 E5	130,818
WORKING CAPITAL(1)	0	9,384		9,384
TOTAL	\$243,917	(\$54,278)		\$189,639

FOOTNOTE:

(1) Calculated using 1/8 of operation and maintenance expenses.

**SERVICE MANAGEMENT SYSTEMS, INC.
STAFF-ASSISTED RATE CASE
DOCKET NO. 021228-WS
NONPOTABLE WATER RATE BASE
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
UTILITY PLANT-IN-SERVICE	\$904,414	\$6,277	E2	\$910,691
LAND & LAND RIGHTS	31,920	0		31,920
CONTRIBUTIONS-IN-AID-OF- CONSTRUCTION	(95,822)	(4,350)	E11	(100,172)
ACCUMULATED DEPRECIATION	(486,303)	(10,344)	E3	(496,647)
ACCUMULATED AMORTIZATION OF CIAC	35,300	82 362	E11 E5	35,744
WORKING CAPITAL(1)	0	9,313		9,313
TOTAL	\$389,509	\$1,340		\$390,849

FOOTNOTE:

(1) Calculated using 1/8 of operation and maintenance expenses.

**SERVICE MANAGEMENT SYSTEMS, INC.
 STAFF-ASSISTED RATE CASE
 DOCKET NO. 021228-WS
 WASTEWATER RATE BASE
 AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
UTILITY PLANT-IN-SERVICE	\$2,098,830	(\$5,702)	E2	\$2,093,128
LAND & LAND RIGHTS	33,680	0		33,680
CONTRIBUTIONS-IN-AID-OF- CONSTRUCTION	(567,330)	(37,000)	E11	(604,330)
ACCUMULATED DEPRECIATION	(1,585,569)	(94,406)	E3	(1,679,975)
ACCUMULATED AMORTIZATION OF CIAC	219,520	685 3,305	E11 E5	223,510
WORKING CAPITAL(1)	0	8,416		8,416
TOTAL	\$199,131	(\$124,702)		\$74,429

FOOTNOTE:

(1) Calculated using 1/8 of operation and maintenance expenses.

**SERVICE MANAGEMENT SYSTEMS, INC.
STAFF-ASSISTED RATE CASE
DOCKET NO. 021228-WS
WATER NET OPERATING INCOME
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
OPERATING REVENUES	\$122,071.40	(\$5,086.20)	E-6	\$102,332.80
		7,447.60	E-10	
		(22,100.00)	E-11	
	-----	-----		-----
OPERATING EXPENSES:				
O&M EXPENSE	85,953.01	(2,530.01)	E17	75,069.57
		(2,169.94)	E7	
		576.14	E8	
		(3,416.72)	E9	
		125.00	E9	
		(1,182.32)	E12	
		(2,285.59)	E13	
DEPRECIATION EXPENSE	24,956.25	11,930.00	E3	36,886.25
		(1,616.00)	E 5	
AMORTIZATION OF CIAC	(8,177.00)	(363.00)	E-11	(10,156.00)
TAXES OTHER THAN INCOME	8,445.03	4,604.98	E14	13,050.01
	-----	-----		-----
TOTAL OPERATING EXPENSE	\$111,177.29	\$3,672.54		\$114,849.83
	=====	=====		=====
NET OPERATING INCOME (LOSS)	\$10,894.11	(\$23,411.14)		(\$12,517.03)

**SERVICE MANAGEMENT SYSTEMS, INC.
 STAFF-ASSISTED RATE CASE
 DOCKET NO. 021228-WS
 NONPOTABLE NET OPERATING INCOME
 HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
OPERATING REVENUES	\$79,167.18	\$6,708.46	E10	\$81,525.64
		(4,350.00)	E-11	
	-----	-----		-----
OPERATING EXPENSES:				
O&M EXPENSE	89,906.98	(200.11)	E2	74,502.73
		(4,743.50)	E2	
		(378.84)	E17	
		(2,169.89)	E7	
		(1,152.27)	E8	
		(3,416.72)	E9	
		125.00	E9	
		(1,182.32)	E12	
		(2,285.60)	E13	
DEPRECIATION EXPENSE	24,346.63	4,772.00	E3	29,118.63
AMORTIZATION OF CIAC	(2,945.00)	(362.00)	E 5	
		(82.00)	E-11	(3,389.00)
TAXES OTHER THAN INCOME	8,478.37	3,668.65	E14	12,147.02
	-----	-----		-----
TOTAL OPERATING EXPENSE	\$119,786.98	(\$7,407.60)		\$112,379.38
	=====	=====		=====
NET OPERATING INCOME (LOSS)	(\$40,619.80)	\$9,766.06		(\$30,853.74)

**SERVICE MANAGEMENT SYSTEMS, INC.
STAFF-ASSISTED RATE CASE
DOCKET NO. 021228-WS
WASTEWATER NET OPERATING INCOME
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
OPERATING REVENUES	\$118,481.73	\$6,708.26	E-10	\$88,189.99
		(37,000.00)	E-11	
	-----	-----		-----
OPERATING EXPENSES:				
O&M EXPENSE	61,959.59	(1,037.00)	E2	67,324.02
		(2,169.90)	E7	
		576.14	E8	
		(3,791.72)	E9	
		125.00	E9	
		(1,182.31)	E12	
		(2,285.60)	E13	
		15,129.82	E15	
DEPRECIATION EXPENSE	85,082.25	24,966.00	E3	110,048.25
AMORTIZATION OF CIAC	(11,732.00)	(3,305.00)	E5	(15,722.00)
		(685.00)	E11	
TAXES OTHER THAN INCOME	8,445.03	3,968.55	E14	12,413.58
	-----	-----		-----
TOTAL OPERATING EXPENSE	\$143,754.87	\$30,308.98		\$174,063.85
	=====	=====		=====
NET OPERATING INCOME (LOSS)	(\$25,273.14)	(\$60,600.72)		(\$85,873.86)

SERVICE MANAGEMENT SYSTEMS, INC.
DOCKET NO. 021228-WS
CAPITAL STRUCTURE
AS OF DECEMBER 31, 2002

DESCRIPTION	PER COMPANY AS OF 12/31/02	AUDIT EXCEPTION	REFER TO(1)	PER AUDIT AS OF 12/31/02	RATIO	COST RATE(3)	WEIGHTED COST OF CAPITAL
COMMON EQUITY	\$10,000	\$0		\$10,000	0.93%	11.10%	0.103%
PAID IN CAPITAL	\$1,614,482	\$0		\$1,614,482	149.54%	11.10%	16.599%
RETAINED EARNINGS	(\$681,401)	(\$27,237)	(4)	(\$708,638)	(65.64)%	11.10%	(7.290)%
LONG-TERM DEBT	\$149,849	\$4,985	E16	\$154,834	14.34%	3.12%	0.447%
LONG-TERM DEBT (AMENDED)	\$8,639	\$328	E16	\$8,967	0.83%	3.55%	0.029%
CUSTOMER DEPOSITS(2)	\$0	\$0		\$0	0.00%	6.00%	0.000%
TOTAL	=====	=====		=====	=====	=====	=====
	\$1,101,569	(\$21,924)		\$1,079,645	100.00%		9.888%

REQUIRED FOOTNOTES:

- 1) Audit adjustments do not include audit disclosures.
- 2) The company does not collect a customer deposit for service connections.
- 3) Cost rate for common equity established in Order No. PSC-02-1252-CO-WS, issued September 11, 2002.
- 4)

E2	\$(15,911)
E2	\$ (246)
E2	\$ (1,955)
E9	\$ (9,125)
Total:	\$(27,237)