

ORIGINAL

State of Florida



Public Service Commission

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

DATE: April 16, 2003
TO: Division of Commission Clerk and Administrative Services
FROM: Tony Sargent, Professional Accountant, Division of Economic Regulation
RE: Docket No. 021228-WS - application for staff assisted rate case in Brevard County by Service Management Systems, Inc.

The attached letter was sent to the Division of Economic Regulation. Please include it in the official docket file for Docket No. 021228-WS.

Thank you.

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SERVICE MANAGEMENT SYSTEMS, INC.

SMS

Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0865

April 11, 2003

ECONOMIC REGULATION

03 APR 16 AM 9:59

PUBLIC SERVICE

Docket No. 021228-WS

Dear Sirs,

I would like to make the following responses to the Statements of Fact and Recommendations found in the Audit report:

Exception No. 1. This states that the utility did not maintain transitional General Ledgers for the years 1997 thru 2000. This is incorrect. This utility at all times maintained transactional general ledgers. Further, this utility had a public accounting firm, Bray Beck & Koetter, CPA's issue reviewed financial statements for 1997 and 1998 and audited financial statements for 1999 and 2000. Obviously transactional general ledgers were maintained, these transactional general ledgers may not have been readily available (other than 2000 which was available on a back up disc) in the utilities computer system located in the utility office at the time of the audit, but these records are available in the form of print outs stored in a records storage company in Melbourne Florida. In addition, every deposit, receipt and paid invoice is stored and was fully audited by a CPA firm. This exception gives a very erroneous impression, and as a public document is unfair and should be corrected.

Exception No. 2. I have no objection to the adjustments proposed here at this time.

Exception No. 3. I have requested that Robert Nixon, CPA review the depreciation and accumulated depreciation for this utility and compare this to the recent audit that was done for the recent transfer of ownership of the majority ownership of this utility. Mr. Nixon will respond to the issue of asset depreciation, depreciation expense, and accumulated depreciation separately.

Exception No. 4. This Utility can fully support CIAC additions for the period of 1997 thru 2001. This utility does not have sufficient income to pay a full time accountant, let alone a full time account trained and sufficiently experienced in NARUC Accounting standards and procedures to produce faultless accounting. Records are maintained; all records are independently reviewed and audited by independent CPA's, reports issued and all records stored.

Exception No. 5. Robert Nixon will also respond to this.

Exception No. 6. I have no objection to this adjustment at this time.

Exception No. 7 Salaries & Wages. The amount of \$6,509.73, which PSC staff states they were unable to reconcile, was payroll tax expense, which was incorrectly charge to wage cost where it should have been charged to payroll tax expense. Therefore I agree with this recommendation to reduce the 2002 wage & salary expense only if this recommendation includes a corresponding expense increase for payroll tax expense.

Exception No. 8. I have no objection to this recommended adjustment at this time.

Exception No. 9. I object to the premise that the legal costs associated with the ownership transfer should be excluded from operating expense. At most, I would agree that this cost of \$9,125.16 should be capitalized over a 3 or 4 year period, and the annual amortization expense included in operating expenses. This was a requires expense of this utility, not a voluntary expense. A through review of the PSA audit of the utilities assets was an action that I felt was important to this utility and it's future operation. It is also now that the audit of these utilities assets be reviewed for consistency with the Staff Assisted Rate Case.

Exception No. 10. I agree with the auditors finding.

Exception No. 11. I have no objection to this recommended adjustment at this time.

Exception No. 12. I object to the recommendation that \$3,543.95 be reduced from operating expenses until the utility get documentation from the prior owner. The prior owner purchases insurance for a number of liability risks it had, and for various property It owned. A prorating of the premium, based on insured values, was made to allocate this utilities portion, and a charge made. If staff had recommended that insurance expense, to the extent that it exceeded customary insurance costs for a utility with a similar amounts of assets and liability risk, be excluded, I would have no objection. Virtually all utilities insure their property and the liability risks inherent in their operation, and would not be responsible to their customers if they did not purchase insurance. Because a former owners insurance policy was not available to an auditor, is no reason allow no expense for a utility in a test year being utilized for rate setting.

Exception No. 13. I have addressed this same issue in exception No. 9 above. This legal cost is a necessary and required cost. The rate base established in this transfer audit is one of the more important factors in this utility being able to properly operate in the

future. There are many costs and fees paid that are required expenses, where one could argue the costs are not beneficial to the utilities customers. This cost is required, and the necessity to go through a lengthy PSC procedure is part of PSC regulations which was enacted, presumably to benefit the customers of utilities regulated by the PSC.

Exception No. 14. I agree with the recommended adjustment.

Exception No. 16. I agree with the recommended adjustment.

Exception No. 17. Agreed.

Disclosure No. 1 I disagree with the Recommendation included with this disclosure. The part time accounting assistant was not hired in 2003, but has provided part time accounting services since July 2001. This individual was employed by another company and no provision was made in 2001 to charge the utility for this cost. In 2002, a charge to the utility was made for this part time accounting assistant of \$5,467.96, which was part of an invoice from Indian River No. 1 Developers, LLC. This invoice also included a prorated share of office, utility, and postage expense for 2002 directly attributable to the utility, totaling \$2,579.21. This invoice, which was given to the staff auditor, further, included an amount of \$5,310.00 for 2002 for the secretarial services of the secretary who handled all of the correspondence for the utility. It does not appear that the PSC staff auditor included this invoice totaling \$13,357.17 in the 2002 expenses, although he was specifically requested to consider this for inclusion in the 2002 expenses. I request that this \$13,357.17 of expenses be included in 2002 expenses.

The part time accounting assistant was put directly on the utility payroll as of January 2003, at the same pay and hours that they had worked for a year and one half, since July 2001.

The annualized salaries for all utility employees and officers, not including approximately \$5,467.96 for secretarial services that will be paid as "contractual services" will be approximately \$89,000.00 (with corresponding payroll tax expense) for 2003 and \$105,000 for 2004 forward. I have no idea what the audit based his annualized salaries for 2003 on. 2003 will not be the same as 2002, as the 2002 wage expenses did not reflect what it would cost this utility to operate in 2003 and future years. A rate based on the auditors projection would not compensate the utility for the costs it will need to incur to properly operate.

Disclosure No. 2. I totally disagree with the recommendation included with this disclosure. This contract with Accurate Utilities was negotiated based on the specific work to be provided by Accurate, who complements a part time licensed operator. This

is not some accounting or engineering exercise to second-guess this. This contract provided the basis, necessary, coverage and testing required by our operating permits that is not done in house by a utility employee.

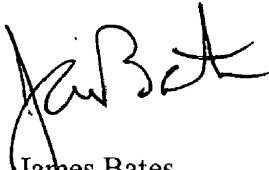
Disclosure No. 3. This is immaterial.

Disclosure No. 4. This utility is at all times trying to navigate a small business through extensive regulation from a wide variety of regulatory agencies. We must always look to finding cost effective ways to operate. You know the small staff of a part time accountant and a part time assistant. To use all "correlating indicators" in paying invoices for services or utilities provided to more than one of the water, non potable water, or wastewater utilities is not cost effective and would further increase the cost of bookkeeping and accounting. In theory this is a good idea, it just lacks good business sense.

Disclosure No. 5. No Comment.

As I mentioned above, our consultant Robert Nixon, will respond to a few of this audit exceptions and disclosures found above. I would appreciate a written response to this letter, and to past letters I have written relative to this docket. Please call me if I can be of any help.

Sincerely Yours,



James Bates
President

cc. Robert Nixon, via fax 727-797-3602
F. Marshall Doreffelt, via fax 864-370-9771