COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF PHELPS GAS COMPANY, INC., FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 9515

O R D E R

IT IS ORDERED that:

1. The Staff Audit Report for Phelps Gas Company, Inc., ("Phelps") attached hereto as Appendix A shall be included as a part of the record in this proceeding.

2. Phelps shall have until the close of business within 2 weeks of the date of this Order to file written comments concerning the contents of Appendix A.

Done at Frankfort, Kentucky, this 20th day of May, 1986.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

REPORT ON LIMITED AUDIT

OF

PHELPS GAS COMPANY

PREFACE

On February 21, 1986, Phelps Gas Company ("Phelps") filed an application pursuant to 807 KAR 5:076, Alternative Rate Filing Procedure for Small Utilities, ("ARF"), requesting authority to increase its rates charged for furnishing gas. The proposed rates would generate $22,473 annually in additional revenues.

In order to expedite the processing of the case and substantially reduce the need for written data requests, the Commission staff chose to perform an audit, limited in scope, on the operations of Phelps. The audit was conducted by Steve Gilley of the Division of Rates and Tariffs on April 15-16, 1986, at the offices of Phelps in Melvin, Kentucky.

SCOPE

The scope of this audit was limited to ascertaining whether the operating expenses for the test period ended December 31, 1985, were accounted for in accordance with the Uniform System of Accounts for Gas Utilities ("Uniform System of Accounts") and were properly allocated. The Audit Division of the Public Service Commission has recently begun a full scope audit of Phelps. Because of the expanded scope of that audit, the findings and discoveries of it may differ from the findings and discoveries made herein.

Associated Organizations

Phelps is operated out of the same office as four other entities: Elzie Neeley Gas Company, Inc.; Mike Little Gas Company, Inc.; Burton Antenna Company, Inc.; and Licking Valley Cable Company, Inc. Mike Little is the owner and operator of each of the five companies, and labor and other resources are shared among the entities. Costs are often allocated among the companies, especially gas-associated costs among the three gas companies. Different allocation methods are used according to the circumstances involved with the cost. Allocation methods observed during the audit included one-third allocation, one-fourth allocation, and allocation based upon the number of customers.

Purchased Gas Expense

Phelps reported 1985 charges to Account No. 730 - Natural Gas Purchases of $97,620. A review of the invoices associated with this amount reflects that $3,663 of the total is a result of interest on past due billings for gas purchases. The Uniform System of Accounts states that Account No. 732 shall include only those expenses incurred directly in connection with the purchase of gas for resale. Interest on past due billings does not meet the criterion established for this account, and should be accounted for and reported in Account No. 431 - Other Interest Expense. An adjustment has been made to reclassify the $3,663 to reflect the proper treatment of this amount.

Refund for Expense of Moving Line

Phelps reported in Account No. 495 - Other Gas Revenues, an amount of $6,594 representing reimbursement by the Commonwealth of

Kentucky for moving a gas pipeline. The explanation of this transaction provided by the management of Phelps reflects that expenses of an approximately equivalent amount are included in 1985 Operating and Maintenance Expense accounts. Statements of the management were that the greatest portion of the expense is related to wages and salaries; however, no separate record was kept for labor, or for any other expense related to the project. The lack of documentation of the precise expenses related to this project and the accounts to which they were charged makes an audit adjustment reflecting the correct accounting by account as prescribed by the Uniform System of Accounts impossible. However, in consideration that this was a capital project, none of the costs associated with it should have been expensed to Operation and Maintenance accounts. Therefore, it is possible to establish that total Operation and Maintenance Expense accounts are overstated by approximately $6,594. The staff has made an adjustment to total Operation and Maintenance expenses of this amount, but further steps to ascertain the exact amounts and exact accounts affected is beyond the scope of this audit and further, in all likelihood, could not be determined anyway due to the lack of records related to these expenditures. The Uniform System of Accounts makes no provision for reimbursements of this type to be accounted for as Other Gas Revenues and an adjustment has likewise been made to eliminate $6,594 from this account.

The reimbursement to Phelps for the cost of relocating this line represents a contribution equivalent to the amount of its cost. The expenditures were capital expenditures and should have been accounted for as such, and the reimbursement was a contribution and should have been accounted for as such. Gas Plant Instruction 1.D of the Uniform System of Accounts provides that gas plant accounts shall not include the cost or other value of gas plant contributed to the company. Contributions in the form of money or its equivalent toward the construction of gas plant shall be credited to the accounts charged with the cost of such construction. Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed when assembling cost data in work orders for posting to plant ledger of accounts. The accumulated gross costs of plant accumulated in the work order shall be recorded as a debit in the plant ledger of accounts along with the related amount of contributions currently being recorded as a credit. Hence, upon retirement of the cost of the original line, the net effect upon plant accounts would be null due to the offsetting credit, representing the reimbursement, and the debit, representing the cost of the new plant. The net total effect would be to lower plant accounts by the amount retired, to remove the associated accumulated depreciation, and to record a gain or loss on the retirement, as appropriate.

Phelps should seek to specifically identify the Operation and Maintenance Expense accounts charged with amounts related to this relocation project and make the appropriate adjustments to reflect their proper accounting.

Office Supplies and Expense

Phelps reported 1985 charges to Account No. 921 - Office Supplies and Expenses of $1,898. A review of the expenses charged to that account reflected that an allocated amount of $326.33 was related to the purchase of an odorometer from Southern Cross, Inc., invoice dated August 16, 1985, and paid by check no. 1197 on October 15, 1985. Inasmuch as this asset will benefit more than one period, it should be charged to a plant account and depreciated over the number of periods of useful life. In this instance, a useful life of 5 years is appropriate and an adjustment has been made; therefore, to reduce Office Supplies and Expenses by $326 and to increase depreciation expense by $16 to reflect 1985 depreciation for the 3 months in service for that period (see Depreciation Expense Section of this report.)

Depreciation Expense

Phelps reported 1985 depreciation expense of $4,880. The depreciation schedule reflects that the calculation of this amount included some assets depreciated by the Accelerated Cost Recovery System ("ACRS") method. The Commission requires utilities under its jurisdiction to use depreciation methods that spread the cost of utility assets evenly, over their estimated useful lives. Accelerated types of depreciation result in recovery of more of the cost of the asset at the beginning of its useful life and less cost near the end of its useful life. For tax purposes, of course, accelerated methods are acceptable to the Commission. Therefore, for all assets depreciated by the ACRS method, the staff has calculated depreciation based upon the undepreciated balance and the remaining useful life. In one instance, for the meters placed in service May 13, 1983, the Commission has determined the appropriate useful life to be 30 years rather than 15 years used by Phelps in its calculation. Additionally, for assets placed in service during 1985, depreciation expense has been calculated on a pro rata basis rather than for the complete year as done by Phelps. Also, as explained in the Section, "Office Supplies and Expenses," a $16 adjustment has been made to reflect the depreciation attributable to the test year for a odorometer which should have been capitalized, but was expensed by Phelps. The cumulative effect of the foregoing adjustments is an $862 reduction in 1985 depreciation expense calculated as shown in Schedule 1 (attached).

The depreciation schedule reflects that Phelps has used accelerated methods of depreciation since at least 1982. Therefore, the undepreciated balances on which the aforementioned calculations were based are to an extent distorted in comparison with the accounting treatment which the Commission requires; however, the limited scope of this audit prohibits a comprehensive correction of plant account balances. The staff does not maintain that the depreciation expense used for the purposes of this audit report is exactly correct and and in conformity with Commission requirements. However, given the limited scope of this audit, the calculations made to depreciation expense are the most appropriate ones available.

Rent

Within the course of the limited audit, it was found that Mike Little is the owner of the building in which Phelps rents office space. Phelps and four other companies occupy one-half of the building and the Melvin Post Office, the other. The rent charged to Phelps is $300 monthly. There does not seem to be any particular basis for this amount, nor does there seem to be any consistency in the determination of the monthly rental charge among the several tenants.

Computer

Included in Account No. 391--Office Furniture and Equipment is an allocated portion of an Abacus computer in the amount of $1,800 and placed in service during May 1985. Test-year depreciation expense associated with the computer was $1,800. According to statements of management, the computer is not currently in service though efforts are in progress to bring the computer on-line as an operating asset of Phelps. As of now; however, the computer does not appear to be used and useful.

Cash Amount

Phelps reported a December 31, 1985, cash balance of <$20,546>. This balance is mostly a result of the issuance of several checks to Mike Little which have not been cashed. The uncashed checks are as follows:

Check No.	Date	Amount
1228	12/31/85	$6,955
1229	12/31/85	$5,000
1230	12/31/85	$5,000
1231	12/31/85	$2,000

SUMMARY

The following is a summary of the effect of these adjustments on Phelps' test-year operating statement:

Acct. No.	Account Name	Test Year Reported	Staff Adjustments	Test Year Adjusted
	Revenues			
480	Residential Sales	$121,626	-0-	$121,626
487	Forfeited Discounts	-0-	$ 3,435	3,435
488	Misc. Serv. Revenues	3,435	<3,435>	-0-
495	Other Gas Revenues	7,456	<6,594>	862
		$132,517	$ <6,594>	$125,923
	Operating Expenses			
730	Gas Purchases	$ 97,620	$ <3,663>	$ 93,957
901	Meter Reading Labor	8,488	-0-	8,488
902	Acct. & Coll. Labor	2,700	-0-	2,700
920	A & G Salaries	12,000	-0-	12,000
921	Office Sup. & Exp.	1,898	<326>	1,572
923	Outside Serv. Emp.	5,389	-0-	5,389
924	Property Insurance	3,846	-0-	3,846
931	Rents	4,200	-0-	4,200
933	Transportation	1,366	-0-	1,366
403	Depreciation	4,880	<705>	4,175
408.1	Other Taxes	6,287	-0-	6,287
	Exp. Related to Reimbursement	-0-	<6,594>	<6,594>
		$148,674	$<11,288>	$137,386
	Other Interest Expense	-0-	3,663	3,663
	NET INCOME (LOSS)	$<16,157>	$ 1,031	$<15,126>

CONCLUSION

The books and records maintained by Phelps are reasonably in accordance with the Uniform System of Accounts. The most serious flaw in its system is the lack of documentation for the wages and salaries accounts. Though according to the management of Phelps' time records are kept, they are discarded at the time of payment for the hours on the time sheet. Phelps should begin to carefully maintain and file these records, not only for its own benefit, but for the benefit of future confirmation by outside auditors. Moreover, Phelps should obtain a copy of the Guide to Record Retention Requirements from the General Services Administration and attempt to adopt the precepts contained therein into its record-keeping system.

Respectfully Submitted,

Steve Gilley
Principal Public Utilities
Financial Analyst
PUBLIC SERVICE COMMISSION
Rates and Tariffs Division
Revenue Requirements Section

SCHEDULE 1

	Placed in Service		Adjusted Annual Depreciation Expense
Meters			
Beginning 1985 Balance	5/13/83	$2,626.82	
Remaining Life (30-2=28)		28	
			$ 94
Pipes			
Beginning 1985 Balance	9/26/83	$2,125.00	
Remaining Life (15-2=13)		13	
			163
Pipes			
Cost ÷	4/20/85	$ 855.00	
Useful Life		15	
		57	
% of Year: 7/12 (0.583)		0.583	
			33
1986 Ford Ranger			
Cost (1/4 allocation of total) ÷	9/85	$2,250.00	
Useful Life		3	
		750.00	
% of Year: 1/4 (0.25)		0.25	
			188
Abacus Computer			
Cost ÷	5/85	$1,800.00	
Useful Life		5	
		360.00	
% of Year: 1/2 (0.50)		0.50	
			180
Other Depreciation			3,501
Depreciation of Odorometer			16
Total Annual Depreciation Expense			$4,175
LESS: 1985 Reported			<4,880>
ADJUSTMENT TO REPORTED DEPRECIATION EXPENSE			$ <705>