

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EAST LAUREL)
WATER DISTRICT OF LAUREL COUNTY,)
KENTUCKY, FOR APPROVAL OF) CASE NO. 9525
CONSTRUCTION, FINANCING, AND RATES)

O R D E R

IT IS ORDERED that:

1. The Staff Audit Report for East Laurel Water District ("East Laurel") attached hereto as Appendix A shall be included as a part of the record in this proceeding.

2. East Laurel 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 29th day of May, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Hemmick
Chairman

Richard D. Hemmick
Vice Chairman

James W. Williams
Commissioner

ATTEST:

Secretary

APPENDIX A
REPORT ON LIMITED AUDIT
OF
EAST LAUREL WATER DISTRICT

PREFACE

On March 17, 1986, East Laurel Water District ("East Laurel") filed an application with the Commission for a certificate of public convenience and necessity authorizing a waterworks construction project, approval of the proposed plan of financing, and authorization to increase its water rates. The proposed rates would generate approximately \$60,277 annually in additional revenues.

The Commission staff chose to perform a limited financial audit in order to verify test period expenditures and substantiate the propriety of the test-year financial statements. The audit was conducted by Carl Combs of the Division of Rates and Tariffs on April 9-10, 1986, at the offices of Wood Creek Water District ("Wood Creek") in London, Kentucky.

SCOPE

The examination consisted of an analysis and review of major cash disbursements and related financial records for calendar year 1985, which is the test year in this case. The audit was limited to a review for proper accounting treatment of expenses charged to the following accounts:

<u>Account No.</u>	<u>Account</u>
622	Fuel or Power Purchased
623	Operation Supplies and Expenses
640	Operation Labor
650	Maintenance of Distribution Reservoirs and Standpipes
651	Maintenance of Mains
652	Maintenance of Services
901	Meter Reading Labor
920	Administrative and General Salaries
921	Office Supplies and Other Expenses
923	Outside Services Employed
930	Miscellaneous General Expenses

Reconciliation tests were performed on the aforementioned accounts and supporting documentation was also examined to determine whether costs reflected in the aforementioned accounts were appropriately expensed under the requirements of the Uniform System of Accounts for Class C Water Utilities ("Uniform System of Accounts"). The audit report on East Laurel's financial statements prepared by Cloyd, Hamilton and Company ("Cloyd"), Certified Public Accountants, was reviewed. Also, Peggy Brown, office manager, was consulted regarding accounting treatment and classification of some expenses.

FINDINGS

Under contract, Laurel County Water District No. 2 ("Laurel No. 2") provides maintenance and office services to East Laurel. Peggy Brown manages Laurel No. 2 as well as Wood Creek. East Laurel purchases water for resale from Wood Creek. Wood Creek also sells water to West Laurel Water Association, Inc., ("West Laurel") and provides maintenance and office services to West Laurel. Laurel No. 2 and Wood Creek employ their own superintendents and maintenance crews. However, the expenses of Peggy

Brown and her office staff are shared by Laurel No. 2 and Wood Creek. East Laurel and West Laurel have no employees.

A review of East Laurel's accounting system revealed no major problems. Based on a sampling of work orders, East Laurel capitalized costs of meters and associated labor expenses. However, some items included in Account No. 345--Services should have been included in Account No. 347--Meter Installations. The Commission staff found other instances where expenses were misclassified.

Following is a discussion of the findings of the audit and the staff adjustment to East Laurel's test-year operating statement.

Salaries

As mentioned previously, East Laurel has no direct employees. The reported test-year salaries expense of \$9,923 was based on charges under the maintenance contract with Laurel No. 2. According to Peggy Brown, these charges represent the cost of supervision and the associated transportation expense. Under the terms of the maintenance contract, Laurel No. 2 charges East Laurel the actual cost of materials and labor. The Uniform System of Accounts requires that the cost of supervision be recorded in the operation labor account of the appropriate operating function or capitalized as necessary. Supervision not chargeable directly to a particular function may be charged to administrative and general salaries. Since the cost of supervision is and has been recorded in the total operation and maintenance expenses, no adjustment has been proposed. However, in the future, East Laurel

should record this cost in the appropriate operating expense accounts and capitalize any applicable labor and related costs.

Office Contract

East Laurel has also entered into a contract for office services with Laurel No. 2. These services are provided at an annual cost of \$27.60 per customer. East Laurel charges the full amount of these expenses to Account No. 921--Office Supplies and Other Expenses. During the test year, \$35,396 was charged to this account. According to the Uniform System of Accounts, these expenses should be distributed to the applicable administrative or general department. However, the supervision fees and expenses paid under this contract should be charged to Account No. 923--Outside Services Employed.

An examination of test year invoices from Laurel No. 2 revealed charges of \$35,027 to East Laurel for office services. During the test year, other expenses totaling \$241 were also charged to Account No. 921--Office Supplies and Other Expenses. As mentioned previously, a total \$35,396 was charged to that account for the test period. Therefore, an adjustment has been made to reduce reported test year charges by \$128.

SUMMARY

The following is a summary of the effect of the adjustment on East Laurel's test-year operating statement:

Acct. No.	Account Name	Test Year Per Annual Report	Staff Audit Adjustments	Staff Adjusted
	<u>Operating Revenue</u>	\$225,684	\$ -0-	\$225,684
	<u>Operating Expenses:</u>			
601	Purchased Water	\$ 84,778	\$ -0-	\$ 84,778
622	Fuel or Power	5,601	-0-	5,601
623	Operation Supplies & Exp.	1,362	-0-	1,362
625	Maint. - Pumping Plant	322	-0-	322
632	Operation Sup. & Expenses	297	-0-	297
640	Operation Labor	3,013	-0-	3,013
650	Maint.- Dist. Reser. & Standpipes	2,585	-0-	2,585
651	Maintenance - Mains	3,313	-0-	3,313
652	Maintenance - Services	2,078	-0-	2,078
653	Maintenance - Meters	435	-0-	435
901	Meter Reading Labor	9,906	-0-	9,906
902	Accounting & Collecting Labor	355	-0-	355
904	Uncollectible Accounts	1,051	-0-	1,051
920	Salaries	9,923	-0-	9,923
921	"Office Contract"	35,396	<128>	35,268
923	Outside Services Employed	2,902	-0-	2,902
924	Property Insurance	142	-0-	142
925	Injuries & Damages	848	-0-	848
930	Misc. Gen. Expenses	3,180	-0-	3,180
403	Depreciation Expense	35,217	-0-	35,217
408	Taxes Other Than Income Taxes	259	-0-	259
	<u>Total Operating Expenses</u>	<u>\$202,963</u>	<u>\$<128></u>	<u>\$202,439</u>
	<u>Operating Income</u>	\$ 22,721	\$ 128	\$ 22,849
	<u>Other Income:</u>			
	Interest and Dividend	7,359	-0-	7,359
	<u>Other Deductions:</u>			
	Interest on Long-Term Debt	30,760	-0-	30,760
	Other Interest Expense	104	-0-	104
	<u>NET INCOME</u>	<u>\$ <784></u>	<u>\$ 128</u>	<u>\$ <656></u>

CONCLUSIONS AND RECOMMENDATIONS

The Uniform System of Accounts requires that each utility keep its books on a monthly, accrual basis. In this manner, each utility will be able to readily furnish full information on any item in any account. In the notes to the 1984 and 1985 financial statements accompanying the audit report, Cloyd states that East Laurel maintains its books on a combination of cash and accrual basis accounting and that the financial statements are prepared on the accrual basis. While the financial statements do appear to fairly present the operations and financial position of East Laurel on the accrual basis, the numerous adjustments required to present the statements in this manner, may have been avoided if East Laurel had kept its books on the accrual basis.

The failure to allocate both the cost of supervision provided under the maintenance contract and the cost of services provided under the office contract to the appropriate operating function or administrative department, do not affect "total" operation and maintenance expenses. However, the cost of operating or administering a specific function or department is distorted.

Laurel No. 2 maintains information, sufficiently detailed, so as to provide an accurate analysis of East Laurel's operations. The staff found this supporting information to be neat and orderly and except for the deviations mentioned in this report to be in accordance with the Uniform System of Accounts. East Laurel's books should be kept on a monthly accrual basis in accordance with the Uniform System of Accounts as required by this Commission. Therefore, East Laurel should convert its records to the monthly

accrual basis retroactive to January 1, 1986, with the expenses from the maintenance and office contracts recorded in the proper accounts.

Respectfully Submitted,

Carl Combs

Carl Combs
Senior Public Utilities
Financial Analyst
PUBLIC SERVICE COMMISSION
Rates and Tariffs Division
Revenue Requirements Section