

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WACO WATER)
DISTRICT, MADISON COUNTY, KENTUCKY,) CASE NO. 91-383
SEEKING APPROVAL TO INCREASE RATES)
FOR WATER SERVICE)

O R D E R

On October 24, 1991, Waco Water District ("Waco") filed its application for Commission approval of a proposed increase in its rates for water service. Commission staff, having performed a limited financial review of Waco's operations, has prepared the attached staff report containing staff's findings and recommendations regarding Waco's proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached staff report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky this 15th day of January, 1992.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY

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In the Matter of:

THE APPLICATION OF WACO WATER)
DISTRICT, MADISON COUNTY,) CASE NO. 91-383
KENTUCKY, SEEKING APPROVAL TO)
INCREASE RATES FOR WATER SERVICE)

STAFF REPORT

January 10, 1992

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STAFF REPORT
ON
WACO WATER DISTRICT
CASE NO. 91-383

A. Preface

On October 24, 1991, Waco Water District ("Waco") filed its application with the Commission seeking approval of its proposed rate increase. Waco proposed to increase its annual operating revenue by \$22,229, an increase of 5.44 percent¹ over test-period normalized revenues from rates of \$408,761.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Waco's operations for the test-period, the calendar year ending December 31, 1990. Since Waco requested and received Staff assistance in filing its application, the field review was performed prior to the filing date of the application.

Waco provided Staff with its available test-period invoices, its general ledger, and accountant's workpapers. Using this information, Mark Frost of the Commission's Division of Rates and Tariffs performed the limited review at the Commission's offices in Frankfort, Kentucky. Nicky Moore of the Commission's Division of Research prepared the billing analysis.

Mr. Frost is responsible for the preparation of this Staff Report except for Section B, Operating Revenues; Section D, Rate

¹ $\$22,229 + \$408,761 = 5.44\%$.

Design; and Appendix B, which were prepared by Mr. Moore. Based on the findings contained in this report, Staff recommends that Waco be allowed to increase its annual revenues from water sales by \$22,229.

Scope

The scope of the review was limited to obtaining information to determine whether the test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

Waco's statement of operation filed in its application shows operating revenue from water sales of \$344,795. The billing analysis filed in the application is based on a test period ending December 31, 1990. Staff concurs with the billing analysis.

Operating Expenses

Waco reported operating expenses of \$325,910 for the test period. The following are staff's recommended adjustments to Waco's actual test-period operations:

Salaries and Wages: Waco proposed a pro forma level of salaries and wages expense of \$61,711, a decrease of \$469 from its test-period level of \$62,180. Waco's adjustment includes wage increases granted in January 1991.

The following is a schedule showing Waco's staff and 1991 wage scale:

System Manager	\$ 435 per week
Part-time Office Employee	\$ 4.68 per hour
Full-time Office Employee	\$ 7.00 per hour
Maintenance Employee	\$ 6.00 per hour
Meter Reader	\$ 0.35 per meter

In evaluating pro forma adjustments, Staff utilizes the rate-making criteria of known and measurable. An adjustment to salaries and wages based on the wage increases granted in 1991 would meet this criteria. Based on a general knowledge of the salaries paid by comparable utilities, Staff is of the opinion that Waco's 1991 wages are reasonable.

Accordingly, Staff recommends that Waco's adjustment be accepted and salaries and wages expense be decreased by \$469.

Purchased Water: Waco proposed a pro forma level of purchased water expense of \$248,678, an increase of \$65,461 above its test-period level of \$183,217. On July 1, 1991, Waco's supplier, the City of Richmond ("Richmond"), increased its wholesale rate to \$1.30 per 1,000 gallons. On June 24, 1991, Waco filed Case No. 91-199, Purchased Water Adjustment of Waco Water District,² to pass through the increased cost to its customers. This adjustment reflects Richmond's increased wholesale rate based on test-period water purchases of 19,129,100 cubic feet.

Since an adjustment based on the increased water rate would meet the rate-making criteria of known and measurable, and Waco's

² Order entered July 22, 1991.

normalized operating revenue recommended herein reflects the rates granted in Case No. 91-199, Staff recommends that purchased water expense be increased by \$65,461.

Electric: Waco proposed a pro forma level of electric expense of \$606, an increase of \$214 above its test-period level of \$392. Waco's adjustment reflects a correction of its adjusting journal entries. Based on its review of the test-period invoices, Staff determined that Waco's electric expense was understated by \$214 and therefore, recommends that electric expense be increased by this amount.

Telephone: Waco proposed a pro forma level of telephone expense of \$696, an increase of \$87 above its test-period level of \$609. Waco's adjustment reflects a correction of its adjusting journal entries. Based on its review of the test-period invoices, Staff determined that Waco's telephone expense was understated by \$87 and therefore, recommends that telephone expense be increased by this amount.

Materials and Supplies: Waco proposed a pro forma level of materials and supplies expense of \$3,576, a decrease of \$7,088 from its test-period level of \$10,664. Waco's adjustment reflects removal of the following: (1) capital expenditures of \$3,358, (2) a nonrecurring expenditure (painting of fire hydrants) of \$230; and (3) a misclassified payable of \$3,500. Furthermore, Waco proposed to depreciate the capital expenditures over a 40-year period and amortize the nonrecurring expenditure over a 5-year period.

Based on its review of the supporting documentation, Staff is of the opinion that Waco's proposed adjustment is correct and that the proposed depreciation and amortization periods are reasonable. Accordingly, materials and supplies have been decreased by \$7,088, depreciation expense increased by \$84,³ and amortization expense increased by \$46.⁴

Engineering: Waco proposed to eliminate its test-period engineering expense of \$712, which represents the costs of \$506 for road easements and \$206 for a grant application. Pursuant to the Uniform System of Accounts for Class A and B Water Districts and Associations, easements should be included in Account No. 303 - Land and Land Rights and thus, should not be expensed. Waco should recover the cost of preparing its grant application from the grant proceeds. Accordingly, Staff recommends that Waco's adjustment be accepted and operating expenses be decreased by \$712.

Accounting: Waco proposed a pro forma level of accounting expense of \$3,120, a decrease of \$1,259 from its test-period level of \$4,379. At the beginning of 1990, Waco hired a new accountant to prepare its monthly and annual financial statements. For this

³ $\$3,358 \div 40\text{-Years} = \$84.$

⁴ $\$230 \div 5\text{-Years} = \$46.$

service Waco is charged \$3,120⁵ per year, which is the basis for its proposed adjustment.

Staff is of the opinion that Waco's proposed adjustment is correct and that the accountant's annual fee is reasonable. Accordingly, accounting expense has been reduced by \$1,259.

Legal: Waco proposed a pro forma level of legal expense of \$400, a decrease of \$745 from its test-period level of \$1,145. Waco's adjustment reflects removal of the costs of road easements in the amount \$311 and a grant application in the amount \$434. As previously discussed the cost of easements should be not be expensed but included in Account No. 303 and the grant application cost will be recovered from the grant proceeds. Accordingly, Staff recommends that Waco's adjustment be accepted and legal expense be reduced by \$745.

Transportation: Waco proposed a pro forma level of transportation expense of \$1,935, a decrease of \$82 from its test-period level of \$2,017. Waco's adjustment reflects removal of capital expenditures of \$902, and inclusion of December 1990's gasoline expense. Furthermore, Waco proposed to depreciate these capital expenditures over a 3-year period.

Based on its review of the supporting documentation, Staff is of the opinion that Waco's proposed adjustment is correct and that

5	Monthly Fee	\$235 x 12-Months =	\$ 2,820
	Annual Fee		+ 300
	Total Accounting Fee		<u>\$ 3,120</u>

the proposed depreciation period is reasonable. Accordingly, transportation expense has been decreased by \$82, and depreciation expense increased by \$301.⁶

Insurance: Waco proposed a pro forma level of insurance expense of \$8,006, a decrease of \$565 from its test-period level of \$8,571. Waco's adjustment is based on the insurance premiums it paid in 1991. In support of its adjustment, Waco provided a schedule that separately listed each policy giving the period covered and the premium.

Upon review of Waco's schedule and 1991 invoices, Staff is of the opinion that Waco's adjustment is correct and should be accepted for rate-making purposes. Accordingly, insurance expense has been decreased by \$565.

Water Samples: Waco proposed a pro forma level of water samples expense of \$984, an increase of \$550 above its test-period level of \$434. Waco currently pays \$82 per month for the required laboratory analysis of its water samples, which is the basis for this adjustment.

An adjustment based on the current monthly fee would meet the rate-making criteria of known and measurable. Accordingly, Staff recommends that Waco's adjustment be accepted and water samples expense be increased \$550.

Postage: Waco proposed a pro forma level of postage expense of \$2,890, a decrease of \$1,563 from its test-period level of

⁶ \$902 + 3-Years = \$301.

\$4,453. Waco's test-period postage expense reflects the rental and usage of a postage meter. In 1991, Waco computerized its customer billing and discontinued its use of the postage meter. Waco's adjustment reflects the current postage rate and the number of test-period bills.

Staff has reviewed Waco's adjustment and is of the opinion that it meets the rate-making criteria of being known and measurable and therefore, recommends that postage expense be reduced by \$1,563.

Miscellaneous: Waco proposed a pro forma level of miscellaneous expense of \$4,560, a decrease of \$408 from its test-period level of \$4,152. Included in miscellaneous expense were payments of \$408 in penalties paid to the Internal Revenue Service and the Kentucky State Treasurer. Waco's proposed adjustment reflects the elimination of those penalties.

Waco was assessed penalties for incorrect payroll tax withholdings and late sales tax payments. These expenses should not be expected to recur in the future. Accordingly, Staff recommends that Waco's adjustment be accepted and miscellaneous expense be reduced by \$408.

Depreciation: Waco proposed a pro forma level of depreciation expense of \$34,001, an increase of \$12,835 above its test-period level of \$21,166. The proposed increase reflects a revised depreciation schedule and the purchase of a new truck.

Upon review of Waco's depreciation schedule, Staff noted that Waco's depreciation lives appeared to be incorrect. Staff consulted with the Commission's Engineering Division

("Engineering"), who recommended that many of the depreciation lives be shortened. This is a known and measurable adjustment and results in a increase to depreciation expense of \$9,035.

Staff was provided with a copy of the "Buyers Order" for Waco's new truck which showed that the truck will cost \$19,000. Waco has proposed to depreciate the new truck over a 5-year period. Staff is of the opinion that Waco's "Buyers Order" represents a reasonable estimate of the cost to replace the truck and recommends that it be accepted for rate making purposes. This results in an increase to depreciation expense of \$3,800.

Accordingly, depreciation expense has been increased by \$12,835.

FICA: Waco proposed a pro forma level of FICA expense of \$5,803, a decrease of \$57 from its test-period level of \$5,860. This adjustment represents FICA tax attributable to Waco's pro forma salaries and wages expense.

Staff is of the opinion that Waco's adjustment is correct and therefore, recommends that FICA expense be decreased by \$57.

Short-Term Interest: Waco proposed a pro forma level of short-term interest expense of \$1,882, which reflects the purchase of a new truck. Waco provided Staff with a copy of the loan commitment from the Richmond Bank and Trust Company ("Richmond Bank") wherein Richmond Bank agreed to loan Waco \$19,000 at a floating interest rate of 2 percent above the prime interest rate published by the Wall Street Journal. Waco's payments are based on a 72 month amortization schedule with the balance becoming due and payable in 2-year increments.

Staff is of the opinion that the loan purpose is reasonable and should be approved for rate-making purposes. Accordingly, Staff recommends that Waco's adjustment be accepted.

Operations Summary

Based on the recommendations of Staff contained in this report, Waco's operating statement would appear as set forth in Appendix A to this report.

C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for "non-profit" water utilities is debt service coverage. Staff recommends the use of this approach in determining Waco's revenue requirement.

Waco's annual debt service is \$36,775. Waco's adjusted operations reflect \$23,783⁷ in income available for debt service which results in a DSC of 0.65x.⁸ The increase in rates requested by Waco would result in income available for debt service of \$44,130⁹ and a DSC of 1.2x.¹⁰

7	Operating Income	\$ 20,271
	Interest Income	+ 3,512
	Income Available for Debt Service	<u>\$ 23,783</u>

8 \$23,783 + 36,775 = 0.65x.

9	Income Available for Debt Service	\$ 23,783
	Requested Increase	+ 22,229
	Subtotal	\$ 46,012
	Less: Short-Term Interest	- 1,882
	Income Available for Debt Service	<u>\$ 44,130</u>


10 \$44,130 + \$36,775 = 1.2x.


Staff is of the opinion that a 1.2x DSC would allow Waco sufficient revenues to cover its operating expenses, service its debt, and provide for reasonable equity growth. Accordingly, Staff recommends that Waco be granted its requested increase in revenues of \$22,229.

D. Rate Design

Waco filed a schedule of its existing and proposed rates and did not propose any changes in the rate structure. The Staff agrees that the present rate structure should not be altered and recommends that the rates proposed by Waco in its application and set out in Appendix B attached hereto be accepted.

E. Signatures


Prepared By: Mark C. Frost
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Requirements Branch
Rates and Tariffs Division


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Communications, Water and
Sewer Rate Design Branch
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APPENDIX A

TO STAFF REPORT CASE NO. 91-383

	Actual Operations -----	Pro Forma Adjustments -----	Pro Forma Operations -----
Operating Revenues:			
Metered Water Sales	\$ 344,795	\$ 63,966	\$ 408,761
Forfeited Discounts	3,801	0	3,801
Miscellaneous	249	0	249
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Total Operating Revenues	\$ 348,845	\$ 63,966	\$ 412,811
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Operating Expenses:			
Operation & Maintenance:			
Salaries & Wages	\$ 62,180	\$ (469)	\$ 61,711
Commissioner Fees	10,800	0	10,800
Pensions & Benifits	1,252	0	1,252
Purchased Water	183,217	65,461	248,678
Electric	392	214	606
Telephone	609	87	696
Materials & Supplies	10,664	(7,088)	3,576
Engineering	712	(712)	0
Accounting	4,379	(1,259)	3,120
Legal	1,145	(745)	400
Rent - Building	2,800	0	2,800
Rent - Equipment	50	0	50
Transportation	2,017	(82)	1,935
Insurance	8,571	(565)	8,006
Bad Debt	174	0	174
Water Samples	434	550	984
Postage	4,453	(1,563)	2,890
Miscellaneous	4,560	(408)	4,152
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Total Operation & Maint	\$ 298,409	\$ 53,421	\$ 351,830
Deprecitation	21,166	13,220	34,386
Amortization	0	46	46
Tax Other Than Income Tax	6,335	(57)	6,278
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Total Operating Expenses	\$ 325,910	\$ 66,630	\$ 392,540
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Net Operating Income	\$ 22,935	\$ (2,664)	\$ 20,271
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Other Income:			
Interest Income	3,512	0	3,512
Interest Expense:			
Long-Term Interest	19,837	0	19,837
Short-Term Interest	0	1,882	1,882
Amortization - Debt Discount	856	0	856
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Net Operating Income	\$ 5,754	\$ (4,546)	\$ 1,208
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APPENDIX B
TO STAFF REPORT CASE NO. 91-383

The Staff recommends the following rate be prescribed for customers of Waco Water District.

<u>Rate Blocks</u>	<u>Rates</u>
First 175 cubic feet	\$6.50 Minimum Bill
Next 225 cubic feet	2.80 per 100 cubic feet
Next 300 cubic feet	2.35 per 100 cubic feet
Next 500 cubic feet	2.05 per 100 cubic feet
Next 1000 cubic feet	1.85 per 100 cubic feet
Over 2200 cubic feet	1.60 per 100 cubic feet