

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WEBSTER COUNTY WATER DISTRICT)
FOR (1) A CERTIFICATE OF PUBLIC CONVENIENCE AND)
NECESSITY AUTHORIZING CONSTRUCTION OF MAJOR)
ADDITIONS AND IMPROVEMENTS TO ITS WATER DISTRI-) CASE NO.
BUTION SYSTEM; (2) SEEKING APPROVAL OF REVISED) 92-314
WATER SERVICE RATES AND CHARGES; AND (3) SEEKING)
APPROVAL OF THE ISSUANCE OF CERTAIN SECURITIES,)
PURSUANT TO THE PROVISIONS OF KRS 278.020 AND)
807 KAR 5:001)

O R D E R

On August 28, 1992, Webster County Water District ("Webster County") filed its application for Commission approval of its proposed construction, financing and increased water rates. Commission Staff, having performed a limited financial review of Webster County's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the 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 6th day of November, 1992.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

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PUBLIC SERVICE
COMMISSION

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THE APPLICATION OF WEBSTER COUNTY)
WATER DISTRICT FOR (1) A CERTIFICATE)
OF PUBLIC CONVENIENCE AND NECESSITY)
AUTHORIZING CONSTRUCTION OF MAJOR)
ADDITIONS AND IMPROVEMENTS TO ITS)
WATER DISTRIBUTION SYSTEM; (2))
SEEKING APPROVAL OF REVISED WATER)
SERVICE RATES AND CHARGES; AND (3))
SEEKING APPROVAL OF THE ISSUANCE OF)
CERTAIN SECURITIES, PURSUANT TO THE)
PROVISIONS OF KRS 278.020 AND)
807 KAR 5:001)

CASE NO. 92-314

STAFF REPORT

October 28, 1992

Prepared By: Karen Harrod, CPA
Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
Requirements Branch
Rates and Tariffs Division

Prepared By: Nicky Moore
Public Utility Rate
Analyst
Communications, Water and
Sewer Rate Design Branch
Research Division

STAFF REPORT
ON
WEBSTER COUNTY WATER DISTRICT
CASE NO. 92-314

A. Preface

On July 30, 1992, Webster County Water District ("Webster County") submitted its application seeking approval of its proposed construction, financing and water rate increase. The application was considered filed on August 28, 1992, when all deficiencies were cured. The proposed rates would generate approximately \$223,819 annually in additional revenues, an increase of 42.9 percent over normalized test-year revenues from water sales, with proposed new customers, of \$520,711.

On October 5, 1992, the Commission issued an Interim Order in this case granting approval of the proposed construction and financing.

In order to evaluate the requested increase in rates, the Commission Staff ("Staff") chose to perform a limited financial review of Webster County's operations for the test period, calendar year 1991. Karen Harrod and Jack Scott Lawless of the Commission's Division of Rates and Tariffs conducted the review on August 25-26, 1992 at Webster County's office in Sebree, Kentucky. Nicky Moore, of the Commission's Research Division, performed his review of the billing analysis at the Commission's office in Frankfort, Kentucky.

The findings of the field review have been reduced to writing in this report. Nicky Moore is responsible for the sections related to operating revenues and rate design. The remaining sections of the Staff Report were prepared by Karen Harrod.

During the course of the review, Webster County was advised that all proposed adjustments to test-year operations must be supported by some form of documentation and that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Webster County be allowed to increase its annual revenues by \$255,450, or 49 percent.

Scope

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

In its application, Webster County stated that an additional 407 customers would be added onto the system if the proposed construction projects were approved. Staff's recommendations made in this report reflect the additional known and measurable expenses to be incurred as a result of the construction and financing which were approved in the Commission's Order of October 5, 1992.

B. Revenue Requirements Determination

Operating Revenues

In its application, Webster County reported test year operating revenue of \$407,986. Of this amount, \$398,174 was attributed to water sales, \$9,227 to forfeited discounts, \$505 to miscellaneous service revenues and \$20 to other water revenue.

In addition, Webster County filed a billing analysis for the test year that produced revenue from water sales in the amount of \$404,521, which is \$6,347 more than reported in the annual report. Staff is of the opinion that the revenue derived from the billing analysis is more representative of the revenue to be collected, therefore, the test year operating revenue from water sales has been adjusted to that produced by the billing analysis.

Also, Webster County has proposed to add to their system 407 additional customers from project I and project II. These customers will produce revenue in the amount of \$116,190. This was determined by using the average water sales to 5/8 inch x 3/4 inch metered customers.

The normalized operating revenue from water sales is \$520,711. The total normalized operating revenue is \$530,523.

Operation and Maintenance Expenses

For the test year, Webster County reported operation and maintenance expenses of \$440,331 which it proposed to increase by \$80,329. The pro-forma adjustments to test-period expenses are discussed in the following sections of this report.

Salary and Wage Expense

For the test period Webster County reported salary and wage expense of \$129,819. Adjustments were proposed to increase this amount by \$17,979 to reflect increased salaries and an additional employee hired subsequent to the test year. Based on the current salary and wage levels of Webster County's employees, Staff has calculated the district's pro forma salary and wage expense to be \$141,036, an increase of \$11,217 over the test-year level, as shown in Appendix C to this report. It should be noted that overtime wages have been included in this calculation based on overtime hours worked during the test year. Although Webster County has hired an additional employee, it is Staff's opinion that this will not have a significant impact on the required number of overtime hours due to the additional work resulting from the 407 new customers being added to the system.

Commissioner Fees Expense

Webster County incurred commissioner fees expense of \$3,300 during the test year. In September of 1991 the district added two commissioners for a total of five. Based on a fee of \$75 per month per commissioner, the pro-forma expense would be \$4,500.¹ Therefore, Staff recommends an increase to test-year expense of \$1,200.

¹ 5 x \$75 x 12 mos. = \$4,500

Purchased Power Expense

For the test year Webster County reported purchased power expense of \$45,996. An adjustment was proposed in the application to increase this expense by \$26,899 to allow for the electricity required to pump additional water through the water treatment plant and distribution system as required for the 407 new customers. During the field review, Webster County did a more thorough analysis of the increased expense and revised the adjustment to an increase of only \$9,257.

Staff has reviewed the calculations supporting this increase and is of the opinion that the adjustment meets the rate-making criteria of being known and measurable. Accordingly, Staff recommends an increase to the test-year purchased power expense of \$9,257.

Chemicals Expense

During the test year Webster County incurred chemicals expense of \$40,300. An adjustment was proposed to increase this amount by 15 percent, or \$6,045, based on the estimated increase in water to be produced for the 407 new customers. Staff is of the opinion that a direct correlation exists between the level of water production and chemical expense. Accordingly, after a review of the supporting calculations, Staff recommends the increase be allowed.

Materials and Transportation Expense

In its application Webster County proposed to increase both transportation expense and materials expense by 15 percent, based on the estimated amount of water to be produced upon completion of the proposed project. In the opinion of Staff, a direct correlation does not exist between water production and materials and transportation expense. Therefore, these increases are not known and measurable and should not be allowed for rate-making purposes.

Contractual Services - Accounting

Webster County reported test-year accounting expenses of \$7,235. Included in that amount were \$315 of expenses which were incurred in 1990 but paid during the test year. To normalize the test-year expense, Staff recommends a decrease of \$315 to contractual services - accounting expense.

Insurance Expense

For the test year Webster County reported insurance expense, excluding health and dental coverage, of \$7,726. In its application, adjustments were proposed to increase insurance expense by \$2,500 to allow for the estimated increase in premiums due to coverage on two additional vehicles and the plant additions approved in this filing. Documentation was not provided to support the increased premium cost for the new construction. However, insurance on the additional vehicles placed into service is included in the property and liability coverage for 1992-93. Based

on Staff's review, the total insurance renewals for 1992-93 were \$10,163. As a result, Staff has made an adjustment to increase insurance expense by \$2,437.

Insurance - Other

Webster County reported insurance - other expense of \$12,612 for the test year, which it proposed to increase by \$15,412. This increase was proposed to reflect health insurance rates currently in effect and to include the entire premium expense for insurance coverage. During the test year, Webster County paid only 50 percent of the family plan policies, however, currently the district pays 100 percent of the expense. According to Webster County's general manager, this benefit is being provided as additional compensation in lieu of a larger salary increase for 1992. Based on the insurance rates in effect as of October 1, 1992, Staff has calculated pro-forma insurance - other expense to be \$24,546, an increase of \$11,934 over the test-year level. Staff is of the opinion that this is a known and measurable adjustment and should be included for rate-making purposes.

Miscellaneous Expense

Webster County reported test-year miscellaneous expense of \$2,930. Included in this amount were \$183 for flowers, \$208 for retirement gifts and \$347 for Christmas gifts. Staff is of the opinion that the ratepayers receive no benefits from these expenditures and therefore should not bear the burden of this expense. Accordingly, Staff recommends an adjustment be included

to decrease miscellaneous expense by \$738 to a pro-forma level of \$2,192.

Rate Case Expense

In its application Webster County estimated total rate case expenses related to this filing to be \$30,000. As of the date of this report, Staff has reviewed invoices to support total rate case expense of \$1,124. Staff recommends this expense be amortized over a period of three years resulting in annual rate case expense of \$375.²

Depreciation Expense

In its application Webster County proposed to increase test-year depreciation expense by \$8,392 to annualize for additions and deletions that occurred during 1991 and to include depreciation for a truck purchased in May 1992. Staff has reviewed the depreciation schedules supporting this proposed adjustment and recommends the increase be allowed for rate-making purposes.

During the field review, Webster County requested to include depreciation expense on the proposed construction in the calculation of pro forma depreciation expense. Staff is of the opinion that it is necessary to include the costs related to the system addition in the determination of pro-forma depreciation expense to ensure that rates will be established at a level sufficient to meet Webster County's debt service requirements.

² \$1,124/3 yrs. = \$375

Pursuant to the Commission's Order in Case No. 10481,³ dated August 22, 1989, Webster County has updated its revenues and expenses to the level anticipated upon completion of the proposed construction. Since these adjustments reflect the impact that the proposed construction and estimated 407 customers would have on its revenues and expenses, as required by the above referenced case, Staff recommends that an increase in depreciation expense of \$78,322⁴ be allowed for rate-making purposes.

As a result of these adjustments, Staff has increased depreciation expense by \$86,714, to a level of \$190,508.

Taxes Other Than Income Taxes

Webster County included taxes other than income tax expense of \$10,598 in its test-year operations. This amount includes \$10,015 of payroll tax expense. Staff recommends an adjustment be made to increase payroll tax expense to allow for FICA and Medicare taxes associated with the recommended increase in salary expense. Accordingly, taxes other than income tax expense has been included

³ Notice of Adjustment of the Rates of Kentucky-American Water Company Effective on February 2, 1989.

	<u>Total Depreciable Cost</u>
Project I	\$1,214,455
Project II	1,918,440
Total	<u>3,132,895</u>
Estimated Service Life	+ 40 yrs
Annual Depreciation Expense	<u>\$ 78,322</u>

at a level of \$11,456, an increase of \$858⁵ over the test-year level.

Operations Summary

Based on the recommendations of Staff, Webster County's operating statement would appear as set forth in Appendix B to this report.

Revenue Requirements Determination

Due to the current favorable market conditions, Webster County proposed to refinance its outstanding long-term debt with a portion of the financing approved in this filing. Based on the new debt to be acquired by the district, the average annual debt service requirement would be \$199,176 as shown in Exhibit 27 of the application. Based on the adjusted test-year operations, Webster County's debt service coverage ("DSC") is $\sim .08x$.⁶ The increased rates proposed by Webster County would produce additional annual revenues of \$223,819, which results in a DSC of $1.04x$.⁷ Staff is of the opinion that a DSC of $1.2x$ is necessary to allow Webster County to meet its operating expenses and service its debt.

⁵	FICA	6.2 %
	Medicare	1.45%
		<u>7.65%</u>
	Salary Increase	<u>x\$11,217</u>
	Recommended Increase	<u>\$ 858</u>

⁶ $\langle \$16,439 \rangle + \$199,176 = \langle .08 \rangle$

⁷	Adjusted Operations	$\langle \$16,439 \rangle$
	Proposed Increase	<u>223,819</u>
		<u>207,380</u>
	Average Debt Service	<u>+199,176</u>
	DSC	<u>\$ 1.04</u>

Therefore, Staff recommends that Webster County be allowed to increase its annual revenues by \$255,450, calculated as follows:

Adjusted Operating Expenses	\$569,315
Annual Debt Service Requirement	199,176
20% Debt Service Coverage	39,835
Total Revenue Requirement	<u>808,326</u>
Less: Normalized Revenues	530,523
Interest Income	<u>22,353</u>
Required Increase	<u>\$255,450</u>

C. Other Issues

Although Webster County maintains a sufficient record keeping system, Staff recommends that a more detailed method of recording disbursements be implemented. Under the current procedure, disbursements are recorded but not charged to the proper account classification as required by the Uniform System of Accounts. In order to ensure the proper classification of expenses, Webster County should charge expenditures to the appropriate account at the time the expense is recorded.

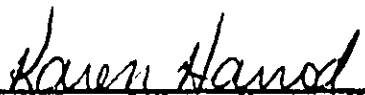
D. Rate Design


On its application, Webster County has proposed to change its present rate structure. The present rate structure is a declining block type with seven steps. The district proposes to eliminate steps 4, 5 and 6 of the structure and to expand the third step to include those customers using from 6,000 gallons to 100,000 gallons per month. This will result in a four (4) step declining block rate design. In support of this proposal for simplification and

restructure of the rate design, Webster County presented a thorough analysis of its water consumption and the revenue generated.

The Staff agrees that the proposed rate structure is reasonable and should be approved. Therefore, the allowed revenue in this report has been applied to the proposed rate structure. The rates in Appendix A will produce the revenue required.

E. Signatures


Prepared By: Karen Harrod, CPA
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Prepared By: Nicky Moore
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Research Division

APPENDIX A
TO STAFF REPORT CASE NO. 92-443

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

Rate Blocks
First 2,000 gallons
Next 4,000 gallons
Next 94,000 gallons
Over 100,000 gallons

Rates
\$15.10 Minimum Bill
6.75 per 1,000 gallons
5.75 per 1,000 gallons
3.05 per 1,000 gallons

Wholesale

\$ 2.75

APPENDIX B
TO STAFF REPORT CASE NO. 92-314

Webster County Water District
Statement of Adjusted Operations
Test Year Ended 12/31/91

	<u>Test Year per Exhibit 30</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenues			
Metered Sales	\$ 398,174	\$ 122,537	\$ 520,711
Other Revenues	<u>9,812</u>		<u>9,812</u>
Total Operating Revs.	407,986	122,537	530,523
Operating Expenses			
Salaries & Wages	129,819	11,217	141,036
Commissioners Fees	3,300	1,200	4,500
Purchased Power	45,996	9,257	55,253
Chemicals	40,300	6,045	46,345
Materials & Supplies	52,751	0	52,751
Contractual Services -			
Engineering	250	0	250
Contractual Services -			
Accounting	7,235	(315)	6,920
Contractual Services -			
Legal	1,650	0	1,650
Contractual Services -			
Other	2,284	0	2,284
Transportation Expense	18,878	0	18,878
Insurance Expense - Other	12,612	11,934	24,546
Insurance Expense	7,726	2,437	10,163
Bad Debt Expense	208	0	208
Miscellaneous	2,930	(738)	2,192
Amortization of Rate			
Case Expense	<u>0</u>	<u>375</u>	<u>375</u>
Total Operating Expense	325,939	41,412	367,351
Depreciation Expense	103,794	86,714	190,508
Taxes Other than Income Tax	<u>10,598</u>	<u>858</u>	<u>11,456</u>
Utility Operating Expenses	<u>440,331</u>	<u>128,984</u>	<u>569,315</u>
Operating Income	(32,345)	(6,447)	(38,792)
Interest Income	<u>22,353</u>		<u>22,353</u>
Income Available for			
Debt Service	<u>\$ (9,992)</u>	<u>\$ (6,447)</u>	<u>\$ (16,439)</u>

**APPENDIX C
TO STAFF REPORT CASE NO. 92-314**

**Webster County Water District
Calculation of Pro Forma Salary and Wage Expense
Test Year Ended 12/31/91**

	<u>Hourly Rate</u>	<u>Regular Hours</u>	<u>Regular Wages</u>	<u>OT Rate</u>	<u>1991 OT Hours</u>	<u>OT Wages</u>	<u>Total Wages</u>
General Manager	\$9.54	2,080	\$19,843	\$14.31	255	\$3,649	\$23,492
Plant & Distribution Manager	9.54	2,080	19,843	14.31	506	7,241	27,084
Asst. Plant & Distribution Manager	8.35	2,080	17,368	12.53	967	12,117	29,485
Certified Operator	7.21	2,080	14,997	10.82	595	6,438	21,435
Apprentice Operator	6.00	2,080	12,480				12,480
Apprentice Operator	6.00	2,080	12,480				12,480
Secretary/Clerk	6.00	2,080	12,480				12,480
Part-Time Employee	5.00	420	2,100				<u>2,100</u>
Total Salary & Wage Expense							\$141,036
Less Test-Year Expense							<u>129,819</u>
Recommended Increase							<u>\$11,217</u>