COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SALT RIVER ELECTRIC COOPERATIVE CORPORATION FOR A CHANGE IN DEPRECIATION RATES	)))	CASE NO. 97-367

O R D E R

On August 19, 1997, Salt River Electric Cooperative Corporation ("Salt River") filed an application to change its depreciation rates. The requested change is contingent upon approval of the proposed rates by the Rural Utilities Service ("RUS").

Salt River included in its application a depreciation study entitled, "Report on Analysis of Distribution Plant in Service - December 31, 1995." Based upon plant in service as of December 31, 1995, the proposed rates will increase Salt River's depreciation accruals from $1,764,114 to $2,112,776 annually, or an increase of $348,662 over current depreciation rates. The increase is solely attributable to recovery of deficits in accumulated depreciation. Although its last depreciation study[1] suggested similar deficits in accumulated depreciation, Salt River elected not to apply adjustments which would have reduced the deficiency because of their potential rate impact. Salt River does not expect the proposed depreciation rates to immediately affect its rates for electric service.

Historically, the Commission has been reluctant to approve large adjustments in depreciation rates to reduce deficiencies in depreciation accruals. The first and foremost

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[1] Salt River's last depreciation study was conducted in 1992 and was based upon accounting data from the inception of the cooperative through December 31, 1990.

reason for this reluctance is that deficiencies in depreciation accruals are the direct result of incorrect estimates used when establishing previous depreciation rates. The term "incorrect estimates" may sound more ominous than it actually is. Incorrect estimates in depreciation rates affect only the timing of recovery of capital investments, not the amount of the recovery. Nevertheless, inequities to customers are possible if, for example, rates paid by current customers are higher because rates in the past had not recovered the full cost of service.

The Commission's reluctance is also due to the lack of evidence of a deficiency in depreciation accruals. Ideally, the utility should maintain accurate accounting records that document its plant's in-service and retirement dates, as well as its original cost, salvage values, and costs of removal. These "vintage records" establish unequivocally whether depreciation rates had been adequate to fully recover the investments over the life of the plant. Unfortunately, maintaining this level of detail, particularly for numerous items, such as utility poles or conductors, may impose administrative costs that could easily exceed the benefits of having this type of data.

Salt River does not maintain vintage records. Instead, its depreciation study was based upon a Simulated Plant Record ("SPR") analysis to estimate the age distribution of its property. While commonly used, the SPR method only provides estimates of age, not actual data. Clearly, simulating aged data is not as accurate as using actual aged data. The record in this case indicates that neither the accumulated provision for depreciation nor salvage information were maintained at the plant account level, but rather were maintained in accounts which reflected information for all plant accounts combined. These amounts were allocated to individual plant accounts for the depreciation analysis and, as such,

would produce results less accurate than if data had been maintained at the plant account level.

Despite the inherent problems with its use, simulated aged data represents an appropriate and reasonable means to approximate depreciation in the absence of actual data. Overall, the results of the study are consistent with similar utilities and with Salt River's last study. To continue to ignore the results of the study could compound the problem and create a serious financial burden on future customers. Therefore, the Commission finds that the proposed depreciation rates, which are based upon Salt River's study, should be approved for accounting purposes. The Commission further finds that Salt River should continue to perform periodic depreciation analyses on the same five-year time table already established to ensure that incorrect estimates are timely corrected.

Salt River's depreciation study indicates that Salt River is experiencing rapid growth. The study notes that distribution plant balances in 1980 totaled $14.2 million. By 1995, the balances had increased to $44.8 million. As Salt River is experiencing fairly high growth, it is possible that equipment may need to be prematurely retired to be replaced with equipment of higher capacity. Furthermore, the Commission notes that in Salt River's last two-year work plan,[2] Salt River indicated that the majority of its single-phase lines are 6A copper-weld conductor. These lines generally have less tolerance for ice and wind loading

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[2] Case No. 94-359, The Application of Salt River Electric Cooperative Corporation (1) for an Order Pursuant to KRS 278.300 and 807 KAR 5:002, Section 11 and Related Sections, Authorizing the Corporation to Borrow an Amount Not to Exceed $2,257,000.00 from the National Bank for Cooperatives and (2) for a Certificate of Convenience and Necessity pursuant to KRS 278.020 (1) and 807 KAR 5:001, Section 9 and Related Sections, Authorizing Certain Proposed Construction and Associated Capital Outlay.

and may have been a contributing factor for the extensive storm-related outages which Salt River experienced in 1994.[3] Consequently, these conductors may also need to be prematurely retired. Salt River should consider the possible impacts that premature retirements may have when it develops future depreciation rates.

The Commission remains concerned over the accuracy of Salt River's accounting data, but recognizes technological limitations prevent complete accuracy. Many of Salt River's accounts date to 1939, a time when even calculators did not exist. The advent of computers makes it more feasible to store and manipulate information; however, it can still be overly burdensome to input the necessary data. Engineering records usually contain information about the age of equipment, such as construction dates, which could be used to maintain aged data. The cost of manually extracting this information would likely exceed any benefit from improved accuracy; however, the current trend toward computerized records may make it more cost effective. As Salt River expands its use of computerized engineering databases, it should consider adding fields which could be used by the accounting department to maintain vintage records.

Salt River's consultant has recommended that Salt River maintain the accumulated provision for depreciation at the individual distribution plant account level to improve the accuracy of future depreciation studies. The Commission concurs with this recommendation.

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[3] According to data in the two-year work plan, Salt River's customers experienced an average of over 68 hours without power as a result of storm damage.

IT IS HEREBY ORDERED that:

1. The depreciation rates proposed by Salt River are approved as filed for accounting purposes.

2. Salt River shall continue to perform periodic depreciation analyses on the same five-year time table already established to ensure that incorrect estimates are timely corrected.

3. When developing future depreciation rates, Salt River shall consider the possible effects of premature retirements.

4. As Salt River expands its use of computerized engineering databases, it shall consider adding fields that may be used by the accounting department to maintain vintage records.

5. Salt River shall maintain its accumulated provision for depreciation at the individual distribution plant account level to improve the accuracy of depreciation studies.

Done at Frankfort, Kentucky, this 10th day of June, 1998.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

ATTEST:

Executive Director

Commissioner