COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF ELAM UTILITY COMPANY INC. FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 2000-432

<u>O R D E R</u>

On September 15, 2000, Elam Utility Company, Inc. ("Elam") applied for an adjustment of rates pursuant to Administrative Regulation 807 KAR 5:076, the alternative rate filing procedure for small utilities. Commission Staff, having performed a limited financial review of Elam'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 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 14th day of March, 2001.

By the Commission

ATTEST:

Executive Director

STAFF REPORT

ON

ELAM UTILITY COMPANY, INC.

CASE NO. 2000-432

Preface

On September 15, 2000, Elam Utility Company, Inc. ("Elam") filed an application for a rate adjustment pursuant to Administrative Regulation 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities ("ARF"). In order to meet the filing requirements for an ARF, a utility must have less than 500 customers or less than $300,000 in gross annual revenues. During 1999, Elam had 494 customers and therefore met the requirements for an ARF filing. The Commission Staff ("Staff"), in examining the proposed rates, has determined that the amount of increase produced by the proposed rates is $59,722, which represents a 13.6 percent increase over revenues from existing rates, including test year gas cost adjustment ("GCA") revenues.

The Commission Staff performed a limited financial review of Elam's operations for the test year ending December 31, 1999. The Commission's objective is to reduce the need for additional written data requests thereby decreasing the expense to the utility. On October 12, 2000, Staff issued a letter specifying information that would be needed during the field review. Katy Finn and Gary Forman of the Commission's Division of Financial Analysis performed the initial field visit on November 15 and 16, 2000, at the business office of Elam in Whitley City, Kentucky. An additional field visit was performed on December 12, 2000. Staff also visited Elam's certified public accountants ("CPAs"), Harrod and Associates, ("Harrod") on November 30, 2000 and

January 3, 2001. Dawn McGee of the Division of Financial Analysis performed a review of Elam's reported revenues at the office of the Commission.

SCOPE

The scope of the review was limited to obtaining information in order to determine that the operating expenses as reported in Elam's application for the period ending December 31, 1999 were representative of normal operations, and to gather information to evaluate the proforma adjustments proposed in Elam's filing. Expenditures charged to test-year operations were reviewed, including supporting invoices and other supporting documentation. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

This report contains three major sections of findings. The first section includes discussion of adjustments that need to be made in accounting and record-keeping procedures. The second section will discuss adjustments necessary to correct the records of Elam for accounting purposes. The third section contains adjustments to revenues and expenses that are required to establish fair just and reasonable rates, and the determination of the revenue requirements in this case.

ACCOUNTING AND RECORD-KEEPING PROCEDURES

The company's accounting records and procedures are subject to the requirements established by the Uniform System of Accounts ("USoA") prescribed for natural gas companies in the Code of Federal Regulations ("CFR"), Title 18, Chapter I, Subchapter F. The Commission has adopted these accounting requirements for all regulated gas utilities in the state of Kentucky.[1] The Commission has also established

[1] 807 KAR 5:006, Section 3(1).

reporting requirements in the Annual Report that is required to be filed by March 31 of each year. Several deviations from the USoA and prescribed practices and procedures were disclosed. We have noted the following exceptions:

Plant Records

Plant records presently maintained by the utility are insufficient to determine the cost of utility property, plant and equipment. It is imperative that the cost of plant assets be effectively controlled and accurately accounted for, because of the importance of these costs in determining periodic depreciation charges. Staff had difficulty determining if any assets were purchased, repaired, or replaced during the test period. Staff recommends accounting records be maintained showing details such as description, location, cost, vendor, date of purchase or installation, estimated salvage value, estimated cost of removal rate and method of depreciation, depreciation accumulated to date, and capitalized repairs, replacements, and improvements.

Records Retention

According to the CFR 18, Subchapter F, Section 225.3, Item 10, general and subsidiary ledgers should be retained for at least 50 years, and the trial balance sheets of the general and subsidiary ledgers should be kept for two years. Elam has not complied with this section of the CFR.

Elam did not produce an accurate copy of its supporting/subsidiary ledgers, transaction journals, or other supporting workpapers necessary to trace receipts and disbursements to its general ledger for the test period. While Elam did produce its 1999 general ledger, it did not produce any supporting schedules tying it to the annual report. It was difficult for Staff to determine how some of the annual report balances were calculated. Additionally, Elam had disposed of several of its bills and invoices for the test period, so there was no supporting documentation for several of its general ledger entries.

Staff recommends that Elam keep a subsidiary ledger of its monthly credit card usage. Specifically, this ledger should show the name of the credit card, the card number and to whom the card is assigned, the monthly purchases, the unpaid balance, interest and fees, and the amount paid during the month. The ledger should also show the accounts charged for each of the purchases made with the credit card. Elam should keep supporting documentation such as receipts, bills, and invoices for the purchases made. Any personal expenditures should be allocated out of the total amounts, and should not be paid for by the company.

<u>Deviations from Governing Statutes and Regulations</u>

Gas distribution utilities in Kentucky are governed by the Kentucky Revised Statutes ("KRS") and regulations as established by the Kentucky Administrative Regulations ("KAR").[2] Potential deviations from KRS 278.300 and the preservation of records standards were disclosed during the review of Elam's records.

A utility is required by KRS 278.300 to obtain prior approval before assuming evidence of indebtedness payable in more than two years from the date of issuance and/or renewing such debt for a period exceeding six years from the date of issuance of the original debt. Prior to the test year, Elam obtained a loan from Modern Acceptance that required Commission approval because of the indebtedness' term to maturity. The date the loan was issued was July 22, 1996, and it had a maturity date of June 5, 2001.

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[2] KRS Chapter 278 *et seq.*, 807 KAR Chapter 5 *et seq.*

This clearly falls under the statute cited above. However, Elam did not seek Commission approval, which appears to be a probable violation of the statute.

A review of Elam's annual reports and other records indicates that, for at least the past three years, Elam has annually borrowed funds from local banks on a short-term basis. This trend would seem to indicate that Elam is using short-term bank notes and lines of credit as permanent sources of capital. Staff recommends that Elam review its capital needs and secure financing that would result in the lowest cost of money. Under this approach, the utility would most likely lower interest costs over time and the capital structure of the utility would be better balanced. Any financing for a term of greater than two years must be approved pursuant to KRS 278.300.

In Case No. 92-488,[3] the Commission approved the transfer of the stock of Elam from B.C. and Ethel Phillips to Doug and Wilma Ison. In that case, the Commission did not approve the loan that was incurred for the transfer of the company. The Commission did not approve the loan because the loan is a personal agreement between the Phillipses and the Isons, and as such should not affect the financial statements of Elam. The Ison's debt to the Phillipses was first reported in the 1993 annual report to the Commission as Other Long Term Debt and is shown on Elam's general ledger as a note payable. The payments on the note are made directly from Elam to the Phillipses. The interest paid on the loan is included in Elam's operating expenses. The final order of Case No. 92-488 specifically states, "The loan is going to be carried by the seller (the Phillipses) with the stock of Elam as the security for the loan. The sale of stock does

[3] Case No. 92-488, The Application for Approval of the Transfer and Sale of Elam Utility Company, Final Order, March 1, 1993.

not encumber the utility and there is no obligation on the utility for the repayment of the loan if the Purchasers (the Isons) default on the repayment of their personal loan from the Sellers. This sale of stock would impact the utility only to the extent that the stock would revert to the former owners if the Purchasers defaulted on the loan." Therefore Elam appears to be in probable violation of KRS 278.300 regarding this matter, and it also appears to be in probable violation of the Commission's order specifying that Elam is not responsible for the debt of the Isons. Elam should work with its CPA and take the necessary steps to correct the financial statements to eliminate the reported liability.

Maintaining Books and Records

According to the USoA General Instructions in Subchapter F, Section 201, Item 2 (Records) states, as follows:

> A. Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto. B. The books and records referred to herein include not only accounting records in a limited technical sense, but all other records, such as minute books, stock books, reports, correspondence, memoranda, etc., which may be useful in developing the history of or facts regarding any transaction.

Elam maintains its own records at its office in West Liberty, and retains the accounting firm of Harrod and Associates to compile its yearly annual report to the Commission. Wilma Ison serves as Elam's bookkeeper and office manager and president. Doug Ison serves as Elam's vice president and chairman of the board and marketing manager. Elam used the calendar year 1999 operating statement information included in the 1999 Annual Report to the Commission as the test period in this case. During Staff's field review, it was found that several accounts and general ledger account entries lacked proper supporting documentation. Staff found certain items that were charged and paid by Elam that were clearly of a personal nature to the Isons. Additionally, there was no documentation, such as receipts, invoices, or bills, for certain expenditures. The general ledger is a permanent organizational record and as such is vital in reporting to regulatory authorities, other federal, state and local authorities, and owners. Proper records must be kept in order to determine the accuracy and legitimacy of the accounts.

Staff also found problems in record keeping related to credit card accounts. Elam could not provide supporting records regarding several credit card accounts. None of the transaction detail or receipts for the charges to the accounts were included in Elam's files. While some of the accounts had monthly invoices that showed the monthly charges and credits, Elam could not find any records for one of the credit card accounts during Staff's second field review. There were no receipts for the purchases made on this credit card. Furthermore, the credit card bills themselves were not available. Therefore, there was no way to determine the principle paid on the card, the carrying balance, the interest charges, or the amount of the purchases made. The only information relating to the card were the cash disbursements shown on the general ledger. Elam made payments of $6,215 to Advanta during the test period. Elam also made payments of $6,630 to Lowe's. These payments were randomly expensed to different accounts. Proper accounting dictates that the company review its credit card bills and corresponding receipts monthly, and allocate the purchases to the proper asset and expense accounts.

It is evident that Elam is carrying balances on the credit card accounts. The amount being charged to the expense accounts is the amount of the monthly payments and not the costs incurred during the month. A portion of each of these payments should be charged to interest expense. Furthermore, Elam is not reflecting the outstanding balance in these accounts as a liability on its balance sheet. Elam should correct its financial statements to include these amounts in the appropriate current liability account. Staff is also concerned about Elam's use of credit cards as a source of short-term or long-term financing. This results in higher carrying costs and circumvents KRS 278.300. Proper accounting for credit cards is shown later in the report in the discussion for Account 232-Accounts Payable.

RECOMMENDED ACCOUNTING ADJUSTMENTS

In accordance with the ARF procedures, the annual report is to be used as the basis for determining the level of revenues required. Staff used December 31, 1999 as the year end for Elam's test period. While Staff did not perform an extensive review of the balance sheet accounts, there were several errors found during the review that should be addressed.

Balance Sheet Accounts

Account 131-Cash and Working Funds

Elam produced a monthly record that it called the cash received summary. Staff reviewed these records and found they were not sufficient to determine if the money received from payments by the customers was actually deposited into Elam's bank accounts. The summaries included a cash expenses column for which Elam provided no receipts for the money spent. As shown on their records, the money received by Elam was not necessarily the amount deposited at the bank.

Elam should develop more internal controls for its cash accounts. Currently, Mrs. Ison takes cash from the daily deposits to make small purchases without recording the transaction. As such, Staff cannot determine if the cash received was used for utility business purposes, or for some other non-utility or personal business. Elam should develop and use a petty cash account. Elam should also keep receipts for items bought with cash. Additionally, the money received relating to gas bills should be deposited in one transaction. Other monies received should be noted with a description and be deposited in the bank separately.

<u>Account 207-Other Paid In Capital</u>

Staff recommends that Elam classify the loans from its shareholders, and the loans from the shareholders' children, as additional "Other Paid In Capital." Elam's general ledger reflects that nine receipts of cash from the owners or their children were classified as notes payable. The only information provided about the funds was the information given in the one line item description of each of the notes on the general ledger. From these brief descriptions, Staff concludes that these notes were all from members of the Ison family. The notes were included in the Accounts Payable account in the annual report, and as a result, there was no detail given. Because Elam provided no signed agreement, Staff could not determine the terms and conditions of the funds, whether Elam was obligated to repay the funds by a certain date, or whether there were carrying charges on the amounts received.

When the owners provide capital to Elam, they should first determine whether the funds will be repaid by Elam. If the funds are not to be repaid they should be treated as paid in capital and recorded in Account 207, Other Paid in Capital. If the funds are to be repaid, the amount advanced should be recorded as long-term or short-term debt, depending on the terms and conditions of the advance. Elam should evaluate all of its obligations to owners and make corrections to the balance sheet to record the transactions properly. Under the circumstances observed by Staff, the funds should be recorded as other paid in capital since there are no loan documents in existence that support the capital advances. Elam has not requested approval of any of the capital advances that would be required under KRS 278.300 if the term is greater than two years. Therefore, Elam has no obligation to repay them.

Account 217-Reacquired Capital Stock

This account is provided to include "the cost of capital stock actually issued by the utility and reacquired by it and not retired or canceled."[4] In 1999, Elam's annual report showed a balance of negative $346,500 in this account. This amount represents the amount of the Isons' loan to the Phillipses after the first payment was made. Elam should not have a balance in this account because it did not reacquire its own stock. The Isons purchased the stock of the company, and guaranteed the associated debt to the Phillipses. Therefore, the loan to the Phillipses should be shown on the Isons' financial statements, not on Elam's. Elam should be required to make correcting journal entries to eliminate the outstanding loan from the Isons.

[4] Code of Federal Regulations ("CFR"), Title 18, Chapter I, Subchapter F, Uniform System of Accounts ("USoA"), Part 201, Account 217, A.

Account 224-Other Long Term Debt

The 1999 annual report balance for this account reflects $239,196.51 of Ison's outstanding debt to the Phillipses. Account 224 should not reflect the balance of the Phillips-Ison loan. The Commission did not authorize this in any of Elam's past cases. Therefore, neither the loan nor the interest associated with it should be shown Elam's financial statements.

Account 232-Accounts Payable

If all of the expenses to the credit cards of Elam were related to its operations, Elam should record the credit card debt in Account 232, Accounts Payable of Elam. Elam currently expenses the monthly payments made to its credit cards to different expense accounts. When recording the initial transactions, if any of the accounts were for personal expenses the amounts should be restored to retained earnings and the Isons should reimburse Elam for the expenses. To record the account payable initially, Elam should debit retained earnings and credit the accounts payable for the amount of debt outstanding. The proper accounting method for its credit card transactions would be to debit the appropriate expense account as each purchase is made or when the credit card bill is received, and credit accounts payable. Then, when Elam pays its credit card bill for the month, it should debit the accounts payable, and credit cash for the amount of the payment. In the event that part of the payment is for accrued interest on the card, it should debit interest expense for the amount of interest accrued during the month. A subsidiary ledger should also be maintained, as described in the "Records Retention" section of this report.

The following is an illustration of the journal entries listed above.

a. To initially record the debt already accrued on the credit card.

Retained Earnings	x x x	
Accounts Payable		x x x

b. To record the purchases made with the credit card:

Appropriate Expense Account	x x x	
Accounts Payable		x x x

c. To record the monthly payment to the credit card—only include interest expense if the balance is not paid in full and interest has accrued:

Accounts Payable	x x x	
Interest Expense	x x x	
Cash		x x x

Income Statement Accounts

Staff has modified the following income statement accounts in order to correct the improper accounting for certain items:

Account 768-Maintenance of Meters and House Regulators

Elam reported $5,127.29 in Account 768, Maintenance of Meters and House Regulators. Elam included in this account $862.12 for payments to Dealers LP Equipment (“Dealers”) and Orgill, Inc. (“Orgill”). The invoices were for the purchase of gas appliances and related supplies. Mrs. Ison stated that the only items purchased from these vendors are water heaters, gas logs, and furnaces, which are resold to the utility customers. Account 416, Costs and Expenses of Merchandising, Jobbing and Contract Work, is to be used for expenses of this nature. While selling appliances is a common business activity for a gas utility, the revenues and expenses for this activity should be recorded in non-utility revenue and expense accounts. Therefore, Staff has reduced this account by $862.12 and assigned this cost to Account 416.

Account 903- (Customer) Supplies and Expenses

Elam reported $10,772.23 in Account 903, Supplies and Expenses. Elam included $200 in this account for donations to various local organizations. Contributions to civic and political organizations should be included in Account 426, Non-Utility Deductions, which is commonly known as Donations. Also included in this account is $6,320.85 related to purchases from Dealers and Orgill that are for appliances sold to customers. These costs should be recorded in Account 416, as previously mentioned, due to the nature of these expenses. Elam also credited $2,297.93 to this account as payments were received from customers for the appliances sold by Elam. Account 415, Revenues from Merchandising, Jobbing and Contract Work, is designed to include revenues from these activities. Therefore, Staff has reduced this account for the $2,297.93 and included this amount in Account 415. The net effect of the adjustments to this account is a reduction of $4,222.92, which leaves a balance of $6,549.31 in Account 903.

Account 921-Office Supplies and Expenses

Elam reported $15,867.64 in Account 921, Office Supplies and Expenses. Staff has increased this account by $90 to include an expenditure for pest control services which was incorrectly charged to Account 930.2, Miscellaneous General Expenses. This account also contained $35 for an occupational tax to the City of West Liberty which should be charged to Account 408.1, Taxes Other than Income Taxes. The net effect of these two adjustments is an increase of $55, which leaves a balance in this account of $15,922.64.

Account 924-Property Insurance and "Other Deductions"

On its 1999 Annual Report to the Commission, Elam reported $9,768.36 in Account 924, Property Insurance. In the income statement account titled "Other Accounts" under the section titled "Other Deductions", Elam recorded $5,697.00 but did not describe how the amount was calculated, or the kind of cost it represented. The total of these two accounts is $15,465.36

During the review process, Staff found that the following accounts from Elam's general ledger and an adjustment made by Harrod totaled the same amount as the two accounts listed above. These accounts are as follows:

Account 428	Life Insurance	$ 9,451.95
Account 924	Property Insurance	$ 50.75
Account 925	Workman's Comp	$ 1,592.94
Account 925.1	Liability Insurance	$ 446.36
CPA Adjustment		$ 3,923.36
Total		$15,465.36

During the first meeting with Harrod, Staff obtained a list of the year-end adjustments that the CPA made to the trial balance of Elam. During the second meeting, Staff requested more information regarding the adjustment made for prepaid insurance. The CPA explained that by using the information and documentation provided by Elam, he calculated what the prepaid insurance balance should have been at the end of 1999. The difference in balances from the beginning of 1999 to the end of 1999 was $3,923.36, the amount of the adjustment. Therefore, he debited insurance expense for $3,923.36 and credited prepaid insurance for the same amount. The adjustment is a number that was used to reconcile the balance sheet account. It was not related specifically to any of the income statement accounts. Although Staff reviewed the workpapers and information provided by the CPA and Elam, it could not, with certainty, determine the original allocation to the expense accounts of the CPA adjustment.

In order to adjust the Other Deductions account and Account 924 from the annual report, Staff had to determine how the balances were originally calculated using the accounts from Elam's general ledger ("GL") and the prepaid insurance adjustment from Elam's CPA. Staff has subjectively determined how the allocation was made. The following schedule shows Staff's allocations. These allocations are used in the calculations for accounting and ratemaking adjustments.

Annual Report Account 924 includes the following:

GL Account 924-Property Insurance	$ 50.75
GL Account 925-Workman's Comp	$1,592.94
GL Account 925.1-Liability Insurance	$ 446.36
CPA Insurance Adjustment	$3,923.36
Part of GL Account 428-Life Insurance	$3,754.95
Total in Annual Report Account 924	$9,768.36

Annual Report Other Deductions Account includes the following:

Part of GL Account 428-Life Insurance	$5,697.00
Total in Annual Report Other Deductions Account	$5,697.00

Elam's general ledger Account 428, Life Insurance, had to be split in order for the accounts to balance. Staff determined the split by using the transactions shown on the general ledger. The transactions allowed Staff to break the general ledger account down by vendor and then separate the vendors into annual report accounts.

Account 924	
Commonwealth	$2,364.00
Anthem	$ 103.95
First Alliance	$1,170.00
Reconciling Item	$ 117.00
Total	$3,754.95

Other Deductions	
Woodmen	$5,074.80
Equity Life Ins.	$ 739.20
Reconciling Item	$ (117.00)
Total	$5,697.00

The totals from this schedule match the split of general ledger Account 428 in the previous schedules. First Alliance is the only company on the above schedule not providing Elam with life insurance. It carried Elam's employees' pension plans in the test year, according to Mrs. Ison. The reconciling item shown on this schedule represents an immaterial amount, $117 that was used to balance the accounts.

Staff has reclassified the Anthem Life Insurance of $103.95 from Account 924 into Account 926. According to Mrs. Ison, this expenditure was for life insurance from Anthem for the two field employees. Also, $1,170 of field employees' pension plans should be removed from Account 924 and added to Account 926. $1,592.94 should be reclassified into Account 925, Injuries and Damages, because it is the amount of workman's compensation paid in 1999. The net effect of the adjustments to Account 924 is a reduction of $2,866.89. The resulting balance of Account 924 after accounting adjustments is $6,901.47.

Staff has also made one accounting adjustment to the annual report account Other Deductions. Staff has reduced the account by $739.20 to reclassify life insurance payments made to Equity Life Insurance to Account 926, Employee Pensions and Benefits. This leaves a balance of $4,957.80 in Other Deductions.

<u>Account 925-Injuries and Damages</u>

Elam did not report an amount in Account 925, Injuries and Damages on its 1999 Annual Report. However, during the test year Elam incurred $1,592.94 for workers' compensation insurance paid to Kentucky Employers' Mutual Insurance and expensed to Account 924. According to the USoA, Account 925 should include "Premiums payable to insurance companies from protection against claims from injuries and damages by employee." Therefore, Staff has increased Account 925 by $1,592.94 and decreased Account 924 by the same amount.

Account 926-Employee Pensions and Benefits

In Account 926, Employee Pensions and Benefits, Elam reported $6,547.36. Staff proposes three accounting adjustments to this account. First, Staff proposes to increase the account by $103.95. This amount should be reclassified from Account 924. This amount represents payments made in 1999 for life insurance for the two field employees of Elam. Additionally, $739.20 should be reclassified from the Account "Other Accounts" of the Other Deductions section of the income statement. This amount represents life insurance that provides coverage for Wilma Ison. The last adjustment is a reclassification from Account 924 of $1,170. These expenses are payments made for an employee pension plan, which should be included in this account. Mrs. Ison stated that Elam now uses a Morgan, Stanley, Dean, Witter plan, but she produced no documentation regarding this. Staff found that the employees had a pension expense taken out of their checks every week, and believes that it is reasonable to include the pension expense in Elam's records. The net effect of the three adjustments is an increase of $2,013.15 to this account.

Account 930.2-Miscellaneous General Expenses

Account 930.2, Miscellaneous General Expense, had a balance of $3,138.06 on the 1999 Annual Report. Staff believes that it is necessary to reclassify several of the expenses from this account to other accounts. Included in the account was $448.00 worth of donations. These donations were made to the "Morgan County Little League," the "Tip Off Club," and other community groups. Therefore $448.00 should be reclassified to Account 426, Non-Utility Deductions. Staff has also reclassified $90.00 to Account 921, Office Expense, for a payment made to a pest control company that was incorrectly charged to this account.

Account 933-Transportation Expense

Staff has increased this account by $47.41 to reclassify truck tax and registration that was incorrectly charged to Account 408.1, Taxes Other Than Income. For reporting purposes, any expenses relating to the vehicles or maintenance of vehicles should be charged to Account 933, Transportation Expense.

Account 408.1-Taxes Other Than Income Taxes

As shown on the Annual Report, this account had a $16,198.70 balance at the end of 1999. Staff has increased this account by $35.00 to correct a misclassification of Elam's occupational tax that was originally charged to Account 921. Staff has reduced this account by $47.41 to charge the truck tax and registration to Account 933, Transportation Expense, as noted in the previous section. The net effect of the adjustment is a reduction of $12.41.

Accounts 415 and 416-Revenues and Expenses from Merchandising, Jobbing, and Contract Work

Elam did not charge any costs or revenues to Account 415, Revenues from Merchandising, Jobbing and Contract Work or Account 416, Costs and Expenses of Merchandising, Jobbing and Contract Work during the test year. As discussed earlier, Staff discovered that Elam has been selling and installing gas appliances. During the field review, Mrs. Ison informed Staff that Elam expenses the costs of appliances purchased for customers, and when payment is received from the customers the expense account is credited with the revenues. By accounting for these transactions in this way, she said that it zeroed out the transactions on the books. She said that any purchases made from Orgill or Dealers were for water heaters or furnaces, or other non-utility items. Therefore, any transactions involving these two dealers should be reclassified into Accounts 415 and 416.

Account 416 should reflect reclassifications from Account 903 of $6,320.85 and from Account 764 of $862.12. The balance of Account 416 should be $7,182.97 at the end of 1999.

Account 415 should reflect a reclassification from Account 903 of $2,297.93.

According to Staff's conversations with Mrs. Ison, the two accounts, Account 415 and 416, should have the same balances. Mrs. Ison stated that as soon as she bought a piece of equipment and re-sold it to a customer, she credited the expense account to which it was originally charged. However, there was no supporting documentation for any customer purchases. Elam did not retain any sales receipts, and did not keep an inventory of non-utility items, according to Mrs. Ison. Elam did have invoices from Dealers and Orgill on file that supported entries in the general ledger for its purchases. Also, Staff learned from the discussion that Elam's employees install the equipment once the customer purchases it. There were no time records supporting how much time each employee spent working on non-utility business. Also, there were no records documenting the mileage or time spent using the company trucks to transport the appliances.

Elam should account for the appliance purchase and sales properly and keep proper documentation of each transaction. Accounts 415 and 416 should be used to record these expenses. Elam should also give customers receipts for sales, and keep copies of those receipts. Currently, the cash received for the appliances is deposited with the monthly gas receipts, and there is no record tying the cash received from appliance sales to the original expense. Also, Staff could not determine how much the customer paid for the appliance, whether the sale price of the appliance matched the expense incurred by Elam, or if the costs for the customer included taxes and shipping. In addition to the cost of the appliance, Account 416 should include the labor costs of installing the appliances, any incidental expenses, and the costs of bookkeeping and other clerical work in connection with merchandising and jobbing activity. Therefore, records such as time sheets, vehicle usage and salary allocations should reflect the time that each employee spends doing work that is not expressly related to utility business. Additionally, Staff found several invoices and bills from a local hardware store and repair part suppliers that were not allocated into proper expense accounts. The bills were entered into one account, such as Maintenance of Lines or Supplies and Expenses, when paid. Staff found several items on the bills that were probably related to installing appliances, such as thermacouples. However, Staff could not determine how much of the amounts were utility, non-utility, or personal. Therefore, Elam should allocate all of its purchases into the appropriate expense accounts instead of expensing the total purchases into one account when they are paid.

Account 426-Non-Utility Deductions ("Donations")

Account 426, Non-Utility Deductions, had a balance of $25 at the end of 1999. $448 of donations from Account 930.2 should be classified in this account, as was explained in the discussion for Account 930.2. Also, $200 from Account 903 should be in Account 426, as previously discussed. The total of Staff's adjustments to this account is $648, increasing this account from $25 to $673.

<u>"Other Accounts" in Other Deductions section of the Income Statement</u>

Accounting adjustments for this account are mentioned under the section titled Account 924, Property Insurance and Other Deductions.

Following is an adjusted income statement reflecting all of the accounting adjustments previously discussed.

Acct. Num	Account Title	Elam's Test-Year	Staff Adjustments	Staff Adjusted Balances
Operating Revenues:				
	Revenues from Base Rates	$238,036.60	$ 0	$238,036.60
	GCA Revenues	200,120.20	0	200,120.20
	Total Gas Service Revenues	$438,156.80	$ 0	$438,972.99
	Other Gas Revenues	2,250.55	0	2,250.55
	Total Operating Revs.	$440,407.35	0	$440,407.35
Operating Expenses:				
730	Natural Gas Purchases	$200,120.20	0	$200,120.20
760	Supervision	35,591.20	0	35,591.20
761	Mains & Svc. Labor	17,795.60	0	17,795.60
762	Mains & Svc. Exp.	12,670.20	0	12,670.20
767	Maint. of Lines	13,179.77	0	13,179.77
768	Maint. of Meters	5,127.29	(862.12)	4,265.17
769	Maint. of Other Plant	1,926.47	0	1,926.47
901	Meter Reading Labor	4,448.90	0	4,448.90
902	Accounting & Collecting	22,244.49	0	22,244.49
903	Supplies and Expenses	10,772.23	(4,222.92)	6,549.31
904	Uncollectible Accounts	760.37	0	760.37
920	Admin. & Gen. Salaries	8,897.81	0	8,897.81
921	Office Supplies & Exp.	15,867.64	55.00	15,922.64
923	Outside Services	3,213.50	0	3,213.50
924	Property Insurance	9,768.36	(2,866.89)	6,901.47
925	Injuries and Damages	0	1,592.94	1,592.94
926	Pensions and Benefits	6,547.36	2,013.15	8,560.51
930.2	Misc. General Exp.	3,138.06	(538.00)	2,600.06
931	Rents	11,700.00	0	11,700.00
933	Transportation Exp.	9,836.01	47.41	9,883.42
403	Depreciation Exp.	32,156.78	0	32,156.78
404	Amortization Exp.	0	0	0
408.1	Taxes Other Than Income	16,198.70	(12.41)	16,186.29
	Total Gas Operating Exps.	$441,960.94	$(4,793.84)	$437,167.10
	Net Operating Income (Loss)	$ (1,553.59)	$ 4,793.84	$ 3,240.25
Other Income:				
415	Revs. from Merchandising, Jobbing & Contract Work	$ 0	$ 2,297.93	$ 2,297.93
	Cancellation of Accrued Int.	42,644.29	0	42,644.29
	Total Other Income	$ 42,644.29	$ 2,297.93	$ 44,942.22
Other Deductions:				
416	Exps. of Merchandising, Jobbing & Contract Work	$ 0	$ (7,182.97)	$ (7,182.97)
427	Interest on Long Term Debt	(22,499.88)	0	(22,499.88)
426	Non-Utility Deductions	(25.00)	(648.00)	(673.00)
431	Other Interest Expense	(9,763.15)	0	(9,763.15)
	Other Deductions	(5,697.00)	739.20	(4,957.80)
	Total Other Deductions	$(37,985.03)	$(7,091.77)	$ (45,076.80)
	Net Income	$ 3,105.67	$ 0	$ 3,105.67

RECOMMENDED RATE-MAKING ADJUSTMENTS

Normalized Revenues

Elam proposed normalized revenues of $438,156.80 that excluded revenues of $1,076.65 for gas used by Elam and for free gas supplied to Wilma Ison. Elam's normalized revenues were based on its retail rates at the time of the filing applied to the 1999 sales volumes and included $200,120 in revenues generated from Elam's Gas Cost Adjustment ("GCA") mechanism. Staff recommends, for ratemaking purposes, that normalized revenues include test year levels for forfeited discounts, miscellaneous service revenues and other gas revenues. In addition, Staff recommends that normalized revenues reflect the $816.19 that Wilma Ison received in free gas as an Employee Benefit from Elam. Also, Staff recommends that normalized revenues reflect an adjustment of $147,027.80 to account for the increase in revenues generated from Elam's most recently-approved GCA. While this increase will not affect the revenue requirement from base rates, it is a part of the total revenues of Elam. Based on the amounts for forfeited discounts, miscellaneous service revenues, and other gas revenues reported in Elam's 1999 Annual Report, the amount that Wilma Ison received as an employee benefit, and GCA revenues, Staff recommends normalized revenues, for ratemaking purposes, in the amount of $588,251.34.

Purchased Gas Expense

Elam proposed normalized purchased gas expense of $200,120 based on volume purchased during 1999 of 53,309 Mcf and the purchased gas cost in effect during the test year. Staff recommends normalizing Elam's purchased gas expense to reflect the most recent GCA. Using the most recent GCA of $6.5120 per Mcf, effective

January 1, 2001, results in an adjustment to purchased gas cost of $147,027.80. The normalized purchases gas expense is $347,148.

Salaries and Wages and Consulting Fees:

Account 760, Supervision; Account 761, Mains and Services Labor; Account 901, Meter Reading Labor; Account 902, Accounting and Collecting Labor; Account 920, Administrative and General Salaries

During the test year Elam incurred salaries and payroll expense as follows:

	Acct. 760	**Acct. 761**	**Acct. 901**	**Acct. 902**	**Acct. 920**	**Total**
Office Mngr.	$18,720.00	$ 9,360.00	$2,340.00	$11,700.00	$4,680.00	$46,800.00
Field-1	$ 8,292.00	$ 4,146.00	$1,036.50	$ 5,182.50	$2,073.00	$20,730.00
Field-2a	$ 7,261.70	$ 3,630.85	$ 907.71	$ 4,538.56	$1,815.43	$18,154.25
Field-2	$ 1,317.50	$ 658.75	$ 164.69	$ 823.43	$ 329.38	$ 3,293.75
Total	$35,591.20	$17,795.60	$4,448.90	$22,244.49	$8,897.81	$88,978.00

Elam proposed to increase the office manager, Mrs. Ison's salary by $13,200, or 28%, and proposed to increase field employees 1 and 2's salaries in total by $2,100, or 5%. During the test year, field employee 2a ended his employment at Elam, and field employee 2 was hired to replace him. The schedule above shows the actual test year expense by employee. Elam had one additional part time employee during the test year whose wages were not recorded in the annual report or on the general ledger as part of the salaries expense.

Elam's basis for the increase in Mrs. Ison's salary was that the salary had been reduced in previous years, so the amount of increase is reasonable. A review of the history of Mrs. Ison's salary, over the 1993 to 1997 period reveals an increase of 27% with the salary increasing from $42,137 to $53,650. Given the financial circumstances of Elam, Staff believes that the reduction in the Mrs. Ison's salary to $46,800, which occurred in 1999, was a prudent action and the salary should not be increased at this time as proposed by Elam. For a utility with less than 500 customers, two additional full time employees, and one part time employee, the level of salary for the principle officer of the company is adequate.

Elam did not provide an explanation for the increase of 5% for the other employees. There was no documentation supporting this adjustment, and Staff has not included the adjustment as it was proposed. Elam submitted the wage levels in 2000 for the field employees, which Staff has accepted. The total annualized salaries based on the 2000 level of wages for the field employees are $37,440. Additionally, Staff believes it is reasonable to increase the field employee's salaries by 5% to reflect a reasonable level for 2001. This results in an increase of $1,872 to the year 2000 annualized wages for the field employees.

Staff has increased the annualized 2000 wages by an additional $7,300[5], or $3,650 per field employee to include the "on-call" wages. Elam has one of its two field employees on-call each night, and it pays him $20 per night for the service, in addition to his regular wages. Mrs. Ison stated that during the test year one of the employees had his on-call wages rolled into his paycheck, while the other employee received both a weekly paycheck and a separate weekly check for his on-call wages. Staff believes that treatment of both employees' wages should be the same.

The combined salary for the field employees for the test year was $42,178. Staff recomputed the salaries of the two field employees and included the payments for their services while on-call and determined that a normalized combined salary of $46,612 is reasonable. This results in an adjustment increasing the field employees' wages by a

[5] $20 per night X 365 nights per year = $7,300.

total of $4,434. For a small gas utility with three full-time employees and one part-time employee, the salaries are adequate at the Staff adjusted level and no adjustment should be made to increase these salaries above this level.

Staff has increased the test year salary expense by $12,000 to reflect a salary for the part-time employee. This reflects a salary of $1,000 per month. Based on information supplied by Elam, this part-time employee is involved in securing the gas supply for Elam and fills in when other employees are not available. There were no records to support the level of work performed by this employee during the test year. In discussions with Mrs. Ison, it appears that this part-time employees' services are not required on a regular basis. Consequently, it would be inappropriate to include any greater level of salary for this person.

Staff notes that while we have increased the salary levels for the two field employees, the salaries and wages expenses will be re-evaluated during Elam's next rate case. Elam's total salaries and wages expenses may be in excess of the level required for a utility with less than 500 customers. Elam has not kept detailed records supporting the wages and salaries. Based on a comparison of other small gas utilities similar in size to Elam, Elam's salaries are above the average. In future proceedings it will be incumbent upon Elam to support the wages and salaries expense to be included in rates. These records should include time sheets for hourly employees that clearly reflect allocation of wages to the proper utility and non-utility accounts. The duties and responsibilities of salaried employees and some detail of the work performed will be required to justify these wages in future proceedings.

With the inclusion of all of the salaries stated previously, the total adjusted salaries expense is $105,412. In consideration of a reasonable level of salary expense for Elam, Staff reviewed the salary history of Elam since Case 92-488. Using the salaries that were being paid to Ms. Phillips, Mrs. Ison, and a field employee in 1992 as a benchmark, Staff inflated the salaries based on the rate of inflation using the Consumer Price Index average since 1992. This resulted in an inflation-adjusted level of wages of $107,827 as set out in Schedule I. Since the total salaries included by Staff are within that amount, Staff believes the level of salaries is adequate for ratemaking purposes in this case.

Following is the distribution of the allowable salaries into the proper accounts using the same allocation as used by Elam during the test year:

	Acct. 760	**Acct. 761**	**Acct. 901**	**Acct. 902**	**Acct. 920**	**Total**
Office Mngr.	$18,720.00	$ 9,360.00	$2,340.00	$11,700.00	$4,680.00	$46,800
Field-1	$10,196.00	$ 5,098.00	$1,274.50	$ 6,372.50	$2,549.00	$25,490
Field-2	$ 8,448.80	$ 4,224.40	$1,056.10	$ 5,280.50	$2,112.20	$21,122
Part-Time	$ 4,800.00	$ 2,400.00	$ 600.00	$ 3,000.00	$1,200.00	$12,000
Total	$42,164.80	$21,082.40	$5,270.60	$27,103.00	$10,541.20	$105,412

In addition to the two adjustments to payroll, Elam proposed to include a consulting fee of $42,173 for a "reclassification of the note payments to the Phillips as a consulting fee to the Isons."[6] The amount of the consulting fee is the same as the annual principle and interest payments on the loan to the Phillips. In case 92-488, Elam stated that the purchase of the stock of Elam would be paid for by the Isons and that Elam would not incur any additional expense as a result of the transfer. The

[6] Elam Application dated September 15, 2000.

Commission's approval of the transfer was based on the statements that the purchase of the utility would not be borne by the customers of Elam. If the Commission had been informed that the purchase would be made from utility funds, it may not have approved the transfer under the proposed terms. Since the transfer was a stock purchase between two private parties, there is no basis to include the payments on the loan to the Phillipses in the cost of providing service by Elam. Therefore, Staff has not included the proposed adjustment.

As stated previously, Staff allocated the total adjusted amount of salaries and wages of $105,421 to the expense accounts using the allocation factors provided by Elam. They are as follows: Supervision, 40%; Mains and Service Labor, 20%; Meter Reading Labor, 5%; Accounting-Collecting, 25%; Administrative Salary, 10%. During the field review, Elam disclosed that these percentages are applied to each employee, whether he or she works in the office or in the field. Staff does not believe that it is appropriate for 20 percent of the office manager's wages to be allocated to mains and services labor, nor does it believe that the employees working out in the field should have 35 percent of their wages allocated to office work and 40 percent allocated to supervision. Therefore Staff recommends that Elam perform a study in order to determine the proper wage expense allocations for each employee.

Elam did not allocate any of the salaries and wage expenses to the non-utility operations. Based on Staff's discussions with Mrs. Ison, the two field employees may perform non-utility service work for customers and charge them a separate fee for their services. Elam should maintain time reports on each employee. Work of a non-utility nature should be allocated properly to the non-utility operations. The 2000 General

Assembly passed a bill that requires utilities with non-utility business activities to allocate costs so that there is no cross-subsidization of the non-utility activity by the utility customers. The USoA also requires the allocation of costs between utility and non-utility operations. Elam keeps no formal records of when the employees work, and what they do while at work. In order to comply with the provisions of USoA, Elam should determine a proper allocation factor for Account 416, Costs and Expenses of Merchandising, Jobbing, and Contract Work, and assign any labor related to non-utility activities to this account.

Account 762, Mains and Services Supplies and Expenses

Elam proposed no adjustment to this account. During the test year, Elam charged $12,670.20 to this account. Of this amount, $2,380 was for payments to Advanta for credit card purchases. The account also contained $600 in payments to Lowe's for an outstanding credit card balance. Elam provided no documentation during the field review supporting purchases made on the Advanta and Lowe's credit cards. Although some of this expense may have been for legitimate utility purposes, there were no receipts or other information that would show the nature of the expense. Therefore, Staff recommends that the expenses be excluded for the purposes of this case. Another expense charged to this account was $650 for vacation pay to Mrs. Ison. Mrs. Ison stated that the vacation pay was for vacation time accrued in previous years. Staff recommends that this amount be excluded for the purposes of this case due to its non-recurring nature.

Account 767-Maintenance of Lines

Elam reported $13,179.77 in this account in 1999. During the test year, Elam made payments of $4,755 to Rob Ison that were charged to this account. Mrs. Ison stated during Staff's visit that these transactions were for his on-call time wages, but there is no documentation regarding these payments. She said that Elam writes Rob a check every week for the on-call time that he works. The two field employees receive $20 a night to be on-call, but Staff notes that there were four checks written to Rob during the year that were $155 or more. These expenditures included more than just being on-call for seven nights a week, but Elam could provide no documentation regarding what the amounts might have included. Due to the failure of Elam to provide supporting documentation, Staff recommends that these costs be excluded for the purposes of this case. Also, Staff recommends disallowing $5,050 relating to credit card payments made to Lowe's and Advanta for the reasons set out in the adjustment to Account 762. These transactions lacked any supporting documentation. Elam charged expenditures made to Chris Murphy for $20 and Rob Ison for $70 which should be disallowed due to both their lack of documentation and their non-recurring nature. Another expense charged to this account was $650 for vacation pay to Mrs. Ison. Mrs. Ison stated that the vacation pay was for vacation time accrued in previous years. Staff recommends that this amount be excluded for the purposes of this case due to its non-recurring nature. The total adjustment to this account for ratemaking purposes should be a reduction of $10,545.

Account 768-Maintenance of Lines

Elam proposed no adjustment to this account. Staff recommends a reduction of $975 to exclude expenses relating to the payments made to Advanta and Lowe's credit cards. There is no documentation supporting the purchases made on these cards.

Account 769-Maintenance of Other Plant

Elam proposed no adjustment to this account. However, Staff recommends a reduction of $1,680 to exclude expenses relating to the Advanta and Lowe's credit cards, as previously mentioned. There is no documentation supporting the purchases made on these cards.

Account 903-(Customer) Supplies and Expenses

Elam reported $10,772.23 of expenses in Account 903 for the test year. Elam proposed an adjustment to reduce this account by $5,107 to write-off obsolete inventory items that are non-recurring. Staff does not accept this adjustment because it was not properly explained or documented. Staff could not determine what items were included in the $5,107 adjustment proposed by Elam, and Elam provided no schedule or workpapers showing the calculation of the adjustment. Staff has reviewed invoices supporting the balance in this account as reported in the annual report and recommends a ratemaking reduction to this account of $3,072.47. This adjustment is in addition to the accounting adjustments of $4,222.92 mentioned earlier in this report. $631.84 of the proposed ratemaking reduction relates to payments made to Blossom Florist for flower arrangements given to deceased customer's families. These expenses are not essential to provide gas service and should not be included for ratemaking purposes. $720.63 of the reduction was for unallowable advertising expenses and a payment made to Contemporary Concepts for pamphlets distributed to customers concerning how to cope with grieving. There were $785 of expenditures to a Pitney Works credit card account for which there was no supporting documentation. Also, $860 should be excluded for payments made to the Advanta credit card due to lack of documentation and receipts. Finally Staff determined that a reduction of $75 should be made for a check written to Sam's Club. The check was written for $105, and $75 was for membership dues of a personal nature to the Ison's that were unrelated to Elam. The resulting balance of this account after both accounting and ratemaking adjustments is $3,476.84.

Account 921-Office Supplies and Expenses

Elam proposed no proforma adjustments to the office supplies and expenses account. Staff made several adjustments to this account, as the following schedule indicates.

GL Description of Expense	**Amount**	**Reason for Excluding**
Frontiervision/Adelphia	$ 386.06	Cable TV is not required to provide utility service.
Cash Received	$ 713.15	No documentation
Telephone Expense	$1,458.72	Exclude personal phone expenses of the employees.
Courier Publishing	$ 17.00	Promotional advertisement
Courier Publishing	$ 15.00	No documentation
UPS	$ 6.25	Personal Expense
Pitney Works	$1,200.00	Credit card-No documentation
Advanta	$1,300.00	Credit card-No documentation
Brown's TV	$ 18.73	Not required to provide utility service
Total to exclude	$5,114.91	

Several items have been disallowed due to lack of substantiation, as noted above. Elam provided no documentation supporting the general ledger entries for those items. Also, while Elam did provide copies of bills paid to their cable provider and television repair, Staff does not believe such expenses are necessary to run the utility, and therefore should be removed from operating expenses for ratemaking purposes. Additionally, Staff determined $1,458.72 of telephone expenses should be removed, as noted above. Every month, Elam pays for each of its employees to have a pager, a cellular phone, and a basic home phone line at his or her residence. Staff realizes that during emergencies, it is necessary to be able to reach the employees at any time. However, Elam's telephone expenses are excessive for a utility its size. Staff believes that providing a cell phone to each employee would be adequate for the purpose of getting in touch with him or her during emergencies. Mrs. Ison told us how much the home phone line charges were per month, and Staff used the monthly telephone bills to determine the pager charges. The calculation for this reduction is as follows:

Office Manager-Home Line	$ 25.00
Field Employee 1-Home Line	$ 22.38
Field Employee 2-Home Line	$ 22.38
Pagers	$ 51.80
Total Monthly Charges	$ 121.56
Multiply by 12 Months	12
Total Reduction	$1,458.72

Staff found an invoice to UPS for $6.25 that should be removed from this account as well because it was a personal expense of the Ison's. The total expenditures that Staff recommends excluding for ratemaking purposes from this account are $5,114.91.

Account 924-Property Insurance and "Other Deductions"

After the accounting adjustments explained in the previous section, Account 924 has a balance of $6,901.47. Staff excluded $2,364.00 of life insurance expenditures to Commonwealth Life Insurance ("Commonwealth") for ratemaking purposes. This expense represents a $500,000 life insurance policy for Wilma Ison. The Isons' personal loan agreement with the Phillipses requires that the Isons carry life insurance on Wilma Ison in the face amount equal to the Company's outstanding aggregate indebtedness, to be payable to the Company and to the Phillipses. While this may be required for the Isons personal loan, it should not be an expense borne by Elam. Elam is not required to carry this life insurance, and as such, Staff recommends that the expense not be included for rate-making purposes. Therefore the total ratemaking adjustment to Account 924 is a reduction of $2,364.00.

Currently, Elam is paying for two $500,000 life insurance policies through Woodmen of the World Insurance ("WOW"). One of these policies covers Wilma Ison, and the other covers Doug Ison. While the Isons may be required to carry life insurance by their agreement with the Phillips, Elam should not be responsible for paying the premiums. Elam paid $422.90 a month in 1999 for the two policies. Therefore, Staff has reduced the Other Deductions account by $5,074.80 to remove the payments made to WOW during the test period. Additionally, Staff has increased this account by $117 to account for the reconciling adjustment explained in the accounting section for Account 924 and Other Deductions. Therefore, the net proforma adjustment to the account Other Deductions is a reduction of $4,957.80

Although Staff has disallowed these life insurance expenses, Staff notes that Elam should look into the proper tax treatment for these items. According to federal income tax guidelines, any group term life insurance coverage that exceeds $50,000 a year per individual provided by an employer should be included in the employee's taxable income for the year and shown on the employee's W-2 forms.

Account 925-Injuries and Damages

Although Elam proposed no adjustment to this account, Staff proposed to increase it by $891.38. After the accounting adjustment explained in the previous Injuries and Damages section, Staff recommends an additional adjustment to increase worker's compensation insurance. A computation of Elam's workers compensation premium based on normalized wages of $105,412 is provided below. The calculation is based on the workers compensation rates on Elam's invoice for insurance from 12-15-1999 to 12-15-2000 from Kentucky Employers' Mutual Insurance.

Base Premium Calculation:

Total office employees' class salaries		$58,800.00		
Rate per $100 of compensation	$0.38	x .0038		
Base Premium on office employees' class			$ 223.44	
Total employees' class salaries for natural gas local distributing, drivers, etc.		$46,612.00		
Rate per $100 of compensation	$4.11	x .0411		
Base Premium on employees' class for natural gas local distributing, drivers, etc.			$ 1,915.75	
Base Premium calculated			$ 2,139.19	
Add: Expense Constant			$ 140.00	
Subtotal			$ 2,279.19	
Add: Kentucky Special Fund Assessment of 9%			$ 205.13	
Staff computed workers compensation policy premium				$ 2,484.32
Less: Adjustment from Account 924 per annual report (accounting adjustment)				$ (1,592.94)
Total Ratemaking Adjustment				$ 891.38

Account 926-Employee Pensions and Benefits

Elam's most recent invoices available for health insurance reflect a premium of $189.33 per month for a single employee. The annual cost of insurance for three employees is $6,815.88. Staff determined that in the test year, Elam paid for family insurance coverage for one of its employees. The Commission does not normally allow for family coverage and finds no compelling reason to do so in this case. The test year health insurance expenditure to Anthem BCBS of $5,232.30 was subtracted from the annualized premiums described above to arrive at the adjustment for health insurance expense. Additionally, Staff removed $620.63 for payments made to Clinic Pharmacy because they were non-recurring charges. Also removed from this account was a non-recurring expenditure of $160.02 to Frederick and May Lumber Company, which Mrs. Ison stated was for insurance coverage for Chris Murphy. Frederick and May was Chris Murphy's previous employer, and Elam had to make a payment to them for his insurance before his coverage under Elam had taken effect. Staff reduced the account by $534.41 to eliminate one non-recurring charge made to CHA Health Insurance. Also Staff annualized $29.70 a month for expenditures made for the two field employees' life insurance. This resulted in a ratemaking increase of $252.45.[7] Following is a summary of the adjustments to this account.

[7] $29.70/month x 12 months = $356.40-$103.95 (accounting adjustment) = $252.45.

Balance after accounting adjustments			$8,560.51
Less:			
Anthem Blue Cross/Blue Shield		$5,232.30	
Clinic Pharmacy		$620.63	
Frederick and May		$160.02	
CHA Health Insurance		<u>$534.41</u>	
Subtotal			($6,547.36)
Add:			
Anthem Blue Cross/Blue Shield		$6,815.88	
Employee Life Insurance		<u>$252.45</u>	
Subtotal			<u>$7,068.33</u>
Total Account 926, After Adjustments			$9,081.48

Staff recommends a ratemaking adjustment to increase this account by a total of $520.97. The total of Account 926, after ratemaking and accounting adjustments is $9,081.48.

<u>Account 930.2-Miscellaneous General Expenses</u>

Elam did not propose to adjust this account. However, Staff recommends several adjustments in addition to the accounting adjustments explained earlier in this report. Elam had no documentation regarding an expenditure of $89.01 to Elder Beerman. This should be removed because Staff cannot determine if the purchase was of a business or personal nature. Also, a charge of $96.42 described as “Correct to Actual” and an expenditure to $675.64 to Robert Hopkins, a former employee of Elam, lacked any supporting documentation and should not be included for ratemaking purposes. An additional transaction of $657.12 paid to Robert Hopkins was identified as vacation pay. Since Robert Hopkins is no longer employed by Elam, this is a non-recurring expense which should not be included. These ratemaking adjustments total $1,518.19, leaving $1,081.97 of allowable expense in this account.

Account 931-Rents

Elam paid $11,700 during the test year to B.C. and Ethel Phillips for office rent. The current rental agreement with the Phillipses requires Elam to pay a monthly rental fee and pay all utilities, insurance, and property taxes on the property owned by the Phillipses. Staff notes that Elam's rental agreement expires in 2001. Staff recommends that Elam be required to solicit bids from the Phillips and other lessors for office space and secure an agreement with terms that are more favorable to Elam. The amount of office space currently leased by Elam may be in excess of what would be required to operate a small gas utility. Therefore, when Elam is securing bids, it should consider a reduced amount of office space, depending on what the most cost-effective option would be.

Account 933-Transportation Expense

Elam did not propose any adjustments to this account. During Staff's review of the invoices and receipts for expenditures, it was noted that Elam has been making monthly payments on a Mazda pick-up truck. Mrs. Ison stated that the two company trucks were a 1995 Dodge Dakota and a 1989 Chevrolet. She also stated that her personal car is sometimes used for business purposes. The lease agreement for the Mazda truck is between the seller, GE Capital Auto Lease, and the buyer, Robert D. Ison. Staff recommends reducing this account by $4,066.04 for payments by Elam made to GE Capital Lease on Rob Ison's personal truck. This is the only ratemaking adjustment Staff proposed for this account.

During its review, Staff found that there is little documentation supporting two credit cards whose purchases Elam charges to this account. The Shell Oil credit card and the Marathon credit card are both credit cards that Elam's employees use to purchase gas. Elam keeps no mileage records on its vehicles, nor does it keep all of the receipts for these credit card purchases. Staff could not determine if the gas purchased was for personal or business use. Staff did not exclude the full expense because gasoline is a reasonable expense for a utility to incur and Staff could not determine a reasonable basis upon which to disallow a portion of this expense. Elam should maintain records of the business use of all vehicles and only amounts for legitimate business purposes should be charged to Elam. Elam should also maintain mileage associated with the merchandising and contract work and include these costs in the proper account. All employees should keep daily mileage logs on each vehicle they use. Elam should be put on notice that the Commission will not allow any undocumented transportation charges in future rate cases.

Account 403-Depreciation and Depletion Expense

Elam proposed no adjustments to this account. Elam uses tax depreciable lives to determine its depreciation expense. Staff recalculated this expense using service lives that are more appropriate for utility ratemaking. Using the depreciation expense report submitted by Elam, Staff applied the new lives to assets that had not previously been fully depreciated. The resulting adjustment is a reduction of $3,544.08 to Account 403. The attached Schedule II contains the recalculation of Depreciation Expense.

Account 404-Amortization Expense

Elam proposed to increase Amortization Expense by $3,600 to amortize the cost of this rate case over a five-year period. The adjustment assumed that Elam would incur $18,000 of costs associated with the rate case. Staff has included an adjustment of $2,601.24 based on the actual invoices for outside services related to this case. Elam incurred $186 of charges for legal advertising of the proposed rates, attorney fees of $1,000.85, and $3,303.75 of accounting fees. Staff proposes amortizing these three amounts over three years, which is an increase to Account 404 of $1,496.87. Staff used a three year amortization period instead of a five year period because that is the usual time frame between rate cases for utilities. Also, Staff recommends that accounting fees for filing the Purchased Gas Adjustments ("PGA") of $2,902.50 be amortized for three years, which is an additional increase to Account 404 of $967.50. The full amount of these fees should not be included on the proforma statement because they were a one-time cost associated with updating seven years of gas costs in order for Elam to file its current PGA. Finally, accounting fees of $4,106.25 relating to work performed in conjunction with the Department of Local Government loan[8] should be amortized over a 30-year period, which corresponds to the life of the loan. This amortization period is in accordance with the USoA that provides for amortization of loan fees over the life of the loan. This amounts to an increase of $136.88 in the yearly amortization expense. Following is a calculation of the adjustment proposed by Staff:

[8] Loan approved in CN 2000-339, Application of Elam Utility Company, Inc., Morgan County, Kentucky, for Authorization to Borrow $180,000 from the Economic Development Administration through the Department of Local Government. Order dated August 22, 2000.

Known Rate Case Expenses:

Legal Advertisements for Proposed Rates	$ 186.00		
Attorney Fees	$1,000.85		
Accounting Fees	$3,303.75		
Total	$4,490.60		
Amortize for 3 years (Divide)	3		
Yearly Rate Case Amortization Expense		$1,496.87	
Add:			
Accountant Fees for Filing PGAs	$2,902.50		
Amortize for 3 years (Divide)	3		
Yearly PGA Amortization Expense		$ 967.50	
Accountant Fees for Filing DLG Loan	$4,106.25		
Amortize for 30 years (Divide)	30		
Yearly Loan Amortization Expense		$ 136.88	
Yearly Amortization Expense			$2,601.24

Account 408.1-Taxes Other Than Income Taxes

Elam reported Taxes Other Than Income Taxes Expense for the test year of $16,198.70. Elam included six accounts from its general ledger in the amount included in Account 408.1 in the Annual Report. Elam proposed that $5,122 from its general ledger Account 935, Penalties, be excluded from Account 408.1. The reason cited for this adjustment is that with the new DLG loan[9], the filing of PGAs, and the rate increase, cash flow should be adequate to prevent penalties on late filings of taxes and other late payments of bills. Staff agrees with this proposed adjustment, and has decreased Account 408.1 by $5,122.04 to reflect the change.

Elam proposed a second adjustment to this account to increase the general ledger account for FICA taxes by $1,170 in order to correspond with the proposed

[9] Id.

proforma adjustment in salaries and wages. Staff recomputed FICA taxes on the $105,412 of payroll expense proposed by Staff. The resulting amount is $8,064.02, which is an increase of $1,064.17 over the FICA amount recorded in the test year. The two adjustments result in a net decrease to Account 408.1 of $4,057.87.

<u>"Cancellation of Accrued Interest"</u>

During the test year, Elam reported $42,644 of income under the "Other Income" section of the income statement titled "Cancellation of Accrued Interest". Elam proposed to remove this income from its proforma statement for the test year because it is non-recurring. The DLG cancelled the accrued interest on Elam's loan in February of 1999. Staff agrees that this adjustment should be made, and has reduced "Other Income" by $42,644.

<u>Account 427-Interest on Long Term Debt and Account 431-Other Interest Expense</u>

Elam reported a total of $32,263.03 of interest expense in its 1999 annual report which consisted of interest on long term debt of $22,499.88 and other interest expense of $9,763.15. Elam's 1999 general ledger also included total interest expense of $32,263.03. However, account 427 on the general ledger included $23,136.90 of interest expense and account 431 included $9,126.13. While the total interest expense between the general ledger and annual report is the same, the two accounts making up the totals are not in agreement. Elam proposed a reduction to interest expense of $5,089. The reason provided for the reduction was "With the new loan from the DLG, the average annual savings will be approx. $5,195." Elam's adjustment was not separated between Account 427 and Account 431.

Elam submitted a schedule of Notes Outstanding with its application, but re-filed it with corrections in response to Item 2 of the Commission's data request dated October 6, 2000. Staff used the re-submitted schedule as a basis to determine the proforma interest expense. Staff has included the schedule in this report as Schedule III for reference purposes.

The interest on long-term debt of $22,499.88 was the interest paid in 1999 on the Isons' loan to the Phillipses. The Commission approved the transfer of the company in case 92-488 on the grounds that the Isons would pay for the stock purchase and Elam would not be encumbered in any way. Therefore, Elam should not include the principle amount of the loan and the interest expense on its books. Staff recommends reducing this account by $22,499.88.

Staff has made an adjustment to increase interest expense by $9,760.81 in Account 427. This adjustment is based on the three year average of interest expense that will be incurred on the DLG loan of $180,000 approved by the Commission in case 2000-339.[10] Staff used the interest expense from October 2001 to September 2004 and averaged the yearly expense. An earlier three-year period was not used because October 2001 is the first month in which a payment will be made on the new loan. A calculation of the average interest expense is included in Schedule IV to this report.

Staff has increased Account 427 for the DLG note that originated in 1981 and was restructured in February of 1999. The original note had an interest rate of 5.5% and a term of 30 years. After the restructuring, the loan had a 15-year term, a 4 percent interest rate, and principal of $436,916.70. Staff determined that a three-year average

[10] Id.

interest expense of $16,592.23, which is based on the amortization schedule provided by DLG to Elam should be used for ratemaking purposes. The three-year period used to compute the average is January 2000 to December 2002. A calculation of the average interest expense is included in Schedule IV to this report.

The schedule of notes outstanding submitted with the application contained an item labeled “Late Filing Payroll Taxes.” Staff has concluded that this expense was penalties for late filing of payroll taxes in the amount of $3,660.84. This was improperly charged to Account 431 and should be excluded for ratemaking purposes. Elam should manage its cash flow better so that it does not incur costs of this nature in the future. Staff also recommends excluding interest on purchases of $2,666.22 because there is no supporting documentation for the interest, and there is no supporting documentation of the purchases made. Commercial Bank Loan #51725901 was repaid on October 20, 2000, and Commercial Bank Loan #51725903 was repaid on February 11, 2000. Therefore interest on these two loans of $259.55 and $352.68, respectively, should be removed from Account 431. The Modern Acceptance loan interest of $457.51 should be excluded for rate-making purposes as well because the loan was paid in full by Wilma Ison, and there is no loan agreement between Elam and Mrs. Ison specifying the terms of repayment. Staff’s proposed reductions to Account 431 total $7,396.80, and result in an ending balance of $2,366.35 for the account.

Following is an adjusted income statement reflecting all of the adjustments previously discussed.

Acct. Num	Account Title	Staff Adjusted Balances	Ratemaking Adjustments	Staff Proposed Balances
Operating Revenues:				
	Revenues from Base Rates	$238,036.60	$ 816.19	$238,852.79
	GCA Revenues	200,120.20	147.027.80	347,148.00
	Total Gas Service Revenues	$438,156.80	$147,843.99	$586,000.79
	Other Gas Revenues	2,250.55	0	2,250.55
	Total Operating Revs.	$440,407.35	$147,843.99	$588,251.34
Operating Expenses:				
730	Natural Gas Purchases	$200,120.20	$147,027.80	$347,148.00
760	Supervision	35,591.20	6,573.60	42,164.80
761	Mains & Svc. Labor	17,795.60	3,286.80	21,082.40
762	Mains & Svc. Exp.	12,670.20	(3,630.00)	9,040.20
767	Maint. of Lines	13,179.77	(10,545.00)	2,634.77
768	Maint. of Meters	4,265.17	(975.00)	3,290.17
769	Maint. of Other Plant	1,926.47	(1,680.00)	246.47
901	Meter Reading Labor	4,448.90	821.70	5,270.60
902	Accounting & Collecting	22,244.49	4,108.51	26,353.00
903	Supplies and Expenses	6,549.31	(3,072.47)	3,476.84
904	Uncollectible Accounts	760.37	0	760.37
920	Admin. & Gen. Salaries	8,897.81	1,643.39	10,541.20
921	Office Supplies & Exp.	15,922.64	(5,114.91)	10,807.73
923	Outside Services	3,213.50	0	3,213.50
924	Property Insurance	6,901.47	(2,364.00)	4,537.47
925	Injuries and Damages	1,592.94	891.38	2,484.32
926	Pensions and Benefits	8,560.51	520.97	9,081.48
930.2	Misc. General Exp.	2,600.06	(1,518.19)	1,081.87
931	Rents	11,700.00	0	11,700.00
933	Transportation Exp.	9,883.42	(4,066.04)	5,817.38
403	Depreciation Exp.	32,156.78	(3,544.08)	28,612.70
404	Amortization Exp.	0	2,601.24	2,601.24
408.1	Taxes Other Than Income	16,186.29	(4,057.87)	12,128.42
	Total Gas Operating Exps.	$437,167.10	$126,907.83	$564,074.93
	Net Operating Income (Loss)	$ 3,240.25	$ 20,936.16	$ 24,176.41
Other Income:				
415	Revs. from Merchandising, Jobbing & Contract Work	$ 2,297.93	$ 0	$ 2,297.93
	Cancellation of Accrued Int.	42,644.29	(42,644.29)	0
	Total Other Income	$ 44,942.22	$(42,644.29)	$ 2,297.93
Other Deductions:				
416	Exps. of Merchandising, Jobbing & Contract Work	$ (7,182.97)	$ 0	$ (7,182.97)
427	Interest on Long Term Debt	(22,499.88)	(3,853.16)	(26,353.04)
426	Non-Utility Deductions	(673.00)	0	(673.00)
431	Other Interest Expense	(9,763.15)	7,396.80	(2,366.35)
	Other Deductions	(4,957.80)	4,957.80	0
	Total Other Deductions	$(45,076.80)	$ (8,501.44)	$(36,575.36)
	Net Income	$ 3,105.67	$(13,206.69)	$(10,101.02)

REVENUE REQUIREMENTS

Elam did not propose a rate of return on rate base approach or the operating ratio method to determine its total revenue requirements in this case. The operating ratio method is used primarily when there is no sound basis for a rate of return determination using the required return on capital and rate base method. In order for the rate of return on equity to be conceptually valid, capitalization must be closely supported by rate base.

In its 1999 annual report to the Commission, Elam reported net utility plant of $231,375. Elam reported a net proprietary capital of negative $628,379, which consisted of $5,000 in common stock, $286,875 of negative retained earnings, and a negative "Reacquired Capital Stock" balance of $346,500. The $346,000 represents the price of the stock purchased from the Phillipses by the Isons. Elam has $680,506 of long term debt on its balance sheet, of which $239,197 is the unpaid balance of the Phillips-Ison loan. Therefore, Staff believes that the operating ratio method is the only appropriate method that can be used to determine revenue requirements in this case because capitalization is not closely supported by rate base.

Applying the 88 percent operating ratio to the Staff adjusted operating expenses, less purchased gas expense, resulted in a revenue requirement from base rates of $246,507.87. Elam's interest expenses were added to this revenue requirement in order to ensure that Elam has enough cash to pay its expense for the year. Additionally, the adjusted cost of gas was added back in order to offset the GCA revenues included in the normalized revenues. This calculation results in a total annual revenue requirement from base rates of $622,375.26 before the adjustment for the

Public Service Commission assessment. Elam did not propose an adjustment for the annual assessment. However, Staff has calculated this expense by applying the year 2000 assessment rate of .0019510 to the normalized revenues, inclusive of the normalized cost of gas, and determined that an additional $288.44[11] of expense should be recorded in Taxes Other than Income Taxes.

This additional adjustment results in a total recommended revenue increase of $34,412.37. This increase should allow Elam to meet its operating expenses, and provide for reasonable equity growth. Therefore, Staff recommends an increase in operating revenue of $34,412.37. Following is a calculation of the revenue requirement based on the adjusted test year:

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[11]

Normalized Intrastate Revenues:	$588,251.34	
Assessment Factor	X .0019510	
Total PSC Assessment-Proposed		$ 1,147.68
1999 Total Intrastate Revenues:	$440,407.35	
Assessment Factor	X .0019510	
Total PSC Assessment-Actual		$ 859.23
Difference between Proposed and Actual		$ 288.44

The proposed assessment fee contains the most recent GCA figures because Elam will have to pay the fee on its entire yearly intrastate revenues, which will include the most recent cost of gas figure.

Total Adjusted Gas Operating Expenses		$564,074.93
Less: Purchased Gas Expense		($347,148.00)
Subtotal		$ 216,926.93
Divide by the Operating Ratio		88%
Base Revenue Requirement		$246,507.87
Add: Purchased Gas Expense		347,148.00
Interest on Long Term Debt	$26,353.04	
Other Interest Expense	$ 2,366.35	
Total Interest Expense		$ 28,719.39
Revenue Requirement before Gross-up		$ 622,375.26
Additional PSC Assessment		$ 288.44[12]
Total Annual Revenue Requirement		$ 622,663.70
Adjusted Test Year Revenues		$(588,251.34)
Net Increase Required		$ 34,412.37

Elam did not propose an adjustment for state and federal taxes. Therefore Staff has not proposed an adjustment due to the fact that Elam has several years of net operating losses that it can carry forward to offset any income tax liability in the foreseeable future.

Rates

Elam's current and proposed rates are as follows:

	Current	Proposed
Residential/Commercial		
Customer Charge	$4.10	$6.15
Volumetric Rate:		
0 – 11 Mcf	$3.5673	$4.4716
Over 11 Mcf	$4.5673	$5.4556
Industrial		
Customer Charge	$5.15	$9.01
Volumetric Rate:		
All Mcf	$3.5673	$4.4716

[12] Id.

Based on the recommended level of revenues of $622,663.70, Staff recommends the following rates for Elam:

	Customer Charge	Base Rate
Residential/Commercial	$6.15	
First 11 Mcf		$4.1214
Over 11 Mcf		$5.1214
Industrial	$9.01	
All Mcf		$4.1214

In order to promote revenue stability, Staff believes it is appropriate in this instance to apply revenue increases to the customer charges before applying it to commodity charges. Staff recommends accepting Elam's proposed customer charges and increasing the commodity rates so that, in combination with the forfeited discounts, miscellaneous service revenues and other gas revenues, the rates will generate Elam's revenue requirement. Staff's recommended rates will maintain the existing relationship between the customer classes.

STAFF RECOMMENDATIONS FOR CORRECTIVE ACTION

Following is a summary of the Staff recommendations for corrective action that are discussed in previous sections of this Staff report:

1. Subsidiary Plant Records – Elam should establish a subsidiary plant ledger to reflect the continuing property records of the utility. The subsidiary plant ledger should contain a card or sheet for each unit of property, showing details such as description, location, cost, vendor, date of purchase or installation, estimated cost of removal and salvage value and method of depreciation, depreciation accumulated to date, and capitalized repairs, replacements, and improvements.

2. Depreciation Records – The depreciation schedules of Elam should be corrected in accordance with the findings of this report. The appropriate depreciation rates should be used to accrue depreciation prospectively, and corrections should be made to the accumulated provision for depreciation to reflect the adjustments contained in this report.

3. Records Retention – Elam should review the requirements of the USoA regarding retention of records and comply with the same. At a minimum, Elam should maintain general and subsidiary ledgers for at least fifty years and the trial balance sheets of those ledgers for at least two years. Records related to revenues and expenses and capitalized assets should be retained for the minimum number of years required by the USoA. Additionally, Elam should maintain schedules that tie its general ledger accounts to the amounts included in its annual reports, and keep supporting records for all of its general ledger entries.

Elam should keep a subsidiary ledger of its monthly credit card usage. Specifically, this ledger should show the name of the credit card, the card number and to whom the card is assigned, the monthly purchases, the unpaid balance, interest and fees, and the amount paid during the month. The ledger should also show the accounts charged for each of the purchases made with the credit card.

4. Financing Approval – Prior to issuing any evidences of indebtedness of a period greater than two years, Elam should obtain Commission approval pursuant to KRS 278.300.

5. Transfer of Elam – The transfer of Elam from the Phillipses to the Isons should not be recorded on Elam's books. Elam should take the necessary steps to

correct the financial statements to eliminate the reported liability and any costs associated with it.

6. Maintaining Books and Records – Elam should correct its accounting procedures to assure that the general ledger supporting the information contained in the Annual Report to the Commission is accurate and has appropriate supporting documentation. Additionally, Elam should allocate its credit card purchases into proper expense and general ledger accounts and keep all documentation relating to credit card purchases.

7. Internal Control of Cash – Elam should develop procedures to increase its internal control over cash.

8. Wage Allocation Study – Elam should perform a wage allocation study in order to determine how much of each employee's salary should be allocated to each of the labor expense accounts. Also, the wage allocations should include a factor associated with merchandising and jobbing.

9. Non-Utility Business Activity – Elam should develop procedures to allocate costs between its utility and non-utility business activity in order to define and separate the operations of the business. The procedures should be written and included in a cost allocation manual, and updated as circumstances change with the utility. To the extent possible, the books and records should be maintained separately, and costs should be directly assigned to the appropriate expense account. Transactions between the utility and the non-utility operations should be conducted in a manner that does not result in any cross-subsidization of the non-regulated business by the regulated utility.

10. Lease Agreement – Elam should solicit bids from the Phillips and other lessors for office space and secure an agreement with terms that are more favorable to Elam.

11. Transportation Records – Elam should maintain records of the business use of all vehicles.

12. Accounting – Elam should correct its accounting procedures for operating expenses as described in the Accounting Adjustments Section in this report for any of the financial reports issued subsequent to the date of this report.

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Schedule I

Adjusted Salaries

The 1992 Annual Report showed the following account balances at year end:

Acct. 760	Acct. 761	Acct. 901	Acct. 902	Acct. 920	Total
$35,180.40	$17,590.70	$4,397.70	$21,987.37	$8,795.33	$87,950.50

By using the November CPI's[13] for each year from 1992 to 2000, Staff inflated the total salaries from case 92-488 in order to see what an acceptable range would be for the salaries and wage expense of this case. The following is the inflation calculation:

	2000 CPI	174.1
Less:	1992 CPI	(142.0)
	Change in CPI	32.1
Divide by:	1992 CPI	142.0
Equals:		.226

.226 represents 22.6 percent. Therefore, the multiplier is 1.226.

By multiplying 1.226 by the total wages in 1992, $87,950.50, the wages adjusted for inflation to the year 2000 are $107,827.31.

[13] CPI figures were found on the internet at the following website: ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt

Schedule II

Adjusted Depreciation Schedule

	Account Number and Title	Plant in Service 12/31/99	Less Fully Depreciated Items	Net Plants Balances 12/31/99	Depreciation Factor Applied	Depreciation Expense	New Life In Years
	Distribution Plant						
374	Land Rights	$ 300.00	$ 300.00	$ -	0.00%		
375	Structures and Improvements	$ 5,969.92	$ 675.53	$ 5,294.39	3.33%	$ 176.30	30
376	Mains	$ 371,945.10	$ 3,053.00	$ 368,892.10	2.86%	$ 10,550.31	35
379	Meas & Reg Stat Equip--City Gate	$ 5,369.75	$ 200.00	$ 5,169.75	3.33%	$ 172.15	30
380	Services	$ 141,191.41	$ 798.00	$ 140,393.41	5.00%	$ 7,019.67	20
381	Meters	$ 27,748.35	$ 9,238.34	$ 18,510.01	5.00%	$ 925.50	20
382	Meter Installations	$ 3,472.01	$ 350.00	$ 3,122.01	5.00%	$ 156.10	20
383	House Regulators	$ 15,883.44	$ 10,276.29	$ 5,607.15	5.00%	$ 280.36	20
384	House Regulator Installations	$ 5,580.38	$ 5,400.38	$ 180.00	5.00%	$ 9.00	20
	Total Distribution Plant	$ 577,460.36	$ 30,291.54	$ 547,168.82		$ 19,289.40	
	General Plant						
391	Office Furniture and Equipment	$ 21,498.40	$ 7,737.37	$ 13,761.03		$ 1,586.60	
392	Transportation Equipment	$ 40,958.60	$ 14,162.75	$ 26,795.85	20.00%	$ 5,359.17	5
394	Tools, Shop, and Garage Equipment	$ 53,313.31	$ 18,149.67	$ 35,163.64	6.67%	$ 2,345.41	15
395	Laboratory Equipment	$ 3,694.71	$ 3,213.17	$ 481.54	6.67%	$ 32.12	15
	Total General Plant	$ 119,465.02	$ 43,262.96	$ 76,202.06		$ 9,323.30	
	Total Gas Plant in Service	$ 696,925.38	$ 73,554.50	$ 623,370.88		$ 28,612.70	

Account 391 Shown Separately to Illustrate Different Lives of its Assets

		Plant in Service	Depreciation Factor Applied	Depreciation Expense	Depreciable Lives In Years
391	Office Furniture and Equipment	$ 1,365.00	6.67%	$ 91.05	15
	Safe	$ 1,372.70	6.67%	$ 91.56	15
	Fax	$ 396.36	6.67%	$ 26.44	15
	Cabinet and Table	$ 868.26	6.67%	$ 57.91	15
	Vacuum	$ 169.54	6.67%	$ 11.31	15
	TV	$ 306.34	6.67%	$ 20.43	15
	Software	$ 3,040.00	20.00%	$ 608.00	5
	Computer and Printer	$ 1,799.88	20.00%	$ 359.98	5
	Keyboard	$ 176.91	20.00%	$ 35.38	5
	Loback Chair	$ 577.70	6.67%	$ 38.53	15
	Calculator	$ 148.35	6.67%	$ 9.89	15
	Mita Copier	$ 1,933.44	6.67%	$ 128.96	15
	Microwave	$ 137.72	6.67%	$ 9.19	15
	2 Chairs	$ 421.88	6.67%	$ 28.14	15
	Okidata Printer	$ 263.94	6.67%	$ 17.60	15
	Copier Stand	$ 253.34	6.67%	$ 16.90	15
	Chair	$ 159.00	6.67%	$ 10.61	15
	Storage Cabinet	$ 146.20	6.67%	$ 9.75	15
	Pamida Cabinet	$ 105.99	6.67%	$ 7.07	15
	Refrigerator	$ 118.48	6.67%	$ 7.90	15
		$ 13,761.03		$ 1,586.60	

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Schedule III

Schedule of Notes Outstanding per Application and Data Request

Loan Reference	Issued Date	Face Amount	Outstanding Balance 12/31/99
BC and Ethel Phillips	5/18/93	$343,000.00	$239,196.51
12/01/07	9.000%	$22,499.88	
Dept. for Local Gov't.	1/14/81	$656,788.28	$436,916.70
01/14/11	5.125%		
	8/18/99		
01/01/16	4.000%		
Commercial Bank:			
#01-320-1-03 LOC	Variable	$15,000.00	$ 15,000.00
11/25/00	Variable	$ 1,646.83	
#51725901	7/14/98	$ 5,000.00	$ 5,000.00
01/14/99	Variable	$ 259.55	
#51725902	8/14/98	$ 5,000.00	$ 5,000.00
02/14/99	Variable	$ 252.81	
#51725903	7/09/99	$ 5,036.00	$ 5,000.00
01/09/00	Variable	$ 0	
#13201/60	2/05/97	$13,017.00	$ 746.07
02/15/00	10.250%	$ 352.68	
Commercial Bank-	3/31/99	$7,536.00	$ 4,392.93
03/31/01	Variable	$ 466.71	
Daysboro			
Modern Acceptance	7/22/96	$11,095.00	$ 3,863.32
06/05/01	8.900%	$ 457.51	
Doug and Wilma Ison	10/1/99	$15,000.00	$ 10,600.00
10/1/00			
Total Notes and Mortgages			$725,715.53
Account Payable-Gasco			$124,253.84
Total			$849,969.37

Late Filing Payroll Taxes	$ 3,660.84
Interest on Purchases	$ 2,666.22
Total	$32,263.03

Schedule IV

Calculation of Interest Payments for Account 427

These calculations are based on information that was provided by Elam during the field review.

Department of Local Government Loan		Department of Local Government Loan	
$180,000 at 5.5% for 30 years		$436,916.70 at 4% for 15 years	
Oct. 2001-Sept. 2002	$ 9,899.99	Jan. 2000-Dec. 2000	$17,476.67
Oct. 2002-Sept. 2003	$ 9,763.32	Jan. 2000-Dec. 2001	$16,603.86
Oct. 2003-Sept. 2004	$ 9,619,13	Jan. 2000-Dec. 2002	$15,696.15
Total Interest	$29,282.44	Total Interest	$49,776.68
3 year average (divide)	3	3 year average (divide)	3
Total Average-1	$ 9,760.81	Total Average-2	$16,592.23

Account 427

Total Average-1	$ 9,760.81
Total Average-2	$16,592.23
Total Account 427	$26,535.04