

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE KNOTT)
COUNTY WATER AND SEWER DISTRICT)
FOR A RATE ADJUSTMENT PURSUANT) CASE NO. 2002-00292
TO THE ALTERNATIVE RATE FILING)
PROCEDURE FOR SMALL UTILITIES)

ORDER

On August 2, 2002, Knott County Water and Sewer District (Knott District) submitted its application requesting the Commission to approve its proposed increase in rates for both water and sewer service pursuant to Administrative Regulation 807 KAR 5:076. Commission Staff, having performed a limited financial review of Knott District s operations, has prepared the attached report containing Staff s findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments on Staff s findings and recommendations 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, no later than 10 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or request for hearing or informal conference. If no request for a hearing or

informal conference is received by this date, this case shall stand submitted to the Commission for a decision on all issues raised by the application.

Done at Frankfort, Kentucky, this 29th day of April, 2003.

By the Commission

ATTEST:

A handwritten signature in black ink, appearing to read "Thomas H. [unclear]", written over a horizontal line.

Executive Director

STAFF REPORT
ON
KNOTT COUNTY WATER AND SEWER DISTRICT
CASE NO. 2002-00292

On August 2, 2002, Knott County Water and Sewer District (Knott District) submitted its application requesting the Commission to approve its proposed increase in its water and sewer rates pursuant to Administrative Regulation 807 KAR 5:076. In its application, Knott District used the calendar year ending December 31, 2001 as its test period. Ordinarily, Commission Staff (Staff) would perform a limited financial review of Knott District s proposed test period operations to evaluate the requested increase in rates. For the reasons explained in the Background section of Attachment E, Staff performed its limited review on Knott District s operations for the calendar year ending December 31, 2002.

The Scope of Staff s review was limited to obtaining information as to whether the calendar year 2002 operating revenues and expenses were representative of normal operations. Insignificant of immaterial discrepancies were not pursued and are not addressed herein. Mark C. Frost and Jason Green of the Commission s Division of Financial Analysis performed the limited review on December 10 and 11, 2002. On January 2, 2003, the Commission Staff issued the First Data Request of Commission Staff to Knott County Water and Sewer District (Staff Data Request). Knott District filed its response to the Staff Data Request on January 15, 2003. Mr. Frost is responsible for the preparation of this Staff Report except for the determination of

normalized operating revenue and the formulation of the rates, which were prepared by Mr. Green.

Comparisons of Knott District's actual and pro forma operations for its Water and Sewer Divisions are shown in Attachment A and Attachment B, respectively. Based upon Staff's pro forma recommendations, Knott District's operating statements for its Water and Sewer Divisions would appear as set forth in Attachment C and Attachment D, respectively. Discussions of Staff's proposed pro forma adjustments for both of Knott District's divisions are in Attachment E.

According to Knott District the pro forma revenues and expenses of the combined Water and Sewer Divisions supports a revenue requirement from rates of \$160,470. However, when Knott District's requested rates are applied to Staff's billing analysis, they produce a revenue requirement from the combined divisions of \$182,320, an increase of \$70,861 or 63.6 percent above Staff's normalized revenue from water and sewer rates of \$111,459. The following table shows Knott District's requested revenue requirement for each individual division and the percentage increase:

<u>Division</u>	<u>Revenue Requirement from Rates</u>	<u>Normalized Revenue from Rates</u>	<u>Requested Increase</u>	<u>Percentage Increase</u>
Water	\$ 111,714	\$ 77,436	\$ 34,278	44.3%
Sewer	+ 70,606	+ 34,023	- 36,583	107.5%
Combined	<u>\$ 182,320</u>	<u>\$ 111,459</u>	<u>\$ 70,861</u>	63.6%

As shown in Attachment F, Knott District's 3-year average debt service of \$7,719, Staff's recommended pro forma operations for the combined Water and Sewer Division, and a 1.2x debt service coverage, results in a revenue requirements range of \$162,851 to \$208,285. Given that Knott District's requested revenue requirement is within this

range, Staff believes that requested revenue will produce an adequate amount of cash flow to allow the water district to meet the adjusted test period operating expenses and the minimum debt service requirements. Therefore, Staff recommends Knott District be allowed to increase its rates to a level that will generate the requested revenue requirement of \$182,320.

Based on Staff's recommended range of revenue requirements, Knott District could justify a revenue requirement of \$208,285 which is \$25,965 above the amount that was requested. If Knott District chooses to amend its application to reflect rates that will generate revenues above those requested, Knott District should do so when filing comments to this Staff Report. If Knott District amends its application to request higher rates, the Commission should require Knott District to give customer notification of its amended request.

Due to changes in the operation and management of the utility, Staff believes that an across the board percentage increase of the rates is appropriate. The percentage increase in the water rates is 44.3 percent and the increase in sewer rates is 107.5 percent. The water and sewer rates contained in Attachment G will produce Staff's recommended revenue requirement of \$182,320. Those rates contained in Attachment H will produce the revenue requirement of \$208,285.

Signatures

Prepared by: Mark C. Frost
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: Jason Green
Rate Analyst, Communications, Water
and Sewer Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
 STAFF REPORT CASE NO. 2002-00292
 KNOTT DISTRICT S PRO FORMA
 OPERATIONS WATER DIVISION

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenues:				
Revenue from Water Rates	\$ 52,022	\$ 0		\$ 52,022
Other Operating Revenues	622	(6)		616
Total Operating Revenues	<u>\$ 52,644</u>	<u>\$ (6)</u>		<u>\$ 52,638</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages Employees	\$ 20,115	\$ (20,115)		\$ 0
Salaries & Wages Commissioners	0	3,264		3,264
Employee Pension & Benefits	2,120	(2,120)		0
Purchased Power	9,315	(9,315)		0
Materials & Supplies	6,931	(6,931)		0
Contractual Services	21,274	(21,274)		0
Contractual Services US Filter	0	80,460		80,460
Contractual Services Clerical	0	2,611		2,611
Contractual Services Accounting	0	1,632		1,632
Travel	0	900		900
Telephone	0	979		979
Transportation	3,140	(3,140)		0
Insurance	1,595	(411)		1,184
Miscellaneous	6,156	(6,156)		0
Debt Service	0	4,015		4,015
Total Operation & Maintenance	<u>\$ 70,646</u>	<u>\$ 24,399</u>		<u>\$ 95,045</u>
Depreciation	0	0		0
Amortization	0	0		0
Taxes Other Than Income	0	0		0
Utility Operating Expenses	<u>\$ 70,646</u>	<u>\$ 24,399</u>		<u>\$ 95,045</u>
Net Utility Operating Income	(18,002)	(24,405)		(42,407)
Other Income & Deductions:				
Interest Income	0	0		0
Net Income	<u>\$ (18,002)</u>	<u>\$ (24,405)</u>		<u>\$ (42,407)</u>

ATTACHMENT B
 STAFF REPORT CASE NO. 2002-00292
 KNOTT DISTRICT S PRO FORMA
 OPERATIONS SEWER DIVISION

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenues:				
Revenue from Sewer Rates	\$ 25,901	\$ 0		\$ 25,901
Other Operating Revenues	325	0		325
Total Operating Revenues	<u>\$ 26,226</u>	<u>\$ 0</u>		<u>\$ 26,226</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages Employees	\$ 8,621	\$ (8,621)		\$ 0
Salaries & Wages Commissioners	0	2,736		2,736
Employee Pension & Benefits	909	(909)		0
Purchased Power	3,992	(3,992)		0
Materials & Supplies	2,971	(2,971)		0
Contractual Services	8,156	(8,156)		0
Contractual Services US Filter	0	52,423		52,423
Contractual Services Clerical	0	2,189		2,189
Contractual Services Accounting	0	1,368		1,368
Travel	0	900		900
Telephone	0	821		821
Transportation	1,346	(1,346)		0
Insurance	1,035	(42)		993
Miscellaneous	2,297	(2,297)		0
Debt Service	0	3,365		3,365
Total Operation & Maintenance	<u>\$ 29,327</u>	<u>\$ 35,468</u>		<u>\$ 64,795</u>
Depreciation	0	0		0
Amortization	0	0		0
Taxes Other Than Income	0	0		0
Utility Operating Expenses	<u>\$ 29,327</u>	<u>\$ 35,468</u>		<u>\$ 64,795</u>
Net Utility Operating Income	(3,101)	(35,468)		(38,569)
Other Income & Deductions:				
Interest Income	0	0		0
Net Income	<u>\$ (3,101)</u>	<u>\$ (35,468)</u>		<u>\$ (38,569)</u>

ATTACHMENT C
STAFF REPORT CASE NO. 2002-00292
STAFF S PRO FORMA
OPERATIONS WATER DIVISION

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenues:				
Revenue from Water Rates	\$ 52,022	\$ 25,414	(a)	\$ 77,436
Other Operating Revenues	622	0		622
Total Operating Revenues	<u>\$ 52,644</u>	<u>\$ 25,414</u>		<u>\$ 78,058</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages Employees	\$ 20,115	\$ 11,251	(b)	\$ 31,366
Salaries & Wages Commissioners	0	3,000	(c)	3,000
Employee Pension & Benefits	2,120	3,286	(d)	5,406
Purchased Power	9,315	1,548	(e)	10,863
Chemicals	0	4,010	(e)	4,010
Materials & Supplies/Maintenance	6,931	1,193	(e)	8,124
Office Supplies	0	394	(e)	394
Sludge Hauling	0	0		0
Contractual Services/Testing	21,274	(18,226)	(e)	3,048
US Filter Contract Fee	0	0		0
Contract Service Clerical	0	4,160	(f)	4,160
Contract Service Accounting	0	1,500	(g)	1,500
Transportation	3,140	470	(e)	3,610
Insurance	1,595	709	(h)	2,304
Office Telephone	0	655	(l)	655
Travel Reimbursement	0	1,088	(j)	1,088
Miscellaneous	6,156	(6,121)	(e)	35
Total Operation & Maintenance	<u>\$ 70,646</u>	<u>\$ 8,917</u>		<u>\$ 79,563</u>
Depreciation	36,415	1,992	(k)	38,407
Amortization	0	186	(l)	186
Taxes Other Than Income	1,639	1,120	(m)	2,759
Utility Operating Expenses	<u>\$ 108,700</u>	<u>\$ 12,215</u>		<u>\$ 120,915</u>
Net Utility Operating Income	(56,056)	13,199		(42,857)
Other Income & Deductions:				
Interest Income	2,505	0		2,505
Income Available for Debt Service	<u>\$ (53,551)</u>	<u>\$ 13,199</u>		<u>\$ (40,352)</u>

ATTACHMENT D
STAFF REPORT CASE NO. 2002-00292
STAFF S PRO FORMA
OPERATIONS SEWER DIVISION

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenues:				
Revenue from Water Rates	\$ 25,901	\$ 8,122	(a)	\$ 34,023
Other Operating Revenues	325	0		325
Total Operating Revenues	<u>\$ 26,226</u>	<u>\$ 8,122</u>		<u>\$ 34,348</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages Employees	\$ 8,621	\$ 26,309	(b)	\$ 34,930
Salaries & Wages Commissioners	0	3,000	(c)	3,000
Employee Pension & Benefits	909	5,113	(d)	6,022
Purchased Power	3,992	1,525	(e)	5,517
Chemicals	1,184	2,373	(e)	3,557
Materials & Supplies/Maintenance	1,787	144	(e)	1,931
Office Supplies	98	297	(e)	395
Sludge Hauling	0	779	(e)	779
Contractual Services/Testing	8,156	(2,737)	(e)	5,419
US Filter Contract Fee	0	0		0
Contract Service Clerical	0	4,160	(f)	4,160
Contract Service Accounting	0	1,500	(g)	1,500
Transportation	1,346	3,264	(e)	4,610
Insurance	1,035	(519)	(h)	516
Office Telephone	0	655	(l)	655
Travel Reimbursement	0	1,088	(j)	1,088
Miscellaneous	2,199	(2,164)	(e)	35
Total Operation & Maintenance	<u>\$ 29,327</u>	<u>\$ 44,787</u>		<u>\$ 74,114</u>
Depreciation	1,607	3,451	(k)	5,058
Amortization	0	1,783	(l)	1,783
Taxes Other Than Income	702	2,344	(m)	3,046
Utility Operating Expenses	<u>\$ 31,636</u>	<u>\$ 52,365</u>		<u>\$ 84,001</u>
Net Utility Operating Income	(5,410)	(44,243)		(49,653)
Other Income & Deductions:				
Interest Income	2,442	0		2,442
Income Available for Debt Service	<u>\$ (2,968)</u>	<u>\$ (44,243)</u>		<u>\$ (47,211)</u>

ATTACHMENT E
STAFF REPORT CASE NO. 2002-00292
STAFF S DISCUSSIONS OF ITS
PRO FORMA ADJUSTMENTS

BACKGROUND

Knott District's Water and Sewer Divisions are both operating under Agreed Orders with the Environmental Protection Cabinet (Division of Water). From 1997 through 1999, the Division of Water cited Knott District for numerous alleged violations of KRS Chapter 224 and the associated Administrative Regulations. Among the alleged violations that were cited at both the Water and Sewer Divisions were Failure to properly operate and maintain the system and Failure to operate the facility by a properly certified operator.

To comply with provisions of the Agreed Orders, Knott District entered into the November 29, 2001 Agreement For Operations, Maintenance and Management Services (Agreement) with U. S. Filter Operating Service, Inc. (U.S. Filter). Under the terms of the Agreement, U. S. Filter was to provide management and operational services for an annual fee of \$132,883. The services that were to be provided by U. S. Filter were: (1) one full time and one part time licensed water and wastewater operators; (2) operate the wastewater and water treatment plants; (3) repair and operate the water pump stations, two water tanks, water distribution system and the wastewater collection system; and (4) meter reading, billing, bookkeeping and related customers services.

The Agreement also required U. S. Filter to provide up to \$96,909 in capital funds to be used to, haul and dispose of sludge, replace water meters, repair the sludge drying beds, prepare O&M manuals, provide engineering services, provide funds to hire an attorney for a PSC rate case, acquire lab and safety equipment plus provide

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specialized technicians and equipment for line inspection and testing. According to the Agreement Knott District was to repay the capital funds within 2-years from the date of the Agreement at an interest rate of 9 percent per annum compounded annually.

On November 28, 2002, the Agreement was amended to require the immediate repayment of the capital funds, renewal for successive 1-years terms unless canceled in writing within 30 days prior to expiration and termination rights for convenience after providing 30-days minimum notice. On February 28, 2003, a representative of Knott informed Staff that U. S. Filter had terminated the Agreement.

The numerous alleged violations cited by the Division of Water prior to the Agreement, is proof that the management of Knott District that existed prior to 2002, was unable to operate the water and wastewater systems within the parameters established by the Division of Water. Therefore Staff believes that the test-period expenses do not fairly represent the costs that will be incurred by Knott District on an on-going basis. Since entering into the Agreement, neither of Knott District s divisions has been cited by the Division of Water for an alleged violation. Therefore, the expenses that have been incurred by Knott District and U. S. Filter during the calendar year 2002 are a more accurate representation of the costs that will be incurred to continue to operate the water and sewer systems in compliance with the Division of Water regulations. For these reasons, Staff performed its limited review of the calendar year 2002 revenues and expenses rather than the test period proposed by Knott District.

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(a) Operating Revenues. In its 2001 Annual Reports, Knott District recorded test period operating revenues from rates for its Water and Sewer Divisions of \$52,022 and \$25,901, respectively. Using the 2002 billing information, Staff calculated operating revenues from rates for the Water Division of \$77,436, which is \$25,414 greater than the amount reported in the 2001 Annual Report. Using the same usage information, Staff calculated operating revenues from rates for the Sewer Division of \$34,023, which is \$8,122 greater than the amount reported in the 2001 Annual Report. Accordingly, Staff has adjusted the operating revenues for both divisions to reflect the results of its billing analysis.

(b) Salaries & Wages - Employees. In 2001, Knott District reported salaries & wages employees expense for its Water and Sewer Divisions of \$20,115 and \$8,621, respectively. Knott District proposes to eliminate the salaries & wages employee expense from its test period operations to reflect the terms of the Agreement, U. S. Filer was to provide the operational and office staff for each division. Knott District has hired a manager and a licensed operator to replace the services that were being provided by U. S. Filter.

Originally, Steve Bashem was hired by the Knott County Fiscal Court (Fiscal Court) to provide consulting services to Knott District, administer Interlocal Agreements, pursue water line extensions for Knott District, secure funding to construct a new water treatment plant, and administer the Agreement. Fiscal Court agreed to pay Mr. Bashem s annual compensation of \$100,000 until June 30, 2003. Since, Mr.

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Bashem has assumed the responsibilities of Knott District's full-time manager the payment of his salary has become the responsibility of the water district. Knott District has also hired Roy Kelsay, a former employee of U. S. Filter and a licensed water and wastewater operator, at an annual salary of \$33,000.

In determining the reasonableness of the manager's compensation, Staff performed an analysis of the salaries being paid to the managers of comparable water districts, associations, and private companies. Staff reviewed the 2001 Annual Reports on file with the Commission of the water utilities with 1,000 or fewer residential customers. The following table is results of Staff's analysis:

<u>Utility Name</u>	<u>No. of Residential Customers</u>	<u>Manager Salary</u>
Corinth Water District	707	\$ 54,334
Dexter-Alamo Heights Water District	522	\$ 8,871
Montgomery County Water District #1	597	\$ 23,200
Morgan County Water District	857	\$ 23,364
Mulhenburg County Water District	295	\$ 41,500
Beech Grove Water System, Inc.	460	\$ 19,656
Auxier Water Company, Inc.	854	\$ 53,143
Averages	613	\$ 33,295

Comparable water utilities are paying their managers salaries in the range of \$8,871 to \$54,334 with an average salary of \$33,295. The compensation being paid to Knott District's manager exceeds the maximum of this range by \$45,666 or 84 percent. Based upon the results of its analysis, the number of customers currently served by Knott District, and the level of the manager's responsibilities, Staff believes that the salary being paid by Knott District is excessive, unreasonable and should not be borne

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by the ratepayers. Staff further believes that the average salary paid to the managers of comparable water utilities of \$33,295 is a fairer and more reasonable level of compensation for Knott District s manager.

During the calendar year 2002, U. S. Filter charged \$29,129 of operator costs against its \$132,883 operational fee. Given the level of the operator fees that were allocated by U. S. Filter and Knott District s past inability to hire and retain a licensed operator, a salary of \$30,000 for a licensed water and wastewater operator appears reasonable.

Staff increased the salary and wages employees expense for the combined operations from \$28,560 to \$66,296 to reflect a manager salary of \$33,296 and an operator salary of \$33,000. Using a 50 percent allocation factor for the manager salary and the U. S. Filter allocations for the operator charges, Staff has increased the Water Division s salaries & wages expense by \$31,366 and Sewer Division s by \$34,930.¹

(c) Salaries & Wages Commissioners. Knott District estimates that it will pay its 5 Commissioners a monthly fee of \$100, which results in an annual expense of \$6,000. Knott District proposes to allocate this common expense between its two divisions by using the number of customers served by each division (customer allocation method).

1	<u>Combined</u>	<u>Water Division</u>	<u>Sewer Division</u>
Manager	\$ 33,296	50.0% \$ 16,648	50.0% \$ 16,648
Operator	+ 33,000	44.6% + 14,718	55.4% + 18,282
Pro Forma	\$ 66,296	47.3% \$ 31,366	52.7% \$ 34,930
Less: Actual	- 28,736	- 20,115	- 8,621
Pro Forma Adj.	<u>\$ 37,560</u>	<u>\$ 11,251</u>	<u>\$ 26,309</u>

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This results in an increase to the Water Division of \$3,264 and an increase of \$2,736 to the Sewer Division.

In its October 4, 2002 resolution, the Fiscal Court authorized Knott District to pay its Commissioners annual compensation of \$3,600 or \$6,000 depending on the successful completion of the appropriate hours of training. In its resolution, Fiscal Court stipulated that the Commissioner fee is only to be paid if Knott District has the funds available. In the test period, Knott District did not pay fees, but its Commissioners voted to resume paying a \$100 month commissioner fee in the calendar year 2003.

Given the resolution of Fiscal Court and Knott District s intent to resume paying the \$100 per month commissioner fee in 2003, the proposed adjustment would meet the rate-making criteria of being known and measurable. However, Staff believes that it is more equitable to divide this expense evenly between Knott District s two divisions rather than by using the proposed customer allocation method. Staff has increased the operating expenses for both the Water and Sewer Divisions by \$3,000.

(d) Employee Pensions & Benefits. In its 2001 Annual Reports, Knott District reported an employee pensions & benefits expense for its water and Sewer Divisions of \$2,120 and \$909, respectively. For the same reason given for the proposed adjustment to salaries & wages employees expense, Knott District proposed to eliminate this expense from its pro forma operations.

Knott District will provide its two employees with the same health insurance and pension benefits that are currently being offered by the Commonwealth of Kentucky to

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its employees. Using the monthly single insurance premium of \$269, the pension contribution rate of 7.5 percent, and the pro forma salaries of \$66,296, Staff has calculated a pro forma level of employee pension and benefit expense for the combined operations of \$11,428,² which is \$8,399 above the test-period level of \$3,029. Allocating pro forma employee pensions and benefits expense based upon Staff's salary allocation results in operating expense increases to the Water and Sewer Divisions of \$3,286 and \$5,113, respectively.

(e) U. S. Filter Expenses. In response to Item 2(a) of the Staff Data Request, U. S. Filter provided an analysis of its actual year-to-date expenses that it incurred to operate Knott District's Water and Sewer Divisions. In reviewing this analysis, Staff identified \$55,366 of the U. S. Filter expenses that represent the on-going costs that Knott District will incur to operate its water and sewer systems.

Knott District's line loss for 2002 was 34.76 percent,³ which exceeds the Commission's allowable limit of 15 percent.⁴ In 2002, Knott District's variable costs of

² \$66,296 (Pro Forma Payroll) x 7.5% (Contribution Rate) =	\$ 4,972
Add: Health Insurance (\$269 x 2-Emp. x12-Months)	+ 6,456
Pro Forma Employee Pension & Benefits	<u>\$ 11,428</u>

³ Water Production	40,189,000
Less: Water Sales Staff's Billing Analysis	- 18,419,200
Less: Water Used by Utility	<u>- 7,800,000</u>
Line Loss	13,969,800
Divided by: Water Production	<u>÷ 40,189,000</u>
Line Loss Percentage	<u>34.76%</u>

⁴ 807 KAR 5:066, Section 6(3) limits line loss for rate purposes.

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water production were chemicals of \$5,374 and electricity of \$6,919. Limiting line loss to 15 percent results in decreases to chemical expense of \$1,364 and electricity expense of \$1,675, which results in an adjusted level of U. S. Filter expenses of \$52,327.

Staff has allocated \$33,123 of the adjusted U. S. Filter expenses to the Water Division, which results in an overall decrease to the 2001 operating expenses of \$16,732. The remaining \$22,423 has been allocated to the Sewer Division, resulting in an increase to the 2001 operating expenses of \$3,481. The following table is a detailed list by expense account of the allocation between the two divisions:

<u>Account Title</u>	<u>Water Division</u>	<u>Sewer Division</u>	<u>Combined Operations</u>
Purchased Power	\$ 10,863	\$ 5,517	\$ 16,380
Chemicals	4,010	3,557	7,567
Materials & Supplies/Maint.	8,124	1,931	10,055
Office Supplies	394	395	789
Sludge Hauling	0	779	779
Testing	3,048	5,419	8,467
Transportation	3,610	4,610	8,220
Miscellaneous	+ 35	+ 35	+ 70
Totals	<u>\$ 33,123</u>	<u>\$ 22,243</u>	<u>\$ 53,327</u>

(f) Contract Service Clerical. In March 2002, Knott District hired a part-time clerical assistant at a rate of \$8 per hour. Knott District estimates that it will pay its clerical assistant \$400 per month or \$4,800 annually. Allocating this fee using the customer allocation method, Knott District proposes to increase the operating expenses at its Water and Sewer Divisions by \$2,611 and \$2,189, respectively.

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Since the Agreement has been terminated, Knott District is responsible for maintaining an office and hiring the appropriate level of office staff. Using the \$8 per hour rate and an average workweek of 20 hours, Staff calculates a pro forma clerical expense of \$8,320.⁵ Allocating 50 percent of the clerical expense to each division results in an operating expense increase to each division of \$4,160.

(g) Contract Service Accounting. Knott District's accountant charges a fee of \$1,500 to prepare the Annual Report and to review the billing records. A separate accountant charges a monthly fee of \$150 or \$1,500 annually to provide the monthly bookkeeping services. Using the customer allocation method, Knott District allocated \$1,632 of the accounting fee to the Water and \$1,632 of the fee to the Sewer Division. Staff believes that it is more equitable to divide this expense evenly between Knott District's two divisions rather than by the method proposed, which results in an increase of \$1,500 to each division.

(h) Insurance. Knott District proposes a pro forma level of insurance expense of \$2,177 for its combined operations, a decrease of \$453 to the actual test period amount of \$2,630. In support of its pro forma expense level, Knott District attached a copy of its a property insurance invoice to the Application. Using the customer allocation method, Knott District proposes a \$411 increase to the Water Division and a decrease to the Sewer Division of \$42.

⁵ \$8 (Hourly Rate) x 2,600-Hours (40-Hours x 52 Weeks) = \$8,320.

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The property insurance invoice for the 12-month period ending December 21, 2003 has an annual premium of \$2,820. Using the 2002 utility plant in service balances as its allocation method, Staff has allocated \$2,304⁶ to the Water Division, which results in an increase of \$709. This method results in an allocation of \$518⁷ to the Sewer Division, a decrease of \$519.

(i) Office Telephone. Knott District maintains an office in the Knott County Human Services Building in Hindman, Kentucky, but it is not charged a rental fee. According to Knott District, the only office cost incurred is for the separate telephone line. Using an estimated telephone bill of \$150 per month and the customer allocation method, Knott District proposes to allocate \$979 to the Water Division and \$821 to the Sewer Division.

The analysis of the 2002 telephone invoices provided by Knott District shows that the actual telephone expense was \$1,314, which is \$486 below Knott District's proposed level. As with the other office expenses, Staff has allocated 50 percent to each division resulting in an operating expense increase of \$655 to each.

(j) Travel Reimbursement. According to Knott District its Commissioners are paid \$1,800 for travel reimbursement. Allocating 50 percent of this expense to each division, Knott District proposes operating expense increases of \$900. In reviewing the invoices and the trial balance, Staff determined that the actual travel reimbursement for 2002

⁶ \$1,126,535 (UPIS Water Division) ÷ \$1,378,744 (UPIS Combined) = 81.707%
\$2,820 (Property Insurance Premium) x 81.707% (Allocation Rate) = \$2,304.

⁷ \$252,209(UPIS Sewer Division) ÷ \$1,378,744 (UPIS Combined) = 18.293%
\$2,820 (Property Insurance Premium) x 81.707% (Allocation Rate) = \$516.

ATTACHMENT E
STAFF REPORT CASE NO. 2002-00292
STAFF S DISCUSSIONS OF ITS
PRO FORMA ADJUSTMENTS

was \$2,176, which is \$376 greater than the amount proposed by Knott District. Allocating the reimbursement of \$2,176 using Knott District's proposed method results in an operating expense increase to each division of \$1,088.

(k) Depreciation. Using Knott District's depreciation schedule and the capital projects funded by U. S. Filter, Staff calculates a pro forma depreciation expense for Knott District's combined operations of \$43,465. The following table shows the pro forma depreciation expense and the adjustment for each division:

<u>Description</u>	<u>Water Division</u>	<u>Sewer Division</u>
Pro Forma Depreciation Existing Plant	\$ 33,769	\$ 166
Add: Capital Projects	+ 4,638	+ 4,892
Pro Forma Depreciation	\$ 38,407	\$ 5,058
Less: 2001 Depreciation Expense	- 36,415	- 1,607
Pro Forma Adjustment	<u>\$ 1,992</u>	<u>\$ 3,451</u>

(l) Amortization. In reviewing the capital projects funded by U. S. Filter, the invoices and trial balance, Staff discovered that in 2002 Knott District incurred \$9,103 in non-recurring expenditures. The following table lists each expenditure, the estimated useful life and the amortization allocation to each division:

<u>Description</u>	<u>Amount</u>	<u>Useful Life</u>	<u>Water Division</u>	<u>Sewer Division</u>
Sludge Hauling	\$ 6,561	5	\$ 0	\$ 1,312
Gravel Sewer Plant	1,426	5	0	285
KRWA National Convention	+ 1,116	3	+ 186	+ 86
Totals	<u>\$ 9,103</u>		<u>\$ 186</u>	<u>\$ 1,783</u>

(m) Taxes Other Than Income. In its 2001 Annual Reports, Knott District reported payroll taxes for its Water Division of \$16,39 and \$702 for its Sewer Division. Using the pro forma salaries for each division, Staff has calculated a pro forma level of payroll

ATTACHMENT E
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PRO FORMA ADJUSTMENTS

taxes for the Water Division of \$2,759, which is \$1,120 above the 2001 level. Staff also calculated pro forma payroll taxes for the Sewer Division of \$3,046, which is \$2,344 above the amount reported in 2001. Accordingly, each division s payroll taxes have been increased by those amounts.

ATTACHMENT F
STAFF REPORT CASE NO. 2002-00292
STAFF S DETERMINATION OF THE
REVENUE REQUIREMENT RANGE
AND REVENUE INCREASES

	Revenue Requirement Range	
3-Year Average Debt Service	\$ 7,719	\$ 7,719
Multiplied by: Debt Service Coverage	1.2	1.2
Income From Operations	\$ 9,263	\$ 9,263
Add: Operating Expenses	153,677	153,677
Depreciation	0	43,465
Amortization	0	1,969
Taxes Other Than Income	5,805	5,805
Total Revenue Requirement	\$ 168,745	\$ 214,179
Less: Other Income & Deductions	4,947	4,947
Revenue Requirement from Operations	\$ 163,798	\$ 209,232
Less: Other Operating Revenues	947	947
Revenue Requirement from Rates	\$ 162,851	\$ 208,285
Less: Staff's Normalized Revenue from Rates	111,459	111,459
Recommended Increase	\$ 51,392	\$ 96,826

	Revenue Requirement Allocations	
<u>Water Division:</u>		
Revenue Requirement from Rates	\$ 162,851	\$ 208,285
Multiplied by: Water Allocation	59.007%	59.007%
Revenue Requirement from Rates - Water Division	\$ 96,093	\$ 122,903
Less: Pro Forma Revenue from Rates Water Division	77,436	77,436
Recommended Increase Water	\$ 18,657	\$ 45,467

<u>Sewer Division:</u>		
Revenue Requirement from Rates	\$ 162,851	\$ 208,285
Multiplied by: Sewer Allocation	40.993%	40.993%
Revenue Requirement from Rates Sewer Division	\$ 66,758	\$ 85,382
Less: Pro Forma Revenue from Rates Sewer Division	34,023	34,023
Recommended Increase Sewer	\$ 32,735	\$ 51,359

ATTACHMENT G
STAFF REPORT CASE NO. 2002-00292
RATES THAT PRODUCE KNOTT DISTRICT S
REQUESTED REVENUE REQUIREMENT

MONTHLY WATER RATES

3/4 Meter

First	2,000	Gallons	\$	18.25	Minimum Bill
Next	8,000	Gallons	\$	5.63	per 1,000 Gallons
Over	10,000	Gallons	\$	4.55	per 1,000 Gallons

2 Meter

First	15,000	Gallons	\$	86.00	Minimum Bill
Over	15,000	Gallons	\$	4.55	per 1,000 Gallons

MONTHLY SEWER RATES

3/4 Meter

First	2,000	Gallons	\$	13.80	Minimum Bill
Next	8,000	Gallons	\$	4.38	per 1,000 Gallons
Over	10,000	Gallons	\$	3.42	per 1,000 Gallons

2 Meter

First	15,000	Gallons	\$	65.77	Minimum Bill
Over	15,000	Gallons	\$	3.42	per 1,000 Gallons

Sewer Only Customers

Residential Flat Rate			\$	26.25	
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ATTACHMENT H
STAFF REPORT CASE NO. 2002-00292
RATES THAT PRODUCE THE MAXIMUM OF
STAFF S REVENUE REQUIREMENT RANGE

MONTHLY WATER RATES

3/4 Meter

First	2,000	Gallons	\$	20.48	Minimum Bill
Next	8,000	Gallons	\$	6.32	per 1,000 Gallons
Over	10,000	Gallons	\$	5.11	per 1,000 Gallons

2 Meter

First	15,000	Gallons	\$	96.49	Minimum Bill
Over	15,000	Gallons	\$	5.11	per 1,000 Gallons

MONTHLY SEWER RATES

3/4 Meter

First	2,000	Gallons	\$	17.18	Minimum Bill
Next	8,000	Gallons	\$	5.42	per 1,000 Gallons
Over	10,000	Gallons	\$	4.26	per 1,000 Gallons

2 Meter

First	15,000	Gallons	\$	81.88	Minimum Bill
Over	15,000	Gallons	\$	4.26	per 1,000 Gallons

Sewer Only Customers

Residential Flat Rate	\$	32.68
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