COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF THE MCKINNEY WATER DISTRICT FOR APPROVAL OF A PROPOSED INCREASE IN RATES FOR WATER SERVICE	)))	CASE NO. 2005-00114

O R D E R

On March 15, 2005, McKinney Water District ("McKinney") filed its application for Commission approval of its proposed water rates. Commission Staff, having performed a limited financial review of McKinney'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 22nd day of June, 2005.

By the Commission

ATTEST:

Robert A. Amato for the

Executive Director

STAFF REPORT

ON

McKINNEY WATER DISTRICT

CASE NO. 2005-00114

Pursuant to a request by McKinney Water District ("McKinney") for assistance with the preparation of a rate application for its water operations, Commission Staff ("Staff") performed a limited financial review of McKinney's test-year operations for the calendar year ending December 31, 2003. The scope of Staff's review was limited to obtaining information as to whether the test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Upon completion of the review, Staff assisted McKinney in the development and preparation of a rate application. The application included an adjusted pro forma operating income statement wherein adjustments were made to test-year operating revenues and expenses that were known and measurable and deemed to be reasonable. The rates proposed by McKinney were based on the pro forma income statement as shown in the application. The application also includes the calculation of McKinney's revenue requirement using a 1.2 debt service coverage, which is frequently used by the Commission to determine revenue requirements for small water utilities. McKinney is proposing to increase its annual revenue from water rates by $145,789, an increase of 27.5 percent over normalized revenues from water sales of $529,317. This would increase the average bill for 5,000 gallons of usage from $29.47 to $37.25, an increase of 26.4 percent.

On March 15, 2005, McKinney filed its rate application with the Commission for consideration. On April 8, 2005, the Attorney General of the Commonwealth of Kentucky ("AG"), who intervened in this case, submitted a Request for Information to McKinney consisting of 7 questions. On May 11, McKinney responded to the AG's information request, although McKinney was unable to respond to four of the AG's questions because they related to information developed by Staff. To address the AG's questions, Staff provides the following responses.

Interest Income – The AG requested an explanation as to why pro forma Interest Income was reduced from $3,386 to $1,117, an adjustment of $2,269. In response, Staff noted during the field review that total cash of $280,694 included $189,217 of restricted cash, according to McKinney's 2003 CPA Audit. Because 67% of the cash was restricted, Staff reduced pro forma Interest Income by 67% and included only $1,117 of this income in the determination of McKinney's revenue requirement.

Nonutility Income – The AG requested information relative to Nonutility Income of $22,097, including a description of the services provided, whether McKinney uses any resources in providing the services, the recipients of the services, an identification of the expenses associated with the services, and the process for removing those expenses from the test year. In response, Staff noted at the beginning of its limited review that 2003 Nonutility Income of $22,097 in the 2003 PSC Annual Report was identical to $22,097 of Connection Fees listed under Nonoperating Income in McKinney's 2003 CPA Audit, and staff removed that income from its determination of McKinney's pro forma revenue requirement. However, because Staff has returned much of the documentation required during its field review to McKinney, it is unable to address the

AG's questions or confirm that any expenses associated with the connection fees were removed from operating expenses. Under these circumstances, Staff recommends that McKinney's pro forma revenue requirement be adjusted to include $22,097 of Nonutility Income, unless McKinney can prove that the entire amount should be excluded.

Debt Service Coverage - The AG requested an explanation of the derivation of pro forma Debt Service Coverage of $112,301, as well as an identification of the impact of the Year 2004 operating results on this amount. In response, Staff derived McKinney's debt service coverage by adding McKinney's 2003 Interest Expense of $58,117 to its average principal payment for 2005-2007 of $35,467 and by multiplying this debt service of $93,584 by 120% to allow for a 1.2 debt service coverage. As for the impact of 2004 operating results, Staff used a 2003 test period, but notes that 2004 Interest Expense of $57,831 differs by only $286 from 2003 Interest Expense, a difference that is not material to Staff's calculation of McKinney's revenue requirement.

Billing Analysis – The AG requested an explanation of the date applicable to the billing analysis. The billing analysis was based on usage information from the test period, January 1, 2003 to December 31, 2003.

With the exception of the $22,097 adjustment to include Nonutility Income in revenue requirements, Staff is hereby adopting the contents of McKinney's application as its recommendation in this report as if fully set out herein, as shown in Attachment B. Jess Thompson is responsible for all revenue adjustments and the calculation of the proposed rates. Jack Kaninberg is responsible for the determination of the revenue requirement. Based on the information included in McKinney's application, adjusted to reduce McKinney's revenue requirement by $22,097, Staff is of the opinion that the rates as shown in Attachment A of this report are reasonable and should be approved by this Commission. This adjustment reduces McKinney's recommended revenue increase to $123,692, an increase of 23.4 percent over normalized revenues from water sales of $529,317.

<u>Signatures</u>

Prepared by: Jack Kaninberg
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

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

ATTACHMENT A
STAFF REPORT CASE NO. 2005-00114
STAFF'S RECOMMENDED RATES

Monthly Water Rates

5/8" x 3/4" Meter:

First	1,000	gallons	$12.15 Minimum Bill
Next	2,000	gallons	6.94 per 1,000 gallons
Next	7,000	gallons	5.61 per 1,000 gallons
Over	10,000	gallons	4.97 per 1,000 gallons

1" Meter:

First	5,000	gallons	$37.25 Minimum Bill
Next	5,000	gallons	5.61 per 1,000 gallons
Over	10,000	gallons	4.97 per 1,000 gallons

2" Meter:

First	20,000	gallons	$115.00 Minimum Bill
Over	20,000	gallons	4.97 per 1,000 gallons

Non-Recurring Charges

Meter Connection/Tap-On Charge	
5/8" x 3/4" Meter	$500.00
Returned Check Charge	10.00
Deposits	2/12 Average Annual Bill

ATTACHMENT B
STAFF'S RECOMMENDED PROFORMA OPERATIONS

Account	2003	Adjustments	Ref.	Adjusted
Metered Sales	$531,363	($2,046)	A	$529,317
Forfeited Discounts	$16,309			
Tot. Op. Revenues	**$547,672**	**($2,046)**		**$545,626**
Employee Salaries	$79,278	($1,244)	B	$78,034
Officer Salaries	$16,900	($2,000) ($1,800)	C	$13,100
Empl. Pensions/Benefits	0	0		0
Purchased Water	$240,583	($37,085)	D	$203,498
Materials/Supplies	$34,616	0		$34,616
Contract. Serv.-Acct.	$5,125	0		$5,125
Contract. Serv.-Legal	$1,935	0		$1,935
Contract. Serv.-Other	$98,511	0		$98,511
Transportation Exp.	$2,633	0		$2,633
Insurance-Vehicles	0	0		0
Ins.-Gen. Liability	$2,307	0		$2,307
Ins.-Workers Comp	$1,894	0		$1,894
Ins. - Other	$1,240	0		$1,240
Advertising Expense	$583	0		$583
Bad Debt Expense	$3,423	0		$3,423
Misc. Exp.	$8,055	0		$8,055
Tot. Water Util. Exp.	*$497,083*	*($42,129)*		*$454,954*
Depreciation Expense	$118,251	$25	E	$118,276
Taxes OT Income	$7,383	($382)	F	$7,001
Total Op. Expenses	**$622,717**	**($42,486)**		**$580,231**
Total Op. Income	***($75,045)***	***$40,440***		***($34,605)***
Interest Income	$3,386	($2,269)	G	$1,117
Nonutility Income	$22,097	0	H	$22,097
Interest Expense	($58,301)	0		($58,301)
Net Income	*($107,863*			*($482)*

Proforma Expenses	$580,231
Debt Service Coverage	$112,301
Revenue Requirement	$692,532
Less Normalized Revenue	($545,626)
Less Interest Income	($1,117)
Requested Increase (27.5%)	$145,789
Adjustment for Nonutility Income	($22,097)
Staff's Recommended Increase	**$123,692**

Debt Service(RD Bonds):
1/1/05 - $33,600 Principal
1/1/06 - $36,000
1/1/07 - $36,800
Total - $106,400/3 = $35,467 Average
Interest for 2003 = $58,117
Total Debt Service = $93,584

DSC at 1.2 = $112,301

Explanatory Notes

A. Normalized Revenues based upon Commission Staff's billing analysis.

B. Normalized Salaries Expense based upon wage rates in effect after 12/11/03:

Name	Rate	Hrs. /Week	Per Week	Per Year	2003
Manager	$16.70	40	$668	$34,736	$35,839
Office Worker	$13.01	32	$416.32	$21,649	$20,676
Office Worker	$13.01	32	$416.32	$21,649	$22,163
Miscellaneous					$600
Totals				$78,034	$79,278

C. Officer Salaries reduced by $2,000 Christmas bonuses and $1,800 reduction in payments for reduced clerical wages associated with Board meetings.

D. Purchased Water Expense based upon normalized sales and an adjustment to reflect allowable line loss. McKinney WD purchases water from the cities of Stanford and Eubanks at rates of $1.77 per thousand gallons from Stanford and $2.00 per thousand gallons over 25,000 gallons from Eubanks ($78.20 for the first 25,000 gallons). During 2003, McKinney's water line loss was 28.3%, but Commission policy is to allow only 15% line loss for ratemaking purposes. Therefore, Staff calculated normalized purchased water expense as follows:

Item	2003	Normalized	*Allowing 15% Line Loss*	*Excess*
Purchases (Gallons)	118,903,000	116,979,720	*98,634,552*	*18,345,168*
%	100%	100%	*100%*	
Sales	84,534,000	83,172,586	83,172,586	
%	71.10%	71.10%	*85%*	
Other Water Use	681,000	666,784	666,784	
%	0.57%	0.57%		
Line Loss	33,688,000	33,140,350	*14,795,182*	*18,345,168*
%	28.33%	28.33%	*15%*	
		Adjustment		
	$1.77	$26,951	Stanford 83%	*15,226,489*
	$3.25?	$10,134	*Eubanks 17%*	*3,118,679*
		$37,085	*Total 100%*	*18,345,168*

E. Normalized Depreciation Expense adjustment.

F. Proforma Taxes Other than Income based upon normalized FICA of $5,970 and PSC assessment of $1,031

G. Interest Income reduced because approximately 67% of cash is restricted.

H. Nonutility Income (connection fees) included.