COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN APPLICATION OF WOODLAND-PRESTON ENTERPRISES, INC., FOR AN ADJUSTMENT OF RATES) CASE NO. 8963

O R D E R

IT IS ORDERED that the Staff Audit Report for Woodland-Preston Enterprises, Inc., ("Woodland") attached hereto as Appendix A shall be included as a part of the record in this proceeding.

IT IS FURTHER ORDERED that Woodland shall have until the close of business on April 10, 1984, to file written comments concerning the contents of Appendix A.

Done at Frankfort, Kentucky, this 30th day of March, 1984.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Secretary

APPENDIX A

AN APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8963 DATED 3/30/84

AUDIT REPORT OF
WOODLAND-PRESTON ENTERPRISES, INC.

PREFACE

On January 11, 1984, Woodland-Preston Enterprises, Inc., ("Woodland") filed its application seeking an increase in its rates for sewer service. Woodland applied under the Alternative Rate Filing ("ARF") procedure for small utilities for an increase in its monthly rate from $5.25 to $8.00.

As part of its endeavor to shorten and simplify the regulatory process for small utilities the Commission chose to perform a limited financial audit of Woodland's operations for calendar years 1982 and 1983 rather then issue written data requests to the utility. Members of the Commission staff working on the rate case were Mr. Gary Forman and Mr. Jeff Shaw of the Division of Rates and Tariffs. They met with Mr. E. Jay Preston, Woodland's president, on February 21, 1984, in Paintsville, Kentucky, for the purpose of performing the audit. Mr. Preston made available all financial records in his possession and made an effort to answer all questions related thereto.

SCOPE

This examination consisted of an analysis and review of all cash receipts and disbursements and related financial records of the utility for the years 1982 and 1983. Inasmuch as it is more current, and therefore, more representative of Woodland's ongoing operations, the financial data for calendar year 1983 has been used as the basis for evaluating the utility's additional revenue needs. The financial data for calendar year 1982 was analyzed for the purpose of determining what, if any, accounting or classification changes might be appropriate. Moreover, in order to facilitate the processing of Woodland's rate case we have gone beyond the test year actual operating statement and recommended adjustments in this report which would be consistent with the Commission's typical rate-making treatment of certain items. The pro forma operating statement contained in this report may or may not be adopted by the Commission in the final analysis of the rate case.

FINDINGS

1982 Operating Revenues

Woodland's 1982 Annual Report reflected $1,183 in operating revenues. The analysis of Woodland's billings and revenue collections shows that actual operating revenues during 1982 were $1,241 and that $58 of the revenues collected were not cleared through the utility's operating revenue account. Based on our review, this amount should have been reflected in revenues and carried through to the statement of retained earnings and then reflected as a deduction to the retained earnings account in the form of an owner's withdrawal of capital.

Plant Additions

In March 1982, Woodland purchased a new pump motor at a cost of $872. In Woodland's 1982 financial statements this amount was recorded as an operating expense and classified under Pumping System - Labor and Materials Expense.

Proper accounting of this type of expenditure under the Uniform System of Accounts for Sewer Utilities would require capitalizing the cost of the motor as an addition to plant in service and then depreciating the asset over its estimated useful life which the Commission generally finds to be 5 years. This accounting treatment would affect two changes to Woodland's 1982 income statement, i.e. - a decrease in operating expenses of $872 and an increase in depreciation expense of $174. The year-end balance sheet for 1982 would also reflect the following changes: An increase of $872 to utility plant, an increase of $174 to the depreciation reserve, and an increase of $698 to retained earnings.

<u>1983 Operating Revenues</u>

The analysis of Woodland's billings and revenue collections for calendar year 1983 reflects sewage service revenues of $1,588. Woodland's 1983 annual report, filed with the Commission on March 14, 1984, showed $2,164 in sewage service revenues. However, this improperly includes amounts transferred from Woodland's savings account as revenue and improperly reflects a loan from Mr. Preston as operating revenue. The amount of the loan was $500 which should be recorded as a liability on which interest will accrue in favor of Mr. Preston.

The deduction of the loan amount from Woodland's reported operating revenues leaves a balance of $1,664 or $76 more than the amount of $1,588 reflected by our audit. However, this does not agree with the amount of $459 which was actually transferred from the savings account to the checking account. We will attempt to reconcile these differences in subsequent correspondence with Woodland related to the accuracy of its annual report.

At the end of 1983, 31 customers were connected to Woodland's sewage treatment system and were being billed a rate of $5.25 per month. This amount represents the rate approved by the Commission in April 1983 in Case No. 8651. Since this rate was in effect for only part of the calendar year, a pro forma adjustment of $365 is required for rate-making purposes to reflect the amount of revenues the current rate would generate over 12 months based on 31 customers.

Maintenance Expense

In September 1983, Woodland incurred an expense of $640 for the rebuilding of an existing pump motor. This represents an unusual, extraordinary expense which should extend the life of the motor significantly. Therefore, for rate-making purposes an adjustment would be required to eliminate the expense of $640; however, an additional adjustment would be made to amortize the expense over a reasonable length of time. A 5-year amortization period would be considered reasonable based on the normal useful life of a pump motor. This would result in an adjustment to increase operating expenses by $128 for rate-making purposes.

Depreciation Expense

In Case No. 8651 the Commission found that the total cost of the utility plant had been recovered through the sale of the subdivision lots in Woodland's service area. Therefore, the annual recorded depreciation expense of $618 would be excluded for rate-making purposes. However, the accounting adjustment for calendar year 1982 would result in additional depreciation expense of $174 for the recovery of the cost of the new pump motor.

Extraordinary Maintenance Expense

In Case No. 8651 the Commission found that Woodland incurred $608 in extraordinary maintenance expense during its test year, calendar year 1981. An adjustment was made to amortize and recover this expense over 2 years for rate-making purposes. Since 1 year remains of the 2-year amortization period, it is proper to still reflect the annual amortization expense of $304 as an operating expense for rate-making purposes. Therefore, an adjustment has been made to increase operating expenses by that amount.

The effect of these adjustments on Woodland's 1983 operating statement would be as follows:

	1983 Actual-Per Audit	Adjustments	1983 Adjusted-Per Audit
Operating Revenues	$ 1,588	$ 365	$ 1,953
Operating Expenses			
Purchased Water	$ 147	-0-	$ 147
Purchased Power	666	-0-	666
Water Testing	136	-0-	136
Maintenance	1,107	(640)	467
Outside Services	160	-0-	160
Miscellaneous Expenses	47	-0-	47
Depreciation	618	(444)	174
Amortization	-0-	432	432
Taxes	151	-0-	151
Total	$ 3,032	$ (652)	$ 2,380
Operating Income	$(1,444)	$1,017	$ (427)
Other Income	$ 6	-0-	$ 6
Net Income	$(1,438)	$1,017	$ (421)

CLOSING

Woodland will be allowed 10 days in which to submit written comments concerning the contents of this report. If no comments are received, the Commission will conclude that Woodland agrees with the report and accepts its findings. Based on the findings herein, Woodland should submit revisions to its 1982 annual report to reflect the accounting changes recommended. The Order and subsequent correspondence may also require that the 1983 annual report be revised to reflect the proper accounting for loan funds and transfers of cash and to incorporate for accounting purposes the changes to utility plant and depreciation expense recommended herein for Woodland's 1982 annual report.