

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF GREEN-TAYLOR)
WATER DISTRICT FOR AN ADJUSTMENT)
OF ITS RATES PURSUANT TO THE) CASE NO. 8971
ALTERNATIVE RATE ADJUSTMENT FOR)
SMALL UTILITIES)

O R D E R

On January 26, 1984, Green-Taylor Water District ("Green-Taylor") filed its application with this Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment for Small Utilities ("ARF"). Green-Taylor requested additional revenues of \$58,343,¹ a 30 percent increase above reported test-period revenue from water sales. However, based on normalized revenues determined herein and Green-Taylor's proposed rates, the requested additional revenue was \$66,737, an increase over normalized revenues of 32 percent.

Based on the determination herein, the Commission has authorized an increase in revenues of \$36,613, an increase of 17.5 percent.

¹ Page 4 of Application dated January 26, 1984.

A hearing was not requested in this matter, and in accordance with the provisions of the ARF, no hearing was conducted. The decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission's offices.

COMMENTARY

Green-Taylor is a non-profit water distribution system organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 1,296 customers in Green and Taylor counties.

The ARF was established to provide a simplified, less expensive, and more timely method for small utilities to apply for rate increases with this Commission. The extensive delay in issuing a final determination in this matter was due in large part to Green-Taylor's untimely and incomplete responses to the Commission's information requests. From March 13, 1984, the Commission repeatedly attempted through information requests to clarify Green-Taylor's original filing. Item No. 10 of the Commission's information request dated March 13, 1984, requested Green-Taylor to reconcile its proposed expense and revenue adjustments to the Uniform System of Accounts prescribed for Class C and D Water Utilities. This was necessary since Green-Taylor's original submission of these adjustments was based on rounded amounts, inflationary trends, speculative future growth rates, was not in accordance with the Uniform System of Accounts for Class C and D Water Utilities and, taken as a whole, provided no

meaningful or useful information. Not until August 13, 1984, did Green-Taylor comply with the intent of the March 13, 1984, information request by re-submitting all revenue and expense adjustments in accordance with the Uniform System of Accounts for Class C and D Water Utilities.

TEST PERIOD

Green-Taylor proposed and the Commission has accepted the 12-month period ending December 31, 1982, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

The financial data from the 1982 annual report has been used as the basis for determining revenue requirements. Green-Taylor proposed adjustments to revenues and expenses as reflected in the comparative income statement filed on August 13, 1984. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications to reflect actual and anticipated operating conditions:

Normalized Revenues

Green-Taylor's annual report for the year ended December 31, 1982, shows 1,358 customers, 96,442,860 gallons of water sold, and revenues from water sales of \$194,805.

The billing analysis filed with Green-Taylor's application shows 1,177 customers, 83,780,430 gallons sold, and revenues from

water sales of \$182,443. The Commission issued several requests for information wherein it requested Green-Taylor to reconcile the difference between the annual report and the billing analysis. While responses from Green-Taylor were received, no satisfactory reconciliation was obtained.

During the period of June 26, 1984, through July 2, 1984, a billing analysis was performed by Commission staff. This billing analysis shows 1,298 customers, 96,415,100 gallons sold, and revenue from water sales of \$208,673. This analysis was accepted by Green-Taylor on August 7, 1984, and has been used for rate-making purposes in this case.

The apparent \$13,868 discrepancy between revenues as reported in Green-Taylor's annual report and revenues as determined by the Commission is due, in large part, to Green-Taylor's use of a modified cash basis of accounting. Under the cash basis of accounting, revenues are not recorded until received in cash, and expenses are assigned to the period in which cash payment is made. The cash basis of accounting does not give a good picture of profitability because it ignores such items as uncollected revenues which have been earned and expenses which have been incurred but not paid.

Consequently, in an effort to obtain a meaningful operating statement which matches expenses incurred to produce revenues earned, end-of-period adjustments must be made to offset cash revenue received in one period but earned in an earlier period and to accrue revenues of the current period which will be

received in later periods. (Similar adjustments must be made for expense items.) Attempting to adjust the cash basis of accounting to the accrual basis requires the accountant (in the case of revenues) to analyze all cash receipts in the beginning of the period and collate those receipts with the prior period billings. To obtain an accurate accrual for earned but uncollected revenue, the accountant must analyze all billings and collate these with the corresponding cash receipts in order to discover those billings earned and not accounted for in cash revenues received. These procedures may work well with a handful of customers and a handful of suppliers or where cash receipts and the earning process are consummated simultaneously, as might substantially occur in a cash-and-carry grocery store. However, when the number of customers is large and the earning process is not consummated simultaneously with the receipt of cash, the effort, extremely meticulous work, and the cost required to accurately restate cash basis accounting to accrual basis accounting far outweighs the short-run cost savings in using the cash basis.

Additionally, the accrual basis of accounting offers many advantages. If revenues are charged to accounts receivable and credited to sales as earned monthly (correspondingly, expenses as well), reliable monthly statements can be provided at a nominal additional cost which would provide information for the control of uncollectible accounts, excessive line loss, excessive material expenditures, delinquent and slow-paying accounts, and provide timely information of profits and losses.

The Uniform System of Accounts requires utilities to maintain accounting records on an accrual basis. Therefore, Green-Taylor should take the necessary steps to implement accrual basis accounting as soon as possible.

Adjustment Beyond Test Period

As part of its filing of August 13, 1984, Green-Taylor proposed five adjustments to expenses for events occurring beyond the test period which would have a net effect of increasing cost of service by \$9,956 annually.

Two of the adjustments, one to purchased water in the amount of \$3,958 and the other to pumping expense in the amount of \$1,153, are adjustments based on the number of 1983 year-end customers.² The remaining three adjustments are directly related to an executed personal services contract for system management which would reduce Administrative and General salaries by \$14,594, decrease payroll taxes by \$1,339, and increase Outside Services by \$20,578³ for a net increase to cost of service of \$4,845 annually.

The Commission is compelled to review all known and measurable changes in a utility's cost of service to its customers. However, Green-Taylor proposed and the Commission has adopted 1982 as the test period in this case. To make selective adjustments to expenses to update the test period for events occurring a year or more beyond the test period without the Commission's ability to scrutinize the remaining expenses,

² Exhibit 6, page 8 of August 13, 1984, filing.

³ Exhibit 6, pages 8 and 9 of August 13, 1984, filing.

revenues, gross assets, contributions in aid of construction, etc., creates an extreme mismatching of revenues, expenses, and investment in utility assets. Additionally, the personal service contract cost was purportedly based on historical average of costs for equipment rentals, salaries and other hired labor, meter reading and system management. Since these costs for 1982 were higher than those reported for both 1980 and 1981, an average cost for these 3 years would be lower than the reported 1982 expenses which are not reflected in the requested increase of \$4,845 annually. Furthermore, it is obvious from the request for increased expenses that, if the personal service contract is a cost-cutting measure, Green-Taylor has not included all on-going expense savings. Excluding the above considerations, the Commission's remaining alternative is to view the personal service contract as a means through which service to Green-Taylor customers is improved; however, the record as it is now submitted offers no support for this view. Therefore, the Commission is of the opinion that these adjustments are not appropriate to use in determining adjusted test-period operating costs and has excluded them from further consideration.

Outside Services

The reported amount of items expensed during the test period to Outside Services was \$21,422. This compares with \$2,115 expended in 1980 and \$1,270 expended in 1981. A breakdown of the test-period expense showed that the entire \$21,422 was attributable to the cost of laying new water lines to provide

service to new customers.⁴ Inasmuch as this expenditure will provide benefits for more than one accounting period, it should not be included as an operating expense for rate-making purposes. Therefore, the Commission has capitalized the \$21,422 as an asset and has reduced outside services expense accordingly.

Rate Case Expense

Green-Taylor proposed an increase in operating expenses of \$3,656 annually based on a 3-year amortization (including 12 percent interest) of expenses incurred in this proceeding which totaled \$8,338. The ARF procedure was established to provide a simplified and less expensive method for small utilities to present cases before the Commission. The ARF application was designed so that the utility should encounter little or no difficulty in presenting its case for an increase in rates. In addition, the type of information requested by the Commission in its March 13, 1984, request should have been readily available in the offices of Green-Taylor and obtainable with only limited assistance and should not have required 5 months to compile. Furthermore, critical parts of the initial application, namely the billing analysis and all revenue and expense adjustments, were so flawed they provided no meaningful information. Therefore, the Commission finds that \$5,838 of the rate case expense attributable to the initial filing, which was not used in the final analysis,

⁴ Response to Item 6 of Information Request dated April 5, 1984.

was imprudently incurred and deems that a fair and reasonable rate case expense amortized over 3 years is \$833.

Depreciation Expense

Green-Taylor reported depreciation expense during the test period of \$38,357. Green-Taylor proposed a \$9,774 reduction to test period depreciation expense in recognition of contributions in aid of construction which were applied exclusively to long-lived assets.⁵ Also, the proposed calculation of depreciation expense assumed equal useful lives for all assets except small tools and transportation equipment; gross utility plant was stated at \$2,268,686, whereas the 1982 annual report states gross utility plant at \$2,321,891; and responses to information requests reflected adjusted contributions in aid of construction of \$1,200,231,⁶ whereas the calculation uses \$1,167,424.

The Commission is of the opinion that the entire gross utility plant in service is necessary if a utility is to provide long-run ongoing service to its customers and thus is necessarily supported by such long-term sources of funds as contributions in aid of construction. Therefore, recognizing contributions in aid of construction as a source of funds for only long-lived assets is

⁵ Exhibit 7 of August 13, 1984, filing.

⁶ Contributions in Aid of Construction:

Response to #1 of April 5, 1984	\$1,106,359
Response to #3 of April 5, 1984	19,190
Response to #2 of April 5, 1984	74,682
Balance, December 31, 1982	<u>\$1,200,231</u>

not fair and reasonable. Second, the broad assumption that all of the longer-lived assets have equally useful lives is unrealistic and arbitrary. Third, the misstatement of gross plant in service and contributions in aid of construction further distorts the proposed amount of depreciation expense.

Therefore, the Commission is of the opinion that the reported test-period depreciation expense is more realistic and less arbitrary, that the test-period end gross utility plant in service is more accurate, and that the restated total amount of contributions in aid of construction of \$1,200,231 is more reliable. Thus, the Commission has reduced reported test-period depreciation expense by \$19,446 and finds that a pro forma depreciation expense of \$18,911, including \$535 additional expense associated with items capitalized herein, is fair and reasonable.

Miscellaneous Income Deductions

Green-Taylor reported \$369 in Miscellaneous Income Deductions for the test period. This account, according to the Uniform System of Accounts for Class C and D Water Utilities, is intended to accumulate expenses such as donations, life insurance premiums on officers where the utility is the beneficiary, penalties and fines, expenditures for the purpose of influencing public opinion, and small extraordinary items. The Commission is of the opinion that expenditures such as these do not benefit utility customers and are not legitimate expenses for rate-making purposes. Therefore, the Commission has reduced these expenditures by \$369.

Interest Expense

Interest expense has been reduced by \$1,309 to reflect interest on long-term debt outstanding at the end of the test period.

After consideration of the aforementioned adjustments, the Commission finds Green-Taylor's adjusted test period operations are as follows:

	<u>Reported Test Period</u>	<u>Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$197,490	\$ 13,868	\$211,358
Operating Expenses	203,390	<29,527>	173,863
Operating Income	\$ <5,900>	\$ 43,395	\$ 37,495
Other Income	3,086	-0-	3,086
Interest Expense on Long-Term Debt	48,287	<1,309>	46,978
Net Income	<u>\$<51,101></u>	<u>\$ 44,704</u>	<u>\$ <6,397></u>

REVENUE REQUIREMENTS

Green-Taylor's debt service based on the average principal and interest payments due within the next 5 years is \$64,328 annually. Green-Taylor's bond ordinances require a 1.2X debt service coverage ratio ("DSC"). The adjusted test period operating statement reflects a net operating loss of \$6,397 which provides inadequate coverage on Green-Taylor's debt service obligations. The Commission is of the opinion that the adjusted operating income is inadequate and will adversely affect the financial condition of Green-Taylor. To improve its financial condition, additional revenues of \$36,613 will be required. Based on adjusted test period results, total revenues of \$247,971 will produce net operating income of \$31,866 which, after considering

other income of \$3,086, will be sufficient to allow Green-Taylor to pay its operating expenses and provide a 1.2X DSC on its annual debt service obligations.

SPECIAL CHARGES

Green-Taylor proposed to increase the tap fee for a 5/8 x 3/4-inch connection from \$200 to \$250. In response to an information request, Green-Taylor provided cost justification showing the actual expense for this size connection to be \$354. Green-Taylor further stated that it had never tried to charge the exact cost for 5/8 x 3/4-inch connections since in the past the customer eventually made up the difference by the use of water.

The Commission is of the opinion that tap fees should be compensatory and that the tap fee for a 5/8 X 3/4-inch connection in this case should be \$350. All larger connections should be charged the actual cost of installation.

Green-Taylor proposed a meter deposit in the amount of \$30. The Commission is of the opinion that Green-Taylor should charge deposits in accordance with 807 KAR 5:006, General Rules, Section 7, Deposits, wherein Green-Taylor may require from any customer or applicant for service a cash deposit not to exceed two-twelfths of the estimated annual bill of such customer or applicant where bills are rendered monthly, or three-twelfths of the estimated annual bill where bills are rendered bimonthly. Further, interest at the rate of 6 percent per annum should be paid on deposits so required, accruing from the date of deposit.

Green-Taylor proposed and provided cost justification to establish a service charge in the amount of \$15. The Commission is of the opinion that this charge is not excessive and should be allowed.

Green-Taylor plans to install a bulk loading station and to use a coin operated meter to collect revenue from bulk sales. Green-Taylor proposed a bulk rate of \$5 per 1,000 gallons. This rate is based on the amortization of the cost of the station, using a 5-year expected replacement life of the station, plus the base retail rate for 1,000 gallons.

The Commission is of the opinion that a bulk rate of \$5 per 1,000 gallons will adequately recover the cost of providing water and allow for any fluctuation in costs.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are fair, just and reasonable rates for Green-Taylor in that they will produce annual operating revenues of approximately \$247,971 and should be approved. These revenues will be sufficient to meet Green-Taylor's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.

2. The rates proposed by Green-Taylor would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Green-Taylor on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Green-Taylor be and they hereby are denied.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Green-Taylor shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 15th day of November, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Wemen
Chairman

Robert L. Gough
Vice Chairman

Sam Shuck
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8971 DATED 11/15/84

The following rates and charges are prescribed for the customers in the area served by Green-Taylor Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RATES: Monthly

First	2,000 gallons	\$7.25 Minimum Bill
Next	4,000 gallons	2.90 per 1,000 gallons
Next	4,000 gallons	2.05 per 1,000 gallons
Next	15,000 gallons	1.55 per 1,000 gallons
Next	25,000 gallons	.99 per 1,000 gallons
Next	50,000 gallons	.79 per 1,000 gallons

<u>Meter Size</u>	<u>All.wable Minimum Gallons</u>	<u>Minimum Rate</u>
5/8 X 3/4-inch	2,000	\$ 7.25
3/4-inch	5,000	15.95
1-inch	10,000	27.05
1 1/2-inch	25,000	50.30
2-inch*	40,000	65.15
3-inch*	100,000	114.55

Tap Fees

5/8-inch X 3/4-inch	\$350
All other size connections	Actual cost of installation

Meter Deposit

The meter deposit shall not exceed two-twelfths of the estimated annual bill where bills are rendered monthly.

Service Call \$15.00

Bulk Sales 5.00 per 1,000 gallons

*No change in the method of billing trailer parks is proposed. The present method as follows is to continue: The minimum bill shall be based upon the domestic minimum for 2,000 gallons multiplied by the capacity of the trailer park and then divided by two. Usage thereafter shall be billed at the regular rate.