

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF RATES OF THE)
KINGSTON-TERRILL WATER DISTRICT OF) CASE NO. 9542
MADISON COUNTY, KENTUCKY)

O R D E R

IT IS ORDERED that:

1. The Staff Audit Report for Kingston-Terrill Water District attached hereto as Appendix A shall be included as a part of the record in this proceeding.

2. Kingston-Terrill Water District shall have 10 days from the date of this Order to file written comments concerning the contents of Appendix A.

Done at Frankfort, Kentucky, this 17th day of July, 1986.
PUBLIC SERVICE COMMISSION

Richard D. Hemery
For the Commission

ATTEST:

Executive Director

STAFF REPORT

ON

KINGSTON-TERRILL WATER DISTRICT

**Prepared By:
Samuel J. Bryant, Jr.**

Staff Audit Report on
Kingston-Terrill Water District

PREFACE

On March 31, 1986, Kingston-Terrill Water District ("Kingston-Terrill") filed its application seeking an increase in its rates for water service. The proposed rates would generate approximately \$115,366 on an annual basis, an increase of approximately 40 percent in the rates currently being charged.

As part of its endeavor to shorten and simplify the regulatory process for utilities the Commission chose to perform a limited financial audit of Kingston-Terrill's operations for the test year, calendar year 1985. The Commission's objective was to substantially reduce the need for written data requests, decrease the time necessary to examine the application and, therefore, decrease the expense to the utility. Mr. Sam Bryant of the Commission's Division of Rates and Tariffs performed the audit on May 28, 1986, at the office of Kingston-Terrill in Richmond, Kentucky.

SCOPE

The scope of the audit was limited to obtaining information to determine whether the operating expenses as reported in Kingston-Terrill's 1985 Annual Report used as the test year in this case were representative of normal operations and to gather information to evaluate pro forma adjustments proposed in Kingston-Terrill's filing. Expenditures charged to test year operations were reviewed as were the invoices. Insignificant or

immaterial discrepancies were not pursued and are not addressed herein.

FINDINGS

Utility Plant in Service

An examination of the records of Kingston-Terrill were inconclusive in directly determining the accuracy of the amount of \$1,238,049 reported on the 1985 balance sheet for Utility Plant in Service. This is due to the inadequate records kept by Kingston-Terrill. Kingston-Terrill produced no records of plant accounts and according to its accountant has no ledger for plant accounts. The two bond issues of \$445,000 and \$210,000 added to the contributions of \$310,502 and other debt in the amount of \$203,000 used for plant expansion supports a level of plant in the amount of \$1,168,502. Additional capital expenditures of \$17,664 during the test period raises the level to \$1,186,166 leaving a difference of \$51,883 from the reported test period level. Staff was unable to reconcile this difference and, therefore, concludes that Kingston-Terrill's representation of \$1,238,049 for utility plant in service is questionable, but adequate at this time.

It is the staff's recommendation that Kingston-Terrill immediately, with the aid of its accountant, begin to identify and attempt to reconcile the balances of all items of plant and to continue to maintain the proper records for all plant accounts under the Uniform System of Accounts ("USoA") prescribed by this Commission.

Operation and Maintenance Expenses

In the course of the audit staff examined invoices related to test period operation and maintenance expenses. Staff found no material discrepancies in the level of test period operation and maintenance expenses, however, some expenses had been misclassified as to the proper account prescribed by the USoA.

Kingston-Terrill reported no expenditure for fuel and power purchased for pumping (Acct. #622) for the test period but upon examination staff determined that \$5,024 had been expended and charged to account number 651, Maintenance of Mains. Staff has accordingly increased Account No. 622 by \$5,024 and reduced Account No. 651 by a like amount. Staff also determined that \$6,279 of expenditures were charged to Account No. 903 but should have been charged to Account No. 921. Accordingly, staff has made appropriate adjustments to both accounts.

It its filing, Kingston-Terrill proposed increases totaling \$26,757 to operation and maintenance expenses. During the audit staff determined that the majority of the increases were related to assets that Kingston-Terrill has proposed to purchase but has not shown adequate evidence of the need or benefit to its ratepayers. One example is a proposed \$3,300 expenditure for maintenance of a truck. Kingston-Terrill has not purchased the truck but has made adjustments to operation and maintenance and depreciation expense. The decision to purchase the truck rests on whether or not Kingston-Terrill can obtain the funds. In addition Kingston-Terrill has made no adjustments to reflect reductions in other expenses resulting from the proposed purchase, ie., the

reimbursements to the manager for use of his truck. Staff recommends that the proposed \$3,300 adjustment for truck maintenance as well as the proposed adjustments for an additional employee of \$7,632, rent for a storage building in the amount of \$828 and the proposed \$4,800 adjustment for employee benefits (health insurance) be denied on the basis that Kingston-Terrill has not shown sufficient evidence for the need and has not proven a benefit to its ratepayers. These adjustments result in a decrease of \$16,560 to Kingston-Terrill's operation and maintenance expenses.

If in its response to this report or at the hearing scheduled for August 20, 1986, Kingston-Terrill can show that these increases are necessary and can result in more efficient operations these items will be reconsidered.

Kingston-Terrill proposed to increase operation and maintenance expenses in the amount of \$2,797 for increases in general liability and workers compensation insurance. In the course of the audit staff verified these figures in a conversation with the insurance agent. It is the staff's judgement that these adjustments are proper and necessary and recommends that they be accepted.

Kingston-Terrill proposed to increase operation and maintenance expenses by \$7,000 as the result of expenses to be incurred for its meter testing program and by \$400 for maintenance on its water tower. During the audit staff determined that the \$7,000 estimate for the meter testing program was for five years. It is the staff's judgment that this expense should be amortized

over a 5-year period and, therefore, operation and maintenance expenses should be decreased by \$5,600.

Purchased Water

Kingston-Terrill reported purchased water expense of \$169,175 for the test period. Kingston-Terrill failed to make an annualization adjustment for an increase in rates by its supplier, the City of Richmond, Kentucky, in May, 1985. Accordingly, the staff has increased Kingston-Terrill's operating expenses by \$15,000.

Depreciation Expense

Kingston-Terrill reported depreciation expense of \$38,511 for the test period. In addition Kingston-Terrill proposed several adjustments that would increase its depreciation expense by \$5,176. These adjustments were proposed to amortize the costs of a group of assets that Kingston-Terrill proposes to purchase. Again Kingston-Terrill has not shown sufficient need nor has it made appropriate adjustments to other expense, revenue, or balance sheet accounts resulting from the proposed purchases. Staff, therefore, recommends that these adjustments be denied and accordingly reduces Kingston-Terrill's proposed depreciation expense by \$5,176.

In addition, the Commission has traditionally disallowed depreciation on plant that has been acquired through contributions. During the course of the audit staff found no evidence that the Commission should change its practice and thus recommends continuing to disallow depreciation expense on contributed property for a reduction to Kingston-Terrill's depreciation expense of \$9,757.

Amortization Expense

Kingston-Terrill proposed to increase amortization expense by \$3,500 for a 5-year amortization of tank maintenance. The staff finds this adjustment to be proper and necessary and recommends it be accepted for rate-making purposes.

Miscellaneous Adjustment

Kingston-Terrill proposed an adjustment of \$60,327 to "maintain financial integrity of district as a percent of total assets". Kingston-Terrill derived this figure by taking five percent of its total assets at the end of 1984. Staff concludes that the figure is arbitrary, capricious and has no support and should be denied.

Recordkeeping

Kingston-Terrill's records consisted mainly of a cash receipts and cash disbursements journal. Kingston-Terrill's General Manager and its Office Manager attempted to keep a general ledger during the test year, however it proved to be inaccurate. Kingston-Terrill, with the aid of its accountants has begun to keep records in accordance with the USoA. The staff recommends that Kingston-Terrill continue this procedure and in the future be able to provide adequate records of its operations.

Sales Revenues

Kingston-Terrill reported test period sales of \$295,852. In May, 1985 Kingston-Terrill received a rate increase for purchased water adjustment. Kingston-Terrill made no adjustment to its revenues to annualize water sales as a result of the rate

increase. The staff recommends that Kingston-Terrill's test period operating revenues be increased by \$19,806.

Interest Income

Kingston-Terrill reported interest income in the amount of \$17,805 for the test period. Kingston-Terrill made no pro forma adjustment to this figure, however it is the staff's judgment that since both interest rates and Kingston-Terrill's investments have decreased over the past year that this figure should be reduced. Staff has determined an interest rate of approximately ten percent and applied it to Kingston-Terrill's end of period investments and accordingly estimates Kingston-Terrill's interest income to be \$12,000 thereby reducing the test period level by \$5,805.

Other Findings

The Commission received a copy of a letter from the Farmers Home Administration ("FmHA") dated May 8, 1986. In the letter FmHA stated that apparently Kingston-Terrill had borrowed funds from local banks without FmHA's written consent. The staff advises Kingston-Terrill that in the future it should obtain the needed approval of FmHA before acquiring additional debt.

SUMMARY

Based on the recommendations proposed by the staff in this report Kingston-Terrill's operations are as follows:

<u>Income:</u>	<u>Kingston-Terrill Pro Forma</u>	<u>Staff Adjustments</u>	<u>Recommended</u>
Water Sales	\$411,218	(62,117)	\$349,101
Misc. Service Revenues	15,373		15,373
Interest Income	17,805	(5,805)	12,000
Total Income	<u>\$444,396</u>	<u>(67,922)</u>	<u>\$376,474</u>
 <u>Operating Expenses:</u>			
Purchased Water	\$169,175	15,000	184,175
Power for Pumping	-0-	5,024	5,024
Maintenance Expenses	29,181	(10,624)	18,557
Labor	39,046	(11,730)	27,316
Supplies & Expenses	17,926		17,926
Transportation Expense	3,300	(3,300)	
Salaries	10,800		10,800
Outside Services	6,100	4,098	10,198
Insurance	7,389		7,389
Pensions & Benefits	4,800	(4,800)	
Depreciation & Amortization Expense	47,187	(14,933)	32,255
Taxes Other Than Income	3,050		3,050
Rent	828	(828)	
Total Operating Expenses	<u>\$338,782</u>	<u><22,093></u>	<u>\$316,690</u>
Net Income Before Interest	\$105,614		59,785
Interest on Long-term Debt	39,435	1,224	40,659
Other Interest Expense	440		440
Net Income	<u>\$ 65,739</u>	<u>(\$47,053)</u>	<u>\$ 18,686</u>

Kingston-Terrill had a Debt Service Coverage ("DSC") for the test period of .52X and a staff adjusted DSC of .53X. The staff is of the opinion that this coverage is neither fair, just, nor reasonable as required by KRS 278.030. Staff is further of the opinion that a DSC of 1.2X would provide sufficient revenues to allow Kingston-Terrill to meet its operating expenses, cover its debt and provide for reasonable equity growth. Therefore, the


staff recommends Kingston-Terrill be allowed to increase its revenues on an annual basis by \$33,444, calculated as follows:

Operating Expenses	\$316,690
Average Annual Debt Service	49,820
20 Percent DSC	<u>9,965</u>
Total Revenue Requirement	\$376,475

LESS:

Annualized Test Period Revenues	(\$315,658)
Interest Income	(12,000)
Misc. Service Revenues	(15,373)
Required Increase	<u>\$ 33,444</u>

Respectfully submitted,



Samuel J. Bryant, Jr.
Public Utilities Financial
Analyst