

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF OHIO COUNTY WATER )  
DISTRICT, (1) FOR A CERTIFICATE THAT )  
PUBLIC CONVENIENCE AND NECESSITY )  
REQUIRES THE CONSTRUCTION OF NEW PLANT ) CASE NO. 9559  
FACILITIES; AND (2) SEEKING APPROVAL OF )  
THE ISSUANCE OF CERTAIN SECURITIES; AND )  
(3) FOR AN ORDER AUTHORIZING ADJUSTMENT )  
OF WATER SERVICE RATES AND CHARGES )

O R D E R

IT IS ORDERED that:

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

2. Ohio County 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 1st day of August, 1986.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:

\_\_\_\_\_  
Executive Director

**STAFF REPORT**  
**ON**  
**OHIO COUNTY WATER DISTRICT**

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

Staff Audit Report on  
Ohio County Water District

PREFACE

On April 4, 1986, Ohio County Water District ("Ohio County") filed its application seeking an increase in its rates for water service in conjunction with its proposed construction project. The proposed rates would generate approximately \$255,404 on an annual basis, an increase of approximately 42 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 Ohio County's operations for the test period, 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 July 21-22, 1986, at the office of Ohio County in Hartford, Kentucky.

SCOPE

The scope of the audit was limited to obtaining information to determine whether the operating expenses as reported in Ohio County's 1985 Annual Report used as the test period in this case were representative of normal operations and to gather information

to evaluate pro forma adjustments proposed in Ohio County'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. All findings herein are contingent upon approval by the Commission of the proposed expansion program and terms of financing as submitted in this proceeding. Based on the findings herein the staff recommends that Ohio County be granted the entire increase requested of \$255,404.

### FINDINGS

#### Utility Plant in Service

Upon examination of the records of Ohio County staff determined that the Utility Plant in Service account was overstated by \$4,000 due to a contribution of land by the Ohio County Fiscal Court that was later retracted. Staff, therefore, recommends that Ohio County's Plant in Service account and its Contributions in Aid of Construction account be reduced by \$4,000.

#### Operating Revenues

Ohio County reported operating revenues of \$613,753 for the test period including Other Water Revenues in the amount of \$13,083. During the course of the audit staff determined that \$9,062 of Other Water Revenues was reimbursement for expenses incurred on two separate projects during the test period. The Kentucky Transportation Cabinet reimbursed Ohio County \$6,405 for expenses incurred for a line relocation and in another instance Ohio County was reimbursed for expenses in the amount of \$2,657 incurred when a water line was damaged. It is the staff's

judgment that the line relocation should be charged to plant in service and contributions in aid of construction. Staff further concludes that the revenues reported for the reimbursement of expenses on the damaged water line are not representative of normal test period operations. Staff therefore, recommends that Ohio County's test period operating revenues be reduced by \$9,062.

Ohio County proposed adjustments to its test period water sales that would result in a net reduction to operating revenues of \$6,482. It is the staff's judgment that the proposed adjustments are proper and necessary and recommends that they be accepted for rate-making purposes.

#### Operating Expenses

During the course of the audit staff found no material discrepancies in Ohio County's reported test period operating expenses, however, the staff recommends that Ohio County closely examine expenditures to determine if they should be capitalized or expensed during the current period.

Ohio County proposed in its filing adjustments to operating expenses totalling \$60,948. Staff finds these adjustments are proper and necessary and recommends that they be accepted with the following exceptions:

#### Meter Testing

Ohio County proposed to increase its operating expenses by \$20,000 due to this Commission's regulation regarding meter testing. Ohio County estimates that it will replace 500 meters per year at a cost of \$30 per meter and that the testing equipment

will cost \$5,000. It is the staff's conclusion that Ohio County will not have to replace every meter that it tests and assumes that Ohio County interpreted the Commission's regulation to mean that twenty percent of its meters should be replaced every year. If this is the case then Ohio County has in fact misinterpreted the regulation. Staff concludes that Ohio County has not provided proper support for this adjustment and it should be denied. In addition, it is the staff's judgment that the \$5,000 expenditure for meter testing equipment should be capitalized. Accordingly staff recommends that Ohio County's operating expenses be reduced by \$20,000.

#### Maintenance Expenses

The staff recommends that Ohio County's maintenance expenses be reduced by \$7,225 in conjunction with staff adjustments to Ohio County's operating revenues.

#### Salaries and Wages

Ohio County proposed to increase its operating expenses to allow for a six percent increase in salaries and wages. Staff concludes that a six percent increase is excessive given the current cost of living and inflation rates. Staff recommends a five percent increase in salaries and wages thus reducing Ohio County's operating expenses by \$1,550. In addition, during examination of Ohio County's filing it was determined that there was a \$10,000 error in the calculation of Ohio County's proposed salary and wage expense. Correction of this error results in an additional reduction of \$10,000 to Ohio County's proposed operating expenses. Staff also recommends a reduction of \$1,837

to Ohio County's wage expense reflective of reimbursement by the Kentucky Transportation Cabinet of labor related expenses incurred by Ohio County on a line relocation.

Office Supplies and Expenses

Ohio County proposed to increase its operating expenses by \$2,577 for the purchase of additional office furniture and an additional telephone line. It is the staff's conclusion that Ohio County has not shown sufficient evidence of need and has not proven a benefit to its ratepayers and that the proposed adjustments be denied thus reducing Ohio County's operating expenses by \$2,577.

Depreciation Expense

Ohio County reported depreciation expense of \$98,703 for the test period resulting in a composite rate of approximately two percent based on utility plant in service of \$4,994,764 and construction work in progress of \$29,737. For rate-making purposes the Commission generally allows depreciation only on that portion of plant acquired through investment and not on plant acquired through contributions. During the course of the audit the staff found no evidence that the Commission should change this practice and therefore recommends that Ohio County's test period depreciation expense be reduced by \$39,708 to reflect the contributed portion of Ohio County's plant in service.

In addition, the staff finds it acceptable to increase Ohio County's depreciation expense by \$266 to reflect depreciation on capitalized items recommended herein.

Ohio County made no adjustment to depreciation expense to reflect the new plant proposed in this proceeding. The non-contributed portion of the expansion is estimated to cost \$2,010,000 and it is the staff's judgment that for rate-making purposes it is acceptable to allow depreciation expense on the non-contributed portion of the expansion and, therefore, recommends that Ohio County's test period depreciation expense be increased by \$40,200.

### SUMMARY

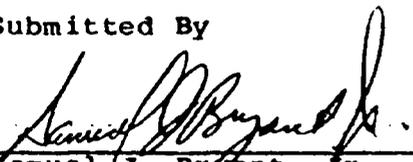
Based on the recommendations proposed by the staff in this report Ohio County's operations are as follows:

<u>Income:</u>	<u>Ohio County Pro Forma</u>	<u>Staff Adjustments</u>	<u>Recommended</u>
Water Sales	\$594,188	\$255,404	\$849,592
Misc. Revenue	13,083	(9,062)	4,021
Interest Income	36,681		36,681
Total Income	<u>643,952</u>	<u>246,342</u>	<u>890,294</u>
 <u>Operating Expenses:</u>			
Power for Pumping	\$ 89,549		\$ 89,549
Supplies and Expenses	28,801	(2,577)	26,224
Maintenance Expenses	46,656	(27,225)	19,431
Labor	174,451	(13,387)	161,064
Salaries	3,250		3,250
Chemicals	26,483		26,483
Uncollectible Accounts	3,375		3,375
Outside Services	13,500		13,500
Insurance	18,500		18,500
Pensions & Benefits	18,127		18,127
Misc. General Expenses	3,637		3,637
Transportation Expenses	25,292		25,292
Depreciation Expense	98,703	758	99,461
Taxes Other Than Income	12,090		12,090
Total Operating Expenses	<u>\$562,414</u>	<u>\$(42,431)</u>	<u>\$519,983</u>
Net Income Before Interest	81,538	288,773	370,311
Interest on Long-Term Debt	108,986	211,050	320,036
Amortization of Debt Expense	720		720
Net Income	<u>\$(28,168)</u>	<u>77,723</u>	<u>49,555</u>

The staff has determined Ohio County's average annual debt service to be \$358,548 inclusive of the proposed \$2,010,000 of new debt at 10 1/2 percent interest. Ohio County's adjusted test period operations will allow for a debt service coverage ("DSC") of .32X. The staff is of the opinion that this coverage is neither fair, just nor reasonable as required by KRS 278.030. The increase requested by Ohio County in this proceeding will provide a DSC of 1.03X. Staff concludes that a DSC of 1.03X will provide Ohio County sufficient revenues to maintain its required reserves, meet its operating expenses, service its debt and provide for reasonable equity growth and recommends that the entire increase requested in the amount of \$255,404 be granted subject to approval of the financing and construction as submitted in this proceeding.

July, 1986

Submitted By

  
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Samuel J. Bryant, Jr.  
Public Financial Utilities  
Analyst