

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MUHLENBERG COUNTY )  
WATER DISTRICT #3 TO CONSTRUCT, ) CASE NO. 94-125  
FINANCE, AND ADJUST RATES )

O R D E R

On June 14, 1994, Muhlenberg County Water District #3 ("Muhlenberg") completed the filing of its application for Commission approval of proposed water system improvements and capital expenditures, financing, and an increase in water rates. Commission Staff, having performed a limited financial review of Muhlenberg'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 15 days from the date of this Order.


IT IS THEREFORE ORDERED that all parties shall have no more than 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a 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 1st day of July, 1994.

ATTEST:

  
Executive Director

PUBLIC SERVICE COMMISSION

  
For the Commission

COMMONWEALTH OF KENTUCKY  
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AND ADJUST RATES )

STAFF REPORT

Prepared By: Karen Harrod, CPA  
Public Utility Financial  
Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Division of Financial Analysis

Prepared By: Nicky Moore  
Public Utility Rate Analyst  
Communications, Water and  
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Division of Rates and Research

STAFF REPORT

ON

MUHLENBERG COUNTY WATER DISTRICT #3

CASE NO. 94-125

A. Preface

On March 31, 1994, Muhlenberg County Water District #3 ("Muhlenberg") submitted an application seeking approval of its proposed water system improvements and capital expenditures, financing and an increase in water rates. The application was considered filed on June 14, 1994, when all deficiencies were cured in accordance with Commission regulations. The proposed rates would generate approximately \$114,740 in additional annual revenues, an increase of 24 percent over normalized test-year revenues from water sales.

In order to evaluate the requested increase in rates, the Commission Staff ("Staff") chose to perform a limited financial review of Muhlenberg's operations for the test period, calendar year 1993. Karen Harrod of the Commission's Division of Financial Analysis began the review on May 5, 1994 at the office of Muhlenberg, in Bremen, Kentucky. Nicky Moore, of the Commission's Division of Rates and Research, performed his review of Muhlenberg's billing analysis at the Commission's office in Frankfort, Kentucky.

Staff's findings and recommendations are contained in this report. Mr. Moore is responsible for the sections related to operating revenues and rate design. The remaining sections of the Staff Report were prepared by Ms. Harrod.

During the course of the review, Muhlenberg was advised that all proposed adjustments to test-year operations must be supported by some form of documentation and that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Muhlenberg be allowed to increase its annual revenues by \$105,539, or 21.6 percent.

### Scope

The scope of the review was limited to obtaining information to determine whether test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

### B. Analysis of Operating Revenues and Expenses

#### Operating Revenues

Muhlenberg reported test-period revenue from water sales of \$479,653 in its 1993 Annual Report. The results of the billing analysis included in its application indicate operations should generate \$477,864 in revenue at current rates, a difference of \$1,789 under reported revenue, and Staff adjusted accordingly. Muhlenberg also reported \$10,635 in other operating revenue, of which Staff made no adjustments. Therefore, for the purposes of this report, total test-period normalized operating revenue shall be considered to be \$488,499.

Operating Expenses

For the test year Muhlenberg reported operating expenses of \$489,244 which it proposed to increase by \$13,000. The pro-forma adjustments to test-period expenses are discussed in the following sections of this report.

Salary and Wage Expense

In its test year operations Muhlenberg reported salary and wage expense of \$126,031. Muhlenberg currently has five full-time employees and one employee who is part-time. Based on the current salary levels of Muhlenberg's employees, Staff has calculated the district's annual salary expense to be \$112,112, a decrease of \$13,919 from the test year level. Since this adjustment is known and measurable Staff recommends it be allowed for rate-making purposes.

Employee Pensions and Benefits

For the test period Muhlenberg reported employee pensions and benefits expense of \$22,297. This amount includes employee insurance expense of \$10,423. Based on Staff's review the current insurance premiums being paid by Muhlenberg for employee health and life insurance total \$843.24 per month, or \$10,119 annually. This reflects a decrease of \$304 from the test year level. Therefore, Staff recommends this decrease be included for rate-making purposes.

Purchased Water Expense

Muhlenberg reported purchased water expense of \$212,380 for the test year. Based on normalized test year usage of 167,041,900 gallons and the maximum line loss generally allowed by the Commission of 15 percent, Staff recommends a decrease to purchased water expense, calculated as follows:

Normalized test year usage	167,041,900 gallons
Adjustment for 15% line loss	<u>+ .85</u>
Allowable Purchased Water for resale	196,519,882 gallons
Water Used by Company	3,720,000 gallons
Water Used by Fire Department	<u>200,000 gallons</u>
Recommended Purchased Water	200,439,882 gallons
Current purchased water rate (\$1.0094 per 1,000 gallons)	<u>x .0010094</u>
Recommended expense	\$ 202,324
Less: Test year expense	<u>212,380</u>
Recommended Decrease	<u>\$( 10,056)</u>

Therefore, Staff has included an adjustment to decrease test year purchased water expense by \$10,056.

Transportation Expense

For the test year Muhlenberg reported transportation expense of \$8,153. Based on Staff's review it was determined that \$1,800 of this expense was for payments of \$50 per month to each of Muhlenberg's three commissioners for vehicle allowance. In accordance with KRS 74.020(6), Commissioners are not permitted to receive compensation in excess of \$3,600 per year or \$300 per month from the water district. Since the \$50 payment is in addition to the maximum \$300 monthly compensation per commissioner, Staff has

included an adjustment to decrease transportation expense by \$1,800.

Miscellaneous Expense

Muhlenberg reported miscellaneous expense of \$3,069 for the test year. Included in this amount were payments of \$50 per month, or \$600 annually, to Brewer's Grocery for bill collection services. Based on Staff's review, Brewer's Grocery will no longer be collecting bills for Muhlenberg after April 1994. Accordingly, Staff has made an adjustment to decrease test year miscellaneous expense by \$600.

Taxes other than Income Tax Expense

Muhlenberg reported taxes other than income tax expense of \$14,493 for the test period. Staff recommends an adjustment be made to decrease payroll tax expense to allow for FICA and Medicare taxes associated with the recommended decrease in salary expense. Accordingly, taxes other than income tax expense has been decreased by \$1,065<sup>1</sup>, to a level of \$13,428.

Depreciation Expense

Muhlenberg reported test year depreciation expense of \$51,246. In its application an adjustment was proposed to increase depreciation expense by \$13,000 for the depreciation of the proposed system improvements and capital expenditures. These

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<sup>1</sup> Recommended Decrease to Salary Expense	\$ 13,919
Applicable FICA and Medicare Rate	x .0765
Recommended Payroll Tax Decrease	<u>\$ 1,065</u>

items were presented in Amended Exhibit C of the application, as follows:

<u>Item No.</u>	<u>Description</u>	<u>Estimated Cost</u>
1	Raise (2) Water Tanks	\$ 155,000
1a	Foundation work for raising tanks	20,000
2	Ecology equipment for pump station #1	6,000
3	(2) Pumps for pump station #2	8,000
4	(1) Truck for operations	8,000
5	Used backhoe, trencher,	30,000
6	(1) Mower	800
7	(1) 6" Main transmission line to run from Bremen to Sacramento	<u>25,000</u>
TOTAL		<u>\$ 252,800</u>

During the review and in subsequent filings, Muhlenberg provided invoices and revised estimates to support a cost of \$323,585 for the items included in its proposed adjustment. Based on the documentation provided and after consulting with the Commission's Engineering Division with regard to reasonable costs and estimated service lives, Staff has calculated an adjustment to depreciation expense as follows:

<u>Item No.</u>	<u>Cost per Estimate/Invoice</u>	<u>Estimated Service Life</u>	<u>Annual Depreciation</u>
1 & 1a	\$ 230,000	30 years	\$ 7,667
2	8,000	10 years	800
3	19,490	5 years	3,898
4	10,296	5 years	2,059
5	28,000	7 years	4,000
7	<u>27,799</u>	30 years	<u>927</u>
	<u>\$ 323,585</u>		<u>\$ 19,351</u>



It was the opinion of the Engineering Staff that Item 6 should be expensed by the utility. Therefore, it was not included in this calculation.

Based on the information provided, Staff recommends an increase to depreciation expense of \$19,351.

Rate Case Expense

In its application Muhlenberg did not propose an adjustment to include rate case expense. However, based on Staff's review, to date Muhlenberg has incurred rate case expense of \$5,621.<sup>2</sup> Staff recommends this expense be amortized over a period of three years resulting in annual rate case expense of \$1,874.

Interest Income

For the test year Muhlenberg reported interest income of \$10,659. Based on Staff's review it was determined that only 31 percent of this income was from non-restricted interest-bearing accounts that could be used to meet Muhlenberg's operating expenses. Accordingly, an adjustment has been included to decrease interest income by \$7,355 to a level of \$3,304.<sup>3</sup>

Non-utility Income and Expense

Muhlenberg reported non-utility income and expense for the test year in the amounts of \$2,138 and \$2,099, respectively. Staff

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<sup>2</sup> Advertising Expenses	\$ 266.63
Accounting Expenses	3,600.00
Legal Expenses	1,754.40
Total Rate Case Expense	<u>\$5,621.03</u>

<sup>3</sup> \$10,659 x 31% = \$3,304

was advised that these monies result from the sale of garbage bags by Muhlenberg on behalf of the Muhlenberg County Fiscal Court because the county requires that a certain type of garbage bag be used in its trash cans. The utility provides this service as a convenience to the county residents. The utility does not make any profit nor incur any expense from the sale of garbage bags. Accordingly, Staff has excluded the non-utility income and expense from the calculation of Muhlenberg's revenue requirement.

#### Operations Summary

Based on the recommendations of Staff, Muhlenberg's operating statement would appear as set forth in Appendix B to this report.

#### C. Revenue Requirements Determination

In its application Muhlenberg proposed to finance the proposed system improvements and capital expenditures through utility funds on hand and a five-year loan in the amount of \$200,000. At an interest rate of 6 percent the monthly payment would be \$3,866.56 which would result in an annual payment of \$46,399.

With regard to existing long-term debt, Muhlenberg's average annual debt service requirement is \$49,115. Combined with the proposed debt this would result in total annual debt service of \$95,514.

Based on the adjusted test period operations, Muhlenberg's average debt service coverage ("DSC") is .09x.<sup>4</sup> Staff is of the opinion that a DSC of 1.2x is necessary to allow Muhlenberg to meet

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<sup>4</sup>  $\$9,115 + \$95,514 = .09$

its operating expenses and service its debt. Therefore, Staff recommends that Muhlenberg be allowed to increase its annual revenues by \$105,539, calculated as follows:

Adjusted Operating Expenses	\$482,725
Average Annual Debt Service	95,514
20 Percent DSC	<u>19,103</u>
Total Revenue Requirement	\$597,342
Less: Normalized Operating Revenues	488,499
Interest Income	<u>3,304</u>
Required Revenue Increase	<u>\$105,539</u>

In the event approval for any portion of the proposed improvements and/or capital expenditures is not obtained, the recommendations contained herein related to financing and expenses for these projects would change accordingly. Assuming these items are approved, Staff recommends that the proposed debt be included in revenue requirements.

D. Rate Design

In its application, Muhlenberg filed a schedule of present and proposed rates that did not include any changes in rate design. Staff agrees that the current rate structure should not be altered, and any increase granted in the case has been added to the existing rate design. The rates recommended by Staff will generate the required operating revenue from rates of \$583,403. Therefore, Staff recommends the rates in Appendix A be approved for water service for the customers of Muhlenberg County Water District #3.

E. Signatures

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Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Division of Financial Analysis

Nicky Moore  
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Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Division of Rates and Research

**APPENDIX A  
TO STAFF REPORT CASE NO. 94-125**

The Staff recommends the following rate be prescribed for customers of Muhlenberg County Water District #3.

**Monthly Rates:**

**Residential & Commercial**

<b>First</b>	<b>2,000 gallons</b>	<b>\$11.10 Minimum Bill</b>
<b>Next</b>	<b>8,000 gallons</b>	<b>3.75 per 1,000 gallons</b>
<b>Next</b>	<b>10,000 gallons</b>	<b>3.14 per 1,000 gallons</b>
<b>Next</b>	<b>30,000 gallons</b>	<b>2.40 per 1,000 gallons</b>
<b>Over</b>	<b>50,000 gallons</b>	<b>1.86 per 1,000 gallons</b>

**Resale - City of Sacramento**

<b>All usage</b>	<b>1.86 per 1,000 gallons</b>
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APPENDIX B  
TO STAFF REPORT CASE NO. 94-125

Muhlenberg County Water District #3  
Statement of Adjusted Operations  
Test Year Ended 12/31/93

	<u>Test Year per</u> <u>Annual Report</u>	<u>Recommended</u> <u>Adjustments</u>	<u>Test Year</u> <u>Adjusted</u>
<b>Operating Revenues:</b>			
Water Sales	\$479,653	(\$ 1,789)	\$477,864
Other Operating Revenues	<u>10,635</u>	<u>          </u>	<u>10,635</u>
<b>Total Operating Revenues</b>	<b>\$490,288</b>	<b>(\$ 1,789)</b>	<b>\$488,499</b>
<b>Operating Expenses:</b>			
Salaries & Wages	\$126,031	(\$ 13,919)	\$112,112
Commissioners Fees	10,800		10,800
Employee Pensions & Benefits	22,297	( 304)	21,993
Purchased Water	212,380	( 10,056)	202,324
Purchased Power	5,221		5,221
Materials & Supplies	13,948		13,948
Contractual Services	9,297		9,297
Rent	695		695
Transportation Expense	8,153	( 1,800)	6,353
Insurance	10,531		10,531
Bad Debt Expense	1,082		1,082
Miscellaneous	3,069	( 600)	2,469
Taxes other than Income	14,493	( 1,065)	13,428
Depreciation Expense	51,247	19,351	70,598
Rate Case Expense	<u>-0-</u>	<u>1,874</u>	<u>1,874</u>
<b>Total Operating Expenses</b>	<b><u>\$489,244</u></b>	<b>(\$ 6,519)</b>	<b><u>\$482,725</u></b>
<b>Operating Income</b>	<b>\$ 1,044</b>	<b>\$ 4,730</b>	<b>\$ 5,774</b>
<b>Interest Income</b>	<u>10,659</u>	( <u>7,355</u> )	<u>3,304</u>
<b>Net Income/(Loss)</b>	<b><u>\$ 11,703</u></b>	<b>(\$ 2,625)</b>	<b><u>\$ 9,078</u></b>