COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A REVIEW OF THE RATES OF ELAM UTILITY COMPANY, INC. PURSUANT TO THE DECISION TO APPROVE THE FINANCING REQUESTED IN CASE NO. 2001-00324	))))	CASE NO. 2003-00171

O R D E R

On May 28, 2003, the Commission initiated a review of the rates of Elam Utility Company, Inc. (Elam) pursuant to the decision to approve the financing requested in Case No. 2001-00324.[1] Commission Staff performed a limited financial review of Elam s operations and has prepared the attached Staff Report containing Staff s findings and recommendations. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for hearing or informal conference. If no request is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 17th day of September, 2003.

ATTEST:

By the Commission

Wm H. Bowker

Deputy Executive Director

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[1] Case No. 2001-00324, Application of Elam Utility Company, Inc., Morgan & Wolfe County, Kentucky, for the Authority to Borrow $797,425 from the Economic Development Administration Through the Department for Local Government.

STAFF REPORT
ON

ELAM UTILTY COMPANY, INC.

CASE NO. 2003-00171

Preface

On May 28, 2003, the Commission initiated on its own motion a review of the rates of Elam Utility Company Inc. (Elam) pursuant to the decision to approve the financing requested in Case No. 2001-00324.[1] On July 17, 2003, Commission Staff performed a limited financial review of Elam s operations for the year ended December 31, 2002. Dawn McGee, Chris Whelan and Rebecca Phillips of the Commission s Division of Financial Analysis performed the field review at the business office of Elam in West Liberty, Kentucky. The examination was based on the 2002 Annual Report for Elam, which shows that Elam had an unadjusted Net Operating Income of $175,467.20. Upon examination of Elam s records it became clear that a portion of this net operating income was due to the over collection of gas costs in 2002 as a result of the company s failure to file timely Gas Cost Adjustments (GCA). This is discussed more fully in the Gas Cost Adjustment Mechanism Section of this Report.

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[1] Case No. 2001-00324, Application of Elam Utility Company, Inc., Morgan & Wolfe County, Kentucky, for the Authority to Borrow $797,425 from the Economic Development Administration Through the Department for Local Government.

MANAGEMENT ISSUES

Recommendations from Last Rate Case

In Case No. 2000-00432,[2] the Commission ordered Elam to adopt the twelve accounting and record-keeping recommendations included in the Staff Report and accepted by Elam in a letter dated March 20, 2001. The twelve recommendations are included herein as Appendix A.

In March 2002, the Commission s Financial Audit Branch conducted a follow-up examination to determine the status of Elam s adoption of these recommendations. The follow-up examination report stated that, although Elam had complied with four of the recommendations, the following items were still deficient:

1. Subsidiary Plant Records
2. Depreciation Records
3. Records Retention
4. Maintaining Books and Records
5. Wage Allocation Study
6. Nonutility Business Activity
7. Transportation Records
8. Accounting

Elam responded by letter dated March 27, 2002 stating the actions it would take to cure the remaining deficiencies. During the field review is this case, Staff determined that Elam has made progress in complying with some of the remaining

[2] Case No. 2000-00432, The Application of Elam Utility Company, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

recommendations including the maintenance of a transportation usage log for the company truck. Additionally, the owner/manager stated that the company is no longer involved in nonutility business and Staff did not find evidence of significant nonutility business activity during the course of the field review.

Elam has been ordered to comply with all recommendations and therefore, the Commission s Financial Audit Branch will perform a second follow-up examination to monitor and assist Elam in curing the remaining deficiencies.

Pension Payment

Staff noted during the field review that, on at least one occasion, an employee of Elam s was issued a check for money withheld from the employee s salary that was originally to have been deposited into the employee s 401K account. In addition to refunding the employee s contribution, the company issued a check to this employee for the matching funds the company would have deposited into the 401K account. It is unclear why the company would issue a check to the employee for amounts that would have normally been deposited, as matching funds, into the 401K account. This is not a reasonable business practice and Staff recommends that Elam should only match funds by paying them directly into a 401K plan.

Customer Deposit Interest

Staff noted during the field review that Elam did not pay interest on customer deposits in 2002. In accordance with KRS 278.460 and 807 KAR 5:006, Section 7(6), Elam is required to pay interest at a rate of 6 percent annually on customer deposits. An allowance for interest on customer deposits is included in the revenue requirements calculation in this Staff Report. It is Elam s duty to pay interest on customer deposits as required by Kentucky statutes and regulations. Elam must pay accrued interest on customer deposits from the last interest payment date.

Depreciation

In the previous rate case,[3] the useful lives of certain assets were adjusted and Elam was directed to make the adjustments to its depreciation schedule. In early 2003, Commission Staff met with Elam s CPA, corresponded by letter, and provided a depreciation schedule to explain the necessary changes. However, during the field review, it was discovered that the changes to Elam s depreciation records were not in accordance with Staff s recommendations. Staff reminds Elam that it is required to adjust its depreciation records to reflect the recommendations contained in the Staff Report issued in Case No. 2000-00432 and as provided to Elam by Commission Staff.

Gas Cost Adjustment Filings

Elam has not filed a quarterly GCA for more than a year. Staff believes it is important to stress to Elam the necessity of filing quarterly GCAs in accordance with its tariff. The GCA mechanism is designed to generate revenues to cover gas supply costs. By not filing its GCA in a timely manner, Elam could experience cash flow problems, as it has in the past, when the price of gas increases. When the price of gas is less than its GCA, Elam receives cash inflows in excess of its gas supply costs, which must eventually be returned to customers.

Dividends

During the course of Staff s review, it was discovered that Elam paid its owners $39,000.00 in dividends during calendar year 2002 and has paid the owners an

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[3] Id.

additional $40,000.00 in dividends through June 2003. These payments followed the Commission s approval of financing totaling $797,425.00 from the Department of Local Government (DLG) in Case No. 2001-00324 and a rate increase granted on May 30, 2001 in Case No. 2000-00432. Loan proceeds were used to pay off past-due gas purchases, to fund accounts payable related to past-due operating expenditures and to refinance existing debts.

The timing of the financing, in addition to the rate increase and the continued collection of past due gas purchases through the GCA mechanism provided sufficient cash flow for the company to believe it was appropriate to pay substantial dividends to its owners. Despite Elam s improved cash flow, Staff is concerned with the magnitude of the dividends declared and paid by the company.

RECOMMENDED RATE-MAKING ADJUSTMENTS

Normalized Revenues

Elam s billing records do not support the revenue reported in its Annual Report. Staff recommends adjusting the Gas Service Revenues, Miscellaneous Service Revenues and Forfeited Discounts in the Annual Report to reflect the amounts supported by Elam s billing records. These adjustments will properly recognize the revenue generated by Elam s rates and non-recurring charges.

Elam s Annual Report includes $712,418.76 in Gas Service Revenues. Elam s billing records, however, support only $689,949.08 in service billings for the test year, which includes $406,601.05 in revenues generated from its Gas Cost Adjustment mechanism (GCA), $282,978.63 in revenues from base rates and $369.40 in free gas used by Elam. Staff recommends adjusting Elam s Gas Service Revenues to reflect its gas cost revenues based on its current GCA of $6.2084 per Mcf and test year base rate revenues based on its billing records. This produces gas cost revenues of $332,838.53 and base rate revenues of $282,978.63, resulting in total Gas Service Revenues of $615,817.16.

Elam reported $195.00 in Miscellaneous Service Revenues in its 2002 Annual Report. Elam s tariffs includes a service charge of $12.00 for establishing gas service for a customer. During the field review, Elam explained that it discontinued applying the charge after the Commission dismissed a case in which Elam had requested to increase the service charge.[4] When the Commission dismissed the case due to Elam s lack of response to an information request, Elam erroneously believed that it was no longer allowed to apply such a service charge. Staff recommends increasing Miscellaneous Service Revenues by $189.00 to $384.00 to include the revenue that Elam could have charged customers but did not.

Elam reported $124.70 in Other Gas Revenues. During the field review, Elam explained that it used this category to report any under or overage in cash and the sales tax discount. Staff recommends excluding this amount from Normalized Revenues since these types of revenues are not normally included.

Elam reported $1,429.61 in Forfeited Discounts in its Annual Report although its billing records indicate that $1,691.86 in Forfeited Discounts was actually charged in 2002. Staff recommends adjusting the Forfeited Discounts to $1,691.86. These

[4] Case No. 2002-00095, Non-Recurring Charges of Elam Utility Company, Inc., Order dated September 11, 2002.

adjusted levels for Miscellaneous Service Revenues and Forfeited Discount Revenues, added to Elam s Gas Service Revenues, result in Total Gas Operating Revenues of $617,893.02.

Purchased Gas Expense

Elam s reported 2002 purchased gas expense was $301,454.70. Staff recommends normalizing Elam s purchased gas expense to reflect its current GCA and its 2002 sales volumes. Using the current GCA of $6.2084 per Mcf, which became effective April 1, 2002, results in normalized purchased gas expense of $332,838.53.

Gas Cost Adjustment Mechanism

Staff has prepared a GCA for Elam, which will be effective with the base rates approved in this case. The recommended GCA filing is attached as Appendix B and is explained further in this section. The GCA mechanism contains multiple components to true up past over- and under-collections, components which are normally placed in effect for 12 months. When Elam did not file a GCA for over a year, these components expired but continued to be billed to customers, creating further under- or over-recoveries.

Elam purchases gas from two suppliers, Cumberland Valley Resources, LLC (Cumberland) and Jefferson Gas Transmission Company, Inc. (Jefferson). It purchases most of its gas from Cumberland under a fixed price contract which is renewed annually effective September 1. The price it pays Jefferson changes monthly. Based on the new Cumberland price effective September 1, 2003 and the average price paid Jefferson for the first six months of 2003, Staff has calculated an Expected Gas

Cost (EGC) of $6.8987 for Elam s new GCA, an increase of $1.2793 from the current EGC of $5.6194.

Because Elam has not filed a GCA for over a year, Staff has calculated an Actual Adjustment (AA) of 25.12 cents per Mcf for the 18-month period January 2002 through June 2003. Since all the previous quarterly AAs have expired, Elam s total AA is also 25.12 cents per Mcf, a decrease of 43.82 cents per Mcf from the previous total AA of 68.94 cents.

Elam has no current Refund Adjustments (RA), however, its existing GCA does contain an RA of .04 cent per Mcf. Removing this expired RA results in a decrease of .04 cent per Mcf from the prior rate.

Elam s existing GCA does not contain any Balancing Adjustments (BA). As a result of the expired AAs mentioned earlier and other AAs which had already been removed as part of Elam s last GCA filing, Elam will have a current quarter BA of (62.5) cents per Mcf, a decrease of 62.5 cents per Mcf from its previous rate.

Staff recommends one further adjustment to Elam s GCA. Elam received approval, in December 2001, to borrow $48,650.72 from the Department for Local Government (DLG) to pay three gas supply invoices.[5] Elam s current GCA includes the amount of these gas supply costs, while its base rates recover the financing of these same costs. Since its base rates recover Elam s financing of these gas costs, Staff

[5] Case No. 2001-00324, Application of Elam Utility Company, Inc. Morgan & Wolf County, Kentucky, for the Authority to Borrow $797,425 from the Economic Development Administration through the Department for Local Government, Order dated December 3, 2001.

recommends returning the $48,650.72 to customers through the BA component of Elam s GCA.

The EGC and adjustments discussed above result in a recommended GCA of $6.5249 per Mcf, an increase of 31.65 cents per Mcf from the previous GCA of $6.2084. Staff recommends that Elam begin filing regular quarterly GCAs to avoid the cash flow and reporting problems already discussed in this section.

Salaries and Wages

Elam s 2002 payroll totaled $114,646.50 for three full-time employees, an owner/manager and two field employees. The owner/manager received a salary of $62,400.00 while field employee no. 1 earned $32,745.00 and field employee no. 2 earned $19,501.50. The owner/manager is responsible for receiving and posting all payments on accounts, responding to customer inquiries and complaints and performing all bookkeeping and record keeping duties. The two field employees duties include initiating and disconnecting service, extending service lines, reading meters, maintaining all field locations, repairing leaks and one of these employees must serve on call 24 hours a day for emergencies.

In the last rate case Staff recommended and the Commission accepted a salary of $46,800.00 for the owner/manager for test year 1999. The current salary of $62,400.00 is 33 percent more than that found reasonable in the last rate case. In order to determine the reasonableness of the owner/manager s current salary, Staff adjusted the approved 1999 test year salary of $46,800.00 to reflect the growth in the Consumer Price Index-Urban for each year 2000, 2001 and 2002. This calculation results in a salary of $50,345.43 for 2002.[6] Staff believes the $50,345.43 is reasonable and has adjusted salary expenses to reflect this level of salary for the owner/manager.

Staff normalized the field employees wages to reflect wage rates which were in effect at year-end. For field employee no. 1, normalized wages was calculated to be $31,750.00 based on a weekly salary of $590.00, plus actual overtime pay of $800.00 (40 hours at $20.00 per hour) and on-call pay of $265.00. Staff s calculation resulted in a $1,000.00 reduction to the reported 2002 wages of field employee no. 1. For field employee no. 2, normalized wages was calculated to be $21,112.00 based on an hourly rate of $8.40 plus on-call pay of $70.00 per week.

The net effect of the adjustments reduced test year payroll by $11,444.07 to $103,202.43. Staff has allocated this reduction utilizing the company s existing wage and salary allocation ratios:

- Acc. No. 870, Supervision, 40%	($4,577.63)
- Acc. No. 874, Mains and Services, 20%	(2,288.81)
- Acc. No. 902, Meter Reading, 5%	(572.21)
- Acc. No. 903,Customer Records, 25%	(2,861.01)
- Acc. No. 920, A&G Salaries, 10%	(1,144.41)
Total Allocated Reduction	$11,444.07

In the previous rate case, Staff had recommended that Elam undertake a wage allocation study to examine the reasonableness of the existing allocations. To date, Elam has not performed that study. Staff has used Elam s current allocation ratios

[6] Test year 1999 Salary $46,800.00
CPI, year 2000, 3.4% $48,391.20
CPI, year 2001, 1.6% $49,165.46
CPI, year 2002, 2.4% $50,345.43

because they are the only ones available. Elam is reminded that the previous recommendation that a new wage allocation study be performed is still outstanding.

Account No. 926, Employee Pensions and Benefits

Staff has made five adjustments to this account. First, Staff normalized health insurance for the most recent health insurance premiums and added an employee who was not covered during 2002 but who has since received coverage, resulting in an increase to test year expenses of $2,777.04. The company has a 401K plan available to its employees in which the company matches 3 percent of the employees salary. Staff calculated the employer s contribution based on its recommended level of wages and salary, which resulted in a normalized 401K contribution of $3,096.07. In addition, Staff removed $2,293.14 in expenses recorded in this account related to 2001 because Staff does not believe it is appropriate to include prior year expenses in the determination of the appropriate level of ongoing expenses. The net effect of these two adjustments is an increase of $802.93 to this account.

This account also was reduced by $743.41 for a check which should have paid into the 401K plan but which was paid directly to an employee during the test year. As discussed in the Management Issues section of this report, Staff does not believe this to be normal business practice. Further, Staff has normalized the company s ongoing 401K contribution based on its proposed wage and salary levels and therefore, this amount must be removed in order to prevent the overstatement of this account.

Staff also reclassified $184.05 in life insurance expenses to this account, which had been incorrectly recorded in Account No. 924, Property Insurance. Additionally, Staff added $17.55 to normalize life insurance for a December payment the company had not made at the end of the test year. Finally, Staff added $720.00 back to this account to reverse an entry made by Elam s CPA to adjust wages to actual. Since Staff has already adjusted wages, there is no support nor is there any justification for this entry. The net effect of these adjustments results in a net increase of $3,758.16 to this account.

Account No. 880, Meter and House Regulator Expenses

Staff removed prior year gasoline purchases totaling $50.92 as it is not appropriate to include more than one year s expense in the determination of the reasonable ongoing level of expense. Property tax totaling $73.88 related to a vehicle retired in 2002 was recorded in this account. Property taxes should be recorded in Account No. 408. In addition, since this expense relates to a vehicle which was replaced in 2002, Staff has removed this item completely from its recommended ongoing expenses. The net effect of these adjustments reduced test year expenses by $124.80.

Account No. 887, Maintenance of Mains Expenses

Staff reduced this account by a total of $227.88. First, Staff removed hardware supply expenses totaling $128.34 related to the prior year. As previously discussed, it is not appropriate to include prior year expenses in the determination of the appropriate level of ongoing expenses. Additionally, Staff removed $99.54 for gas logs purchased for Mrs. Ison. Staff notes that it is not appropriate to include the cost of personal items in Elam s rates nor is it appropriate for Elam to record such items on its books.

Account No. 904, Uncollectible Accounts Expense

Elam did not record any expense related to uncollectible accounts expense during 2002. However, an examination of past due accounts provided by the company shows $4,476.90 in bad debts occurring in 2002. Staff believes it is reasonable to recognize a level of uncollectible accounts expense and recommends including the $4,476.90 for ratemaking purposes.

Account No. 921, Office Supplies and Expenses

Staff made several adjustments to this account as follows:

- Elam ceased providing cell phones to each employee after the end of the test year, retaining only one for use by the company. Staff has included $259.38, the cost of providing one cell phone, for ratemaking purposes, which represents a reduction of $1,159.96 to test year expense.

- Expenses totaling $728.77 incurred in 2002 related to corporate advertising, seasonal office decorations, subscriptions and florist charges were removed from this account. Advertising that does not produce a material benefit to ratepayers is expressly disallowed for ratemaking purposes pursuant 807 KAR 5:016. The remaining items are being removed as they are not necessary for the provision of gas service and their removal is consistent with previous ratemaking decisions of the Commission.

- Prior year postal machine rental expense of $212.25 and prior year credit card purchases totaling $2,066.05 were removed. As previously discussed, it is not appropriate to include prior year expenses in the determination of the appropriate level of ongoing expenses.

- Staff reversed journal entries made by the CPA totaling $13,709.70 to adjust balance sheet accounts to actual. There were three separate adjusting journal entries, $151.57 to adjust cash to actual, ($6,705.73) to adjust inventory to actual and ($7,155.54) related to gas purchases. Staff could not find any support for these adjustments and has excluded them in the calculation of ongoing expenses in this account.

- A miscellaneous entry of ($32.07) was reversed, as it was an unidentified amount recorded to this account per book.

- $4,101.08 in natural gas purchase expense was recorded in this account by the CPA when making the year-end accounts payable journal entry. Gas purchases are not office expenses and should not be recorded in this account. Accordingly, Staff has removed them from the ongoing reasonable level of expense related to this account.

- $3,842.50 in CPA services expense was reclassified to Account No. 923, Outside Services Employed.

The net effect of these adjustments resulted in an increase of $1,631.16 to this account.

<u>Account No. 923, Outside Services Expenses</u>

Staff reduced this account for prior year CPA services totaling $3,236.28. As previously discussed, it is not appropriate to include prior year expenses in the determination of the appropriate level of ongoing expenses. Staff also increased this account for $3,842.50 in expenses for CPA services originally recorded in Account No. 921 but which should have been recorded in this account. The net effect of these adjustments results in an increase of $606.22 to this account.

Account No. 924, Property Insurance

There were several adjustments made to this account. Staff normalized commercial package insurance and automobile insurance resulting in a decrease of $757.44 to this account. This reduction includes the removal of prior year insurance cost included in the 2002 book balance. Also, because Staff normalized insurance expense, an adjusting journal entry of $2,412.57 made by the CPA to establish prepaid insurance has been reversed.

Additionally, Staff reduced this account by $734.70 for life insurance on the owners, which was purchased in support of the owner s personal loan incurred to buy the company. As determined in the previous rate case, Elam s ratepayers are not to bear any costs associated with the loan the current owners secured to purchase Elam. Staff also decreased this account by $184.05 to reflect a reclassification of life insurance to Account No. 926, Employee Pensions and Benefits and removed $14.30 in costs related to health insurance, which was normalized in Account No. 926. The net effect of these adjustments results in an addition of $722.08 to this account.

Account No. 928, Regulatory Commission Expense

Staff removed $1,557.47 in expenses related to prior year property taxes and reclassified $997.92 in property tax expense, which should have been recorded in Account No. 408, Taxes Other Than Income Taxes. As previously discussed, it is not appropriate to include prior year expenses in the determination of the appropriate level of ongoing expenses.

Account No. 930.2, Miscellaneous General Expenses

Staff removed donations of $25.00, tax penalties of $4,531.73 and floral charges of $42.40 resulting in a decrease of $4,599.13 to this account. The Commission has consistently disallowed donations in its determination of the ongoing expenses of a utility and Staff has done so in this instance. The tax penalties are nonrecurring; therefore, Staff does not believe such amounts should be included in the determination of future rates. Lastly, the floral expenses are not necessary for the provision of utility service and its removal is consistent with previous ratemaking decisions of the Commission.

Account No. 403, Depreciation

Elam reported depreciation of $20,056.23 for the test year and provided a depreciation schedule to support that amount. As previously discussed in the Management Issues section of this Report, this schedule was not in accordance with the Commission Staff s recommendations for effecting the useful life changes established in the previous Staff Report. Staff has recalculated Elam s depreciation schedule using the depreciation schedule sent to Elam in previous correspondence and has determined that the test year deprecation expense should be increased by $1,541.92.

Account No 408, Taxes Other than Income Taxes

Elam recorded $39,371.25 in taxes other than income taxes for 2002. Staff could not identify every item of expense that was recorded in this account. However, it appears that sales and possibly school taxes were incorrectly recorded in this account and for this reason, the account reflects a very high expense amount. Elam is reminded that sales and school taxes are not legitimate items of revenue or expense of the utility and should not be recorded on its books as such.

Staff included in this account the following items:

• Property Taxes, plant and vehicles	$ 4,800.63
• Federal and State Unemployment	242.83
• PSC Assessment, normalized	1,127.09
• FICA/Medicare, employer share	7,894.99
• Secretary of State Filing Fee	15.00
• Total Staff Proposed Balance	$14,080.54

Inclusion of only these expenses results in a reduction of $25,290.71 to this account.

Account 427, Interest on Long Term Debt

Staff normalized interest expense based on the amortization of the test-year-end level of debt and the interest as reflected in the amortization schedule of the Department of Local Government s Gas System Restoration Project loan approved in Case No. 2001-00324. This results in an increase to the test year expense of $4,056.33.

Account No. 431, Other Interest Expense

In conjunction with the Staff s recommendation in the Management Issues section of this Report that Elam pay interest on customer deposits, Staff adjusted this account to reflect the ongoing level of interest expense related to customer deposits. This resulted in a decrease of $1,063.54 to this account.

Following is an adjusted income statement reflecting all of the adjustments discussed herein.

ACCT. #	**USOA ACCOUNT TITLES**	**ANNUAL REPORT BALANCE 12/31/02**	**STAFF ADJUSTMENTS**	**STAFF NORMALIZED 12/31/02**
	Base Rate revenues (including cust chg)	$305,817.71	$(22,839.08)	$ 282,978.63
	Gas Purchase Revenues	406,601.05	(73,762.52)	332,838.53
	Total Gas Service Revenues	**712,418.76**	**(96,601.60)**	**615,817.16**
487	Forfeited Discounts	1,429.61	262.25	1,691.86
488	Miscellaneous Service Rev	195.00	189.00	384.00
495	Other Gas Revenues	124.70	(124.70)	0.00
	Total Operating Revenues	**714,168.07**	**(96,275.05)**	**617,893.02**
804	**Natural Gas Purchases**	**301,454.70**	**31,383.83**	**332,838.53**
870	Supervision	45,858.60	(4,577.63)	41,280.97
874	Mains & Services Expense	22,929.30	(2,288.81)	20,640.49
880	Meter/House Reg. Exp.	5,512.40	(124.80)	5,387.60
887	Maintenance of Mains	3,620.33	(227.88)	3,392.45
	Total Distribution Expenses	**77,920.63**	**(7,219.12)**	**70,701.51**
902	Meter Reading Labor	5,732.33	(572.21)	5,160.12
903	Customer Records/Collection	28,661.62	(2,861.01)	25,800.61
904	Uncollectible Accounts	0.00	4,476.90	4,476.90
	Total Customer Accounts Exp	**34,393.95**	**1,043.68**	**35,437.63**
920	A&G Salaries	11,464.65	(1,144.41)	10,320.24
921	Office Supplies/Exp	10,889.51	1,631.16	12,520.67
923	Outside Services	4,904.58	606.22	5,510.80
924	Property Insurance	10,064.51	722.08	10,786.59
926	Employee Pensions/Benefits	8,483.95	3,758.16	12,242.11
928	Reg. Comm. Exp.	2,555.39	(2,555.39)	0.00
930.2	Miscellaneous Gen Exp	5,941.52	(4,599.13)	1,342.39
931	Rents	11,200.00	0.00	11,200.00
	Subtotal	**65,504.11**	**(1,581.31)**	**63,922.80**
	Total Gas O&M Exp	**479,273.39**	**23,627.08**	**502,900.47**
403	Depreciation Exp	20,056.23	1,541.92	21,598.15
408.1	Taxes Other Than Inc. Taxes	39,371.25	(25,291.38)	12,953.45
	Total Gas Oper. Exp	**538,700.87**	**(122.38)**	**538,578.49**
	Net Oper. Income (Loss)	**175,467.20**	**(96,152.67)**	**79,314.53**
419	Int/Dividend Income	510.00	0.00	510.00
427	Int. on Long Term Debt	27,271.90	4,056.33	31,328.23
431	Other Interest Expense	2,961.02	(1,063.54)	1,897.48
	Net Income (Loss) from Base Rates	**$145,744.28**	**$(99,145.46)**	**$46,598.82**

REVENUE REQUIREMENTS

In determining recommended revenue requirements, Staff typically analyzes market conditions and establishes a rate of return on rate base based on the required return on invested capital. However, Elam s capital structure is very unbalanced with negative retained earnings of $544,297.12 and a long-term debt balance of $795,353.47. In situations such as this, Staff typically uses the 88 percent operating ratio methodology and has done so in this instance. Additionally, the operating ratio methodology was used in Elam s last rate case. The operating ratio method is used primarily when there is no sound basis for a rate of return determination using the required return on capital and rate base methodology.

Applying the 88 percent operating ratio to Staff s adjusted operating expenses, less purchased gas expense, results in a base rate revenue requirement of$233,795.41. Pro forma gas purchases expense of $332,838.53 was added back as was Elam s normalized interest expense totaling $33,225.71.[7] Interest expense is added back dollar for dollar to revenue requirements in order to ensure that Elam has enough cash to pay its interest expense yearly. This results in a total Staff-proposed annual revenue requirement of $599,859.65. Staff s calculation results in a total revenue reduction of $18,033.37 or approximately 2.92 percent less than Elam s normalized revenues of $617,893.02. Staff believes the total revenues calculated for Elam will still allow the company to meet its operating expenses and provide for equity growth. Therefore, Staff recommends a reduction of $18,033.37. The calculation of the revenue requirement based on the adjusted test year is as follows:

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[7] The total normalized interest expense reflects interest on long-term debt of $31,328.23 and interest on customer deposits of $1,897.48.

Revenue Requirement Calculation Based on the 88 Percent Operating Ratio:

Pro Forma Operating Expenses	$538,578.49
Less: Pro Forma Gas Costs	(332,838.53)
Net Pro Forma Operating Expenses	205,739.96
Divided by 88%	0.88
Total Revenue Requirement	233,795.41
Add: Interest Expense	33,225.71
Add: Gas Costs	332,838.53
Total Revenues Required	599,859.65
Less: Pro Forma Normalized Revenue	(617,893.02)
Rate Increase (Decrease)	$ (18,033.37)

Rates and Rate Design

Elam s current rates are as follows:

	Base Rate	Gas Cost Adjustment	Total
Residential/Commercial			
Customer Charge	$6.15		
Volumetric Rate:			
0 11 Mcf	$4.1214	$6.2084	$10.3298
Over 11 Mcf	$5.1214	$6.2084	$11.3298
Industrial			
Customer Charge	$9.01		
Volumetric Rate:			
All Mcf	$4.1214	$6.2084	$10.3298

Based on the recommended level of base rate revenues of $264,945.26,[8] Staff recommends a reduction in base rates for Elam. The decrease in base rate revenues

[8] Total revenues required minus gas purchase revenues, forfeited discounts and miscellaneous service revenues ($599,859.65 $332,838.53 - $1,691.86 - $384.00).

has been assigned to Elam s residential/commercial rate classes and its industrial rate class so that both classes base rate revenues are reduced by 2.92 percent. Staff recommends consolidating the two-step rate currently in use for residential and commercial customers into a one-step rate for all Mcf and rounding the Industrial Customer Charge to $9.00. This should simplify Elam s billings to customers and improve its billing records as well. Absent any decrease in base rates, the change from a two-step to a one-step rate for the residential/commercial classes would result in a rate of approximately $4.60 for all Mcf. With the base rate reduction, the overall effect will be a decrease of roughly 30 cents per Mcf for this class and for the industrial rate class. Staff s recommended rates, including the new GCA, are as follows.

	Base Rate	Gas Cost Adjustment	Total
Residential/Commercial			
Customer Charge	$6.15		
All Mcf	$4.2999	$6.5249	$10.8248
Industrial			
Customer Charge	$9.00		
All Mcf	$3.8101	$6.5249	$10.3350

SIGNATURES

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<u>APPENDIX A</u>

Case No. 2000-00432

STAFF RECOMMENDATIONS FOR CORRECTIVE ACTION

Following is a summary of the Staff recommendations for corrective action that was originally issued in Case No. 2000-00432. These recommendations are discussed in previous sections of this Staff Report:

1. Subsidiary Plant Records Elam should establish a subsidiary plant ledger to reflect the continuing property records of the utility. The subsidiary plant ledger should contain a card or sheet for each unit of property, showing details such as description, location, cost, vendor, date of purchase or installation, estimated cost of removal and salvage value and method of depreciation, depreciation accumulated to date, and capitalized repairs, replacements, and improvements.

2. Depreciation Records The depreciation schedules of Elam should be corrected in accordance with the findings of this report. The appropriate depreciation rates should be used to accrue depreciation prospectively, and corrections should be made to the accumulated provision for depreciation to reflect the adjustments contained in this report.

3. Records Retention Elam should review the requirements of the USoA regarding retention of records and comply with the same. At a minimum, Elam should maintain general and subsidiary ledgers for at least fifty years and the trial balance sheets of those ledgers for at least two years. Records related to revenues and expenses and capitalized assets should be retained for the minimum number of years required by the USoA. Additionally, Elam should maintain schedules that tie its general ledger accounts to the amounts included in its annual reports, and keep supporting records for all of its general ledger entries.

Elam should keep a subsidiary ledger of its monthly credit card usage. Specifically, this ledger should show the name of the credit card, the card number and to whom the card is assigned, the monthly purchases, the unpaid balance, interest and fees, and the amount paid during the month. The ledger should also show the accounts charged for each of the purchases made with the credit card.

4. Financing Approval Prior to issuing any evidences of indebtedness of a period greater than two years, Elam should obtain Commission approval pursuant to KRS 278.300.

5. Transfer of Elam The transfer of Elam from the Phillipses to the Isons should not be recorded on Elam s books. Elam should take the necessary steps to correct the financial statements to eliminate the reported liability and any costs associated with it.

6. Maintaining Books and Records Elam should correct its accounting procedures to assure that the general ledger supporting the information contained in the Annual Report to the Commission is accurate and has appropriate supporting documentation. Additionally, Elam should allocate its credit card purchases into proper expense and general ledger accounts and keep all documentation relating to credit card purchases.

7. Internal Control of Cash Elam should develop procedures to increase its internal control over cash.

8. Wage Allocation Study Elam should perform a wage allocation study in order to determine how much of each employee s salary should be allocated to each of

the labor expense accounts. Also, the wage allocations should include a factor associated with merchandising and jobbing.

9. Non-Utility Business Activity Elam should develop procedures to allocate costs between its utility and non-utility business activity in order to define and separate the operations of the business. The procedures should be written and included in a cost allocation manual, and updated as circumstances change with the utility. To the extent possible, the books and records should be maintained separately, and costs should be directly assigned to the appropriate expense account. Transactions between the utility and the non-utility operations should be conducted in a manner that does not result in any cross-subsidization of the non-regulated business by the regulated utility.

10. Lease Agreement Elam should solicit bids from the Phillips and other lessors for office space and secure an agreement with terms that are more favorable to Elam.

11. Transportation Records Elam should maintain records of the business use of all vehicles.

12. Accounting Elam should correct its accounting procedures for operating expenses as described in the Accounting Adjustments Section in this report for any of the financial reports issued subsequent to the date of this report.

<u>APPENDIX B</u>

Case No. 2003-00171

Schedule III, Refund Adjustment, is not included in this appendix because it is not applicable to Elam at this time.

SCHEDULE I

GAS COST RECOVERY RATE SUMMARY

Component	Unit	Amount
Expected Gas Cost (EGA)	$/Mcf	$6.8987
Refund Adjustment (RA)	$/Mcf	$0.0000
Actual Adjustment (AA)	$/Mcf	$0.2512
Balance Adjustment (BA)	$/Mcf	($0.6250)
Gas Cost Recovery Rate (GCR)	$/Mcf	$6.5249

A. EXPECTED GAS COST CALCULATION	Unit	Amount
Total Expected Gas Cost (Sch II)	$/Mcf	$381,573.65
/Sales for the 12 months ended June 30, 2003	$/Mcf	55,311.00
Expected Gas Cost	$/Mcf	$6.8987

B. REFUND ADJUSTMENT CALCULATION	Unit	Amount
Supplier Refund Adjustment for Reporting Period (Sch III)	$/Mcf	$0.0000
+Previous Quarter Supplier Refund Adjustment	$/Mcf	$0.0000
+Second Previous Quarter Supplier Refund Adjustment	$/Mcf	$0.0000
+Third Previous Quarter Supplier Refund Adjustment	$/Mcf	$0.0000
=Refund Adjustment (RA)	$ Mcf	$0.0000

C. ACTUAL ADJUSTMENT CALCULATION	Unit	Amount
Actual Adjustment for the Reporting Period (Sch IV)	$/Mcf	$0.2512
+Previous Quarter Reported Actual Adjustment	$/Mcf	$0.0000
+Second Previous Quarter Reported Actual Adjustment	$/Mcf	$0.0000
+Third Previous Quarter Reported Actual Adjustment	$/Mcf	$0.0000
=Actual Adjustment (AA)	$ Mcf	$0.2512

D. BALANCE ADJUSTMENT CALCULATION	Unit	Amount
Balance Adjustment for the Reporting Period (Sch V)	$/Mcf	($0.6250)
+Previous Quarter Reported Balance Adjustment	$/Mcf	$0.0000
+Second Previous Quarter Reported Balance Adjustment	$/Mcf	$0.0000
+Third Previous Quarter Reported Balance Adjustment	$/Mcf	$0.0000
=Balance Adjustment (BA)	$ Mcf	($0.6250)

SCHEDULE II
EXPECTED GAS COST

Actual Mcf Purchases for 12 months ended June 30, 2003

(1) Supplier	(2) Dth	(3) Btu Conversion Factor	(4) Mcf	(5) Rate	(6) (4) x (5) Cost
Cumberland Valley			49,559	$6.85	$339,479.15
Jefferson Gas			3,990	$10.55	$42,094.50
Totals			53,549		$381,573.65

Line loss for 12 months ended 6/30/2003 is based on purchases of 54,505.0

and sales of 55,311.0 Mcf. -1.48%

	Unit	Amount
Total Expected Cost of Purchases (6)		$381,573.65
/ Mcf Purchases (4)		54,505
= Average Expected Cost Per Mcf Purchased		$7.0007
x Allowable Mcf Purchases (must not exceed Mcf sales / .95)		54,505.00
= Total Expected Gas Cost (to Schedule IA)		$381,573.65

SCHEDULE IV

ACTUAL ADJUSTMENT

For the 18 month period ended June 30, 2003

Particulars	Unit	Jan-02 Month 1	Feb-02 Month 2	Mar-02 Month 3	Apr-02 Month 4	May-02 Month 5	June '02 Month 6	July 02 Month 7	Aug-02 Month 8	Sep Mon
Total Supply Volumes Purchased	Mcf	9648	8618	7108	3,027.0	2,279.0	1,076.0	1,152.0	1,219.0	1,
Total Cost of Volumes Purchased	$	$55,723.25	$52,226.74	$52,038.99	$21,916.85	$14,102.69	$12,728.15	$8,626.52	$8,650.05	$7,9
/ Total Sales *	Mcf	11,049.0	8,206.0	7,151.0	3,314.0	2,450.0	1,238.0	1,094.4	1,192.0	1,
= Unit Cost of Gas	$/Mcf	$5.0433	$6.3645	$7.2772	$6.6134	$5.7562	$10.2812	$7.8824	$7.2568	$6
- EGC in Effect for Month	$/Mcf	$5.6162	$5.6162	$5.6162	$5.6194	$5.6194	$5.6194	$5.6194	$5.6194	$5
= Difference	$/Mcf	($0.5729)	$0.7483	$1.6610	$0.9940	$0.1368	$4.6618	$2.2630	$1.6374	$0
x Actual Sales during Month	Mcf	11,049.0	8,206.0	7,151.0	3,314.0	2,450.0	1,238.0	1,084.0	1,192.0	1,
= Monthly Cost Difference	$	($6,330.14)	$6,140.20	$11,877.54	$3,294.16	$335.16	$5,771.33	$2,453.11	$1,951.73	$7

	Unit	Jan-03 Month 10	Feb-03 Month 11	Mar-03 Month 12	Apr-03 Month 13	May-03 Month 14	Jun-03 Month 15	Total
Total Supply Volumes Purchased	Mcf	12,349.0	9,580.0	5,221.0	2,707.0	1,301.0	1,226.0	32,
Total Cost of Volumes Purchased	$	$40,579.61	$87,119.16	$24,514.67	$22,724.69	$31,787.68	$8,762.75	$215,4
/ Total Sales *	Mcf	12,816.0	9,764.0	5,793.0	3,271.0	1,897.0	1,567.0	
= Unit Cost of Gas	$/Mcf	$3.1663	$8.9225	$4.2318	$6.9473	$16.7568	$5.5921	
- EGC in Effect for Month	$/Mcf	$5.6194	$5.6194	$5.6194	$5.6194	$5.6194	$5.6194	
= Difference	$/Mcf	($2.4531)	$3.3031	($1.3876)	$1.3279	$11.1374	($0.0273)	
x Actual Sales during Month	Mcf	12,816.0	9,764.0	5,793.0	3,271.0	1,897.0	1,567.0	35,
= Monthly Cost Difference	$	($31,438.62)	$32,251.34	($8,038.51)	$4,343.63	$21,127.68	($42.85)	$18,2

Total Cost Difference	$	$13,896.40
/ Sales for 12 months ended 6/30/03	Mcf	55,311.0
= Actual Adjustment for the Reporting Period (to Sch IC)		$0.2512

* May not be less than 95% of supply volume

SCHEDULE V
BALANCE ADJUSTMENT

Expired AA Components

	9845-G	9845-H	9845-I	2000-432-A	2000-432-B	2002-00081
Total Cost to Recover thru AA	($13,043.00)	$13,536.00	$139,462.00	$44,611.43	$875.53	($4,208.65)
Total Recovered thru 6/03	($19,596.09)	$20,106.29	$119,384.44	$82,057.87	$1,384.02	($5,327.76)
(Over)/Under Collected	$6,553.09	($6,570.29)	$20,077.56	($37,446.44)	($508.49)	$1,119.11

Subtotal Net (Over)/Under Collected	($16,775.46)
Adj for DLG pmt of past gas bills	($48,650.72)
Total Net (Over)/Under Collected	($65,426.18)
24 Mo. Sales Vol. Ended 6/30/03	104,679
BA Factor	($0.6250)

9845-G	Sales Volume	AA Factor	Amt. Rec/(Rtn)	Balance
Beginning Balance				($13,043.00)
October-00	2,481	($0.1246)	($309.13)	($12,733.87)
November-00	6,086	($0.1246)	($758.32)	($11,975.55)
December-00	10,776	($0.1246)	($1,342.69)	($10,632.86)
January-01	11,901	($0.1246)	($1,482.86)	($9,150.00)
February-01	8,158	($0.1246)	($1,016.49)	($8,133.51)
March-01	6,733	($0.1246)	($838.93)	($7,294.58)
April-01	3,570	($0.1246)	($444.82)	($6,849.76)
May-01	1,647	($0.1246)	($205.22)	($6,644.54)
June-01	1,241	($0.1246)	($154.63)	($6,489.91)
July-01	1,034	($0.1246)	($128.84)	($6,361.08)
August-01	1,070	($0.1246)	($133.32)	($6,227.75)
September-01	1,237	($0.1246)	($154.13)	($6,073.62)
October-01	2,297	($0.1246)	($286.21)	($5,787.42)
November-01	4,866	($0.1246)	($606.30)	($5,181.11)
December-01	5,456	($0.1246)	($679.82)	($4,501.30)
January-02	11,049	($0.1246)	($1,376.71)	($3,124.59)
February-02	8,206	($0.1246)	($1,022.47)	($2,102.12)
March-02	7,151	($0.1246)	($891.01)	($1,211.11)
April-02	3,314	($0.1246)	($412.92)	($798.18)
May-02	2,450	($0.1246)	($305.27)	($492.91)
June-02	1,238	($0.1246)	($154.25)	($338.66)
July-02	1,084	($0.1246)	($135.07)	($203.59)
August-02	1,192	($0.1246)	($148.52)	($55.07)
September-02	1,210	($0.1246)	($150.77)	$95.70
October-02	2,452	($0.1246)	($305.52)	$401.22
November-02	5,080	($0.1246)	($632.97)	$1,034.18
December-02	9,185	($0.1246)	($1,144.45)	$2,178.63
January-03	12,816	($0.1246)	($1,596.87)	$3,775.51
February-03	9,764	($0.1246)	($1,216.59)	$4,992.10
March-03	5,793	($0.1246)	($721.81)	$5,713.91
April-03	3,271	($0.1246)	($407.57)	$6,121.48
May-03	1,897	($0.1246)	($236.37)	$6,357.84
June-03	1,567	($0.1246)	($195.25)	$6,553.09
Total	94,175		($19,596.09)	

9845-H	Sales Volume	AA Factor	Amt. Rec/(Rtn)	Balance
Beginning Balance				$13,536.00
January-01	11,901	$0.2659	$3,164.48	$10,371.52
February-01	8,158	$0.2659	$2,169.21	$8,202.31
March-01	6,733	$0.2659	$1,790.30	$6,412.01
April-01	3,570	$0.2659	$949.26	$5,462.74
May-01	1,647	$0.2659	$437.94	$5,024.81
June-01	1,241	$0.2659	$329.98	$4,694.83
July-01	1,034	$0.2659	$274.94	$4,419.88
August-01	1,070	$0.2659	$284.51	$4,135.37
September-01	1,237	$0.2659	$328.92	$3,806.45
October-01	2,297	$0.2659	$610.77	$3,195.68
November-01	4,866	$0.2659	$1,293.87	$1,901.81
December-01	5,456	$0.2659	$1,450.75	$451.06
January-02	11,049	$0.2659	$2,937.93	($2,486.87)
February-02	8,206	$0.2659	$2,181.98	($4,668.84)
March-02	7,151	$0.2659	$1,901.45	($6,570.29)
Total	75,616		$20,106.29	

9845-I	Sales Volume	AA Factor	Amt. Rec/(Rtn)	Balance
Beginning Balance				$139,462.00
April-01	3,570	$2.4452	$8,729.36	$130,732.64
May-01	1,647	$2.4452	$4,027.24	$126,705.39
June-01	1,241	$2.4452	$3,034.49	$123,670.90
July-01	1,034	$2.4452	$2,528.34	$121,142.56
August-01	1,070	$2.4452	$2,616.36	$118,526.20
September-01	1,237	$2.4452	$3,024.71	$115,501.49
October-01	2,297	$2.4452	$5,616.62	$109,884.86
November-01	4,866	$2.4452	$11,898.34	$97,986.52
December-01	5,456	$2.4452	$13,341.01	$84,645.51
January-02	11,049	$2.4452	$27,017.01	$57,628.49
February-02	8,206	$2.4452	$20,065.31	$37,563.18
March-02	7,151	$2.4452	$17,485.63	$20,077.56
Total	48,824		$119,384.44	

2002-432-A	Sales Volume	AA Factor	Amt. Rec/(Rtn)	Balance
Beginning Balance				$44,611.43
July-01	1,034	$0.7839	$810.55	$43,800.88
August-01	1,070	$0.7839	$838.77	$42,962.10
September-01	1,237	$0.7839	$969.68	$41,992.42
October-01	2,297	$0.7839	$1,800.62	$40,191.80
November-01	4,866	$0.7839	$3,814.46	$36,377.34
December-01	5,456	$0.7839	$4,276.96	$32,100.39
January-02	11,049	$0.7839	$8,661.31	$23,439.07
February-02	8,206	$0.7839	$6,432.68	$17,006.39
March-02	7,151	$0.7839	$5,605.67	$11,400.72
April-02	3,314	$0.7839	$2,597.84	$8,802.88
May-02	2,450	$0.7839	$1,920.56	$6,882.32
June-02	1,238	$0.7839	$970.47	$5,911.85
July-02	1,084	$0.7839	$849.75	$5,062.11
August-02	1,192	$0.7839	$934.41	$4,127.70
September-02	1,210	$0.7839	$948.52	$3,179.18
October-02	2,452	$0.7839	$1,922.12	$1,257.06
November-02	5,080	$0.7839	$3,982.21	($2,725.16)
December-02	9,185	$0.7839	$7,200.12	($9,925.28)
January-03	12,816	$0.7839	$10,046.46	($19,971.74)
February-03	9,764	$0.7839	$7,654.00	($27,625.74)
March-03	5,793	$0.7839	$4,541.13	($32,166.87)
April-03	3,271	$0.7839	$2,564.14	($34,731.01)
May-03	1,897	$0.7839	$1,487.06	($36,218.07)
June-03	1,567	$0.7839	$1,228.37	($37,446.44)
Total	94,175		$82,057.87	

2002-432-B	Sales Volume	AA Factor	Amt. Rec/(Rtn)	Balance
Beginning Balance				$875.53
January-02	11,049	$0.0156	$172.36	$703.17
February-02	8,206	$0.0156	$128.01	$575.15
March-02	7,151	$0.0156	$111.56	$463.60
April-02	3,314	$0.0156	$51.70	$411.90
May-02	2,450	$0.0156	$38.22	$373.68
June-02	1,238	$0.0156	$19.31	$354.37
July-02	1,084	$0.0156	$16.91	$337.45
August-02	1,192	$0.0156	$18.60	$318.86
September-02	1,210	$0.0156	$18.88	$299.98
October-02	2,452	$0.0156	$38.25	$261.73
November-02	5,080	$0.0156	$79.25	$182.48
December-02	9,185	$0.0156	$143.29	$39.20
January-03	12,816	$0.0156	$199.93	($160.73)
February-03	9,764	$0.0156	$152.32	($313.05)
March-03	5,793	$0.0156	$90.37	($403.42)
April-03	3,271	$0.0156	$51.03	($454.45)
May-03	1,897	$0.0156	$29.59	($484.04)
June-03	1,567	$0.0156	$24.45	($508.49)
Total	88,719		$1,384.02	

2002-00081	Sales Volume	AA Factor	Amt. Rec/(Rtn)	Balance
Beginning Balance				($4,208.65)
April-02	3,314	($0.0855)	($283.35)	($3,925.30)
May-02	2,450	($0.0855)	($209.48)	($3,715.83)
June-02	1,238	($0.0855)	($105.85)	($3,609.98)
July-02	1,084	($0.0855)	($92.68)	($3,517.30)
August-02	1,192	($0.0855)	($101.92)	($3,415.38)
September-02	1,210	($0.0855)	($103.46)	($3,311.93)
October-02	2,452	($0.0855)	($209.65)	($3,102.28)
November-02	5,080	($0.0855)	($434.34)	($2,667.94)
December-02	9,185	($0.0855)	($785.32)	($1,882.62)
January-03	12,816	($0.0855)	($1,095.77)	($786.85)
February-03	9,764	($0.0855)	($834.82)	$47.97
March-03	5,793	($0.0855)	($495.30)	$543.27
April-03	3,271	($0.0855)	($279.67)	$822.94
May-03	1,897	($0.0855)	($162.19)	$985.13
June-03	1,567	($0.0855)	($133.98)	$1,119.11
Total	62,313		($5,327.76)	