

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MALLARD POINT)	
DISPOSAL SYSTEMS, INC. FOR AN)	CASE NO.
ADJUSTMENT OF RATES PURSUANT)	2003-00284
TO THE ALTERNATIVE RATE FILING)	
PROCEDURE FOR SMALL UTILITIES)	

ORDER

On July 7, 2003, Mallard Point Disposal Systems, Inc. (Mallard Point) submitted its application requesting the Commission to approve its proposed increase in sewer rates. On November 18, 2003, Mallard Point filed a motion for leave to file untimely responses to interrogatories filed by Intervenor Robert Warhus upon the grounds that the responses to Warhus were inadvertently omitted from its responses as directed in the Commission s Order of October 6, 2003. The Commission finds that Mallard Point s motion should be granted.

The Commission further finds that Commission Staff, having performed a limited financial review of Mallard Point s operations, has prepared the attached report containing Staff s findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments on Staff s findings and recommendations or requests for a hearing no later than 15 days from the date of this Order. Any party filing a request for a formal hearing is to include in said request its comments as to the particular finding of the Staff Report to which it objects and a brief summary of testimony it would present at a formal hearing

IT IS THEREFORE ORDERED that:

1. Mallard Point's motion for leave to file untimely responses to interrogatories filed by Intervenor Robert Warhus is granted.
2. All parties shall, no later than 15 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or requests for hearing.
3. Any party filing a request for a formal hearing is to include in said request its comments as to the particular finding of the Staff Report to which it objects and a brief summary of testimony it would present at a formal hearing.
4. If no request for a formal hearing is received by this date, this case shall stand submitted to the Commission for a decision on all issues raised by the application.

Done at Frankfort, Kentucky, this 21st day of November, 2003.

By the Commission

ATTEST:


Executive Director

STAFF REPORT
ON
MALLARD POINT DISPOSAL SYSTEMS, INC.
CASE NO. 2003-00284

Pursuant to a request by Mallard Point Disposal Systems, Inc. (Mallard Point) for assistance with the preparation of a rate application, Commission Staff performed a limited financial review of Mallard Point s test-period operations, the calendar year ending December 31, 2002. The scope of Staff s review was limited to obtaining information as to whether the test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Mark Frost and Eddie Beavers of the Commission s Division of Financial Analysis performed the limited financial review of Mallard Point s test-period operations. Mr. Frost is responsible for the preparation of this Staff Report, with the exception of (1) the determination of normalized operating revenue and the rate calculation, which were prepared by Mr. Beavers; and (2) the Certificate recommendation, which was prepared by James Rice of the Commission s Division of Engineering.

Upon completion of its limited review, Staff assisted Mallard Point in the development and preparation of two separate applications. The first application was for a Certificate of Public Convenience and Necessity (Certificate) and approval of financing, which the Commission docketed as Case No. 2003-00283. The second application is a request for an increase in rates filed pursuant to 807 KAR 5:076, which the Commission docketed as Case No. 2003-00284. By its Order of October 6, 2003,

the Commission consolidated Case Nos. 2003-00283 and 2003-00284 into Case No. 2003-00284.

In developing its findings and recommendations, Staff relied upon the limited financial information Mallard Point made available at the time of its field review. Mallard Point accepted the findings and recommendations of Staff's review and included those as its pro forma operating statement in its application, which is appended hereto as Attachment A. Using Mallard Point's responses to the interrogatories, Staff made several modifications, to its original findings and recommendations. Based upon Staff's modifications Mallard Point's operating statement would appear as set forth in Attachment B, and Attachment C is Staff's discussions on its proposed pro forma adjustments.

Mallard Point's pro forma operations support a revenue requirement from sewer rates of \$188,463, an increase of \$57,915 or 44.36 percent above Staff's normalized revenue from sewer rates of \$130,548. As shown in Attachment D, Staff's modified pro forma operations and an operating ratio of 88 percent, result in a revenue requirement from rates of \$156,944, an increase of \$26,396 or 16.82 percent above Staff's normalized revenue from sewer rates of \$130,548.

Using Mallard Point's responses to the interrogatories, Staff has established for rate-making purposes that there are 349.8 residential equivalents. To calculate the monthly revenue requirement of \$13,079, Staff has divided the total revenue requirement from sewer rates of \$156,944 by 12 months. Dividing the monthly revenue requirement by the 349.8 residential equivalents calculates a flat residential rate of \$37.39 per month. Staff recommends the Commission direct Mallard Point to bill each

residential customer the flat monthly rate and to bill the commercial customer the monthly flat rate per residential equivalent.

Signatures

Prepared by: Mark C. Frost
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: Eddie Beavers
Rate Analyst, Communications, Water
and Sewer Rate Design Branch
Division of Financial Analysis

Prepared by: James Rice
Engineer, Water and Sewer Branch
Division of Engineering

ATTACHMENT A
 STAFF REPORT CASE NO. 2003-00284
 MALLARD POINT S REQUESTED
 PRO FORMA OPERATIONS

	Test Period Actual	Pro Forma Adjustments	Ref.	Pro Forma Operations
Operating Revenues:				
Flat Rate Revenues	\$ 127,443	\$ 2,356		\$ 129,799
Late Penalty Payments	0	125		125
Total Operating Revenues	<u>\$ 127,443</u>	<u>\$ 2,481</u>		<u>\$ 129,924</u>
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	\$ 0	\$ 3,600		\$ 3,600
Sludge Hauling	7,200	(3,140)		4,060
Utility Service Water	7,800	(6,805)		995
Other - Labor, Mat. & Exp.	26,000	(26,000)		0
Fuel & Power	0	5,579		5,579
Testing	0	16,000		16,000
Chemicals	2,000	650		2,650
Routine Maint. Fee	0	13,200		13,200
Maintenance Labor	0	25,915		25,915
Maintenance	0	27,128		27,128
Office Supplies	1,250	(1,050)		200
Outside Services	10,800	(3,553)		7,247
Insurance	1,420	(19)		1,401
Total Operation & Maint.	<u>\$ 56,470</u>	<u>\$ 51,505</u>		<u>\$ 107,975</u>
Depreciation	0	24,413		24,413
Amortization	0	565		565
Taxes Other than Income Tax	1,967	(1,700)		267
Total Operating Expenses	<u>\$ 58,437</u>	<u>\$ 74,783</u>		<u>\$ 133,220</u>
Net Operating Income	<u>\$ 69,006</u>	<u>\$ (72,302)</u>		<u>\$ (3,296)</u>
Other Deductions:				
Interest Exp.	\$ 33,242	\$ 3,834		\$ 37,076
Supplies & Parts	62,317	(62,317)		0
Total Other Deductions	<u>\$ 95,559</u>	<u>\$ (58,483)</u>		<u>\$ 37,076</u>
Net Income	<u>\$ (26,553)</u>	<u>\$ (13,819)</u>		<u>\$ (40,372)</u>

ATTACHMENT B
STAFF REPORT CASE NO. 2003-00284
STAFF S RECOMMENDED
PRO FORMA OPERATIONS

	Test Period Actual	Pro Forma Adjustments	Ref.	Pro Forma Operations
Operating Revenues:				
Flat Rate Revenues	\$ 127,443	\$ 3,105	(a)	\$ 130,548
Late Penalty Payments	0	125	(b)	125
Total Operating Revenues	<u>\$ 127,443</u>	<u>\$ 3,230</u>		<u>\$ 130,673</u>
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	\$ 0	\$ 0	(c)	\$ 0
Sludge Hauling	7,200	(3,140)	(d)	4,060
Utility Service Water	7,800	(6,805)	(e)	995
Other - Labor, Mat. & Exp.	26,000	(26,000)	(f)	0
Fuel & Power	0	5,579	(g)	5,579
Testing	0	10,800	(h)	10,800
Chemicals	2,000	650	(i)	2,650
Routine Maint. Fee	0	13,200	(j)	13,200
Maintenance Labor	0	25,915	(k)	25,915
Maintenance	0	6,699	(l)	6,699
Office Supplies	1,250	(1,050)	(m)	200
Outside Services	10,800	(5,553)	(n)	5,247
Insurance	1,420	(19)	(o)	1,401
Total Operation & Maint. Exp.	<u>\$ 56,470</u>	<u>\$ 20,276</u>		<u>\$ 76,746</u>
Depreciation	0	21,765	(p)	21,765
Amortization	0	5,663	(q)	5,663
Taxes Other than Income Tax	1,967	(1,700)	(r)	267
Total Operating Expenses	<u>\$ 58,437</u>	<u>\$ 46,004</u>		<u>\$ 104,441</u>
Net Operating Income	<u>\$ 69,006</u>	<u>\$ (42,774)</u>		<u>\$ 26,232</u>
Other Deductions:				
Interest Exp.	\$ 33,242	\$ 5,144	(s)	\$ 38,386
Supplies & Parts	62,317	(62,317)	(t)	0
Total Other Deductions	<u>\$ 95,559</u>	<u>\$ (57,173)</u>		<u>\$ 38,386</u>
Net Income	<u>\$ (26,553)</u>	<u>\$ 14,399</u>		<u>\$ (12,154)</u>

ATTACHMENT C
STAFF REPORT CASE NO. 2003-00284
STAFF S DISCUSSIONS ON THE
PRO FORMA ADJUSTMENTS

BACKGROUND

In Mallard Point s last rate case proceeding,¹ Staff noted that Mallard Point had not retained its invoices for calendar year 1993 and that the canceled checks were not available for its review. The records Staff relied upon to conduct its limited review were the accountant s workpapers, the copies of invoices provided by T.M. Regan, and the expense schedule provided by Kentucky Utilities Company (KU).

In 1997 the Commission s Financial Audits Branch Staff (Audit Staff) attempted to conduct a financial audit of Mallard Point s books and records for the year ended December 31, 1996. In its August 20, 1997 Report of Examination, Audit Staff stated that, [i]t became apparent that completion of the audit would not be possible due to scope limitations which resulted primarily from the manner in which Mallard maintained records during 1996. For this reason Audit Staff did not proceed with the audit, but rather performed a limited review of Mallard Point s operations.

Audit Staff made the following Internal Control recommendations: (1) immediately perform and retain monthly bank reconciliations; (2) retain invoices for all expenditures in an orderly fashion; (3) maintain a formal receipts and disbursements journal; and (4) Mark Smith should keep his personal finances separate from those of Mallard Point. In its September 11, 1997 response, Mallard Point stated that (1) bank reconciliations will be maintained; (2) vendor invoices will be maintained; (3) a more diligent effort will be

¹ Case No. 1994-00266, The Application of the Mallard Point Disposal System, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (February 2, 1999).

made in the area of posting errors; and (4) the practice of commingling of funds will cease.

When Staff conducted its field review, Mallard Point provided bank statements with photocopies of the canceled checks, letters from vendors documenting increased costs,² an expense schedule from KU, and a hand written schedule of Mallard Point's test-period operating expenses. However, Mallard Point could not produce monthly bank reconciliations, vendor invoices, or a formal receipts and disbursements journal. Upon its review of the bank statements, Staff finds that Mr. Smith continues to commingle his private funds with those of the regulated utility, Mallard Point.

In its responses to the interrogatories, Mallard Point states that following Staff's field review, the bank statements with photocopies of the canceled checks have been lost. In its interrogatories, the Commission requested documentation for items purchased from Straffer Sales, Southern States, and American Express. Mallard Point was unwilling to contact those vendors to obtain a listing of the items it had purchased during the test period.³

a. Normalized Operating Revenues. Mallard Point provides sewer service to 327 residential customers and 1 commercial customer. Based upon the initial information provided by Mallard Point, Staff determined that the residential equivalent number was 347.8,⁴ which when applied to the tariffed rate of \$31.10 results in a normalized revenue

² Vendor letters were from Craig and Hall Insurance Agency, Inc., Noel Norton, and Kenvirons.

³ Response to Item 2 of the Second Data Request of Robert H. Warhus.

⁴ 327 (Residential) + 20.8 (Commercial) = 347.8.

from rates of \$129,799. Therefore, the application reflects increasing the revenue from sewer rates of \$127,443 by \$2,356.

Upon review of Mallard Point's responses to the interrogatories of the Attorney General,⁵ Staff has calculated a revised residential equivalent number of 349.8 and applied this to the current tariffed rate to arrive at a normalized level of revenue from sewer rates of \$130,548. Accordingly, Staff has increased operating revenues from sewer rates by \$3,105 to reflect the revised normalized revenue from sewer rates.

b. Late Penalty Payments. Mallard Point did not report collecting late penalty payments in the test period. However, upon its review of the billing data, Staff determined that late penalty payments of \$125 were collected by Mallard Point, but were incorrectly classified as operating revenues from sewer rates. Staff has increased pro forma operating revenues by \$125 to correct the misclassification error.

c. Owner/Manager Fee. Mallard Point did not incur an owner/manager fee during the test period, but it did propose to include a fee of \$3,600 in its pro forma operations. The past practice has been to allow utilities of Mallard Point's size an owner/manager fee of \$3,600 when it has been shown that the duties and responsibilities of the owner/manager warrant that level of compensation.

In Case No. 1994-00266, the Commission determined that Mallard Point's owner/manager, Mr. Smith, [h]as certain managerial responsibilities and duties and, therefore, is entitled to be compensated. In that proceeding the Commission determined that a reasonable level of owner/manager compensation was \$2,400.

⁵ Response to Item 5 of the Attorney General's information Request in Case No. 2003-00283.

In this proceeding it has been shown that Mr. Smith has neglected his owner/manager duties by not performing monthly bank reconciliations, maintaining vendor invoices, or keeping a formal receipts and disbursements journal. Because Mr. Smith continues to commingle his personal funds with those of Mallard Point, Staff was unable to determine Mallard Point's financial condition. In a proceeding before the Commission, it is the owner/manager's responsibility to provide detailed responses to all interrogatories. Staff believes that Mallard Point has failed to establish a record to support the level of the rate increase requested.

For these reasons Staff believes that Mr. Smith is not entitled to any level of compensation. Therefore, Staff's pro forma operating expenses do not include the requested \$3,600 owner/manager fee.

d. Sludge Hauling. Mallard Point reports a test-period sludge hauling expense of \$7,200. Upon its review of the canceled checks, Staff determined that during the test period Mallard Point paid \$4,060 for its sludge hauling, which is \$3,140 below the level reported in the 2002 Annual Report. Therefore, Staff has reduced sludge hauling expense by that amount.

e. Utility Service Water. Mallard Point reports a test-period utility service water expense of \$7,800. Upon reviewing the canceled checks, Staff determined that during the test period Mallard Point purchased \$995 of water from the Kentucky-American Water Company, which is \$6,805 below the level reported in the 2002 Annual Report. Therefore, Staff has reduced utility service water expense by that amount.

f. Other Labor, Material and Expenses. In its 2002 Annual Report, Mallard Point reports an other labor, material and expenses of \$26,000. In reviewing the

information provided by Mallard Point, Staff was not able to verify what expenses were included in this account. For this reason, Staff has reduced pro forma operating expenses by \$26,000 to eliminate this expense.

g. Fuel and Power. Mallard Point did not report a test-period fuel and power expense. KU provided Mallard Point with a schedule of its account activity for the period of February 2002 through February 2003. Upon its review of this schedule, Staff determined that the test-period electricity expense was \$5,579 and, therefore, has increased pro forma operating expenses by that amount.

h. Testing/Analysis. Mallard Point did not report a test-period testing/analysis expense. By its letter of May 23, 2003, Kenvirons informed Mallard Point that for the calendar year 2003 the sampling and analysis fees would be \$16,000. In a subsequent letter dated October 28, 2003, Kenvirons states that Mallard Point has paid in 2003 \$9,000 for its sampling/analysis services.⁶

For calendar year 2003, Mallard Point's average testing/analysis fee is \$900, which results in an annual expense of \$10,800.⁷ Accordingly, Staff has increased its pro forma operating expenses by that amount.

i. Chemicals. Mallard Point reports a test-period chemical expense of \$2,000. Upon reviewing the canceled checks, Staff determined that during the test period Mallard Point paid \$13,300 to its licensed operator, Noel Norton. Mallard Point informed Staff that Mr. Norton provides the chemicals for Mallard Point and the monthly

⁶ Mallard Point's Response to Item 3 of Commission Staff's Interrogatories and Requests for Production of Documents.

⁷ \$900 (Average Monthly Fee) x 12 Months = \$10,800.

payments to Mr. Norton in excess of the routine maintenance fee are for the reimbursement for the cost of the chemicals. During the test period the annual routine maintenance fee was \$10,650, which is \$2,650 less than the reported amount Mallard Point paid to Mr. Norton. Accordingly, chemical expense has been increased by \$650 to reflect the cost of chemicals.

Staff is troubled with the arrangement Mallard Point has with Mr. Norton with regard to its chemicals. By not having the actual chemical invoices, Mallard Point is unable to verify the chemical costs or the types of chemicals being used at its treatment facilities. Staff recommends that Mallard Point cease its arrangement with Mr. Norton and either purchase its own chemicals or require Mr. Norton to produce an invoice prior to reimbursement.

j. Routine Maintenance Fee. Mallard Point did not report a test-period routine maintenance fee expense. In his undated letter, Mr. Norton informed Mallard Point that on June 1, 2003 the routine maintenance fee would increase from \$900 to \$1,100 per month. Staff believes that the \$1,100 per month fee is reasonable and, therefore, has increased pro forma operating expense by \$13,200.

k. Maintenance Labor. In its review of the canceled checks, Staff documented payments to Charlie Hanson of \$25,915. Mr. Hanson is responsible for the daily maintenance for Mallard Point. According to Mallard Point, it hired Mr. Hanson in calendar year 2000 on a contract basis for an annual fee of \$26,000.⁸ The following is a partial list of the services provided to Mallard Point by Mr. Hanson: (1) open and release

⁸ Mallard Point's Response to Item 3 of Commission Staff's Interrogatories and Requests for Production of Documents.

air valves during all rains; (2) remove any pop up from clarifier; (3) clean weirs; (3) transfer sludge from one holding tank to another; (4) de-water sludge holding tanks; (5) clean splitter box; (6) repair all leaks in service lines; (7) wash down plant; and (8) replace belts and blower motors.⁹

Given the services provided by Mr. Hanson, Staff believes that an annual contract fee of \$26,000 is reasonable. However, since only \$25,915 in payments were documented, Staff's pro forma operations reflect this amount

I. Maintenance. Mallard Point did not report a test-period maintenance expense. However, Mallard Point does reimburse Mr. Hanson for any supplies that are used to perform the daily maintenance. Upon its review of the canceled checks, Staff determined that during the test period, Mr. Hanson's maintenance supply reimbursement was \$5,146. Staff further discovered that an additional \$1,553 was paid to other vendors for maintenance supplies. Therefore, Staff has increased pro forma operating expenses by \$6,699 to reflect the cost of the test-period maintenance supplies.

As it was with the chemical arrangement, Staff is also troubled with the reimbursement arrangement Mallard Point has with Mr. Hanson. By not having the actual invoices, Mallard Point is unable to verify the cost of the maintenance supplies or if the supplies have been used at its treatment facilities. Staff recommends that Mallard Point cease its arrangement with Mr. Hanson and either purchase its own maintenance supplies or require Mr. Hanson to produce an invoice prior to reimbursement.

⁹ Mallard Point's Response to Item 16 of Interrogatories from Intervenors James R. Marlow, Judith H. Harlowe, and Winston Faircloth.

m. Office Supplies. Mallard Point reports a test-period office supply expense of \$1,250. Upon reviewing the canceled checks, Staff determined that during the test period Mallard Point purchased \$200 of office supplies, which is \$1,050 below the level reported in the 2002 Annual Report. Therefore, Staff has reduced office supplies expense by that amount.

n. Outside Services. Mallard Point reports a test-period outside service expense of \$10,800. Upon its review of the canceled checks, Staff determined that Mallard Point paid the following amounts for accounting and customer billing and collection:

Christy Combs	Billing and Collections	\$	4,200
Christy Combs	Billing Supplies	\$	1,047
Louis Lazowitz	Accounting	\$	2,000

To reflect the results of Staff review, Mallard Point proposed to reduce outside services expense by \$3,553 to a pro forma level of \$7,247.

Throughout this proceeding, Intervenors have noted differences between Mallard Point's 2002 income tax returns and Annual Report. In its responses to the interrogatories, Mallard Point has been unable to explain these differences. Given Staff's inability to verify the amounts reported in the 2002 Annual Report and Mallard Point's responses, Staff believes that the Mr. Lazowitz did not perform the services for which he was paid. Therefore, Staff has reduced outside services expense by \$5,553 to eliminate the accounting fee.

o. Insurance. Mallard Point reports a test-period chemical expense of \$1,420. In its letter dated March 12, 2003, Craig Hall Insurance Agency, Inc., the company providing Mallard Point's insurance, states that for the policy period from December 6, 2002

through December 6, 2003 Mallard Point's insurance premiums will total \$1,401.¹⁰ Insurance expense has been decreased by \$19 to reflect that amount.

p. Depreciation. Mallard Point did not report a depreciation expense in its 2002 Annual Report. In Case No. 1994-00266, the Commission noted that Mallard Point used an accelerated depreciation method and a composite depreciation life of 10 years. In that proceeding the Commission calculated a depreciation expense for the existing plant of \$6,389 based upon plant investment of \$127,775 being depreciated over a composite depreciation life of 20 years.

In that prior proceeding Mallard Point was proposing to install a 100,000 GPD treatment plant at a cost of \$191,028 and a 7,000 gallon sludge holding tank at a cost of \$20,296. The Commission calculated a depreciation expense of \$10,566 based upon the plant expansion cost of \$211,324 being depreciated over the same composite life.

In this proceeding, Mallard Point is requesting a Certificate to rehabilitate its 50,000 GPD treatment plant. According to its Kentucky Pollutant Discharge Permit (KPDES),¹¹ Mallard Point is permitted to treat up to 150,000 GPD. However, Mallard Point is currently only using the 100,000 GPD plant to treat wastewater and the 50,000 GPD plant as a sludge holding tank. Mallard Point's existing 100,000 GPD wastewater treatment plant is nearing full capacity. The proposed rehabilitation of the existing 50,000 GPD will bring Mallard Point's treatment capacity up to the KPDES-permitted amount. Therefore, Staff believes that it is in the public interest and is required to permit continued growth and to provide adequate wastewater service to the existing

¹⁰\$428 (General Liability) + \$973 (Workers Compensation) = \$1,401.

¹¹KPDES No. KY0074829.

ratepayers. Since there is no other wastewater utility providing service to the Mallard Point Subdivision, this treatment facility will not compete with any other utility in the area. For these reasons Staff recommends that the Commission grant Mallard Point the requested Certificate.

Mallard Point has provided bids showing that the rehabilitation of the 50,000 GPD will cost approximately \$71,460. Using the bid estimates, Staff calculates a pro forma depreciation expense for the 50,000 GPD plant rehabilitation of \$3,867.¹²

In its responses to the Commission's interrogatories, Mallard Point provided invoices from M & M Electric, Inc. showing that in 2003 the electrical panel and wiring controls were replaced at a cost of \$4,715. Since this is a capital expenditure, Staff calculates a depreciation expense of \$943 based on depreciating this capital expenditure over 5 years.

Staff's recommended pro forma operating expenses reflect a depreciation expense of \$21,765, which is comprised of:

Original Treatment Facility	\$ 6,389
100,000 GPD Treatment Facility	10,566
50,000 GPD Plant Renovation	3,867
Electrical Panel & Wiring Controls	+ 943
Pro Forma Depreciation Expense	<u>\$ 21,765</u>

q. Amortization. In its response to the Commission's August 21, 2003 Order, Mallard Point estimates that it will spend approximately \$15,000 in legal fees associated with this rate case proceeding. The legal invoices provided by Mallard Point show that

¹² \$1,960 (Sludge Removal) ÷ 5 Years =	\$ 392
\$ 51,309 (Treatment Renovation) ÷ 20 Years =	2,565
\$18,191 (Sand Blasting & Paint) ÷ 20 Years =	+ 910
Pro Forma Depreciation Plant Renovation	<u>\$ 3,867</u>

to date the cost of this rate case is \$15,293. Amortizing these fees over a 3-year period results in an amortization expense of \$5,098.

During the test period Mallard Point paid its KPDES permit fee of \$1,700 and engineering fees for obtaining the permit of \$560. Amortizing these costs over the 4-year life of the KPDES permit results in an amortization expense of \$565.

Pro forma operating expenses have been increased by \$5,663 to reflect the amortization of rate case cost and the KPDES permit.

r. Taxes Other than Income. Mallard Point reported taxes other than income tax expense of \$1,967. Included in this expense account is the KPDES permit fee of \$1,700. This fee is a nonrecurring expenditure that should be amortized rather than expensed. Accordingly, taxes other than income tax expense has been reduced by \$1,700 and the associated amortization is contained in the above section.

s. Interest Expense. Mallard Point proposes to increase test-period interest expense of \$33,242 by \$3,834 to a pro forma level of \$37,076. This adjustment reflects financing the 50,000 GPD renovation with a loan for \$53,802 for a 10-year term with an interest rate of 7.95 percent per annum. Given that Staff recommends the Commission grant the Certificate, approval should also be given for the proposed loan.

Since filing its applications, Mallard Point has increased its estimated cost of the 50,000 GPD renovation from \$53,269 to \$71,460 to include the sand blasting and painting of the plant. The increase in the capital expenditure has a corresponding impact to the proposed loan amount. Using a principal amount of \$72,175, a 10-year term and an interest rate of 7.95 percent per annum, Staff calculates a 3-year average

interest expense of \$5,144. Accordingly, pro forma interest expense has been increased by \$5,144 to reflect the interest expense for the proposed loan.

t. Supplies and Parts. In its 2002 Annual Report, Mallard Point reported supplies and parts expense of \$62,317. Staff requested Mallard Point to contact its accountant to provide a schedule of the costs included in this expense account. In his letter of June 4, 2003, Louis Lazowitz, Mallard Point's accountant, states that because his records were stored at a facility that has been closed, he is unable to provide the requested information. However, Mr. Larzowitz's audit notes show that this account includes \$41,888 of capital expenditures and that the remaining \$20,429 was for line breaks and road repairs.

In reviewing the canceled checks, Staff identified \$71,612 purchases that would have supported the amount reported in this expense account. Therefore, Staff's original recommendation included \$20,429 as maintenance expense and depreciation expense of \$4,501 to reflect depreciating the capital costs of \$41,888.

To verify Staff's original recommendation, Mallard Point was requested to provide a detailed listing of the items purchased with the test-period checks written to Straeffer Pump and Supply, Inc., Southern States and American Express. In its responses, Mallard Point stated that all but \$6,100 of the identified checks were not utility related and that the \$6,100 was for a duplex high head pump.¹³ Mallard Point did not provide any supporting documentation for the purchase of the duplex high speed pump.

Given Mallard Point's responses and its unwillingness to obtain verification of its purchases from the identified vendors, Staff has modified its original recommendation

¹³Responses to Items 1, 2, and 3 of the Commission's Order of August 21, 2003.

by eliminating all expenses in its pro forma operations associated with the supplies and parts expense of \$62,317.

ATTACHMENT D
 STAFF REPORT CASE NO. 2003-00284
 COMPARISON OF MALLARD POINT S AND STAFF S
 REVENUE REQUIREMENT DETERMINATION
 AND CALCULATION OF RATES

	<u>Application</u>	<u>Staff Report</u>
Operating Expenses	\$ 133,220	\$ 104,441
Divided by: Operating Ratio	÷ 88%	÷ 88%
Subtotal	<u>\$ 151,387</u>	<u>\$ 118,683</u>
Add: Interest Expense	+ 37,076	+ 38,386
Requested Revenue Requirement	<u>\$ 188,463</u>	<u>\$ 157,069</u>
Less: Late Payment Penalties	- 0	- 125
Revenue Requirement - Sewer Rates	<u>\$ 188,463</u>	<u>\$ 156,944</u>
Less: Normalized Operating Revenue	- 129,924	- 130,548
Requested Increase in Revenue from Rates	<u><u>\$ 58,539</u></u>	<u><u>\$ 26,396</u></u>
Requested Revenue Requirement	\$ 188,463	\$ 156,944
Divided by: 12-Months	÷ 12	÷ 12
Monthly Requested Revenue Requirement	<u>\$ 15,705</u>	<u>\$ 13,079</u>
Divided by: End-of-Period Customer Level	÷ 348	÷ 350
Monthly Rate per Customer	<u><u>\$ 45.16</u></u>	<u><u>\$ 37.39</u></u>