

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF)
BIG SANDY WATER DISTRICT) CASE NO. 9156

O R D E R

IT IS ORDERED that the staff Audit Report for Big Sandy Water District ("Big Sandy") attached hereto as Appendix A shall be included as a part of the record in this proceeding.

IT IS FURTHER ORDERED that Big Sandy shall have until the close of business February 25, 1985, to file written comments concerning the contents of Appendix A.

Done at Frankfort, Kentucky, this 15th day of February, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Demanph
For the Commission

ATTEST:

Secretary

APPENDIX A
AN APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9156 DATED

AUDIT REPORT OF
BIG SANDY WATER DISTRICT

PREFACE

On October 11, 1984, Big Sandy Water District ("Big Sandy") filed its application seeking an increase in its rates for water service. The proposed rates would result in an increase in revenue of approximately \$106,000, from \$143,000 to \$249,000, and increase the average consumer monthly bill by approximately 74 percent.

As part of its endeavor to shorten and simplify the regulatory process for small utilities the Commission chose to perform a limited financial audit of Big Sandy's operations for the test year, calendar year 1983. The Commission's objective was to substantially reduce the need for written data requests and, therefore, the expense to the utility. Members of the Commission staff conducting the audit were Mr. Gary Forman and Mr. Steve Gilley of the Division of Rates and Tariffs. The audit was performed on November 28-29, 1984, at the offices of Kelly, Galloway, and Company ("Kelly, Galloway"), CPAs in Ashland, Kentucky, and Big Sandy in Catlettshurg, Kentucky.

SCOPE

This examination consisted of an analysis and review of major cash disbursements and related financial records of Big Sandy for the calendar year 1983. The audit was limited to analysis of the following accounts:

Account
Number

Account

601	Purchased Water
602	Operation Supplies and Expense
605	Maintenance of Water Source Plant
921	Office Supplies and Other Expenses
923	Outside Services Employed
933	Transportation

PURPOSE

The purpose of the audit was to verify reported test year expenses and to determine what, if any, accounting or classification changes might be appropriate. The objective was to establish an adjusted test-year operating statement within the limitations defined within the scope of this report based on generally accepted accounting principles and the Uniform System of Accounts for Class C Water Utilities ("Uniform System of Accounts"). No recommendations concerning rate-making treatment of specific items are contained in this report.

FINDINGS

Purchased Water

Big Sandy reported a test-year purchased water expense of \$24,968. A review of test-year purchased water invoices confirms this amount as being correct and, therefore, no adjustments to this account are necessary.

Transportation

Big Sandy reported a test-year transportation expense of \$4,429. A review of test year charges to this account confirms this amount as correct and, therefore, no adjustments are necessary.

Outside Services Employed

Big Sandy reported test year charges to Account No. 923-- Outside Services Employed of \$26,891. Upon examination of the invoices and cash disbursements associated with the test year charges to Outside Services Employed, it was found that \$17,346 was improperly expensed by Big Sandy to this account during the test year.

Disbursements improperly expensed to this account are as follows:

1. Check No. 115 dated August 8, 1983 and Check No. 136 dated September 6, 1983 - Kelly, Galloway invoice dated September 6, 1983. The service description dated February 25, 1983, reflects that numerous billings for services unrelated to 1983 were charged to 1983 operations. The description states that this billing is primarily for setting up of the accounting system and preparation of accounting data for 1982. The description reflects that services pertaining to only 1 month of 1983 are included in this billing. As services pertaining to only 1 month of 1983 are reflected in the service description, all but the monthly fee for 1 month of accounting services, \$350, should be removed from 1983 operations. This results in an adjustment of \$4,486 which, because it is related to the construction period, should be capitalized. For the purposes of this report we have charged this amount to Account No. 101--Utility Plant in Service and used the composite depreciation rate of 2 percent to determine annual depreciation expense.

2. Check No. 84 dated September 16, 1983 - Kenco Invoice No. 83190 dated June 30, 1983. The description of services rendered contained within the invoice reflects that this billing is for engineering services related to the construction of the distribution system. The Uniform System of Accounts requires that such costs be capitalized to utility plant accounts. Therefore, the \$1,301 for engineering should be capitalized. For the purposes of this report we have charged this amount to Account No. 101--Utility Plant in Service and used the composite depreciation rate of 2 percent to determine annual depreciation expense.

3. Check No. 210 dated June 30, 1983 - Ann Young invoice. Examination of the invoice associated with this payment reflects that services rendered by Ann Young during 1978 through 1982, were included in 1983 operations. The invoice reflects that this expenditure is for 598 hours of bookkeeping and other services charged at a rate of \$3.35 per hour; however, only 96 hours pertain to services performed during 1983. Therefore, the expense associated with 502 hours of service during 1978 through 1982 should be eliminated from 1983 operations. This results in an adjustment to decrease Outside Services Employed expense by \$1,682 (502 X \$3.35/hour). As these costs were incurred during the construction period they should be capitalized. For the purposes of this report we have charged this amount to Account No. 101--Utility Plant in Service and used the composite depreciation rate of 2 percent to determine annual depreciation expense.

4. Reclassification of Certain Charges to Account No. 902--Accounting Collecting Labor. The Uniform System of Accounts requires the cost of labor incurred for accounting, billing and collection functions be charged to Account No. 902--Accounting and Collection Labor. A review of test year charges to Outside Services reflects that numerous payments for Accounting and Collecting labor were improperly expensed to Outside Services in 1983.

Disbursements improperly expensed are as follows:

<u>Date</u>	<u>Check No.</u>	<u>Payee</u>	<u>Amount</u>	<u>Description</u>
5/31	170	Charles Robinson	\$2,940	1982 Audit
9/6	131	Charles Robinson	2,475	6-Month Audit
9/6	136	Kelly, Galloway	1,361	Accounting Services
Various	Various	Kelly, Galloway	<u>1,111.75</u>	Accounting/Billing
			<u>\$7,887.75</u>	

The \$7,888 should be reclassified to Accounting and Collection Labor. The result of these adjustments is to reduce Outside Services \$15,357. \$7,469 should be capitalized to Account No. 101--Utility Plant in Service and \$7,888 should be reclassified to Account No. 902--Accounting and Collecting Labor. See Attachment II for a listing of major cash disbursements to Outside Services during 1983.

Maintenance of Water Source Plant

Big Sandy reported test year charges to Account No. 605--Maintenance of Water Source Plant of \$13,514. Upon examination of the invoices associated with the test year charges to Maintenance of Water Source Plant, it was found that \$7,604 was improperly expensed by Big Sandy to this account during the test year.

Based on the guidelines established by the Uniform System of Accounts disbursements improperly expensed are as follows:

1. Check No. 457 dated May 5, 1983 - W & M Contractors' invoice dated April 20, 1983. The \$1,250 expensed for three fire hydrants should be capitalized to Account No. 348--Hydrants and depreciated at a rate of 3 percent annually.

2. Check No. 103 dated November 4, 1983 - Bill Walters, payee. The water tap job of October 27, 1983, for \$201.50 should be capitalized to Account No. 347--Meter Installations and depreciated at a rate of 2 percent annually.

3. Check No. 138 dated September 7, 1983 - Bill Walter's Invoice Nos. 7643 and 7644 dated September 7, 1983. The water tap jobs of July 12, July 25, August 10, August 22, September 2, and September 3, 1983, totaling \$1,573.50 should be capitalized to Account No. 347--Meter Installations and depreciated at a rate of 2 percent annually.

4. Check No. 104 dated December 7, 1983 - Bill Walter's invoice. The water tap jobs of November 18, November 21, and November 22, 1983, totaling \$1,090.50 should be capitalized to Account No. 347--Meter Installations and depreciated at a rate of 2 percent annually.

5. Check No. 519 dated October 6, 1983 - Claude Wilburn and Sons' invoice. The meter cost of \$275 should be capitalized to Account No. 346--Meters and depreciated at a rate of 6.67 percent annually; the cost of the pipe and the bore and jack totaling \$2,802.50 should be capitalized to Account No. 345--Services and depreciated at a rate of 2 percent annually.

Operations Supplies and Expense

Big Sandy reported test year charges to Account No. 602-- Operations Supplies and Expense of \$8,510. Upon an examination of test year invoices charged to Operations Supplies and Expense, it was determined that \$5,691.22 was improperly expensed by Big Sandy to this account during the test year.

Disbursements improperly expensed are as follows:

1. Check No. 121 dated September 6, 1983 - C. I. Thornburg's Invoice No. 51753 dated August 9, 1983, item no. 150605. The cost of the bronze meter of \$516.60 should be capitalized to Account No. 346--Meters and depreciated at a rate of 6.67 percent annually.

2. Check No. 169 dated November 4, 1983 - C. I. Thornburg's invoice for meter appurtenances. Full amount of invoice, \$815, should be capitalized to Account No. 346--Meters and depreciated at a rate of 6.67 percent annually.

3. Check No. 151 dated October 4, 1983 - C. I. Thornburg's Invoice No. 53187 dated September 16, 1983, item no. 150605. The cost of the bronze meter of \$258.30 should be capitalized to Account No. 346--Meters and depreciated at a rate of 6.67 percent annually.

4. Check No. 202 dated June 30, 1983 - C. I. Thornburg's Invoice No. 49607 dated June 7, 1983, for a drilling machine. Full amount of invoice totaling \$131.52 should be capitalized to Account No. 394--Tools, Shop and Garage Equipment and depreciated at a rate of 20 percent annually.

5. Check No. 181 dated December 7, 1983 - C. I. Thornburg's Invoice No. 55934 dated November 14, 1983, item no. 300520. Fire Hydrant, totaling \$671.36 should be capitalized to Account No. 348--Hydrants and depreciated at a rate of 3 percent annually. Item no. 461145, DI MJ TEE, totaling \$243.10, should be capitalized to Account No. 345--Services and depreciated at a rate of 2 percent annually.

6. Check No. 139 dated September 19, 1983 - Payee, John Wright. The \$450 cost of the tool boxes and racks should be capitalized to Account No. 394--Tools, Shop and Garage Equipment and depreciated at a rate of 20 percent annually.

7. Check No. 201 dated June 30, 1983 - Water Works and Industrial Supply Invoice No. 47557 dated June 30, 1983, for a tap machine and drill and Invoice No. 46891 dated June 10, 1983, for a meter reading scope. The full amount of both invoices totaling \$321.57 should be capitalized to Account No. 394--Tools, Shop and Garage Equipment and should be depreciated at a rate of 20 percent annually.

8. Check No. 133 dated April 7, 1983 - Water Works and Industrial Supply Invoice No. 4490 dated March 23, 1983, and Invoice No. 45223 dated March 31, 1983. Invoice No. 44990 totaling \$231 for meters should be capitalized to Account No. 346--Meters and depreciated at a rate of 6.67 percent annually; Invoice No. 45223 totaling \$469.77 for a box locator and other equipment should be capitalized to Account No. 398--Miscellaneous Equipment and depreciated at a rate of 20 percent annually.

9. Check No. 180 dated December 7, 1983 - Water Works Supply Invoice No. 9473 dated November 11, 1983, for service accessories. The total invoice amount, \$1,583, should be capitalized to Account No. 345--Services and depreciated at a rate of 20 percent annually.

Office Supplies and Other Expenses

Big Sandy reported test year charges to Account No. 921--Office Supplies and Other Expenses of \$6,921. Upon an examination of test year invoices it was determined that this amount includes an outlay for the purchase of telemetering equipment and installation which should be capitalized. The reported expense should be modified as follows:

1. Check No. 198 dated June 30, 1983 - General Telephone of Kentucky Invoice No. 3-40-83R dated June 10, 1983, for telemetering equipment. The entire amount of this invoice, totaling \$96, should be capitalized to Account No. 397--Communication Equipment and depreciated at a rate of 10 percent annually.

Depreciation

The result of the foregoing adjustments to Maintenance Expense, Operations Supplies and Expense, and Office Supplies and Other Expense is the capitalization of \$21,313.40 in outlays improperly expensed during 1983; therefore, 1983 operating expense has been reduced by this amount. Based on appropriate depreciation rates applied to the capitalized amounts, an adjustment has been made to increase depreciation expense by \$867.41 calculated as follows:

A. Outside Services Employed

<u>Check No.</u>	<u>Reclassify to Account No.</u>	<u>Amount</u>	<u>Depreciation Rate</u>	<u>Annual Depreciation</u>
115				
136	101	\$ 4,486.00	2%	\$ 89.72
84	101	1,301	2%	26.02
210	101	<u>1,682</u>	2%	<u>33.64</u>
Total Outside Services Employed		\$ 7,469.00		\$149.38

B. Maintenance Expense

457	348	\$ 1,250.00	3%	\$ 37.50
103	347	201.50	2%	4.03
138	347	1,573.00	2%	31.46
104	347	1,090.50	2%	21.81
519				
a.	346	275.00	6.67%	18.43
b.	345	<u>2,802.50</u>	2%	<u>56.05</u>
Total Maintenance		\$ 7,192.50		\$169.28

C. Operations Supplies and Expense

121	346	\$ 516.60	6.67%	\$ 34.46
169	346	815.00	6.67%	54.36
151	346	258.30	6.67%	17.23
202	394	131.52	20%	26.30
181(a)	348	671.36	3%	20.14
(b)	345	243.10	2%	4.86
139	394	450.00	20%	90.00
201	394	321.57	20%	64.31
133(a)	346	231.00	6.67%	15.41
(b)	398	469.77	20%	93.95
180	345	<u>1,583.00</u>	2%	<u>31.66</u>
Total Operations Sup- plies and Expense		\$ 5,691.22		\$452.68

D. Office Supplies and Expense

198	397	<u>\$ 960.68</u>	10%	<u>\$ 96.07</u>
Total Office Supplies and Expense		\$ 960.68		\$ 19.22
TOTALS		<u>\$21,313.40</u>		<u>\$867.41</u>

The effect of these adjustments on Big Sandy's 1983 operating statement is as follows:

	<u>1983 Actual Test Year Per Annual Report</u>	<u>Adjustments</u>	<u>Adjusted Test Year</u>
<u>Operating Revenues</u>	\$121,785	-	\$121,785
<u>Operating Expenses</u>			
Purchased Water	24,968	-	24,968
Operation Supplies & Expenses	8,511	\$ <5,691>	2,820
Maintenance of Water Plant	13,514	<7,193>	6,321
Purchased Power	4,608	-	4,608
Meter Reading Labor	3,157	-	3,157
Accounting & Coll.	12,327	7,888	20,215
A & G Salaries	3,706	-	3,706
Office Supplies & Expenses	6,291	<961>	5,330
Outside Services	26,891	<15,357>	11,534
Property Insurance	5,215	-	5,215
Misc. Gen.	136	-	136
Transportation	4,429	-	4,429
Depreciation	33,945	867	34,812
Other Taxes	<u>384</u>	<u>-</u>	<u>384</u>
Total Operating Expenses	\$148,084	\$<20,449>	\$127,635
<u>Other Income</u>			
Interest & Div.	\$ 4,823	-	\$ 4,823
Misc. Income	2,391	-	2,391
<u>Other Deductions</u>			
Interest on Long- Term Debt	<u>\$ 22,750</u>	<u>-</u>	<u>\$ 22,750</u>
Net Income	<u>\$<41,835></u>	<u>\$ 20,449</u>	<u>\$<21,386></u>

CLOSING

Based on the findings herein, Big Sandy should submit revisions to its 1983 Annual Report to reflect the accounting changes recommended. Journal entries to make the revisions are contained in Attachment I of this report. For amounts charged to

Account No. 101--Utility Plant in Service for the purposes of this report, Big Sandy should seek to properly allocate the amounts to appropriate sub-accounts in accordance with the Uniform System of Accounts.

ATTACHMENT I

Journal Entries to Make Revisions Recommended in Audit Report of Big Sandy Water District

<u>Item</u>	<u>Account No.</u>	<u>Debits</u>	<u>Credits</u>
1. Hydrants	348	\$1,250	
Meter Instal.	347	2,865	
Meters	275	275	
Services	345	2,802.50	
Maintenance of Water Source Plant	605		\$7,192.50
To capitalize outlays improperly expensed to Account No. 605.			
2. Meters	346	\$1,820.90	
Tools & Equip.	394	903.09	
Hydrants	348	671.36	
Services	345	1,826.10	
Misc. Equip.	398	469.77	
Operation Sup- plies & Expense	602		\$5,691.22
To capitalize outlays improperly expensed to Account No. 602.			
3. Communications Equip.	937	\$ 961	
Office Sup- plies	921		\$ 961
To capitalize outlays improperly expensed to Account No. 937.			
4. Depreciation Expense	403	\$ 867	
Accumulated Depreciation	110		\$ 867
To adjust depreciation expense to reflect the capitalization of items improperly expensed.			

<u>Item</u>	<u>Account No.</u>	<u>Debits</u>	<u>Credits</u>
5. Utility Plant			
in Service	101	\$7,469	
Accounting and			
Collection	902	7,888	
Outside Services			
Employed	923		\$15,357

To adjust outside services expense to eliminate disbursements which should have been capitalized or classified.

ATTACHMENT II

Breakdown of 1983 Cash Disbursements Charged to Account No. 923--Outside Services

<u>Date</u>	<u>Check No.</u>	<u>Payee</u>	<u>Amount</u>	<u>Description</u>
5/31	170	Charles Robinson	\$2,940	1982 Audit
6/30	210	Ann Young	2,003.40	Bookkeeping Services
8/3	115	Kelly, Galloway	3,000	Accounting Services
9/6	131	Charles Robinson	2,475	6-Month Audit
9/6	136	Kelly, Galloway	2,847	Accounting Services
9/16	84	Kenco	1,301.06	Engineering Services
10/4	150	Roger Hall	1,151.99	Legal Services
11/7	286	Kenco	1,687	Engineering Services
11/22	288	Boyd County Sheriff	25	N/A
Various	Var.	Kelly, Galloway	1,112.25	Accounting/Billing
Various	Var.	Roger Hall; Adkins Hall, Howell	1,322	Legal