

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF HENDERSON COUNTY )  
WATER DISTRICT FOR AN ALTERNATIVE ) CASE NO.  
RATE FILING ) 2013-00154

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of June 18, 2013, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to paragraphs 2, 3, and 4 of the Commission's June 18, 2013 Order, Henderson County Water District is required to file written comments regarding the findings of Commission Staff no later than August 29, 2013.



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Jeff Derouen  
Executive Director  
Public Service Commission  
P.O. Box 615  
Frankfort, KY 40602

DATE     AUG 15 2013    

cc: Parties of Record

STAFF REPORT  
ON  
HENDERSON COUNTY WATER DISTRICT

CASE NO. 2013-00154

Henderson County Water District ("Henderson District") provides water service to approximately 6,384 customers residing in the Kentucky counties of Henderson and Webster.<sup>1</sup> On April 18, 2013, Henderson District tendered an application to the Commission for an adjustment in its water service rates pursuant to 807 KAR 5:076. The proposed rates would increase the monthly cost of 5,000 gallons of water purchased through a 5/8-inch x 3/4-inch meter from \$33.13 to \$35.77, an increase of \$2.64 or 8 percent.

Henderson District based its application on the test year ended December 31, 2012.<sup>2</sup> Using operations reported for the test year, Henderson District determined that a revenue increase of \$415,680 or 15.17 percent is warranted. To minimize consumer rate shock, Henderson District proposed rates that would increase revenue by \$219,188, an 8.0 percent increase. The financial exhibits presented in Henderson District's application that support its proposed revenue increase are shown below in condensed form.

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<sup>1</sup> Annual Report of Henderson County Water District (Water Division) to the Public Service Commission for the Calendar Year Ended December 31, 2012 ("Annual Report") at 5 and 27.

<sup>2</sup> 807 KAR 5:076, Section 3, requires that the Commission make its decision based upon the utility's annual report for the immediate past year. At the time Henderson County submitted its application, the most recently filed report was for the year ended December 31, 2012.

Operating Expenses	\$2,841,003
Plus: Average Annual Debt Principal and Interest Payments	<u>421,790</u>
Overall Revenue Requirement	3,262,793
Less: Other Operating Revenues and Non-Operating Revenue	(86,395)
Interest Income	<u>(20,045)</u>
Revenue Required from Rates	3,156,353
Less: Pro Forma Present Rate Revenue	<u>(2,740,673)</u>
Revenue Increase Required to Meet Overall Revenue Requirement	415,680
Less: Depreciation Expense for which Recovery was not Requested	<u>(196,492)</u>
Requested Revenue Increase	<u>\$ 219,188</u>

To determine the reasonableness of the proposed rates, Staff performed a limited financial review of Henderson District's test year operations. The scope of the review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test year operations were identified and adjustments were made when their effects were deemed to be material. Insignificant and immaterial discrepancies were not pursued or addressed.

Staff's findings are summarized in this report. Jack Scott Lawless reviewed the calculation of revenue requirements. Jason Green reviewed the billing analysis, reported revenues, and rate design.

### **Summary of Findings**

1. **Overall Revenue Requirement and Required Revenue Increase.** Staff applied the Debt Service Coverage ("DSC") method to Henderson District's adjusted test year operations and determined Henderson District's overall revenue requirement

to be \$3,147,473. A revenue increase of \$363,846 is necessary to generate this overall revenue requirement.

2. Rates. To calculate the rates to produce the Staff-recommended revenue requirement, Staff increased current rates by the percentage increase in the Staff-recommended revenue requirement evenly across the board to Henderson District's current rates. This method, which Henderson District also used, allocates the revenue requirement increase to all customers in an equal manner. Henderson District performed a cost-of-service study in Case No. 2005-00072;<sup>3</sup> therefore, Staff finds that increasing current rates across the board is an appropriate method in this case. Another cost-of-service study would not be needed unless there have been significant changes to Henderson District's system. Since there have been no such changes, and only a minimal increase in their number of customers, a new cost-of-service study is not needed at the time.

The water rates set forth in Attachment A of this report will produce the additional annual water revenues to recover the Staff recommended revenue requirement. These rates will increase the monthly cost of 5,000 gallons of water from \$33.13 to \$37.63, an increase of \$4.50, or 13.59 percent.

3. Depreciable Lives. In this report, Staff revised the depreciable lives assigned to many of Henderson District's assets for rate-making purposes. The revised lives should be used for accounting purposes in all future reporting periods. They better match the life expectancy of Henderson District's assets and will better match expenses to the revenues generated by the water service rates approved in this proceeding. This

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<sup>3</sup> Case No. 2005-00072, *Application of the Henderson County Water District for Approval of a Proposed Increase In Rates for Water Service* (Ky. PSC tendered Feb. 9, 2005).

action will minimize the erosion of equity. Staff does not recommend that any adjustment to accumulated depreciation or retained earnings be made to account for the retroactive effect of this change in accounting estimate.

4. Internal Controls – Work Order System. The Uniform System of Accounts (“USoA”) requires that a work order system be maintained to account for the cost of constructing and the retiring utility plant in service. The work order system must clearly show the source or sources of all costs.<sup>4</sup> These costs include, but may not be limited to, labor and labor overhead charges, transportation, and equipment costs including depreciation on vehicles and equipment, and materials and supplies.

Henderson District does not use a work order system. Commission Staff recommends that it develop and adopt a work order system that complies with the requirements of the USoA to account for the cost of construction projects. This action would strengthen Henderson District’s accounting and internal controls for utility plant in service, materials and supplies inventory, and materials and supplies expense.

5. Internal Controls – Approval of Pay Rates for Henderson District’s Board of Commissioners. Henderson District has five commissioners who are paid a monthly salary of \$150. This pay is required to be set by the county judges/executive of Henderson County and Webster County with the approval of Henderson and Webster counties’ Fiscal Court.<sup>5</sup> Henderson District could not provide evidence of this action. Henderson District should obtain the required approvals.

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<sup>4</sup> USoA at 33.

<sup>5</sup> KRS 74.020 (6).

6. Internal Controls – Approval of Employee Salaries and Pay Rates.

Henderson District's Board of Commissioners is required to set the salary of its general manager.<sup>6</sup> Henderson District could not provide evidence demonstrating that its Board had approved its general manager's salary. To meet the requirements of KRS Chapter 74 and to strengthen internal controls, Henderson District's Board of Commissioners should approve the salary of the general manager, as well as the pay rates of all its employees. The Board of Commissioners should routinely review payroll documents to ensure that the approved salaries and pay rates are equal to the amounts actually paid to employees. Execution of these procedures should be documented in the minutes of the Board of Commissioners meeting.

**Pro Forma Operating Statement**

Henderson District's Pro Forma Operating Statement for the test-year ended December 31, 2012, as determined by Staff, appears below.

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<sup>6</sup> KRS 74.040.

	Test Year	Adjustments	Ref.	Pro Forma
<b>Operating Revenues</b>				
Sales of Water	\$ 2,740,673	(90,584)	(A)	
		27,098	(B)	\$2,677,187
Other Operating Revenue	86,395			86,395
<b>Total Operating Revenue</b>	<b>2,827,068</b>	<b>(63,486)</b>		<b>2,763,582</b>
<b>Operating Expenses</b>				
<b>Operation and Maintenance Expenses</b>				
Salaries and Wages - Employees	385,983			385,983
Salaries and Wages - Officers	10,500			10,500
Employee Pension and Benefits	207,291			207,291
Purchased Water	1,192,750	(82,593)	(A)	
		18,984	(B)	
		(31,771)	(C)	1,097,370
Purchased Power	54,154	(2,959)	(A)	
		(1,119)	(C)	50,076
Materials and Supplies	189,202	3,707	(D)	192,909
Contractual Services - Acct.	23,365	(8,800)	(E)	14,565
Contractual Services - Legal	13,018	(13,018)	(F)	-
Contractual Services - Other	3,355	(1,530)	(F)	1,825
Rental of Equipment	535			535
Transportation Expenses	57,758			57,758
Insurance - Vehicle	7,514			7,514
Insurance General Liability	22,541			22,541
Insurance Workers Comp	8,622			8,622
Insurance - Other	229			229
Advertising Expense	318			318
Bad Debt	37,970	(22,806)	(A)	15,164
Miscellaneous Expenses	13,165	(900)	(F)	
		(3,215)	(G)	9,050
<b>Total Operation and Maintenance Expenses</b>	<b>2,228,270</b>	<b>(146,020)</b>		<b>2,082,250</b>
Depreciation Expense	539,492	(108,902)	(H)	430,590
Taxes Other Than Income	36,443			36,443
<b>Total Operating Expenses</b>	<b>2,804,205</b>	<b>(254,922)</b>		<b>2,549,283</b>
Net Operating Income	22,863	191,436		214,299
Interest and Dividend Income	20,045			20,045
<b>Income Available to Service Debt</b>	<b>\$ 42,908</b>	<b>\$ 191,436</b>		<b>\$ 234,344</b>

A. Patriot Coal Corporation Leak Adjustment. In May 2012, Patriot Coal Corporation ("Patriot Coal") experienced a large leak in a service line to one of its meter connections that resulted in water usage of 31,931,900 gallons. The bill was \$151,700. Patriot Coal's average monthly usage at that time was 1,737,250 gallons, with an average bill of \$8,275. A \$15,170 late-payment penalty was assessed to the May bill after Patriot Coal did not make payment by the bill's due date. This increased the total bill payable to Henderson District to \$166,870.

In June, Henderson District, through application of the provisions of its tariff, allowed Patriot Coal a leak adjustment. Through this process, Henderson District adjusted the bill downward by \$52,841 and removed the late-payment penalty of \$15,170. Patriot Coal then owed \$98,859 or \$90,584 above its average bill. The \$98,859 remained in test year Water Sales Revenue.

At the time of Staff's field work, more than one year after the leak occurred, Patriot Coal had not made payment on the May bill but continued to receive water service. On July 11, 2012, Patriot Coal filed for protection under Chapter 11 of the United States Bankruptcy Code. All debts that Patriot Coal incurred prior to the date are subject to adjustment and discharge by the Bankruptcy Court. Pursuant to 11 U.S.C. §366, Henderson District could not take any action to discontinue Patriot Coal's water service for debts incurred prior to the filing of its petition for relief. Henderson District states that Patriot Coal has paid all monthly bills for water service in a timely manner except for the May bill.

As part of its 2012 audit, Henderson District's external auditor determined that there is only a remote likelihood that Henderson District will realize any additional

revenue from the May billing. Accordingly, its auditor established a \$22,806 allowance for uncollectible accounts recognizing approximately one-fourth of the May billing as a test year bad-debt expense.

Staff agrees that the likelihood of collection of the May billing is remote. Further, it is Staff's opinion that the amount above Patriot Coal's average billings, \$90,584, is a material, nonrecurring item that Henderson District will likely never realize, and should, therefore, be removed from test year operations along with all related expenses. Staff made the following adjustments to eliminate the effects of the leak from test year operations.

Water Sales	\$(90,584)
Purchased Water and Power for Pumping	(85,552) <sup>7</sup>
Bad Debt Expense	(22,806)

If the Commission finds that the amount may likely be realized in a future period and disagrees with Staff's removal of these items, the Commission should recognize the

<sup>7</sup> The cost to purchase and pump Patriot Coal's 30,194,650 gallon leak (31,931,900 gallons, Patriot Coal's May Use – 1,737,250, Patriot Coal's Average Use) was calculated to be \$85,552 as shown below.

	Purchased Water	Purchased Power for Pumping	Total
Expense Reported for the Test Year	\$ 1,192,750	\$ 42,731	\$ 1,235,481
Divide by: Total Test-Year Gallons Sold	<u>436,051,000</u>	<u>436,051,000</u>	<u>436,051,000</u>
Cost per Gallon Sold	\$ 0.00273535	\$ 0.00009800	\$ 0.00283334
Times: Patriot Coal's Leak Allowance	<u>30,194,650</u>	<u>30,194,651</u>	<u>30,194,651</u>
Cost of Patriot Coal's Leak	<u>\$ 82,593</u>	<u>\$ 2,959</u>	<u>\$ 85,552</u>

amounts shown above as nonrecurring items that should be amortized over a five-year period, the anticipated life of the water service rates approved in this case.<sup>8</sup>

B. Purchased Water Adjustment. On March 1, 2012, the city of Henderson increased the wholesale water rates it charges to Henderson District. As a result, Henderson District's test year Purchased Water expense should be increased by \$18,984, as calculated below, to annualize test-year purchases at the new wholesale water rates.

	Northern Connections	Southern Connections
Gallons Purchased during January and February of Test Year	74,029,000	1,462,400
Times: New Rate, per 1,000 gallons	<u>\$ 2.2118</u>	<u>\$ 3.0668</u>
Cost at New Rate	163,737	4,485
Less: Expense Reported for January and February of Test Year	<u>(145,199)</u>	<u>(4,040)</u>
Increase for Northern Connections and Southern Connections	<u>\$ 18,538</u>	<u>\$ 445</u>
Total Increase		<u>\$ 18,984</u>

Pursuant to 807 KAR 5:068, the Kentucky Public Service Commission allowed Henderson District to pass the city's wholesale rate increase through to its customers. Henderson District's pass-through rate increase became effective on April 1, 2012, one

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<sup>8</sup> Generally, when there is no evidence to support an alternative amortization period, the Commission amortizes an intangible regulatory asset or liability identified in a rate proceeding over the anticipated life of the utility rates approved in that proceeding. This life is generally based on the frequency of the utility's historic rate case filings. In recent history, Henderson District has generally submitted an application to adjust its rates for service every six to seven years. This evidence suggests that a six- or seven-year amortization period may be appropriate; however, it is Staff's opinion that the rates approved in this proceeding will become obsolete after a five-year period due to changes that will likely occur to Henderson District's cost of service during this time. Accordingly, absent a more reasonable amortization period, a regulatory asset or liability recognized in this proceeding should be amortized over a five-year period.

month after the city's wholesale rate increase became effective.<sup>9</sup> Water Sales Revenues reported for January, February, and March of the test year should be increased by \$27,098, as shown below, to annualize Henderson District's pass-through rate increase.

Total Annual Revenue from Billing Analysis with Pass-Through Rates	\$ 2,767,771
Less: Test-Year Water Sales Revenue	<u>(2,740,673)</u>
Increase in Revenues for January, February, March	<u>\$ 27,098</u>

C. Excess Water Loss. 807 KAR 5:066, Section 6(3), limits water loss to 15 percent for ratemaking purposes unless an alternative level is found reasonable by the Commission. Henderson District reported test year water loss at 17.8137 percent,<sup>10</sup> 2.8137 percent above the allowable limit. Henderson District did not petition the Commission for an alternative level. With the adjustments shown below, Staff has removed the cost of purchasing and pumping the excess water loss from test year operations.

	Purchased Water	Purchased Power
Expense Reported for the Test Year	\$ 1,192,750	\$ 42,731
Add: Increase in Wholesale Water Cost	18,984	
Less: Removal of Patriot Coal Leak	<u>(82,593)</u>	<u>(2,959)</u>
Test-Year Amount Subject to Loss Limitation	1,129,141	39,772
Times: Water Loss in Excess of 15 Percent	<u>-2.8137%</u>	<u>-2.8137%</u>
Decrease	<u>\$ (31,771)</u>	<u>\$ (1,119)</u>

<sup>9</sup> See Case No. 2012-00090, *In the Matter of Purchased Water Adjustment Filing of Henderson County Water District* (Ky. PSC. Apr. 9, 2012).

<sup>10</sup> Annual Report at 30.

D. Billing Service Fee. Kubra Tennessee, LLC ("Kubra") provides Henderson District with contracted services that include printing and mailing all customer monthly billings. During the test year, Henderson District reported a \$48,373 expense in account 620, Materials and Supplies, for these services. Omitted from this amount was a \$3,707 Kubra invoice dated January 2, 2013, that was for December services from the test year. Staff increased the test year expense by \$3,707 to properly accrue and report the December bill as a test year expense.

E. Contractual Services - Accounting. During the test year, Henderson District contracted with Myriad CPA Group ("Myriad") to perform consulting services designed to identify and mitigate risks that threaten Henderson District's ability to effectively and efficiently meet its operating objectives. As a result of the Myriad services, Henderson District made changes to its accounting and operating systems that appear to have strengthened its internal control structure and resulted in more efficient operations.

The Myriad consulting fee totaled \$11,000 and was reported in test year operating expenses. Henderson District included the entire amount in the calculation of its Overall Revenue Requirement. While Staff agrees that the Myriad contract was beneficial and that rate recovery is therefore warranted, Staff disagrees with including the entire fee in the Overall Revenue Requirement.

The consulting fee is a one-time, nonrecurring expense that will benefit future periods. The fee should be accounted for as a regulatory asset that is amortized so that a portion of its cost is recognized in each year a benefit is realized. The number of years that Henderson District will actually benefit from the Myriad Services cannot be

determined. Absent a more reasonable amortization period, Staff selected a five-year period to coincide with the anticipated life of the water service rates that will be approved by the Commission in this proceeding. Accordingly, Staff reduced test year expenses by \$8,800 to reflect the five-year amortization of the Myriad Consulting Services.<sup>11</sup>

F. Land and Land Rights. During the test year, Henderson District reported \$13,018 of legal fees in Contractual Services – Legal that were incurred to obtain land easements. It reported \$1,530 of land surveying fees in Contractual Services – Other that were necessary to mark the location of new land easements where utility plant will be constructed. Finally, it reported \$900 in Miscellaneous Expenses that were related to the condemnation of property upon which a new pumping station will be constructed. For accounting purposes, all of these fees are considered to be part of the cost of the acquired land. Proper accounting requires that these costs be capitalized to account 303, Land and Land Rights.<sup>12</sup> Staff removed these fees from test year expenses and reclassified them to account 303, Land and Land Rights.

G. Miscellaneous Expenses. Henderson District reported \$13,165 for test year Miscellaneous Expenses. The expenditures listed below were included in this

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Myriad Consulting Fee	\$	11,000
Divide by: Five Years		<u>5</u>
Annual Recovery		2,200
Less: Test Year		<u>(11,000)</u>
Decrease	\$	<u>(8,800)</u>

<sup>12</sup> USoA at 28 and 67.

account. Each expenditure was unnecessary for the delivery of potable water and was, therefore, outside Henderson District's statutory purpose.<sup>13</sup>

Check No.	Check Date	Vendor	Description	Amount
30104	January 13, 2012	Shaw's Flowers	Flowers	\$ 65
30287	April 6, 2012	Shaw's Flowers	Flowers	115
30355	May 1, 2012	Shaw's Flowers	Flowers	60
30785	October 4, 2012	Shaw's Flowers	Flowers	80
30926	November 14, 2012	D&M Family Foods	Thanksgiving Turkeys	375
31061	December 20, 2012	Louis Moore	Christmas Hams	1,080
31066	December 28, 2012	Business Card	Christmas Party Supplies	<u>1,440</u>
Total				<u>\$ 3,215</u>

Staff removed the items shown above from Miscellaneous Expenses and reclassified them to account 426, Miscellaneous Nonutility Expenses,<sup>14</sup> a "below-the-line" account that was excluded from Henderson's District's overall revenue requirement. Please note that the Kentucky Attorney General has previously opined that the members of a water district's board of commissioners may be required to personally reimburse a water district for all expenditures that are outside a district's statutory purpose.<sup>15</sup>

H. Depreciation Expense. Henderson District reported test year depreciation expense of \$539,492. As shown below, Staff decreased this amount by \$108,902 to account for changes to the depreciable lives assigned to certain assets and to accrue depreciation on post-test year plant additions.

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<sup>13</sup> "As a creature of statute, a water district created pursuant to KRS Chapter 74 may expend funds only in keeping with its statutory purpose, or express statutory authorization." OAG 92-43 (Mar. 19, 1992).

<sup>14</sup> Uniform System of Accounts for Class A/B Water Districts and Associations at 84.

<sup>15</sup> See 1956 OAG 36,219 (Oct. 19, 1956).

Change to Depreciable Lives	\$ (143,239)
Depreciation on New Construction Approved in Case No. 2012-00352	<u>34,337</u>
To Account for Changes to Depreciable Lives	<u>\$ (108,902)</u>

Changes to Depreciable Lives. Henderson District calculated test year depreciation expense by dividing the plant's original cost by its estimated useful life. A summary of Staff's review of the estimated lives is found at Attachment B of this report. Following the changes to the depreciable lives discussed in Attachment B, Staff reduced test year depreciation expense by \$143,239 as shown below.

Account Group	Depreciable Basis at December 31, 2012	Depreciable Life	Pro Forma	Less: Test Year	Adjustment
Building and Improvements	\$ 335,321	37.5	\$ 8,942	\$ (12,101)	\$ (3,159)
Meter Installations	374,964	45	8,333	(14,236)	(5,903)
Meters	855,697	40	21,392	(70,782)	(49,390)
Structures and Improvements	85,318	20	4,266	(8,531)	(4,265)
Transmission and Distribution Mains	12,445,061	62.5	<u>199,121</u>	<u>(279,643)</u>	<u>(80,522)</u>
Total			<u>\$242,054</u>	<u>\$(385,293)</u>	<u>\$(143,239)</u>

Post-Test Year Plant Additions. In its Order of August 23, 2012 in Case No. 2012-00352,<sup>16</sup> the Commission approved Henderson District's request to finance and construct a water main replacement project with an estimated cost of \$1,694,045. As of the date of this report, the project was 95 percent complete and partially operational. Staff anticipates that it will be 100 percent complete and fully operational at the time the Commission issues a final decision in this proceeding. When establishing rates, it is appropriate to account for the changes to test year operations that will occur as a result of this construction. Staff made adjustments to depreciation expense, as calculated

<sup>16</sup> Case No. 2012-00352, *Application of the Henderson County Water District for a Certificate of Public Convenience and Necessity to Construct and Finance Pursuant to KRS 278.023* (Ky. PSC Aug. 23, 2012).

below, and to Henderson District's debt-service requirements to account for the payments on the bonds used to finance the project, which will begin in 2014. No other adjustments are required. Revenues and purchased water will not increase, since no additional customers were added to the system as a result of the construction.

Capital Assets Approved in Case No. 2012-00352

Structures and Improvements	\$ 298,390	37.5	\$ 7,957
Transmission and Distribution Mains	1,276,552	62.5	20,425
Pumping Equipment	<u>119,103</u>	20	<u>5,955</u>
Total	<u>\$ 1,694,045</u>		<u>\$ 34,337</u>

Overall Revenue Requirement and Required Revenue Increase. Henderson District calculated its overall revenue requirement to be \$3,066,301. It requested rate recovery of all pro forma operation and maintenance expenses and pro forma tax expenses. Likewise, it requested to recover the three-year average principal and interest payments on its Kentucky Rural Water Finance Corporation bonds and on a note payable to the Henderson County Fiscal Court Henderson District requested recovery of \$343,000 of its \$539,492 test year depreciation expense. To generate the overall revenue requirement, Henderson District requested rates that will generate \$219,188 in additional annual revenues, an 8 percent increase. The net revenues that would result from the requested rates will meet the DSC ratio requirements of Henderson District's lenders.<sup>17</sup>

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<sup>17</sup> Henderson District's lenders included the Kentucky Rural Water Finance Corporation ("KRWFC"), the United States Department of Agriculture Rural Development ("RD"), and the Henderson County Fiscal Court. KRWFC and RD require that Henderson District maintain net revenues that are equal to at least 120 percent of the average annual principal and interest payments of the highest ranking debts. The highest ranking debts are those owed to KRWFC and RD. The note payable to the fiscal court is not on par with these debts.

Staff applied the DSC Method to calculate Henderson District's overall revenue requirement to be \$3,147,473. This method is historically accepted by the Commission to calculate the revenue requirement of a water district or a water association that has outstanding long-term indebtedness. To generate the overall revenue requirement calculated by Staff, Henderson District would require an increase in revenues of \$363,846. A comparison of the calculations made by Staff and by Henderson District is shown below.

	Henderson District	Staff
Operating Expenses	\$ 2,841,003	\$ 2,549,283
Less: Unrecovered Depreciation Expense	(196,492)	
Plus: Average Annual Debt Principal and Interest Payments Additional Working Capital	421,790	498,559 99,631
Overall Revenue Requirement	3,066,301	3,147,473
Less: Other Operating Revenues and Non-Operating Revenue Interest Income	(86,395) (20,045)	(86,395) (20,045)
Revenue Required from Rates	2,959,861	3,041,033
Less: Pro Forma Present Rate Revenue	(2,740,673)	(2,677,187)
Revenue Increase Required to Meet Overall Revenue Requirement	<u>\$ 219,188</u>	<u>\$ 363,846</u>
Percentage Increase to Meet Overall Revenue Requirement	<u>8.00%</u>	<u>13.59%</u>
DSC Ratio Resulting from Revenue Increase <sup>18</sup>	<u>172%</u>	<u>206%</u>

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18

	Henderson District	Staff
Gross Revenues	\$ 2,975,717	\$ 3,147,473
Less: Operation and Maintenance Expenses and Taxes Note Payable to Henderson County Fiscal Court (2014 Only)	(2,118,693) (2,016)	(2,118,693) (2,016)
Net Revenues	855,008	1,026,764
Divide by: Average Annual Principal and Interest Payments on Highest Rank Debts	<u>498,155</u>	<u>498,155</u>
Debt Service Coverage Ratio	<u>172%</u>	<u>206%</u>

There is a material difference in the average annual debt principal and interest payment calculated by Henderson District and by Staff. Henderson District calculated its average annual debt payment using a three-year period beginning January 1, 2013, the year immediately following the test year. It included bonds payable to KRWFC and a note payable to the Henderson County Fiscal Court. Henderson District did not provide a calculation of its three-year average with its application. Staff's attempt to reproduce Henderson District's calculation is presented below. There is a difference between the reproduction amount and the amount requested by Henderson District that is not material.

Year	Principal and Interest Payments			
	2013	2014	2015	3 Year Average
2003B KRWFC Bond	\$ 95,812	\$101,578	\$ 102,250	\$ 99,880
2006A KRWFC Bond	317,490	324,970	317,190	319,883
Notes Payable to Fiscal Court	2,016	2,016		1,344
<b>Total</b>	<b>\$415,318</b>	<b>\$428,564</b>	<b>\$ 419,440</b>	<b>\$ 421,107</b>

Staff calculated Henderson District's average annual debt payment using the five-year period beginning January 1, 2014. This period better matches the anticipated life of the rates to be approved by the Commission in this proceeding than the three-year average requested by Henderson District. Staff included the RD bonds that Henderson District issued to finance the construction of water facilities. The Commission authorized the issuance of the bonds and construction of the water facilities in Case No. 2012-00352. Staff anticipates that the construction project will be completed and become fully operational before December 31, 2013. The first full principal and interest payments on these bonds are expected to become due in 2014 and each year thereafter until the principal is fully retired. Staff's use of a five-year

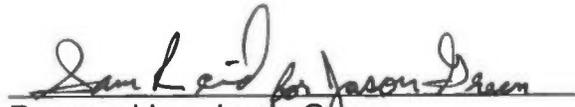
average that includes the RD payments provides Henderson District with the best opportunity to recover its actual debt payments while the rates approved in this proceeding are in effect. Staff's five-year average calculation is shown below.

Year	Principal and Interest Payments					5 Year Average
	2014	2015	2016	2017	2018	
2003B KRWFC Bond	\$101,578	\$102,250				\$ 40,766
2006A KRWFC Bond	324,970	317,190	\$ 411,370	\$ 407,350	\$413,681	374,912
2013 RD Bond	82,478	82,478	82,478	82,478	82,478	82,478
Total for Highest Ranking Debts						498,155
Note Payable to Fiscal Court	2,016					403
Total						\$ 498,559

Staff included the payment to Henderson County Fiscal Court in the average debt-service payment. The original note payable to the Court, in the amount of \$50,400, was negotiated by the parties on December 3, 1985. Proceeds from the note were used by Henderson District to fund a portion of the construction of a water system expansion project. Henderson District agreed to repay the note with interest by making annual payments of \$2,016. The last payment will be made in 2014. Staff found no evidence that Henderson District sought Commission approval for either the financing or the construction. The Commission may find that inclusion of the note payable for rate recovery is not appropriate. Removal of the note would reduce the overall revenue requirement by \$403, or .013 percent. Removal of this amount will not affect the rates calculated by Staff.



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ATTACHMENT A  
STAFF REPORT, CASE NO. 2013-00154  
STAFF'S RECOMMENDED RATES

Monthly Water Rates

5/8 X 3/4 Inch Meter

First 2,000 Gallons	\$18.28 Minimum Bill
Next 8,000 Gallons	6.45 Per 1,000 Gallons
Next 20,000 Gallons	5.92 Per 1,000 Gallons
Over 30,000 Gallons	5.39 Per 1,000 Gallons

1 Inch Meter

First 5,000 Gallons	\$37.63 Minimum Bill
Next 5,000 Gallons	6.45 Per 1,000 Gallons
Next 20,000 Gallons	5.92 Per 1,000 Gallons
Over 30,000 Gallons	5.39 Per 1,000 Gallons

2 Inch Meter

First 16,000 Gallons	\$105.40 Minimum Bill
Next 14,000 Gallons	5.92 Per 1,000 Gallons
Over 30,000 Gallons	5.39 Per 1,000 Gallons

3 Inch Meter

First 30,000 Gallons	\$188.28 Minimum Bill
Over 30,000 Gallons	5.39 Per 1,000 Gallons

4 Inch Meter

First 50,000 Gallons	\$296.08 Minimum Bill
Over 50,000 Gallons	5.39 Per 1,000 Gallons

6 Inch Meter

First 100,000 Gallons	\$565.58 Minimum Bill
Over 100,000 Gallons	5.39 Per 1,000 Gallons

Volunteer Fire Department (Metered Services)

Flat Rate	\$18.28 Maximum Bill
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ATTACHMENT B  
 STAFF REPORT, CASE NO. 2013-00154  
 HENDERSON COUNTY WATER DISTRICT  
 ENGINEERING DIVISION'S  
 ANALYSIS OF ASSET SERVICE LIVES

Historically, the Commission has relied on the National Association of Regulatory Utility Commissioners Study of Depreciation Practices for Small Water Utilities ("NARUC Study"), dated August 15, 1979, to evaluate the reasonableness of a utility's depreciation practices. This study outlines expected service life ranges for various asset groups designed, installed, and maintained in accordance with good water works practices. Typically, an adjustment is made when the Commission finds that a utility is proposing to use a service life that falls outside of this range, while service lives falling within these ranges are generally accepted.

In the following table, Engineering staff has identified the account classifications for which the utility's current service lives are not consistent with the service lives contained in the NARUC Study. The table shows the utility's current and Engineering staff's recommended reasonable and appropriate service lives based on a review of information contained in the record of this case.

<b>Asset Classification</b>	<b>Current</b>	<b>Staff Recommended</b>	<b>NARUC Study</b>
Group: Buildings and Improvement, Asset 179, Office Building	30	37.5	35-40
Group: Buildings and Improvement, Asset 373, Parking Lot Expansion	15	37.5	35-40
Group: Meter Installation	10-40	45	40-50
Group: Meters	10-40	40	35-45
Group: Structures and Improvements, Assets 331 and 355	10	20	20
Group: Transmission	40-50	62.5	50-75

The utility appears to be utilizing service lives outside the range recommended by NARUC. Absent any specific and verifiable evidence supporting alternative service lives, Engineering Staff finds that service lives based on the NARUC Study, as shown in the above table, are reasonable and appropriate.

Prepared July 9, 2013

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