COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE	)	CASE NO.
WATER SERVICE RATES OF LEBANON WATER	)	2017-00417
WORKS	)	

DIRECT TESTIMONY OF CHARLES M. WHITE, CPA

ON BEHALF OF MARION COUNTY WATER DISTRICT

Filed: May 14, 2018

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

A. Charles M. White, Certified Public Accountant, 219 S. Proctor Knott Ave, Lebanon, KY 40033.

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A. I received a Bachelors of Science in Accounting degree from the University of Kentucky. I have been a licensed and practicing CPA for over 40 years.

Q. PLEASE BRIEFLY DESCRIBE YOUR AFFILIATION WITH MARION COUNTY WATER DISTRICT ("MCWD").

A. Our firm has represented MCWD for more than 35 years. Our firm performs their annual audit. We have also assisted MCWD many times with their accounting needs related to various projects including financing construction, rate increases, or other analysis needed.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. Our firm has analyzed components of the information presented by Lebanon Water Works Company ("LWWC") regarding the proposed rate increase and I am presenting our analysis.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes. Exhibit CMW- 1 is a spreadsheet our firm has prepared. It shows the last 3 years of audited financial statements, a column for the average of those 3 years, a column representing the revenues and costs as presented in LWWC's rate increase calculation at Exhibit 1-1 labeled "Per Pro Forma" and the difference in the change between the 3-year average and the Per Pro Forma. Exhibit CMW-2 is a calculation of projected cost savings from the purchase of water from Campbellsville based on 2017 audited costs. Exhibit CMW-3 is a comparison of the depreciation expense that LWWC would realize if it had used the same depreciation schedules that the Commission requires MCWD to use. CMW-4 is the recreated depreciation schedule for LWWC for the year ended June 30, 2016. CMW-5 is roll-forward of the June 30, 2016 depreciation schedule to June 30, 2017. Exhibit CMW-6 is a Summary of Findings. These Exhibits were prepared by me or under my supervision.

Q. WHAT HAS YOUR ANALYSIS OF THE DEPRECIATION SCHEDULES OF LEBANON WATER WORKS COMPANY REVEALED?

A. I have reviewed the depreciation schedule of LWWC and compared it to the company's capitalization policy and also compared it to the depreciation schedule of MCWD.

First, our firm recreated the schedule provided by LWWC in the same depreciation system used for maintaining the depreciation schedules for MCWD. We accumulated the assets to the best of our ability into categories similar to those of MCWD to be able to more easily compare the two schedules. The total

cost per the schedule provided and the recreated schedule do agree with book cost totaling $22,864,495. Further, all assets listed were given the same useful lives as the original schedule. The recreated schedule is not a mirror image of the original schedule since faults were found with the existing schedule. An example is that some assets had accumulated depreciation values greater than the cost of the asset. Since this is not possible, the software our firm uses does not allow that type of entry. Thus, the accumulated depreciation amounts do not match.

Our firm initially began this process of recreating the depreciation schedules with the year ended June 30, 2016 (Exhibit CMW-4). We ensured that the asset costs and current depreciation agreed to the LWWC 2016 depreciation schedule. In our software, we can simply roll forward the depreciation schedule to the next year. We did so and then added the 2017 additions per the 2017 LWWC depreciation schedule (Exhibit CMW-5). We also matched the depreciation expense for those new additions to the LWWC schedule. Our software calculated depreciation expense to be $15,675 less than was reported as current depreciation expense for LWWC.

Further, the useful lives for many of the assets do not agree with LWWC's capitalization policy as provided in LWWC's response to Request No. 2 of Commission Staff's Initial Requests for Information submitted on March 7, 2018 or a second, differing capitalization policy submitted with Exhibit 10-1 in response to MCWD's First Requests for Information. While some of the items in the two separate capitalization policies agree, several do not. Specifically, the

depreciable years for transmission and distribution mains and meters do not agree between the schedules. They also do not agree with the depreciation schedule. Since the useful life of the asset directly impacts the depreciation expense of the asset, the capitalization policy driving the depreciable years of the assets is important. In the depreciation schedule for LWWC, it should be noted that many useful lives for distribution and transmission mains are shorter (33.5 years) than the capitalization policy of LWWC from Question #2 (40 years) and even shorter than Exhibit 10-1 (50-75 years) for the same category of asset.

MCWD recently completed its own Rate Case in 2016. Its depreciation schedule was reviewed during that rate case, and depreciable years for transmission and distribution mains and service lines were required to be set at 62.5 years, which is significantly longer than the number of years being used by LWWC. Similarly, LWWC used between 10 and 40 years for most components of its distribution reservoirs and standpipes. MCWD was required to use a depreciable life of 50 years for similar assets. The change in useful lives had to be applied to all depreciable assets regardless of the purchase date. Thus, MCWD assets are being depreciated at a much slower rate than those of LWWC.

Exhibit CMW-3 shows the cost of the assets, the depreciable years required to be used by MCWD, the depreciation per year based on those years, the approximate depreciation amount for the same category for LWWC using the recreated depreciation schedule, and the difference between the two depreciation cost totals. The analysis indicates that depreciation expense is overstated by $54,154.

Q. HAVE YOU ANALYZED THE COSTS OF THE CITY'S WATER AND WHAT HAS THAT ANALYSIS REVEALED?

A. The LWWC stated that they provided the City of Lebanon approximately 3,700,000 cubic feet of free water. While there is some trade-off of expenses for treating of sludge and borrowing of equipment, these items do not appear to have been accounted for within the ledger of the LWWC.

3,700,000 x 7.480519 = 27,677,920 gallons of water, with 7.480519 being the conversion rate for cubic feet to gallons

27,677,920 gallons x $3.34/1000 (rate before any rate increase) = $92,438 of free water

$92,438 x 56.24% = $51,987 cost to MCWD, with 56.24% being the calculated percentage of water purchased by MCWD from LWWC

With MCWD being the largest customer of LWWC, they, by default, are paying for more than half of the cost of production of the City's water.

Q. HAVE YOU ANALYZED THE COSTS OF LWWC AS DESCRIBED IN EXHIBIT 1-1 AND WHAT HAS THAT ANALYSIS REVEALED?

A. Our firm has noted the following three points that we believe to be key:

1) The prior three years of audited financial statements show an average of $35,445 of revenues per year collected from customers for penalties and late fees. $0 of revenue for this category was included in the calculation of the rate increase proposal. MCWD also receives revenues from penalties and late fees annually. There is minimal fluctuation in the amount of revenues received for this category

from year to year. Thus, these revenues are general operating revenues and should have been considered in the proposed rate increase calculation.

2) Concerning the purchase contract agreement with Campbellsville Water and Sewer System (See Exhibit CMW-2):

a) It is noted that LWWC plans to purchase 400,000 gallons per day when they are only required to purchase 300,000 per day. That results in an additional cost of $122,640 per year to LWWC.

b) We have calculated 400,000 per day to be approximately 18% of the usage of LWWC. If this percentage is accurate, then purchased power, pump station and filter plant, and chemical costs should decrease by approximately 18%. However, the cost savings projected by LWWC is only $29,950 per Exhibit 1-1. This does not seem to be a reasonable amount of savings from the water purchased from Campbellsville Water and Sewer System. Based on the three cost categories noted, an 18% savings would be $85,051, which is $55,101 more than what was used in calculation of the rate increase.

3) Four Cost Categories That Do Not Appear to Be Reasonable (See Exhibit CMW-1).

a) The three year average of Maintenance and Repair Costs is $128,933. The Per Pro Forma used to calculate the rate increase lists those same costs at $201,500. That's an increase of $72,567 or 56.3%. With that type of increase, I question

whether the costs listed are repair costs or capital improvements costs that should be depreciated.

b) The Per Pro Forma lists salaries and wages at $615,200 compared to the three year average of $562,787. That is a 9.3% increase ($52,413). However, the three year average also appears to be skewed since salaries and wages for 2017 ($643,122) reflects a 22% increase. It does not appear that LWWC has made an effort to normalize these expenditures when calculating the proposed rate increase.

c) Outside Services expenditures Per Pro Forma are $65,400 while the three year average is only $43,054. That's an increase of $22,346 or 51.9%. That does not seem reasonable and suggests that LWWC incurred costs that are neither normal nor recurring.

d) Miscellaneous expenditures Per Pro Forma are $44,000 compared to the three year average that is $19,268. That is an increase of $24,732 or 128.4%. This does not appear to be reasonable and is also a clear example of budgeted figures being used for the rate increase compared to historical, actual costs.

Q. CAN YOU SUMMARIZE YOUR TESTIMONY?

A. Yes, I have prepared Exhibit CMW-6 which summarizes the impact of the differences discussed above on LWWC's operating income per Exhibit 1-1. The impact is significant and results in a proposed operating deficit of $217,790

changing to an operating income of $317,316. That is a $535,286 difference in operating income.

Q. IN YOUR PROFESSIONAL OPINION, DO YOU CONSIDER THE RATE INCREASE PROPOSED BY LWWC TO BE FAIR, JUST, AND REASONABLE?

A. Based upon my analysis, no I do not.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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VERIFICATION OF CHARLES M. WHITE

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF MARION)

Charles M. White, Certified Public Account, White And Company, PSC, on behalf of Marion County Water District, being duly sworn, states that he has supervised the preparation of his Direct Testimony in the above-styled matter, that he would respond in the same manner to the questions if so asked upon taking the stand, and that his testimony is true and accurate to the best of his knowledge, information, and belief formed after a reasonable inquiry.

Charles M. White

The foregoing Verification was signed, acknowledged and sworn to before me this 14th day of May, 2018, by Charles M. White.

Stephanie A. Abell
NOTARY PUBLIC, Notary # 566851
Commission expiration: 10/14/20