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BEFORE  THE  IDAHO  PUBLIC  UTILITIES  COMMISSION

IN THE MATTER OF THE APPLICATION OF )

OF EAGLE WATER COMPANY, INC. FOR)CASE  NO.  EAG-W-95-1

AUTHORITY TO EXPAND ITS)

CERTIFICATED AREA AND AMEND ITS)

CERTIFICATE OF PUBLIC CONVENIENCE)REPLY COMMENTS OF

AND NECESSITY NO. 278)THE COMMISSION STAFF

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COMES  NOW  the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Scott Woodbury, Deputy Attorney General, and in response to the Financial Plan filed by Eagle Water Company, Inc. on June 11, 1996, submits the following comments.

Staff has reviewed the financial plan filed by Eagle Water Company, Inc. (Eagle Water, Company, Water Company) on June 11, 1996 and has made a limited audit of Eagle Water’s 1995 accounting records.  Staff finds that Eagle Water has included Eagle Water Company, Inc., Construction Division (Construction Company) with the regulated Company in the financial plan.  Staff believes that by including the Construction Company’s financial impact it is impossible to determine the viability of the regulated Water Company.  Therefore, Staff has prepared Attachment A showing financial projections for the regulated Water Company from data obtained in the audit and from the workpapers provided by the Company.  Eagle Water Company’s Annual Report was received June 19, 1996 so the annual report information was not used to develop Attachment A.  Staff is aware that there will be differences between the Company’s 1995 year-end financial position as reported in the Company’s Annual Report and Staff’s projected 1995 year-end financial position.  After reviewing the annual report, Staff does not believe that the differences are materially significant or require a change in Attachment A.

Staff’s financial projection shows that with continued growth, continued collection of the surcharge hook-up fees and only small increases in expenses, Eagle Water should be able to meet it’s financial obligations.  If growth does not occur or if expenses have major increases the Company will continue to have the same financial problems it has experienced in the past.  Without growth, increases in expenses will require Eagle Water to file a rate case to cover its revenue requirement.  Staff has also shown placement of the surcharge hook-up fees in an escrow account.  Staff believes the surcharge fees were intended to fund specific needs.  The surcharges collected to date, on an after income tax basis, have exceeded the costs of the well and water report they were intended to pay.  Staff contends the Company should be ordered to justify the continued collection of surcharge fees now that enough has been collected to pay for the intended engineering study and new well.  Eagle Water should file for approval of a specific plan as to the future use of these funds.  If the Commission allows the Company to continue to collect the surcharges, Staff recommends that the funds be placed in an interest bearing escrow account to insure that the funds are available when they are needed.

Staff has prepared Attachment B as an example of the hook-up surcharge escrow and the hook-up surcharge held for future use accounting entries.  Basically the hook-up surcharge escrow account is a dedicated cash account to be used to finance assets.  Staff recommends that the Company file a plan with the Commission showing the intended use before payments for assets are made.  The hook-up surcharge held for future use is a liability of the Company owed to the ratepayers.  Because this account would not be included as a deduction to rate base the Company should pay interest on the account balance at the authorized rate of return for the ratepayers benefit.  As assets are placed in service this account would be reduced when the Contribution in Aid of Construction account is increased for the amount of the assets.

Because the balance sheet shows that Eagle Water has a negative utility plant in service balance and a negative owners equity, Staff concludes that the Company is over earning.  Staff does not, however, believe it is realistic to lower water rates for the Company at this time.  Therefore, Staff recommends that any net income above the Company’s working capital, interest and debt needs be placed in a funded escrow account for future emergency repairs.  This will ensure that the customers of Eagle Water, who have already fully paid for rate base, receive the benefit they are paying for, a secure water source, and would prevent the Company’s shareholders from reaping a windfall on assets they have not paid for.

The improvement in the projected net income is the result of the Company’s projected growth of 184 new residential customers and 28 new commercial customers for each of the next three years.  This projection is consistent with the City of Eagle projections.  With a new billing system the Company claims there will be no material increases in expenses.  The Company has projected a 54% increase in income in 1996, a 29% increase in income in 1997, a 12.4% increase in income in 1998, and an 11% increase in income in 1999.  Staff believes there are many things that could affect this growth.  At present the City of Eagle has a building moratorium.  If this moratorium is not soon lifted, new customer hook-ups could be less than projected.  Also, if interest rates increase or if there is a down turn in the Treasure Valley economy new home sales may decline.  Further, if the Company is unable to hold the expenses to approximately a 7% increase each year, the net income could turn to a net loss.  It would only take one major repair problem to eliminate any regulated operating net income.

The balance sheet shows that Eagle Water Company will continue to have a negative net utility plant in service due to contribution of plant and depreciation.  The Company has projected construction of two new wells in 1996.  Well No. 6 is projected at 3,500 GPM and has been drilled and tested in 1996.  The Company claims this well is needed to supply water to new subdivisions currently being constructed and meet fire protection requirements.  The Company claims the cost of this well will be between $160,000 and $170,000.  Staff projects the cost of this well will be paid with existing and future surcharge hook-up fees and therefore will be 100% contributed.  Well No. 5 is also projected to be drilled in 1996.  This well is not currently needed but the Company has already extended the well permit and is afraid they might lose the water rights if it is not drilled this year.  This will raise the question of whether the well should be allowed in rate base or put in plant held for future use.  Either way the accounting for this well should have a zero impact on rate base since this well will be paid for by the surcharge hook-up fees or developers and therefore 100% contributed.  The Company is also showing a $77,000 increase in mains in 1996.  Debt has been forgiven by developers in return for part of the building of these mains and Staff has shown the remaining cost as coming from surcharge hook-up fees as it is impossible to tell at this time if more of the costs will be covered by the developers.  The Company is also negotiating the sale of Well No. 3 in 1997.  This well is 100% contributed according to Staff’s records.  The well pumps 300 to 400 GPM but is currently only used as backup due to the iron level of the well.  With the larger wells in service, this well will be non-essential to the Water Company.  The well is on the golf course and would be purchased by the golf course.  Because this well is 100% contributed Staff believes any proceeds from the sale should be returned to the well escrow account to fund future asset needs.  Because all of the asset additions and retirements will be or have been contributed there will be zero impact on rate base.

The utility plant in service negative balance continues to increase because the normal hook-up fee of $250 is considered a contribution in aid of construction (CIAC).  Because the hook-up fee is greater than the asset cost booked for the customers hook-up, the negative position continues to increase.  Staff recommends that the Commission change the accounting for the hook-up fee by directing that these funds also be placed in the surcharge hook-up escrow account.  This way the CIAC will match to the asset booked to plant in service and the escrow account will grow with interest.  This should also ensure that the funds are available for assets as needed and would stop the utility plant in service from becoming a larger negative amount due to the hook-up fee.

Staff has shown the cash in two accounts, one for general cash and the other as an escrow account for future asset needs associated with the growth of the Company.  Staff recommends that the Commission order the Company to set up an escrow account for the surcharge hook-up fees to ensure the accountability of these funds.  Without more detail, Staff has been unable to reconcile the surcharge hook-up fees collected with the expenditures to ensure that the fees are being properly booked or used.

The Company has supplied loan payment schedules that show the payment of loans to the Star Merc.  The payment of this loan is long overdue.  The Company also shows that principal payments will be made on the Nyburg loan which has been outstanding for some time.  The Staff believes the Company should continue to pay off the high interest loans.  The Company has not shown and Staff has not included a $55,000 loan used to purchase materials for the construction of Well No. 6 and the related mains.  This loan was supposed to be paid off on December 28, 1995 but, on June 18, 1996 this loan was still outstanding.  This loan has been guaranteed by a certificate of deposit of Water Company funds.  Part of this loan should be collected from the developers but Staff is unable to determine how much and when.  Part of the loan may also be the responsibility of the Construction Company and again at this time Staff was unable to determine how much.

The Cash Flow Statement, Attachment A, page 3 shows that of the $240,487 increase in the general cash account $204,681 was generated from the $250 hook-up fee after the cost of the hook-up has been deducted.  This shows the importance of growth to the continued cash flow health of the Company.  Staff also notes that the increase in net income is directly related to customer growth while expenses are contained.  Therefore, Staff’s original opinion that the Company must have continued growth to be viable and that without this growth the Company would have trouble generating cash to cover emergency repairs, debt and interest payments is still valid.  Staff is also still concerned with the close ties between the Construction Company and the Water Company and how problems in the Construction Company could affect the security of the Water Company.  Staff has previously requested a legal separation of the two Companies and continues to believe it is in the interest of the ratepayer that the Construction Company is recognized as a separate legal entity.  Staff has also requested a separation between the Water Company accounting and the Construction Company accounting.  This can be accomplished with proper allocations to separate accounts.  Staff still believes this is a major concern and recommends the Commission order this separation.

Staff’s long-standing concerns with the Company’s accounting records and methods of allocating common costs between the Water Company and the Construction Company are still valid.  This Company had approximately $250,000 in revenue in 1995 but is still doing minimum accounting and is still using the cash method of accounting.  The Company continues to rely on an external accountant to determine where costs need to be charged at the end of the year based on minimal records.  Staff has difficulty auditing because there is little or no audit trail and the numbers continue to change as new information is found.  In Staff’s August 1992 audit report Staff recommended:

The Company must keep and maintain adequate records.  The computer billings must be printed out monthly and reconciled to the input records, checked to be sure all meter readings have been correctly entered, and checked to be sure all checks received are properly posted.  This printout must than be kept for future reference.  An accounts payable ledger must be maintained.  This does not mean a slip of paper with a listing of bills received.  It means a continuing record by vendor of debts as they are incurred with a record of payments made with check number and date.  Files must be properly set up and maintained.  This filing system should be kept in a file cabinet not somewhere on the desk.  All receipts must be kept and filed, preferably by vendor.  It is recommended that the bill be marked “paid” and the check number and date of payment written on the bill before it is filed.  When files are pulled at year end they must be kept together in proper files not just thrown in a box.

Proper allocations must be made between the Water Company and the Construction Company.  Administration and general costs, accounting costs, legal fees, employee benefits, insurance costs, supplies and materials, transportation expenses, property taxes, and any other joint costs and/or assets must be allocated between the Water Company and the Construction Company if they cannot be directly separated by billings.  Staff suggests an allocation factor using the average of gross revenue and payroll.

Staff’s recommendation is as valid now, as then.

The external accountant of Eagle Water is making allocations based on Staff’s recommendations but this allocation is being made at the end of the year and may or may not be representative of the actual intercompany transactions and common cost allocations.  In 1995 this allocation resulted in a $135,559 accounts receivable for the Water Company from the Construction Company.  Staff believes the Company is big enough that they should have a full time bookkeeper capable of determining a direct assignment of costs based on payroll records, invoices and contracts and that common costs need to be examined to determine if there is a cost causation factor that would be more appropriate than the one currently used.  Staff also believes that this bookkeeper should be required to keep the books on an accrual basis instead of the current cash basis.  Staff would be willing to work with the external accountant to straighten out the plant accounts, hook-up fees, hook-up surcharges depreciation and CIAC.  Without proper accounting records, cash flow management, and asset budgets this Company will continue to have problems.

DATED  at Boise, Idaho, this            day of June 1996.

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Scott Woodbury

Deputy Attorney General

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Madonna Faunce

Senior Auditor

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