TROY HOFFMAN WATER CO.

CASE NO.  TRH-W-95-1

IDAHO PUBLIC UTILITIES COMMISSION

STAFF AUDIT REPORT

Prepared by

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&

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BACKGROUND

Troy Hoffman Water Company (Company) filed this general rate case on August 31, 1995.  The Company used a 1993 test year adjusted for the addition of flow meters to its system.  The addition of the flow meters has been required by the Idaho Division of Environmental Quality (DEQ).  The 1993 test year used in the application is prior to the sale of ownership interest in the Company.  Subsequent to the sale of ownership interest, significant changes have occurred in the way this Company is managed.

The application requested an increase in water rates of 30%.  This increase would generate approximately $2,550 of additional revenue each year.  The primary cause of the Company's request was the need to install flow meters in the Company's well house.  The Company estimated the cost of installing the meters to be $10,000.  Staff requested copies of firm bids from the Company in support of its estimate.  The Company began a bid solicitation process and provided the requested copy on January 31, 1996.

When it filed the application, the Company had not yet issued the required notices to its customers nor had it placed any advertisements or legal notices in local newspapers.  The application did not include proposed new rate schedules or a requested effective date.

Staff visited representatives of the Company in October and November of 1995.  During these visits, Staff performed financial audit analysis, toured the system and discussed the requirement for installation of flow meters with representatives of the DEQ.

During the course of these visits, Staff informed the Company it must inform its customers of the application through direct notice and publication in local newspapers before the Idaho Public Utilities Commission (Commission; IPUC) could process the application.  The Company notified the Staff on March 7, 1996 that it had informed its customers of the application through bill stuffers mailed on February 15, 1996 and through a press release sent to two newspapers and two radio stations serving the service area of the Company.

CONSUMER ISSUES

Since January 1, 1994, the Idaho Public Utilities Commission has received one inquiry/complaint regarding Troy Hoffman Water Company.  The customer wanted to know about the 30% proposed rate increase and asked about the required customer notification when a water test showed “bad.”  The customer was referred to DEQ for water test information requirements.

A review of Troy Hoffman Water Corporation's bills, disconnect notice and consumer rules summary, shows that the Company has updated its consumer information.  The Company does need to include in its tariff the general rules and conditions under which customers receive service.  The Commission has available a model set of rules, General Rules and Regulations for Small Water Utilities, that may be adopted by the Company.

FINANCIAL REVIEW

Staff has reviewed and audited the financial data used in the Company’s application.  Since the test year used by the Company (1993) was prior to the sale of proprietary interest in this Company, Staff also reviewed and audited the Company’s 1994 financial data.  For the purpose of this report, Staff has elected to rely upon the more recent data as more indicative of this Company’s financial condition.

Staff has reviewed prior orders of the Commission, prior audit reports and correspondence for compliance with the Commission's rules and directives.  With the exception of some accounting classifications, the Company is in compliance.  Financial statements have been restated to recognize prior period customer connection fees as contributions in aid of construction.  As directed by Staff, the Company has not increased the stated value of ownership equity to recognize any premium paid by the current owners for the stock in this corporation.

The attached exhibits summarize the results of the Staff investigation.  On Exhibit “A”, Staff has reclassified some of the accounts to comply with the uniform system of accounts adopted by the Commission.  Staff has adjusted the reclassified actual results of 1994 operations on Exhibit “B” to recognize known and measurable changes to the Company’s methods of operation as follows:

1.During 1994 the Company had an employee who was responsible for meter reading and maintenance of the physical plant of the water system.  Late in 1994 the Company began contracting for these service and no longer has an employee for this purpose.  On lines six and seven, Staff has eliminated the employee costs including salary, taxes and insurance from the 1994 test year and on line ten, has substituted the contract cost of these services.

2.During 1994 the Company used the services of an outside accounting firm for customer billing and monthly accounting services.  The Company no longer uses these services.  Rather, one of the owners, who is a practicing attorney, has his assistant perform these services for which the Company pays an hourly rate to the legal firm.  On line eight, Staff has removed the accounting firm expenses from the test year and substituted on line nine the hourly cost charged for the service by the legal firm.

3.The Division of Environmental Quality has required the installation of flow meters at the Company's well.  Staff requested and received from the Company, firm bids for this installation.  Staff has proformed the 1994 test year to recognize the addition of the flow meters in the Company's rate base and the additional depreciation expense associated with the equipment.  Line 12 of Exhibit “B” reflects the effect of the depreciation expense on the Company’s operating results.

4.Staff has also adjusted the 1994 test year to depict “normal” weather conditions.  Revenue can be affected by many things, but Staff believes the primary factor in this case is weather.  As a means of normalizing revenues, the average of the annual revenue per customer from 1990 through 1994 was calculated.  This method, while simple, incorporates weather-related variations as well as other unidentified annual variations in revenue.  Staff chose to use only the last five years, since earlier years are probably not as indicative of current customer water usage patterns.  Exhibit “C” shows, both graphically and in tabular form, the average revenue per customer from 1980 through 1994. The average revenue per customer during the past five years is $122.27.  Using this annual revenue per customer and the number of customers in the test year, the normalized test year total revenue is $17,607.

5.Pumping power expenses were also analyzed to determine whether a normalization adjustment was warranted.  Staff examined the correlation between metered sales revenue and pumping power expenses.  Exhibit “D” shows the correlation analysis.  There is fairly good correlation if the 1981-1994 period is considered; however, there is no correlation when just the last five years are considered.

One of the reasons for a lack of correlation in the last five years could be that demand charges, which are unrelated to the quantity of water pumped, constitute a significant portion of pumping power expenses.  In addition, the Company uses two pumps at various times, each of which has a different horsepower rating and a different pumping efficiency, hence different demand charges.  Finally, the operating schedules of the pumps may have been different each year because of different operators, higher or lower water demands in shoulder months, changes in pumping equipment, or other factors.  Considering the combination of these factors, the lack of correlation from 1990-1994 is not surprising.  Since neither Staff nor the Company is aware of the prior operating history of the system, Staff is reluctant to normalize pumping power expenses based on correlation with metered sales revenue.  Staff believes a simple five-year average of pumping power expenses is likely just as representative for the normalized test year.  Using this approach, the normalized pumping power expense is nearly the same as the actual pumping power expense in 1994, the test year.  Consequently, no adjustment to test year pumping power expenses is recommended.

Exhibit “E”presents 1993-1994 comparative balance sheets for the Company in Columns A and B.  Staff has found the balances of these accounts are fairly stated and in compliance with the Commissions rules and prior orders.  Column D, lines one through 14 and line 23 of this exhibit shows the accounts used to develop a 1994 rate base for the Company.

Exhibit “F” completes the 1994 rate base calculation by incorporating a proforma adjustment in Column B to recognize the addition of the flow meters discussed earlier and incorporating an allowance for working capital shown on line six.  The $17,240 shown in Column C on line 12 is the rate base valuation Staff proposes for use in this case.

Exhibit “G” presents the Staff-calculated revenue deficiency for the Company.  The revenue deficiency shown on line seven of $4,050 would require an average increase in the Company’s rates of 23% which would increase the average customers bill by approximately $2.34 per month.

The calculation of the revenue requirement shown on this exhibit incorporates a return on the Company’s rate base of 12% which is comparable to returns the Commission has been finding reasonable for other small water companies in Idaho.  The calculation also includes recognition, on line six, of the income tax liability that is associated with an increase in the revenues.  Staff has used the minimum income tax rates in the calculation of the tax gross-up factor.  The tax gross-up factor calculation is shown on lines 8 - 14 of this exhibit.

RATE DESIGN

In its application, the Company has not requested any change from the present rate design.  Staff has reviewed the present rate design and believes it to be simple and reasonably fair to all customers.  Consequently, no change to the basic rate design is recommended, only to the rates themselves.

Staff’s analysis indicates that a revenue increase of $4,050 or 23% is supported by the adjusted 1994 test year.  Staff proposes that the increase be applied roughly equally to both the monthly base rates and the commodity rate (so that rounded figures can be used for the base rates and the commodity rates).  Staff recommends that the monthly base rate for customers with 3/4-inch meters be increased from $4.25 to $5.50.  For customers with 1-inch meters, the base rate would increase from $5.75 to $7.50.  The recommended commodity rate for all customers would be

increased from $0.50 per 1000 gallons to $0.60 per 1000 gallons.  No change is proposed in the 3000 gallons-per-customer monthly allowance.  These suggested rates will generate the calculated revenue increase under normal conditions.

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Robert E. Smith

Senior Auditor

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Rick Sterling

Staff Engineer

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Attachments

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