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IDAHO PUBLIC UTILITIES COMMISSION

BEFORE THE

IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER SERVICE IN THE STATE OF IDAHO	)	CASE NO. UWI-W-04-4

DIRECT TESTIMONY OF PATRICIA HARMS

IDAHO PUBLIC UTILITIES COMMISSION

APRIL 6, 2005

Q. Please state your name and address for the record.

A. My name is Patricia Harms. My business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed and in what capacity?

A. I am employed by the Idaho Public Utilities Commission (Commission) as a Senior Auditor.

Q. Give a brief description of your educational background and experience.

A. I graduated from Boise State University, Boise, Idaho in 1981 with a B.A. degree in Business Administration, emphasis in Accounting. I am a Certified Public Accountant licensed by the State of Idaho. Prior to joining the Commission Staff in 2000, I was employed by the State of Alaska as an In Charge Auditor and performed both financial and performance audits of governmental agencies. I have attended many seminars and classes involving auditing and accounting. While at the Commission I have audited a number of utilities including water, electric, gas and telephone utilities and provided comments and testimony in a number of cases that dealt with general rates, hook-up fees, accounting issues, and other regulatory issues. I have also completed the National Association of Regulatory Utility Commissioners' (NARUC) annual regulatory studies program at Michigan

State University. I also attend meetings of NARUC's Staff Subcommittee on Accounting and Finance. I am a member of the State/Federal Joint Oversight team for the Qwest 272 Audit.

Q. What is the purpose of your testimony?

A. My testimony summarizes Staff adjustments, rate base, revenue requirement and revenue requirement increase proposed in this case.

Q. What exhibits are you sponsoring?

A. I am sponsoring Exhibit Nos. 110 through 116. Exhibit Nos. 110 and 111 outline Staff's proposed revenue requirement, rate base and itemize Staff's adjustments to the United Water Idaho, Inc. (United Water; UWI; Company) adjusted test year operating results and the Company's recorded rate base.

Staff Exhibit Nos. 112, 113, 114, 115 and 116 calculate rate base components based on a 13-Month average and identifies the resulting adjustments to the Company's recorded amounts.

Q. What is the purpose of Staff Exhibit No. 110?

A. This exhibit shows the overall net operating income requirement and revenue requirement deficiency for the Company as calculated by Staff.

Q. What revenue requirement does Staff propose?

A. The total net operating income requirement proposed by Staff is $10,086,477 as shown on Exhibit No. 110, line 3. Staff's Adjusted Net Operating Income for the Company is $9,747,299. This results in an overall rate increase of $570,837 or 1.8%. The Company has requested an overall rate increase of $6,767,870 or 21.46%.

Q. How is this revenue requirement calculated?

A. Staff calculated the revenue requirement using a 13-Month Average Rate Base of $124,524,407, an 8.10% overall rate of return described in Staff witnesses Hall's and Carlock's testimony, and Staff's adjusted net operating income of $9,747,299.

Q. Please describe the reason for a 13-Month average rate base.

A. As described in Staff Policy witness Lobb's and Staff witness Carlock's testimony, using a 13-Month average rate base reduces the expense/revenue mismatch identified by the Commission that occurs when the costs of plant adjustments are added as if they were in place for a whole year without adding any benefits.

Q. Please describe this expense/revenue mismatch.

A. In Order No. 29505 entered in Case No. IPC-E-03-13, the Commission stated it "expects all utilities to attempt to identify expense saving and revenue producing effects when proposing rate base adjustments for major plant additions." Page 7.

Q. In this case, did United Water add any plant adjustments to rate base as if they were in place for a whole year?

A. Yes. United Water added to Plant in Service approximately $30 Million in capital project expenditures estimated through May 31, 2005 as identified in Witness Rhead's Exhibit No. 8 dated October 21, 2004. These costs include projects related to the Company's Columbia Water Treatment Plant (CWTP) and approximately 90 other projects.

Q. Did Staff add any plant adjustments to rate base as if they were in place for a whole year?

A. Yes. The Company's CWTP In-Service Additions per Witness Rhead's March 22, 2005 updated Exhibit No. 8 were added to rate base as if they were in place for a whole year. Staff accepts this adjustment. In addition, Staff also annualized costs associated with CWTP-related projects completed (costs closed to Plant in Service) during the test year (August 1, 2003 through July 31, 2004). The adjustment amount to annualize costs for CWTP totals $23,927,985.

Q. Do these costs represent the total Company investment in CWTP?

A. No. There are many CWTP-related projects that were completed (costs closed to Plant in Service) before the beginning of the Company's test year. Therefore, those costs were already included in rate base for the entire year. Staff witness Sterling thoroughly discusses CWTP in his testimony.

Q. Did the Company identify expense saving and revenue producing effects associated with CWTP?

A. Yes. The Company proposed Adjustment No. 16 that decreased power and chemical expense at wells as a result of the operation of CWTP. According to Witness Healy, with the operation of CWTP the Company will rely less on ground water resources. The Company also proposed adjustments increasing expenses as a result of operating CWTP for items such as increased power, chemicals, purchased water and staffing costs (Company Adjustment Nos. 1 and 15). In addition, the Company projected customer growth through May 31, 2005 and increased revenue accordingly. Correspondingly, the Company increased postage expenses, billing costs, and operation and maintenance costs associated with customer growth (Company Adjustment Nos. 18, 19, and 30).

Staff witness English's testimony discusses these adjustments in detail.

Q. Does the Company propose any other post-test year additions?

A. Yes. The Company proposed a test year of August 1, 2004 through July 31, 2004 and essentially proformed its rate base through May 31, 2005 on a year-end basis. (Witness Healy Exhibit No. 1, Page 1 of 9).

Q. Does Staff accept the Company's adjustments to rate base as proposed in Witness Healy Exhibit No. 1, Page 1 of 9?

A. No. As discussed earlier, except for CWTP, Staff has prepared rate base on a 13-month average.

13-Month Average Rate Base

Q. What activity is included in Staff's 13-month rate base average?

A. Staff's 13-month average rate base is calculated by averaging the monthly balances from July 31, 2003 through July 31, 2004 for Plant in Service, Customer Advances, and Contributions in Aid of Construction. Except for CWTP, post-test year activity through December 31, 2004 (Exhibit No. 8) is treated as if it occurred in the last month of the test year or as of July 31, 2004. As a result, that activity has a weighting of one-thirteenth (1/13) in the 13-month average.

Q. What other components of this case are affected by the 13-month average of Plant in Service related accounts?

A. Depreciation Expense, Accumulated Depreciation and Amortizations, and Accumulated Deferred Federal Income Taxes.

Q. How does this 13-month average compare to the amounts contained in the Company's accounting records for July 31, 2004?

A. The 13-month average increases July 31, 2004 Utility Plant in Service by $18,038,678 (Exhibit No. 112, Column H), decreases Customer Advances by $195,891 (Exhibit No. 114, Column G, Line 17), decreases Contributions in Aid of Construction by $1,467,382 (Exhibit No. 115, Line 13), and increases Accumulated Depreciation and Amortizations by $1,843,624 (Exhibit No. 113, Column G, Line 19). Staff's proposed Depreciation Expense is $490,539 (Exhibit No. 116, Page 1, Line 6) lower than that proposed by the Company in Witness Healy's Adjustment No. 37.

Q. How does the revenue requirement on a 13-Month Average Rate Base compare to the revenue requirement prepared by the Company through May 31, 2005?

A. The 13-Month Average Rate Base proposed by Staff (Exhibit No. 111, Column C) is approximately $12 million lower than the May 31, 2005 Rate Base filed by the Company. Solely due to the difference in rate base and the related Depreciation Expense, Staff's revenue requirement is approximately $2 million lower than the Company's.

Columbia Water Treatment Plant Adjustments

Q. What adjustments are proposed to CWTP?

A. Exhibit 111, Column D eliminates costs associated with CWTP land and building costs that Staff witness Sterling determined as not used and useful for the current operation of the plant.

As discussed in his testimony Staff witness Sterling determined that approximately 25% of the land and approximately 15% of the building associated with CWTP is for future use and therefore should not earn a return. This adjustment reduces Plant in Service by $533,084 (Exhibit No. 111, Column D).

Q. Does Staff propose to remove Depreciation Expense and Accumulated Depreciation associated with the building Plant Held for Future Use?

A. No. In Case No. UWI-W-97-6 the Commission denied the Company a return on the Boise River Intake (BRI) project that was not used and useful. However, the expense allowance associated with BRI was approved to provide for the recovery of the Company's investment. Order Number 27690.

Q. Should the Company earn Allowance for Funds Used During Construction (AFUDC) until the land and building become used and useful?

A. No, it is not under construction and should not earn a return as if it were used and useful or as if it were under construction. In Case No. UWI-W-97-6 the Company requested that the Commission permit continued accrual of AFUDC on BRI. The Commission in that case did not grant continued accrual of AFUDC. Order No. 27690. The same treatment is appropriate in this case. In the alternative, the full amount could be left in Plant Held for Future Use. When the plant is used and useful it would be rate based at that time with the depreciation also starting at the same time. Staff believes its recommended treatment is preferable.

Q. What other adjustment is proposed to CWTP?

A. Staff proposes that costs associated with a cancelled purchase order be removed from the Company's rate base. In December 2002 the Company was billed and accrued costs for a portion of CWTP's membrane system. In August 2003 the purchase order associated with this transaction was terminated. In February 2004 and October 2004 credits were posted to the CWTP project which removed the financial effect of the transaction except the Allowance for Funds Used During Construction (AFUDC) that accrued during the time period before funds were received and/or written off associated with this transaction. Staff adjustment (Exhibit No. 111, Column E) removes $258,772 AFUDC from Plant in Service and the related Depreciation Expense and Accumulated Depreciation of $12,939.

Q. Are there any other adjustments related to CWTP's membrane filtration system?

A. Yes. Staff proposes that the Commission order the Company to depreciate the CWTP membrane filters over a 10-year life (10% depreciation rate). The Company in this case has proposed depreciating the membrane filters over a 7-year life (14% depreciation rate). When Staff toured the CWTP facility the CDM representative with extensive membrane filtration experience stated that the membrane filters are lasting 10 years in many plants. Given that information, Staff has proposed reducing Depreciation Expense and Related Accumulated Depreciation by $20,000 (Exhibit No. 111, Column F).

Water Rights

Q. Does Staff propose any adjustments related to water rights?

A. Yes. Staff proposes to adjust water rights to remove costs not used and useful. Staff witness Sterling's testimony discusses this in detail. The reductions in rate base are $677,452 for the Initial Butte water right, $644,700 for the Integrated Municipal

Application Package and $29,697 for a Ground Water Recharge Permit (Exhibit No. 111, Columns G through I).

Staff witness Stockton proposes removing AFUDC from the costs of water right projects because the nature of water rights does not justify accrual of AFUDC.

Q. Are there any other adjustments associated with Allowance for Funds Used During Construction?

A. Yes. Staff witness Stockton proposes removing a portion of the AFUDC the Company accrues for an equity tax gross up. This adjustment reduces Plant in Service by $684,962, Depreciation Expense by $13,482 and Accumulated Depreciation by $7,067 (Exhibit No. 111, Column J).

Taxes

Q. Does Staff propose any adjustments related to taxes?

A. Yes. Staff witness Stockton calculated the effect of Staff's proposed 13-Month Average Rate Base to Accumulated Deferred Federal Income Taxes (ADFIT). The adjustment (Exhibit No. 111, Col. B, Line 7) increases ADFIT by $3,377,279.

Staff witness Stockton also proposes an adjustment to include the effect of a production tax credit related to the Jobs Creation Act of 2004. Staff witness Stockton discusses in further detail this adjustment reducing Federal Income Taxes by $87,501 (Exhibit No. 111, Column K).

Staff witness Stockton also increased Federal Income Taxes by $444,429 and decreased State Income Taxes by $96,162 due to the debt interest associated with the rate base adjustments proposed by Staff (Exhibit No. 111, Column O). Staff witness Stockton's testimony describes the need for these adjustments.

Q. Does Staff witness Stockton propose any other adjustments?

A. Yes. Staff witness Stockton decreased Operating Expenses by $20,678 to remove the non-regulated portion of M&S (United Water Management and Services) Fees (Exhibit No. 111, Column L).

Staff witness Stockton also incorporated into this case $5,628 (Exhibit No. 111, Column M) in revenue resulting from the sale of the Carriage Hill non-contiguous water system (Case No. UWI-W-04-3).

Operating Expense Adjustments and Deferred Debits

Q. Please describe the entries in Exhibit No. 111, Column N.

A. These entries summarize adjustments prepared by Staff witness English and Staff witness Sterling and are described in detail in the respective testimony.

Q. Are there any other items that Staff needs further information from the Company?

A. Yes. Staff has requested documentation associated with the accounting software upgrade that started processing financial data of the Company on October 1, 2004. The Company has included approximately $1,200,000 in rate base costs associated with this program on its Exhibit No. 8. These costs are allocated from the Company's Corporate Office. While Staff has received a general overview of how these costs are allocated to UWI and has been provided the Capital Expenditure Authorizations that were approved by the Company in March 2005, no detailed allocation spreadsheets have been provided. Staff has not proposed an adjustment in this case related to this cost because the software program is in place and operating. However, Staff has been unable to verify the allocation of these costs and therefore cannot verify the actual amounts included in rate base until the additional documentation is received.

Q. Does this conclude your direct testimony in this proceeding?

A. Yes, it does.