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BEFORE THE ARIZONA CORPORA.

COMMISSIONERS

MARC SPITZER - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF AJO
IMPROVEMENT COMPANY FOR RATE
ADJUSTMENTS IN ITS WATER AND
WASTEWATER RATES.

DOCKET NO. WS-01025A-03-0350

STAFF'S NOTICE OF FILING
DIRECT TESTIMONY

Staff of the Arizona Corporation Commission hereby files the Direct Testimony of Crystal S. Brown of the Utilities Division and John A. Chelus of the Engineering Division in the above-referenced matter.

RESPECTFULLY SUBMITTED this 9th day of January 2004.

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Arizona Corporation Commission

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**DIRECT
TESTIMONY**

OF

**CRYSTAL S. BROWN
JOHN A. CHELUS**

DOCKET NO. WS-0125A-03-0350

**IN THE MATTER OF THE APPLICATION OF
AJO IMPROVEMENT COMPANY FOR RATE
ADJUSTMENTS IN ITS WATER AND
WASTEWATER RATES**

JANUARY 9, 2004

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BROWN

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF)
AJO IMPROVEMENT COMPANY FOR)
RATE ADJUSTMENTS IN ITS WATER AND)
WASTEWATER RATES)
_____)

DOCKET NO. SW-01025A-03-0350

DIRECT
TESTIMONY
OF
CRYSTAL S. BROWN
PUBLIC UTILITIES ANALYST V
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

JANUARY 9, 2004

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**EXECUTIVE SUMMARY
AJO IMPROVEMENT COMPANY
WATER AND WASTEWATER DEPARTMENTS
DOCKET NO. SW-01025A-03-0350**

Ajo Improvement Company ("Ajo" or "Company") is a certificated Arizona based company that provides electric, water and wastewater public service to approximately 1,076 water and 1,089 wastewater customers in and around the unincorporated community of Ajo, in Pima County, Arizona. Ajo is a wholly owned subsidiary of Phelps Dodge Corporation.

On May 28, 2003, Ajo filed an application for a permanent rate increase for its Water and Wastewater Departments. The Company states that it incurred operating losses of \$54,930 for the Water Department and \$68,533 for the Wastewater Department during the Test Year.

For the Water Department, the Company proposes revenues of \$752,769 that provide a 10 percent rate of return on the Water Department's \$92,745 rate base. For the Wastewater Department, the Company proposes revenues of \$251,823 that provide a 10 percent rate of return on the Wastewater Department's \$217,822 rate base.

For the Water Department, Staff recommends a \$68,833, or 10.73 percent, revenue increase from \$641,644 to \$710,477. Staff's proposed revenue increase would produce an operating income of \$10,187 for an 8.8 percent rate of return on an original cost rate base of \$115,786. Staff's recommended rates would decrease the typical residential bill with a median usage of 4,275 gallons, from \$19.86 to \$19.33, for a decrease of \$0.53 or 2.7 percent.

For the Wastewater Department, Staff recommends a \$135,071, or 141.43 percent, revenue increase from \$95,505 to \$230,576. Staff's proposed revenue increase would produce an operating income of \$19,291 for an 8.8 percent rate of return on an original cost rate base of \$219,254. Staff's recommended rates would increase the typical residential bill from \$6.08 to \$15.65, for an increase of \$9.57 or 157.4 percent.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Crystal S. Brown. I am a Public Utilities Analyst V employed by the Arizona
4 Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff").
5 My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Briefly describe your responsibilities as a Public Utilities Analyst V.**

8 A. I am responsible for the examination and verification of financial and statistical
9 information included in utility rate applications. In addition, I develop revenue
10 requirements, prepare written reports, testimonies, and schedules that include Staff
11 recommendations to the Commission. I am also responsible for testifying at formal
12 hearings on these matters.

13
14 **Q. Please describe your educational background and professional experience.**

15 A. I received a Bachelor of Science Degree in Business Administration from the University
16 of Arizona and a Bachelor of Science Degree in Accounting from Arizona State
17 University. After successfully meeting the prescribed requirements established by the
18 Institute of Internal Auditors, I was awarded the professional designation of Certified
19 Internal Auditor ("CIA").

20
21 Since joining the Commission, I have participated in numerous rate cases and other
22 regulatory proceedings involving large electric, gas, telecommunications, and water
23 utilities. I have testified on matters involving regulatory accounting and auditing. During
24 the past six years, I have attended utility-related seminars on regulation, accounting,
25 finance and income taxes designed to provide continuing and updated education in these
26 areas. Various professional and industry organizations sponsored these seminars.

1 I have been employed by the Commission as a regulatory auditor and a rate analyst since
2 August 1996. Prior to joining the Commission, I was employed by the Department of
3 Revenue as a Senior Internal Auditor and by the Office of the Auditor General as a
4 Financial Auditor. I was a Cost Center Review Specialist for Blue Cross Blue Shield of
5 Arizona prior to my employment in state government.
6

7 **Q. What is the scope of your testimony in this case?**

8 A. I am presenting Staff's analysis and recommendations regarding Ajo Improvement
9 Company's ("Ajo" or "Company") application for a permanent rate increase in the areas
10 of rate base, operating income, revenue requirement, rate design and cost of capital. Staff
11 witness John Chelus is presenting Staff's engineering analysis and recommendations.
12

13 **Q. What is the basis of your recommendations?**

14 A. I performed a regulatory audit of the financial statements that were filed in support of
15 Ajo's application to determine whether sufficient, relevant, and reliable evidence exists to
16 support the Company's requested rate increase. The regulatory audit consisted of
17 examining and testing the financial information, accounting records, and other supporting
18 documentation and verifying that the accounting principles applied were in accordance
19 with the Commission adopted National Association of Regulatory Utility Commissioners
20 ("NARUC") Uniform System of Accounts ("USOA").
21

22 **BACKGROUND**

23 **Q. Please review the background of this application.**

24 A. Ajo is a certificated Arizona-based company that provides electric, water, and wastewater
25 public service in and around the unincorporated community of Ajo, in Pima County,
26 Arizona. The Company served approximately 1,030 electric customers, 1,076 water

1 customers, and 1,089 sewer customers during the Test Year. Ajo is a wholly owned
2 subsidiary of Phelps Dodge Corporation.

3
4 On May 28, 2003, Ajo filed an application for a permanent rate increase for its Water and
5 Wastewater Departments. On June 30, 2003, Ajo filed amendments to its application. On
6 July 14, 2003, Staff filed a letter declaring the application sufficient.

7
8 **CONSUMER SERVICE**

9 **Q. Please provide a brief history of customer complaints received by the Commission**
10 **regarding Ajo. Also, please discuss customer responses to Ajo's proposed rate**
11 **increase.**

12 A. Staff reviewed the Commission's records and found no formal complaints since 2001.
13 One opinion not in favor of the proposed rate increase was received.

14
15 **ORDER OF TESTIMONY**

16 **Q. Briefly summarize how your testimony is organized.**

17 A. My testimony is organized to present my analysis, recommendations, and supporting
18 schedules for the cost of capital, Water and Wastewater Departments separately.

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COST OF CAPITAL

1 **COST OF CAPITAL**

2
3 **What is Staff's recommended rate of return ("ROR") in this case?**

4 A. Staff recommends an 8.8 percent ROR. Staff's recommended ROR is shown in the
5 following table:

6 **Table 1**

	Weight	Cost	Weighted Cost
Long-term Debt	19.9%	10.0%	1.99%
Common Equity	80.1%	8.5%	6.81%
ROR			8.8%

7
8 Staff's recommended ROR is based on the Company's December 31, 2002, capital
9 structure which consisted of 19.9 percent long-term debt and 80.1 percent equity. The
10 Company's cost of debt is 10.0 percent and Staff recommends an 8.5 percent return on
11 equity ("ROE")

12
13 **Q. What is the basis of Staff's ROE recommendation?**

14 A. Staff's ROE recommendation is based on the recent cost of equity analysis and
15 recommendation made by Staff in Docket No. WS-01303A-02-0867¹ et al. ("Arizona-
16 American case"), a rate case currently pending before the Commission. According to
17 Staff's market-based analysis in that case, the average cost of equity to a water/wastewater
18 utility is 8.5 percent.²

19
20
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¹ Application of Arizona-American Water Company for a rate increase.

² See surrebuttal testimony of Joel M. Reiker, dated October 31, 2003, in Docket No WS-01303A-02-0867 et al.

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WATER DEPARTMENT

1 **WATER DEPARTMENT**

2 **Q. Please review the background of the Water Department.**

3 A. Ajo's Water Department provides service to approximately 1,076 customers in Pima
4 County, Arizona. Its current rates were approved in Decision No. 54709, dated October
5 10, 1985. That order authorized an operating income of \$100,500 to provide a 6.5 percent
6 rate of return on a \$1,544,880 rate base.

7
8 **Q. What are the primary reasons stated by the Company for requesting a permanent
9 rate increase for the Water Department?**

10 A. The Company's application states that it has not requested a rate increase for the Water
11 Department in approximately 19 years. Additionally, it states that it has incurred an
12 operating loss of \$54,930 for the Water Department resulting in no rate of return on the
13 Department's \$92,745 rate base during the Test Year.

14
15 **SUMMARY OF PROPOSED REVENUES – WATER DEPARTMENT**

16 **Q. Please summarize the Company's filing for the Water Department.**

17 A. The Company proposes rates that produce operating revenue of \$752,769 and operating
18 income of \$9,275 for a 10.0 percent rate of return on an original cost rate base of \$92,745.
19 The Company's proposal would increase annual operating revenues by \$111,125 (or 17.32
20 percent) over Test Year revenues.

21
22 **Q. Please summarize Staff's recommended revenue.**

23 A. Staff recommends total annual operating revenue of \$710,477 and operating income of
24 \$10,187 for an 8.8 percent rate return on an original cost rate base of \$115,786. This
25 revenue amount represents an increase of \$68,833, or 10.73 percent, over Test Year
26 revenues.

1 **Q. Please summarize the rate base and operating income recommendations and**
2 **adjustments addressed in your testimony for the Water Department.**

3 A. My testimony addresses the following issues:

4
5 Meters – This adjustment increases Meters by \$35,827.

6
7 Office Furniture and Equipment – This adjustment increases Office Furniture and
8 Equipment by \$2,000.

9
10 Accumulated Depreciation – This adjustment increases Accumulated Depreciation by
11 \$14,218.

12
13 Working Capital – This adjustment decreases Working Capital by \$568.

14
15 Salaries and Wage Expense – This adjustment decreases Salaries and Wage Expense by
16 \$282.

17
18 Pensions and Benefits – This adjustment decreases Pensions and Benefits by \$187.

19
20 Outside Services, Legal and Consulting – This adjustment decreases Outside Services
21 Expense by \$2,074.

22
23 General and Administrative – This adjustment decreases General and Administrative
24 Expense by \$2,000.

25
26 Depreciation Expense – This adjustment decreases Depreciation Expense by \$29,405.

1 Property Tax Expense – This adjustment increases Property Tax Expense by \$153.

2

3 Income Tax Expense – This adjustment increases Income Tax Expense by \$22,939.

4

5 **RATE BASE - WATER DEPARTMENT**

6

7 **Fair Value Rate Base**

8 **Q. Has the Company prepared a Schedule showing the elements of Reconstruction Cost**
9 **New Rate Base (“RCND”)?**

10 A. No. The Company requested to waive the RCND schedule filing requirement. Therefore,
11 Staff evaluated the original cost rate base as the fair value rate base (“FVRB”).

12

13 **Rate Base Summary – Water Department**

14 **Q. Please summarize Staff’s adjustments to the Water Department’s rate base shown on**
15 **Schedule CSB-3.**

16 A. Staff’s adjustments to the Water Department’s rate base resulted in a net increase of
17 \$23,041, from \$92,745 to \$115,786. This increase was primarily due to Staff capitalizing
18 plant costs that the Company had expensed.

19

20 **Rate Base Adjustment 1 – Water Department, Meters**

21 **Q. What is Ajo proposing for Meters?**

22 A. Ajo is proposing \$25,265 for Meters. The Company also proposes a separate \$2,403 pro
23 forma adjustment to capitalize meters that were expensed during the Test Year.

24

1 **Q. During Staff's review of the Meters account, Staff found that the Company had**
2 **expensed additional used and useful meters. Should used and useful plant be**
3 **expensed?**

4 **A.** Plant that is used and useful in the provision of service should be capitalized by recording
5 the cost in the appropriate plant account and depreciating the cost over the useful life of
6 the plant asset in accordance to the NARUC USOA.

7
8 Staff found that the Company improperly expensed over 600 meters costing \$38,230
9 during the period of 1993 to 2002. Staff added \$38,230 in meters and removed the
10 Company's \$2,403 pro forma adjustment to capitalize meters expensed during the Test
11 Year as the pro forma adjustment did not agree to the actual cost of meters expensed
12 during the Test Year.³

13
14 **Q. What adjustment is Staff recommending?**

15 **A.** Staff recommends increasing the Meters account by \$38,230, from \$25,265 to \$63,495
16 and removing the Company proposed \$2,403 pro forma adjustment as shown on
17 Schedules CSB-4 and CSB-5.

18
19 **Rate Base Adjustment 2 – Water Department, Computer Software**

20 **Q. What is Ajo proposing for Office Furniture and Equipment?**

21 **A.** Ajo is proposing \$1,348 for Office Furniture and Equipment.
22
23
24

³ Data request response CSB 4-6

1 **Q. During Staff's review of Operating Expenses, Staff found that the Company**
2 **expensed computer software. Should the computer software be expensed?**

3 A. The \$2,000 in software costs⁴ (the Water Department's allocated portion of the total
4 \$6,000 software cost) should have been capitalized. Plant that is used and useful in the
5 provision of service should be capitalized by recording the cost in the appropriate plant
6 account and depreciating the cost over the useful life of the plant asset in accordance to
7 the NARUC USOA. Thus, reclassification of the software costs from General and
8 Administrative Expense to Office Furniture and Equipment is appropriate.

9
10 **Q. What is Staff recommending?**

11 A. Staff recommends increasing Office Furniture and Equipment by \$2,000, from \$1,348 to
12 \$3,348 as shown on Schedules CSB-4 and CSB-6. This cost is removed from expense in
13 Operating Income Adjustment No. 4.

14
15 **Q. Did anything else come to your attention while performing the audit of plant in**
16 **service?**

17 A. Staff noted that the Company employed a capitalization policy⁵ that was not consistent
18 with the NARUC Uniform System of Accounts during the 2002 test year. That policy
19 required items costing less than \$5,000 to be expensed. A review of the meters and
20 services (assets costing less than \$5,000) for the Water Department showed no additions
21 or retirements to these accounts since 1981, over 20 years.

22
23 The Company's capitalization policy is not consistent with the matching principle which
24 requires that revenues of an accounting period be matched to the expenses that were used
25 to generate that revenue. It also over-states expenses and under-states plant. Further, the

⁴ Data request response CSB 2-9

⁵ Data request response CSB 1-17

1 Company's capitalization policy is not consistent with the capitalization policy proposed
2 in the NARUC USOA. The breakover point for capitalization versus expensing is \$400
3 for utilities with revenues between \$200,000 and \$1,000,000.

4
5 The same problem was identified during the 1999 rate proceeding for Ajo Improvement
6 Company's Electric Department. The Electric Department expensed meters, services,
7 poles, street lights and other plant items costing under \$5,000. In that case, the
8 Commission adopted the recommendation that Ajo Electric capitalize rather than expense
9 assets costing less than \$5,000 (Decision No. 62764, dated August 2, 2000).

10
11 The Company did not implement the change in its capitalization policy for its Water and
12 Wastewater Departments at the same time it made the required change for the Electric
13 Department. The Company indicated in response to data request CSB 1-17 that it began
14 capitalizing assets less than \$5,000 for the Water Department in 2003. Staff did not
15 review the plant added in 2003 and can make no assertion concerning compliance with the
16 NARUC USOA.

17
18 **Q. What is Staff recommending?**

19 **A.** Staff recommends that the Company continue with its plan to capitalize plant costing less
20 than \$5,000 for both its Water and Wastewater Departments in order to comply with the
21 NARUC USOA

22
23
24
25

1 **Rate Base Adjustment 3 – Water Department, Accumulated Depreciation**

2 **Q. What is Ajo proposing for Accumulated Depreciation?**

3 A. Ajo is proposing \$1,429,092 for Accumulated Depreciation. The amount is composed of
4 the \$1,421,455 Accumulated Depreciation balance recorded at the end of the Test Year
5 and a \$7,637 pro forma adjustment to reflect the restatement based on the depreciation
6 rates used by Litchfield Park in Docket No. W-01427A-01-0487.⁶

7
8 **Q. During Staff's review of Accumulated Depreciation, Staff found that Ajo used
9 depreciation rates that were different than that authorized by the Commission.
10 Should the Company use unauthorized depreciation rates?**

11 A. No. Companies are required to use the depreciation rate(s) authorized by the Commission.
12 In Ajo's last rate case (Decision No. 54709, dated October 10, 1985), the Commission
13 authorized a five percent depreciation rate.

14
15 Decision No. 54709 states that Ajo accepted the Staff report.⁷ The Staff report contained
16 the five percent depreciation rate that was authorized by the Commission. Staff
17 recalculated the 2002 Accumulated Depreciation balance by applying the five percent
18 depreciation rate to the Staff recommended plant balances for the years 1983 to 2002.

19
20 **Q. What is Staff recommending?**

21 A. Staff recommends increasing Accumulated Depreciation by \$14,218, from \$1,429,092 to
22 \$1,443,310 as shown on Schedules CSB-4 and CSB-7.

23
24

⁶ Per Company's response to data request CSB 3-4.

⁷ Page 15, line 24 of Decision No. 54709, dated October 10, 1985

1 **Rate Base Adjustment 4 – Water Department, Working Capital**

2 **Q. What is Ajo proposing for its Working Capital?**

3 A. Ajo is proposing \$42,292 for Working Capital.
4

5 **Q. How did Ajo and Staff calculate Working Capital?**

6 A. The Working Capital was calculated by using the formula method which equals one-
7 eighth of the operating expenses less depreciation, property and income taxes, and
8 purchased water expense, plus one twenty-fourth of purchased water expense. Staff's
9 working capital amount is different from Ajo's because some of Staff's recommended
10 operating expenses are different than the Company's.
11

12 **Q. What is Staff recommending?**

13 A. Staff recommends decreasing Working Capital by \$568, from \$42,292 to \$41,724 as
14 shown on Schedules CSB-4 and CSB-8.
15

16 **OPERATING INCOME – WATER DEPARTMENT**

17
18 **Operating Income Summary – Water Department**

19 **Q. What are the results of Staff's analysis of Test Year revenues, expenses, and
20 operating income?**

21 A. As shown on Schedules CSB-9 and CSB-10 Staff's analysis resulted in Test Year
22 revenues of \$641,644, expenses of \$685,411, and an operating loss of \$43,767.
23
24
25

1 **Operating Income Adjustment No. 1 – Water Department, Salaries and Wages**

2 **Q. What is the Company proposing for Salaries and Wages?**

3 A. The Company is proposing \$29,012 for Salaries and Wages. That amount is composed of
4 \$28,167 of Test Year salary and wage expense and an \$845 pro forma adjustment to
5 reflect annualization of a salary and wage increase at three percent. The increase became
6 effective in July of the Test Year.

7
8 **Q. During Staff's review of Salaries and Wage expense, Staff found that Ajo**
9 **inadvertently used a three percent rather than the actual two percent increase to**
10 **calculate the pro forma adjustment. Did Staff correct the error?**

11 A. Yes. Staff corrected the error by recalculating the annualization adjustment using the two
12 percent increase authorized by Phelps Dodge.

13
14 **Q. What is Staff recommending?**

15 A. Staff recommends decreasing Salary and Wages by \$282, from \$29,012 to \$28,730 as
16 shown on Schedules CSB-10 and CSB-11.

17
18 **Operating Income Adjustment No. 2 – Water Department, Pensions and Benefits Expense**

19 **Q. What is the Company proposing for Pensions and Benefits Expense?**

20 A. The Company is proposing \$19,302 for Pensions and Benefits Expense. That amount is
21 composed of \$18,740 of Test Year 2002 pensions and benefits expense and a \$562 pro
22 forma adjustment to reflect annualization of a pensions and benefits increase at three
23 percent. The increase became effective in July of the Test Year.

24
25

1 **Q. During Staff's review of Pensions and Benefits expense, Staff found that Ajo used a**
2 **three percent rather than the actual two percent increase to calculate the pro forma**
3 **adjustment. Did Staff correct the error?**

4 A. Yes. Staff corrected the error by recalculating the annualization adjustment using the
5 Phelps Dodge authorized two percent increase.

6
7 **Q. What is Staff recommending?**

8 A. Staff recommends decreasing Pensions and Benefits by \$187, from \$19,302 to \$19,115 as
9 shown on Schedules CSB-10 and CSB-12.

10
11 **Operating Income Adjustment No. 3 – Water Department, Outside Services – Legal and**
12 **Consulting**

13 **Q. What is the Company proposing for Outside Services – Legal and Consulting**
14 **Expense?**

15 A. The Company is proposing \$3,153 for Outside Services – Legal and Consulting.

16
17 **Q. During Staff's review of the Outside Services – Legal and Consulting expense, Staff**
18 **found that Ajo had not amortized its computer conversion and training costs.**
19 **Should the computer conversion and training costs be amortized?**

20 A. Yes. The computer conversion and related training costs should be amortized because
21 they benefit multiple years. Costs should be allocated over the period they benefit. Staff
22 amortized the expense over the number of years the conversion and training costs are
23 expected to benefit the Company (i.e., five years).

24
25
26

1 **Q. What is Staff recommending?**

2 A. Staff recommends decreasing Outside Services – Legal and Consulting expense by
3 \$2,074, from \$3,153 to \$1,079 as shown on Schedules CSB-10 and CSB-13.

4
5 **Operating Income Adjustment No. 4 – Water Department, General and Administrative**

6 **Q. What is the Company proposing for General and Administrative Expense?**

7 A. The Company is proposing \$25,400 for General and Administrative.

8
9 **Q. During Staff's review of the General and Administrative expense, Staff found that**
10 **Ajo had expensed computer software costs. Should computer software costs be**
11 **expensed?**

12 A. No. Generally Accepted Accounting Principles ("GAAP") and specifically, Statement of
13 Procedure 98-1 issued by the Financial Accounting Standards Board ("FASB"), indicate
14 that software that is obtained for internal use should be capitalized and amortized over its
15 service life. Thus, reclassification of the software costs from General and Administrative
16 Expense to Office Furniture and Equipment is appropriate.

17
18 **Q. What is Staff recommending?**

19 A. Staff recommends decreasing General and Administrative expense by \$2,000, from
20 \$25,400 to \$23,400 as shown on Schedules CSB-10 and CSB-14.

21
22 **Operating Income Adjustment No. 4 – Water Department, Depreciation Expense**

23 **Q. What is the Company proposing for Depreciation Expense?**

24 A. The Company is proposing \$35,963 for Depreciation Expense.

25

1 **Q. Please explain why Staff's plant balances used in the depreciation expense**
2 **calculation are less than that proposed by the Company.**

3 A. The Company used a depreciation rate that was lower than the Commission authorized
4 depreciation rate, therefore, the plant assets were depreciated at an overall lower rate than
5 authorized, resulting in higher net plant balances (i.e., original cost less depreciation).
6 Also, plant items that should have been fully depreciated over an 18 year period at a five
7 percent depreciation rate were not fully depreciated.

8
9 Staff used the Commission authorized five percent depreciation rate to calculate the
10 depreciation expense on plant from 1983 to 2002. As a result of using the correct
11 depreciation rate, Staff calculated lower net plant balances (i.e. original cost less
12 depreciation) and more fully depreciated plant items. Depreciation expense should not be
13 calculated on fully depreciated plant as this would result in an over-recovery of plant cost.
14 Therefore, Staff calculated depreciation expense by removing fully depreciated plant and
15 applying Staff's recommended depreciation rates to Staff's recommended plant account
16 balances.

17
18 **Q. What is Staff recommending?**

19 A. Staff recommends decreasing Depreciation Expense by \$29,405, from \$35,963 to \$6,558
20 as shown on Schedules CSB-10 and CSB-15.

21
22 **Operating Income Adjustment No. 5 – Water Department, Property Tax Expense**

23 **Q. What is the Company proposing for Property Tax Expense?**

24 A. The Company is proposing \$39,382 for Property Tax Expense.
25

1 **Q. Please discuss the primary difference between Staff's and the Company's property**
2 **tax formula.**

3 A. The Department of Revenue's property tax calculation is based on a three-year average of
4 revenue. There is a two-year lag between the year of billing and the most recent of the
5 years included in the average. For example, a property tax bill issued in August 2002 will
6 be based on revenues for the years 1998, 1999, and 2000.

7
8 The Company calculates the three year average of revenue by adding the 2000, 2001, and
9 2002 revenues and dividing the sum by three. Staff's methodology calculates the three
10 year average of revenue by adding twice the 2002 Revenue to the Staff Proposed Revenue
11 then dividing the sum by three. Staff's pro forma adjustment to include Staff
12 recommended revenue in the three-year average of revenue provides a better
13 normalization of property tax expense.

14
15 The reason is that the Company's property tax expense will increase in future years if its
16 revenues increase as the result of a rate increase. However, there is a two-year lag
17 between the year of a rate increase and the year the increase is reflected in property tax
18 expense. Staff's method of calculating property tax expense is normalized to recognize
19 that it is revenue dependent.

20
21 **Q. What is Staff recommending?**

22 A. Staff recommends increasing Property Tax Expense by \$153, from \$39,382 to \$39,229 as
23 shown on Schedules CSB-10 and CSB-16.

24
25

1 **Operating Income Adjustment No. 6 – Water Department, Income Tax Expense**

2 **Q. What is the Company proposing for Income Tax Expense?**

3 A. The Company is proposing a negative \$35,731 for Income Tax Expense.

4

5 **Q. Would you please discuss the primary differences between Staff's and the**
6 **Company's income tax expense?**

7 A. The primary differences between the Company's and Staff's income tax expenses are due
8 to the amount of operating loss and the formula used. Staff's formula applies the statutory
9 rates to the operating loss as shown on Schedule CSB-17. The Company's formula
10 applies a 38.598 percent tax rate to its entire taxable loss amount.

11

12 **Q. What is Staff recommending?**

13 A. Staff recommends increasing Test Year Income Tax Expense by \$22,939, from (\$35,731)
14 to (\$12,792) as shown on Schedules CSB-10 and CSB-17.

15

16 **RATE DESIGN – WATER DEPARTMENT**

17

18 **Q. Have you prepared a schedule summarizing the present, Company proposed, and**
19 **Staff's recommended rates and service charges?**

20 A. Yes. Schedule CSB-18 provides a summary of the Company's present, Company's
21 proposed, and Staff's recommended rates.

22

23 **Q. Please summarize the present rate design.**

24 A. The present monthly customer charges vary by meter size as follows: 5/8-3/4 inch \$9.00;
25 1-inch, \$15.00; 1 1/2 -inch, \$25.00; 2-inch, \$50.00; 3-inch, \$100; 4-inch, \$200; and 6-inch,

1 \$300. No gallons are included in the customer charge. The present commodity rate is
2 \$2.54 per 1,000 gallons for treated water and \$1.75 per 1,000 gallons for untreated water.

3

4 **Q. Please summarize the Company's proposed rate design.**

5 A. The Company's proposed monthly customer charges are as follows: 5/8-3/4 inch \$9.25; 1-
6 inch, \$15.75; 1 1/2 -inch, \$26.25; 2-inch, \$52.50; 3-inch, \$105; 4-inch, \$210; and 6-inch,
7 \$300. No gallons are included in the customer charge. The proposed commodity rate is
8 \$3.14 per 1,000 gallons for treated water and \$1.85 per 1,000 gallons for untreated water.
9 Additionally, the Company proposed new service related charges and increases to existing
10 service related charges.

11

12 **Q. Please summarize Staff's recommended rate design.**

13 A. As shown on Schedule CSB-18, Staff recommends an inverted tier rate structure to
14 encourage efficient water use. The rate structure is based on the usage of customers on
15 various meter sizes for treated and untreated water. Staff recommends rates and charges
16 for meter sizes that the Company currently does not have. Additionally, Staff
17 recommends new service related charges and increases to existing service related charges.

18

19 **Q. The Typical Bill Analysis (Schedule CSB-19, page 1 of 10) shows that a customer
20 with a 5/8" x 3/4" meter would experience a decrease in his/her monthly bill for use
21 between 2,000 and 5,000 gallons under Staff's recommended rates. Please explain
22 why this occurs.**

23 A. The current monthly customer charge is \$9.00. Staff's recommended monthly customer
24 charge is \$9.85. Therefore, a customer with no consumption would experience an \$0.85
25 increase.

26

1 The currently commodity rate is \$2.54 per 1,000 gallons for all usage. Staff recommends
2 an inverted three tier rate structure where cost increases with usage as shown on Schedule
3 CSB-18.

4
5 The rates per 1,000 gallons for the first, second and third tiers are \$1.93, \$2.90, and \$3.47,
6 respectively. Since Staff's recommended first tier rate is \$0.61 per thousand gallons less
7 than the current commodity rate, the commodity savings exceeds the \$0.85 increase in the
8 monthly customer charge when consumption reaches 2,000 gallons. That is, two times
9 \$0.61 is greater than \$0.85. This \$0.61 savings per 1,000 gallons continues for use
10 through 3,000 gallons.

11
12 Under Staff's recommended rates, a customer's bill for 3,000 gallons of use would be
13 \$0.98 less than under current rates. Although Staff's recommended second tier rate (i.e.
14 \$2.90, which begins with 3,001 gallons of use) exceeds the current commodity rate by
15 \$0.36, a customer's total bill will not exceed the current bill until the accumulation of the
16 \$0.36 incremental cost per 1,000 gallons exceeds the \$0.98 deficit that occurred at the
17 3,000 gallon use level. This occurs at 6,000 gallons. The tables below show detailed
18 billings under present and Staff recommended rates for 5,000 through 7,000 gallons of
19 use.

20
21
22
23
24
25
26

1

Company Present Rates

	5,000 Gallons	6,000 Gallons	7,000 Gallons
Monthly Customer Charge	\$ 9.00	\$ 9.00	\$ 9.00
Commodity Rate (\$2.54 for 0 to 3,000 gallons)	\$ 7.62	\$ 7.62	\$ 7.62
Commodity Rate (\$2.54 for 3,001 to 14,000 gallons)	\$ 5.08	\$ 7.62	\$10.16
Total Bill	\$21.70	\$24.24	\$26.78

2

3

Staff's Recommended Rates

	5,000 Gallons	6,000 Gallons	7,000 Gallons
Monthly Customer Charge	\$ 9.85	\$ 9.85	\$ 9.85
Commodity Rate (\$1.93 for 0 to 3,000 gallons)	\$ 5.79	\$ 5.79	\$ 5.79
Commodity Rate (\$2.90 for 3,001 to 14,000 gallons)	\$ 5.80	\$ 8.70	\$11.60
Total Bill	\$21.44	\$24.34	\$27.24

4

5

6

7

8

9

10

11

12

13

Q. Does the revenue generated by Staff's recommended rates result in an overall increase to the 5/8" x 3/4" meter customer class?

A. Yes. Staff's recommended average commodity rate is \$2.56⁸ per thousand gallons compared to the present rate of \$2.54 per thousand gallons. Applying Staff's recommended rates to the Test Year billing determinant data for the 5/8" x 3/4" meter customer class results in an overall increase to that class. Thus, while a 5/8" x 3/4" meter customer with median use would experience a small decrease in his/her bill, the overall billings to the 5/8" x 3/4" meter customers would increase.

⁸ Average commodity rate = (Staff recommended commodity revenue / gallons sold) = \$195,713 / 76,499 = \$2.56.

Ajo Improvement Company - Water Department
 Docket No. WS-01025A-03-0350
 Test Year Ended December 31, 2002

Schedule CSB-1

REVENUE REQUIREMENT

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY ORIGINAL COST</u>	<u>[B] STAFF ORIGINAL COST</u>
1	Adjusted Rate Base	\$ 92,745	\$ 115,786
2	Adjusted Operating Income (Loss)	\$ (54,930)	\$ (43,767)
3	Current Rate of Return (L2 / L1)	-59.23%	-37.80%
4	Required Rate of Return	10.00%	8.80%
5	Required Operating Income (L4 * L1)	\$ 9,275	\$ 10,187
6	Operating Income Deficiency (L5 - L2)	\$ 64,205	\$ 53,955
7	Gross Revenue Conversion Factor	1.73080	1.27575
8	Increase In Gross Revenue (L7 * L6)	\$ 111,125	\$ 68,833
9	Adjusted Test Year Revenue	\$ 641,644	\$ 641,644
10	Proposed Annual Revenue (L8 + L9)	\$ 752,769	\$ 710,477
11	Required Increase in Revenue (%) (L8/L9)	17.32%	10.73%

References:

Column [A]: Company Schedules A-1, C-1, C-3 & D-1

Column [B]: Staff Schedules CSB-2, CSB-3, & CSB-9

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<i>Calculation of Gross Revenue Conversion Factor:</i>					
1	Billings	1.000000			
2	Uncollectible Factor	0.000000			
3	Revenues	1.000000			
4	Less: Combined Federal and State Tax Rate (Line 12)	0.216148			
5	Subtotal (L3 - L4)	0.7839			
6	Revenue Conversion Factor (L1 / L5)	1.27575			
 <i>Calculation of Effective Tax Rate:</i>					
7	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
8	Arizona State Income Tax Rate	6.9680%			
9	Federal Taxable Income (L7 - L8)	93.0320%			
10	Applicable Federal Income Tax Rate (Line 34)	15.7438%			
11	Effective Federal Income Tax Rate (L9 x L10)	14.6468%			
12	Combined Federal and State Income Tax Rate (L8 +L11)	21.6148%			
13	Required Operating Income (Schedule CSB-1, Line 5)	\$ 10,187			
14	Adjusted Test Year Operating Income (Loss) (Schedule CSB-10, Line 16)	\$ (43,767)			
15	Required Increase in Operating Income (L13 - L14)		\$ 53,955		
16	Income Taxes on Recommended Revenue (Col. (D), L33)	\$ 2,086			
17	Income Taxes on Test Year Revenue (Col. (B), L33)	\$ (12,792)			
18	Required Increase in Revenue to Provide for Income Taxes (L16 -L17)		\$ 14,878		
19	Total Required Increase in Revenue (L15 + L18)		\$ 68,833		
<i>Calculation of Income Tax:</i>					
		<u>Test Year</u>		<u>Staff Proposed</u>	
20	Revenue (Schedule CSB-9, Columns C and E)	\$ 641,644		\$ 710,477	
21	Less: Operating Expenses Excluding Income Taxes	\$ 698,204		\$ 698,204	
22	Less: Synchronized Interest (L37)	\$ 2,305		\$ 2,305	
23	Arizona Taxable Income (L20 - L21 - L22)	\$ (58,865)		\$ 9,968	
24	Arizona State Income Tax Rate	6.968%		6.968%	
25	Arizona Income Tax (L23 x L24)		\$ (4,102)		\$ 695
26	Federal Taxable Income (L23 - L25)	\$ (54,763)		\$ 9,274	
27	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ (7,500)		\$ 1,391	
28	Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25%	\$ (1,191)		\$ -	
29	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -		\$ -	
30	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -		\$ -	
31	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -		\$ -	
32	Total Federal Income Tax		\$ (8,691)		\$ 1,391
33	Combined Federal and State Income Tax (L25 + L32)		\$ (12,792)		\$ 2,086
34	Applicable Federal Income Tax Rate [Col. (D), L32 - Col. (B), L32] / [Col. (C), L26 - Col. (A), L26]				15.7438%
 <i>Calculation of Interest Synchronization:</i>					
35	Rate Base (Schedule CSB-3, Col. (C), Line 13)	\$ 115,786			
36	Weighted Average Cost of Debt	1.99%			
37	Synchronized Interest (L35 x L37)	\$ 2,305			

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS REF	(C) STAFF AS ADJUSTED
1	\$ 1,479,545	\$ 37,827	\$ 1,517,372
2	(1,429,092)	(14,218)	(1,443,310)
3	<u>\$ 50,453</u>	<u>\$ 23,609</u>	<u>\$ 74,062</u>
<u>LESS:</u>			
4	\$ -	\$ -	\$ -
5	\$ -	\$ -	\$ -
6	\$ -	\$ -	\$ -
7	-	-	-
8	<u>-</u>	<u>-</u>	<u>-</u>
9	\$ -	\$ -	\$ -
10	\$ -	\$ -	\$ -
11	\$ -	\$ -	\$ -
<u>ADD:</u>			
12	\$ 42,292	\$ (568)	\$ 41,724
13	<u>\$ 92,745</u>	<u>\$ 23,041</u>	<u>\$ 115,786</u>

References:

Column [A], Company Schedule B-1, Page 1;
Column [B]: Schedule CSB-4
Column [C]: Column [A] + Column [B]

SUMMARY OF RATE BASE ADJUSTMENTS

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] ADJ No.1	[C] ADJ No.2	[D] ADJ No.3	[E] ADJ No.4	[F] ADJ No.5	[I] STAFF ADJUSTED
PLANT IN SERVICE:								
1	Intangible Plant	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2	Wells	-	-	-	-	-	-	-
3	Pumping Plant	-	-	-	-	-	-	-
4	Water Treatment Plant	644,369	-	-	-	-	-	644,369
5	Storage Tanks	194,594	-	-	-	-	-	194,594
6	Transmission and Distribution Mains	487,756	-	-	-	-	-	487,756
7	Services	72,768	-	-	-	-	-	72,768
8	Meters	25,265	38,230	-	-	-	-	63,495
9	Hydrants	23,555	-	-	-	-	-	23,555
10	General Plant	-	-	-	-	-	-	-
11	Office Furniture and Equipment	1,348	-	2,000	-	-	-	3,348
12	Transportation Equipment	27,487	-	-	-	-	-	27,487
13	Total Plant in Service - Actual	1,477,142	38,230	2,000	-	-	-	1,517,372
14	Pro-forma Adjustment, 2002 Meters	2,403	(2,403)	-	-	-	-	-
15	Total Plant in Service - Adjusted	\$ 1,479,545	\$ 35,827	\$ 2,000	\$ -	\$ -	\$ -	\$ 1,517,372
16	Less: Accumulated Depreciation - Actual	\$ (1,421,455)	-	-	(21,855)	-	-	(1,443,310)
17	Less: Accumulated Depreciation - Pro Forma	(7,637)	-	-	7,637	-	-	-
18	Total Accumulated Depreciation - Adjusted	\$ (1,429,092)	\$ -	\$ -	\$ (14,218)	\$ -	\$ -	\$ (1,443,310)
19	Net Plant in Service	\$ 50,453	\$ 35,827	\$ 2,000	\$ (14,218)	\$ -	\$ -	\$ 74,062
LESS:								
20	Advances in Aid of Construction (AIAC)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
21	Service Line and Meter Advances	-	-	-	-	-	-	-
22	Contributions in Aid of Construction (CIAC)	-	-	-	-	-	-	-
23	Less: Accumulated Amortization	-	-	-	-	-	-	-
24	Net CIAC	-	-	-	-	-	-	-
25	Total Advances and Contributions	-	-	-	-	-	-	-
26	Customer Deposits	-	-	-	-	-	-	-
27	Deferred Income Tax Credits	-	-	-	-	-	-	-
ADD:								
28	Working Capital Allowance	42,292	-	-	-	(568)	-	41,724
29	Other Additions	-	-	-	-	-	-	-
30	Total Rate Base	\$ 92,745	\$ 35,827	\$ 2,000	\$ (14,218)	\$ (568)	\$ -	\$ 115,786

ADJ.No.	References:
1	Meters
2	Office Furn. & Equip - Software
3	Accumulated Depreciation
4	Working Capital
	Schedule CSB-5
	Schedule CSB-6
	Schedule CSB-7
	Schedule CSB-8

RATE BASE ADJUSTMENT NO. 1 - CAPITALIZED METER COSTS

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Meters	\$ 25,265	\$ 38,230	\$ 63,495
2	Pro Forma Plant In Service, Meters	\$ 2,403	\$ (2,403)	\$ -
3		\$ 27,668	\$ 35,827	\$ 63,495

LINE NO.	DESCRIPTION	Company	Additions	Total
		As Filed	1993 to 2002 (Per CSB 4-6)	
4	Company As Filed	\$ 25,265.00	\$ -	\$ 25,265.00
5	1993 Additions	\$ -	\$ 2,327.50	\$ 2,327.50
6	1994 Additions	\$ -	\$ 5,736.25	\$ 5,736.25
7	1995 Additions	\$ -	\$ 6,034.09	\$ 6,034.09
8	1996 Additions	\$ -	\$ 3,778.18	\$ 3,778.18
9	1997 Additions	\$ -	\$ 2,730.30	\$ 2,730.30
10	1998 Additions	\$ -	\$ 3,257.20	\$ 3,257.20
11	1999 Additions	\$ -	\$ 7,410.20	\$ 7,410.20
12	2000 Additions	\$ -	\$ 3,346.97	\$ 3,346.97
13	2001 Additions	\$ -	\$ 1,403.93	\$ 1,403.93
14	2002 Additions	\$ -	\$ 2,204.98	\$ 2,204.98
15	Total	\$ 25,265.00	\$ 38,229.60	\$ 63,494.60

References:

Column A: Company Schedule C-2, Page 1

Column B: Testimony, CSB, Company Data Request Responses CSB 3-18 and CSB 3-19

Column C: Column [A] + Column [B]

Ajo Improvement Company - Water Department
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Schedule CSB-6

**RATE BASE ADJUSTMENT NO. 2 - OFFICE FURNITURE AND EQUIPMENT
SOFTWARE COST**

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Office Furniture & Equipment, Software	\$ 1,348	\$ 2,000	\$ 3,348

References:

Column A: Company Schedule E-5, Page 1

Column B: Testimony, CSB, Company Data Request Responses CSB 2-9

Column C: Column [A] + Column [B]

Ajo Improvement Company - Water Department
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Schedule CSB-7

RATE BASE ADJUSTMENT NO. 3 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	\$ (1,421,455)	\$ (21,855)	\$ (1,443,310)
2	Accumulated Depreciation, Pro-forma	\$ (7,637)	\$ 7,637	\$ -
		<u>\$ (1,429,092)</u>	<u>\$ (14,218)</u>	<u>\$ (1,443,310)</u>

References:

Column [A]: Company Schedule B-2, Page 1
Column [B]: Testimony, CSB
Column [C]: Column [A] + Column [B]

RATE BASE ADJUSTMENT NO. 4 - WORKING CAPITAL ALLOWANCE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	1/24th Purchased Water			
2	Purchased Water Expense	\$ 477,938	\$ -	\$ 477,938
3	Multiplied by	x 1/24		x 1/24
		<u>\$ 19,914</u>		<u>\$ 19,914</u>
4	1/8th O & M (Less Depr, Taxes, and Pur Water)			
5	Salaries and Wages	\$ 29,012	\$ (282)	\$ 28,730
6	Employee Pension and Benefits	\$ 19,302	\$ (187)	\$ 19,115
7	Purchased Water	\$ -	\$ -	\$ -
8	Outside Services - Legal and Consulting	\$ 3,153	\$ (2,074)	\$ 1,079
9	Outside Services - Oper. and Maint.	\$ 85,787	\$ -	\$ 85,787
10	Rental Expense	\$ 1,200	\$ -	\$ 1,200
11	Materials and Supplies	\$ 15,168	\$ -	\$ 15,168
12	General and Administrative	\$ 25,400	\$ (2,000)	\$ 23,400
13	Depreciation	\$ -	\$ -	\$ -
14	Property Taxes	\$ -	\$ -	\$ -
15	Income Taxes	\$ -	\$ -	\$ -
16		<u>\$ 179,022</u>	<u>\$ (4,543)</u>	<u>\$ 174,479</u>
17	Multiplied by	x 1/8		x 1/8
18		<u>\$ 22,378</u>		<u>\$ 21,810</u>
19	Total Working Capital Allowance	<u>\$ 42,292</u>	<u>\$ (568)</u>	<u>\$ 41,724</u>

References:

- Column [A]: Company Schedule B-5, Page 1
- Column [B]: Testimony, CSB
- Column [C]: Column [A] + Column [B]

OPERATING INCOME - TEST YEAR AND STAFF PROPOSED

LINE NO.	DESCRIPTION	[A] COMPANY TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
REVENUES:						
	Water Sales	\$ 634,658	\$ -	\$ 634,658	\$ 66,353	\$ 703,491
	Other Water Revenues	6,986	-	6,986	2,480	9,466
1	Total Operating Revenues	\$ 641,644	\$ -	\$ 641,644	\$ 68,833	\$ 710,477
EXPENSES:						
2	Salaries and Wages	\$ 29,012	\$ (282)	\$ 28,730	\$ -	\$ 28,730
3	Employee Pension and Benefits	19,302	(187)	19,115	-	19,115
4	Purchased Water	477,938	-	477,938	-	477,938
5	Outside Services - Legal and Consulting	3,153	(2,074)	1,079	-	1,079
6	Outside Services - Oper. and Maint.	85,787	-	85,787	-	85,787
7	Rental Expense	1,200	-	1,200	-	1,200
8	Materials and Supplies	15,168	-	15,168	-	15,168
9	General and Administrative	25,400	(2,000)	23,400	-	23,400
10	Depreciation	35,963	(29,405)	6,558	-	6,558
11	Property Taxes	39,382	(153)	39,229	-	39,229
12	Income Taxes	(35,731)	22,939	(12,792)	14,878	2,086
13	Total Operating Expenses	\$ 696,574	\$ (11,163)	\$ 685,411	\$ 14,878	\$ 700,290
14	Operating Income (Loss)	\$ (54,930)	\$ 11,163	\$ (43,767)	\$ 53,955	\$ 10,188

References:

- Column (A): Company Schedule C-1, Page 2
- Column (B): Schedule CSB-9
- Column (C): Column (A) + Column (B)
- Column (D): Schedules CSB-1 and CSB-2
- Column (E): Column (C) + Column (D)

SUMMARY OF OPERATING INCOME ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] ADJ #1	[C] ADJ #2	[D] ADJ #3	[E] ADJ #4	[F] ADJ #5	[G] ADJ #6	[H] ADJ #7	[I] STAFF ADJUSTED
REVENUES:										
1	Water Sales	\$ 634,658	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 634,658
2	Other Water Revenues	6,986	-	-	-	-	-	-	-	6,986
3	Total Revenues	\$ 641,644	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 641,644
OPERATING EXPENSES:										
4	Salaries and Wages	\$ 29,012	(282)	-	-	-	-	-	-	28,730
5	Employee Pension and Benefits	19,302	-	(187)	-	-	-	-	-	19,115
6	Purchased Water	477,938	-	-	-	-	-	-	-	477,938
7	Outside Services - Legal and Consulting	3,153	-	-	(2,074)	-	-	-	-	1,079
8	Outside Services - Oper. and Maint.	85,787	-	-	-	-	-	-	-	85,787
9	Rental Expense	1,200	-	-	-	-	-	-	-	1,200
10	Materials and Supplies	15,168	-	-	-	-	-	-	-	15,168
11	General and Administrative	25,400	-	-	-	(2,000)	-	-	-	23,400
12	Depreciation	35,963	-	-	-	-	(29,405)	-	-	6,558
13	Property Taxes	39,382	-	-	-	-	-	(153)	-	39,229
14	Income Taxes	(35,731)	-	-	-	-	-	-	22,939	(12,792)
15	Total Operating Expenses	\$ 696,574	\$ (282)	\$ (187)	\$ (2,074)	\$ (2,000)	\$ (29,405)	\$ (153)	\$ 22,939	\$ 685,411
16	Operating Income (Loss)	\$ (54,930)	\$ 282	\$ 187	\$ 2,074	\$ 2,000	\$ 29,405	\$ 153	\$ (22,939)	\$ (43,767)

ADJ No.	References:
1	Salaries and Wages
2	Pensions and Benefits
3	Outside Services, Legal & Cons.
4	General and Administrative
5	Depreciation Expense
6	Property Taxes
7	Income Taxes
	Schedule CSB-11
	Schedule CSB-12
	Schedule CSB-13
	Schedule CSB-14
	Schedule CSB-15
	Schedule CSB-16
	Schedule CSB-17

Ajo Improvement Company - Water Department
Docket No. WS-01025A-03-0350
Test Year Ended December 31, 2002

Schedule CSB-11

OPERATING INCOME ADJUSTMENT NO. 1 - SALARY AND WAGE INCREASE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Salary and Wage Expense	\$ 28,167	\$ -	\$ 28,167
2	Percentage	3%	-1%	2%
3	Salary and Wage Adjustment	\$ 845	\$ (282)	\$ 563

References:

- Column A: Company Data Request Response CSB 1-20, Company Workpaper 000025
- Column B: Testimony, CSB
- Column C: Column [A] + Column [B]

Ajo Improvement Company - Water Department
Docket No. WS-01025A-03-0350
Test Year Ended December 31, 2002

Schedule CSB-12

OPERATING INCOME ADJUSTMENT NO. 2 - PENSIONS AND BENEFITS

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Pension and Benefits	\$ 18,740	\$ -	\$ 18,740
2	Percentage	3%	-1%	2%
3	Pension and Benefits Adjustment	\$ 562	\$ (187)	\$ 375

References:

Column A: Company Data Request Response CSB 1-20, Company Workpaper 000025
Column B: Testimony, CSB
Column C: Column [A] + Column [B]

Ajo Improvement Company - Water Department
Docket No. WS-01025A-03-0350
Test Year Ended December 31, 2002

Schedule CSB-13

OPERATING INCOME ADJUSTMENT NO. 3 - OUTSIDE SERVICES, LEGAL & CONSULTING

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Data File Conversion	967	-	967
2	Training	\$ 1,625	-	\$ 1,625
3	Total Computer Conversion Expense	\$ 2,592	-	\$ 2,592
4	Division Factor	1		5
5	Total Annual Computer Conversion Exp	\$ 2,592	\$ (2,074)	\$ 518

References:

Column A: Company Data Request Response CSB 1-24 and 2-9

Column B: Testimony, CSB

Column C: Column [A] + Column [B]

Ajo Improvement Company - Water Department
Docket No. WS-01025A-03-0350
Test Year Ended December 31, 2002

Schedule CSB-14

OPERATING INCOME ADJUSTMENT NO. 4 - GENERAL & ADMINSTRATIVE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	General & Administrative, Computer Software	\$ 2,000	\$ (2,000)	\$ -

References:

- Column A: Company Data Request Response CSB 1-3 and 2-9
- Column B: Testimony, CSB
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 5 - DEPRECIATION EXPENSE ON TEST YEAR PLANT

LINE NO.	DESCRIPTION	[A]	[B]	[C]	[D]	[E]
		PLANT IN SERVICE	FULLY DEPRECIATED PLANT	DEPRECIABLE PLANT (Col A - Col B)	DEPRECIATION RATE	DEPRECIATION EXPENSE (Col C x Col D)
1	Water Treatment Plant	\$ 644,369	\$ 623,963	\$ 20,406	3.33%	\$ 680
2	Storage Tanks	\$ 194,594	\$ 168,815	\$ 25,779	2.22%	\$ 572
3	Transmission and Distribution Mains	\$ 487,756	\$ 423,997	\$ 63,759	2.00%	\$ 1,275
4	Services	\$ 72,768	\$ 72,768	\$ -	3.33%	\$ -
5	Meters	\$ 63,495	\$ 23,147	\$ 40,348	8.33%	\$ 3,361
6	Hydrants	\$ 23,555	\$ 23,555	\$ -	2.00%	\$ -
7	Office Furniture and Equipment	\$ 3,348	\$ -	\$ 3,348	20.00%	\$ 670
8	Transportation Equipment	\$ 27,487	\$ 27,487	\$ -	20.00%	\$ -
9	Total Plant	\$ 1,517,372	\$ 1,363,732	\$ 153,640		\$ 6,558
10	Composite Depreciation Rate (Depr Exp / Depreciable Plant):		4.27%			
11	CIAC: \$		\$ -			
12	Amortization of CIAC (Line 10 x Line 11): \$		\$ -			
13	Depreciation Expense Before Amortization of CIAC: \$		\$ 6,558			
14	Less Amortization of CIAC: \$		\$ -			
15	Test Year Depreciation Expense - Staff: \$		\$ 6,558			
16	Depreciation Expense - Company: \$		\$ 35,963			
17	Staff's Total Adjustment: \$		\$ (29,405)			

References:

- Column [A]: Schedule CSB-4
- Column [B]: Staff Workpapers
- Column [C]: Column [A] - Column [B]
- Column [D]: Engineering Staff Report
- Column [E]: Column [C] x Column [D]

OPERATING INCOME ADJUSTMENT NO. 6 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	2002 Staff Adjusted Test Year Revenues			\$ 641,644
2	Weight Factor			\$ 2
3	Subtotal (Line 1 x Line 2)			\$ 1,283,288
4	Staff Recommended Revenue			\$ 710,477
5	Subtotal (Line 4 + Line 5)			\$ 1,993,765
6	Number of Years			\$ 3
7	Three Year Average (Line 5 / Line 6)			\$ 664,588
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			\$ 1,329,177
10	Plus: 10% of 2002 CWIP			\$ -
11	Less: Net Book Value of Licensed Vehicles			\$ -
12	Full Cash Value (Line 9 + Line 10 - Line 11)			\$ 1,329,177
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			\$ 332,294
15	Composite Property Tax Rate			0.118055
16	Staff Proposed Property Tax Expense (Line 14 x Line 15)	\$ 39,382	\$ (153)	\$ 39,229

References:

- Column A: Company Schedule C-1, Page 2
- Column B: Testimony, CSB
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 7 - INCOME TAXES

LINE NO.	DESCRIPTION	(A)	(B)
	<u>Calculation of Income Tax:</u>		
		<u>Test Year</u>	
1	Revenue (Schedule CSB-9, Line 9)	\$ 641,644	
2	Less: Operating Expenses Excluding Income Taxes	\$ 698,204	
3	Less: Synchronized Interest (L17)	\$ 2,305	
4	Arizona Taxable Income (L1- L2 - L3)	<u>\$ (58,865)</u>	
5	Arizona State Income Tax Rate	6.968%	
6	Arizona Income Tax (L4 x L5)		\$ (4,102)
7	Federal Taxable Income (L4 - L6)	\$ (54,763)	
8	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ (7,500)	
9	Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25%	\$ (1,191)	
10	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -	
11	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -	
12	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -	
13	Total Federal Income Tax		<u>\$ (8,691)</u>
14	Combined Federal and State Income Tax (L6 + L13)		<u>\$ (12,792)</u>
	<u>Calculation of Interest Synchronization:</u>		
15	Rate Base (Schedule CSB-3, Col. (C), Line 13)	\$ 115,786	
16	Weighted Average Cost of Debt	1.99%	
17	Synchronized Interest (L16 x L17)	<u>\$ 2,305</u>	
18		Income Tax - Per Staff \$ (12,792)	
19		Income Tax - Per Company \$ (35,731)	
20		Staff Adjustment \$ 22,939	

RATE DESIGN

Monthly Customer Charge:

5/8" x 3/4" Meter
3/4" Meter
1" Meter
1 1/2" Meter
2" Meter
3" Meter
4" Meter
6" Meter

Monthly Customer Charge			
Present Rates	---Proposed Rates---		
	Company	Staff	
\$ 9.00	\$ 9.25	\$ 9.85	
(a)	(a)	\$ 12.80	
\$ 15.00	\$ 15.75	\$ 17.55	
\$ 25.00	\$ 26.25	\$ 29.25	
\$ 50.00	\$ 52.50	\$ 58.50	
\$ 100.00	\$ 105.00	\$ 117.00	
\$ 200.00	\$ 210.00	\$ 234.00	
\$ 300.00	\$ 300.00	\$ 300.00	

Gallons Included In Monthly Customer Charge:

5/8" x 3/4" Meter
3/4" Meter
1" Meter
1 1/2" Meter
2" Meter
3" Meter
4" Meter
6" Meter

0	0	0
(a)	(a)	0
0	0	0
0	0	0
0	0	0
0	0	0
0	0	0
0	0	0

TREATED WATER

Commodity Rates For 5/8 Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	N/A	N/A	\$ 1.93
Per 1,000 Gallons for 3,001 to 14,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 14,000	N/A	N/A	\$ 3.47

Commodity Rates For 3/4 Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	(a)	(a)	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	(a)	(a)	\$ 1.93
Per 1,000 Gallons for 3,001 to 14,000 Gallons	(a)	(a)	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 14,000	(a)	(a)	\$ 3.47

Commodity Rates For 1-Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 25,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 25,000	N/A	N/A	\$ 3.47

Commodity Rates For 1 1/2-Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 42,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 42,000	N/A	N/A	\$ 3.47

Commodity Rates For 2-Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 63,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 63,000	N/A	N/A	\$ 3.47

Commodity Rates For 3-Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 120,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 120,000	N/A	N/A	\$ 3.47

Commodity Rates For 4-Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 180,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 180,000	N/A	N/A	\$ 3.47

Commodity Rates For 6-Inch Meter - Treated Water:

Per 1,000 Gallons (In Excess of Minimum)	\$ 2.54	\$ 3.14	N/A
Per 1,000 Gallons for 0 to 290,000 Gallons	N/A	N/A	\$ 2.90
Per 1,000 Gallons for Gallons in Excess of 290,000	N/A	N/A	\$ 3.47

**RATE DESIGN
 CONTINUED**

UNTREATED WATER

Commodity Rates For 5/8 Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 14,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 14,000	N/A	N/A	\$ 2.02

Commodity Rates For 3/4 Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	(a)	(a)	N/A
Per 1,000 Gallons for 0 to 14,000 Gallons	(a)	(a)	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 14,000	(a)	(a)	\$ 2.02

Commodity Rates For 1-Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 25,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 25,000	N/A	N/A	\$ 2.02

Commodity Rates For 1 1/2-Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 42,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 42,000	N/A	N/A	\$ 2.02

Commodity Rates For 2-Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 63,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 63,000	N/A	N/A	\$ 2.02

Commodity Rates For 3-Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 120,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 120,000	N/A	N/A	\$ 2.02

Commodity Rates For 4-Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 180,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 180,000	N/A	N/A	\$ 2.02

Commodity Rates For 6-Inch Meter - Untreated Water:

	Present Rates	---Proposed Rates---	
		Company	Staff
Per 1,000 Gallons (In Excess of Minimum)	\$ 1.75	\$ 1.85	N/A
Per 1,000 Gallons for 0 to 290,000 Gallons	N/A	N/A	\$ 1.68
Per 1,000 Gallons for Gallons in Excess of 290,000	N/A	N/A	\$ 2.02

Service Line and Meter Installation Charge:

	Present Rates	---Proposed Rates---	
		Company	Staff
5/8" x 3/4" Meter	\$ 100.00	\$ 100.00	\$ 400.00
3/4" Meter	(a)	(a)	\$ 450.00
1" Meter	\$ 150.00	\$ 500.00	\$ 500.00
1 1/2" Meter	\$ 200.00	\$ 750.00	\$ 750.00
2" Meter	\$ 250.00	\$ 1,300.00	\$ 1,300.00
3" Meter	\$ 250.00	\$ 1,300.00	\$ 2,000.00
4" Meter	Cost	Cost (b)	\$ 3,000.00
6" Meter	Cost	Cost (b)	\$ 6,035.00

Service Charges:

	Present Rates	---Proposed Rates---	
		Company	Staff
Establishment (Regular Hours)	\$ 25.00	\$ 25.00	\$ 25.00
Establishment (After Hours)	(a)	\$ 40.00	\$ 40.00
Re-establishment Within 12 Months	(c)	(c)	(c)
Re-connection of Service (Regular Hours)	\$ 10.00	\$ 50.00	\$ 25.00
Re-connection of Service (After Hours)	(a)	\$ 65.00	\$ 40.00
Water Meter Test (If Correct)	Cost (b)	Cost (b)	Cost (b)
Water Meter Relocation at Customer's Request	Cost (b)	Cost (b)	Cost (b)
Meter Re-read (If Correct)	\$ 10.00	\$ 10.00	\$ 10.00
NSF Check Charge	\$ 10.00	\$ 20.00	\$ 20.00
Late Charge	1.50%	1.50%	1.50%
Deferred Payment Finance Charge	1.50%	1.50%	1.50%
Service Calls - After Hours Only	\$25/hr	\$40/hr	\$40/hr
Deposits	(d)	(d)	(d)
Deposit Interest	(d)	(d)	(d)

(a) No current tariff or Company proposal
 (b) Cost includes materials, labor, and overheads
 (c) Monthly minimum times months off system (Rule A.A.C. R14-2-403D)
 (d) Per A.A.C. R14-2-403B
 N/A Non applicable

TYPICAL BILL ANALYSIS
TREATED WATER
General Service 5/8 X 3/4 - Inch Meter

Average Number of Customers: 1088

<u>Company</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	5,861	\$23.89	\$27.65	\$3.77	15.8%
Median Usage	4,275	\$19.86	\$22.67	\$2.81	14.2%
<u>Staff</u>					
Average Usage	5,861	\$23.89	\$23.92	\$0.04	0.1%
Median Usage	4,275	\$19.86	\$19.33	(\$0.53)	-2.7%

Present & Proposed Rates (Without Taxes)
General Service 5/8 X 3/4 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$9.00	\$9.25	2.8%	\$9.85	9.4%
1,000	11.54	12.39	7.4%	11.78	2.1%
2,000	14.08	15.53	10.3%	13.71	-2.6%
3,000	16.62	18.67	12.3%	15.64	-5.9%
4,000	19.16	21.81	13.8%	18.54	-3.3%
5,000	21.70	24.95	15.0%	21.43	-1.2%
6,000	24.24	28.09	15.9%	24.33	0.4%
7,000	26.78	31.23	16.6%	27.22	1.6%
8,000	29.32	34.37	17.2%	30.12	2.7%
9,000	31.86	37.51	17.7%	33.01	3.6%
10,000	34.40	40.65	18.2%	35.91	4.4%
15,000	47.10	56.35	19.6%	50.96	8.2%
20,000	59.80	72.05	20.5%	68.33	14.3%
25,000	72.50	87.75	21.0%	85.70	18.2%
50,000	136.00	166.25	22.2%	172.55	26.9%
75,000	199.50	244.75	22.7%	259.40	30.0%
100,000	263.00	323.25	22.9%	346.25	31.7%
125,000	326.50	401.75	23.0%	433.10	32.6%
150,000	390.00	480.25	23.1%	519.95	33.3%
175,000	453.50	558.75	23.2%	606.80	33.8%
200,000	517.00	637.25	23.3%	693.65	34.2%

TYPICAL BILL ANALYSIS
TREATED WATER
General Service 1.5 - Inch Meter

Average Number of Customers: 1

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	500	\$26.27	\$27.82	\$1.55	5.9%
Median Usage	500	\$26.27	\$27.82	\$1.55	5.9%
<u>Staff Proposed</u>					
Average Usage	500	\$26.27	\$30.70	\$4.43	16.9%
Median Usage	500	\$26.27	\$30.70	\$4.43	16.9%

Present & Proposed Rates (Without Taxes)
General Service 1.5 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$25.00	\$26.25	5.0%	\$29.25	17.0%
1,000	27.54	29.39	6.7%	32.15	16.7%
2,000	30.08	32.53	8.1%	35.04	16.5%
3,000	32.62	35.67	9.4%	37.94	16.3%
4,000	35.16	38.81	10.4%	40.83	16.1%
5,000	37.70	41.95	11.3%	43.73	16.0%
6,000	40.24	45.09	12.1%	46.62	15.9%
7,000	42.78	48.23	12.7%	49.52	15.7%
8,000	45.32	51.37	13.3%	52.41	15.6%
9,000	47.86	54.51	13.9%	55.31	15.6%
10,000	50.40	57.65	14.4%	58.20	15.5%
15,000	63.10	73.35	16.2%	72.68	15.2%
20,000	75.80	89.05	17.5%	87.15	15.0%
25,000	88.50	104.75	18.4%	101.63	14.8%
50,000	152.00	183.25	20.6%	178.63	17.5%
75,000	215.50	261.75	21.5%	265.48	23.2%
100,000	279.00	340.25	22.0%	352.33	26.3%
125,000	342.50	418.75	22.3%	439.18	28.2%
150,000	406.00	497.25	22.5%	526.03	29.6%
175,000	469.50	575.75	22.6%	612.88	30.5%
200,000	533.00	654.25	22.7%	699.73	31.3%

TYPICAL BILL ANALYSIS
TREATED WATER
General Service 2.0 - Inch Meter

Average Number of Customers: 15

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	99,220	\$302.02	\$364.05	\$62.03	20.5%
Median Usage	35,766	\$140.84	\$164.80	\$23.96	17.0%
<u>Staff Proposed</u>					
Average Usage	99,220	\$302.02	\$366.71	\$64.69	21.4%
Median Usage	35,766	\$140.84	\$162.04	\$21.20	15.0%

Present & Proposed Rates (Without Taxes)
General Service 2.0 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$50.00	\$52.50	5.0%	\$58.50	17.0%
1,000	52.54	55.64	5.9%	61.40	16.9%
2,000	55.08	58.78	6.7%	64.29	16.7%
3,000	57.62	61.92	7.5%	67.19	16.6%
4,000	60.16	65.06	8.1%	70.08	16.5%
5,000	62.70	68.20	8.8%	72.98	16.4%
6,000	65.24	71.34	9.4%	75.87	16.3%
7,000	67.78	74.48	9.9%	78.77	16.2%
8,000	70.32	77.62	10.4%	81.66	16.1%
9,000	72.86	80.76	10.8%	84.56	16.1%
10,000	75.40	83.90	11.3%	87.45	16.0%
15,000	88.10	99.60	13.1%	101.93	15.7%
20,000	100.80	115.30	14.4%	116.40	15.5%
25,000	113.50	131.00	15.4%	130.88	15.3%
50,000	177.00	209.50	18.4%	203.25	14.8%
75,000	240.50	288.00	19.8%	282.57	17.5%
100,000	304.00	366.50	20.6%	369.42	21.5%
125,000	367.50	445.00	21.1%	456.27	24.2%
150,000	431.00	523.50	21.5%	543.12	26.0%
175,000	494.50	602.00	21.7%	629.97	27.4%
200,000	558.00	680.50	22.0%	716.82	28.5%

TYPICAL BILL ANALYSIS
TREATED WATER
 General Service 3.0 - Inch Meter

Average Number of Customers: 3

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	58,171	\$247.76	\$287.66	\$39.90	16.1%
Median Usage	50,714	\$228.81	\$264.24	\$35.43	15.5%
<u>Staff Proposed</u>					
Average Usage	58,171	\$247.76	\$285.41	\$37.65	15.2%
Median Usage	50,714	\$228.81	\$263.82	\$35.00	15.3%

Present & Proposed Rates (Without Taxes)
 General Service 3.0 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$100.00	\$105.00	5.0%	\$117.00	17.0%
1,000	102.54	108.14	5.5%	119.90	16.9%
2,000	105.08	111.28	5.9%	122.79	16.9%
3,000	107.62	114.42	6.3%	125.69	16.8%
4,000	110.16	117.56	6.7%	128.58	16.7%
5,000	112.70	120.70	7.1%	131.48	16.7%
6,000	115.24	123.84	7.5%	134.37	16.6%
7,000	117.78	126.98	7.8%	137.27	16.5%
8,000	120.32	130.12	8.1%	140.16	16.5%
9,000	122.86	133.26	8.5%	143.06	16.4%
10,000	125.40	136.40	8.8%	145.95	16.4%
15,000	138.10	152.10	10.1%	160.43	16.2%
20,000	150.80	167.80	11.3%	174.90	16.0%
25,000	163.50	183.50	12.2%	189.38	15.8%
50,000	227.00	262.00	15.4%	261.75	15.3%
75,000	290.50	340.50	17.2%	334.13	15.0%
100,000	354.00	419.00	18.4%	406.50	14.8%
125,000	417.50	497.50	19.2%	481.77	15.4%
150,000	481.00	576.00	19.8%	568.62	18.2%
175,000	544.50	654.50	20.2%	655.47	20.4%
200,000	608.00	733.00	20.6%	742.32	22.1%

TYPICAL BILL ANALYSIS
TREATED WATER
 General Service 4.0 - Inch Meter

Average Number of Customers: 1

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	5,333,251	\$13,746.46	\$16,956.41	\$3,209.95	23.4%
<u>Staff Proposed</u>					
Average Usage	5,333,251	\$13,746.46	\$18,657.49	\$4,911.04	35.7%

Present & Proposed Rates (Without Taxes)
 General Service 4.0 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$200.00	\$210.00	5.0%	\$234.00	17.0%
1,000	202.54	213.14	5.2%	236.90	17.0%
2,000	205.08	216.28	5.5%	239.79	16.9%
3,000	207.62	219.42	5.7%	242.69	16.9%
4,000	210.16	222.56	5.9%	245.58	16.9%
5,000	212.70	225.70	6.1%	248.48	16.8%
6,000	215.24	228.84	6.3%	251.37	16.8%
7,000	217.78	231.98	6.5%	254.27	16.8%
8,000	220.32	235.12	6.7%	257.16	16.7%
9,000	222.86	238.26	6.9%	260.06	16.7%
10,000	225.40	241.40	7.1%	262.95	16.7%
15,000	238.10	257.10	8.0%	277.43	16.5%
20,000	250.80	272.80	8.8%	291.90	16.4%
25,000	263.50	288.50	9.5%	306.38	16.3%
50,000	327.00	367.00	12.2%	378.75	15.8%
75,000	390.50	445.50	14.1%	451.13	15.5%
100,000	454.00	524.00	15.4%	523.50	15.3%
125,000	517.50	602.50	16.4%	595.88	15.1%
150,000	581.00	681.00	17.2%	668.25	15.0%
175,000	644.50	759.50	17.8%	740.63	14.9%
200,000	708.00	838.00	18.4%	824.58	16.5%

TYPICAL BILL ANALYSIS
UNTREATED WATER
General Service 5/8 X 3/4 - Inch Meter

Average Number of Customers: 7

<u>Company</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	68,034	\$128.06	\$135.11	\$7.05	5.5%
Median Usage	40,820	\$80.44	\$84.77	\$4.33	5.4%
<u>Staff</u>					
Average Usage	68,034	\$128.06	\$142.30	\$14.24	11.1%
Median Usage	40,820	\$80.44	\$87.44	\$7.00	8.7%

Present & Proposed Rates (Without Taxes)
General Service 5/8 X 3/4 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$9.00	\$9.25	2.8%	\$9.85	9.4%
1,000	10.75	11.10	3.3%	11.53	7.3%
2,000	12.50	12.95	3.6%	13.21	5.7%
3,000	14.25	14.80	3.9%	14.89	4.5%
4,000	16.00	16.65	4.1%	16.57	3.6%
5,000	17.75	18.50	4.2%	18.25	2.8%
6,000	19.50	20.35	4.4%	19.93	2.2%
7,000	21.25	22.20	4.5%	21.61	1.7%
8,000	23.00	24.05	4.6%	23.29	1.3%
9,000	24.75	25.90	4.6%	24.97	0.9%
10,000	26.50	27.75	4.7%	26.65	0.6%
15,000	35.25	37.00	5.0%	35.39	0.4%
20,000	44.00	46.25	5.1%	45.47	3.3%
25,000	52.75	55.50	5.2%	55.55	5.3%
50,000	96.50	101.75	5.4%	105.95	9.8%
75,000	140.25	148.00	5.5%	156.35	11.5%
100,000	184.00	194.25	5.6%	206.75	12.4%
125,000	227.75	240.50	5.6%	257.15	12.9%
150,000	271.50	286.75	5.6%	307.55	13.3%
175,000	315.25	333.00	5.6%	357.95	13.5%
200,000	359.00	379.25	5.6%	408.35	13.7%

TYPICAL BILL ANALYSIS
UNTREATED WATER
General Service 2.0 - Inch Meter

Average Number of Customers: 2

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	659,129	\$1,203.48	\$1,271.89	\$68.41	5.7%
Median Usage	16,000	\$78.00	\$82.10	\$4.10	5.3%
<u>Staff Proposed</u>					
Average Usage	659,129	\$1,203.48	\$1,366.14	\$162.66	13.5%
Median Usage	16,000	\$78.00	\$85.38	\$7.38	9.5%

Present & Proposed Rates (Without Taxes)
General Service 2.0 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$50.00	\$52.50	5.0%	\$58.50	17.0%
1,000	51.75	54.35	5.0%	60.18	16.3%
2,000	53.50	56.20	5.0%	61.86	15.6%
3,000	55.25	58.05	5.1%	63.54	15.0%
4,000	57.00	59.90	5.1%	65.22	14.4%
5,000	58.75	61.75	5.1%	66.90	13.9%
6,000	60.50	63.60	5.1%	68.58	13.4%
7,000	62.25	65.45	5.1%	70.26	12.9%
8,000	64.00	67.30	5.2%	71.94	12.4%
9,000	65.75	69.15	5.2%	73.62	12.0%
10,000	67.50	71.00	5.2%	75.30	11.6%
15,000	76.25	80.25	5.2%	83.70	9.8%
20,000	85.00	89.50	5.3%	92.10	8.4%
25,000	93.75	98.75	5.3%	100.50	7.2%
50,000	137.50	145.00	5.5%	142.50	3.6%
75,000	181.25	191.25	5.5%	188.53	4.0%
100,000	225.00	237.50	5.6%	238.93	6.2%
125,000	268.75	283.75	5.6%	289.33	7.7%
150,000	312.50	330.00	5.6%	339.73	8.7%
175,000	356.25	376.25	5.6%	390.13	9.5%
200,000	400.00	422.50	5.6%	440.53	10.1%

TYPICAL BILL ANALYSIS
UNTREATED WATER
General Service 3.0 - Inch Meter

Average Number of Customers: 4

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	383,041	\$770.32	\$813.63	\$43.30	5.6%
Median Usage	99,550	\$274.21	\$289.17	\$14.96	5.5%
<u>Staff Proposed</u>					
Average Usage	383,041	\$770.32	\$848.89	\$78.57	10.2%
Median Usage	99,550	\$274.21	\$284.24	\$10.03	3.7%

Present & Proposed Rates (Without Taxes)
General Service 3.0 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$100.00	\$105.00	5.0%	\$117.00	17.0%
1,000	101.75	106.85	5.0%	118.68	16.6%
2,000	103.50	108.70	5.0%	120.36	16.3%
3,000	105.25	110.55	5.0%	122.04	16.0%
4,000	107.00	112.40	5.0%	123.72	15.6%
5,000	108.75	114.25	5.1%	125.40	15.3%
6,000	110.50	116.10	5.1%	127.08	15.0%
7,000	112.25	117.95	5.1%	128.76	14.7%
8,000	114.00	119.80	5.1%	130.44	14.4%
9,000	115.75	121.65	5.1%	132.12	14.1%
10,000	117.50	123.50	5.1%	133.80	13.9%
15,000	126.25	132.75	5.1%	142.20	12.6%
20,000	135.00	142.00	5.2%	150.60	11.6%
25,000	143.75	151.25	5.2%	159.00	10.6%
50,000	187.50	197.50	5.3%	201.00	7.2%
75,000	231.25	243.75	5.4%	243.00	5.1%
100,000	275.00	290.00	5.5%	285.00	3.6%
125,000	318.75	336.25	5.5%	328.68	3.1%
150,000	362.50	382.50	5.5%	379.08	4.6%
175,000	406.25	428.75	5.5%	429.48	5.7%
200,000	450.00	475.00	5.6%	479.88	6.6%

TYPICAL BILL ANALYSIS
UNTREATED WATER
General Service 4.0 - Inch Meter

Average Number of Customers: 1

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	305,985	\$732.41	\$776.07	\$43.66	6.0%
<u>Staff Proposed</u>					
Average Usage	305,985	\$732.41	\$790.38	\$57.97	7.9%

Present & Proposed Rates (Without Taxes)
General Service 4.0 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$200.00	\$210.00	5.0%	\$234.00	17.0%
1,000	201.74	211.85	5.0%	235.68	16.8%
2,000	203.48	213.70	5.0%	237.36	16.7%
3,000	205.22	215.55	5.0%	239.04	16.5%
4,000	206.96	217.40	5.0%	240.72	16.3%
5,000	208.70	219.25	5.1%	242.40	16.1%
6,000	210.44	221.10	5.1%	244.08	16.0%
7,000	212.18	222.95	5.1%	245.76	15.8%
8,000	213.92	224.80	5.1%	247.44	15.7%
9,000	215.66	226.65	5.1%	249.12	15.5%
10,000	217.40	228.50	5.1%	250.80	15.4%
15,000	226.10	237.75	5.2%	259.20	14.6%
20,000	234.80	247.00	5.2%	267.60	14.0%
25,000	243.50	256.25	5.2%	276.00	13.3%
50,000	287.00	302.50	5.4%	318.00	10.8%
75,000	330.50	348.75	5.5%	360.00	8.9%
100,000	374.00	395.00	5.6%	402.00	7.5%
125,000	417.50	441.25	5.7%	444.00	6.3%
150,000	461.00	487.50	5.7%	486.00	5.4%
175,000	504.50	533.75	5.8%	528.00	4.7%
200,000	548.00	580.00	5.8%	576.72	5.2%

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WASTEWATER DEPARTMENT

1 **WASTEWATER DEPARTMENT**

2
3 **Q. What are the primary reasons stated by the Company for requesting a permanent**
4 **rate increase for the Wastewater Department?**

5 A. The Company's application states that it has not requested a rate increase for the
6 Wastewater Department in approximately 17 years. Additionally, the application states
7 that the Company has incurred an operating loss of \$68,533 for the Wastewater
8 Department resulting in no rate of return on the department's \$217,822 rate base during
9 the Test Year.

10
11 **SUMMARY OF PROPOSED REVENUES – WASTEWATER DEPARTMENT**

12
13 **Q. Please summarize the Company's filing for the Wastewater Department.**

14 A. The Company proposes rates that produce operating revenue of \$251,823 and operating
15 income of \$21,782 for a 10.0 percent rate of return on an original cost rate base of
16 \$217,822. The Company's proposal would increase annual operating revenues by
17 \$156,318 (or 163.67 percent) over Test Year revenues.

18
19 **Q. Please summarize Staff's recommended revenue.**

20 A. Staff recommends total annual operating revenue of \$230,576 and operating income of
21 \$19,291 for an 8.8 percent rate of return on an original cost rate base of \$219,254. This
22 revenue amount represents an increase of \$135,071, or 141.43 percent, over Test Year
23 revenues.

24
25
26

1 **Q. Please summarize the recommendations and adjustments addressed in your**
2 **testimony for the Wastewater Department.**

3 A. My testimony addresses the following issues:
4

5 Office Furniture and Equipment – This adjustment increases the Office Furniture and
6 Equipment account by \$2,000.

7
8 Working Capital – This adjustment decreases Working Capital by \$568.
9

10 Salaries and Wage Expense – This adjustment decreases Salaries and Wage Expense by
11 \$282.
12

13 Pensions and Benefits – This adjustment decreases Pensions and Benefits by \$192.
14

15 Outside Services, Legal and Consulting – This adjustment decreases Outside Services,
16 Legal and Consulting Expense by \$2,074.
17

18 General and Administrative – This adjustment decreases General and Administrative
19 Expense by \$2,000.
20

21 Depreciation Expense – This adjustment decreases Depreciation Expense by \$680.
22

23 Property Tax Expense – This adjustment increases Property Tax Expense by \$2,720.
24

25 Income Tax Expense – This adjustment increases Income Tax Expense by \$12,300.
26

1 **RATE BASE - WASTEWATER DEPARTMENT**

2
3 **Fair Value Rate Base**

4 **Q. Has the Company prepared a Schedule showing the elements of Reconstruction Cost**
5 **New Rate Base ("RCND")?**

6 A. No. The Company requested to waive the RCND schedule filing requirement. Therefore,
7 Staff evaluated the original cost rate base as the fair value rate base ("FVRB").
8

9 **Rate Base Summary – Wastewater Department**

10 **Q. Please summarize Staff's adjustments to the Wastewater Department's rate base**
11 **shown on Schedule CSB-3.**

12 A. Staff's adjustments to the Wastewater Department's rate base resulted in a net increase of
13 \$1,432, from \$217,822 to \$219,254. This increase was primarily due to Staff reclassifying
14 costs from an expense account to the Office Furniture and Equipment account.
15

16 **Rate Base Adjustment 1 – Wastewater Department, Office Furniture and Equipment**

17 **Q. What is Ajo proposing for Office Furniture and Equipment?**

18 A. Ajo is proposing \$1,348 for Office Furniture and Equipment.
19

20 **Q. During Staff's review of Operating Expenses, Staff found that the Company**
21 **expensed computer software. Should the computer software be expensed?**

22 A. The \$2,000 in software costs⁹ (the Wastewater Department's allocated portion of the total
23 \$6,000 software cost) should have been capitalized. Plant that is used and useful in the
24 provision of service should be capitalized by recording the cost in the appropriate plant
25 account and depreciating the cost over the useful life of the plant asset in accordance to

⁹ Data request responses CSB 2-9

1 the NARUC USOA. Thus, reclassification of the software costs from General and
2 Administrative Expense to Office Furniture and Equipment is appropriate.

3
4 **Q. What is Staff recommending?**

5 A. Staff recommends increasing Office Furniture and Equipment by \$2,000, from \$1,348 to
6 \$3,348 as shown on Schedules CSB-4 and CSB-5. This cost is removed from expense by
7 Staff Operating Income Adjustment No. 4.

8
9 **Rate Base Adjustment 2 – Wastewater Department, Working Capital**

10 **Q. What is Ajo proposing for its Working Capital?**

11 A. Ajo is proposing \$24,439 for Working Capital.

12
13 **Q. How did Ajo and Staff calculate Working Capital?**

14 A. Working Capital was calculated by using the formula method which equals one-eighth of
15 the operating expenses less depreciation, property and income taxes, and purchased power
16 expense, plus one twenty-fourth of purchased power expense. Staff's working capital
17 amount is different from Ajo's because some of Staff's recommended operating expenses
18 are different than the Company's.

19
20 **Q. What is Staff recommending?**

21 A. Staff recommends decreasing Working Capital by \$568, from \$24,439 to \$23,871 as
22 shown on Schedules CSB-4 and CSB-6.

23

1 **OPERATING INCOME – WASTEWATER DEPARTMENT**

2 **Operating Income Summary – Wastewater Department**

3 **Q. What are the results of Staff's analysis of Test Year revenues, expenses, and**
4 **operating income?**

5 A. As shown on Schedules CSB-7 and CSB-8, Staff's analysis resulted in Test Year revenues
6 of \$95,505, expenses of \$173,828, and an operating loss of \$78,323.

7
8 **Operating Income Adjustment No. 1 – Wastewater Department, Salaries and Wages**

9 **Q. What is the Company proposing for Salaries and Wages?**

10 A. The Company is proposing \$29,012 for Salaries and Wages. That amount is composed of
11 \$28,167 of Test Year salary and wage expense and an \$845 pro forma adjustment to
12 reflect annualization of salary and wage increase at three percent. The increase became
13 effective in July of 2002.

14
15 **Q. During Staff's review of Salaries and Wage expense, Staff found that Ajo**
16 **inadvertently used a three percent rather than the actual two percent increase to**
17 **calculate the pro forma adjustment. Did Staff correct the error?**

18 A. Yes. Staff corrected the error by recalculating the annualization adjustment using the two
19 percent increase authorized by Phelps Dodge.

20
21 **Q. What is Staff recommending?**

22 A. Staff recommends decreasing Salary and Wages by \$282, from \$29,012 to \$28,730 as
23 shown on Schedules CSB-8 and CSB-9.

24

1 **Operating Income Adjustment No. 2 – Wastewater Department, Pensions and Benefits**
2 **Expense**

3 **Q. What is the Company proposing for Pensions and Benefits Expense?**

4 A. The Company is proposing \$19,741 for Pensions and Benefits Expense. The amount is
5 composed of \$19,166 of Test Year 2002 pensions and benefits expense and a \$575 pro
6 forma adjustment to reflect annualization of salary and wage increase at three percent.
7 The increase became effective in July of 2002.

8
9 **Q. During Staff's review of Pensions and Benefits expense, Staff found that Ajo used a**
10 **three percent rather than the actual two percent increase to calculate the pro forma**
11 **adjustment. Did Staff correct the error?**

12 A. Yes. Staff corrected the error by recalculating the annualization adjustment using the
13 Phelps Dodge authorized two percent increase.

14
15 **Q. What is Staff recommending?**

16 A. Staff recommends decreasing Pensions and Benefits by \$192, from \$19,741 to \$19,549 as
17 shown on Schedules CSB-8 and CSB-10.

18
19 **Operating Income Adjustment No. 3 – Wastewater Department, Outside Services – Legal**
20 **and Consulting**

21 **Q. What is the Company proposing for Outside Services – Legal and Consulting**
22 **Expense?**

23 A. The Company is proposing \$4,343 for Outside Services – Legal and Consulting.
24

1 **Q. During Staff's review of the Outside Services – Legal and Consulting expense, Staff**
2 **found that Ajo had not amortized its computer conversion and training costs.**
3 **Should the computer conversion and training costs be amortized?**

4 A. Yes. The computer conversion and related training costs should be amortized because
5 they benefit multiple years. Costs should be distributed over the periods benefited. Staff
6 amortized the expense over the number of years the conversion and training costs are
7 expected to benefit the Company (i.e., five years).

8
9 **Q. What is Staff recommending?**

10 A. Staff recommends decreasing Outside Services – Legal and Consulting expense by
11 \$2,074, from \$4,343 to \$2,269 as shown on Schedules CSB-8 and CSB-11.

12

13 **Operating Income Adjustment No. 4 – Wastewater Department, General and**
14 **Administrative**

15 **Q. What is the Company proposing for General and Administrative Expense?**

16 A. The Company is proposing \$15,020 for General and Administrative.

17

18 **Q. During Staff's review of the General and Administrative expense, Staff found that**
19 **Ajo had expensed computer software costs. Should computer software costs be**
20 **expensed?**

21 A. No. Generally Accepted Accounting Principles ("GAAP") and specifically, Statement of
22 Procedure 98-1 issued by the Financial Accounting Standards Board ("FASB"), indicate
23 that software that is obtained for internal use should be capitalized and amortized over its
24 service life. Thus, reclassification of the software costs from General and Administrative
25 Expense to Office Furniture and Equipment is appropriate.

26

1 **Q. What is Staff recommending?**

2 A. Staff recommends decreasing General and Administrative expense by \$2,000, from
3 \$15,020 to \$13,020 as shown on Schedules CSB-8 and CSB-12. This cost is capitalized
4 by Staff Rate Base Adjustment No. 1.
5

6 **Operating Income Adjustment No. 4 – Wastewater Department, Depreciation Expense**

7 **Q. What is the Company proposing for Depreciation Expense?**

8 A. The Company is proposing \$7,965 for Depreciation Expense.
9

10 **Q. Please explain Staff's depreciation expense calculation.**

11 A. Staff calculated depreciation expense by applying Staff's recommended depreciation rates
12 to Staff's recommended plant account balances.
13

14 **Q. What is Staff recommending?**

15 A. Staff recommends decreasing Depreciation Expense by \$680, from \$7,965 to \$7,285 as
16 shown on Schedules CSB-8 and CSB-13.
17

18 **Operating Income Adjustment No. 5 – Wastewater Department, Property Tax Expense**

19 **Q. What is the Company proposing for Property Tax Expense?**

20 A. The Company is proposing \$5,575 for Property Tax Expense.
21

22 **Q. Please discuss the primary difference between Staff's and the Company's property
23 tax formula.**

24 A. The Department of Revenue's property tax calculation is based on a three-year average of
25 revenue. There is a two-year lag between the year of billing and the most recent of the

1 years included in the average. For example, a property tax bill issued in August 2002 will
2 be based on revenues for the years 1998, 1999, and 2000.

3
4 The Company calculates the three year average of revenue by adding the 2000, 2001, and
5 2002 revenues and dividing the sum by three. Staff's methodology calculates the three
6 year average of revenue by adding twice the 2002 Revenue to the Staff Proposed Revenue
7 then dividing the sum by three. Staff's pro forma adjustment to include Staff
8 recommended revenue in the three-year average of revenue provides a better
9 normalization of property tax expense.

10
11 The reason is that the Company's property tax expense will increase in future years if its
12 revenues increase as the result of a rate increase. However, there is a two-year lag
13 between the year of a rate increase and the year the increase is reflected in property tax
14 expense. Staff's method of calculating property tax expense is normalized to recognize
15 that it is revenue dependent.

16

17 **Q. What is Staff recommending?**

18 A. Staff recommends increasing Property Tax Expense by \$2,720, from \$5,575 to \$8,295 as
19 shown on Schedules CSB-8 and CSB-14.

20

21 **Operating Income Adjustment No. 6 – Wastewater Department, Income Tax Expense**

22 **Q. What is the Company proposing for Income Tax Expense?**

23 A. The Company is proposing a negative \$45,805 for Income Tax Expense.

24

25

26

1 **Q. Would you please discuss the primary differences between Staff's and the**
2 **Company's income tax expense?**

3 A. The primary differences between the Company's and Staff's income tax expenses are due
4 to the amount of operating loss and the formula used. Staff's formula applies the statutory
5 rates to the operating loss as shown on Schedule CSB-15. The Company's formula
6 applies a 38.598 percent rate to its entire taxable loss amount.

7
8 **Q. What is Staff recommending?**

9 A. Staff recommends increasing Test Year Income Tax Expense by \$12,300, from (\$45,805)
10 to (\$33,502) as shown on Schedules CSB-8 and CSB-15.

11

12 **RATE DESIGN – WASTEWATER DEPARTMENT**

13

14 **Q. Have you prepared a schedule summarizing the present, Company proposed, and**
15 **your recommended rates and service charges?**

16 A. Yes. Schedule CSB-16 provides a summary of the Company's present, Company's
17 proposed, and Staff's recommended rates.

18

19 **Q. Please summarize the present rate design.**

20 A. The present monthly customer charges vary by customer class as follows: Residential,
21 \$6.08; Small Commercial, \$6.08 (Additional toilet, \$1.53); Restaurants with Dishwashers,
22 \$18.43; Additional Monthly Commercial Charges (Laundromats \$2.93 per washing
23 machine and Wash Racks \$2.93 per wash rack); and Residential Equivalents, \$6.08.

24

25

26

1 **Q. Please summarize the Company's proposed rate design.**

2 A. The present monthly customer charges vary by customer class as follows: Residential,
3 \$16.64; Small Commercial, \$21.91; Restaurants with Dishwashers, \$50.44; Additional
4 Monthly Commercial Charges (Laundromats \$8.02 per washing machine and Wash Racks
5 \$8.02 per wash rack); and Residential Equivalents, \$16.64. Additionally, the Company
6 proposes new service related charges and increases to existing service related charges.
7

8 **Q. Please summarize Staff's recommended rate design.**

9 A. As shown on Schedule CSB-16, Staff's recommended rate design is as follows:
10 Residential, \$15.65; Small Commercial, \$19.60; Restaurants with Dishwashers, \$46.14;
11 Additional Monthly Commercial Charges (Laundromats \$7.33 per washing machine and
12 Wash Racks \$7.33 per wash rack); and Residential Equivalents, \$15.65. Additionally,
13 Staff recommends new service related charges and increases to existing service related
14 charges.
15

16 **Q. Does this conclude your testimony?**

17 A. Yes, it does.
18

Ajo Improvement Company - Wastewater Department
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Schedule CSB-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	[A] COMPANY ORIGINAL COST	[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	\$ 217,822	\$ 219,254
2	Adjusted Operating Income (Loss)	\$ (68,533)	\$ (78,326)
3	Current Rate of Return (L2 / L1)	-31.46%	-35.72%
4	Required Rate of Return	10.00%	8.80%
5	Required Operating Income (L4 * L1)	\$ 21,782	\$ 19,291
6	Operating Income Deficiency (L5 - L2)	\$ 90,315	\$ 97,617
7	Gross Revenue Conversion Factor	1.73080	1.38369
8	Increase In Gross Revenue (L7 * L6)	\$ 156,318	\$ 135,071
9	Adjusted Test Year Revenue	\$ 95,505	\$ 95,505
10	Proposed Annual Revenue (L8 + L9)	\$ 251,823	\$ 230,576
11	Required Increase in Revenue (%) (L8/L9)	163.67%	141.43%

References:

Column [A]: Company Schedules A-1, C-1, C-3, & D-1

Column [B]: Staff Schedules CSB-2, CSB-3, & CSB-7

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Billings	1.000000			
2	Uncollectible Factor	0.000000			
3	Revenues	1.000000			
4	Less: Combined Federal and State Tax Rate (Line 12)	0.277293			
5	Subtotal (L3 - L4)	0.7227			
6	Revenue Conversion Factor (L1 / L5)	1.38369			
<u>Calculation of Effective Tax Rate:</u>					
7	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
8	Arizona State Income Tax Rate	6.9680%			
9	Federal Taxable Income (L7 - L8)	93.0320%			
10	Applicable Federal Income Tax Rate (Line 34)	22.3163%			
11	Effective Federal Income Tax Rate (L9 x L10)	20.7613%			
12	Combined Federal and State Income Tax Rate (L8 +L11)	27.7293%			
13	Required Operating Income (Schedule CSB-1, Line 5)	\$ 19,291			
14	Adjusted Test Year Operating Income (Loss) (Schedule CSB-8, Line 16)	\$ (78,326)			
15	Required Increase in Operating Income (L13 - L14)		\$ 97,617		
16	Income Taxes on Recommended Revenue (Col. (D), L33)	\$ 3,950			
17	Income Taxes on Test Year Revenue (Col. (B), L33)	\$ (33,505)			
18	Required Increase in Revenue to Provide for Income Taxes (L16 -L17)		\$ 37,454		
19	Total Required Increase in Revenue (L15 + L18)		\$ 135,072		
<u>Calculation of Income Tax:</u>					
20	Revenue (Schedule CSB-7, Columns C and E)	\$ 95,505		\$ 230,577	
21	Less: Operating Expenses Excluding Income Taxes	\$ 207,336		\$ 207,336	
22	Less: Synchronized Interest (L37)	\$ 4,364		\$ 4,364	
23	Arizona Taxable Income (L20 - L21 - L22)	\$ (116,195)		\$ 18,877	
24	Arizona State Income Tax Rate	6.968%		6.968%	
25	Arizona Income Tax (L23 x L24)	\$ (8,096)		\$ 1,315	
26	Federal Taxable Income (L23 - L25)	\$ (108,099)		\$ 17,562	
27	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ (7,500)		\$ 2,634	
28	Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25%	\$ (6,250)		\$ -	
29	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ (8,500)		\$ -	
30	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ (3,158)		\$ -	
31	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -		\$ -	
32	Total Federal Income Tax	\$ (25,408)		\$ 2,634	
33	Combined Federal and State Income Tax (L25 + L32)	\$ (33,505)		\$ 3,950	
34	Applicable Federal Income Tax Rate [Col. (D), L32 - Col. (B), L32] / [Col. (C), L26 - Col. (A), L26]				22.3163%
<u>Calculation of Interest Synchronization:</u>					
35	Rate Base (Schedule CSB-3, Col. (C), Line 13)	\$ 219,254			
36	Weighted Average Cost of Debt	1.99%			
37	Synchronized Interest (L35 x L37)	\$ 4,364			

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS REF	(C) STAFF AS ADJUSTED
1	\$ 537,455	\$ 2,000	\$ 539,455
2	(344,072)	-	(344,072)
3	<u>\$ 193,383</u>	<u>\$ 2,000</u>	<u>\$ 195,383</u>
<u>LESS:</u>			
4	\$ -	\$ -	\$ -
5	\$ -	\$ -	\$ -
6	\$ -	\$ -	\$ -
7	-	-	-
8	<u>-</u>	<u>-</u>	<u>-</u>
9	\$ -	\$ -	\$ -
10	\$ -	\$ -	\$ -
11	\$ -	\$ -	\$ -
<u>ADD:</u>			
12	\$ 24,439	\$ (568)	\$ 23,871
13	<u>\$ 217,822</u>	<u>\$ 1,432</u>	<u>\$ 219,254</u>

References:
Column [A], Company Schedule B-1, Page 1
Column [B]: Schedule CSB-4
Column [C]: Column [A] + Column [B]

SUMMARY OF RATE BASE ADJUSTMENTS

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] ADJ No.1	[C] ADJ No.2	[D] ADJ No.3	[E] ADJ No.4	[F] ADJ No.5	[I] STAFF ADJUSTED
PLANT IN SERVICE:								
1	Oxidation Ponds / Treatment Facilities	\$ 231,085	-	\$ -	-	-	\$ -	\$ 231,085
2	Collection Mains	150,376	-	-	-	-	-	150,376
3	Manholes	23,774	-	-	-	-	-	23,774
4	Pumping Equipment	19,444	-	-	-	-	-	19,444
5	Collection Services	65,920	-	-	-	-	-	65,920
6	Office Furniture and Equipment	1,348	2,000	-	-	-	-	3,348
7	Transportation Equipment	11,252	-	-	-	-	-	11,252
8	Tools & Shop Equipment	34,256	-	-	-	-	-	34,256
9	Total Plant in Service - Actual	537,455	2,000	-	-	-	-	539,455
10	Pro-forma Adjustment	-	-	-	-	-	-	-
11	Total Plant in Service	\$ 537,455	\$ 2,000	\$ -	\$ -	\$ -	\$ -	\$ 539,455
12	Less: Accumulated Depreciation - Actual	\$ (339,665)	-	-	-	-	-	(339,665)
13	Less: Accumulated Depreciation - Pro Forma	(4,407)	-	-	-	-	-	(4,407)
14	Total Accumulated Depreciation - Adjusted	\$ (344,072)	-	\$ -	-	-	\$ -	\$ (4,407)
15	Net Plant in Service	\$ 193,383	\$ 2,000	\$ -	\$ -	\$ -	\$ -	\$ 195,383
LESS:								
16	Advances in Aid of Construction (AIAC)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
17	Service Line and Meter Advances	-	-	-	-	-	-	-
18	Contributions in Aid of Construction (CIAC)	-	-	-	-	-	-	-
19	Less: Accumulated Amortization	-	-	-	-	-	-	-
20	Net CIAC	-	-	-	-	-	-	-
21	Total Advances and Contributions	-	-	-	-	-	-	-
22	Customer Deposits	-	-	-	-	-	-	-
23	Deferred Income Tax Credits	-	-	-	-	-	-	-
ADD:								
24	Working Capital Allowance	24,439	-	(568)	-	-	-	-
25	Other Additions	-	-	-	-	-	-	23,871
26	Total Rate Base	\$ 217,822	\$ 2,000	\$ (568)	\$ -	\$ -	\$ -	\$ 219,254

ADJ No.	References:
1	Office Furn. & Equip - Software Schedule CSB-5
2	Working Capital Schedule CSB-6

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Schedule CSB-5

**RATE BASE ADJUSTMENT NO. 1 - OFFICE FURNITURE AND EQUIPMENT
SOFTWARE COST**

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Office Furniture & Equipment, Software	\$ 1,348	\$ 2,000	\$ 3,348

References:

Column A: Company Schedule E-5, Page 2

Column B: Testimony, CSB, Company Data Request Responses CSB 2-9

Column C: Column [A] + Column [B]

RATE BASE ADJUSTMENT NO. 2 - WORKING CAPITAL ALLOWANCE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	1/24th Purchased Power			
2	Purchased Power Expense	\$ 1,183	\$ -	\$ 1,183
3	Multiplied by	x 1/24		x 1/24
		<u>\$ 49</u>		<u>\$ 49</u>
4	1/8th O & M (Less Depr, Taxes, and Pur Water)			
5	Salaries and Wages	\$ 29,012	\$ (282)	\$ 28,730
6	Employee Pension and Benefits	\$ 19,741	\$ (192)	\$ 19,549
7	Purchased Power	\$ 1,183	\$ (1,183)	\$ -
8	Outside Services - Legal and Consulting	\$ 4,343	\$ (2,074)	\$ 2,269
9	Outside Services - Oper. and Maint.	\$ 103,637	\$ -	\$ 103,637
10	Rental Expense	\$ 15,600	\$ -	\$ 15,600
11	Materials and Supplies	\$ 7,767	\$ -	\$ 7,767
12	General and Administrative	\$ 15,020	\$ (2,000)	\$ 13,020
13	Depreciation	\$ -	\$ -	\$ -
14	Property Taxes	\$ -	\$ -	\$ -
15	Income Taxes	\$ -	\$ -	\$ -
16		<u>\$ 196,303</u>	<u>\$ (5,730)</u>	<u>\$ 190,573</u>
17	Multiplied by	x 1/8		x 1/8
		<u>\$ 24,538</u>		<u>\$ 23,822</u>
18	To Reconcile to Company	\$ (148)		\$ -
19	Total Working Capital Allowance	<u>\$ 24,439</u>	<u>\$ (568)</u>	<u>\$ 23,871</u>

References:

- Column [A]: Company Schedule B-5, Page 1 and Schedule C-1, Page 1
- Column [B]: Testimony, CSB
- Column [C]: Column [A] + Column [B]

OPERATING INCOME - TEST YEAR AND STAFF PROPOSED

LINE NO.	DESCRIPTION	[A] COMPANY TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
<u>REVENUES:</u>						
	Water Sales	\$ 89,796	\$ -	\$ 89,796	\$ 135,071	\$ 224,867
	Other Water Revenues	5,709	-	5,709	320	6,029
1	Total Operating Revenues	<u>\$ 95,505</u>	<u>\$ -</u>	<u>\$ 95,505</u>	<u>\$ 135,391</u>	<u>\$ 230,576</u>
<u>EXPENSES:</u>						
2	Salaries and Wages	\$ 29,012	\$ (282)	\$ 28,730	\$ -	\$ 28,730
3	Employee Pension and Benefits	19,741	(192)	19,549	-	19,549
4	Purchased Power	1,183	-	1,183	-	1,183
5	Outside Services - Legal and Consulting	4,343	(2,074)	2,269	-	2,269
6	Outside Services - Oper. and Maint.	103,637	-	103,637	-	103,637
7	Rental Expense	15,600	-	15,600	-	15,600
8	Materials and Supplies	7,767	-	7,767	-	7,767
9	General and Administrative	15,020	(2,000)	13,020	-	13,020
10	Depreciation	7,965	(680)	7,285	-	7,285
11	Property Taxes	5,575	2,720	8,295	-	8,295
12	Income Taxes	(45,805)	12,300	(33,505)	37,454	3,950
13	Total Operating Expenses	<u>\$ 164,038</u>	<u>\$ 9,793</u>	<u>\$ 173,831</u>	<u>\$ 37,454</u>	<u>\$ 211,285</u>
14	Operating Income (Loss)	<u>\$ (68,533)</u>	<u>\$ (9,793)</u>	<u>\$ (78,326)</u>	<u>\$ 97,617</u>	<u>\$ 19,291</u>

References:

Column (A): Company Schedule C-1, Page 2
Column (B): Schedule CSB-8
Column (C): Column (A) + Column (B)
Column (D): Schedules CSB-1 and CSB-2
Column (E): Column (C) + Column (D)

SUMMARY OF OPERATING INCOME ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] ADJ #1	[C] ADJ #2	[D] ADJ #3	[F] ADJ #4	[G] ADJ #5	[H] ADJ #6	[I] ADJ #7	[K] STAFF ADJUSTED
REVENUES:										
1	Water Sales	\$ 89,796	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 89,796
2	Other Water Revenues	5,709	-	-	-	-	-	-	-	5,709
3	Total Revenues	<u>\$ 95,505</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 95,505</u>
OPERATING EXPENSES:										
4	Salaries and Wages	\$ 29,012	(282)	-	-	-	-	-	-	28,730
5	Employee Pension and Benefits	19,741	-	(192)	-	-	-	-	-	19,549
6	Purchased Power	1,183	-	-	-	-	-	-	-	1,183
7	Outside Services - Legal and Consulting	4,343	-	-	(2,074)	-	-	-	-	2,269
8	Outside Services - Oper. and Maint.	103,637	-	-	-	-	-	-	-	103,637
9	Rental Expense	15,600	-	-	-	-	-	-	-	15,600
10	Materials and Supplies	7,767	-	-	-	-	-	-	-	7,767
11	General and Administrative	15,020	-	-	-	(2,000)	-	-	-	13,020
12	Depreciation	7,965	-	-	-	-	(680)	-	-	7,285
13	Property Taxes	5,575	-	-	-	-	-	2,720	-	8,295
14	Income Taxes	(45,805)	-	-	-	-	-	-	-	(33,505)
15	Total Operating Expenses	<u>\$ 164,038</u>	<u>\$ (282)</u>	<u>\$ (192)</u>	<u>\$ (2,074)</u>	<u>\$ (2,000)</u>	<u>\$ (680)</u>	<u>\$ 2,720</u>	<u>\$ 12,300</u>	<u>\$ 173,831</u>
16	Operating Income (Loss)	<u>\$ (68,533)</u>	<u>\$ 282</u>	<u>\$ 192</u>	<u>\$ 2,074</u>	<u>\$ 2,000</u>	<u>\$ 680</u>	<u>\$ (2,720)</u>	<u>\$ (12,300)</u>	<u>\$ (78,326)</u>

ADJ No.	References:
1	Salaries and Wages
2	Pensions and Benefits
3	Outside Services, Legal & Cons.
4	General and Administrative
5	Depreciation Expense
6	Property Taxes
7	Income Taxes

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Schedule CSB-9

OPERATING INCOME ADJUSTMENT NO. 1 - SALARY AND WAGE INCREASE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Salary and Wage Expense	\$ 28,167	\$ -	\$ 28,167
2	Percentage	3%	-1%	2%
3	Salary and Wage Adjustment	\$ 845	\$ (282)	\$ 563

References:

- Column A: Company Data Request Response CSB 1-20, Company Workpaper 000025
- Column B: Testimony, CSB
- Column C: Column [A] + Column [B]

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Schedule CSB-10

OPERATING INCOME ADJUSTMENT NO. 2 - PENSIONS AND BENEFITS

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Pensions and Benefits	\$ 19,166	\$ -	\$ 19,166
2	Percentage	3%	-1%	2%
3	Pensions and Benefits Adjustment	\$ 575	\$ (192)	\$ 383

References:

Column A: Company Data Request Response CSB 1-20, Company Workpaper 000025
Column B: Testimony, CSB
Column C: Column [A] + Column [B]

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Schedule CSB-11

OPERATING INCOME ADJUSTMENT NO. 3 - OUTSIDE SERVICES, LEGAL & CONSULTING

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Data File Conversion	967	-	967
2	Training	\$ 1,625	-	\$ 1,625
3	Total Computer Conversion Expense	\$ 2,592	-	\$ 2,592
4	Division Factor	1		5
5	Total Annual Computer Conversion Exp	\$ 2,592	\$ (2,074)	\$ 518

References:

Column A: Company Data Request Response CSB 1-24 and 2-9

Column B: Testimony, CSB

Column C: Column [A] + Column [B]

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Schedule CSB-12

OPERATING INCOME ADJUSTMENT NO. 4 - GENERAL & ADMINSTRATIVE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	General & Admin., Computer Software	\$ 2,000	\$ (2,000)	\$ -

References:

- Column A: Company Data Request Response CSB 1-3 and 2-9
- Column B: Testimony, CSB
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 5 - DEPRECIATION EXPENSE ON TEST YEAR PLANT

LINE NO.	DESCRIPTION	[A]	[B]	[C]	[D]	[E]
		PLANT IN SERVICE	FULLY DEPRECIATED PLANT	DEPRECIABLE PLANT (Col A - Col B)	DEPRECIATION RATE	DEPRECIATION EXPENSE (Col C x Col D)
1	Oxidation Ponds / Treatment Facilities	\$ 231,085	\$ 31,085	\$ 200,000	3.33%	\$ 6,660
2	Collection Mains	\$ 150,376	\$ 150,376	\$ -	0.00%	\$ -
3	Manholes	\$ 23,774	\$ 23,774	\$ -	0.00%	\$ -
4	Pumping Equipment	\$ 19,444	\$ 19,444	\$ -	0.00%	\$ -
5	Collection Services	\$ 65,920	\$ 65,920	\$ -	0.00%	\$ -
6	Office Furniture and Equipment, Computers	\$ 3,348	\$ 225	\$ 3,123	20.00%	\$ 625
7	Transportation Equipment	\$ 11,252	\$ 11,252	\$ -	0.00%	\$ -
8	Tools & Shop Equipment	\$ 34,256	\$ 34,256	\$ -	0.00%	\$ -
9	Total Plant	\$ 539,455	\$ 336,332	\$ 203,123		\$ 7,285
10	Composite Depreciation Rate (Depr Exp / Depreciable Plant):	3.59%				
11	CIAC: \$	-				
12	Amortization of CIAC (Line 10 x Line 11): \$	-				
13	Depreciation Expense Before Amortization of CIAC: \$	7,285				
14	Less Amortization of CIAC: \$	-				
15	Test Year Depreciation Expense - Staff: \$	7,285				
16	Depreciation Expense - Company: \$	7,965				
17	Staff's Total Adjustment: \$	(680)				

References:

- Column [A]: Schedule CSB-4
- Column [B]: Staff Workpapers
- Column [C]: Column [A] - Column [B]
- Column [D]: Engineering Staff Report
- Column [E]: Column [C] x Column [D]

Ajo Improvement Company - Wastewater Department
 Docket No. WS-01025A-03-0350
 Test Year Ended December 31, 2002

Schedule CSB-14

OPERATING INCOME ADJUSTMENT NO. 6 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	2002 Staff Adjusted Test Year Revenues			\$ 95,505
2	Weight Factor			\$ 2
3	Subtotal (Line 1 x Line 2)			\$ 191,010
4	Staff Recommended Revenue			\$ 230,576
5	Subtotal (Line 4 + Line 5)			\$ 421,586
6	Number of Years			\$ 3
7	Three Year Average (Line 5 / Line 6)			\$ 140,529
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			\$ 281,057
10	Plus: 10% of 2002 CWIP			\$ -
11	Less: Net Book Value of Licensed Vehicles			\$ -
12	Full Cash Value (Line 9 + Line 10 - Line 11)			\$ 281,057
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			\$ 70,264
15	Composite Property Tax Rate			0.118055
16	Staff Proposed Property Tax Expense (Line 14 x Line 15)	\$ 5,575	\$ 2,720	\$ 8,295

References:

Column A: Company Schedule C-1, Page 2
 Column B: Testimony, CSB
 Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 7 - INCOME TAXES

LINE NO.	<u>DESCRIPTION</u>	(A)	(B)
	<i>Calculation of Income Tax:</i>		
		<u>Test Year</u>	
1	Revenue (Schedule CSB-9, Line 9)	\$ 95,505	
2	Less: Operating Expenses Excluding Income Taxes	\$ 207,336	
3	Less: Synchronized Interest (L17)	\$ 4,364	
4	Arizona Taxable Income (L1- L2 - L3)	\$ (116,195)	
5	Arizona State Income Tax Rate	6.968%	
6	Arizona Income Tax (L4 x L5)		\$ (8,096)
7	Federal Taxable Income (L4 - L6)	\$ (108,099)	
8	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ (7,500)	
9	Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25%	\$ (6,250)	
10	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ (8,500)	
11	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ (3,158)	
12	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -	
13	Total Federal Income Tax		\$ (25,408)
14	Combined Federal and State Income Tax (L6 + L13)		<u>\$ (33,505)</u>
	<i>Calculation of Interest Synchronization:</i>		
15	Rate Base (Schedule CSB-3, Col. (C), Line 13)	\$ 219,254	
16	Weighted Average Cost of Debt	1.99%	
17	Synchronized Interest (L16 x L17)	<u>\$ 4,364</u>	
18		Income Tax - Per Staff \$ (33,505)	
19		Income Tax - Per Company \$ (45,805)	
20		Staff Adjustment \$ 12,300	

RATE DESIGN

	Present Rates	---Proposed Rates---	
		Company	Staff
Residential Service - Per Month	\$ 6.08	\$ 16.64	\$ 15.65
Commercial and Municipal			
Regular Service	\$ 6.08	\$ 21.91	\$ 19.60
Additional Toilets	\$ 1.53	None	None
Restaurants with Dishwashers	\$ 18.43	\$ 50.44	\$ 46.14
Additional Monthly Commercial Charges:			
Laundromats - Per Washing Machine	\$ 2.93	\$ 8.02	\$ 7.33
Wash Racks - Per Rack	\$ 2.93	\$ 8.02	\$ 7.33
Residential Equivalents (REU):			
Industrial and Commercial - Per REU	\$ 6.08	\$ 16.64	\$ 15.65
Schools - Per REU	\$ 6.08	\$ 16.64	\$ 15.65

Service Charges:	Present Rates	---Proposed Rates---	
		Company	Staff
Establishment (Regular Hours)	\$ 25.00	\$ 25.00	\$ 25.00
Establishment (After Hours)	(a)	\$ 40.00	\$ 40.00
Re-establishment Within 12 Months	(b)	(b)	(b)
Re-connection of Service (Regular Hours)	\$ 10.00	\$ 50.00	\$ 25.00
Re-connection of Service (After Hours)	(a)	\$ 65.00	\$ 40.00
NSF Check Charge	\$ 10.00	\$ 20.00	\$ 20.00
Late Charge	1.50%	1.50%	1.50%
Deferred Payment Finance Charge	1.50%	1.50%	1.50%
Service Calls - After Hours Only	\$25/hr	\$40/hr	\$40/hr
Deposits	(d)	(d)	(d)
Deposit Interest	(d)	(d)	(d)

- (a) No current tariff.
- (b) Monthly minimum times months off system (Rule A.A.C. R14-2-603D)
- (c) Per A.A.C. R14-2-603D
- (d) Per A.A.C. R14-2-603B

Ajo Improvement Company - Wastewater Department
Docket No. WS-01025A-03-00350
Test Year Ended December 31, 2002

Schedule 17

TYPICAL BILL ANALYSIS
Residential Service

	<u>Present</u> <u>Rates</u>	<u>Proposed</u> <u>Rates</u>	<u>Dollar</u> <u>Increase</u>	<u>Percent</u> <u>Increase</u>
Company	\$6.08	\$16.64	\$10.56	173.7%
Staff	\$6.08	\$15.65	\$9.57	157.4%

CHELUS

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF)
AJO IMPROVEMENT COMPANY FOR RATE)
ADJUSTMENTS IN ITS WATER AND)
WASTEWATER RATES)
_____)

DOCKET NO. WS-0125A-03-0350

DIRECT TESTIMONY

OF

JOHN A CHELUS

UTILITIES ENGINEER

UTILITIES DIVISION

January 9, 2004

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**EXECUTIVE SUMMARY
AJO IMPROVEMENT COMPANY
DOCKET NO. WS-0125A-03-0350**

Water Division

CONCLUSIONS

- I. ADEQ reported TOTAL COMPLIANCE with the state drinking water rules. ADEQ certified that the water system is delivering water that does not exceed any maximum contaminant level and meets the water quality standards of the Safe Drinking Water Act.
- II. The system has adequate storage and well capacity.

RECOMMENDATIONS

- I. Staff recommends that Ajo Improvement Company use depreciation rates by individual National Association of Regulatory Utilities Commissioners ("NARUC") category, as delineated in Exhibit 4.
- II. Staff recommends that the Company file a curtailment tariff within 45 days after the effective date of any decision and order pursuant to this application. The tariff shall be submitted to the Director of the Utilities Division for his review and certification. Staff also recommends that the tariff shall generally conform to the sample tariff found posted on the Commission's web site (www.cc.state.az.us/utility) or available upon request from Commission Staff.
- III. Staff recommends adopting the meter and service line installation charges proposed by the Company with the modifications proposed by Staff as shown in table 1 Section L.
- IV. Staff recommends that the Company, within 6 months from the effective date of a decision in this proceeding, submit a report to the Commission's Utilities Division describing what steps the Company is planning to take in order to reduce the arsenic level in its water to a concentration below 10 µg/l.
- V. The Company reported water testing expenses for Ajo Water of \$440 for the test year ending December 31, 2002. Staff considers the reported expense reasonable.

Wastewater Division

RECOMMENDATIONS

- I. Staff recommends that Ajo Improvement Company use depreciation rates by individual NARUC category, as delineated in Exhibit 4.
- II. Staff recommends that any permanent rates and charges in this matter shall become effective on the first day of the month after the Director of the Utilities Division receives notice from the Arizona Department of Environmental Quality that Ajo Improvement Company – Wastewater Division meets the standards required by the Arizona Administrative Code.

1 INTRODUCTION

2 **Q. Please state your name, place of employment and job title.**

3 A. My name is John A. Chelus. My place of employment is the Arizona Corporation
4 Commission ("Commission"), Utilities Division, 1200 West Washington Street, Phoenix,
5 Arizona 85007. My job title is Utilities Engineer.

6
7 **Q. How long have you been employed by the Commission?**

8 A. I have been employed by the Commission since September 1990.

9
10 **Q. Please list your duties and responsibilities.**

11 A. As a Utilities Engineer, specializing in water and wastewater engineering, my
12 responsibilities include: the inspection, investigation, and evaluation of water and
13 wastewater systems; obtaining data, preparing reconstruction cost new and/or original cost
14 studies, cost of service studies and investigative reports; providing technical
15 recommendations and suggesting corrective action for water and wastewater systems; and
16 providing written and oral testimony on rate applications and other cases before the
17 Commission.

18
19 **Q. How many companies have you analyzed for the Utilities Division?**

20 A. I have analyzed approximately 145 companies in various areas for the Utilities Division.

21
22 **Q. Have you previously testified before this Commission?**

23 A. Yes.

1 **Q. What is your educational background?**

2 A. I graduated from the Rochester Institute of Technology in 1976 with a Bachelors Degree
3 in Civil Engineering and from Oklahoma State University in 1978 with a Masters Degree
4 in Environmental Engineering.

5
6 **Q. Briefly describe your pertinent work experience.**

7 A. I worked for the Dallas Water Utilities as an engineer in the Wastewater Division, and
8 then in the Engineering Design Division from 1978 to 1981. I moved to Grand Junction,
9 Colorado and worked for Multi Mineral Corporation as a research engineer until 1982.
10 After this I worked for Westwater Engineering Consultants as a design engineer. In 1983,
11 I was employed by Sauter Construction as a construction engineer for the construction of
12 the Ute Water Treatment facilities in Palisade, Colorado. In 1984 and 1985, I was
13 employed by the City of Grand Junction as a Grade IV wastewater operator at its 12
14 million gallon per day activated sludge treatment facility. In 1986, I moved to Phoenix
15 and began working for the Arizona Department of Environmental Quality ("ADEQ"),
16 Office of Water Quality, as a design review engineer, and then as a field engineer. I
17 stayed at ADEQ until transferring to the Commission in 1990.

18

19 **PURPOSE OF TESTIMONY**

20 **Q. Were you assigned to provide an engineering analysis and recommendation for the**
21 **Ajo Improvement Company ("Company") in this proceeding?**

22 A. Yes. I reviewed the Company's application and responses to data requests, and I visited
23 the water and wastewater systems on September 25, 2003. This testimony and its
24 attachments will present Staff's findings and engineering evaluation.

25

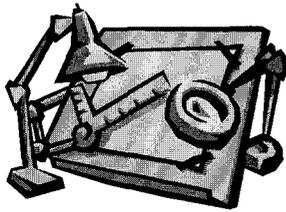
1 **ENGINEERING REPORT**

2 **Q. Please describe the attached Engineering Reports, Exhibit JAC-1 and JAC-2.**

3 A. Exhibit JAC-1 presents the details and analyses of Staff's findings of the Ajo
4 Improvement Company – Water Division, and is attached to this direct testimony. Exhibit
5 JAC-1 contains the following major topics: (1) location of the company, (2) a description
6 of the water system and the processes, (3) arsenic analysis (4) compliance with the rules of
7 the Arizona Department of Environmental Quality, (5) compliance with the Arizona
8 Corporation Commission, (6) compliance with the Arizona Department of Water
9 Resources, (7) water testing expense, (8) water use, (9) growth, (10) depreciation rates,
10 (11) curtailment tariffs, and (12) service line and meter installation charges. Exhibit JAC-
11 2 presents the details and analyses of my findings of the Ajo Improvement Company –
12 Wastewater Division, and is attached to this direct testimony. Exhibit JAC-2 contains the
13 following major topics: (1) location of the company, (2) a description of the water system
14 and the processes, (3) compliance with the rules of the Arizona Department of
15 Environmental Quality, (4) compliance with the Arizona Corporation Commission (5)
16 wastewater flow, (6) growth, (7) and depreciation rates. Staff's conclusions and
17 recommendations from the engineering report are contained in the "EXECUTIVE
18 SUMMARY", above.

19
20 **Q. Does this conclude your direct testimony?**

21 A. Yes, it does.



ENGINEERING REPORT FOR
AJO IMPROVEMENT COMPANY
WATER DIVISION (RATES)
Docket No. WS-01025A-03-0350
By John A. Chelus
January 9, 2004

A. LOCATION OF COMPANY

Ajo Improvement Company - Water Division ("Ajo Water or Company") serves approximately 1,130 customers in Ajo, Arizona in Pima County. Ajo is approximately 110 miles southwest of downtown Phoenix. Exhibit 1 describes the location of the Company within Pima County, and Exhibit 2 describes the certificated area of the Company within Pima County.

B. DESCRIPTION OF THE WATER SYSTEM

The plant facilities were visited on September 25, 2003, by John A. Chelus, Utilities Engineer, in the accompaniment of Mike Lane, Operations Manager for Phelps Dodge Corporation (Phelps Dodge).

Phelps Dodge Well and Booster System

Phelps Dodge owns a number of wells located approximately eight miles outside of the town of Ajo. These wells supply water to the Phelps Dodge mines and Ajo Water. The wells that supply Ajo Water are listed in the following table. During the inspection, only Well No. 12 was supplying water to Ajo Water. Well No. 10 was down for repair and the others were out of service for other reasons.

Well No.	ADWR No.	Location	Depth (feet)	Casing Diameter (inches)	Water Level (feet)	Pump Size & Type	Max Pump Capacity (gpm)	Date Complete
9	55-600485	C(11-6) 24 bda	1,200	24/20	711	Sub.	1,710	01/15/53
10	55-600488	C(11-6) 24 ada	1,333	24/20	724	500 hp Sub	1,700	10/29/54
11	55-600489	C(11-6) 24 bda	1,350	30/24/20	722	Sub.	N/A	08/06/60
12	55-600590	C(11-6) 24 add	1,170.	30/20	732	500 hp Turb.	1,750	12/19/74

Water from the wells is pumped through two 10,000 gallon surge tanks. From here the water enters a booster pump building. Three 400-hp booster pumps send the water over approximately 8 miles of 24-inch and 30-inch Drisco (polyethelene) pipe up a rise of over 400 feet where raw water is stored in two 500,000 gallon elevated tanks for delivery to Ajo Water.

Ajo Improvement Company System - 10-221

Ajo Improvement Company is a consecutive system to the Phelps Dodge system. Water from the Phelps Dodge raw water storage tanks is gravity fed to a water treatment facility where the water is fed through three activated alumina towers to remove arsenic and fluoride. The raw water arsenic concentration is at 75 micrograms per liter ($\mu\text{g/l}$) and fluoride is at 8.7 milligrams per liter (mg/l). Gas chlorination is used for disinfection prior to treatment. Caustic soda and sulfuric acid are used to regenerate the activated alumina and adjust pH. The towers are regenerated after every 7 or 8 million gallons of water is treated. Approximately 350,000 gallons are used for each re-generation. The backwash water from this process is sent to the wastewater treatment lagoons for disposal. Arsenic is reduced in the treated water to an arsenic level of 22 $\mu\text{g/l}$ and a fluoride level below 4.0 mg/l . The treated water is blended with raw water to reach the current arsenic maximum contaminant level (MCL) of 50 $\mu\text{g/l}$ and fluoride level of 4.0 mg/l . Treated water is pumped using two 25-hp booster pumps to two 500,000 gallon elevated treated water storage tanks. These tanks are called the Hot Rod tanks. From here, the water is sent to the distribution system. Ajo Water is charged for the water that is used by the customers. At points in the distribution system, there are interconnections to the Arizona Water Company Ajo Heights system and the Five Acres Water Corporation and the Phelps Dodge Plant. The following tables list the Ajo Water plant in tabular form. Exhibit 3 provides a process schematic for the water system. The water system has adequate storage and well production.

Treatment, Storage, Pumping

Structure or equipment	Quantity and Capacity
Treatment Plant	Three tower activated alumina reactors
Booster Pumps	Two 25 hp
Storage Tanks	Two - 500,000 gallons
Fire Hydrants	130

Distribution Mains

Diameter	Material	Length
12 inch	Ductile Iron & Asbestos Cement	3,900/3,300
10 inch	Ductile Iron & Asbestos Cement	11,400/13,060
8 inch	Cast Iron & Steel	600/9,500 ft
6 inch	Asbestos Cement & PVC	11,300/600 ft
5 inch	Cast Iron	7,600 ft
4 inch	Cast Iron/PVC/Steel	1,200/900/1,200 ft
2 inch	Copper & PVC	2,100/300 ft
	Total	66,960 ft.

Meters

Size	Quantity
5/8 x 3/4 inch	1,073
1 inch	19
1 1-2 inch	1
2 inch	17
Turbo 3 inch	7
Turbo 4 inch	2

C. ARSENIC

The U.S. Environmental Protection Agency (EPA) has reduced the MCL in drinking water from 50 micrograms per liter ($\mu\text{g}/\text{l}$) to 10 $\mu\text{g}/\text{l}$. The date for compliance with the new MCL is January 23rd, 2006. The most recent lab analysis by the Company indicated that the arsenic level in its source supply is 75 $\mu\text{g}/\text{l}$. Ajo Water has the treatment facilities in place to bring the level down to 22 $\mu\text{g}/\text{l}$. This level of treatment is adequate to reach the current MCL of 50 $\mu\text{g}/\text{l}$ but will fall short of meeting the new standard of 10 $\mu\text{g}/\text{l}$. The Company will be required to implement a plan to address this issue. This could mean installing additional treatment facilities or locating better sources of water to achieve 10 $\mu\text{g}/\text{l}$ or less.

Staff recommends that the Company, within 6 months from the effective date of a decision in this case, submit a report to the Commission's Utilities Division describing what steps the Company is planning to take in order to reduce the arsenic level in its water to a concentration below 10 $\mu\text{g}/\text{l}$.

D. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY COMPLIANCE (ADEQ)

ADEQ has determined that this system is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

E. ARIZONA CORPORATION COMMISSION COMPLIANCE

A check with the Utilities Division Compliance Unit showed no outstanding compliance issues.

F. ARIZONA DEPARTMENT OF WATER RESOURCES COMPLIANCE

Ajo Water is not within any Active Management Area, and consequently is not subject to reporting and conservation rules.

G. WATER TESTING EXPENSES

Water Testing Expense

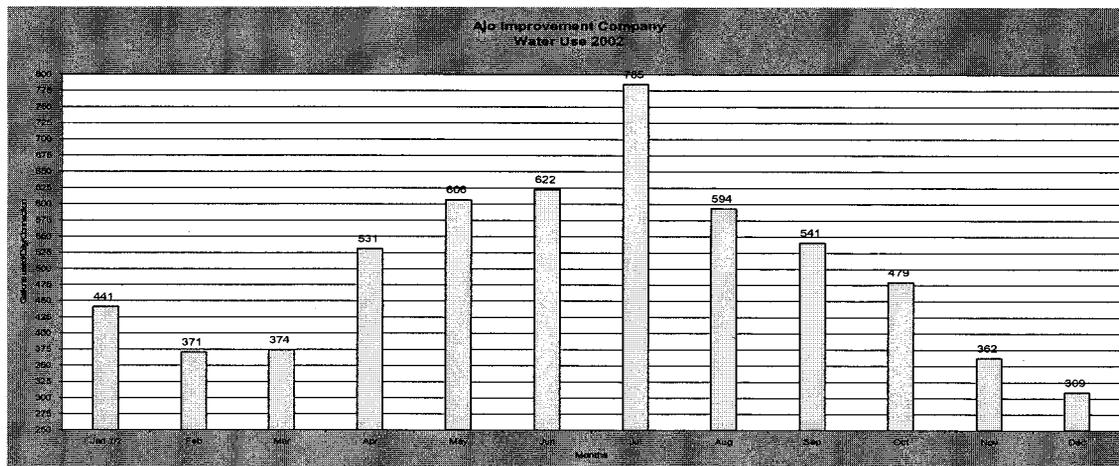
The Company reported water testing expenses for Ajo Water of \$440 for the test year ending December 31, 2002 in response to Staff data request CSB-2-10. Staff considers the reported expense reasonable.

H. WATER USE

Water Sold

Based on the information provided by the Company in its 2002 annual report, water use for the year 2002 is presented below. Customer consumption experienced a high monthly

water use of 785 gallons per day (“GPD”) per connection and a low monthly water use of 309 GPD per connection for an average annual use of 501 GPD per connection.



Non-account Water

Non-account water should be 10% or less and never more than 15%. It is important to be able to reconcile the difference between water sold and the water produced by the source. A water balance will allow a water company to identify water and revenue losses due to leakage, theft, and flushing. Based on water usage reported in the 2002 annual report, non-account water was calculated to be 5.40%, which is within acceptable limits.

I. GROWTH

Based on information provided by Ajo Water in its annual reports, the Company has grown from 1,123 customers in 1999 to 1,130 customers in 2002. There are no indications this slow growth rate will change in the near future.

J. DEPRECIATION RATES

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Exhibit 4. It is recommended that the Company use depreciation rates by individual National Association of Regulatory Utilities Commissioners (NARUC) category, as delineated in Exhibit 4.

K. CURTAILMENT PLAN TARIFF

A curtailment tariff is an effective tool to allow a water company to manage its resources during periods of shortages due to pump breakdowns, droughts, or other unforeseeable events. Since Ajo Water does not have a curtailment tariff, this rate application provides an opportune time to prepare and file such a tariff. Staff recommends that the Company file a curtailment tariff within 45 days after the effective date of any decision and order pursuant to this application. The tariff shall be submitted to the Director of the Utilities Division for his review and certification. Staff also recommends that the tariff shall generally conform to the sample tariff found posted on the Commission's web site (www.cc.state.az.us/utility) or available upon request from Commission Staff.

L. SERVICE LINE AND METER INSTALLATION CHARGES

The Company has requested to change its meter and service line charges as shown in the following table. These charges are refundable advances. The Company's proposed charges are considered reasonable and customary charges. The Company did not provide charges for all meter sizes. Therefore, Staff recommends adopting the meter and service line installation charges proposed by Staff which includes charges for all meter sizes

**Table 1
Service Line and Meter Installation Charges**

Meter Size	Current Charges	Proposed Charges	Staff Recommendation
5/8 x3/4-inch	\$100	\$400	\$400
3/4-inch	--	--	\$450
1-inch	\$150	\$500	\$500
1-1/2-inch	--	\$750	\$750
2-inch	\$150	\$1,300	\$1,300
3-inch	--	--	\$2,000
4-inch	--	--	\$3,000
6-inch	--	--	\$6,035

EXHIBITS

LOCATION OF AJO IMPROVEMENT COMPANY EXHIBIT 1

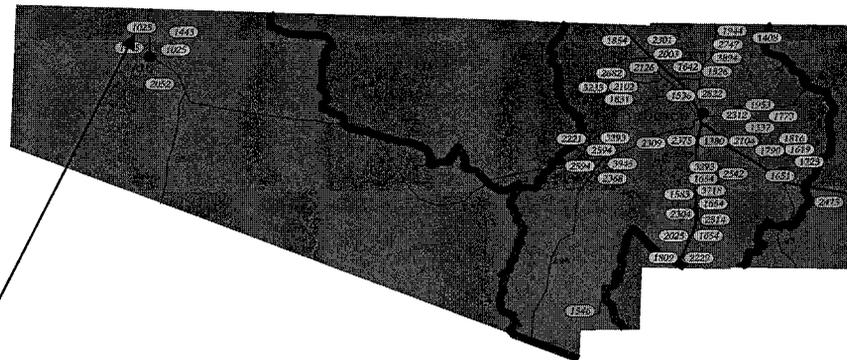
CERTIFICATED AREA OF AJO IMPROVEMENT COMPANY..... EXHIBIT 2

PROCESS SCHEMATIC EXHIBIT 3

DEPRECIATION RATES EXHIBIT 4

Exhibit 1

P I M A C O U N T Y

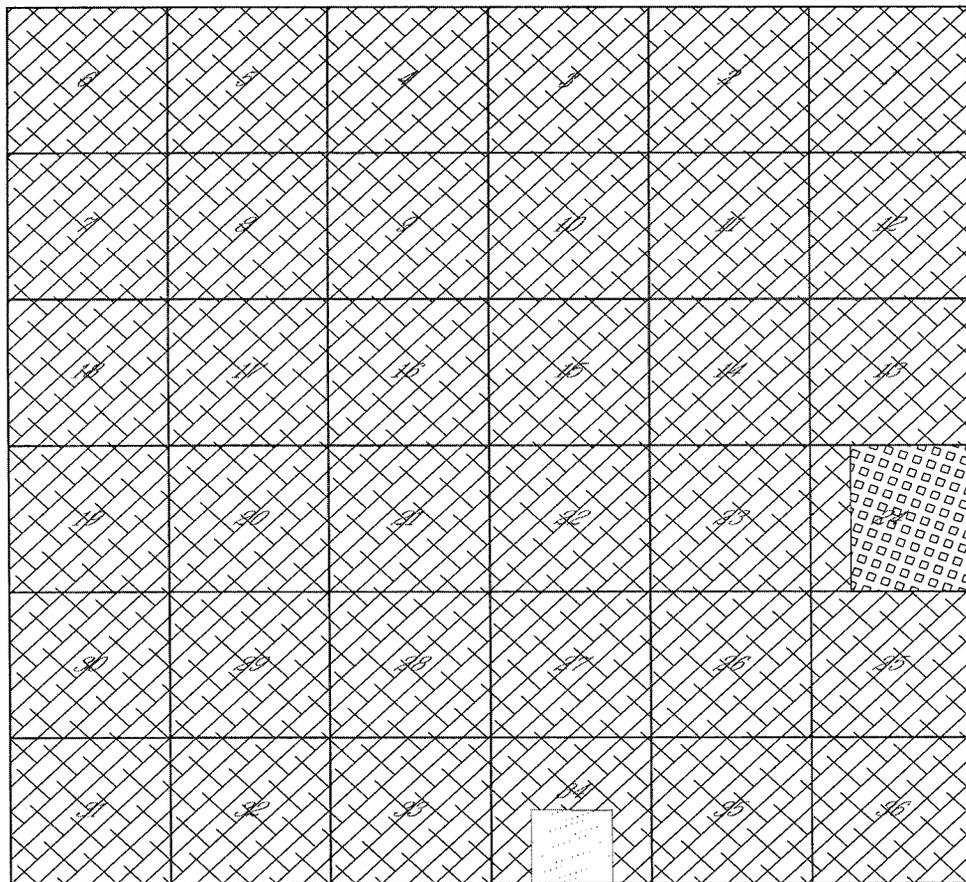


- | | | | |
|------|---|------|---|
| 1025 | AJO IMPROVEMENT COMPANY | 2368 | MIRABELL WATER COMPANY, INC. |
| 2473 | ANDERSON WATER COMPANY, INC. | 1408 | MT. LEMMON COOPERATIVE WATER COMPANY, INC. |
| 3233 | ANWAY MANVILLE L.L.C. WATER COMPANY | 2314 | QUAIL CREEK WATER COMPANY, INC. |
| 1546 | ARIVACATOWNSITE COOPERATIVE WATER COMPANY | 2102 | RANCHO DEL CONEJO WATER COMMUNITY COOPERATIVE |
| 1445 | ARIZONA WATER COMPANY (AJO HEIGHTS) | 3918 | RANCHO SAHUARITA WATER COMPANY |
| 2126 | AVRA WATER COOPERATIVE, INC. | 1380 | RAY WATER COMPANY |
| 2304 | COMMUNITY WATER COMPANY OF GREEN VALLEY | 2003 | RILLITO WATER USERS |
| 1642 | DESPOBLADO WATER COMPANY | 1619 | RINCON CREEK WATER COMPANY |
| 2309 | DIABLO VILLAGE WATER COMPANY | 1337 | RINCON RANCH ESTATES WATER COMPANY, INC. |
| 1654 | FARMERS WATER COMPANY | 1723 | RINCON WATER COMPANY |
| 1777 | FORTY-NINER WATER COMPANY | 1790 | SAGUARO WATER COMPANY |
| 3945 | FRANCESCA WATER COMPANY, INC. | 1851 | SANDARIO WATER COMPANY |
| 2025 | GREEN VALLEY WATER COMPANY | 2822 | SLEEPY HOLLOW MOBILE HOME ESTATES |
| 2312 | HALCYON ACRES ANNEX # 2 WATER COMPANY, INC. | 1816 | SPANISH TRAIL WATER COMPANY |
| 1953 | HALCYON ACRES WATER USERS ASSOCIATION | 3894 | STEAM PUMP INVESTORS, L.L.C. |
| 2542 | LA CASITA WATER COMPANY, INC. | 3293 | THIM UTILITY COMPANY |
| 1944 | LAGO DEL ORO WATER COMPANY | 2594 | THIM WATER CORPORATION |
| 1809 | LAKEWOOD WATER COMPANY | 2682 | TIERRA LINDA HOMEOWNERS ASSOCIATION, INC. |
| 1583 | LAS QUINTAS SERENAS WATER COMPANY | 2301 | TORTOLITA WATER COMPANY, INC. |
| 1536 | LAZY C WATER SERVICE | 1651 | VAL WATER COMPANY |
| 2747 | LOS CERROS WATER COMPANY, INC. | 2229 | VIVA DEVELOPMENT CORPORATION |
| 1554 | LYN-LEE WATER COMPANY | 2104 | VOYAGER WATER COMPANY |
| 1526 | MESALAND WATER COMPANY, INC. | 2052 | WHY UTILITY COMPANY |
| 2375 | MIDVALE FARMS WATER COMPANY | 2221 | WORDEN WATER COMPANY |

Exhibit 2

COUNTY: *Pima*

RANGE 6 West



TOWNSHIP 11 South



(2)

Five Acres Water Corporation
(Non-jurisdictional)



E-1025 (3)

Ajo Improvement Company



U-1445 (4)

Arizona Water Company (Ajo Heights)

Exhibit 3

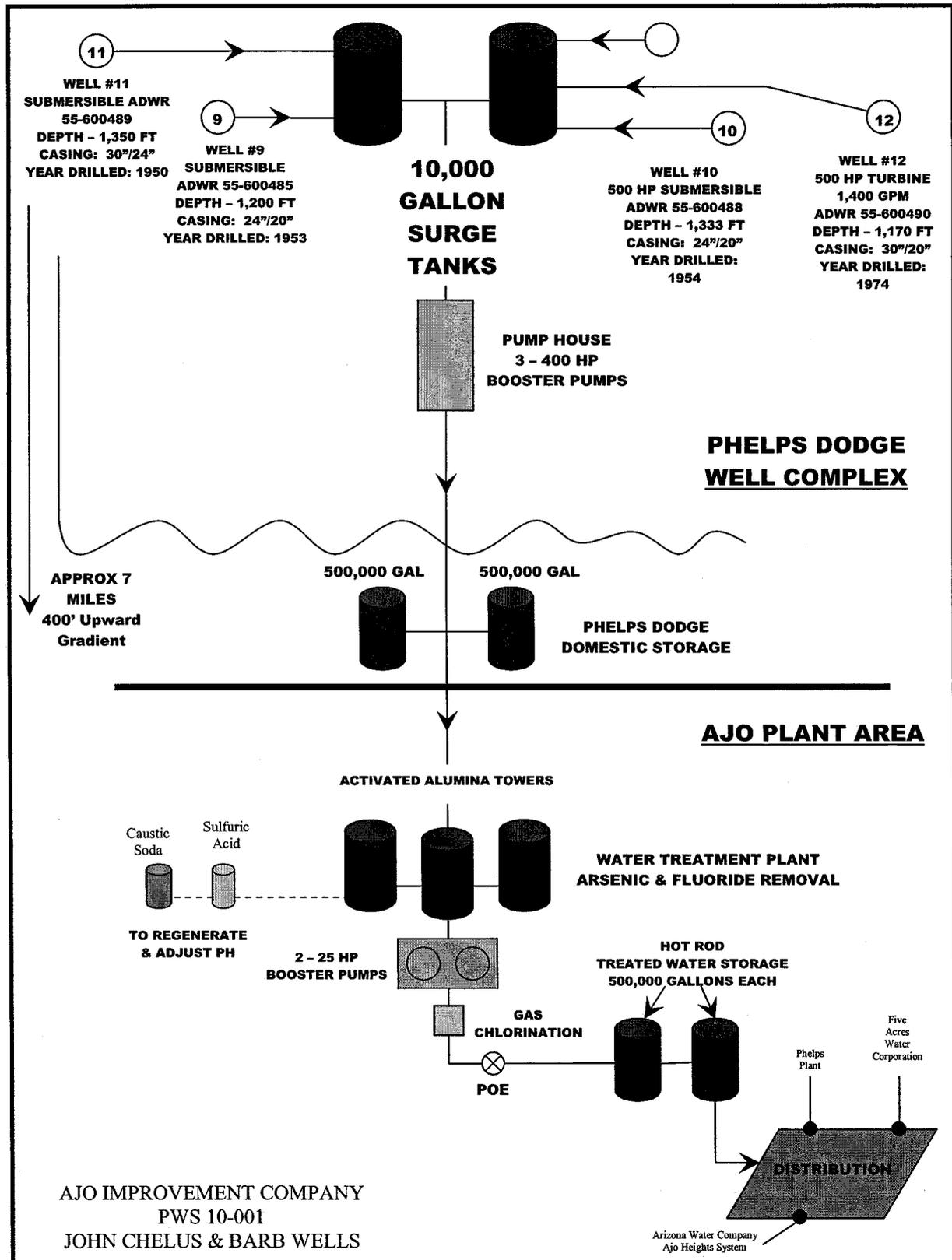
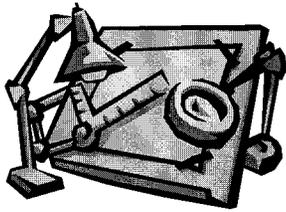


Exhibit 4
TYPICAL DEPRECIATION RATES FOR WATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.



**ENGINEERING REPORT FOR
AJO IMPROVEMENT COMPANY
WASTEWATER DIVISION (RATES)
Docket No. WS-01025A-03-0350
By John A. Chelus
January 9, 2004**

A. LOCATION OF COMPANY

Ajo Improvement Company - Wastewater Division ("Ajo Sewer or Company") serves approximately 1,130 customers in Ajo, Arizona, Pima County. Ajo is approximately 110 miles southwest of downtown Phoenix. Exhibit 1 describes the location of the Company within Pima County, and Exhibit 2 describes the certificated area of the Company within Pima County.

B. DESCRIPTION OF THE WASTEWATER SYSTEM

The plant facilities were visited on September 25, 2003, by John A. Chelus, Utilities Engineer, in the accompaniment of Mike Lane, Operations Manager for Phelps Dodge Corporation (Phelps Dodge). The wastewater lagoons are located on Phelps Dodge Mining Company property between Well Road and the Phelps Dodge tailing pond. The plant is owned and operated by the Ajo Improvement Company.

The wastewater treatment facilities consist of a newly completed 0.6 million gallon per day (MGD) three cell lined aerated lagoon system. The facilities were completed in 2001. This replaced an 11 acre wastewater stabilization lagoon. See Exhibit 3 for a schematic of the facilities. The major components and process is as follows:

1. The first, or primary cell includes a 171,000 cubic foot (cu-ft) anoxic fermentation pit in the center of the cell which is surrounded by 323,000 cu-ft biomass maintained in an aerobic environment separated by a floating baffle. Aeration is provided by two 7.5 horsepower floating aerators.
2. The secondary cell includes a 204,700 cu ft. anoxic fermentation pit in the center of the cell surrounded by 323,000 cu ft of biomass maintained in an aerobic environment separated by a floating baffle. Aeration is supplied by the use of two 7.5 horsepower floating aerators.
3. The third cell is a facultative "maturation" pond which allows for final treatment and flow surge containment and consists of 133,200 cu ft of storage volume.
4. The effluent from the "maturation" pond flows through a sluice gate into the effluent lift station.
5. The effluent lift station consists of an effluent surge tank with 6,000 gallons of capacity and two 55 hp pumps, each with a capacity of 834 gallons per minute. The effluent is pumped into the adjacent North Dam tailings impoundment for disposal.
6. A recycle pump is located after the effluent station which returns effluent to the primary pond.

7. All cells are lined with a 60 mil HDPE (synthetic rubber) liner.
8. There is no disinfection or solids removal.

Wastewater Treatment Plant

Treatment Facilities

Aerated Lagoon	Three cells 0.6 mgd capacity
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Lift Stations

Location Name	Horsepower per Pump	Quantity of Pumps	Capacity Per Pump (gpm)	Wet Well Capacity (gals)
11 th Street	7.5 hp	2	125	47,000

Collection Mains

Size	Material	Length (feet)	Size	Material	Length (feet)
4"	Clay Tile	3,200	10"	A/C	9,300
6"	Clay Tile	25,200	10"	Clay Tile	1,000
6"	A/C	2,100	12"	Clay Tile	2,800
8"	Clay Tile	4,000	15"	A/C	800
8"	A/C	36,900			

Manholes	
Type	Quantity
Standard	232

Cleanouts (Qty)
None

Force Mains		
Size	Material	Length (Feet)
4-inch	Steel	2,000

Services

Size	Material	Quantity
4"	Red Clay & Transite	1,200

C. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY COMPLIANCE (ADEQ)

ADEQ reported NON-COMPLIANCE with the state aquifer protection rules. The Aquifer Protection Permit P-101678, reporting requirements and monitoring results which have been submitted and the most recent facility inspection indicate this facility is not in compliance based on the current information that is available to ADEQ. The following information details the reason for Non-Compliance:

1. Exceedance of Total Fluoride on April 28, 2003, Monitoring Point 15494.
2. Exceedance of Total Arsenic on April 28, 2003, Monitoring Point 15494.
3. Missing data for daily average flow, all weekends, 2nd Quarter of 2003.
4. Exceedance of Freeboard, 2nd Quarter of 2003, Monitoring point 15498

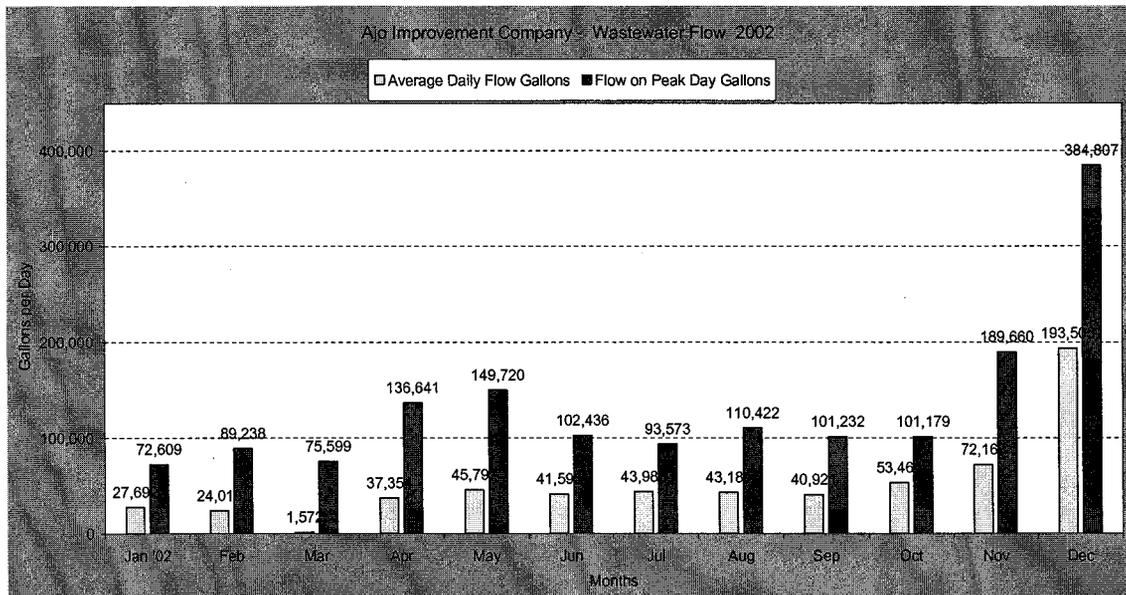
Staff recommends that any permanent rates and charges in this matter shall become effective on the first day of the month after the Director of the Utilities Division receives notice from the Arizona Department of Environmental Quality that Ajo Improvement Company – Wastewater Division meets the standards required by the Arizona Administrative Code.

D. ARIZONA CORPORATION COMMISSION COMPLIANCE

A check with the Utilities Division Compliance Unit showed no outstanding compliance issues.

E. WASTEWATER FLOW

The wastewater treatment plant has a capacity of 600,000 gallons per day. In the year 2002, the highest average daily flow occurred in the month of December, when an average of 193,505 gallons was treated. The lowest average daily flow during the year 2002 was 1,572 gallons, which occurred in March. The highest peak daily flow for the year occurred in February when 384,807 gallons was treated in one day.



F. GROWTH

Based on information provided by Ajo Sewer in its annual reports, the Company has grown from 1,087 customers in 1999 to 1,089 customers in 2002. There are no indications this slow growth rate will change in the near future.

G. DEPRECIATION RATES

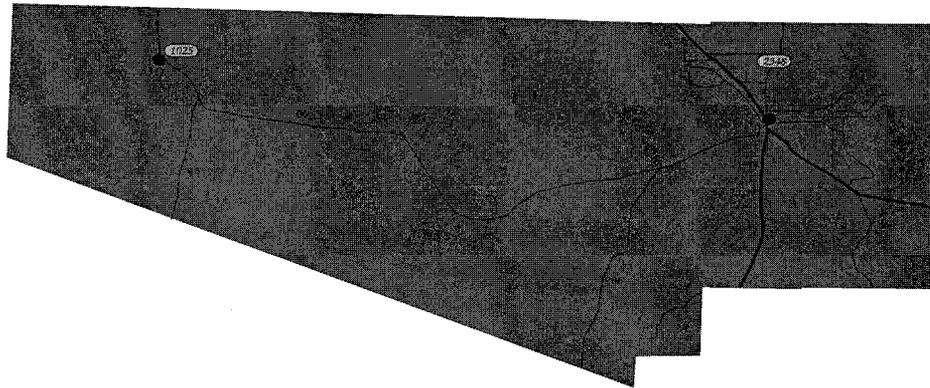
Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Exhibit 4. It is recommended that the Company use depreciation rates by individual National Association of Regulatory Utilities Commissioners (NARUC) category, as delineated in Exhibit 4.

EXHIBITS

LOCATION OF AJO IMPROVEMENT COMPANY..... EXHIBIT 1
CERTIFICATED AREA OF AJO IMPROVEMENT COMPANY..... EXHIBIT 2
PROCESS SCHEMATIC EXHIBIT 3
DEPRECIATION RATES EXHIBIT 4

Exhibit 1

P I M A C O U N T Y (S E W E R)



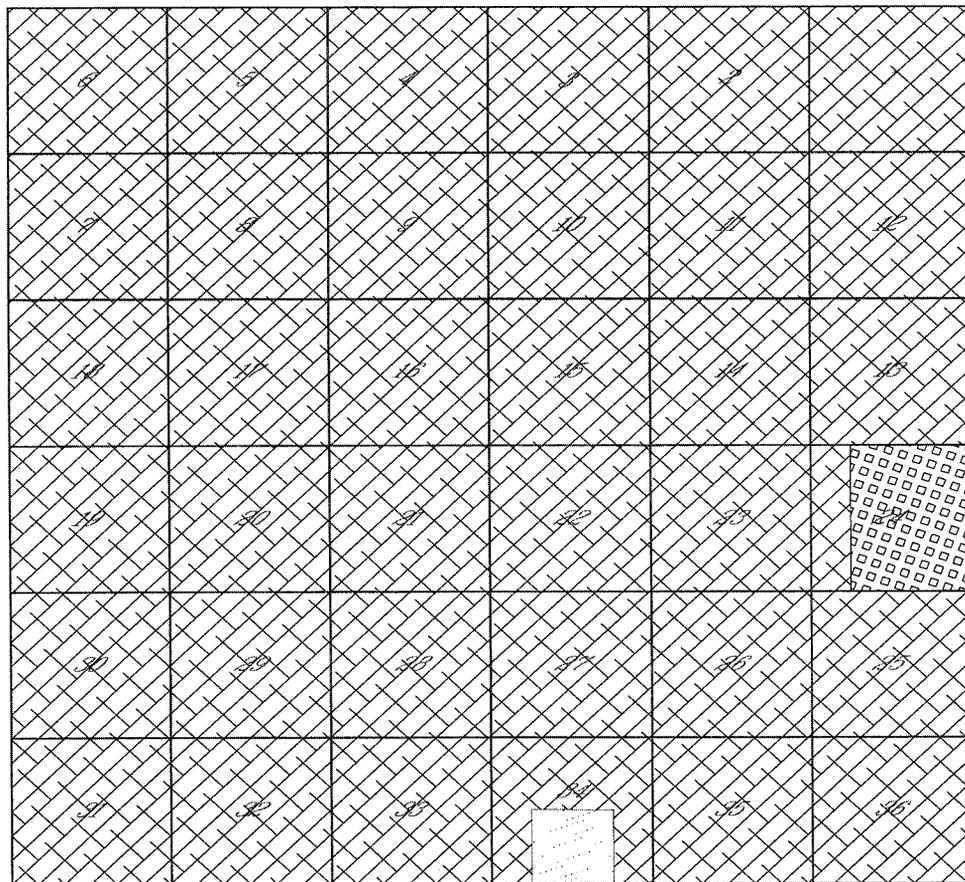
1025 AJO IMPROVEMENT COMPANY

2348 CANADA HILLS WATER COMPANY LIMITED PARTNERSHIP

Exhibit 2

COUNTY: *Pima*

RANGE 6 West

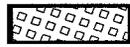


TOWNSHIP 11 South



(2)

Five Acres Water Corporation
(Nonjurisdictional)



E-1025 (3)

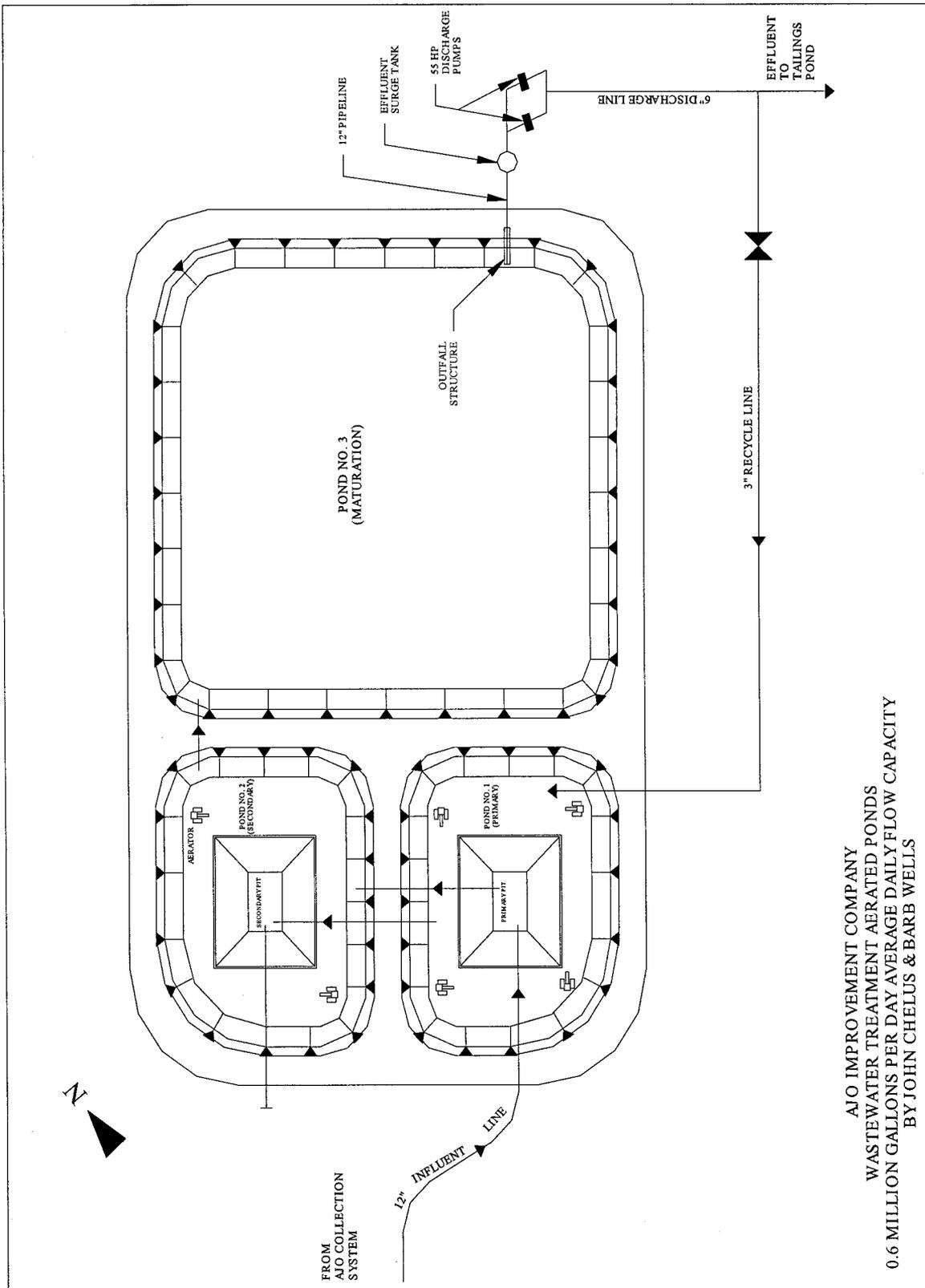
Ajo Improvement Company



U-1445 (4)

Arizona Water Company (Ajo Heights)

Exhibit 3



AJO IMPROVEMENT COMPANY
WASTEWATER TREATMENT AERATED PONDS
0.6 MILLION GALLONS PER DAY AVERAGE DAILY FLOW CAPACITY
BY JOHN CHELUS & BARB WELLS

EXHIBIT 4
TYPICAL DEPRECIATION RATES FOR WASTEWATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
354	Structures & Improvements	30	3.33
355	Power Generation Equipment	30	3.33
360	Collection Sewers – Force	50	2.0
361	Collection Sewers- Gravity	50	2.0
362	Special Collecting Structures	50	2.0
363	Services to Customers	50	2.0
364	Flow Measuring Devices	10	10.0
365	Flow Measuring Installations	20	5.00
366	Reuse Services	50	2.00
367	Reuse Meters and Meter Installations	30	3.33
370	Receiving Wells	30	3.33
371	Pumping Equipment	10	10.0
374	Reuse Distribution Reservoirs	40	2.50
375	Reuse Transmission and Distribution System	50	2.0
380	Treatment and Disposal Equipment	20	5.0
381	Plant Sewers	20	5.0
382	Outfall Sewer Lines	25	4.0
389	Other Plant & Miscellaneous Equipment	15	6.67
390	Office Furniture & Equipment	15	6.67
390.1	Computers & Software	5	20.0
391	Transportation Equipment	5	20.0
392	Stores Equipment	25	4.0
393	Tools, Shop & Garage Equipment	20	5.0
394	Laboratory Equipment	10	10.0
395	Power Operated Equipment	20	5.0
396	Communication Equipment	10	10.0
397	Miscellaneous Equipment	10	10.0
398	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Wastewater companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.