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BEFORE THE ARIZONA CORPORATION COMMI

MARC SPITZER
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS EASTERN GROUP AND FOR CERTAIN RELATED APPROVALS	)	DOCKET NO. W-01445A-02-0619

DIRECT

TESTIMONY

OF

RONALD E. LUDDERS

PUBLIC UTILITIES ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 8, 2003

ALL-STATE LEGAL® EXHIBIT
S-45
Admitted

EXECUTIVE SUMMARY
ARIZONA WATER COMPANY CORPORATION
EASTERN GROUP
DOCKET NO. W-01445A-02-0619

General Background

Arizona Water Company is a certificated Arizona public service corporation with headquarters located in Phoenix, Arizona. The Company supplies water to approximately 60,000 customers in eight counties throughout Arizona. The Company is composed of 18 separate water systems located in Ajo Heights, Apache Junction, Bisbee, Casa Grande, Coolidge, Lakeside, Miami, Oracle, Overgaard, Pinewood, Rimrock, San Manuel, Sedona, Sierra Vista, Stanfield, Superior, White Tank, and Winkelman. This permanent rate application applies only to the eight systems that comprise the Eastern Group (i.e. Apache Junction, Bisbee, Miami, Oracle, San Manuel, Sierra Vista, Superior, and Winkelman). The Eastern Group serves approximately 29,000 customers.

Apache Junction System

Proposed Revenue Increase – Apache Junction

The Company requested total annual operating revenues of $10,249,590. This revenue amount represents an increase of $1,305,663, or 14.60 percent, over the Company filed adjusted test year revenue of $8,943,927.

Staff recommends total annual operating revenues of $8,137,215. This revenue amount represents a decrease of $901,427, or 9.97 percent, below Staff's adjusted test year revenue of $9,038,642.

Rate Base – Apache Junction

Staff recommends an original cost rate base of $18,346,065, a reduction of $5,860,951, or 24.21, percent compared to the Company's proposed rate base of $24,207,016.

Operating Income – Apache Junction

Staff recommends adjusted operating income of $1,571,524, a decrease of $1,091,248, or 40.98 percent, compared to the Company's proposal of $2,662,772.

Adopting Staff's recommended operating income results in an 8.566 rate of return versus the Company's proposal of 11.00 percent.

Bisbee System

Proposed Revenue Increase – Bisbee

The Company requested total annual operating revenues of $1,869,599. This revenue amount represents an increase of $612,649, or 48.74 percent, over the Company filed adjusted test year revenue of $1,256,950.

Staff recommends total annual operating revenues of $1,613,909. This revenue amount represents an increase of $357,306, or 28.43 percent, over the Staff adjusted test year revenue of $1,256,603.

Rate Base - Bisbee

Staff recommends an original cost rate base of $3,425,681, a reduction of $274,432, or 7.42 percent, compared to the Company's proposed rate base of $3,700,113.

Operating Income - Bisbee

Staff recommends operating income of $293,444, a decrease of $113,568, or 27.90 percent, compared to the Company's proposed operating income of $407,012.

Adopting Staff's recommended operating income results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

Miami System

Proposed Revenue Increase – Miami

The Company requested total annual operating revenues of $2,179,657. This revenue amount represents an increase of $722,718, or 49.61 percent, over the Company filed adjusted test year revenue of $1,456,939.

Staff recommends total annual operating revenues of $1,641,342. This revenue amount represents an increase of $184,620, or 12.67 percent, over the Staff adjusted test year revenue of $1,456,722.

Rate Base - Miami

Staff recommends an original cost rate base of $2,740,612, a reduction of $1,829,584, or 40.03 percent, compared to the Company's proposed rate base of $4,570,196.

Operating Income - Miami

Staff recommends operating income of $234,761, a decrease of $267,961, or 53.30 percent, compared to the Company's proposed operating income of $502,722.

Adopting Staff's recommended rates results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

Oracle System

Proposed Revenue Increase – Oracle

The Company requested total annual operating revenues of $1,060,904. This revenue amount represents an increase of $233,327, or 28.19 percent, over the Company filed adjusted test year revenue of $827,577.

Staff recommends total annual operating revenues of $905,849. This revenue amount represents an increase of $77,081, or 9.30 percent, over the Staff adjusted test year revenue of $828,768.

Rate Base - Oracle

Staff recommends an original cost rate base of $2,415,268, a reduction of $404,132, or 14.33 percent, compared to the Company's proposed rate base of $2,819,400.

Operating Income - Oracle

Staff recommends operating income of $47,232, a decrease of $95,702, or 66.96 percent, compared to the Company's proposed operating income of $142,934.

Adopting Staff's recommended operating income results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

San Manuel System

Proposed Revenue Increase – San Manuel

The Company requested total annual operating revenues of $921,119. This revenue amount represents an increase of $446,869, or 94.23 percent, over the Company filed adjusted test year revenue of $474,250.

Staff recommends total annual operating revenues of $821,535. This revenue amount represents an increase of $347,419, or 73.28 percent, over the Staff adjusted test year revenue of $474,116.

Rate Base Adjustments – San Manuel

Staff recommends an original cost rate base of $641,450, a reduction of $152,543, or 19.21 percent, compared to the Company's proposed rate base of $793,993.

Operating Income – San Manuel

Staff recommends operating income of $54,947, a decrease of $32,392, or 37.08 percent, compared to the Company's proposed operating income of $87,339.

Adopting Staff's recommended operating income results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

Sierra Vista System

Proposed Revenue Increase – Sierra Vista

The Company requested total annual operating revenues of $1,308,079. This revenue amount represents an increase of $411,594, or 45.91 percent, over the Company adjusted test year revenue of $896,485.

Staff recommends total annual operating revenues of $1,105,272. This revenue amount represents an increase of $208,109, or 23.20 percent, over the Staff adjusted test year revenue of $897,163.

Rate Base – Sierra Vista

Staff recommends an original cost rate base of $2,200,445, a reduction of $374,242, or 14.54 percent, compared to the Company's proposed rate base of $2,574,687.

Operating Income – Sierra Vista

Staff recommends operating income of $188,490, a decrease of $94,726, or 33.4 percent, compared to the Company's proposed operating income of $283,216.

Adopting Staff's recommended operating income results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

Superior System

Proposed Revenue Increase – Superior

The Company requested total annual operating revenues of $1,190,319. This revenue amount represents an increase of $491,351, or 70.30 percent, over the Company filed adjusted test year revenue of $698,968.

Staff recommends total annual operating revenues of $1,024,222. This revenue amount represents an increase of $325,633, or 46.61 percent, over the Staff adjusted test year revenue of $698,589.

Rate Base - Superior

Staff recommends an original cost rate base of $2,400,573, a reduction of $273,003, or 10.21 percent, compared to the Company's proposed rate base of $2,673,576.

Operating Income - Superior

Staff recommends operating income of $205,633, a decrease of $88,460, or 30.08 percent, compared to the Company's proposed operating income of $294,093.

Adopting Staff's recommended operating income results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

Winkelman System

Proposed Revenue Increase – Winkelman

The Company requested total annual operating revenues of $129,358. According to the Company, this revenue amount represents an increase of $32,343, or 31.97 percent, over the Company adjusted test year revenue of $98,022.

Staff recommends total annual operating revenues of $115,659. This revenue amount represents an increase of $16,935, or 17.15 percent, over the Staff adjusted test year revenue of $98,724.

Rate Base - Winkelman

Staff recommends an original cost rate base of $232,924, a reduction of $32,975, or 12.40 percent, compared to the Company's proposed rate base of $265,899.

Operating Income - Winkelman

Staff recommends total operating revenue of $19,952, a decrease of $9,297, or 31.79 percent, compared to the Company's proposed operating revenue of $29,249.

Adopting Staff's recommended operating income results in an 8.566 percent rate of return versus the Company's proposed 11.00 percent.

Arsenic Removal Recovery Mechanism

There is currently no arsenic removal plant constructed in the Eastern Group. However, the recommended arsenic order is pending and, therefore, Staff's recommendation regarding an arsenic cost recovery system cannot be finalized until the Commission determines what action it accepts in dealing with this issue.

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SCHEDULES

INTRODUCTION

Q. Please state Staff's name, occupation and business address.

A. My name is Ronald E. Ludders. I am a Public Utilities Analyst V with the Utilities Division of the Arizona Corporation Commission ("Commission"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

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

A. I have been employed by the Commission since December 1989.

Q. What are your responsibilities as a Public Utilities Analyst?

A. Among other responsibilities, I review and analyze the accounting books and records of regulated utilities for accuracy, completeness, and reasonableness; interpret rules and regulations, prepare work-papers, schedules, revenue requirements, rate design, staff reports and testimony for rate-making purposes regarding utility applications for rate adjustments, financing and other matters that come before the Commission.

Q. Have you previously testified before this Commission?

A. Yes.

Q. What is your educational background?

A. I obtained a Bachelor of Science Degree in Business Administration, with majors in Marketing and Accounting from Eastern Illinois University. I possess a minor in Business Management. I have attended NARUC (National Association of Regulatory Utility Commissioners) classes, rate seminars and numerous in-house training classes and courses regarding statistics, utility auditing, management accounting, rate design, taxation, cash working capital studies, and utility service charges.

I have been a member of the National Association of Accountants (now the Institute of Management Accountants) and the Institute of Internal Auditors.

Q. **Briefly describe Staff's pertinent work experience.**

A. Prior to my employment with the Commission, I held several positions with Arizona Public Service, serving as a Project Accountant, Cost Control Analyst and Internal Auditor. I have also served as a Senior Auditor for the State of Arizona – Auditor General and the Governor's Management and Audit Team. Further, I have served as a Revenue Auditor with the Arizona Department of Transportation.

As a Commission employee I have been assigned water and wastewater rate cases, financing cases, acquisitions and sales of assets, fuel adjustors, Certificates of Convenience and Necessity, interim rate cases, depreciation and tariff matters.

Q. **Please describe your duties and responsibilities as a Public Utilities Analyst.**

A. I am responsible for the examination and verification of financial and statistical information included in assigned utility rate applications. I develop revenue requirements, design rates, prepare written reports, testimony, and schedules that support recommendations presented to the Commission. I am also responsible for testifying at formal hearings on these matters.

PURPOSE OF TESTIMONY

Q. **What is the purpose of your testimony in this proceeding?**

A. The purpose of my testimony is to present the Arizona Corporation Commission Utilities Division Staff's ("Staff") analysis and recommendations regarding the Eastern Group of Arizona Water Company's ("Arizona Water" or "Company") application for a permanent rate increase. I present recommendations in the areas of rate base, operating income, revenue requirement and rate design. Staff witness Joel Reiker, presents the cost of capital recommendations. Staff witness Lyndon Hammon, presents the engineering analysis and recommendations. Staff witness John Thornton presents rate design. Staff also presents its recommendation regarding the Company's application for an adjustor mechanism to recover costs incurred to comply with new maximum contaminant level ("MCL") arsenic regulations.

Q. What is the basis of Staff's recommendations contained in this testimony?

A. I performed a regulatory audit of the Company's records to determine whether sufficient, relevant and reliable evidence exists to support the proposals in Arizona Water's rate application. Staff's regulatory audit consisted of the following: (1) examining and testing Arizona Water Company's accounting ledgers, reports and supporting documents; (2) tracing recorded amounts to source documents; and, (3) verifying that the Company-applied accounting principles were in accordance with the NARUC Uniform System of Accounts ("USOA").

BACKGROUND

Q. Would you please review the Company's background?

A. Arizona Water Company is a certificated Arizona public service corporation with headquarters located in Phoenix, Arizona. The Company supplies water to approximately 60,000 customers in eight counties throughout Arizona. The Company is composed of 18 separate water systems located in Ajo Heights, Apache Junction, Bisbee, Casa Grande, Coolidge, Lakeside, Miami, Oracle, Overgaard, Pinewood, Rimrock, San Manuel, Sedona, Sierra Vista, Stanfield, Superior, White Tank, and Winkelman. The instant application applies only to the systems that comprise the Eastern Group (i.e. Apache Junction, Bisbee, Miami, Oracle, San Manuel, Sierra Vista, Superior, and Winkelman). The Eastern Group serves over 29,000 customers.

Q. How is Arizona Water authorized to file these eight systems as a group?

A. Decision No. 58120, dated December 23, 1992, authorized Arizona Water to make rate filings by group instead of filing all eighteen of its water systems simultaneously. Due to the complexity and time involved in processing eighteen simultaneous rate cases, Decision No. 58120 authorized Arizona Water to "implement the three-group concept..." for future rate proceedings. (See Decision No. 58120, page 39, line 10) Under the three-group concept recognized in that decision, the Company's operations would be divided into three groups: Eastern Group, Southern Group, and Northern Group based on geographical and existing divisional considerations. On August 14, 2002, Arizona Water Company filed an application for a permanent rate increase for the Eastern Group. The application was found insufficient on September 13, 2002 and made sufficient on October 11, 2002.

Q. What decision(s) authorized the Eastern Group's current rates?

A. Arizona Water's Eastern Group's current rates and charges were authorized in Decision No. 58120, dated December 23, 1992. The service charges were later modified in Decision No. 60512, dated December 3, 1997. The purchased power adjustor mechanisms ("PPAM") were changed in Decision No. 58293, dated May 19, 1993, and Decision No. 62755, dated July 25, 2000. The Monitoring Assistance Program ("MAP") surcharge was established in Decision No. 62141, dated December 14, 1999.

Q. Please summarize the Company's rate request for the Eastern Group.

A. The Company proposes rates that produce operating revenue of $18,692,677 and operating income of $4,576,537 for an 11.00 percent rate of return on an original cost rate base of $41,604,880. The Company's proposal would increase revenue by 29.5 percent for the Eastern Group.

Q. What test year was used by the Company in the instant case?

A. Arizona Water's rate filing is based on the historical test year over the twelve months ending December 31, 2001 ("Test Year") with post-test year increases to rate base.

Q. Did the Company prepare Reconstruction Cost New Rate Base Net of Depreciation ("RCND") schedules?

A. No. The Company did not file RCND schedules. Therefore, Staff used the original cost rate base ("OCLD") as the fair value rate base ("FVRB") for all systems of the Eastern Group.

ORDER OF TESTIMONY

Q. How is Staff's testimony organized?

A. Staff's testimony is organized to present analysis, recommendations, and supporting schedules for each of the eight water systems independently. Staff testimony for the individual systems is presented in the following order: Apache Junction, Bisbee, Miami, Oracle, San Manuel, Sierra Vista, Superior, and Winkelman. Finally, Staff addresses the Company's request for an adjustment mechanism to recover the treatment costs that will be incurred to comply with the new Environmental Protection Agency ("EPA") maximum contaminant level for arsenic.

Q. Are there any items or adjustments in the Staffs report that are common to all systems within the Eastern Group?

A. Yes, there are many items common to all systems. Staff has chosen to discuss many of these items in this section here rather than repeat this information in each individual system. Adjustments made to each system will include the dollar amount of the adjustment and any information specific to that system. The common issues discussed here are: post-test year cut-off date, gross revenue conversion factor ("GRCF"), depreciation rates and expense, lead-lag analysis, annualization of revenue and expenses, purchased power adjustment mechanism ("PPAM"), purchased water adjustment mechanism ("PWAM"), water testing expenses, donations to charity, rate case expenses, property taxes, rate design and service charges.

Post-Test Year Cut-Off Date

Q. Why did Staff use a cut-off date of December 31, 2002?

A. Staff had to determine a cut-off date for two reasons. First, Staff needed a reasonable cut-off date to complete its audit. Second, if utility plant placed in service long after the test year's conclusion is included in rate base, then the rate base will be out of synchronization with test year revenue and expenses. The Company, through the direct testimony of its Vice President, Mr. Michael J. Whitehead, suggests that Staff extend its post-test year cut-off date to a time immediately before the hearing on this matter. On page 7 of Mr. Whitehead's direct testimony, he states that "Ideally, Staff would update the findings in its Staff Report to a date immediately before the hearing". If that were done, Staff would be accepting post-test year plant twenty-one months after the close of the test year and would have no time to conduct the analysis required to complete its testimony. Therefore, Staff used the cut-off date of December 31, 2002, because it was a reasonable time period after the test year's end but not so far into the future as to require an updated test year.

Gross Revenue Conversion Factor

Q. Does Staff agree with the Company's proposed Gross Revenue Conversion Factor of 1.63241?

A. No.

Q. Does Staff agree with portions of the Company's Gross Revenue Conversion Factor calculation?

A. Yes. Staff agrees that uniform marginal Federal and State income tax rates based on the Eastern Group as a whole is appropriate. Staff also agrees that the respective marginal Federal and State income tax rates are 6.968 and 34.00 percent. Further, Staff agrees that the GRCF should include a component to recognize the Company's 0.2032 percent uncollectible rate.

Q. What is Staff's disagreement with the Company's GRCF?

A. The Company did not properly use the tax and uncollectible rates to calculate the GRCF. The proper calculation is shown on Schedule REL-2. The Company's calculation incorrectly uses the uncollectible rate. The Company's calculation uses the actual uncollectible rate. Since there is no income tax on uncollected revenue, the uncollectible rate must be adjusted to an after tax basis by multiplying the uncollectible rate times one minus the effective combined Federal and State income tax rate. Schedule REL-2 shows a reconciliation of Staff's proposed revenue and the incremental operating income, income taxes, and uncollectible expense.

<u>Depreciation Rates and Expenses</u>

Q. Has the Company made any adjustments to the depreciation rates as required in the Northern Division's Decision?

A. Yes, the schedule submitted in Mr. Ralph Kennedy's direct testimony (page 16) contains component rates for each plant account. The Company's depreciation expense and associated accumulated depreciation contained in its application were based on these rates. On February 12, 2003, Mr. Kennedy informed Staff that the Company inadvertently did not use its most current depreciation study in its calculation and submitted its most current component rates. The depreciation rates contained in this most current submittal have been reviewed and approved by Staff Engineering and are contained in Exhibit E of Mr. Lyndon Hammon's direct testimony and are applicable to all systems within the Eastern Group.

Q. How did the Company determine depreciation expense?

A. The Company's proposal includes two pro forma adjustments. The Company's first pro forma adjustment increased depreciation expense to provide an additional six months of depreciation expense on test year plant additions. The Company's second pro forma adjustment increased depreciation expense to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

<u>Lead-Lag Analysis</u>

Q. What is the purpose of a lead-lag analysis?

A. A lead-lag analysis measures the timing of cash receipts and disbursements. The purpose of a lead-lag study is to estimate of the average amount of funds either supplied by shareholders or received in advance from ratepayers for business operations. If cash is received from the ratepayer prior to its use, a reduction is made to the rate base to reflect the actual amount of working capital provided by the ratepayers. When the Company makes payments prior to receiving cash from ratepayers, rate base is increased to reflect the additional funds supplied by shareholders.

Q. Does Staff agree with the Company's proposed cash working capital?

A. No. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. Does Staff agree with the Company's lead-lag analysis?

A. The Company's calculation of expense lag days included depreciation and amortization expense and federal deferred income taxes, which are all non-cash expenses, and should be excluded from such an analysis. The Company further failed to include interest expense, which is a cash expense and should be included in the analysis. The Company's method compared dollar-day revenue lag to dollar-day expense lag to calculate excess dollar-day revenue lag. The Company's analysis mismatches the dollar amount included in the dollar-day revenue and dollar-day expense lag amounts. The effect is to include non-cash items in the dollar-day revenue lag amount and exclude non-cash items in the dollar-day expense lag amount. This results in a mismatch and overstates cash working capital.

Q. Did Staff prepare a lead-lag analysis?

A. Yes. Staff's analysis was done on a system-by- system basis. Staff's analysis made the following adjustments to the Company's analysis: (1) Staff used expense amounts and expense lag days for each individual system; (2) Staff removed depreciation expense and deferred income taxes from the calculation of expense lag days; (3) Staff recognized interest expense; (4) Staff incorporated its adjustments to operating expenses; and (5) Staff used a method that eliminates the mismatch between the dollar amount included in the dollar-day revenue and dollar-day expense lag amounts by comparing revenue lag days directly to payment lag days. Finally, Staff adjusted the number of expense days on Property Taxes to co-ordinate the appropriate expense lag as determined by the Department of Revenue.

<u>Annualization of Revenue</u>

Q. Does Staff agree with the Company's annualization of revenue and expenses?

A. No. Staff reviewed the annualization and determined that it was inconsistent. The average annual revenue per customer was calculated based on the revenue for a 5/8-inch meter only and not the total of revenue from all meter sizes in order to properly match revenue and expenses. This procedure created a revenue mismatch and increased the Company's revenue adjustment by $96,209, from $211,509 to $307,718.

The Company calculated variable expense adjustments based on total expenses for all customers, not just the 5/8-inch metered customers. The result of Staff's analysis is an increase of $492, from $116,040 to $116,532.

Purchased Power Adjustment Mechanism

Q. Is the Company requesting continuation of its Purchased Power Adjustment Mechanism?

A. Yes, on page 22 of Ms. Sheryl Hubbard's direct testimony, she states "that the Company proposes that the adjustor mechanism be reset to zero with new base levels established in this proceeding at the current level of expense."

Q. Please explain what a PPAM is and how it works.

A. The adjustor was established so the Company could pass the additional or reduced cost of electric power on to its customers thereby recovering or reducing the expense. In the past, the price of purchased power had been somewhat volatile with monthly fluctuations that would increase or decrease the cost of either purchased electric or natural gas power. In the case of Arizona Water Company, the adjustor mechanism applies to all its systems. Currently, Arizona Water Company is the only water provider still using this adjustor. Staff recommends eliminating the PPAM because the procedure for accounting and reporting PPAMs involves monthly tracking by the Company, and review and analysis by Staff. The PPAMs approved in 2003 were:

Apache Junction - 1/10 of 1 cent per 100 gallons
Bisbee – 1/5 of one cent per 100 gallons
Miami – 1/10 of one cent per 100 gallons
San Manuel – 1/10 of one cent per 100 gallons
Superior 3/10 of one cent per 100 gallons.)

Because of the immateriality of these amounts, Staff believes the cost of tracking the Purchased Power Adjustor Mechanism outweighs its benefit and recommends its elimination.

Purchased Water Adjustment Mechanism

Q. Is the Company requesting continuation of its Purchased Water Adjustment Mechanism?

A. Yes, on page 22 of Ms. Sheryl Hubbard's direct testimony, she states "that the Company proposes that the adjustor mechanism be reset to zero with new base levels established in this proceeding at the current level of expense."

Q. Please explain what a PWAM is and how it works.

A. In 1986, the Company was granted a purchased water adjustment mechanism for the Ajo, San Manuel, and Superior systems that would increase or decrease the purchased water expense as the market price fluctuated. The adjustor mechanism would pass the additional or reduced cost of purchased water on to customers, thereby recovering or reducing the expense. Currently, Arizona Water Company is the only water provider still using this form of adjustor. Like the PPAM, the accounting for this procedure includes both Company and Staff costs. Staff believes these costs outweigh any benefit due to the insignificant changes in the adjustor rate. Therefore, Staff recommends the elimination of the adjustor altogether.

Water Testing Expense

Q. Has Staff reviewed the Water Testing Expenses proposed by the Company?

A. Staff reviewed the Company's proposed Water Testing Expenses and discusses its findings in Mr. Hammon's direct testimony.

Q. Has Staff reviewed the pro forma Chlorination Labor and Wages Expenses (Water Treatment) proposed by the Company?

A. Staff has reviewed the Company's pro forma Chlorination Labor and Wages Expenses and has found that they do not meet the "known and measurable" standard. Staff used actual 2002 expenses because of the uncertainties of Company estimates. Please refer to Mr. Hammon's direct testimony.

Donations to Charity

Q. Did Staff remove contributions to charities from the Company's income statement?

A. Yes. Company donations to charities are expenses that should be properly borne by shareholders and not ratepayers. Staff has made an adjustment for this.

Rate Case Expenses

Q. Did the Company increase its proposed Rate Case Expense?

A. Yes. The Company notified Staff in its response to Staff's data request REL 18-3 that it had planned to increase its Rate Case Expenses by $15,000, from $257,550 to $274,550. The Company claimed this expense was necessary due to Staff's motion to extend the procedural deadlines and the possibility of future depositions.

Q. **Does Staff agree with the Company's proposed Rate Case Expense?**

A. No. Staff's review of the Company's Rate Case Expense began with an analysis of the 1992 rate case that included all 18 systems at a cost of $90,970 or $5,053 per system. In that case, the Commission allowed Rate Case Expense of $90,970 amortized over three-years or $30,323 per year. In this instance, the Company has not filed an Eastern Group rate case for eleven years.

If the Company receives the rate case expense it originally requested in this case (i.e. $257,550 for 8 systems) plus the amount allowed in the Northern group's rate case (i.e.

$216,982 for 5 systems) the Company will incur $474,532 for only 13 of its 18 systems. The 1992 Rate Case Expense for 13 systems would have been only $65,689 ($90,970 divided by 18 = $5,053 per system multiplied by 13 = $65,689). The increase in Rate Case Expense of $408,843, from $65,585 to $474,843 results in an increase of 622 percent.

Rate Case Expense increases of this magnitude are not consistent with economies of scale that should result from the filings of two of the three divisions (groups) of the Company.

Although it is difficult to determine exactly what the Rate Case Expense should be, due to the estimated costs to be incurred upon completion of the rate case, Staff is proposing an expense level of $180,913, a reduction of $76,637 or 29.8 percent less than the Company's requested expense of $257,550. Staff arrived at this number by determining the amount of attorney fees incurred as of April 30, 2003, or about the half way point of the rate case. This number was approximately $50,000 to which Staff added another $50,000 for the second half of the case for a total of $100,000. Additionally, the Company estimated Utility Resources (Cost of Capital) expenses to be $49,000 of which only $25,687 had been expended as of April 30, thus a remaining balance of over $23,000 to cover rebuttal and hearing expenses. Staff estimates these expenses not to exceed $8,000 ($200 per hour x 40 additional hours = $8,000). Further, Staff reviewed the Company's anticipated Payroll and Payroll Overheads expense of $48,000 and its estimated Miscellaneous expense of $14,550 and projected the expense to be three-fourths of what was proposed for a total Staff adjusted expense of $180,913. Moreover, even if Staff's adjustment is not adopted, the additional ten per cent claimed by the Company regarding the Motion to Continue should be disallowed, because the motion was directly related to the Company's lack of completeness of responses to Staff's data requests.

Q. Does Staff agree with the Company's proposal to amortize Rate Case Expense over three years?

A. No. According to the Administrative Law Judge's proposed order in Docket No. W-01445A-00-0962 on the arsenic cost recovery mechanism, and the Company's acceptance to file a rate case using a test year of 2006, a five-year amortization period should be utilized. The application of a three-year amortization period would allow the Company to over-earn its approved Rate Case Expense by two years. Therefore, Staff amortized its recommended Rate Case Expense over five years.

<u>Depreciation Expense</u>

Q. Does Staff agree with the Company's method for determining depreciation expense?

A. No. Depreciation expense should reflect the proposed depreciation rate which is then applied to the authorized balance for each plant account. Staff recommends disallowing a portion of the Company's proposed post-test year plant additions that were not revenue neutral or not in service by Staff's cut-off date, December 31, 2002. The difference between Staff's plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using dated component depreciation rates that it later corrected during the course of Staff's analysis. Staff reviewed and accepted the new rates and Staff used these new rates in calculating this expense.

<u>Property Tax</u>

Q. How did Staff determine each system's Property Tax expense?

A. Staff used the "Arizona Department of Revenue ("ADOR") New Valuation Methodology for Water and Sewer Companies". Under this method, the Company is required to file form 82055 with ADOR who uses it to determine the full cash value for water and wastewater property used in Arizona. Staff requested and received the Company's 2002 form 82055 for each of the Eastern Group's systems.

Since the Company leases its vehicles, it was not required to report the dollar value of its licensed vehicles on line 3, Balance Sheet Information, Form 82055, page 4 of 6. The Company did not complete page 5 of 6 – Schedule of Non-Capitalized Leased or Rented Operating Property (System) for Water Utility Companies which it was required to report.

The effect of this oversight is to overpay property taxes because, under the DOR's valuation methodology, the net book value of licensed vehicles (owned or leased) is deducted from the value indicated by gross revenue. The Company is paying taxes on its vehicles twice.

According to the Department of Revenue, "The new methodology uses revenue as a base then adds Construction Work in Progress ("CWIP") and deducts for vehicles. The vehicle allowance, i.e. deducting the net book value of licensed vehicles from the value, is designed to avoid double taxation. Owners of licensed vehicles pay an in lieu property tax on these (vehicles). If a water or sewer company uses vehicles in its operation and the company does not provide the net book value of these vehicles and this net book value is not deducted from the value of the operating utility, then the company is probably being over-valued based on the formula we follow."

To eliminate this overpayment, Staff has deducted the net book cost of licensed vehicles in its determination of property taxes for each system.

<u>Metered Revenue Requirement</u>

Q. How did Staff determine its metered revenue requirement?

A. Once Staff determined a system's revenue requirement, it deducted revenue obtained from other operating revenue. The resulting revenue requirement was the basis for Staff's metered rates.

Q. How does Staff's proposed rate structure compare with the Company's?

A. The Company proposed single-tier rates for each of it systems based on customer class distinguished by meter size, in addition to a monthly minimum charge. Staff proposes a three-tier rate structure for the commodity charge. Customer class is distinguished by meter size and the monthly minimum. Please refer to Mr. Thornton's testimony.

Q. What are the advantages of a three-tier inverted rate structure over a uniform rate?

A. Flat commodity rates assume there are no increases in costs associated with increases in usage. Under uniform rates there is no incentive to reduce water usage. Because of the ever-increasing demand for a finite resource, innovative and more complex rate structures are being proposed nationwide and internationally in an attempt to properly affect consumer choices.

Q. Has Staff reviewed the Company's requested increase in some of its Service Charges?

A. Yes. The Company proposed increases in two of its existing service-related charges. The Company proposed that its returned check charge (Non-Sufficient Funds) be increased from $10 to $25. Additionally, the Company requested a late charge tariff of 1.5 percent per month for bills delinquent for more than 15 days.

Q. Does Staff agree with the Company's returned check charge and late charge proposals?

A. Yes. These-service related charges need to be revised in accordance with rising labor and other expenses. Additionally, these increases in the service-related charges will allow the Company to recover expenses from its cost-causers. Finally, the Company proposed service charges are consistent with those recommended in the Northern Group rate case (Decision No. 64282, dated December 28, 2001).

Q. Does that conclude your discussion on the Eastern Groups common issues?

A. Yes, it does.

APACHE JUNCTION

Summary of Proposed Revenue – Apache Junction

Q. Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirements?

A. Yes. Please refer to Schedule REL-1. The Company proposed total annual operating revenue of $10,249,590, which represents an increase of $1,305,663, or 14.60 percent, over the Company's adjusted test year revenue of $8,943,927. However, the Company's Schedule A-1 shows an increase of $1,735,319 that when added to the adjusted test year revenue of $8,943,927 results in annual revenue of $10,679,246 or a difference of $432,656.

Staff recommends total annual operating revenue for the Apache Junction system of $8,137,215. Staff's recommendation represents a decrease of $901,427, or 9.97 percent, under its adjusted test year revenue of $9,038,642.

Rate Base – Apache Junction

<u>Original Cost Rate Base</u>

Q. Did Staff prepare an Original Cost Rate Base Schedule?

A. Yes, as shown on Schedule REL-3, Staff recommends a rate base of $18,346,065, which represents a decrease of $5,860,951 from the Company's proposed $24,207,016. Staff's rate base adjustments are described below.

<u>Rate Base Adjustment No. 1– Test Year Plant In Service</u>

Q. Please explain Staff's adjustments to Plant In Service?

A. Staff's adjustment to Plant In Service resulted in a reduction of $3,412,565. The first part of this adjustment represents the reclassification of $6,292 of plant inadvertently posted to Purchased Pumping Power rather than Electrical Pumping Equipment. The second part of the adjustment consists of a decrease of $2,604,304 which represents the portion of post-test year plant in service that was not revenue neutral or was not in service by December 31, 2002. The third part of the adjustment reflects post-test year retired plant for $109,650 not shown on the Company's application. This adjustment is proper to remove the corresponding plant that was replaced by the post-test year plant additions that Staff accepted. Finally, Staff reclassified Deferred Central Arizona Project ("CAP") charges of $704,903 to a separate line item in the rate base schedule. This was done so that these charges were segregated for clarification and ease of recording annual amortization of the deferred charges.

Q. Please summarize Staff's recommendation regarding Plant In Service.

A. Staff recommends $51,814,226 for Plant In Service, a $3,412,565 decrease from the Company's proposed $55,226,791. The calculation of Staff's recommendation is shown on Schedule REL-5.

Rate Base Adjustment No. 5 and 6 – CAP Deferrals

Q. How did Staff treat the CAP deferrals?

A. Staff established separate line items for the CAP deferral and accumulated amortization similar to the way Contributions in Aid of Construction are listed. Staff accepted the Apache Junction deferral of $704,903 and amortized $20,118 of annual expense to record the recovery of the deferral over the 34 year remaining life of the CAP contract. Staff's adjustment is shown on Schedule REL-6.

Rate Base Adjustment Nos. 7, 8, 9 and 10 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 2 of 11, of the filing, increased Accumulated Depreciation by $112,897 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 2 of 11, of the filing, decreased Accumulated Depreciation by $2,886 and according to the Company represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant actually in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated

Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") to the appropriate plant accounts.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-7. Staff increased Accumulated Depreciation by $1,100,547, from $8,791,705 to $9,892,252. This adjustment is made up of several components including a $35,589 (adjustment no. 7) increase as a result of Staff's analysis. Staff recommends increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $1,307,339 (adjustment no. 9) from $2,886 to $1,304,453, and recommends decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $96,399 (adjustment no. 8) from $112,897 to $16,498. Additionally, Staff removed $145,982 (adjustment no. 10) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC – USOA accounting procedures.

<u>Rate Base Adjustment No. 11 – Cash Working Capital Allowance</u>

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $559,088 for working capital. Schedule B-5, page 1 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $328,417 cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of working capital?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicated a negative $941,880 cash working capital component or a reduction of $1,270,297 below the Company's $328,417 figure. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Working Capital?

A. Staff increased the Materials and Supply Inventory by $19,303, from $43,863 to $63,166 as a result of materials that were transferred from Repairs and Maintenance expense to Working Capital.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of negative $691,906 as shown on Schedule REL-8.

<u>Rate Base Adjustment No. 12 and 13 – Allocated Post-Test Year Additions</u>

Q. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

A. Yes. Staff accepted only revenue neutral plant that was in service by the December 31, 2002, cut off date. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $765,834, which included $36,332 of post-test year retired plant. Additionally, Staff reduced the Meter Shop allocation by $15,796. Staff's adjustment reduced the Phoenix Office and Meter Shop allocations by $781,630, from $870,209 to $88,579 as shown on Schedule REL-9.

Operating Income – Apache Junction

Operating Income Summary

Q. What did Staff recommend for test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $9,038,642, expenses of $6,914,757, and an operating income of $2,123,885 as shown on Schedules REL-10. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize 2001 revenue?

A. The Company multiplied 591 (that represents the average growth in customers on the Apache Junction system during the test year) by $350 (the Company's determination of annual revenue per customer) which resulted in a revenue increase of $206,850.

Q. Did Staff make an adjustment to annual revenue in the Company's calculation?

A. Yes. Staff made a $94,715 adjustment to increase the Company's proposed annualization from $206,850 to $301,565. Staff's calculation of the adjustment is shown on Schedule REL-12. Staff reviewed the Company's annualization and determined that it was inconsistent. The average annual revenue per customer was calculated based on the revenue for a 5/8-inch meter only and not the total of revenue from all meter sizes in order to properly match revenue and expenses. This procedure created a revenue mismatch. Staff's recalculation recognizes revenue from all meter sizes and calculated the average annual revenue per customer to be $510 rather than the Company's $350.

Operating Income Adjustment No. 2 – CAP Purchased Water Adjustment

Q. What is Arizona Water proposing for Purchased Water Expense for the Apache Junction System?

A. The Company proposed $1,003,040 for Purchased Water Expense. This number is composed of $805,211 in actual 2001 purchased water expenses and $197,829 in pro forma adjustments as shown on schedule REL-13.

Q. Please discuss the components of the Company's $805,211 actual Purchased Water Expense.

A. The $805,211 amount is composed of $703,309 in CAP and City of Mesa treatment costs incurred for potable water; $94,027 for golf course effluent (i.e., non potable CAP water); and a $7,875 unrecognized amount ($703,309 + $94,027 + $7,875 = $805,211).

Q. Did Staff make any adjustments to the Company's $805,211 Purchased Water Expense amount?

A. Yes. Staff increased the CAP and City of Mesa treatment costs by $25,188, from $703,309 to $728,497 as a result of using the actual 2002 CAP and City of Mesa treatment costs. Staff also removed the $7,875 unreconciled amount as it was not an expense incurred by the Apache Junction system and reclassified to the Miami system's as a BHP Copper purchased water adjustment.

Q. Please discuss the components of the Company's $197,829 pro forma adjustment to Purchased Water Expense.

A. The Company's $197,829 pro forma adjustment to purchased water expense is composed of $10,982 to normalize the 2001 City of Mesa treatment costs; $113,939 to expense CAP Municipal and Industrial ("M & I") costs that are currently being deferred; $41,304 to reflect a rate increase in the Central Arizona Water Conservation District ("CAWCD") contract delivery charge; and $31,604 to annualize the expense.

Q. Would you please discuss the Company's $10,982 pro forma adjustment to normalize the 2001 City of Mesa treatment costs?

A. The City of Mesa bills Arizona Water for capital M&I costs each month. Normally, there are 12 bills in any given year. However, during the test year, the CAP canal was closed for repairs in November. The Company included the November 2001 charge as an ongoing expense by estimating the November M&I charge (i.e., total M&I costs $120,801 / 11 months = $10,982) and adding the amount to the total test year M&I costs.

Q. Did Staff accept the Company's $10,982 pro forma adjustment to normalize the 2001 City of Mesa treatment costs?

A. No. Staff removed the amount. Staff used the actual 2002 M&I capital cost as it was known and measurable and included 12 months of M&I bills. Therefore, the $10,982 adjustment to estimate and include an additional month was not necessary.

Q. Please discuss the Company's $113,939 pro forma adjustment to include M&I charges in Purchased Water Expense.

A. The Commission, in Decision No. 58120 (dated December 23, 1992) authorized Arizona Water to defer the CAP M&I charges. Since substantially all of the CAP allocation for the Apache Junction system is used and useful, the Company is proposing to expense all test year CAP M&I charges by including the $113,939 in M&I charges in Purchased Water Expense.

Q. Did you make any changes to the Company's $113,939 pro forma adjustment to Purchased Water expense?

A. Yes. Staff decreased the CAP M&I capital charges by $4,839, from $113,939 to $109,100 as a result of using the Company's actual 2002 costs. The 2002 costs are known and measurable and reflect 12 months of M&I capital costs.

Q. Please discuss the Company's $41,304 pro forma adjustment to reflect a CAWCD contract rate increase in Purchased Water Expense.

A. The Company was notified in June 2002 that the CAWCD contract delivery charge would increase by $8 from $58 to $66 per acre-foot effective January 1, 2003. The $4 per acre-foot increase would result in an annual Purchased Water Expense increase of $41,304. The increase was calculated by multiplying the test year acre-feet by the $4 increase (5,163 acre-feet x $8 = $41,304).

Q. Did Staff make any changes to the Company's $41,304 pro forma adjustment to Purchased Water Expense?

A. Yes. Staff increased the amount by $2,128, from $41,304 to $43,432 as a result of using the 2002 acre-feet (5,429 acre-feet x $8 = $43,432).

Q. Please discuss the Company's $31,604 pro forma adjustment to annualize Purchased Water Expense.

A. The Company annualized test year revenue and expenses using the test year end number of customers. The annualization study increased purchased water expense by $31,604.

Q. Did Staff accept the Company's $31,604 pro forma adjustment to Purchased Water Expense?

A. No. Staff removed the adjustment as Staff is using the 2002 actual purchased water expense of $728,497 shown on line 1 of Schedule REL-13.

Q. What is Staff's net adjustment to Purchased Water expense for the Apache Junction system?

A. Staff decreased Purchased Water expense by $27,984, from $1,003,040 to $975,056 as shown on Schedule REL-13.

Operating Income Adjustment No. 3 – CAP Amortization Adjustment

Q. What did Arizona Water propose for its deferred CAP Municipal and Industrial charges?

A. The Company proposed to amortize $704,903 in deferred CAP charges over a three-year period as shown on schedule REL-14.

Q. Does Staff agree that the balance to be amortized is $704,903?

A. No. The Company's balance was calculated using an estimated amount. Staff's balance used actual amounts.

The Company's $704,903 balance was composed of two amounts: $46,315 + $658,588. The $46,315 was the actual balance of the unamortized portion of the $60,000 deferred CAP authorized in Decision No. 58120 (dated December 23, 1992). The $658,588 was an estimate of the deferred CAP M&I balance accrued from 1986 through December 31, 2002. Staff used the Company's actual December 31, 2002 deferred CAP M&I balance of $645,207, as shown on Schedule REL-14.

Q. Does Staff agree that the amortization period is three years?

A. No. The Company's three-year amortization period was not consistent with generally accepted accounting principles ("GAAP"). GAAP requires that deferred charges be amortized over the asset's estimated benefit period, not to exceed 40 years. Staff amortized the contract over its remaining life (i.e., 32 years).

Q. What was Staff's adjustment to Depreciation and Amortization expense for the Apache Junction system?

A. Staff decreased depreciation and amortization expense by $213,470, from $233,588 to $20,118.

Operating Income Adjustment Nos. 4, 6, 9, 11 and 12 – 2001 Expense Annualization Adjustment

Q. Did Staff recalculate annualized expenses?

A. Yes. Staff's calculations are shown as adjustments nos. 4, 6, 9, 11 and 12 and are shown on Schedule REL-15. Staff recommends an expense annualization adjustment of $115,344, an increase in expense of $495 compared to the Company's expense adjustment of $114,849.

Operating Income Adjustment No. 5 – Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power with the exception of a repaired pump inadvertently posted as an expense. The $6,276 was reclassified to Electrical Pumping Equipment as shown on Schedule REL-16.

Operating Income Adjustment No. 7 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes, Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to Apache Junction was decreased from the Company's pro forma adjustment by $2,868, from $191,642 to $188,774 as shown on Schedule REL-17. Please refer to Mr. Hammon's testimony.

Operating Income Adjustment No. 8 – Water Testing Expense

Q. Does Staff agree with the Company's Water Testing Expense?

A. No. Staff recommended this expense be based on Staff's water testing expense analysis of $36,869, which increases annual operating expenses by $8,176. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 10 – Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. Staff reclassified $19,303 from Transmission and Distribution Expense to Materials and supplies. The Company inadvertently posted $19,303 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory as shown on Schedule REL-19.

Operating Income Adjustment No. 16 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even though charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $7,647 from the Administrative and General account as shown on REL-20.

Operating Income Adjustment No. 14 – Rate Case Expense

Q. What Rate Case Expense did Arizona Water propose for the Apache Junction system?

A. The Company proposed total Rate Case Expense of $133,952 for the Apache Junction system. Rate Case Expense is a component of the Company's proposed $896,828 Administrative and General Expense, shown on Schedule REL-21.

Q. Does Staff agree that the Company's Rate Case Expense for the Apache Junction system is reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Apache Junction system?

A. Staff recommends allocating $94,093 to the Apache Junction system. Staff's recommended allocation uses the Company-proposed allocation factor of 0.52010 percent ($180,913 x 0.52010 = $94,093). Staff recommends annual Rate Case Expense of $18,819 ($94,093 amortized over five years) a decrease of $25,832 from the Company's requested $44,651, as shown on Schedule REL-21.

Operating Income Adjustment No. 15 – Depreciation and Amortization Expense

Q. What did the Company propose for depreciation expense?

A. The Company proposed $1,425,605 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 7 of 36, of the filing, increased depreciation expense by $2,886 to provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 8 of 36, of the filing, increased depreciation expense by $112,897 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using dated component depreciation rates that it later corrected. Staff reviewed and accepted the new rates and Staff used the new rates in calculating rates.

Q. What are the components of Apache Junction's proposed depreciation expense?

A. The Company's proposed depreciation expense is composed of $1,082,006 recorded in the test year, a negative $2,886 pro forma adjustment to recognize an additional half-year of depreciation of test year plant additions, and a positive $112,897 pro forma adjustment to recognize twelve months of depreciation of post-test year plant additions. Furthermore, the Company made a positive pro forma adjustment of $233,588 to recognize the annual amortization it is requesting to be charged to deferred Central Arizona Project M & I charges for pre-1991 and post-1990 M & I deferrals. These represent the Company's $1,425,605 proposed depreciation and amortization expenses.

Q. Why is Staff's recommended depreciation expense different than the Company's proposed amount?

A. Staff's recommended depreciation expense is different for two reasons. First, the Company's calculated depreciation expense used a dated component depreciation schedule which it later changed during the course of Staff's analysis. Staff recommends adopting the individual component account rates identified in the Company's late-filed depreciation study which was reviewed and accepted by Engineering Staff who used it to calculate the Staff's depreciation expense. Second, Staff calculated depreciation expense on its recommended plant, which reflects adjustments previously discussed.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommends $1,067,852 for depreciation expense, a $357,753 decrease from the Company's proposed $1,425,605. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL-22.

<u>Operating Income Adjustment No. 16 – Property Taxes</u>

Q. What is Arizona Water proposing for property tax expense for the Apache Junction system?

A. The Company proposes property tax expense of $751,447, $638,730 for Maricopa County and 112,717 for Pinal County.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $789,185. Staff recommends an increase of Maricopa County taxes of $35,528, from $112,717 to $148,245. Staff also recommends an increase in Pinal County taxes of $2,210, from $638,730 to $640,940. Staff's calculations are shown on Schedules REL–23 and REL-24.

<u>Operating Income Adjustment Nos. 17 and 18 – Income Taxes</u>

Q. What income tax expense did Arizona Water propose?

A. The Company proposed $508,210 in federal income taxes and $77,441 in state income taxes for a combined income tax of $585,651.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and Staff's recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedules REL-25, Staff recommends federal income tax of $847,452 and state income tax of $186,686 for a combined income tax of $1,034,138.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $562,902 and state income tax of $124,002 for a combined income tax of $686,904.

Rate Design – Apache Junction

<u>Rate Consolidation</u>

Q. Did Staff review the Company's proposal to consolidate rates for the Apache Junction and Superior systems?

A. Yes. Staff has reviewed the rate consolidation plan.

Q. What is the Company's rationale for the rate consolidation plan?

A. The Company seeks an interconnection between the two systems which it believes will provide increased reliability for customers of both systems. The Company proposes to do this in two phases. Phase one would equalize the two system's basic monthly charges. Step two, to be considered in the Eastern Groups next rate case, would combine the commodity charges of the two systems. (See Direct Testimony of Ralph Kennedy, pages 11 and 12.)

Q. Does Staff recommend approval of the Company's rate consolidation plan?

A. No. According to Staff Engineering there is no interconnection between Apache Junction and Superior, and there are CC&N voids between the Apache Junction system and the well field at Florence Junction. Additionally, the Apache Junction and Superior systems exhibit differences in revenue requirements due to the age of the respective infrastructure, maintenance costs, power costs and growth rates. Staff recommends that each of the Eastern Group's eight systems have their own unique rates based upon the characteristics of each system. Rate consolidation causes cross-subsidization among systems and results in unfair rates.

Rate Design

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and its recommended rates and charges?

A. Yes. Schedule REL-26 provides a summary of the present rates, Company-proposed rates, and Staff's recommended rates.

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all gallons sold.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at over 50,000 gallons. The three-tier rate structure applies to all metered customers.

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	24,207,016	$	18,346,065
2	Adjusted Operating Income (Loss)	$	1,862,934	$	2,123,885
3	Current Rate of Return (L2 / L1)		7.70%		11.58%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	2,662,772	$	1,571,524
6	Operating Income Deficiency (L5 - L2)	$	799,838	$	(552,362)
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 * L6)	$	1,305,663	$	(901,427)
9	Adjusted Test Year Revenue	$	8,943,927	$	9,038,642
10	Proposed Annual Revenue (L8 + L9) Note A	$	10,249,590	$	8,137,215
11	Require Increase in Revenue (%) (L8/L9)		14.60%		-9.97%

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

GROSS REVENUE CONVERSION FACTOR

Line No.			
	Calculation of Gross Revenue Conversion Factor:		
1	Recommended Revenue Increase:		
2	Billings		1.000000
3	Combined Federal and State Income Tax Rate	38.59888%	
4	Uncollectible Rate After Income Taxes	0.12477%	
5	Total Tax Rate		38.72365%
6	Gross Revenue Conversion Factor		**1.631951**
	Calculation of Effective Income Tax Rate:		
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%	
8	Arizona State Income Tax Rate	6.96800%	
9	Federal Taxable Income (L5 - L6)	93.03200%	
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%	
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%	
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%	
	Calculation of Uncollectible Rate After Income Taxes:		
13	Uncollectible Rate		0.20320%
14	Combined Federal and State Income Tax Rate	38.59888%	
15	1 minus Combined Federal and State Income Tax Rate		61.40112%
16	Uncollectible Rate After Income Taxes		0.12477%
	Revenue Reconciliation:		
17	Recommended Increase in Revenue (from REL-1, L8)	$ (901,427)	
18	Uncollectible Rate	0.203200%	
19	Required Increase in Revenue to Provide for Uncollectibles		$ (1,832)
20	Recommended Increase in Revenue (from REL-1,L8)	$ (901,427)	
21	Required Increase in Revenue to Provide for Uncollectibles	(1,832)	
22	Incremental Taxable Income	$ (899,595)	
23	Combined Federal and State Income Tax Rate	38.59888%	
24	Required Increase in Revenue to Provide for Income Taxes		(347,234)
25	Required Operating Income	$ 1,571,524	
26	Adjusted Test Year Operating Income (Loss)	2,123,885	
27	Required Increase in Operating Income		(552,362)
28	Total Required Increase In Revenue		$ (901,427)

Line No.	*Calculation of Income Tax:*	Test Year		STAFF Recommended	
29	Revenue	$ 9,038,642		$ 8,137,215	
30	Less: Operating Expenses Excluding Income Taxes	$ 5,880,619		$ 5,878,787	
31	Less: Synchronized Interest	$ 478,832		$ 478,832	
32	Arizona Taxable Income	$ 2,679,191		$ 1,779,596	
33	Arizona State Income Tax Rate	6.968%		6.968%	
34	Arizona Income Tax		$ 186,686		$ 124,002
35	Federal Taxable Income	$ 2,492,505		$ 1,655,593	
36	Federal Income Tax @ 34%		$ 847,452		$ 562,902
37	Combined Federal and State Income Tax		$ 1,034,138		$ 686,904
				$ (347,234)	

Line No.	*Calculation of Interest Synchronization:*	
38	Rate Base	$ 18,346,065
39	Weighted Average Cost of Debt	2.610%
40	Synchronized Interest	$ 478,832

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 55,226,791	$ (3,412,565)	$ 51,814,226
2	Less: Accumulated Depreciation	(8,791,705)	(1,100,547)	(9,892,252)
4	Net Plant in Service	$ 46,435,086	$ (4,513,112)	$ 41,921,974
	LESS:			
5	Advances in Aid of Construction (AIAC)	(15,443,377)	-	(15,443,377)
6	Contributions in Aid of Construction (CIAC)	$ (6,228,486)	$ -	$ (6,228,486)
7	Less: Accumulated Amortization	713,806	-	713,806
8	Net CIAC	(5,514,680)	-	(5,514,680)
9	Total Advances and Contributions	(20,958,057)	-	(20,958,057)
10	Customer Deposits	-	-	-
11	Meter Advances	-	-	-
12	Deferred Income Tax Credits	(2,699,309)	-	(2,699,309)
	ADD:			
13	Deferred Central Arizona Project Charges	-	704,903	704,903
14	Less: Accumulated Amortization	-	(20,118)	(20,118)
	Net Deferred CAP Charges	-	684,785	684,785
13	Working Capital	559,087	(1,250,994)	(691,907)
14	Phoenix Office Allocation	852,453	(765,834)	86,619
15	Meter Shop Allocation	17,756	(15,796)	1,960
17	**Total Rate Base**	$ 24,207,016	$ (5,860,951)	$ 18,346,065

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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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] ADJ No. 10	[L] ADJ No. 11	[M] ADJ No. 12	[N] ADJ No. 13	[O] STAFF ADJUSTED
	PLANT IN SERVICE:															
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	1,435	-	-	-	-	-	-	-	-	-	-	-	-	-	1,435
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	113,956	-	-	-	-	-	-	-	-	-	-	-	-	-	113,956
5	Other Source of Supply Land	49,438	-	-	-	-	-	-	-	-	-	-	-	-	-	49,438
6	Wells	2,505,438	-	-	-	-	-	-	-	-	-	-	-	-	-	2,505,438
7	Pumping Plant Land	14,187	-	-	-	-	-	-	-	-	-	-	-	-	-	14,187
8	Pumping Plant Structures & Improvements	43,621	-	-	-	-	-	-	-	-	-	-	-	-	-	43,621
9	Electric Pumping Equipment	2,461,590	6,292	-	-	-	-	-	-	-	-	-	-	-	-	2,467,882
10	Gas Engine Equipment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	9,760	-	-	-	-	-	-	-	-	-	-	-	-	-	9,760
13	Water Treatment Equipment	122,743	-	-	-	-	-	-	-	-	-	-	-	-	-	122,743
14	Transmission and Distribution Land	183,798	-	-	-	-	-	-	-	-	-	-	-	-	-	183,798
15	Storage Tanks	3,755,335	-	-	-	-	-	-	-	-	-	-	-	-	-	3,755,335
16	Transmission and Distribution Mains	28,329,468	-	-	-	-	-	-	-	-	-	-	-	-	-	28,329,468
17	Fire Sprinkler Taps	352,430	-	-	-	-	-	-	-	-	-	-	-	-	-	352,430
18	Services	7,442,934	-	-	-	-	-	-	-	-	-	-	-	-	-	7,442,934
19	Meters	1,263,272	-	-	-	-	-	-	-	-	-	-	-	-	-	1,263,272
20	Hydrants	2,422,487	-	-	-	-	-	-	-	-	-	-	-	-	-	2,422,487
21	General Plant Land	47,015	-	-	-	-	-	-	-	-	-	-	-	-	-	47,015
22	General Plant Structures	412,571	-	-	-	-	-	-	-	-	-	-	-	-	-	412,571
23	Leasehold Improvements	164,370	-	-	-	-	-	-	-	-	-	-	-	-	-	164,370
24	Office Furniture and Improvements	177,890	-	-	-	-	-	-	-	-	-	-	-	-	-	177,890
25	Warehouse Equipment	3,469	-	-	-	-	-	-	-	-	-	-	-	-	-	3,469
26	Tools, Shop and Garage Equipment	147,593	-	-	-	-	-	-	-	-	-	-	-	-	-	147,593
27	Laboratory Equipment	8,708	-	-	-	-	-	-	-	-	-	-	-	-	-	8,708
28	Power Operated Equipment	30,448	-	-	-	-	-	-	-	-	-	-	-	-	-	30,448
29	Communication Equipment	671,660	-	-	-	-	-	-	-	-	-	-	-	-	-	671,660
30	Miscellaneous Equipment	32,926	-	-	-	-	-	-	-	-	-	-	-	-	-	32,926
31	Total Plant in Service - Actual	50,768,542	6,292	-	-	-	-	-	-	-	-	-	-	-	-	$ 50,774,834.00
	Pro-forma Adjustment - Post TY Plant	3,753,346	-	(2,604,304)	-	-	-	-	-	-	-	-	-	-	-	1,149,042
	Post Test Year - Retired Plant	-	-		(109,650)	-	-	-	-	-	-	-	-	-	-	(109,650)
33	Deferred Central Arizona Project Charges	704,903			-	(704,903)		-								-
34	Total Plant in Service - Adjusted	$ 55,226,791	$ 6,292	$ (2,604,304)	$ (109,650)	$ (704,903)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 51,814,226
35	Less: Accumulated Depreciation - Actual	$ (8,681,694)	-	-	-	-	-	-	(35,589)	-	-	-	-	-	-	(8,717,283)
36	Less: Accumulated Depreciation - Post T Y	(112,897)	-	-	-	-	-	-	-	96,399	-	-	-	-	-	(16,498)
37	Less: Accumulated Depreciation - 12 Mos T Y	2,886	-	-	-	-	-	-	-	-	(1,307,339)	-	-	-	-	(1,304,453)
38	Less: Accumulated Depreciation - Retired Plant	-	-	-	-	-	-	-	-	-	-	145,982	-	-	-	145,982
39	Total Accumulated Depreciation - Adjusted	$ (8,791,705)	$ -	$ -	$ -	$ -	$ -	$ -	$ (35,589)	$ 96,399	$(1,307,339)	$ 145,982	$ -	$ -	$ -	$ (9,892,252)
40	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
41	Net Plant in Service	$ 46,435,086	$ 6,292	$ (2,604,304)	$ (109,650)	$ (704,903)	$ -	$ -	$ (35,589)	$ 96,399	$(1,307,339)	$ 145,982	$ -	$ -	$ -	$ 41,921,974
	LESS:															
42	Advances in Aid of Construction (AIAC)	$ (15,443,377)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	(15,443,377)
43	Contributions in Aid of Construction (CIAC)	(6,228,486)	-	-	-	-	-	-	-	-	-	-	-	-	-	(6,228,486)
44	Less: Accumulated Amortization	713,806	-	-	-	-	-	-	-	-	-	-	-	-	-	713,806
45	Net CIAC (L25 - L26)	(5,514,680)	-	-	-	-	-	-	-	-	-	-	-	-	-	(5,514,680)
46	Total Advances and Contributions	(20,958,057)	-	-	-	-	-	-	-	-	-	-	-	-	-	(20,958,057)
47	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
48	Meter Advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
49	Deferred Income Tax Credits	(2,699,309)	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,699,309)
	ADD:															
50	Deferred Central Arizona Project Charges	-					704,903									704,903
51	Less: Accumulated Amortization	-						(20,118)								(20,118)
52	Net Deferred CAP Charges	-	-	-	-	-	704,903	(20,118)	-	-	-	-	-	-	-	684,785
50	Working Capital Allowance	559,087	-	-	-	-	-	-	-	-	-	-	(1,250,994)	-	-	(691,907)
51	Phoenix Office Allocation	852,453	-	-	-	-	-	-	-	-	-	-	-	(765,834)	-	86,619
52	Meter Shop Allocation	17,756	-	-	-	-	-	-	-	-	-	-	-	-	(15,796)	1,960
53	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
54	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
55	Other Additions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
56	Total Rate Base	$ 24,207,016	$ 6,292	$ (2,604,304)	$ (109,650)	$ (704,903)	$ 704,903	$ (20,118)	$ (35,589)	$ 96,399	$(1,307,339)	$ 145,982	$(1,250,994)	$ (765,834)	$ (15,796)	$ 18,346,065

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Schedule REL-5

RATE BASE ADJUSTMENT NOS. 1, 2, 3 and 4 - PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 50,768,542	$ 6,292	$ 50,774,834
2	Post-Test Year Plant	$ 3,753,346	$ (2,604,304)	$ 1,149,042
3	Post-Test Year Retired Plant	$ -	$ (109,650)	$ (109,650)
4	Deferred CAP Charges	$ 704,903	$ (704,903)	$ -
5	**Adjusted Test Year Plant**	**$ 55,226,791**	**$ (3,412,565)**	**$ 51,814,226**

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Schedule REL- 6

RATE BASE ADJUSTMENT NOS. 5 and 6 - CAP DEFERRALS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Deferred CAP Charges	$ -	$ 704,903	$ 704,903
2	Less Amortization	-	$ (20,118)	(20,118)
3	Total	$ -	$ 684,785	$ 684,785

Staff amortized its recommeded annual recovery of the deferred CAP charges over the life of the CAP contract rarther than over three years as requested by the Company.

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Schedule REL-7

RATE BASE ADJUSTMENT NOS. 7, 8, 9 and 10 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (8,681,694)	$ (35,589)	$ (8,717,283)
2	Accumulated Depreciation, Post-Test Year Plant	$ (112,897)	$ 96,399	$ (16,498)
3	Accumulated Depreciation, Test Year Plant	$ 2,886	$ (1,307,339)	$ (1,304,453)
4	Accumulated Depreciation, Retired Plant	$ -	$ 145,982	$ 145,982
		$(8,791,705)	**$ (1,100,547)**	**$ (9,892,252)**

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Schedule REL- 8

OPERATING INCOME ADJUSTMENT NO. 11 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ 328,417	$ (1,270,297)	$ (941,880)
2	Materials and Supplies Inventory	43,863	19,303	63,166
3	Required Bank Balances	118,768	-	118,768
4	Prepayments and special Deposits	68,040	-	68,040
5	Total	$ 559,088	$ (1,250,994)	(691,906)

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Schedule REL-9

RATE BASE ADJUSTMENT NOS. 12 and 13 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 852,453	$ (729,502)	$ 122,951
2	Meter Shop Allocations	$ 17,756	$ (15,796)	$ 1,960
3	Phoenix Office Allocation - Retirements	$ -	$ (36,332)	$ (36,332)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 870,209**	**$ (781,630)**	**$ 88,579**

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Schedule REL-10

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:					
1	Total Operating Revenues	$ 8,943,927	$ 94,715	$ 9,038,642	$ (901,427)	$ 8,137,215
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ 1,003,040	$ (241,454)	$ 761,586	$ -	$ 761,586
3	Other	23,251	-	23,251	-	23,251
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	618,711	(6,251)	612,460	-	612,460
5	Purchased Gas	-	-	-	-	-
6	Other	117,465	-	117,465	-	117,465
7	Water Treatment Expenses	191,642	5,320	196,962	-	196,962
8	Transmission and Distribution Expenses	758,594	(19,050)	739,544	-	739,544
9	Customer Account Expenses	636,246	225	636,471	(1,832)	634,639
10	Sales Expenses	2,059	-	2,059	-	2,059
11	Administrative and General Expenses	896,828	(33,499)	863,329	-	863,329
12	Total Operation and Maintenance	$ 4,247,836	(294,709)	3,953,127	(1,832)	3,951,296
13	Depreciation and Amortization	1,425,605	(357,753)	1,067,852	-	1,067,852
15	Ad Valorem (Property)	751,447	37,738	789,185	-	789,185
	Taxes:					
14	Federal & State Income Tax	585,651	448,487	1,034,138	(347,234)	686,904
16	Other	70,454	-	70,454	-	70,454
17	**Total Operating Expenses**	$ 7,080,993	$ (166,236)	$ 6,914,757	$ (349,065)	$ 6,565,691
18	**Operating Income (Loss)**	$ 1,862,934	$ 260,951	$ 2,123,885	$ (552,362)	$ 1,571,524

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Schedule REL-11

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11
	REVENUES:												
1	**Total Operating Revenues**	$ 8,943,927	$ 94,715		$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
	EXPENSES:												
	Source of Supply Expenses:												
2	Purchased Water	$ 1,003,040	$ -	$ (27,984)	$ (213,470)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	23,251	-	-	-	-	-	-	-	-	-	-	-
	Pumping Expenses:												
4	Purchased Power	618,711	-		-	25	(6,276)	-	-	-	-	-	-
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	117,465	-	-	-	-	-	-	-	-	-	-	-
7	Water Treatment Expenses	191,642	-	-	-	-		12	(2,868)	8,176	-	-	-
8	Transmission and Distribution Expenses	758,594	-	-	-	-	-	-	-		253	(19,303)	-
9	Customer Account Expenses	636,246	-	-	-	-	-	-		-	-		225
10	Sales Expenses	2,059	-	-	-	-	-	-	-	-	-	-	-
11	Administrative and General Expenses	896,828	-	-	-	-	-	-	-		-	-	
12	Total Operation and Maintenance	4,247,836	-	(27,984)	(213,470)	25	(6,276)	12	(2,868)	8,176	253	(19,303)	225
13	Depreciation and Amortization	1,425,605	-	-	-	-	-	-	-	-			
15	Ad Valorem (Property)	751,447	-	-	-	-	-	-	-	-	-	-	-
	Taxes												
14	Federal & State Income Tax	585,651	-	-	-	-	-	-	-	-	-	-	-
16	Other	70,454											
17	**Total Operating Expenses**	$ 7,080,993	$ -	$ (27,984)	$ (213,470)	$ 25	$ (6,276)	$ 12	$ (2,868)	$ 8,176	$ 253	$ (19,303)	$ 225
18	**Operating Income (Loss)**	$ 1,862,934	$ 94,715	$ 27,984	$ 213,470	$ (25)	$ 6,276	$ (12)	$ 2,868	$ (8,176)	$ (253)	$ 19,303	$ (225)

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Schedule REL-11

SUMMARY OF OPERATING INCOME ADJUSTMENT

LINE NO.	DESCRIPTION	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] ADJ #15	[Q] ADJ #16	[R] ADJ #17	[S] ADJ #18	[T] STAFF ADJUSTED
	REVENUES:								
1	**Total Operating Revenues**	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 9,038,642
	EXPENSES:								
	Source of Supply Expenses:								
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 761,586
3	Other	-	-	-	-	-	-	-	23,251
	Pumping Expenses:								
4	Purchased Power	-	-	-	-	-	-	-	612,460
5	Purchased Gas	-	-	-	-	-	-	-	-
6	Other	-	-	-	-	-	-	-	117,465
7	Water Treatment Expenses	-	-	-	-	-	-	-	196,962
8	Transmission and Distribution Expenses	-	-	-	-	-	-	-	739,544
9	Customer Account Expenses	-	-	-	-	-	-	-	636,471
10	Sales Expenses	-	-	-	-	-	-	-	2,059
11	Administrative and General Expenses	(20)	(7,647)	(25,832)	-	-	-	-	863,329
12	Total Operation and Maintenance	(20)	(7,647)	(25,832)	-	-	-	-	3,953,127
13	Depreciation and Amortization				(357,753)	-	-	-	1,067,852
15	Ad Valorem (Property)	-	-	-	-	37,738			789,185
	Taxes								
14	Federal & State Income Tax	-	-	-	-	-	339,242	109,245	1,034,138
16	Other								70,454
17	**Total Operating Expenses**	$ (20)	$ (7,647)	$ (25,832)	$ (357,753)	$ 37,738	$ 339,242	$ 109,245	$ 6,914,757
18	**Operating Income (Loss)**	$ 20	$ 7,647	$ 25,832	$ 357,753	$ (37,738)	$ (339,242)	$ (109,245)	$ 2,123,885

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OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	$ 591		$ 591
2	Avg Annual Bill Per Customer for TY	350		510
3	Avg Annual Revenue for Additional Customers	$ 206,850	$ 94,715	$ 301,565

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Schedule REL-13

OPERATING INCOME ADJUSTMENT NO. 2 - CAP PURCHASED WATER ADJUSTMENT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Purchased Water - CAP & City of Mesa Treatment	$ 703,309	$ 25,188	$ 728,497
2	Purchased Water - Effluent	$ 94,027	$ -	$ 94,027
3	Purchased Water - Unreconciled Amount	$ 7,875	$ (7,875)	$ -
4	Subtotal	$ 805,211	$ 17,313	$ 822,524
5	November 2001 Mesa Treatment Cost	$ 10,982	$ (10,982)	$ -
6	M&I Capital Costs (Currently Deferred)	$ 113,939	$ (4,839)	$ 109,100
7	Increase in CAWCD Charge Per Acre-Feet	$ 41,304	$ 2,128	$ 43,432
8	Subtotal	$ 166,225	$ (13,693)	$ 152,532
9	Expense Annualization Adjustment	$ 31,604	$ (31,604)	$ -
10	Subtotal	$ 197,829	$ (45,297)	$ 152,532
11	**Total Purchased Water (L4+L10)**	**$ 1,003,040**	**$ (27,984)**	**$ 975,056**

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Schedule REL-14

OPERATING INCOME ADJUSTMENT NO. 3 - CAP AMORTIZATION ADJUSTMENT

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENT**	**STAFF AS ADJUSTED**
1	2002 Unamortized Balance of $60,000 Deferred CAP	$ 46,315	$ -	$ 46,315
2	2002 Deferred CAP Balance (Accrued from1986 to 2002)	$ 658,588	$ (13,381)	$ 645,207
3	Total Deferred CAP Balance To Be Amortized	$ 704,903	$ (13,381)	$ 691,522
4	Proposed Amortization Period (In Months)	36	350	386
5	Monthly Deferred CAP Amortization Expense	$ 19,581	$ (17,789)	$ 1,792
6	Multiplied by 12 Months	12	-	12
7	Annual Deferred CAP Amortization Expense	$ 234,968	$ (213,470)	$ 21,498
8	Less: Test year Amort Exp on $60,000 Deferred CAP	$ 1,380	-	$ 1,380
	Total Annual CAP Amortization Expense	**$ 233,588**	**$ (213,470)**	**$ 20,118**

9	Calculation of Staff Proposed Amortization Period (In Months)	
10	2035	End of CAP Contract (March 15, 2035)
11	- 2003	Beginning of Amortization Period
12	32	Full Years Remaining on Life of Contract (Jan 2003 to Dec 2034)
13	x 12	Multiplied by 12 months
14	384	Number of Months From Jan 2003 to Dec 2034
15	+ 2	Plus 2 Months (Jan 2035 to March 15, 2035)
16	386	Staff Proposed Amortization Period (In Months)

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL- 15

OPERATING INCOME ADJUSTMENT NOS. 4, 6, 9, 11 and 12 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ 31,604	$ (20)	$ 31,584
2	Purchased Pumping Power	26,903	25	26,928
3	Water Treatment Expense	7,226	12	7,238
4	Transmission & Distribution Expense	26,012	253	26,265
5	Customer Accounting	23,104	225	23,329
6	Total	$ 114,849	$ 495	$ 115,344

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL-16

OPERATING INCOME ADJUSTMENT NO. 5 - PURCHASED PUMPING POWER ADJUSTMENT

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Purchased Pumping Power	$ 618,711	$ (6,276)	$ 612,435

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL- 17

OPERATING INCOME ADJUSTMENT NO. 7 - WATER TREATMENT EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Water Treatment	$ 191,642	$ (2,868)	$ 188,774

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL-18

OPERATING INCOME ADJUSTMENT NO. 8 - WATER TESTING EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Annual Water Testing Expense	$ 28,693	$ 8,176	$ 36,869

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL-19

OPERATING INCOME ADJUSTMENT NO. 10 TRANSMISSION AND DISTRIBUTION EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Transmission and Distribution Expense	$ 758,594	$ (19,303)	$ 739,291

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL-20

OPERATING INCOME ADJUSTMENT NO. 13 - CHARITABLE CONTRIBUTIONS

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 7,647	$ (7,647)	$ -

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL- 21

OPERATING INCOME ADJUSTMENT NO. 14 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.52010		0.52010
3	Annual Rate Case Expense for Eastern Group	$ 133,952	$ (39,859)	$ 94,093
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 44,651	$ (25,832)	$ 18,819

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL-22

OPERATING INCOME ADJUSTMENT NO. 15 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENT**	**STAFF AS ADJUSTED**
1	Depreciation Expense	$ 1,425,605	$ (212,006)	$ 1,213,599
2	CIAC Amortization	-	(145,747)	(145,747)
		$ 1,425,605	$ (357,753)	$ 1,067,852

Arizona Water Company - Apache Junction (Maricopa County)
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL- 23

OPERATING INCOME ADJUSTMENT NO. 16 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 1,273,158
2	2001 Annual Gross Revenues			$ 1,289,733
3	2002 Annual Gross Revenues			$ 1,403,919
4	Plus Staff's Recommended Increase			$ (135,214)
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 3,831,596
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 1,277,199
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 2,554,397
10	Plus: 10% of 2001 CWIP			-
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 31,814
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 2,522,583
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 630,646
15	Composite Property Tax Rate (See Note B Below)			0.235069
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 112,717	$ 35,528	$ 148,245

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

Arizona Water Company - Apache Junction (Pinal County)
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL- 24

OPERATING INCOME ADJUSTMENT NO. 16 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 7,214,564
2	2001 Annual Gross Revenues			$ 7,303,486
3	2002 Annual Gross Revenues			$ 7,955,543
4	Plus Staff's Recommended Increase			$ (766,213)
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 21,707,380
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 7,235,793
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 14,471,587
10	Plus: 10% of 2001 CWIP			-
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 180,278
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 14,291,309
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 3,572,827
15	Composite Property Tax Rate (See Note B Below)			0.179393
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 638,730	$ 2,210	$ 640,940

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

Arizona Water Company - Apache Junction
Docket No. W-01445A-02-0619
Test Year Ended December 31, 2001

Schedule REL- 25

OPERATING INCOME ADJUSTMENT NOS. 17 and 18 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ 508,210	$ 339,242	$ 847,452
2	State Income Taxes	77,441	$ 109,245	186,686
3	Total Income Taxes	$ 585,651	$ 448,487	$ 1,034,138

ARIZONA WATER COMPANY - APACHE JUNCTION
DOCKET NO. W-01445A-02-0619
TEST YEAR ENDED DECEMBER 31, 2001

RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 12.43	$ 18.13	$ 12.43
1" Meter	$ 24.86	$ 40.79	$ 35.71
2" Meter	$ 62.15	$ 117.85	$ 113.80
3" Meter	$ 103.58	$ 211.58	$ 283.79
4" Meter	$ 207.16	$ 377.65	$ 532.97
6" Meter	$ 362.53	$ 717.59	$ 717.50
8" Meter	$ 362.53	$ 989.54	$ 862.25
10" Meter	$ 673.27	$ 1,624.09	$ 1,003.50
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 2.5690	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 2.5690	$ 2.5250	$ 1.5008
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 2.5690	$ 2.5250	$ 1.8760
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 2.5690	$ 2.5250	$ 2.2512
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	(a)
1" Meter	(a)	(a)	(a)
2" Meter	(b)	(b)	(b)
3" Meter	(b)	(b)	(b)
4" Meter	(b)	(b)	(b)
6" Meter	(b)	(b)	(b)

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

RATE DESIGN
CONTINUED

	Present	---Proposed Rates---	
Service Charges:	**Rates**	**Company**	**Staff**
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishehement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

BISBEE SYSTEM

Summary of Proposed Revenue – Bisbee

Q. Did Staff prepare a schedule representative of the Company proposed increase and Staff's recommended revenue requirement?

A. Yes. Please refer to Schedule REL-1. The Company proposes total annual operating revenue of $1,869,599. This represents an increase of $612,649, or 48.74 percent, over the Company adjusted test year revenue of $1,256,950.

Q. Please summarize Staff's recommended revenue for the Bisbee system.

A. Staff's recommended total annual operating revenue for the Bisbee system is $1,613,909. Staff's recommendation represents an increase of $357,306, or 28.43 percent, over its adjusted test year revenue of $1,256,603.

Rate Base - Bisbee

Original Cost Rate Base

Q. Did Staff prepare an Original Cost Rate Base Schedule?

A. Yes, shown on Schedule REL-3, Staff recommends a rate base of $3,425,681. Staff's recommended rate base is a decrease of $274,432 from the Company's proposal of $3,700,113. Staff's rate base adjustments are described below

Rate Base Adjustment No. 1 – Plant In Service

Q. What adjustment to actual test year plant did the Company propose for the Bisbee system?

A. The Company recommended increasing actual Plant In Service by $597,543. This amount represents all actual and projected plant additions placed in service or expected to be placed in service by December 31, 2002. Twelve months past the 2001 test year.

Rate Base Adjustment No. 1 – Reclassification of Expense to Plant

Q. Did Staff make any adjustments to the Company's test year Plant In Service?

A. Yes. Staff reclassified $6,328 in plant erroneously classified as Purchased Pumping Power expense into the Electrical Pumping Equipment account. This adjustment is made up of $3,783 charged to the Bisbee Purchased Pumping Power account and $2,545 charged to the Sierra Vista Purchased Pumping Power account and reclassified to the Bisbee Electrical Pumping Power account. This adjustment increased test year Plant In Service from $6,836,398 to $6,842,726 as shown on Schedule REL-5.

Rate Base Adjustment No. 2 – Addition of Post-Test Year Plant

Q. Does Staff's recommended rate base include plant placed into service after the test year?

A. Yes. Staff included $786,254 of plant in rate base that the Company placed into service after the end of the test year but no later than December 31, 2002 as shown on REL-5. Staff increased the Company's pro forma post-test year plant additions by $188,711, from $597,543 to $786,254 to recognize revenue neutral plant placed in service by December 31, 2002.

Rate Base Adjustment No. 3 – Post–Test Year Retired Plant

Q. Did the Company make any adjustment for plant retired due to the 2002 post-test year plant placed in Service?

A. No, the Company's application did not reflect plant retired due to the plant that was replaced by the post-test year additions. Staff therefore removed $15,065 from Plant In Service as shown on Schedule REL-5 and from Accumulated Depreciation.

Q. **Please summarize Staff's recommendations regarding Plant In Service.**

A. Staff recommends $7,613,915 for Plant In Service, a $179,974 increase from the Company's proposed $7,433,941, as shown on Schedule REL-5

Rate Base Adjustment Nos. 4, 5, 6 and 7 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 3 of 11, of the filing, increased Accumulated Depreciation by $20,636 to reflect twelve months depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 3 of 11, of the filing, increased Accumulated Depreciation by $6,993 and represents six months depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant included in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff increased Accumulated Depreciation by $128,966, from $3,099,049 to $3,228,015. This adjustment is made up of several components including a $7,458 (adjustment no. 4) reduction as a result of Staff's analysis. Staff's recommended increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $169,679 (adjustment no. 6) from $6,993 to $176,672, and it recommended decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $10,094 (adjustment no. 5) from $20,636 to $10,542. Additionally, Staff removed $23,161 (adjustment no. 7) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC – USOA accounting procedures.

Rate Base Adjustment No. 8 – Cash Working Capital Allowance

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $100,985 for working capital. Schedule B-5, page 1 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $28,193 cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of working capital?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicates a negative $127,335 cash working capital component or a reduction of $155,528 below the Company's $28,193 figure. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Working Capital?

A. Staff increased the Materials and Supply Inventory by $4,258 from $31,166 to $35,424 as a result of materials that were transferred from Transmission and Distribution Expense to Working Capital.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of negative $50,285 as shown on Schedule REL-7.

Rate Base Adjustment No. 9 and 10 – Allocated Post-Test Year Additions

Q. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

A. Yes. Staff accepted only revenue neutral plant that was in service by the December 31, 2002, cut off date. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $170,650, which included $8,096 of post-test year retired plant and the Meter Shop allocation by $3,520. Staff's adjustment reduced the Phoenix Office and Meter shop allocations by $174,170, from $193,907 to $19,737. Staff's analysis is shown on Schedule REL-9.

Operating Income - Bisbee

Operating Income Summary

Q. What are Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $1,256,603 as adjusted by Staff, expenses of $1,182,103, and an operating income of $74,500 as shown on Schedules REL-9. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied negative 6 (that represents the average growth in customers on the Bisbee system during the test year) by $311 (which is the Company's determination of annual revenue per customer) that resulted in a revenue decline of $1,866.

Q. Did Staff make an adjustment to annual revenue in the Company's calculation?

A. Yes. Staff made a negative $347 adjustment to decrease the Company's proposed annualization from a negative $1,866 to a negative $2,213. Staff's calculation of the adjustment is shown on Schedule REL-11. Staff's recalculation recognizes revenue from all meter sizes and calculated the average annual revenue per customer to be $369 rather than the Company's $311.

Operating Income Adjustment No. 2 – Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power Expense with the exception of a repaired pump of $3,782 inadvertently allocated and posted to Bisbee's Purchased Pumping Power expense. Staff reclassified the pump to Plant In Service, Electric Pumping Equipment, as shown on Schedule REL-13.

Operating Income Adjustment No. 3 – Water Testing Expense

Q. What is Arizona Water's proposed Water Testing Expense?

A. Arizona Water's proposed Water Testing Expense is $3,610 for the Bisbee system. Water Testing Expense is a component of the Company's proposed $47,494 Water Treatment Expense shown on Schedule REL -13.

Q. Did Staff agree with the Company's Water Testing Expense?

A. No. Staff recommends this expense be based on Staff's water testing expense analysis of $3,257, which decreases annual operating expenses by $353. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 4 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes. Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to Bisbee was decreased from the Company's pro forma expense by $5,790, from $47,494 to $41,704 as shown on Schedule REL-14. Please refer to Mr. Hammon's testimony.

Operating Income Adjustment No. 5– Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. Staff's reduced Transmission and Distribution Expenses by $4,258. The Company inadvertently posted $4,258 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory, as shown on Schedule REL-15.

Operating Income Adjustment No. 6 and 7 – Expense Annualization Adjustment

Q. Did Staff recalculate annualized expenses?

A. Yes. Staff's calculations are shown as adjustments nos. 6 and 7and are shown on Schedule REL-16. Staff recommends an expense annualization adjustment of a negative $1,121, an increase of $6.

Operating Income Adjustment No. 8 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even though charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $1,704 from the Administrative and General account as shown on REL-17.

Operating Income Adjustment No. 9 – Rate Case Expense

Q. What Rate Case Expense did Arizona Water propose for the Bisbee system?

A. The Company proposed total Rate Case Expense of $29,850 for the Bisbee system. Rate Case Expense is a component of the Company's proposed $235,785 Administrative and General Expense, shown on Schedule REL-18.

Q. Does Staff agree that the Company's Rate Case Expense for the Bisbee system is reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Bisbee system?

A. Staff recommends allocating $20,968 to the Bisbee system. Staff recommends allocation use the Company-proposed allocation factor of 0.11590 percent ($180,913 x 0.11590 = $20,968). Staff recommends annual Rate Case Expense of $4,194 ($20,968 amortized over five years), a decrease of $5,756 from the Company's requested of $9,950, as shown on Schedule REL-18.

<u>Operating Income Adjustment No. 10 – Depreciation and Amortization Expense</u>

Q. What did the Company propose for depreciation expense?

A. The Company proposed $200,874 for depreciation expense. The Company's proposal included two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 11 of 36 of the filing, increased depreciation expense by $6,993 to provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 12 of 36 of the filing, increased depreciation expense by $20,636 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using dated component depreciation rates that it later corrected. Staff reviewed and accepted the new depreciation rates which were used in calculating rates.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommended $205,252 for depreciation expense, a $4,378 increase over the Company's proposed $200,874. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL-19.

Q. What are the components of Bisbee's proposed depreciation expense?

A. The Company's proposed depreciation expense is composed of $173,245 recorded in the test year, a $6,993 pro forma adjustment to recognize an additional half-year of depreciation on test year plant additions, and $20,636 pro forma adjustment to recognize twelve months of depreciation on post-test year plant additions for a total of $200,874.

Q. Why is Staff's recommended depreciation expense different than the Company's proposed amount?

A. Staff's recommended depreciation expense is different for two reasons. First, the Company's calculated depreciation expense used a dated component depreciation schedule which it later changed during the course of Staff's analysis. Staff recommends adopting the individual component account rates identified in the Company's late-filed depreciation study which was reviewed and accepted by Staff who used it to calculate Staff's depreciation expense. Second, Staff calculated depreciation expense on its recommended plant, which reflects adjustments previously discussed.

Operating Income Adjustment No. 11– Property Taxes

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $106,595.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $99,661, a decrease of $6,934 from the Company's proposal of $106,595, as shown on Schedule REL-20.

Operating Income Adjustment Nos.12 and 13 – Income Taxes

Q. What income tax expense did Arizona Water propose?

A. The Company proposed $845 in federal taxes and a negative $1,297 in state income tax for a combined federal and state income tax of a negative $452.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and Staff recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedules REL-21, Staff recommends a negative federal income tax of $7,681 and a negative state income tax of $1,692 for a combined negative income tax of $9,373.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $105,108 and state income tax of $23,154 for a combined income tax of $128,262.

Rate Design - Bisbee

<u>Rate Design</u>

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and Staff's recommended rates and charges?

A. Yes. Schedule REL-22 provides a summary of the present rates, Company-proposed rates, and Staff's recommended rates.

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at over 50,000 gallons. The three-tier rate structure applies to all metered customers.

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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	[A] COMPANY ORIGINAL COST	[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$ 3,700,113	$ 3,425,681
2	Adjusted Operating Income (Loss)	$ 31,709	$ 74,500
3	Current Rate of Return (L2 / L1)	0.86%	2.17%
4	Required Rate of Return	11.0000%	8.5660%
5	Required Operating Income (L4 * L1)	$ 407,012	$ 293,444
6	Operating Income Deficiency (L5 - L2)	$ 375,303	$ 218,944
7	Gross Revenue Conversion Factor	1.63241	1.63195
8	Increase In Gross Revenue (L7 * L6)	$ 612,649	$ 357,306
9	Adjusted Test Year Revenue	$ 1,256,950	$ 1,256,603
10	Proposed Annual Revenue (L8 + L9) Note A	$ 1,869,599	$ 1,613,909
11	Require Increase in Revenue (%) (L8/L9)	48.74%	28.43%

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Schedule REL- 2

Line No.						
	Calculation of Gross Revenue Conversion Factor:					
1	Recommended Revenue Increase:					
2	Billings		1.000000			
3	Combined Federal and State Income Tax Rate	38.59888%				
4	Uncollectible Rate After Income Taxes	0.12477%				
5	Total Tax Rate		38.72365%			
6	Gross Revenue Conversion Factor		**1.631951**			
	Calculation of Effective Income Tax Rate:					
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%				
8	Arizona State Income Tax Rate	6.96800%				
9	Federal Taxable Income (L5 - L6)	93.03200%				
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%				
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%				
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%				
	Calculation of Uncollectible Rate After Income Taxes:					
13	Uncollectible Rate		0.20320%			
14	Combined Federal and State Income Tax Rate	38.59888%				
15	1 minus Combined Federal and State Income Tax Rate		61.40112%			
16	Uncollectible Rate After Income Taxes		0.12477%			
	Revenue Reconciliation:					
17	Recommended Increase in Revenue (from REL-1, L8)	$ 357,306				
18	Uncollectible Rate	0.203200%				
19	Required Increase in Revenue to Provide for Uncollectibles		$ 726			
20	Recommended Increase in Revenue (from REL-1,L8)	$ 357,306				
21	Required Increase in Revenue to Provide for Uncollectibles	726				
22	Incremental Taxable Income	$ 356,580				
23	Combined Federal and State Income Tax Rate	38.59888%				
24	Required Increase in Revenue to Provide for Income Taxes		137,636			
25	Required Operating Income	$ 293,444				
26	Adjusted Test Year Operating Income (Loss)	74,500				
27	Required Increase in Operating Income		218,944			
28	Total Required Increase In Revenue		$ 357,306			
	Calculation of Income Tax:	Test Year		STAFF Recommended		
29	Revenue	$ 1,256,603		$ 1,613,909		
30	Less: Operating Expenses Excluding Income Taxes	$ 1,191,477		$ 1,192,203		
31	Less: Synchronized Interest	$ 89,410		$ 89,410		
32	Arizona Taxable Income	$ (24,284)		$ 332,296		
33	Arizona State Income Tax Rate	6.968%		6.968%		
34	Arizona Income Tax		$ (1,692)		$ 23,154	
35	Federal Taxable Income	$ (22,592)		$ 309,142		
36	Federal Income Tax @ 34%		$ (7,681)		$ 105,108	
37	Combined Federal and State Income Tax		$ (9,373)		$ 128,263	
				$ 137,636		
	Calculation of Interest Synchronization:					
38	Rate Base	$ 3,425,681				
39	Weighted Average Cost of Debt	2.610%				
40	Synchronized Interest	$ 89,410				

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Schedule REL-3

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 7,433,939	179,974	$ 7,613,913
2	Less: Accumulated Depreciation	(3,099,049)	(128,966)	(3,228,015)
3	Net Plant in Service	$ 4,334,890	$ 51,008	$ 4,385,898
	LESS:			
4	Advances in Aid of Construction (AIAC)	(190,083)	-	(190,083)
5	Contributions in Aid of Construction (CIAC)	$ (372,133)	$ -	$ (372,133)
6	Less: Accumulated Amortization	55,613	-	55,613
7	Net CIAC	(316,520)	-	(316,520)
8	Total Advances and Contributions	(506,603)	-	(506,603)
9	Customer Deposits	-	-	-
10	Meter Advances	-	-	-
11	Deferred Income Tax Credits	(423,066)	-	(423,066)
	ADD:			
12	Working Capital	100,985	(151,270)	(50,285)
13	Phoenix Office Allocation	189,951	(170,650)	19,301
14	Meter Shop Allocation	3,956	(3,520)	436
15		-	-	-
16		-	-	-
17		-	-	-
18	**Total Rate Base**	$ 3,700,113	$ (274,432)	$ 3,425,681

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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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] ADJ No. 10	[M] STAFF ADJUSTED
	PLANT IN SERVICE:												
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises		-	-	-	-	-	-	-	-	-	-	-
3	Other Intangibles		-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	5,294	-	-	-	-	-	-	-	-	-	-	5,294
5	Other Source of Supply Land	4,033	-	-	-	-	-	-	-	-	-	-	4,033
6	Wells	48,766	-	-	-	-	-	-	-	-	-	-	48,766
7	Pumping Plant Land	7,054	-	-	-	-	-	-	-	-	-	-	7,054
8	Pumping Plant Structures & Improvements	26,509	-	-	-	-	-	-	-	-	-	-	26,509
9	Electric Pumping Equipment	513,405	6,328	-	-	-	-	-	-	-	-	-	519,733
10	Gas Engine Equipment	164,220	-	-	-	-	-	-	-	-	-	-	164,220
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	31,930	-	-	-	-	-	-	-	-	-	-	31,930
13	Water Treatment Equipment	38,243	-	-	-	-	-	-	-	-	-	-	38,243
14	Transmission and Distribution Land	5,044	-	-	-	-	-	-	-	-	-	-	5,044
15	Storage Tanks	353,044	-	-	-	-	-	-	-	-	-	-	353,044
16	Transmission and Distribution Mains	3,965,590		-	-	-	-	-	-	-	-	-	3,965,590
17	Fire Sprinkler Taps	29,546	-	-	-	-	-	-	-	-	-	-	29,546
18	Services	817,067	-	-	-	-	-	-	-	-	-	-	817,067
19	Meters	211,876	-	-	-	-	-	-	-	-	-	-	211,876
20	Hydrants	193,556	-	-	-	-	-	-	-	-	-	-	193,556
21	General Plant Land	-	-	-	-	-	-	-	-	-	-	-	-
22	General Plant Structures	16,438	-	-	-	-	-	-	-	-	-	-	16,438
23	Leasehold Improvements	8,058	-	-	-	-	-	-	-	-	-	-	8,058
24	Office Furniture and Improvements	79,855	-	-	-	-	-	-	-	-	-	-	79,855
25	Warehouse Equipment	-	-	-	-	-	-	-	-	-	-	-	-
26	Tools, Shop and Garage Equipment	37,681	-	-	-	-	-	-	-	-	-	-	37,681
27	Laboratory Equipment	543	-	-	-	-	-	-	-	-	-	-	543
28	Power Operated Equipment	15,583	-	-	-	-	-	-	-	-	-	-	15,583
29	Communication Equipment	242,999	-	-	-	-	-	-	-	-	-	-	242,999
30	Miscellaneous Equipment	20,062	-	-	-	-	-	-	-	-	-	-	20,062
31	Total Plant in Service - Actual	6,836,396	6,328	-	-	-	-	-	-	-	-	-	6,842,724
	Pro-forma Adjustment - Post TY Plant	597,543	-	188,711	-	-	-	-	-	-	-	-	786,254
32	Post Test Year - Retired Plant	-			(15,065)								(15,065)
33	Total Plant in Service - Adjusted	$ 7,433,939	$ 6,328	$ 188,711	$ (15,065)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 7,613,913
34	Less: Accumulated Depreciation - Actual	$ (3,071,420)	-	-		7,458	-	-	-	-	-	-	(3,063,962)
35	Less: Accumulated Depreciation - Post TY	(20,636)	-	-	-		10,094	-	-	-	-	-	(10,542)
36	Add: Accumulated Depreciation - 12 Mos TY	(6,993)	-	-	-	-		(169,679)	-	-	-	-	(176,672)
37	Less: Accumulated Depreciation - Retired Plant	-							23,161	-	-	-	23,161
38	Total Accumulated Depreciation - Adjusted	$ (3,099,049)	$ -	$ -	$ -	$ 7,458	$ 10,094	$ (169,679)	$ 23,161	$ -	$ -	$ -	$ (3,228,015)
39	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-	-
40	Net Plant in Service	$ 4,334,890	$ 6,328	$ 188,711	$ (15,065)	$ 7,458	$ 10,094	$ (169,679)	$ 23,161	$ -	$ -	$ -	$ 4,385,898

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] ADJ No. 10	[M] STAFF ADJUSTED
	LESS:												
41	Advances in Aid of Construction (AIAC)	$ (190,083)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (190,083)
42	Contributions in Aid of Construction (CIAC)	(372,133)	-	-	-	-	-	-	-	-	-	-	(372,133)
43	Less: Accumulated Amortization	55,613	-	-	-	-	-	-	-	-	-	-	55,613
44	Net CIAC (L25 - L26)	(316,520)	-	-	-	-	-	-	-	-	-	-	(316,520)
45	Total Advances and Contributions	(506,603)	-	-	-	-	-	-	-	-	-	-	(506,603)
46	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-	-
47	Meter Advances	-	-	-	-	-	-	-	-	-	-	-	-
48	Deferred Income Tax Credits	(423,066)	-	-	-	-	-	-	-	-	-	-	(423,066)
	ADD:												
49	Working Capital Allowance	100,985	-	-	-	-	-	-	-	(151,270)	-	-	(50,285)
50	Phoenix Office Allocation	189,951	-	-	-	-	-	-	-	-	(170,650)	-	19,301
51	Meter Shop Allocation	3,956	-	-	-	-	-	-	-	-	-	(3,520)	436
52	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-	-
53	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-	-
54	Other Additions	-	-	-	-	-	-	-	-	-	-	-	-
55	**Total Rate Base**	$ 3,700,113	$ 6,328	$ 188,711	$ (15,065)	$ 7,458	$ 10,094	$ (169,679)	$ 23,161	$ (151,270)	$ (170,650)	$ (3,520)	$ 3,425,681

Adjustments

1 $6,328 Reclass from Purchased Pumping Power to Electrical Pumping Equipment
2 $188,711 To record post-test *year additional plant in service*
3 $15,065, To record post-test year plant retirements
4 $7,458 To record Staff's negative variance to accumulated depriciation,

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Schedule REL-5

RATE BASE ADJUSTMENT NOS. 1, 2 and 3 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 6,836,398	$ 6,328	$ 6,842,726
2	Post-Test Year Plant	$ 597,543	$ 188,711	$ 786,254
3	Post-Test Year Retired Plant	$ -	$ (15,065)	$ (15,065)
	Adjusted Test Year Plant	**$ 7,433,941**	**$ 179,974**	**$ 7,613,915**

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Schedule REL-6

RATE BASE ADJUSTMENT NOS. 4, 5, 6 AND 7 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (3,071,420)	$ 7,458	$ (3,063,962)
2	Accumulated Depreciation, Post-Test Year Plant	$ (20,636)	$ 10,094	$ (10,542)
3	Accumulated Depreciation, Test Year Plant	$ (6,993)	$ (169,679)	$ (176,672)
3	Accumulated Depreciation, Retired Plant	$ -	$ 23,161	$ 23,161
		$(3,099,049)	**$ (128,966)**	**$ (3,228,015)**

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Schedule REL- 7

OPERATING INCOME ADJUSTMENT NO. 8 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ 28,193	$ (155,528)	$ (127,335)
2	Materials and Supplies Inventory	31,166	4,258	35,424
3	Required Bank Balances	26,465	-	26,465
4	Prepayments and special Deposits	15,161	-	15,161
5	Total	$ 100,985	(151,270)	$ (50,285)

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Schedule REL-8

RATE BASE ADJUSTMENT NOS. 9 and 10 - PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Phoenix Office Allocation	$ 189,951	$ (162,554)	$ 27,397
2	Meter Shop Allocations	$ 3,956	$ (3,520)	$ 436
3	Phoenix Office Allocation - Retirements	$ -	$ (8,096)	$ (8,096)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 193,907**	**$ (174,170)**	**$ 19,737**

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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:					
1	Total Operating Revenues	$ 1,256,950	$ (347)	$ 1,256,603	$ 357,306	$ 1,613,909
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ -	$ -	$ -	$ -	$ -
3	Other	2,275	-	2,275	-	2,275
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	181,448	(3,783)	177,665	-	177,665
5	Purchased Gas	401	-	401	-	401
6	Other	43,218	-	43,218	-	43,218
7	Water Treatment Expenses	47,494	(6,143)	41,351	-	41,351
8	Transmission and Distribution Expenses	213,823	(4,261)	209,562	-	209,562
9	Customer Account Expenses	168,474	(3)	168,471		168,471
10	Sales Expenses	987	-	987	-	987
11	Administrative and General Expenses	235,785	(7,460)	228,325	726	229,051
12	Total Operation and Maintenance	$ 893,905	(21,650)	872,255	726	872,981
13	Depreciation and Amortization	200,874	(5,632)	195,242	-	195,242
14	Ad Valorem (Property)	106,595	(6,934)	99,661	-	99,661
	Taxes:					
15	Federal & State Income Tax	(452)	(8,921)	(9,373)	137,636	128,263
16	Other	24,319	-	24,319	-	24,319
17	**Total Operating Expenses**	$ 1,225,241	$ (43,138)	$ 1,182,103	$ 138,362	$ 1,320,465
18	**Operating Income (Loss)**	$ 31,709	$ 42,791	$ 74,500	$ 218,944	$ 293,444

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Schedule REL-10

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	[J] ADJ #8	[K] ADJ #9	[L] ADJ #10	[M] ADJ #11	[N] ADJ #12	[O] ADJ #13	[P] STAFF ADJUSTED
	REVENUES:															
1	**Total Operating Revenues**	$ 1,256,950	$ (347)		$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,256,603
	EXPENSES:															
	Source of Supply Expenses:															
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	2,275	-	-	-	-	-	-	-	-	-	-	-	-	-	2,275
	Pumping Expenses:															-
4	Purchased Power	181,448	-	(3,783)	-	-	-	-	-	-	-	-	-	-	-	177,665
5	Purchased Gas	401	-	-	-	-	-	-	-	-	-	-	-	-	-	401
6	Other	43,218	-	-	-	-	-	-	-	-	-	-	-	-	-	43,218
7	Water Treatment Expenses	47,494	-	-	(353)	(5,790)	-	-	-	-	-	-	-	-	-	41,351
8	Transmission and Distribution Expenses	213,823	-	-	-	-	(4,258)	(3)	-	-	-	-	-	-	-	209,562
9	Customer Account Expenses	168,474	-	-	-	-	-	-	(3)	-	-	-	-	-	-	168,471
10	Sales Expenses	987	-	-	-	-	-	-	-	-	-	-	-	-	-	987
11	Administrative and General Expenses	235,785	-	-	-	-	-	-		(1,704)	(5,756)	-	-	-	-	228,325
12	Total Operation and Maintenance	893,905	-	(3,783)	(353)	(5,790)	(4,258)	(3)	(3)	(1,704)	(5,756)	-	-	-	-	872,255
13	Depreciation and Amortization	200,874	-	-	-	-	-	-	-			(5,632)			-	195,242
15	Ad Valorem (Property)	106,595	-	-	-	-	-	-	-				(6,934)	-	-	99,661
	Taxes:															
14	Federal & State Income Tax	(452)	-	-	-	-	-	-	-	-	-	-	-	(8,526)	(395)	(9,373)
16	Other	24,319														24,319
17	**Total Operating Expenses**	$ 1,225,241	$ -	$ (3,783)	$ (353)	$ (5,790)	$ (4,258)	$ (3)	$ (3)	$ (1,704)	$ (5,756)	$ (5,632)	$ (6,934)	$ (8,526)	$ (395)	$ 1,182,103
18	**Operating Income (Loss)**	$ 31,709	$ (347)	$ 3,783	$ 353	$ 5,790	$ 4,258	$ 3	$ 3	$ 1,704	$ 5,756	$ 5,632	$ 6,934	$ 8,526	$ 395	$ 74,500

ADJ No.		References:
1	Revenue Annualization	Schedule REL-12
2	Purchased Pumping Power Expense	Schedule REL-13
3	Water Testing Expense	Schedule REL-14
4	Watert Treatment Expense	Schedule REL-15
5	Transmission and Distribution Expense	Schedule REL-16
6	Expense Annualization-Transmission/Distribution	Schedule REL-17
7	Expense Annualization-Customer Accounting	Schedule REL-17
8	Charitable Contribution	Schedule REL-18
9	Rate Case Expense	Schedule REL-19
10	Depreciation Expense	Schedule REL-20
11	Property Tax Expense	Schedule REL-21
12	Income Tax Expense	Schedule REL-22
13	Income Tax Expense	Schedule REL-22

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Schedule REL- 11

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	$ (6)		$ (6)
2	Avg Annual Bill Per Customer for TY	311		369
3	Avg Annual Revenue for Additional Customers	$ (1,866)	$ (347)	$ (2,213)

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Schedule REL-12

OPERATING INCOME ADJUSTMENT NO. 2 - PURCHASE PUMPING POWER EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Purchased Pumping Power	$ 181,448	$ (3,783)	$ 177,665

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Schedule REL-13

OPERATING INCOME ADJUSTMENT NO. 3 - WATER TESTING EXPENSE

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Annual Water Testing Expense	$ 3,610	$ (353)	$ 3,257

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Schedule REL- 14

OPERATING INCOME ADJUSTMENT NO. 4 - WATER TREATMENT EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Water Treatment	$ 47,494	$ (5,790)	$ 41,704

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Schedule REL-15

OPERATING INCOME ADJUSTMENT NO. 5 - TRANSMISSION AND DISTRIBUTION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Transmission and Distribution Expense	$ 213,823	$ (4,258)	$ 209,565

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Schedule REL- 16

OPERATING INCOME ADJUSTMENT NO. 6 and 7 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ (4)	$ -	$ (4)
2	Purchased Pumping Power	(396)	-	(396)
3	Water Treatment Expense	(61)	-	(61)
4	Transmission & Distribution Expense	(359)	(3)	(362)
5	Customer Accounting	(295)	(3)	(298)
6	Total	$ (1,115)	$ (6)	$ (1,121)

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Schedule REL-17

OPERATING INCOME ADJUSTMENT NO. 8 - CHARITABLE CONTRIBUTIONS

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 1,704	$ (1,704)	$ -

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Schedule REL- 18

OPERATING INCOME ADJUSTMENT NO. 9 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.11590		0.11590
3	Annual Rate Case Expense for Eastern Group	$ 29,850	$ (8,882)	$ 20,968
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 9,950	$ (5,756)	$ 4,194

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Schedule REL-19

OPERATING INCOME ADJUSTMENT NO. 10 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENT**	**STAFF AS ADJUSTED**
1	Depreciation Expense	$ 200,874	$ 4,378	$ 205,252
2	CIAC Amortization	-	(10,010)	(10,010)
		$ 200,874	$ (5,632)	$ 195,242

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Schedule REL- 20

OPERATING INCOME ADJUSTMENT NO. 11 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 1,322,741
2	2001 Annual Gross Revenues			$ 1,258,793
3	2002 Annual Gross Revenues			$ 1,304,641
4	Plus Staff's Recommended Increase			$ 357,306
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 4,243,481
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 1,414,494
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 2,828,987
10	Plus: 10% of 2001 CWIP			
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 38,859
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 2,790,128
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 697,532
15	Composite Property Tax Rate (See Note B Below)			0.142877
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 106,595	$ (6,934)	$ 99,661

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 21

OPERATING INCOME ADJUSTMENT NOs 12 and 13 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ 845	$ (8,526)	$ (7,681)
2	State Income Taxes	(1,297)	(395)	(1,692)
3	Total Income Taxes	$ (452)	$ (8,921)	$ (9,373)

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RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 13.47	$ 20.11	$ 15.87
1" Meter	$ 24.86	$ 43.64	$ 41.50
2" Meter	$ 62.15	$ 126.89	$ 133.27
3" Meter	$ 155.37	$ 266.86	$ 267.25
4" Meter	$ 207.16	$ 406.02	$ 449.50
6" Meter	$ 362.53	$ 773.43	$ 662.53
8" Meter	$ 362.53	$ 1,075.08	$ 891.27
10" Meter	$ 673.27	$ 1,759.42	$ 1,200.36
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 2.4860	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 2.4860	$ 3.1600	$ 2.3696
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 2.4860	$ 3.1600	$ 2.9620
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 2.4860	$ 3.1600	$ 3.5544
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	(a)
1" Meter	(a)	(a)	(a)
2" Meter	(b)	(b)	(b)
3" Meter	(b)	(b)	(b)
4" Meter	(b)	(b)	(b)
6" Meter	(b)	(b)	(b)

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

RATE DESIGN
CONTINUED

	Present	---Proposed Rates---	
Service Charges:	**Rates**	**Company**	**Staff**
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

MIAMI SYSTEM

Summary of Proposed Revenue - Miami

Q. Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirement?

A. Yes, please refer to schedule REL-1. The Company proposes total annual operating revenue of $2,179,657 which represents an increase of $722,718, or 49.61 percent, over the Company adjusted test year revenue of $1,456,939.

Staff's recommended total annual operating revenue for the Miami system is $1,641,342. Staff's recommendation represents an increase of $184,620, or 12.67 percent, over Staff's adjusted test year revenue of $1,456,722.

Rate Base - Miami

<u>Original Cost Rate Base</u>

Q. Did Staff prepare an Original Cost Rate Base Schedule?

A. As shown on Schedule REL–3, Staff recommends a rate base of $2,740,612. Staff's recommended rate base is a decrease of $1,829,584 from the Company's proposal of $4,570,196. Staff's rate base adjustments are described below.

<u>Rate Base Adjustment No. 1 – Plant In Service</u>

Q. What adjustment to actual test year plant did Staff propose for the Miami system?

A. Staff increased actual Plant In Service by $1,130, from $6,336,685 to $6,337,815. Staff increased Electrical Pumping Equipment by $1,123 as result of the Company inadvertently posting it to Purchased Pumping Power. Additionally, Staff increased plant by $7 as a result of rounding due to its analysis, as shown on Schedule REL-5.

Rate Base Adjustment No. 2 – Post-Test Year Plant In Service

Q. Does Staff's recommended rate base include plant placed into service after the test year?

A. Yes. Staff included $476,144 of plant in rate base that the Company placed into service after the end of the test year but no later than December 31, 2002, a reduction of $24,837 from the Company's figure of $500,981 as shown on Schedule REL-5.

Q. Why did Staff exclude $24,837 of the Company's post-test year plant additions from its recommended rate base?

A. Staff excluded $24,837 from the Company's post-test year plant additions in order to exclude all plant that was not in service by December 31, 2002 or was not revenue neutral.

Rate Base Adjustment No. 3 – Post-Test Year Plant Retirements

Q. **Did the Company make any adjustment for plant retired due to the 2002 post-test year plant additions?**

A. No, the Company's application did not reflect plant retired due to the replaced plant by the post-test year additions. Staff therefore removed $43,151 from Plant In Service, as shown on Schedule REL-5 and from Accumulated Depreciation as shown on REL-6.

Q. Please summarize Staff's recommendation regarding Plant In Service.

A. Staff recommended $6,770,808 for Plant In Service, a $66,858 decrease from the Company's proposed $6,837,666. The calculation of Staff's recommendation is shown on Schedule REL-5.

Rate Base Adjustment Nos. 4, 5, 6 and 7 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 5 of 11 of the filing, increased Accumulated Depreciation by $13,951 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 5 of 11, of the filing, increased Accumulated Depreciation by $32,152 and represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant included in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff increased Accumulated Depreciation by $31,176, from $1,713,977 to $1,745,153. This adjustment is made up of several components including a $31,501 (adjustment no. 4) reduction as a result of Staff's analysis. Staff recommended increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $121,479 (adjustment no. 6) from $32,152 to $153,631, and it recommended decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $7,418 (adjustment no. 5) from $13,951 to $6,533. Additionally, Staff removed $51,384 (adjustment no. 7) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC, USOA accounting procedures.

Rate Base Adjustment Nos. 8 and 9 – Pinal Creek Group

Q. What does this adjustment represent?

A. The Company received a $1,400,000 settlement from the Miami mining conglomerate called the Pinal Creek Group. The details of this agreement are confidential, and, therefore the Company made no mention, nor allowance of this windfall in their application. The settlement was given to Arizona Water's Miami system for past damages to its source of water supply. In addition, the Miami system is to receive free water until October, 30, 2028, which will be discussed in the section of this report entitled Operating Income. Since the $1,400,000 was not the investment of the shareholders a reduction to the rate base is appropriate.

Q. How has Staff chosen to treat this settlement?

A. Staff has chosen to establish a line item on Schedule REL-3 (similar to its accounting treatment of Contributions in Aid of Construction and accompanying amortization) recording the $1,400,000 as a reduction to rate base and amortize the resulting settlement amount over the 28 remaining years of the agreement or $50,000 per year as shown on Schedule REL-7.

Rate Base Adjustment No. 10 – Cash Working Capital Allowance

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $81,767 for a working capital allowance for the Miami system. Schedule B-5, page 1, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Did Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $30,159 cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of working capital?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicates a negative $180,529 cash working capital component or a reduction of $210,688 below the Company's $30,159 figure. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Working Capital?

A. Staff increased the Materials and Supply Inventory by $6,259, from $9,277 to $15,536. Staff's $6,259 adjustment included $3,787 reclassified from Miami's Transmission and Distribution Expense, $1,236 from Miami's Water Treatment Expense and $1,236 from the Superior system's Water Treatment Expense.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of negative $122,662, as shown on Schedule REL-8.

<u>Rate Base Adjustment No. 11 and 12 – Allocated Post-Test Year Additions</u>

Q. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

A. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $177,121, which included $8,233 of post-test year retired plant. Additionally, Staff reduced the Meter Shop allocation by $3,580. Staff's adjustments reduced the Phoenix Office and Meter Shop allocations by $177,121, from $197,194 to $20,073, as shown on Schedule REL-9.

Operating Income - Miami

Operating Income Summary

Q. What is Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $1,456,722, expenses of $1,335,089 and an operating income of $121,633 as shown on Schedule REL-10. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied a negative two customers (that represents the average growth in customers on the Miami system during the test year) by $371 (which is the Company's determination of annual revenue per customer) that resulted in a revenue decline of $742.

Q. Did Staff make an adjustment to annual revenue in the Company's calculation?

A. Yes. Staff made a negative $217 adjustment to increase the Company's proposed annualization from $742 to $959. Staff's calculation of the adjustment is shown on Schedule REL-12. Staff's recalculation recognizes revenue from all meter sizes to properly match to the total expenses used by the Company to record the pro forma expenses due to the annualization of customers. Staff's average annual revenue per customer is $480 rather than the Company's $371.

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Operating Income Adjustment No. 2 – Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power with the exception of a repaired pump inadvertently allocated and posted to Miami's Purchased Pumping Power expense. The $1,123 Purchased Pumping Power expense was reclassified and transferred to Miami's Plant In Service, Electrical Pumping Equipment.

Additionally, as a result of the Miami systems settlement with the Pinal Creek Group, it is Staff's opinion that Purchased Pumping Power should be reduced by $39,000 per year. Additional details of this adjustment may be bound in Mr. Hammon's testimony.

Staff's reduced Purchased Pumping Power by $40,123, from 151,322 to 111,199.

<u>Operating Income Adjustment No. 4 and 5 – Water Treatment Expense</u>

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes. Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them <u>not</u> to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to Miami was decreased from the Company's pro forma adjustment by $53,646, which included $1,236 of reclassified equipment charged to this account that properly belongs in the Material and Supplies Inventory account. This adjustment reduced the Water Treatment Expense, from $95,544 to $41,898, as shown on Schedule REL-14.

<u>Operating Income Adjustment No. 4 – Water Testing Expense</u>

Q. What is Arizona Water's proposed Water Testing Expense?

A. Arizona Water's proposed Water Testing Expense for the Miami system is $13,894. Water Testing Expense is a component of the Company's proposed $95,544 Water Treatment Expense shown on Schedule REL-15.

Q. Does Staff agree with the Company's Water Testing Expense?

A. No. Staff recommends this expense be based on Staff's water testing expense analysis of $4,548, which decreases the annual operating expenses by $9,346. The adjustment is discussed in greater detail in the testimony of Staff witness, Lyndon Hammon.

Operating Income Adjustment No. 7 and 9 – Expense Annualization Adjustment

Q. Did Staff recalculate annualized expenses?

A. Yes. Staff's calculations are shown as adjustments nos. 6 and 8 and are shown on Schedule REL-17. Staff recommends an expense annualization adjustment of a negative $469, an increase in expenses of $2 compared to the Company's negative adjustment of $467.

Operating Income Adjustment No. 7 – Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. Staff decreased Transmission and Distribution Expenses downward by $3,787. The Company inadvertently posted $3,787 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory. This adjustment reduced Transmission and Distribution Expense from $263,028 to $259,241, as shown on Schedule REL-17.

Operating Income Adjustment No. 10 – Rate Case Expense

Q. What Rate Case Expense did Arizona Water propose for the Miami system?

A. The Company proposed total Rate Case Expense of 30,365 for the Miami system. Rate Case Expense is a component of the Company's proposed $246,728 Administrative and General Expense, shown on Schedule REL-18.

Q. Do you agree that the Company's Rate Case Expense for the Miami system is reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Miami system?

A. Staff recommends allocating $21,330 to the Miami system. Staff's recommended allocation uses the Company-proposed allocation factor of 0.11790 percent ($180,913 x 0.11790 = $21,330 rounded). Staff recommends annual Rate Case Expense of $4,266 ($21,330 amortized over five years), a decrease of $5,856 from the Company's request $10,122, as shown on Schedule REL-18.

Operating Income Adjustment No. 11 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No. Charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $1,733 from the Administrative and General account as shown on REL-19.

Operating Income Adjustment Nos. 12 – Depreciation and Amortization Expense

Q. What did the Company propose for depreciation expense?

A. The Company proposed $204,884 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 19 of 36 of the filing, increased depreciation expense by $32,152 to provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 20 of 36 of the filing, increased depreciation expense by $13,951 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between the Staff plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using incorrect component depreciation rates that it later corrected. Staff reviewed and accepted the new rates and Staff used the new rates in calculating rates.

Q. **What are the components of Miami's proposed depreciation expense?**

A. The Company's proposed depreciation expense is composed of $158,782 recorded in the test year, a $32,152 pro forma adjustment to recognize an additional half-year of depreciation on test year plant additions, and a $13,951 pro forma adjustment to recognize twelve months of depreciation on post-test year plant additions for a total of $204,884.

Q. **Why is Staff's recommended depreciation expense different than the Company's proposed amount?**

A. Staff's recommended depreciation expense is different for two reasons. First, the Company's calculated depreciation expense used a dated component depreciation schedule which it later changed during the course of Staff's analysis. Staff recommends adopting the individual component account rates identified in the Company's late-filed depreciation study which was reviewed and accepted by Staff who used it to calculate the Staff's depreciation expense. Second, Staff calculated depreciation expense on its recommended plant, which reflects adjustments previously discussed.

Q. **Please summarize Staff's recommendations for depreciation expense.**

A. Staff recommends $139,114 for depreciation expense, a $65,770 decrease from the Company's proposed $204,884. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff recommendation is shown on Schedules REL-20 and REL-21.

Q. Does the Miami Depreciation and Amortization expense reflect the amortization of the Pinal Creek Group settlement?

A. Yes. Staff reduced the Depreciation and Amortization expense by $50,000 to reflect the amortization of the Company's Pinal Creek Group settlement, as shown on Schedule REL-20.

<u>Operating Income Adjustment No. 12 – Property Taxes</u>

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $121,044.

Q. Do you agree with the Company's amount?

A. No. Staff adopted the Department of Revenue's new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $119,636, a decrease of $1,408 compared to the Company's proposal, as shown on Schedule REL-22.

<u>Operating Income Adjustment No.8 – Income Taxes</u>

Q. What income tax expense did Arizona Water propose for the Miami system?

A. The Company proposed negative $8,496 in federal income taxes and a negative $4,612 in state income taxes for a combined income tax of $13,108

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and its recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedule REL-23, Staff recommends federal income tax of $87,441 and state income tax of $19,263, for a combined income tax of $106,704.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $145,719 and state income tax of $32,101 for a combined income tax of $177,820.

Rate Design - Miami

Rate Design

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and its recommended rates and charges?

A. Yes. Schedule REL–24 provides a summary of the present rates, Company-proposed rates, and Staff's recommended rates.

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at 50,000 gallons. The three-tier rate structure applies to all metered customers.

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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	4,570,196	$	2,740,612
2	Adjusted Operating Income (Loss)	$	59,991	$	121,633
3	Current Rate of Return (L2 / L1)		1.31%		4.44%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	502,722	$	234,761
6	Operating Income Deficiency (L5 - L2)	$	442,731	$	113,128
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 * L6)	$	722,718	$	184,620
9	Adjusted Test Year Revenue	$	1,456,939	$	1,456,722
10	Proposed Annual Revenue (L8 + L9) Note A	$	2,179,657	$	1,641,342
11	Require Increase in Revenue (%) (L8/L9)		49.61%		12.67%

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GROSS REVENUE CONVERSION FACTOR

Line No.					
	Calculation of Gross Revenue Conversion Factor:				
1	Recommended Revenue Increase:				
2	Billings		1.000000		
3	Combined Federal and State Income Tax Rate	38.59888%			
4	Uncollectible Rate After Income Taxes	0.12477%			
5	Total Tax Rate		38.72365%		
6	Gross Revenue Conversion Factor		1.631951		
	Calculation of Effective Income Tax Rate:				
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%			
8	Arizona State Income Tax Rate	6.96800%			
9	Federal Taxable Income (L5 - L6)	93.03200%			
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%			
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%			
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%			
	Calculation of Uncollectible Rate After Income Taxes:				
13	Uncollectible Rate		0.20320%		
14	Combined Federal and State Income Tax Rate	38.59888%			
15	1 minus Combined Federal and State Income Tax Rate		61.40112%		
16	Uncollectible Rate After Income Taxes		0.12477%		
	Revenue Reconciliation:				
17	Recommended Increase in Revenue (from REL-1, L8)	$ 184,620			
18	Uncollectible Rate	0.203200%			
19	Required Increase in Revenue to Provide for Uncollectibles		$ 375		
20	Recommended Increase in Revenue (from REL-1,L8)	$ 184,620			
21	Required Increase in Revenue to Provide for Uncollectibles	375			
22	Incremental Taxable Income	$ 184,244			
23	Combined Federal and State Income Tax Rate	38.59888%			
24	Required Increase in Revenue to Provide for Income Taxes		71,116		
25	Required Operating Income	$ 234,761			
26	Adjusted Test Year Operating Income (Loss)	121,633			
27	Required Increase in Operating Income		113,128		
28	Total Required Increase In Revenue		$ 184,620		
	Calculation of Income Tax:	Test Year		STAFF Recommended	
29	Revenue	$ 1,456,722		$ 1,641,342	
30	Less: Operating Expenses Excluding Income Taxes	$ 1,108,749		$ 1,109,124	
31	Less: Synchronized Interest	$ 71,530		$ 71,530	
32	Arizona Taxable Income	$ 276,443		$ 460,687	
33	Arizona State Income Tax Rate	6.968%		6.968%	
34	Arizona Income Tax		$ 19,263		$ 32,101
35	Federal Taxable Income	$ 257,180		$ 428,587	
36	Federal Income Tax @ 34%		$ 87,441		$ 145,719
37	Combined Federal and State Income Tax		$ 106,704		$ 177,820
				$ 71,116	
	Calculation of Interest Synchronization:				
38	Rate Base	$ 2,740,612			
39	Weighted Average Cost of Debt	2.610%			
40	Synchronized Interest	$ 71,530			

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 6,837,666	$ (66,858)	$ 6,770,808
2	Less: Accumulated Depreciation	(1,713,977)	(31,176)	(1,745,153)
3	Net Plant in Service	$ 5,123,689	$ (98,034)	$ 5,025,655
	LESS:			
4	Advances in Aid of Construction (AIAC)	(109,428)	-	(109,428)
5	Contributions in Aid of Construction (CIAC)	$ (188,394)	$ -	$ (188,394)
6	Less: Accumulated Amortization	32,086	-	32,086
7	Net CIAC	(156,308)	-	(156,308)
8	PCG Settlement	$ -	$ (1,400,000)	$ (1,400,000)
9	Less: Accumulated Amortization	-	50,000	50,000
10	Net Pinal County Group Settlement	$ -	$ (1,350,000)	$ (1,350,000)
11	Total Advances, Contributions and PCG	(265,736)	(1,350,000)	(1,615,736)
12	Customer Deposits	-	-	-
13	Meter Advances	-	-	-
14	Deferred Income Tax Credits	(566,719)	-	(566,719)
	ADD:			
15	Working Capital	81,768	(204,429)	(122,661)
16	Phoenix Office Allocation	193,170	(173,541)	19,629
17	Meter Shop Allocation	4,024	(3,580)	444
18		-	-	-
19		-	-	-
20		-	-	-
21	**Total Rate Base**	$ 4,570,196	$ (1,829,584)	$ 2,740,612

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Schedule REL-4

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] ADJ No. 10	[L] ADJ No. 11	[M] ADJ No. 12	[N] STAFF ADJUSTED
	PLANT IN SERVICE:														
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	1,225	-	-	-	-	-	-	-	-	-	-	-	-	1,225
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	328,531	-	-	-	-	-	-	-	-	-	-	-	-	328,531
5	Other Source of Supply Land	62,425	-	-	-	-	-	-	-	-	-	-	-	-	62,425
6	Wells	1,133,177	-	-	-	-	-	-	-	-	-	-	-	-	1,133,177
7	Pumping Plant Land	4,723	-	-	-	-	-	-	-	-	-	-	-	-	4,723
8	Pumping Plant Structures & Improvements	32,391	-	-	-	-	-	-	-	-	-	-	-	-	32,391
9	Electric Pumping Equipment	863,472	1,130	-	-	-	-	-	-	-	-	-	-	-	864,602
10	Gas Engine Equipment	163	-	-	-	-	-	-	-	-	-	-	-	-	163
11	Water Treatment Land	550	-	-	-	-	-	-	-	-	-	-	-	-	550
12	Water Treatment Structures & Improvmnts	19,640	-	-	-	-	-	-	-	-	-	-	-	-	19,640
13	Water Treatment Equipment	61,624	-	-	-	-	-	-	-	-	-	-	-	-	61,624
14	Transmission and Distribution Land	5,835	-	-	-	-	-	-	-	-	-	-	-	-	5,835
15	Storage Tanks	424,176	-	-	-	-	-	-	-	-	-	-	-	-	424,176
16	Transmission and Distribution Mains	1,957,169	-	-	-	-	-	-	-	-	-	-	-	-	1,957,169
17	Fire Sprinkler Taps	29,560	-	-	-	-	-	-	-	-	-	-	-	-	29,560
18	Services	664,496	-	-	-	-	-	-	-	-	-	-	-	-	664,496
19	Meters	202,443	-	-	-	-	-	-	-	-	-	-	-	-	202,443
20	Hydrants	143,406	-	-	-	-	-	-	-	-	-	-	-	-	143,406
21	General Plant Land	2,814	-	-	-	-	-	-	-	-	-	-	-	-	2,814
22	General Plant Structures	48,770	-	-	-	-	-	-	-	-	-	-	-	-	48,770
23	Leasehold Improvements	30,876	-	-	-	-	-	-	-	-	-	-	-	-	30,876
24	Office Furniture and Improvements	75,599	-	-	-	-	-	-	-	-	-	-	-	-	75,599
25	Warehouse Equipment	4,509	-	-	-	-	-	-	-	-	-	-	-	-	4,509
26	Tools, Shop and Garage Equipment	74,593	-	-	-	-	-	-	-	-	-	-	-	-	74,593
27	Laboratory Equipment	2,066	-	-	-	-	-	-	-	-	-	-	-	-	2,066
28	Power Operated Equipment	3,898	-	-	-	-	-	-	-	-	-	-	-	-	3,898
29	Communication Equipment	136,472	-	-	-	-	-	-	-	-	-	-	-	-	136,472
30	Miscellaneous Equipment	22,062	-	-	-	-	-	-	-	-	-	-	-	-	22,062
31	Total Plant In Service - Actual	6,336,685	1,130	-	-	-	-	-	-	-	-	-	-	-	6,337,815
	Pro-forma Adjustment - Post TY Plant	500,981	-	(24,837)	-	-	-	-	-	-	-	-	-	-	476,144
32	Post Test Year - Retired Plant	-	-	-	(43,151)	-	-	-	-	-	-	-	-	-	(43,151)
33	Total Plant in Service - Adjusted	$ 6,837,666	$ 1,130	$ (24,837)	$ (43,151)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 6,770,808
34	Less: Accumulated Depreciation - Actual	$ (1,667,874)	-	-	-	31,501	-	-	-	-	-	-	-	-	(1,636,373)
35	Less: Accumulated Depreciation - Post T Y	(13,951)	-	-	-	-	7,418	-	-	-	-	-	-	-	(6,533)
36	Less: Accumulated Depreciation - 12 Mos T Y	$ (32,152)	-	-	-	-	-	(121,479)	-	-	-	-	-	-	(153,631)
37	Less: Accumulated Depreciation - Retired Plant	-	-	-	-	-	-	-	51,384	-	-	-	-	-	51,384
38	Total Accumulated Depreciation - Adjusted	$ (1,713,977)	$ -	$ -	$ -	$ 31,501	$ 7,418	$ (121,479)	$ 51,384	$ -	$ -	$ -	$ -	$ -	$ (1,745,153)
39	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-	-	-	-
40	Net Plant in Service	$ 5,123,689	$ 1,130	$ (24,837)	$ (43,151)	$ 31,501	$ 7,418	$ (121,479)	$ 51,384	$ -	$ -	$ -	$ -	$ -	$ 5,025,655
	LESS:														
41	Advances in Aid of Construction (AIAC)	$ (109,428)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	(109,428)
42	Contributions in Aid of Construction (CIAC)	(188,394)	-	-	-	-	-	-	-	-	-	-	-	-	(188,394)
43	Less: Accumulated Amortization	32,086	-	-	-	-	-	-	-	-	-	-	-	-	32,086
44	Net CIAC (L25 - L26)	(156,308)	-	-	-	-	-	-	-	-	-	-	-	-	(156,308)
45	PCG Settlement	-	-	-	-	-	-	-	-	(1,400,000)	-	-	-	-	(1,400,000)
46	Less: Accumulated Amortization	-	-	-	-	-	-	-	-	-	50,000	-	-	-	50,000
47	Net Pinal County Group Settlement	-	-	-	-	-	-	-	-	(1,400,000)	50,000	-	-	-	(1,350,000)
48	Total Advances, Contributions and PCG Settlement	(265,736)	-	-	-	-	-	-	-	-	-	-	-	-	(1,615,736)
49	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-
50	Meter Advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-
51	Deferred Income Tax Credits	(566,719)	-	-	-	-	-	-	-	-	-	-	-	-	(566,719)
	ADD:														
52	Working Capital Allowance	81,768	-	-	-	-	-	-	-	-	-	(204,429)	-	-	(122,661)
53	Phoenix Office Allocation	193,170	-	-	-	-	-	-	-	-	-	-	(173,541)	-	19,629
54	Meter Shop Allocation	4,024	-	-	-	-	-	-	-	-	-	-	-	(3,580)	444
55	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-	-	-	-
56	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-	-	-	-
57	Other Additions	-	-	-	-	-	-	-	-	-	-	-	-	-	-
58	Total Rate Base	$ 4,570,196	$ 1,130	$ (24,837)	$ (43,151)	$ 31,501	$ 7,418	$ (121,479)	$ 51,384	$(1,400,000)	$ 50,000	$ (204,429)	$ (173,541)	$ (3,580)	$ 2,740,612

Arizona Water Company - Miami
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Test Year Ended December 31, 2001

Schedule REL-5

RATE BASE ADJUSTMENT NOS. 1, 2 and 3 - PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 6,336,685	$ 1,130	$ 6,337,815
2	Post-Test Year Plant	$ 500,981	$ (24,837)	$ 476,144
3	Post Test Year Retired Plant	$ -	$ (43,151)	$ (43,151)
4	**Adjusted Test Year Plant**	**$ 6,837,666**	**$ (66,858)**	**$ 6,770,808**

Arizona Water Company - Miami
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Schedule REL-6

RATE BASE ADJUSTMENT NOS. 4, 5, 6 AND 7 - ACCUMULATED DEPRECIATION

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (1,667,874)	$ 31,501	$ (1,636,373)
2	Accumulated Depreciation, Post-Test Year Plant	$ (13,951)	$ 7,418	$ (6,533)
3	Accumulated Depreciation, Test Year Plant	$ (32,152)	$ (121,479)	$ (153,631)
4	Accumulated Depreciation, Retired Plant	$ -	$ 51,384	$ 51,384
		$(1,713,977)	$ (31,176)	$ (1,745,153)

Arizona Water Company - Miami
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Schedule REL- 7

RATE BASE ADJUSTMENT NOS. 8 and 9 - PINAL COUNTY GROUP

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Base Treatment of PCG Settlement	$ -	$ (1,400,000)	$ (1,400,000)
2	Less: Accumulated Amortization	-	50,000	50,000
		$ -	$ (1,350,000)	$ (1,350,000)

This adjustment was made for the recognition of Arizona Water's settlement with the Pinal Creek Group and to pass the result of the agreement to Miami ratepayers over the term of the agreement.

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Schedule REL- 8

OPERATING INCOME ADJUSTMENT NO. 10 - CASH WORKING CAPITAL

		(A)	(B)	(C)
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Cash Working Capital	$ 30,159	$ (210,688)	$ (180,529)
2	Materials and Supplies Inventory	9,277	6,259	15,536
3	Required Bank Balances	26,913	-	26,913
4	Prepayments and special Deposit	15,418	-	15,418
5	Total	$ 81,767	(204,429)	$ (122,662)

Arizona Water Company - Miami
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Schedule REL-9

RATE BASE ADJUSTMENT NOS. 11 and 12 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 193,170	$ (165,308)	$ 27,862
2	Meter Shop Allocations	$ 4,024	$ (3,580)	$ 444
3	Phoenix Office Allocation - Retirements	$ -	$ (8,233)	$ (8,233)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 197,194**	**$ (177,121)**	**$ 20,073**

Arizona Water Company - Miami
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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:					
1	Total Operating Revenues	$ 1,456,939	$ (217)	$ 1,456,722	$ 184,620	$ 1,641,342
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ -	$ -	$ -	$ -	$ -
3	Other	8,832	-	8,832	-	8,832
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	151,322	(40,123)	111,199	-	111,199
5	Purchased Gas	-	-	-	-	-
6	Other	97,770	-	97,770	-	97,770
7	Water Treatment Expenses	95,544	(62,992)	32,552	-	32,552
8	Transmission and Distribution Expenses	263,028	(3,788)	259,240	-	259,240
9	Customer Account Expenses	190,636	(1)	190,635	375	191,010
10	Sales Expenses	1,311	-	1,311	-	1,311
11	Administrative and General Expenses	246,728	(7,589)	239,139	-	239,139
12	Total Operation and Maintenance	$ 1,055,171	(114,493)	940,678	375	941,053
13	Depreciation and Amortization	204,884	(65,770)	139,114	-	139,114
15	Ad Valorem (Property)	121,044	(1,408)	119,636	-	119,636
	Taxes:					
14	Federal & State Income Tax	(13,108)	119,812	106,704	71,116	177,820
16	Other	28,957	-	28,957	-	28,957
17	**Total Operating Expenses**	$ 1,396,948	$ (61,859)	$ 1,335,089	$ 71,491	$ 1,406,581
18	**Operating Income (Loss)**	$ 59,991	$ 61,642	$ 121,633	$ 113,128	$ 234,761

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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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] ADJ #15	[Q] STAFF ADJUSTED
	REVENUES:																	
1	Total Operating Revenues	$ 1,456,939	$ (217)		$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,456,722
	EXPENSES:																	
	Source of Supply Expenses:																	
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	6,832	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6,832
	Pumping Expenses:																	
4	Purchased Power	151,322	-	(40,123)	-	-	-	-	-	-	-	-	-	-	-	-	-	111,199
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	97,770	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	97,770
7	Water Treatment Expenses	95,544	-	-	(1,236)	(52,410)	(9,346)	-	-	-	-	-	-	-	-	-	-	32,552
8	Transmission and Distribution Expenses	263,028	-	-	-	-	-	(1)	(3,787)	-	-	-	-	-	-	-	-	259,240
9	Customer Account Expenses	190,636	-	-	-	-	-	-	-	(1)	-	-	-	-	-	-	-	190,635
10	Sales Expenses	1,311	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,311
11	Administrative and General Expenses	246,728	-	-	-	-	-	-	-	-	(5,856)	(1,733)	-	-	-	-	-	239,139
12	Total Operation and Maintenance	1,055,171	-	(40,123)	(1,236)	(52,410)	(9,346)	(1)	(3,787)	(1)	(5,856)	(1,733)	-	-	-	-	-	940,678
13	Depreciation and Amortization	204,884	-	-	-	-	-	-	-	-	-	-	(50,000)	(15,770)	-	-	-	139,114
15	Ad Valorem (Property)	121,044	-	-	-	-	-	-	-	-	-	-	-	-	(1,408)	-	-	119,636
	Taxes:																	
14	Federal & State Income Tax	(13,108)	-	-	-	-	-	-	-	-	-	-	-	-	-	95,937	23,875	106,704
16	Other	28,957																28,957
17	Total Operating Expenses	$ 1,396,948	$ -	$ (40,123)	$ (1,236)	$ (52,410)	$ (9,346)	$ (1)	$ (3,787)	$ (1)	$ (5,856)	$ (1,733)	$ (50,000)	$ (15,770)	$ (1,408)	$ 95,937	$ 23,875	$ 1,335,089
18	Operating Income (Loss)	$ 59,991	$ (217)	$ 40,123	$ 1,236	$ 52,410	$ 9,346	$ 1	$ 3,787	$ 1	$ 5,856	$ 1,733	$ 50,000	$ 15,770	$ 1,408	$ (95,937)	$ (23,875)	$ 121,633

Arizona Water Company - Miami
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Schedule REL- 12

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	(2)		(2)
2	Avg Annual Bill Per Customer for TY	371		480
3	Avg Annual Revenue for Additional Customers	$ (742)	$ (217)	$ (959)

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Schedule REL-13

OPERATING INCOME ADJUSTMENT NO. 2 - PURCHASED PUMPING POWER EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Purchased Pumping Power Expense	$ 151,322	$ (1,123)	$ 150,199
2	Purchased Pumping Power Expense	$ -	$ (39,000)	$ (39,000)
3	Total Purchased Pumping Power Expense	$ 151,322	$ (40,123)	$ 111,199

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Schedule REL-14

OPERATING INCOME ADJUSTMENT NOS. 4 and 5 - WATER TREATMENT EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Water Treatment Expense	$ 95,544	$ (1,236)	$ 94,308
2	Water Treatment Expense - Chlorine	-	(52,410)	(52,410)
	Water Treatment Expense	$ 95,544	$ (53,646)	$ 41,898

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Schedule REL-15

OPERATING INCOME ADJUSTMENT NO. 6 - WATER TESTING EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Annual Water Testing Expense	$ 13,894	$ (9,346)	$ 4,548

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Schedule REL- 16

OPERATING INCOME ADJUSTMENT NOS. 7 and 9 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ (6)	$ -	$ (6)
2	Purchased Pumping Power	(164)	-	(164)
3	Water Treatment Expense	(16)	-	(16)
4	Transmission & Distribution Expense	(156)	(1)	(157)
5	Customer Accounting	(125)	(1)	(126)
6	Total	$ (467)	$ (2)	$ (469)

Arizona Water Company - Miami
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Schedule REL-17

OPERATING INCOME ADJUSTMENT NO. 8 - TRANSMISSION AND DISTRIBUTION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Transmission and Distribution Expense	$ 263,028	$ (3,787)	$ 259,241

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OPERATING INCOME ADJUSTMENT NO. 10 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.11790		0.11790
3	Annual Rate Case Expense for Eastern Group	$ 30,365	$ (9,036)	$ 21,330
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 10,122	$ (5,856)	$ 4,266

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Schedule REL-19

OPERATING INCOME ADJUSTMENT NO. 11 - CHARITABLE CONTRIBUTIONS

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 1,733	$ (1,733)	$ -

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OPERATING INCOME ADJUSTMENT NO. 3 - AMORTIZATION EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Amortization of PCG Settlement	$ -	(50,000)	$ (50,000)

This adjustment was made for the recognition of Arizona Water's settlement with the Pinal Creek Group and to pass the results of the savings to the Miami ratepayers over 28 years (the remaining life of the agreement).

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Schedule REL-21

OPERATING INCOME ADJUSTMENT NO. 12 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Depreciation Expense	$ 204,884	$ (10,363)	$ 194,521
2	CIAC Amortization		(5,407)	(5,407)
		$ 204,884	$ (15,770)	$ 189,114

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Schedule REL- 22

OPERATING INCOME ADJUSTMENT NO. 13 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 1,522,007
2	2001 Annual Gross Revenues			$ 1,456,934
3	2002 Annual Gross Revenues			$ 1,484,061
4	Plus Staff's Recommended Increase			$ 184,620
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 4,647,622
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 1,549,207
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 3,098,415
10	Plus: 10% of 2001 CWIP			
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 56,228
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 3,042,187
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 760,547
15	Composite Property Tax Rate (See Note B Below)			0.157303
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 121,044	$ (1,408)	$ 119,636

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 23

OPERATING INCOME ADJUSTMENT NOS. 14 and 15 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ (8,496)	$ 95,937	$ 87,441
2	State Income Taxes	(4,612)	23,875	19,263
3	Total Income Taxes	$ (13,108)	$ 119,812	$ 106,704

RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
	Rates	Company	Staff
Monthly Usage Charge:			
5/8" x 3/4" Meter	$ 13.47	$ 20.22	$ 16.36
1" Meter	$ 24.86	$ 43.88	$ 36.80
2" Meter	$ 62.15	$ 127.59	$ 123.96
3" Meter	$ 103.58	$ 229.29	$ 238.19
4" Meter	$ 207.16	$ 408.24	$ 511.03
6" Meter	$ 362.53	$ 777.66	$ 1,006.31
8" Meter	$ 362.53	$ 1,080.96	$ 1,163.12
10" Meter	$ 673.27	$ 1,769.05	$ 1,305.25
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 3.3040	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 3.3040	$ 4.3300	$ 2.4584
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 3.3040	$ 4.3300	$ 3.0730
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 3.3040	$ 4.3300	$ 3.6876
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	
1" Meter	(a)	(a)	
2" Meter	(b)	(b)	
3" Meter	(b)	(b)	
4" Meter	(b)	(b)	
6" Meter	(b)	(b)	

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

RATE DESIGN
CONTINUED

Service Charges:	**Present Rates**	**---Proposed Rates--- Company**	**Staff**
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	(c)	(c)	(c)
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	(d)	(d)	(d)
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	(e)	(e)

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

ORACLE SYSTEM

Summary of Proposed Revenue - Oracle

Q. Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirement?

A. Yes, please refer to schedule REL-1. The Company proposes total annual operating revenue of $1,060,904 which represents an increase of $233,327, or 28.19 percent, over the Company adjusted test year revenue of $827,577.

Staff's recommended total annual operating revenue for the Oracle system is $828,768. Staff's recommendation represents an increase of $77,081, or 9.30 percent, over its adjusted test year revenue of $828,768. Schedule REL–1 presents the calculation of the recommended revenue requirements.

Rate Base - Oracle

<u>Original Cost Rate Base</u>

Q. Did Staff prepare an Original Cost Rate Base Schedule?

A. Yes, shown on Schedule REL-3, Staff's recommended rate base is $2,415,268. Staff's recommended rate base is a decrease of $404,132 from the Company's proposal of $2,819,400. Staff's rate base adjustments are described below.

<u>Rate Base Adjustment No. 1 – Addition of Post-Test Year Plant</u>

Q. Does Staff's recommended rate base include plant placed into service after the test year?

A. Yes, Staff included $224,542 of plant in rate base that the Company placed into service after the end of the test year but no later than December 31, 2002, as shown on REL-5. Staff decreased the Company's post-test year plant additions by $106,365, from $330,907 to $224,542.

Rate Base Adjustment No. 2 – Post –Test Year Retired Plant

Q. Did the Company make any adjustment for plant retired during the 2002 post-test year period?

A. No. Since the Company had requested the Plant In Service additions of certain plant, it is proper that Staff remove the corresponding plant retired due to additions. Therefore, Staff removed $8,026 from Plant In Service also shown on Schedule REL-5 and from Accumulated Depreciation.

Q. Please summarize Staff's recommendations regarding Plant In Service.

A. Staff recommends $5,064,631 for Plant In Service, a $114,391 decrease from the Company's proposed $5,179,022. The calculation of Staff's recommendation is shown on Schedule REL-5

Rate Base Adjustment Nos. 3, 4, 5 and 6 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 7 of 11 of the filing, increased Accumulated Depreciation by $8,034 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 7 of 11 of the filing, increased Accumulated Depreciation by $4,547 and represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant included in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff increased Accumulated Depreciation by $101,769, from $1,468,545 to $1,570,314. This adjustment is made up of several components including a $96 (adjustment no. 3) increase as a result of Staff's analysis. Staff recommends increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $118,613 (adjustment no. 5) from $4,547 to $123,160, and it recommends decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $4,950 (adjustment no. 4) from $8,034 to $3,084. Additionally, Staff removed $11,990 (adjustment no. 6) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC – USOA accounting procedures.

Rate Base Adjustment No. 7– Cash Working Capital Allowance

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $52,085 for working capital. Schedule B-5, page 2 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $28,184 cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of working capital allowance?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicates a negative $76,038 cash working capital component or a reduction of $104,422 compared to the Company's $28,184 figure. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Working Capital?

A. Staff increased the Materials and Supply Inventory by $1,729, from $3,519 to $5,248 as a result of materials that were transferred from Transmission and Distribution Expense to Materials and Supplies Inventory.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of negative $50,608, as shown on Schedule REL-7.

<u>Rate Base Adjustment No. 8 and 9 – Allocated Post-Test Year Additions</u>

A. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

Q. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $83,556, which included $3,964 of post-test year retired plant. Additionally, Staff reduced the Meter Shop allocation by $1,723. Staff's total adjustment reduced the Phoenix Office and Meter shop allocations by $85,279, from $94,945 to $9,666. Staff's analysis is shown on Schedule REL-8.

Operating Income - Oracle

Operating Income Summary

Q. What are Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $828,768 as adjusted by Staff, expenses of $669,108, and an operating income of $159,660, as shown on Schedules REL-9. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied 15 customers (that represents the average growth in customers on the Oracle system during the test year) by $504 (which is the Company's determination of annual revenue per customer) which resulted in a revenue increase of $7,560.

Q. Did Staff make an adjustment to annual revenue?

A. Yes. Staff made a $1,191 adjustment to increase the Company's proposed annualization from $7,560 to $8,751. Staff's calculation of the adjustment is shown on Schedule REL-11. Staff's recalculation recognizes revenue from all meter sizes and calculates the average annual revenue per customer to be $583 rather than the Company's $501.

Operating Income Adjustment No. 2 – Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power with the exception of a repaired pump inadvertently allocated and posted to Oracle expense. The $916 was reclassified from Oracle Purchased Pumping Power and transferred to San Manuel's Plant In Service, Electrical Pumping Equipment account.

Operating Income Adjustment No. 3 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes, Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to Oracle was increased from the Company's pro forma by $10,176, from $13,318 to $23,494, as shown on Schedule REL-13.

Operating Income Adjustment No. 4 – Water Testing Expense

Q. What is Arizona Water's proposed Water Testing Expense?

A. Arizona Water's proposed water testing expense is $2,942. Water testing expense is a component of the Company's proposed $13,318 Water Treatment Expense shown on Schedule REL–14.

Q. Does Staff agree with the Company's Water Testing Expense?

A. No. Staff's recommends this expense be based on Staff's water testing expense analysis of $1,780 which decreases annual operating expenses by $1,162. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 5 and 7 – Expense Annualization Adjustment

Q. Has Staff recalculated the amount of annualized expenses?

A. Yes. Staff's calculations are shown as adjustments nos. 5 and 7 and are shown on Schedule REL-15. Staff recommends an expense annualization adjustment of $3,301, an increase of $10 over the Company's adjustment of $3,291.

Operating Income Adjustment No. 6– Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. The Company inadvertently posted $1,729 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory. This entry reduced the Company's expense from $89,698 to $87,969, as shown on Schedule REL-16.

Operating Income Adjustment No. 8 – Rate Case Expense

Q. What Rate Case Expenses did Arizona Water propose for the Oracle system?

A. The Company proposed total Rate Case Expense of $14,603 for the Oracle system. Rate Case Expense is a component of the Company's proposed $104,590 Administrative and General Expense, shown on Schedule REL -17.

Q. Does Staff agree that the Company's Rate Case Expenses for the Oracle system are reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Oracle system?

A. Staff recommends allocating $10,258 to the Oracle system. Staff's recommended allocation uses the Company-proposed allocation factor of 0.05670 percent ($180,913 x 0.05670 = $10,258). Staff recommends annual Rate Case Expense of $2,052 ($10,258 amortized over five years), a decrease of $2,816 from the Company's proposed $4,868, as shown on Schedule REL-17.

Operating Income Adjustment No. 8 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even though charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $834 from the Administrative and General account as shown on REL-18.

Operating Income Adjustment Nos. 10 – Depreciation and Amortization Expense

Q. What did the Company propose for Depreciation Expense?

A. The Company proposed $129,495 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 27 of 36 of the filing, increased depreciation expense by $4,547 to provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 28 of 36 of the filing, increased depreciation expense by $8,034 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using incorrect component depreciation rates that it later corrected. Staff reviewed and accepted the new rates and Staff used the new rates in calculating rates.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommends $132,704 for depreciation expense, a $3,209 increase from the Company's proposed $129,495. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL–19.

Q. Why is Staff's recommended depreciation expense different than the Company's proposed amount?

A. Staff's recommended depreciation expense is different for two reasons. First, the Company's calculated depreciation expense used an old component depreciation schedule which it later changed during the course of Staff's analysis. Staff recommends adopting the individual component account rates identified in the Company's late-filed depreciation study which was reviewed and accepted by Staff and who used it to calculate the Staff's depreciation expense. Second, Staff calculated depreciation expense on its recommended plant, which reflects adjustments previously discussed.

<u>Operating Income Adjustment No. 11 – Property Taxes</u>

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $57,070.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $57,357, an increase of $287 from the Company's proposal, as shown on Schedule REL–21.

<u>Operating Income Adjustment No.8 – Income Taxes</u>

Q. What income tax expense did the Oracle system propose?

A. The Company proposed $49,775 in federal income taxes and $10,965 in state income taxes for a combined income tax of $60,739.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and Staff's recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedules REL-21, Staff recommends federal income tax of $49,775 and state income tax of $10,965 for a combined income tax of $60,739.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $74,106 and state income tax of $16,325 for a combined income tax of $90,431.

Rate Design - Oracle

<u>Rate Design</u>

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and Staff's recommended rates and charges?

A. Yes. Schedule REL-22 provides a summary of the present rates, Company-proposed rates, and Staff's recommended rates.

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at 50,000 gallons. The three-tier rate structure applies to all metered customers.

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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	2,819,400	$	2,415,268
2	Adjusted Operating Income (Loss)	$	167,200	$	159,660
3	Current Rate of Return (L2 / L1)		5.93%		6.61%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	310,134	$	206,892
6	Operating Income Deficiency (L5 - L2)	$	142,934	$	47,232
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 * L6)	$	233,327	$	77,081
9	Adjusted Test Year Revenue	$	827,577	$	828,768
10	Proposed Annual Revenue (L8 + L9) Note A	$	1,060,904	$	905,849
11	Require Increase in Revenue (%) (L8/L9)		28.19%		9.30%

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Schedule REL- 2

GROSS REVENUE CONVERSION FACTOR

Line No.			
	Calculation of Gross Revenue Conversion Factor:		
1	Recommended Revenue Increase:		
2	Billings		1.000000
3	Combined Federal and State Income Tax Rate	38.59888%	
4	Uncollectible Rate After Income Taxes	0.12477%	
5	Total Tax Rate		38.72365%
6	Gross Revenue Conversion Factor		**1.631951**
	Calculation of Effective Income Tax Rate:		
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%	
8	Arizona State Income Tax Rate	6.96800%	
9	Federal Taxable Income (L5 - L6)	93.03200%	
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%	
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%	
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%	
	Calculation of Uncollectible Rate After Income Taxes:		
13	Uncollectible Rate		0.20320%
14	Combined Federal and State Income Tax Rate	38.59888%	
15	1 minus Combined Federal and State Income Tax Rate		61.40112%
16	Uncollectible Rate After Income Taxes		0.12477%
	Revenue Reconciliation:		
17	Recommended Increase in Revenue (from REL-1, L8)	$ 77,081	
18	Uncollectible Rate	0.203200%	
19	Required Increase in Revenue to Provide for Uncollectibles		$ 157
20	Recommended Increase in Revenue (from REL-1,L8)	$ 77,081	
21	Required Increase in Revenue to Provide for Uncollectibles	157	
22	Incremental Taxable Income	$ 76,924	
23	Combined Federal and State Income Tax Rate	38.59888%	
24	Required Increase in Revenue to Provide for Income Taxes		29,692
25	Required Operating Income	$ 206,892	
26	Adjusted Test Year Operating Income (Loss)	159,660	
27	Required Increase in Operating Income		47,232
28	Total Required Increase In Revenue		$ 77,081

Line No.	*Calculation of Income Tax:*	Test Year		STAFF Recommended	
29	Revenue	$ 828,768		$ 905,849	
30	Less: Operating Expenses Excluding Income Taxes	$ 608,369		$ 608,525	
31	Less: Synchronized Interest	$ 63,038		$ 63,038	
32	Arizona Taxable Income	$ 157,361		$ 234,285	
33	Arizona State Income Tax Rate	6.968%		6.968%	
34	Arizona Income Tax		$ 10,965		$ 16,325
35	Federal Taxable Income	$ 146,396		$ 217,960	
36	Federal Income Tax @ 34%		$ 49,775		$ 74,106
37	Combined Federal and State Income Tax		$ 60,739		$ 90,431
				$ 29,692	

Line No.	*Calculation of Interest Synchronization:*	
38	Rate Base	$ 2,415,268
39	Weighted Average Cost of Debt	2.610%
40	Synchronized Interest	$ 63,038

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 5,179,022	$ (114,391)	$ 5,064,631
2	Less: Accumulated Depreciation	(1,468,545)	(101,769)	(1,570,314)
3	Net Plant in Service	$ 3,710,477	$ (216,160)	$ 3,494,317
	LESS:			
4	Advances in Aid of Construction (AIAC)	(473,356)	-	(473,356)
5	Contributions in Aid of Construction (CIAC)	$ (258,151)	$ -	$ (258,151)
6	Less: Accumulated Amortization	37,740	-	37,740
7	Net CIAC	(220,411)	-	(220,411)
8	Total Advances and Contributions	(693,767)	-	(693,767)
9	Customer Deposits	-	-	-
10	Meter Advances	-	-	-
11	Deferred Income Tax Credits	(344,341)	-	(344,341)
	ADD:			
12	Working Capital	52,086	(102,693)	(50,607)
13	Phoenix Office Allocation	93,008	(83,556)	9,452
14	Meter Shop Allocation	1,937	(1,723)	214
15		-	-	-
16		-	-	-
17		-	-	-
18	**Total Rate Base**	$ 2,819,400	$ (404,132)	$ 2,415,268

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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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] STAFF ADJUSTED
	PLANT IN SERVICE:											
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	-	-	-	-	-	-	-	-	-	-	-
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	54,555	-	-	-	-	-	-	-	-	-	54,555
5	Other Source of Supply Land	15,943	-	-	-	-	-	-	-	-	-	15,943
6	Wells	244,509	-	-	-	-	-	-	-	-	-	244,509
7	Pumping Plant Land	2,742	-	-	-	-	-	-	-	-	-	2,742
8	Pumping Plant Structures & Improvements	22,043	-	-	-	-	-	-	-	-	-	22,043
9	Electric Pumping Equipment	723,785	-	-	-	-	-	-	-	-	-	723,785
10	Gas Engine Equipment	-	-	-	-	-	-	-	-	-	-	-
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	35,054	-	-	-	-	-	-	-	-	-	35,054
13	Water Treatment Equipment	44,721	-	-	-	-	-	-	-	-	-	44,721
14	Transmission and Distribution Land	19,680	-	-	-	-	-	-	-	-	-	19,680
15	Storage Tanks	287,052	-	-	-	-	-	-	-	-	-	287,052
16	Transmission and Distribution Mains	2,712,853	-	-	-	-	-	-	-	-	-	2,712,853
17	Fire Sprinkler Taps	-	-	-	-	-	-	-	-	-	-	-
18	Services	407,077	-	-	-	-	-	-	-	-	-	407,077
19	Meters	81,774	-	-	-	-	-	-	-	-	-	81,774
20	Hydrants	102,497	-	-	-	-	-	-	-	-	-	102,497
21	General Plant Land	-	-	-	-	-	-	-	-	-	-	-
22	General Plant Structures	28,141	-	-	-	-	-	-	-	-	-	28,141
23	Leasehold Improvements	-	-	-	-	-	-	-	-	-	-	-
24	Office Furniture and Improvements	1,440	-	-	-	-	-	-	-	-	-	1,440
25	Warehouse Equipment	32	-	-	-	-	-	-	-	-	-	32
26	Tools, Shop and Garage Equipment	12,557	-	-	-	-	-	-	-	-	-	12,557
27	Laboratory Equipment	146	-	-	-	-	-	-	-	-	-	146
28	Power Operated Equipment	-	-	-	-	-	-	-	-	-	-	-
29	Communication Equipment	51,514	-	-	-	-	-	-	-	-	-	51,514
30	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-	-	-
31	Total Plant in Service - Actual	4,848,115	-	-	-	-	-	-	-	-	-	4,848,115
32	Pro-forma Adjustment - Post TY Plant	330,907	(106,365)	-	-	-	-	-	-	-	-	224,542
33	Accumulated Depreciation, Retired Plant	-		(8,026)								(8,026)
34	Total Plant in Service - Adjusted	$ 5,179,022	$ (106,365)	$ (8,026)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,064,631
35	Less: Accumulated Depreciation - Actual	$ (1,455,964)	-	-	(96)	-	-	-	-	-	-	(1,456,060)
36	Less: Accumulated Depreciation - Post TY	(8,034)	-	-	-	4,950	-	-	-	-	-	(3,084)
37	Less: Accumulated Depreciation - 12 Mos TY	(4,547)	-	-		-	(118,613)	-	-	-	-	(123,160)
38	Less: Accumulated Depreciation - Retired Plant							11,990	-	-		11,990
39	Total Accumulated Depreciation - Adjusted	$ (1,468,545)	$ -	$ -	$ (96)	$ 4,950	$ (118,613)	$ 11,990	$ -	$ -	$ -	$ (1,570,314)
40	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-
41	Net Plant in Service	$ 3,710,477	$ (106,365)	$ (8,026)	$ (96)	$ 4,950	$ (118,613)	$ 11,990	$ -	$ -	$ -	$ 3,494,317
	LESS:											
42	Advances in Aid of Construction (AIAC)	$ (473,356)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	(473,356)
43	Contributions in Aid of Construction (CIAC)	(258,151)	-	-	-	-	-	-	-	-	-	(258,151)
44	Less: Accumulated Amortization	37,740	-	-	-	-	-	-	-	-	-	37,740
45	Net CIAC (L25 - L26)	(220,411)	-	-	-	-	-	-	-	-	-	(220,411)
46	Total Advances and Contributions	(693,767)	-	-	-	-	-	-	-	-	-	(693,767)
47	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-
48	Meter Advances	-	-	-	-	-	-	-	-	-	-	-
49	Deferred Income Tax Credits	(344,341)	-	-	-	-	-	-	-	-	-	(344,341)
	ADD:											
50	Working Capital Allowance	52,086	-	-	-	-	-	-	(102,693)	-	-	(50,607)
51	Phoenix Office Allocation	93,008	-	-	-	-	-	-	-	(83,556)	-	9,452
52	Meter Shop Allocation	1,937	-	-	-	-	-	-	-	-	(1,723)	214
53	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-
54	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-
55	Other Additions	-	-	-	-	-	-	-	-	-	-	-
56	**Total Rate Base**	$ 2,819,400	$ (106,365)	$ (8,026)	$ (96)	$ 4,950	$ (118,613)	$ 11,990	$ (102,693)	$ (83,556)	$ (1,723)	$ 2,415,268

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RATE BASE ADJUSTMENT NOS. 1 and 2 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 4,848,115	$ -	$ 4,848,115
2	Post-Test Year Plant	$ 330,907	$ (106,365)	$ 224,542
3	Post Test Year Retired Plant	$ -	$ (8,026)	$ (8,026)
4	**Adjusted Test Year Plant**	**$ 5,179,022**	**$ (114,391)**	**$ 5,064,631**

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Schedule REL-6

RATE BASE ADJUSTMENT NOS. 3, 4, 5 and 6 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (1,455,964)	$ (96)	$ (1,456,060)
2	Accumulated Depreciation, Post-Test Year Plant	$ (8,034)	$ 4,950	$ (3,084)
3	Accumulated Depreciation, Test Year Plant	$ (4,547)	$ (118,613)	$ (123,160)
4	Accumulated Deprec, Test Year Retired Plant	$ -	$ 11,990	$ 11,990
		$(1,468,545)	**$ (101,769)**	**$ (1,570,314)**

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Schedule REL- 7

OPERATING INCOME ADJUSTMENT NO. 7 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ 28,184	$ (104,422)	$ (76,238)
2	Materials and Supplies Inventory	3,519	1,729	5,248
3	Required Bank Balances	12,958	-	12,958
4	Prepayments and special Deposits	7,424	-	7,424
5	Total	$ 52,085	$ (102,693)	$ (50,608)

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Schedule REL-8

RATE BASE ADJUSTMENT NOS. 8 and 9 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 93,008	$ (79,592)	$ 13,416
2	Meter Shop Allocations	$ 1,937	$ (1,723)	$ 214
3	Phoenix Office Allocation - Retirements	$ -	$ (3,964)	$ (3,964)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 94,945**	**$ (85,279)**	**$ 9,666**

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Schedule REL-9

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:					
1	Total Operating Revenues	$ 827,577	$ 1,191	$ 828,768	$ 77,081	$ 905,849
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ -	$ -	$ -	$ -	$ -
3	Other	6,728	-	6,728	-	6,728
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	83,755	(916)	82,839	-	82,839
5	Purchased Gas	-	-	-	-	-
6	Other	29,003	-	29,003	-	29,003
7	Water Treatment Expenses	13,318	9,014	22,332	-	22,332
8	Transmission and Distribution Expenses	89,698	(1,724)	87,974	-	87,974
9	Customer Account Expenses	84,928	5	84,933	157	85,090
10	Sales Expenses	428	-	428	-	428
11	Administrative and General Expenses	104,590	(3,650)	100,940	-	100,940
12	Total Operation and Maintenance	$ 412,448	2,729	415,177	157	415,333
13	Depreciation and Amortization	129,495	(3,555)	125,940	-	125,940
15	Ad Valorem (Property)	57,070	287	57,357	-	57,357
	Taxes:					
14	Federal & State Income Tax	51,469	9,270	60,739	29,692	90,431
16	Other	9,895	-	9,895	-	9,895
17	**Total Operating Expenses**	$ 660,377	$ 8,731	$ 669,108	$ 29,848	$ 698,957
18	**Operating Income (Loss)**	$ 167,200	$ (7,540)	$ 159,660	$ 47,232	$ 206,892

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Schedule REL-10

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] STAFF ADJUSTED
	REVENUES:																
1	**Total Operating Revenues**	$ 827,577	$ 1,191	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 828,768
	EXPENSES:																
	Source of Supply Expenses:																
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	6,728	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6,728
	Pumping Expenses:																
4	Purchased Power	83,755	-	(916)	-	-	-	-	-	-	-	-	-	-	-	-	82,839
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	29,003	-	-	-	-	-	-	-	-	-	-	-	-	-	-	29,003
7	Water Treatment Expenses	13,318	-	-	10,176	(1,162)	-	-	-	-	-	-	-	-	-	-	22,332
8	Transmission and Distribution Expenses	89,698	-	-	-	-	5	(1,729)	-	-	-	-	-	-	-	-	87,974
9	Customer Account Expenses	84,928	-	-	-	-	-	-	5	-	-	-	-	-	-	-	84,933
10	Sales Expenses	428	-	-	-	-	-	-	-	-	-	-	-	-	-	-	428
11	Administrative and General Expenses	104,590	-	-	-	-	-	-	-	(2,816)	(834)	-	-	-	-	-	100,940
12	Total Operation and Maintenance	412,448	-	(916)	10,176	(1,162)	5	(1,729)	5	(2,816)	(834)	-	-	-	-	-	415,177
13	Depreciation and Amortization	129,495	-	-	-	-	-	-	-	-	-	(3,555)	-	-	-	-	125,940
15	Ad Valorem (Property)	57,070	-	-	-	-	-	-	-	-			287		-		57,357
	Taxes:																
14	Federal & State Income Tax	51,469	-	-	-	-	-	-	-	-			-	5,360	3,911	-	60,739
16	Other	9,895															9,895
17	**Total Operating Expenses**	$ 660,377	$ -	$ (916)	$ 10,176	$ (1,162)	$ 5	$ (1,729)	$ 5	$ (2,816)	$ (834)	$ (3,555)	$ 287	$ 5,360	$ 3,911	$ -	$ 669,108
18	**Operating Income (Loss)**	$ 167,200	$ 1,191	$ 916	$ (10,176)	$ 1,162	$ (5)	$ 1,729	$ (5)	$ 2,816	$ 834	$ 3,555	$ (287)	$ (5,360)	$ (3,911)	$ -	$ 159,660

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Schedule REL- 11

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	15		15
2	Avg Annual Bill Per Customer for TY	504		583
1	Avg Annual Revenue for Additional Customers	$ 7,560	$ 1,191	$ 8,751

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Schedule REL-12

OPERATING INCOME ADJUSTMENT NO. 2 - PURCHASED PUMPING POWER EXPENSE

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Purchased Pumping Power	$ 83,755	$ (916)	$ 82,839

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Schedule REL- 13

OPERATING INCOME ADJUSTMENT NO. 3 - WATER TREATMENT EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Water Treatment	$ 13,318	$ 10,176	$ 23,494

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Schedule REL-14

OPERATING INCOME ADJUSTMENT NO. 4 - WATER TESTING EXPENSE

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Annual Water Testing Expense	$ 2,942	$ (1,162)	$ 1,780

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Schedule REL- 15

OPERATING INCOME ADJUSTMENT NO. 5 and 7 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ 72	$ -	$ 72
2	Purchased Pumping Power	1,264	-	1,264
3	Water Treatment Expense	187	-	187
4	Transmission & Distribution Expense	865	5	870
5	Customer Accounting	903	5	908
6	Total	$ 3,291	$ 10	$ 3,301

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Schedule REL-16

OPERATING INCOME ADJUSTMENT NO. 6 - TRANSMISSION AND DISTRIBUTION EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Transmission and Distribution Expense	$ 89,698	$ (1,729)	$ 87,969

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Schedule REL- 17

OPERATING INCOME ADJUSTMENT NO. 8 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.05670		0.05670
3	Annual Rate Case Expense for Eastern Group	$ 14,603	$ (4,345)	$ 10,258
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 4,868	$ (2,816)	$ 2,052

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Schedule REL-18

OPERATING INCOME ADJUSTMENT NO. 9 - CHARITABLE CONTRIBUTIONS

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 834	$ (834)	$ -

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Schedule REL-19

OPERATING INCOME ADJUSTMENT NO. 10 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Depreciation Expense	$ 129,495	$ 3,209	$ 132,704
2	CIAC Amortization		(6,764)	(6,764)
		$ 129,495	$ (3,555)	$ 125,940

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Schedule REL- 20

OPERATING INCOME ADJUSTMENT NO. 11 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 834,637
2	2001 Annual Gross Revenues			$ 808,847
3	2002 Annual Gross Revenues			$ 934,278
4	Plus Staff's Recommended Increase			$ 77,081
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 2,654,843
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 884,948
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 1,769,895
10	Plus: 10% of 2001 CWIP			-
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ -
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 1,769,895
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 442,474
15	Composite Property Tax Rate (See Note B Below)			0.129628
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 57,070	$ 287	$ 57,357

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 21

OPERATING INCOME ADJUSTMENT NO. 12 and 13 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ 44,415	$ 5,360	$ 49,775
2	State Income Taxes	7,054	3,911	10,965
3	Total Income Taxes	$ 51,469	$ 9,270	$ 60,739

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RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 15.54	$ 20.05	$ 18.75
1" Meter	$ 38.84	$ 50.13	$ 38.63
2" Meter	$ 103.58	$ 146.97	$ 181.73
3" Meter	$ 155.37	$ 250.63	$ 220.51
4" Meter	$ 207.16	$ 384.36	$ 286.45
6" Meter	$ 492.01	$ 818.64	$ 335.79
8" Meter	$ 621.48	$ 1,203.00	$ 625.36
10" Meter	$ 673.27	$ 1,687.41	$ 837.19
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 5.7490	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 5.7490	$ 6.2980	$ 4.4640
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 5.7490	$ 6.2980	$ 5.5800
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 5.7490	$ 6.2980	$ 6.6960
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	
1" Meter	(a)	(a)	
2" Meter	(b)	(b)	
3" Meter	(b)	(b)	
4" Meter	(b)	(b)	
6" Meter	(b)	(b)	

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

**RATE DESIGN
CONTINUED**

	Present Rates	---Proposed Rates--- Company	Staff
Service Charges:			
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge, or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

SAN MANUEL SYSTEM

Summary of Proposed Revenue – San Manuel

Q. Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirement?

A. Yes, please refer to schedule REL-1. The Company proposes total annual operating revenue of $921,119 which represents an increase of $446,869, or 94.23 percent, over the Company-filed adjusted test year revenue of $474,250.

Staff's recommended total annual operating revenue for the San Manuel system is $821,535. Staff's recommendation represents an increase of $347,419, or 73.28 percent, over its adjusted test year revenue of $474,116.

Rate Base – San Manuel

<u>Original Cost Rate Base</u>

Q. Did Staff prepare an Original Cost Rate Base schedule?

A. Yes, shown on Schedule REL–3. Staff recommends a rate base of $641,450. Staff's recommended rate base is a decrease of $152,543 from the Company's proposal of $793,993. Staff's rate base adjustments are described below.

<u>Rate Base Adjustment No. 1 – Plant In Service</u>

Q. What adjustment to actual test year plant did the Company propose for the San Manuel system?

A. The Company recommends increasing actual Plant In Service by $99,591. This amount represents all actual and projected plant additions placed in service or expected to be placed in service by December 31, 2002, twelve months past the 2001 test year.

Rate Base Adjustment No. 1 – Reclassification of Expense to Plant

Q. Did Staff make any adjustments to the Company's test year Plant In Service?

A. Yes, Staff reclassified $2,058 from Purchased Pumping Power Expense into the Electrical Pumping Equipment plant account. This adjustment consisted of a reclassification of $1,024 from Purchased Pumping Power; a reclassification of $916 from Purchased Pumping Power from the Oracle system and a reclassification of $123 in Purchased Pumping Power expense from the Winkelman system to Electric Pumping Equipment. Further, Staff reduced the actual test year plant by $5 due to rounding. These adjustments increased test year plant from $1,455,009 to $1,457,067 as shown on Schedule REL-5.

Rate Base Adjustment No. 2 – Post-Test Year Plant In Service

Q. Does Staff's recommended rate base include plant placed into service after the test year?

A. Yes. Staff included $68,291 of plant in rate base that the Company placed into service after the end of the test year but no later than December 31, 2002, twelve months after the test year.

Q. Why did Staff exclude $31,300 of the Company's post-test year plant additions from its recommended rate base?

A. Staff excluded $31,300 from the Company's post-test year plant additions in order to exclude all plant that was not in service by December 31, 2002 or was not revenue neutral.

Rate Base Adjustment No. 3 – Post-Test Year Plant Retirements

Q. Did the Company make any adjustment for plant retired during the 2002 post-test year period?

A. No, since the Company had requested the Plant In Service additions of post-test year plant, it is proper that Staff remove the corresponding plant retired due to those additions. Staff therefore removed $10,517 from Plant In Service, as shown on Schedule REL-5, and from Accumulated Depreciation.

Q. Please summarize Staff's recommendations regarding Plant In Service.

A. Staff recommends $1,514,841 for Plant In Service, a $39,759 decrease from the Company's proposed $1,554,600. The calculation of Staff's recommendation is shown on Schedule REL–5.

Rate Base Adjustment Nos. 4, 5, 6 and 7 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 6 of 11 of the filing, increased Accumulated Depreciation by $4,209 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 6 of 11 of the filing, increased Accumulated Depreciation by $7,568 and represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant included in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff decreased Accumulated Depreciation by $27,119, from $736,074 to $708,955. This adjustment is made up of several components including a $36,235 (adjustment no. 4) reduction as a result of Staff's analysis. Staff recommends increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $25,177 (adjustment no. 6) from $7,568 to $33,745, and it recommends decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $3,175 (adjustment no. 5) from $4,209 to $1,034. Additionally, Staff removed $13,886 (adjustment no. 7) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC - USOA accounting procedures.

Rate Base Adjustment No. 8 – Cash Working Capital Allowance

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $28,714 for working capital. Schedule B-5, page 2 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $7,402 cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of working capital?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicates a negative $61,992 cash working capital component or a reduction of $69,394 compared to the Company's $7,402 figure. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Working Capital?

A. Staff increased the Materials and Supply Inventory by $1,980 from $3,987 to $5,967 as a result of materials that were transferred from expense accounts.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of a negative $38,700 as shown on Schedule REL-7.

<u>Rate Base Adjustment No. 9 and 10 – Allocated Post-Test Year Additions</u>

Q. Did Staff adjust the Phoenix Office and Meter Shop post-test year additions?

A. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $72,489, which included $3,369 of post-test year retired plant and the Meter Shop allocation of $1,465. Staff's total adjustment reduced the Phoenix Office and Meter shop allocations by $72,489, from $80,704 to $8,215 as shown on Schedule REL-8.

Operating Income – San Manuel

<u>Operating Income Summary</u>

Q. What is Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $474,116, expenses of $632,055, and an operating loss of $157,939 as shown on Schedules REL-9. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied a negative 5 customers (that represents the average decline in customers on the San Manuel system during the test year) by $271 (which is the Company's determination of annual revenue per customer) which resulted in a revenue decline of $1,355.

Q. Did Staff make an adjustment to annual revenue?

A. Yes. Staff made a $134 adjustment to increase the Company's proposed annualization from a negative $1,355 to negative $1,489. Staff's calculation of the adjustment is shown on Schedule REL-11. Staff's recalculation recognizes revenue from all meter sizes and calculated the average annual revenue per customer to be $298 rather than the Company's $271.

Operating Income Adjustment No. 3– BHP Purchased Water

Q. Did Staff make any adjustments to Purchased Water Expense?

A. Yes. During Staff's analysis, it found that $7,875 of purchased water from BHP Copper, Inc., inadvertently was recorded to Apache Junction's CAP water expense. Staff corrected this error on the Apache Junction books and increased San Manuel's Purchased Water Expense by $7,875, from $258,703 to $266,578, as shown on Schedule REL-12.

Operating Income Adjustment No. 3– Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power with the exception of a repaired pump inadvertently allocated and posted to San Manuel expense. The $1,024 was reclassified and transferred to Plant In Service – Electrical Pumping Equipment, as shown on Schedule REL-13.

Operating Income Adjustment No. 4 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes. Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to San Manuel was decreased from the Company's pro forma by $8,240, from $30,393 to $22,153 as shown on Schedule REL-14. Please refer to Mr. Hammon's testimony.

Operating Income Adjustment No. 5– Water Testing Expense

Q. What is San Manuel's proposed Water Testing Expense?

A. The San Manuel proposed water testing expense is $2,374, as shown on Schedule REL-15. Water Testing Expense is a component of the Company's proposed $30,393 Water Treatment Expense.

Q. Does Staff agree with the Company's Water Testing Expense?

A. No. Staff recommends this expense be based on Staff's water testing expense analysis of $1,345, which decreases annual operating expenses by $1,029. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 6 and 8 – Expense Annualization Adjustment

Q. Has Staff recalculated the amount of annualized expenses?

A. Yes. Staff calculations are shown as adjustments nos. 6 and 8 and are shown on Schedules REL-17. Staff recommends an expense annualization adjustment of a negative $1,287, this adjustment increased expenses by $2 compared to the Company's adjustment of a negative $1,287, as shown on Schedule REL-16.

Operating Income Adjustment No. 7 – Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. Staff adjusted Transmission and Distribution Expense downward by $1,980. The Company inadvertently posted $1,980 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory, as is shown on Schedule REL-17.

Operating Income Adjustment No. 10 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even thought charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $709 from the Administrative and General account as shown on REL-18.

Operating Income Adjustment No. 10 - Rate Case Expense

Q. What Rate Case Expense does Arizona Water propose for the San Manuel system?

A. The Company proposed total Rate Case Expense of $12,414. Rate Case Expense is a component of the Company's proposed $107,529 Administrative and General Expense, shown on Schedule REL-19.

Q. Does Staff agree that the Company's Rate Case Expense for the San Manuel system are reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the San Manuel system?

A. Staff recommends allocating $8,720 to the San Manuel system. Staff's recommended allocation used the Company-proposed allocation factor of 0.04820 percent ($180,913 x 0.04820 = $8,720). Staff recommends annual Rate Case Expense of $1,744 ($8,720 amortized over five years), a decrease of $2,394 the Company's request of $4,138, as shown on Schedule REL-19.

Operating Income Adjustment Nos. 11 - Depreciation and Amortization Expense

Q. What did the Company propose for depreciation expense?

A. The Company proposed $52,727 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 23 of 36 of the filing, increased depreciation expense by $7,568 to provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 24 of 36 the filing, increased depreciation expense by $4,209 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff's plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using incorrect component depreciation rates that it later corrected. Staff reviewed and accepted the new rates and Staff used the new rates in calculating rates.

Q. Why is Staff's recommended depreciation expense different than the Company's proposed amount?

A. Staff's recommended depreciation expense is different for two reasons. First, the Company's calculated depreciation expense used an incorrect component depreciation schedule which it later changed during the course of Staff's analysis. Staff recommended adopting the individual component account rates identified in the Company's late-filed depreciation study which was reviewed and accepted by Staff and utilized to calculate the Staff's depreciation expense. Second, Staff calculated depreciation expense on its recommended plant, which reflects adjustments previously discussed.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommends $40,261 for depreciation expense, a $12,466 decrease from the Company's proposed $52,727. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL-20.

<u>Operating Income Adjustment No. 12 – Property Taxes</u>

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $53,253.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $59,612, an increase of $6,359 from the Company's proposal, as shown on Schedule REL-21.

Operating Income Adjustment Nos. 13 and 14 – Income Taxes

Q. What income tax expense does Arizona Water propose for the San Manuel system?

A. The Company proposed a negative $78,713 in federal income taxes and a negative $16,642 in state income taxes for a negative $95,355 combined income tax expense.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and Staff's recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedule REL-22, Staff recommends a negative federal income tax of $89,987 and a negative state income tax of $19,823 for a combined negative income tax of $109,811.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $19,681 and state income tax of $4,336 for a combined income tax of $24,017.

Rate Design – San Manuel

Rate Design

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and Staff's recommended rates and charges?

A. Yes. Schedule REL-23 provides a summary of the present rates, Company-proposed rates, and Staff's recommended rates.

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at 50,000 gallons. The three-tier rate structure applies to all metered customers.

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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	793,993	$	641,450
2	Adjusted Operating Income (Loss)	$	(186,409)	$	(157,939)
3	Current Rate of Return (L2 / L1)		-23.48%		-24.62%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	87,339	$	54,947
6	Operating Income Deficiency (L5 - L2)	$	273,748	$	212,886
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 * L6)	$	446,869	$	347,419
9	Adjusted Test Year Revenue	$	474,250	$	474,116
10	Proposed Annual Revenue (L8 + L9) Note A	$	921,119	$	821,535
11	Require Increase in Revenue (%) (L8/L9)		94.23%		73.28%

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Schedule REL- 2

GROSS REVENUE CONVERSION FACTOR

Line No.			
	Calculation of Gross Revenue Conversion Factor:		
1	Recommended Revenue Increase:		
2	Billings		1.000000
3	Combined Federal and State Income Tax Rate	38.59888%	
4	Uncollectible Rate After Income Taxes	0.12477%	
5	Total Tax Rate		38.72365%
6	Gross Revenue Conversion Factor		**1.631951**
	Calculation of Effective Income Tax Rate:		
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%	
8	Arizona State Income Tax Rate	6.96800%	
9	Federal Taxable Income (L5 - L6)	93.03200%	
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%	
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%	
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%	
	Calculation of Uncollectible Rate After Income Taxes:		
13	Uncollectible Rate		0.20320%
14	Combined Federal and State Income Tax Rate	38.59888%	
15	1 minus Combined Federal and State Income Tax Rate		61.40112%
16	Uncollectible Rate After Income Taxes		0.12477%
	Revenue Reconciliation:		
17	Recommended Increase in Revenue (from REL-1, L8)	$ 347,419	
18	Uncollectible Rate	0.203200%	
19	Required Increase in Revenue to Provide for Uncollectibles		$ 706
20	Recommended Increase in Revenue (from REL-1,L8)	$ 347,419	
21	Required Increase in Revenue to Provide for Uncollectibles	706	
22	Incremental Taxable Income	$ 346,713	
23	Combined Federal and State Income Tax Rate	38.59888%	
24	Required Increase in Revenue to Provide for Income Taxes		133,827
25	Required Operating Income	$ 54,947	
26	Adjusted Test Year Operating Income (Loss)	(157,939)	
27	Required Increase in Operating Income		212,886
28	Total Required Increase In Revenue		$ 347,419

	Calculation of Income Tax:	Test Year		STAFF Recommended	
29	Revenue	$ 474,116		$ 821,535	
30	Less: Operating Expenses Excluding Income Taxes	$ 741,866		$ 742,572	
31	Less: Synchronized Interest	$ 16,742		$ 16,742	
32	Arizona Taxable Income	$ (284,492)		$ 62,222	
33	Arizona State Income Tax Rate	6.968%		6.968%	
34	Arizona Income Tax		$ (19,823)		$ 4,336
35	Federal Taxable Income	$ (264,668)		$ 57,886	
36	Federal Income Tax @ 34%		$ (89,987)		$ 19,681
37	Combined Federal and State Income Tax		$ (109,811)		$ 24,017
				$ 133,827	

	Calculation of Interest Synchronization:	
38	Rate Base	$ 641,450
39	Weighted Average Cost of Debt	2.610%
40	Synchronized Interest	$ 16,742

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Schedule REL-3

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 1,554,600	$ (39,759)	$ 1,514,841
2	Less: Accumulated Depreciation	(736,074)	27,119	(708,955)
3	Net Plant in Service	$ 818,526	$ (12,640)	$ 805,886
	LESS:			
4	Advances in Aid of Construction (AIAC)	(23,194)	-	(23,194)
5	Contributions in Aid of Construction (CIAC)	$ (20,375)	$ -	$ (20,375)
6	Less: Accumulated Amortization	2,990	-	2,990
7	Net CIAC	(17,385)	-	(17,385)
8	Total Advances and Contributions	(40,579)	-	(40,579)
9	Customer Deposits	-	-	-
10	Meter Advances	-	-	-
11	Deferred Income Tax Credits	(93,372)	-	(93,372)
	ADD:			
12	Working Capital	28,714	(67,414)	(38,700)
13	Phoenix Office Allocation	79,057	(71,024)	8,033
14	Meter Shop Allocation	1,647	(1,465)	182
15		-	-	-
16		-	-	-
17		-	-	-
18	**Total Rate Base**	$ 793,993	$ (152,543)	$ 641,450

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Schedule REL-4

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] ADJ No. 10	[L] STAFF ADJUSTED
	PLANT IN SERVICE:												
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	-	-	-	-	-	-	-	-	-	-	-	-
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	154,157	-	-	-	-	-	-	-	-	-	-	154,157
5	Other Source of Supply Land	-	-	-	-	-	-	-	-	-	-	-	-
6	Wells	-	-	-	-	-	-	-	-	-	-	-	-
7	Pumping Plant Land	-	-	-	-	-	-	-	-	-	-	-	-
8	Pumping Plant Structures & Improvements	457	-	-	-	-	-	-	-	-	-	-	457
9	Electric Pumping Equipment	4,653	2,058	-	-	-	-	-	-	-	-	-	6,711
10	Gas Engine Equipment	-	-	-	-	-	-	-	-	-	-	-	-
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	411	-	-	-	-	-	-	-	-	-	-	411
13	Water Treatment Equipment	3,303	-	-	-	-	-	-	-	-	-	-	3,303
14	Transmission and Distribution Land	-	-	-	-	-	-	-	-	-	-	-	-
15	Storage Tanks	98,349	-	-	-	-	-	-	-	-	-	-	98,349
16	Transmission and Distribution Mains	520,125	-	-	-	-	-	-	-	-	-	-	520,125
17	Fire Sprinkler Taps	100	-	-	-	-	-	-	-	-	-	-	100
18	Services	235,142	-	-	-	-	-	-	-	-	-	-	235,142
19	Meters	120,289	-	-	-	-	-	-	-	-	-	-	120,289
20	Hydrants	53,666	-	-	-	-	-	-	-	-	-	-	53,666
21	General Plant Land	-	-	-	-	-	-	-	-	-	-	-	-
22	General Plant Structures	12,496	-	-	-	-	-	-	-	-	-	-	12,496
23	Leasehold Improvements	35,214	-	-	-	-	-	-	-	-	-	-	35,214
24	Office Furniture and Improvements	86,811	-	-	-	-	-	-	-	-	-	-	86,811
25	Warehouse Equipment	1,128	-	-	-	-	-	-	-	-	-	-	1,128
26	Tools, Shop and Garage Equipment	61,006	-	-	-	-	-	-	-	-	-	-	61,006
27	Laboratory Equipment	2,618	-	-	-	-	-	-	-	-	-	-	2,618
28	Power Operated Equipment	2,695	-	-	-	-	-	-	-	-	-	-	2,695
29	Communication Equipment	55,305	-	-	-	-	-	-	-	-	-	-	55,305
30	Miscellaneous Equipment	7,084	-	-	-	-	-	-	-	-	-	-	7,084
31	Total Plant in Service - Actual	1,455,009	2,058	-	-	-	-	-	-	-	-	-	1,457,067
	Pro-forma Adjustment - Post TY Plant	99,591	-	(31,300)	-	-	-	-	-	-	-	-	68,291
32	Post Test Year Retired Plant	-			(10,517)								(10,517)
33	Total Plant in Service - Adjusted	$ 1,554,600	$ 2,058	$ (31,300)	$ (10,517)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,514,841
34	Less: Accumulated Depreciation - Actual	$ (724,297)	-	-	-	36,235	-		-	-	-	-	(688,062)
35	Less: Accumulated Depreciation - Post TY	(4,209)	-	-	-	-	3,175	-	-	-	-	-	(1,034)
36	Less: Accumulated Depreciation - 12 Mos TY	(7,568)	-	-	-	-	-	(26,177)					(33,745)
37	Less: Accumulated Depreciation - Retired Plant	-	-	-	-	-	-		13,886	-	-	-	13,886
38	Total Accumulated Depreciation - Adjusted	$ (736,074)	$ -	$ -	$ -	$ 36,235	$ 3,175	$ (26,177)	$ 13,886	$ -	$ -	$ -	$ (708,955)
39	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-	-
40	Net Plant in Service	$ 818,526	$ 2,058	$ (31,300)	$ (10,517)	$ 36,235	$ 3,175	$ (26,177)	$ 13,886	$ -	$ -	$ -	$ 805,886
	LESS:												
41	Advances in Aid of Construction (AIAC)	$ (23,194)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (23,194)
42	Contributions in Aid of Construction (CIAC)	(20,375)	-	-	-	-	-	-	-	-	-	-	(20,375)
43	Less: Accumulated Amortization	2,990	-	-	-	-	-	-	-	-	-	-	2,990
44	Net CIAC (L25 - L26)	(17,385)	-	-	-	-	-	-	-	-	-	-	(17,385)
45	Total Advances and Contributions	(40,579)	-	-	-	-	-	-	-	-	-	-	(40,579)
46	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-	-
47	Meter Advances	-	-	-	-	-	-	-	-	-	-	-	-
48	Deferred Income Tax Credits	(93,372)	-	-	-	-	-	-	-	-	-	-	(93,372)
	ADD:												
49	Working Capital Allowance	28,714	-	-	-	-	-	-		(67,414)			(38,700)
50	Phoenix Office Allocation	79,057	-	-	-	-	-	-	-	-	(71,024)	-	8,033
51	Meter Shop Allocation	1,647	-	-	-	-	-	-	-	-	-	(1,465)	182
52	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-	-
53	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-	-
54	Other Additions	-	-	-	-	-	-	-	-	-	-	-	-
55	**Total Rate Base**	$ 793,993	$ 2,058	$ (31,300)	$ (10,517)	$ 36,235	$ 3,175	$ (26,177)	$ 13,886	$ (67,414)	$ (71,024)	$ (1,465)	$ 641,450

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Schedule REL-5

RATE BASE ADJUSTMENT NOS. 1, 2 and 3- PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 1,455,009	$ 2,058	$ 1,457,067
	Post-Test Year Plant	$ 99,591	$ (31,300)	$ 68,291
2	Post Test Year Retired Plant	$ -	$ (10,517)	$ (10,517)
3	**Adjusted Test Year Plant**	**$ 1,554,600**	**$ (39,759)**	**$ 1,514,841**

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Schedule REL-6

RATE BASE ADJUSTMENT NOS. 4, 5, 6 and 7 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (724,297)	$ 36,235	$ (688,062)
2	Accumulated Depreciation, Post-Test Year Plant	$ (4,209)	$ 3,175	$ (1,034)
3	Accumulated Depreciation, Test Year Plant	$ (7,568)	$ (26,177)	$ (33,745)
4	Accumulated Depreciation, Retired Plant	$ -	$ 13,886	$ 13,886
		$ (736,074)	**$ 27,119**	**$ (708,955)**

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OPERATING INCOME ADJUSTMENT NO. 8 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ 7,402	$ (69,394)	$ (61,992)
2	Materials and Supplies Inventory	3,987	1,980	5,967
3	Required Bank Balances	11,015	-	11,015
4	Prepayments and special Deposit	6,310	-	6,310
5	Total	$ 28,714	$ (67,414)	$ (38,700)

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Schedule REL-8

RATE BASE ADJUSTMENT NOS. 9 and 10 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 79,057	$ (67,655)	$ 11,402
2	Meter Shop Allocations	$ 1,647	$ (1,465)	$ 182
3	Phoenix Office Allocation - Retirements	$ -	$ (3,369)	$ (3,369)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 80,704**	**$ (72,489)**	**$ 8,215**

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Schedule REL-9

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:					
1	Total Operating Revenues	$ 474,250	$ (134)	$ 474,116	$ 347,419	$ 821,535
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ 258,703	$ 7,875	$ 266,578	$ -	$ 266,578
3	Other	6,246	-	6,246	-	6,246
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	31,358	(1,024)	30,334	-	30,334
5	Purchased Gas	-	-	-	-	-
6	Other	32,609	-	32,609	-	32,609
7	Water Treatment Expenses	30,393	(9,269)	21,124	-	21,124
8	Transmission and Distribution Expenses	83,146	(1,981)	81,165	-	81,165
9	Customer Account Expenses	86,740	(1)	86,739	706	87,445
10	Sales Expenses	472	-	472	-	472
11	Administrative and General Expenses	107,529	(3,103)	104,426	-	104,426
12	Total Operation and Maintenance	$ 637,196	(7,503)	629,693	706	630,399
13	Depreciation and Amortization	52,727	(13,004)	39,723	-	39,723
14	Ad Valorem (Property)	53,253	6,359	59,612	-	59,612
	Taxes:					
15	Federal & State Income Tax	(95,355)	(14,456)	(109,811)	133,827	24,017
16	Other	12,838	-	12,838	-	12,838
17	**Total Operating Expenses**	$ 660,659	$ (28,604)	$ 632,055	$ 134,533	$ 766,589
18	**Operating Income (Loss)**	$ (186,409)	$ 28,470	$ (157,939)	$ 212,886	$ 54,947

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Schedule REL-10

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] STAFF ADJUSTED
	REVENUES:																
1	**Total Operating Revenues**	$ 474,250	$ (134)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 474,116
	EXPENSES:																
	Source of Supply Expenses:																
2	Purchased Water	$ 258,703		$ 7,875	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 266,578
3	Other	6,246	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6,246
	Pumping Expenses:																
4	Purchased Power	31,358	-	-	(1,024)	-	-	-	-	-	-	-	-	-	-	-	30,334
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	32,609	-	-	-	-	-	-	-	-	-	-	-	-	-	-	32,609
7	Water Treatment Expenses	30,393	-	-	-	(8,240)	(1,029)	-	-	-	-	-	-	-	-	-	21,124
8	Transmission and Distribution Expenses	83,146	-	-	-	-	-	(1)	(1,980)	-	-	-	-	-	-	-	81,165
9	Customer Account Expenses	86,740	-	-	-	-	-		-	(1)	-	-	-	-	-	-	86,739
10	Sales Expenses	472	-	-	-	-	-	-	-	-	-	-	-	-	-	-	472
11	Administrative and General Expenses	107,529	-		-	-	-	-		-	(709)	(2,394)	-	-	-	-	104,426
12	Total Operation and Maintenance	637,196	-	7,875	(1,024)	(8,240)	(1,029)	(1)	(1,980)	(1)	(709)	(2,394)	-	-	-	-	629,693
13	Depreciation and Amortization	52,727	-	-	-	-	-	-	-		-	-	(13,004)	-	-	-	39,723
15	Ad Valorem (Property)	53,253	-	-	-	-	-	-	-	-				6,359		-	59,612
	Taxes:																
14	Federal & State Income Tax	(95,355)	-	-	-	-	-	-	-	-	-	-	-	-	(11,274)	(3,181)	(109,811)
16	Other	12,838															12,838
17	**Total Operating Expenses**	$ 660,659	$ -	$ 7,875	$ (1,024)	$ (8,240)	$ (1,029)	$ (1)	$ (1,980)	$ (1)	$ (709)	$ (2,394)	$ (13,004)	$ 6,359	$ (11,274)	$ (3,181)	$ 632,055
18	**Operating Income (Loss)**	$ (186,409)	$ (134)	$ (7,875)	$ 1,024	$ 8,240	$ 1,029	$ 1	$ 1,980	$ 1	$ 709	$ 2,394	$ 13,004	$ (6,359)	$ 11,274	$ 3,181	$ (157,939)

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Schedule REL- 11

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	$ (5)		$ (5)
2	Avg Annual Bill Per Customer for TY	271		298
1	Avg Annual Revenue for Additional Customers	$ (1,355)	$ (134)	$ (1,489)

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Schedule REL-12

OPERATING INCOME ADJUSTMENT NO. 2 - BHP PURCHASED WATER ADJUSTMENT

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Purchased Water - BHP Copper Mine - Actual	$ 135,178	$ -	$ 135,178
2	BHP Contract Increase - Pro-forma Adjustment	$ 123,525	$ -	$ 123,525
4	Purchased Water - Unreconciled Amount	$ -	$ 7,875	$ 7,875
5	Total Purchased Water	$ 258,703	$ 7,875	$ 266,578

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Schedule REL-13

OPERATING INCOME ADJUSTMENT NO. 3 - PURCHASED PUMPING POWER EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Purchased Pumping Power	$ 31,358	$ (1,024)	$ 30,334

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Schedule REL- 14

OPERATING INCOME ADJUSTMENT NO. 4 - WATER TREATMENT EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Water Treatment	$ 30,393	$ (8,240)	$ 22,153

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Schedule REL-15

OPERATING INCOME ADJUSTMENT NO. 5 - WATER TESTING EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Annual Water Testing Expense	$ 2,374	$ (1,029)	$ 1,345

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Schedule REL- 16

OPERATING INCOME ADJUSTMENT NOS. 6 and 8 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ (454)	$ -	$ (454)
2	Purchased Pumping Power	(209)	-	(209)
3	Water Treatment Expense	(60)	-	(60)
4	Transmission & Distribution Expense	(285)	(1)	(286)
5	Customer Accounting	(277)	(1)	(278)
6	Total	$ (1,285)	$ (2)	$ (1,287)

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Schedule REL-17

OPERATING INCOME ADJUSTMENT NO. 7 - TRANSMISSION AND DISTRIBUTION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Transmission and Distribution Expense	$ 83,146	$ (1,980)	$ 81,166

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Schedule REL-18

OPERATING INCOME ADJUSTMENT NO. 9 - CHARITABLE CONTRIBUTIONS

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 709	$ (709)	$ -

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Schedule REL- 19

OPERATING INCOME ADJUSTMENT NO. 10 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.04820		0.04820
3	Annual Rate Case Expense for Eastern Group	$ 12,414	$ (3,694)	$ 8,720
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 4,138	$ (2,394)	$ 1,744

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Schedule REL-20

OPERATING INCOME ADJUSTMENT NO. 11 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Depreciation Expense	**$ 52,727**	$ (12,466)	$ 40,261
2	CIAC Amortization	-	(538)	(538)
		$ 52,727	$ (13,004)	$ 39,723

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Schedule REL- 21

OPERATING INCOME ADJUSTMENT NO. 12 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 540,035
2	2001 Annual Gross Revenues			$ 524,678
3	2002 Annual Gross Revenues			$ 676,557
4	Plus Staff's Recommended Increase			$ 347,419
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 2,088,689
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 696,230
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 1,392,459
10	Plus: 10% of 2001 CWIP			
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 43,939
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 1,348,520
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 337,130
15	Composite Property Tax Rate (See Note B Below)			0.176821
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 53,253	$ 6,359	$ 59,612

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 22

OPERATING INCOME ADJUSTMENT NOS. 13 and 14 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ (78,713)	(11,274)	$ (89,987)
2	State Income Taxes	(16,642)	(3,181)	(19,823)
3	Total Income Taxes	$ (95,355)	$ (14,456)	$ (109,811)

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RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 13.98	$ 27.47	$ 19.26
1" Meter	$ 31.07	$ 64.83	$ 41.60
2" Meter	$ 93.22	$ 201.36	$ 183.76
3" Meter	$ 155.37	$ 358.76	$ 212.35
4" Meter	$ 269.31	$ 607.91	$ 443.74
6" Meter	$ 362.53	$ 1,043.04	$ 526.78
8" Meter	$ 362.53	$ 1,455.09	$ 854.56
10" Meter	$ 673.27	$ 2,378.35	$ 1,228.50
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 0.9220	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 0.9220	$ 1.6220	$ 1.3600
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 0.9220	$ 1.6220	$ 1.7000
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 0.9220	$ 1.6220	$ 2.0400
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	
1" Meter	(a)	(a)	
2" Meter	(b)	(b)	
3" Meter	(b)	(b)	
4" Meter	(b)	(b)	
6" Meter	(b)	(b)	

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

RATE DESIGN
CONTINUED

	Present	---Proposed Rates---	
Service Charges:	**Rates**	**Company**	**Staff**
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 20.00	$ 20.00	$ 20.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

SIERRA VISTA

Summary of Proposed Revenue – Sierra Vista

Q. Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirement?

A. Yes, please refer to schedule REL-1. The Company proposes total annual operating revenue of $1,308,079 which represents an increase of $411,594, or 45.91 percent, over the Company adjusted test year revenue of $896,485.

Staff's recommended total annual operating revenue for the Sierra Vista system is $1,105,272. Staff's recommendation represents an increase of $208,109, or 23.20 percent, over Staff's adjusted test year revenue of $897,163.

Rate Base – Sierra Vista

Original Cost Rate Base

Q. Did Staff prepare an Original Cost Rate Base schedule?

A. Yes, shown on Schedule REL-3, Staff recommends rate base of $2,200,445. Staff's recommended rate base is a decrease of $374,242 from the Company's proposal of $2,574,687. Staff's rate base adjustments are described below.

Rate Base Adjustment No. 1 – Plant In Service

Q. What adjustment to actual test year plant did the Company propose for the Sierra Vista system?

A. The Company recommended increasing actual Plant In Service by $160,557. This amount represents all actual and projected plant additions placed in service or expected to be placed in service by December 31, 2002, twelve months past the test year.

Q. Does Staff's recommended rate base include plant placed into service after the test year?

A. Yes. Staff included $106,477 of plant in rate base that the Company placed into service after the end of the test year but not later than December 31, 2002, a reduction of $54,080 from the Company's figure of $160,557 as shown on Schedule REL-5.

Rate Base Adjustment No. 2 – Post-Test Year Plant Retirements

Q. Did the Company make any adjustment for plant retired during the 2002 post-test year period?

A. No, since the Company had requested the Plant In Service additions of certain plant, it is proper to remove corresponding plant that was replaced by the post-test year additions. Staff therefore removed $8,986 from Plant In Service as shown on Schedule REL- 5, and from Accumulated Deprecation.

Q. Please summarize Staff's recommendations regarding Plant In Service.

A. Staff recommends $5,219,298 for Plant In Service, a $63,066 decrease from the Company's proposed $5,282,364. The calculation of Staff's recommendation is shown on Schedule REL-5.

Rate Base Adjustment Nos. 3, 4, 5 and 6 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 4 of 11 of the filing, increased Accumulated Depreciation by $5,537 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 4 of 11 of the filing, increased Accumulated

Depreciation by $20,152 and represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant including in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the

Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff increased Accumulated Depreciation by $92,722, from $1,406,900 to $1,499,622. This adjustment is made up of several components including a $946 (adjustment no. 3) reduction to actual Accumulated Depreciation as a result of Staff's analysis. Staff recommends increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $112,131 (adjustment no. 5) from $20,152 to $132,283, and it recommends decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $3,912 (adjustment no. 4) from $5,537 to $1,625. Additionally, Staff removed $14,551 (adjustment no. 6) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC – USOA accounting procedures.

<u>Rate Base Adjustment No. 7 – Cash Working Capital Allowance</u>

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $70,439 for working capital. Schedule B-5, page 1 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $24,193 cash working capital component of working capital.

Q. Why does Staff disagree with the Company's proposed cash working capital component of the working capital allowance?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicates a negative $74,539 cash working capital component or a reduction of $98,732 below the Company's $24,193 figure. In other words, ratepayers are providing working capital to the system.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of negative $28,293, as shown on Schedule REL-7.

<u>Rate Base Adjustment No. 8 and 9 – Allocated Post-Test Year Additions</u>

Q. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

A. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $117,737, which included $5,565 of post-test year retired plant. Additionally, Staff reduced the Meter Shop allocation by $2,420. Staff's total adjustment reduced the Phoenix Office and Meter Shop allocations by $119,722, from $133,289 to $13,567 as shown on Schedule REL-8.

Operating Income –Sierra Vista

Operating Income Summary

Q. What are Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $897,163, expenses of $836,195, and an operating income of $60,968 as shown on Schedules REL–9. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied 11 (that represents the average growth in customers on the Sierra Vista's system during the test year) by $326 (which is the Company's determination of annual revenue per customer) that resulted in a revenue increase of $3,586.

Q. Did Staff make an adjustment to annual revenue in the Company's calculation?

A. Yes. Staff made a $678 adjustment to increase the Company's proposed annualization from $3,586 to $4,264. Staff's calculation of the adjustment is shown on Schedule REL-11. Staff's recalculation recognizes revenue from all meter sizes and calculated the average annual revenue per customer to be $388 rather than the Company's $326.

Operating Income Adjustment No. 2 – Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power with the exception of a repaired pump inadvertently allocated and posted to Sierra Vista expense. Staff reclassified and transferred the $2,545 Purchased Pumping Power expense to the Bisbee system Plant In Service - Electrical Pumping Power account, thereby reducing Sierra Vistas' Purchased Pumping Power expense by $2,545, from $162,283 to $159,738, as shown on Schedule REL-12.

Operating Income Adjustment Nos. 3, 6, and 7 – Expense Annualization Adjustment

Q. Did Staff recalculate annualized expenses?

A. Yes. Staff's calculations are shown as adjustments nos. 3, 6 and 7 and are shown on Schedule REL-13. Staff recommends an expense annualization adjustment of $2,288, increasing expenses by $9 compared to the Company's expense adjustment of $2,279.

Operating Income Adjustment No. 4 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes. Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to Sierra Vista was decreased from the Company's pro forma adjustment by $639, from $26.475 to $25,836, as shown on Schedule REL-14. Please refer to Mr. Hammon's testimony.

Operating Income Adjustment No. 5 – Water Testing Expense

Q. What is Arizona Water's proposed Water Testing Expense for the Sierra Vista system?

A. Sierra Vista's proposed Water Testing Expense is $7,102. Water Testing Expense is a component of the Company's proposed $26,475 Water Treatment Expense, as shown on Schedule REL–15.

Q. Does Staff agree with the Company's Water Testing Expense?

A. No. Staff recommends this expense be based on Staff's water testing expense analysis of $2,710, which decreases annual operating expenses by $4,392. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 5 – Rate Case Expense

Q. What Rate Case Expense does Arizona Water propose for the Sierra Vista system?

A. The Company proposed total Rate Case Expense of $20,527. Rate Case Expense is a component of the Company's proposed $158,596 Administrative and General Expense, shown on Schedule REL-16.

Q. Does Staff agree that the Company's Rate Case Expense for the Sierra Vista system is reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Sierra Vista system?

A. Staff recommends allocating $14,419 to the Sierra Vista system. Staff's recommended allocation uses the Company-proposed allocation factor of 0.07970 percent ($180,913 x 0.07970 = $14,419). Staff's recommended annual Rate Case Expense of $2,884 ($14,419 amortized over five years), is a decrease of $3,958 compared to the Company's request of 6,842, as shown on Schedule REL-16.

Operating Income Adjustment No. 9 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even though charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $1,171 from the Administrative and General account, as shown on REL-17.

Operating Income Adjustment No. 10 – Depreciation and Amortization Expense

Q. What did the Company propose for depreciation expense?

A. The Company proposed $142,473 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 15 of 36 of the filing, increased depreciation expense by $20,152 to provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 16 of 36 of the filing, increased depreciation expense by $5,537 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff's plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using dated component depreciation rates that it later corrected. Staff reviewed and accepted the new rates which were used in this calculation.

Q. What are the components of Sierra Vista's proposed depreciation expense?

A. The Company proposed depreciation expense is composed of $116,754 recorded in the test year, a $20,152 pro forma adjustment to recognize an additional half-year of depreciation of test year plant additions, and a positive $5,537 pro forma adjustment to recognize twelve months of depreciation and amortization of post-test year plant additions for a total of $142,443.

Q. Why is Staff's recommended depreciation expense different than the Company's proposed amount?

A. Staff's recommended depreciation expense is different for two reasons. First, the Company's calculated depreciation expense used a dated component depreciation schedule which it later changed during the course of Staff's analysis. Staff recommends adopting the individual component account rates identified in the Company's late-filed depreciation study which was reviewed and accepted by Staff who used it to calculate Staff's depreciation expense. Second, Staff calculated depreciation expense on its recommended plant, which reflects adjustments previously discussed.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommends $154,176 for depreciation expense, a $11,733 increase from the Company's proposed $142,443. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL-18.

<u>Operating Income Adjustment No. 11 – Property Taxes</u>

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $63,555.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $57,518, a decrease of $6,037 from the Company's proposal, as shown on Schedule REL–19.

Operating Income Adjustment No. 12 and 13 – Income Taxes

Q. What income tax expense does Arizona Water propose for the Sierra Vista system?

A. The Company proposed $4,033 in federal income taxes and a negative $231 in state income taxes for a combined income tax of $3,802.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and its recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedules REL-20, Staff recommends a federal income tax of $1,822 and a state income tax of $401 for a combined income tax of $2,223.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $67,515 and state income tax of $14,873 for a combined income tax of $82,388.

Rate Design – Sierra Vista

Rate Design

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and Staff's recommended rates and charges?

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

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at 50,000 gallons. The three-tier rate structure applies to all metered customers.

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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	2,574,687	$	2,200,445
2	Adjusted Operating Income (Loss)	$	31,077	$	60,968
3	Current Rate of Return (L2 / L1)		1.21%		2.77%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	283,216	$	188,490
6	Operating Income Deficiency (L5 - L2)	$	252,139	$	127,522
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 • L6)	$	411,594	$	208,109
9	Adjusted Test Year Revenue	$	896,485	$	897,163
10	Proposed Annual Revenue (L8 + L9) Note A	$	1,308,079	$	1,105,272
11	Require Increase in Revenue (%) (L8/L9)		45.91%		23.20%

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Schedule REL- 2

Line No.							
	Calculation of Gross Revenue Conversion Factor:						
1	Recommended Revenue Increase:						
2	Billings		1.000000				
3	Combined Federal and State Income Tax Rate	38.59888%					
4	Uncollectible Rate After Income Taxes	0.12477%					
5	Total Tax Rate		38.72365%				
6	Gross Revenue Conversion Factor		1.631951				
	Calculation of Effective Income Tax Rate:						
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%					
8	Arizona State Income Tax Rate	6.96800%					
9	Federal Taxable Income (L5 - L6)	93.03200%					
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%					
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%					
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%					
	Calculation of Uncollectible Rate After Income Taxes:						
13	Uncollectible Rate		0.20320%				
14	Combined Federal and State Income Tax Rate	38.59888%					
15	1 minus Combined Federal and State Income Tax Rate		61.40112%				
16	Uncollectible Rate After Income Taxes		0.12477%				
	Revenue Reconciliation:						
17	Recommended Increase in Revenue (from REL-1, L8)	$ 208,109					
18	Uncollectible Rate	0.203200%					
19	Required Increase in Revenue to Provide for Uncollectibles		$ 423				
20	Recommended Increase in Revenue (from REL-1,L8)	$ 208,109					
21	Required Increase in Revenue to Provide for Uncollectibles	423					
22	Incremental Taxable Income	$ 207,686					
23	Combined Federal and State Income Tax Rate	38.59888%					
24	Required Increase in Revenue to Provide for Income Taxes		80,165				
25	Required Operating Income						
26	Adjusted Test Year Operating Income (Loss)						
27	Required Increase in Operating Income		127,522				
28	Total Required Increase In Revenue		$ 208,109				
	Calculation of Income Tax:	Test Year		STAFF Recommended			
29	Revenue	$ 897,163		$ 1,105,272			
30	Less: Operating Expenses Excluding Income Taxes	$ 833,971		$ 834,394			
31	Less: Synchronized Interest	$ 57,432		$ 57,432			
32	Arizona Taxable Income	$ 5,760		$ 213,446			
33	Arizona State Income Tax Rate	6.968%		6.968%			
34	Arizona Income Tax		$ 401		$ 14,873		
35	Federal Taxable Income	$ 5,359		$ 198,573			
36	Federal Income Tax @ 34%		$ 1,822		$ 67,515		
37	Combined Federal and State Income Tax		$ 2,223		$ 82,388		
				$ 80,165			
	Calculation of Interest Synchronization:						
38	Rate Base	$ 2,200,445					
39	Weighted Average Cost of Debt	2.610%					
40	Synchronized Interest	$ 57,432					
			$ 188,490				
			$ 60,968				
			$ 127,522				
			1.631951				
			$ 208,109				

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 5,282,359	$ (63,066)	$ 5,219,293
2	Less: Accumulated Depreciation	(1,406,900)	(92,722)	(1,499,622)
3	Net Plant in Service	$ 3,875,459	$ (155,788)	$ 3,719,671
	LESS:			
4	Advances in Aid of Construction (AIAC)	(587,611)	-	(587,611)
5	Contributions in Aid of Construction (CIAC)	$ (699,448)	$ -	$ (699,448)
6	Less: Accumulated Amortization	113,980	-	113,980
7	Net CIAC	(585,468)	-	(585,468)
8	Total Advances and Contributions	(1,173,079)	-	(1,173,079)
9	Customer Deposits	-	-	-
10	Meter Advances	-	-	-
11	Deferred Income Tax Credits	(331,421)	-	(331,421)
	ADD:			
12	Working Capital	70,439	(98,732)	(28,293)
13	Phoenix Office Allocation	130,569	(117,302)	13,267
14	Meter Shop Allocation	2,720	(2,420)	300
15		-	-	-
16		-	-	-
17		-	-	-
18	**Total Rate Base**	$ 2,574,687	$ (374,242)	$ 2,200,445

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Schedule REL-4

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[K] ADJ No. 10	[L] STAFF ADJUSTED
	PLANT IN SERVICE:											
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	-	-	-	-	-	-	-	-	-	-	-
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	3,470	-	-	-	-	-	-	-	-	-	3,470
5	Other Source of Supply Land	8,932	-	-	-	-	-	-	-	-	-	8,932
6	Wells	665,211	-	-	-	-	-	-	-	-	-	665,211
7	Pumping Plant Land	1,881	-	-	-	-	-	-	-	-	-	1,881
8	Pumping Plant Structures & Improvements	13,385	-	-	-	-	-	-	-	-	-	13,385
9	Electric Pumping Equipment	626,077	-	-	-	-	-	-	-	-	-	626,077
10	Gas Engine Equipment	15,174	-	-	-	-	-	-	-	-	-	15,174
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	14,812	-	-	-	-	-	-	-	-	-	14,812
13	Water Treatment Equipment	117,341	-	-	-	-	-	-	-	-	-	117,341
14	Transmission and Distribution Land	-	-	-	-	-	-	-	-	-	-	-
15	Storage Tanks	380,625	-	-	-	-	-	-	-	-	-	380,625
16	Transmission and Distribution Mains	2,034,956		-	-	-	-	-	-	-	-	2,034,956
17	Fire Sprinkler Taps	46,740	-	-	-	-	-	-	-	-	-	46,740
18	Services	522,118	-	-	-	-	-	-	-	-	-	522,118
19	Meters	143,103	-	-	-	-	-	-	-	-	-	143,103
20	Hydrants	191,343	-	-	-	-	-	-	-	-	-	191,343
21	General Plant Land	66	-	-	-	-	-	-	-	-	-	66
22	General Plant Structures	23,225	-	-	-	-	-	-	-	-	-	23,225
23	Leasehold Improvements	-	-	-	-	-	-	-	-	-	-	-
24	Office Furniture and Improvements	63,433	-	-	-	-	-	-	-	-	-	63,433
25	Warehouse Equipment	-	-	-	-	-	-	-	-	-	-	-
26	Tools, Shop and Garage Equipment	21,180	-	-	-	-	-	-	-	-	-	21,180
27	Laboratory Equipment	539	-	-	-	-	-	-	-	-	-	539
28	Power Operated Equipment	12,198	-	-	-	-	-	-	-	-	-	12,198
29	Communication Equipment	208,384	-	-	-	-	-	-	-	-	-	208,384
30	Miscellaneous Equipment	7,609	-	-	-	-	-	-	-	-	-	7,609
31	Total Plant in Service - Actual	5,121,802	-	-	-	-	-	-	-	-	-	5,121,802
32	Pro-forma Adjustment - Post TY Plant	160,557	(54,080)	-	-	-	-	-	-	-	-	106,477
33	Post-Test Year, Retired Plant	-		(8,986)								(8,986)
34	Total Plant in Service - Adjusted	$ 5,282,359	$ (54,080)	$ (8,986)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,219,293
35	Less: Accumulated Depreciation - Actual	$ (1,381,211)	-	-	946	-	-	-	-	-	-	(1,380,265)
36	Less: Accumulated Depreciation - Post TY	(5,537)	-	-	-	3,912	-	-	-	-	-	(1,625)
37	Less: Accumulated Depreciation - 12 Mos TY	(20,152)					(112,131)					(132,283)
37	Less: Accumulated Depreciation - Retired Plant	-	-	-		-	-	14,551	-	-	-	14,551
38	Total Accumulated Depreciation - Adjusted	$ (1,406,900)	$ -	$ -	$ 946	$ 3,912	$ (112,131)	$ 14,551	$ -	$ -	$ -	$ (1,499,622)
39	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-
40	Net Plant in Service	$ 3,875,459	$ (54,080)	$ (8,986)	$ 946	$ 3,912	$ (112,131)	$ 14,551	$ -	$ -	$ -	$ 3,719,671
	LESS:											
41	Advances in Aid of Construction (AIAC)	$ (587,611)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (587,611)
42	Contributions in Aid of Construction (CIAC)	(699,448)	-	-	-	-	-	-	-	-	-	(699,448)
43	Less: Accumulated Amortization	113,980	-	-	-	-	-	-	-	-	-	113,980
44	Net CIAC (L25 - L26)	(585,468)	-	-	-	-	-	-	-	-	-	(585,468)
45	Total Advances and Contributions	(1,173,079)	-	-	-	-	-	-	-	-	-	(1,173,079)
46	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-
47	Meter Advances	-	-	-	-	-	-	-	-	-	-	-

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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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[K] ADJ No. 10	[L] STAFF ADJUSTED
48	Deferred Income Tax Credits	(331,421)	-	-	-	-	-	-	-	-	-	(331,421)
	ADD:											
49	Working Capital Allowance	70,439	-	-	-	-	-	-	(98,732)	-		(28,293)
50	Phoenix Office Allocation	130,569	-	-	-	-	-	-	-	(117,302)		13,267
51	Meter Shop Allocation	2,720	-	-	-	-	-	-	-	-	(2,420)	300
52	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-
53	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-
54	Other Additions	-	-	-	-	-	-	-	-	-	-	-
55	**Total Rate Base**	$ 2,574,687	$ (54,080)	$ (8,986)	$ 946	$ 3,912	$ (112,131)	$ 14,551	$ (98,732)	$ (117,302)	$ (2,420)	$ 2,200,445

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Schedule REL-5

RATE BASE ADJUSTMENT NO. 1 and 2 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 5,121,807	$ -	$ 5,121,807
2	Post-Test Year Plant	$ 160,557	$ (54,080)	$ 106,477
3	Post-Test Year Retired Plant	$ -	$ (8,986)	$ (8,986)
4	**Adjusted Test Year Plant**	**$ 5,282,364**	**$ (63,066)**	**$ 5,219,298**

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Schedule REL-6

RATE BASE ADJUSTMENT NOS. 3, 4, 5 AND 6 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (1,381,211)	$ 946	$ (1,380,265)
2	Accumulated Depreciation, Post-Test Year Plant	$ (5,537)	$ 3,912	$ (1,625)
3	Accumulated Depreciation, Test Year Plant	$ (20,152)	$ (112,131)	$ (132,283)
4	Accumulated Depreciation, Retired Plant	$ -	$ 14,551	$ 14,551
		$ (1,406,900)	**$ (92,722)**	**$ (1,499,622)**

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Schedule REL- 7

OPERATING INCOME ADJUSTMENT NO. 7 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ 24,193	$ (98,732)	$ (74,539)
2	Materials and Supplies Inventory	17,633	-	17,633
3	Required Bank Balances	18,191	-	18,191
4	Prepayments and special Deposits	10,422	-	10,422
5	Total	$ 70,439	$ (98,732)	(28,293)

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Schedule REL-8

RATE BASE ADJUSTMENT NO. 8 and 9 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 130,569	$ (111,737)	$ 18,832
2	Meter Shop Allocations	$ 2,720	$ (2,420)	$ 300
3	Phoenix Office Allocation - Retirements	$ -	$ (5,565)	$ (5,565)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 133,289**	**$ (119,722)**	**$ 13,567**

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Schedule REL-9

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:					
1	Total Operating Revenues	$ 896,485	$ 678	$ 897,163	$ 208,109	$ 1,105,272
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ -	$ -	$ -	$ -	$ -
3	Other	1,540	-	1,540	-	1,540
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	162,283	(2,544)	159,739	-	159,739
5	Purchased Gas	504	-	504	-	504
6	Other	27,471	-	27,471	-	27,471
7	Water Treatment Expenses	26,475	(5,031)	21,444	-	21,444
8	Transmission and Distribution Expenses	139,484	4	139,488	-	139,488
9	Customer Account Expenses	122,643	4	122,647	423	123,070
10	Sales Expenses	666	-	666	-	666
11	Administrative and General Expenses	158,596	(5,129)	153,467	-	153,467
12	Total Operation and Maintenance	$ 639,662	(12,696)	626,966	423	627,388
13	Depreciation and Amortization	142,443	(8,901)	133,542	-	133,542
15	Ad Valorem (Property)	63,555	(6,037)	57,518	-	57,518
	Taxes:					
14	Federal & State Income Tax	3,802	(1,579)	2,223	80,165	82,388
16	Other	15,946	-	15,946	-	15,946
17	**Total Operating Expenses**	$ 865,408	$ (29,213)	$ 836,195	$ 80,588	$ 916,782
18	**Operating Income (Loss)**	$ 31,077	$ 29,891	$ 60,968	$ 127,522	$ 188,490

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Schedule REL-10

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] STAFF ADJUSTED
	REVENUES:															
1	**Total Operating Revenues**	$ 896,485	$ 678	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 897,163
	EXPENSES:															
	Source of Supply Expenses:															
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	1,540	-	-	-	-	-	-	-	-	-	-	-	-	-	1,540
	Pumping Expenses:															-
4	Purchased Power	162,283	-	(2,545)	1	-	-	-	-	-	-	-	-	-	-	159,739
5	Purchased Gas	504	-	-	-	-	-	-	-	-	-	-	-	-	-	504
6	Other	27,471	-	-	-	-	-	-	-	-	-	-	-	-	-	27,471
7	Water Treatment Expenses	26,475	-	-	-	(639)	(4,392)	-	-	-	-	-	-	-	-	21,444
8	Transmission and Distribution Expenses	139,484	-	-	-	-	-	4	-	-	-	-	-	-	-	139,488
9	Customer Account Expenses	122,643	-	-	-	-	-	-	4	-	-	-	-	-	-	122,647
10	Sales Expenses	666	-	-	-	-	-	-	-	-	-	-	-	-	-	666
11	Administrative and General Expenses	158,596	-	-	-	-	-	-	-	(3,958)	(1,171)	-	-	-	-	153,467
12	Total Operation and Maintenance	639,662	-	(2,545)	1	(639)	(4,392)	4	4	(3,958)	(1,171)	-	-	-	-	626,966
13	Depreciation and Amortization	142,443	-	-	-	-	-				-	(8,901)	-	-	-	133,542
15	Ad Valorem (Property)	63,555	-	-	-	-	-	-	-	-	-	-	(6,037)	-	-	57,518
	Taxes:															
14	Federal & State Income Tax	3,802	-	-	-	-	-	-	-	-		-	-	(2,211)	632	2,223
16	Other	15,946												-		15,946
17	**Total Operating Expenses**	$ 865,408	$ -	$ (2,545)	$ 1	$ (639)	$ (4,392)	$ 4	$ 4	$ (3,958)	$ (1,171)	$ (8,901)	$ (6,037)	$ (2,211)	$ 632	$ 836,195
18	**Operating Income (Loss)**	$ 31,077	$ 678	$ 2,545	$ (1)	$ 639	$ 4,392	$ (4)	$ (4)	$ 3,958	$ 1,171	$ 8,901	$ 6,037	$ 2,211	$ (632)	$ 60,968

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Schedule REL- 11

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	11		11
2	Avg Annual Bill Per Customer for TY	326		388
1	Avg Annual Revenue for Additional Customers	$ 3,586	$ 678	$ 4,264

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Schedule REL-12

OPERATING INCOME ADJUSTMENT NO. 2 - PURCHASED PUMPING POWER EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Purchased Pumping Power Expense	$ 162,283	$ (2,545)	$ 159,738

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Schedule REL- 13

OPERATING INCOME ADJUSTMENT NO. 3, 6 and 7 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ 7	$ -	$ 7
2	Purchased Pumping Power	914	1	915
3	Water Treatment Expense	105	-	105
4	Transmission & Distribution Expense	670	4	674
5	Customer Accounting	583	4	587
6	Total	$ 2,279	$ 9	$ 2,288

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Schedule REL-14

OPERATING INCOME ADJUSTMENT NO. 4 - WATER TESTING EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Water Trea Water Treatment	$ 26,475	$ (639)	$ 25,836

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Schedule REL-15

OPERATING INCOME ADJUSTMENT NO. 5 - WATER TESTING EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Annual Water Testing Expense	$ 7,102	$ (4,392)	$ 2,710

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Schedule REL- 16

OPERATING INCOME ADJUSTMENT NO. 8 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.07970		0.07970
3	Annual Rate Case Expense for Eastern Group	$ 20,527	$ (6,108)	$ 14,419
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 6,842	$ (3,958)	$ 2,884

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Schedule REL-17

OPERATING INCOME ADJUSTMENT NO. 9 - CHARITABLE CONTRIBUTIONS

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 1,171	$ (1,171)	$ -

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Schedule REL-18

OPERATING INCOME ADJUSTMENT NO. 10 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Depreciation Expense	$ 142,443	$ 11,733	$ 154,176
2	CIAC Amortization		(20,634)	(20,634)
		$ 142,443	$ (8,901)	$ 133,542

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Schedule REL- 19

OPERATING INCOME ADJUSTMENT NO. 11 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 923,693
2	2001 Annual Gross Revenues			$ 900,775
3	2002 Annual Gross Revenues			$ 987,194
4	Plus Staff's Recommended Increase			$ 208,109
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 3,019,771
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 1,006,590
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 2,013,181
10	Plus: 10% of 2001 CWIP			-
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 27,613
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 1,985,568
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 496,392
15	Composite Property Tax Rate (See Note B Below)			0.115872
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 63,555	$ (6,037)	$ 57,518

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 20

OPERATING INCOME ADJUSTMENT NO. 12 and 13 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ 4,033	$ (2,211)	$ 1,822
2	State Income Taxes	(231)	632	401
3	Total Income Taxes	$ 3,802	$ (1,579)	$ 2,223

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RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 12.43	$ 18.25	$ 16.20
1" Meter	$ 24.86	$ 41.06	$ 33.01
2" Meter	$ 62.15	$ 118.63	$ 154.12
3" Meter	$ 103.58	$ 212.98	$ 296.19
4" Meter	$ 207.16	$ 380.15	$ 419.16
6" Meter	$ 362.53	$ 722.34	$ 604.72
8" Meter	$ 362.53	$ 996.09	$ 725.66
10" Meter	$ 673.27	$ 1,634.84	$ 907.08
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 1.5950	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 1.5950	$ 2.1130	$ 1.3580
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 1.5950	$ 2.1130	$ 1.6980
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 1.5950	$ 2.1130	$ 2.0380
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	
1" Meter	(a)	(a)	
2" Meter	(b)	(b)	
3" Meter	(b)	(b)	
4" Meter	(b)	(b)	
6" Meter	(b)	(b)	

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

RATE DESIGN
CONTINUED

	Present	---Proposed Rates---	
Service Charges:	**Rates**	**Company**	**Staff**
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

SUPERIOR SYSTEM

Summary of Proposed Revenue- Superior

Q. Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirement?

A. Yes, please refer to schedule REL-1. The Company proposes total annual operating revenue of $1,190,319 which represents an increase of $491,351, or 70.30 percent, over the Company adjusted test year revenue of $698,968. However, the Company's Schedule A-1 shows an increase in revenue of $61,063 that when added to the adjusted test year revenue of $698,968 results in annual revenue of $760,031 or a difference of $430,288.

Staff's recommended total annual operating revenue for the Superior system is $1,024,222. Staff's recommendation represents an increase of $325,633, or 46.61 percent, over its adjusted test year revenue of $698,589.

Rate Base - Superior

<u>Original Cost Rate Base</u>

Q. Did Staff prepare an Original cost Rate Base schedule?

A. Yes, shown on Schedule REL-3, Staff recommends a rate base of $2,400,573. Staff's recommended rate base is a decrease of $273,003 from the Company's proposal of $2,673,576. Staff's rate base adjustments are described below.

<u>Rate Base Adjustment No. 1 – Addition of Post-Test Year Plant</u>

Q. Does Staff's recommended rate base include plant placed into service after the test year?

A. Yes, Staff included $276,104 of plant in rate base that the Company placed into service after the end of the test year but no later than December 31, 2002 as shown on REL-5.

Staff decreased the Company's post-test year plant additions by $27,773, from $303,877 to $276,104.

Rate Base Adjustment No. 2 – Post –Test Year Retired Plant

Q. **Did the Company make any adjustment for plant retired during the 2002 post-test year period?**

A. No, since the Company had requested the Plant In Service additions of certain plant, it is proper to remove the corresponding plant that was replaced by the plant additions. Staff therefore removed $700 from Plant In Service also shown on Schedule REL-5, and from Accumulated Depreciation.

Q. **Please summarize Staff's recommendations regarding Plant In Service.**

A. Staff recommends $4,299,052 for Plant In Service, a $28,473 decrease from the Company's proposed $4,327,525. Staff's recommendation is shown on Schedule REL-5

Rate Base Adjustment Nos. 3, 4, 5 and 6 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 9 of 11 of the filing, increased Accumulated Depreciation by $6,515 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 9 of 11 of the filing, increased Accumulated Depreciation by $9,524 and represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002 cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant included in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff increased accumulated depreciation by $80,890, from $986,086 to $1,066,976. This adjustment is made up of several components including a $5,364 (adjustment no. 3) decrease as a result of Staff's analysis. Staff recommends increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $93,550 (adjustment no. 5) from $9,524 to $103,074, and it recommends decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $2,769 (adjustment no. 4) from $6,515 to $3,746. Additionally, Staff removed $4,527 (adjustment no. 6) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC - USOA accounting procedures.

<u>Rate Base Adjustment No. 5 – Cash Working Capital Allowance</u>

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $27,887 for working capital. Schedule B-5, page 2 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed $7,767 cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of working capital?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff lead-lag analysis indicates a negative $75,180 cash working capital component or a reduction of $82,947 compared the Company's $7,767 figure. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Cash Working Capital?

A. Staff increased the Materials and Supply Inventory by $1,635, from $443 to $2,078 as a result of materials that were transferred from Transmission and Distribution Expense to Working Capital.

Q. What Working Capital allowance does Staff recommend?

A. Staff recommends a working capital allowance of negative $53,425 as shown on Schedule REL-7.

Rate Base Adjustment No. 8 and 9 – Allocated Post-Test Year Additions

Q. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

A. Using the Company's allocation factors, Staff decreased the Phoenix Office allocation by $80,665, which included $3,827 of post-test year retired plant. The Meter Shop allocation was reduced by $1,663. Staff's total adjustment reduced the Phoenix Office and Meter shop allocations by $82,328, from $91,658 to $9,330. Staff's analysis is shown on Schedule REL-8.

Operating Income - Superior

Operating Income Summary

Q. What are Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $698,589, expenses of $692,492 and an operating income of $6,097 as shown on Schedules REL-9. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied a negative 7 (that represents the average loss in customers on the Superior system during the test year) by $379 (which is the Company's determination of annual revenue per customer) that resulted in a revenue decrease of $3,367.

Q. Did Staff make an adjustment to annual revenue in the Company's calculation?

A. Yes. Staff made a $481 adjustment to decrease the Company's proposed annualization from negative $3,367 to negative $3,746. Staff's calculation of the adjustment is shown on Schedule REL-11. Staff's recalculation recognizes revenue from all meter sizes and calculated the average annual revenue per customer to be $481 rather than the Company's $379.

Operating Income Adjustment No. 2 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes, Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. (See Mr. Hammon's testimony). The amount applicable to Superior was decreased from the Company's pro forma expense by $7,104. Additionally, Staff removed $1,236 of Superior's Water Treatment

Expense and transferred it to the Miami system and reclassified it as Material and Supplies Inventory. This adjustment, totaling $8,340 reduced Water Treatment Expense from $30,792 to $22,452 as shown on Schedule REL-12.

Operating Income Adjustment No. 3 – Water Testing Expense

Q. What is Arizona Water's proposed Water Testing Expense?

A. Arizona Water's proposed Water Testing Expense of $2,125 for the Superior system. Water Testing Expense is a component of the Company's proposed $30,792 Water Treatment Expense, shown on Schedule REL -13.

Q. Did Staff agree with the Company's Water Testing Expense?

A. No. Staff recommended this expense be based on Staff's water testing expense analysis of $1,618, which decreases annual operating expenses by $507. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 4– Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. Staff adjusted Transmission and Distribution Expenses downward by $1,635. The Company inadvertently posted $1,635 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory. This entry reduced the account from $159,574 to $157,939 and corrects the misclassification as shown on Schedule REL-14.

Operating Income Adjustment No. 5 and 6 – Expense Annualization Adjustment

Q. Has Staff recalculated the amount of annualized expenses?

A. Yes. Staff calculations are shown as adjustments nos. 5 and 6 and are shown on Schedule REL-15. Staff recommended an expense annualization adjustment of a negative $2,130, a decrease of $6 from the Company's adjustment of a negative $2,121.

Operating Income Adjustment No. 7 – Rate Case Expense

Q. What Rate Case Expense did Arizona Water propose for the Superior system?

A. The Company proposed total Rate Case Expense of $14,114 for the Superior system. Rate Case Expense is a component of the Company's proposed $98,965 Administrative and General Expense, shown on Schedule REL-16.

Q. Does Staff agree that the Company's Rate Case Expense for the Superior system is reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Superior system?

A. Staff recommends allocating $9,914 to the Superior system. Staff's recommended allocation uses the Company-proposed allocation factor of 0.05480 percent ($180,913 x 0.05480 = $9,914 Staff recommends annual Rate Case Expense of $1,983 ($9,914 amortized over five years), a decrease of $2,722 from the Company's request of $4,705, as shown on Schedule REL-16

Operating Income Adjustment No. 8 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even though charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $805 from the Administrative and General account, as shown on REL-17.

Operating Income Adjustment No. 9 – Depreciation and Amortization Expense

Q. What did the Company propose for depreciation expense?

A. The Company proposed $118,817 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 31 of 36 of the filing, increased depreciation expense by $2,532 provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 32 of 36 of the filing, increased depreciation expense by $516 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff's plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using dated component depreciation rates that it later corrected. Staff reviewed and accepted the new depreciation rates which were used in calculating rates.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommends $118,359 for depreciation expense, a $458 decrease from the Company's proposed $118,817. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL-18.

<u>Operating Income Adjustment No. 10 – Property Taxes</u>

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $64,071.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $74,875, an increase of $10,805 from the Company's proposal of $64,071 as shown on Schedule REL–19.

<u>Operating Income Adjustment Nos. 10 and 11 – Income Taxes</u>

Q. What income tax expense did Arizona Water propose?

A. The Company proposed a negative $22,627 in federal income taxes and a negative $5,474 in state income taxes for a combined negative income tax of $28,101.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and Staff's recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedules REL-20, Staff recommends negative federal income tax of $29,136 and negative state income tax of $6,418 for a combined negative income tax of $35,554.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $73,655 and state income tax of $16,226 for a combined income tax of $89,881.

Rate Design – Superior

<u>Rate Consolidation</u>

Q. Did Staff review the Company's proposal to consolidate rates for the Apache Junction and Superior systems?

A. Yes. Staff has reviewed the rate consolidation plan.

Q. What is the Company's rationale for the rate consolidation plan?

A. The Company seeks an interconnection between the two systems which it believes will provide increased reliability for customers of both systems. The Company proposes to do this in two phases. Phase one would equalize the two systems basic monthly charge. Step two, to be considered in the Eastern Groups next rate case would combine the commodity charges of the two systems. (See Direct Testimony of Ralph Kennedy, pages 11 and 12.)

Q. Does Staff recommend approval of the Company's rate consolidation plan?

A. No. According to Staff Engineering there is no interconnection between Apache Junction and Superior, and there are CC&N voids between the Apache Junction system and the well field at Florence Junction. Additionally, the Apache Junction and Superior systems exhibit differences in revenue requirements due to the age of the respective infrastructure, maintenance costs, power costs and growth rates. Staff recommends that each of the Eastern Group's eight systems have their own unique rates based upon the characteristics of each system. Rate consolidation causes cross-subsidization among systems and results in unfair rates.

<u>Rate Design</u>

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and Staff's recommended rates and charges?

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

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at 50,000 gallons. The three-tier rate structure applies to all metered customers.

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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	2,673,576	$	2,400,573
2	Adjusted Operating Income (Loss)	$	(6,904)	$	6,097
3	Current Rate of Return (L2 / L1)		-0.26%		0.25%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	294,093	$	205,633
6	Operating Income Deficiency (L5 - L2)	$	300,997	$	199,536
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 * L6)	$	491,351	$	325,633
9	Adjusted Test Year Revenue	$	698,968	$	698,589
10	Proposed Annual Revenue (L8 + L9) Note A	$	1,190,319	$	1,024,222
11	Require Increase in Revenue (%) (L8/L9)		70.30%		46.61%

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Schedule REL- 2

GROSS REVENUE CONVERSION FACTOR

Line No.			
	Calculation of Gross Revenue Conversion Factor:		
1	Recommended Revenue Increase:		
2	Billings		1.000000
3	Combined Federal and State Income Tax Rate	38.59888%	
4	Uncollectible Rate After Income Taxes	0.12477%	
5	Total Tax Rate		38.72365%
6	Gross Revenue Conversion Factor		1.631951
	Calculation of Effective Income Tax Rate:		
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%	
8	Arizona State Income Tax Rate	6.96800%	
9	Federal Taxable Income (L5 - L6)	93.03200%	
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%	
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%	
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%	
	Calculation of Uncollectible Rate After Income Taxes:		
13	Uncollectible Rate		0.20320%
14	Combined Federal and State Income Tax Rate	38.59888%	
15	1 minus Combined Federal and State Income Tax Rate		61.40112%
16	Uncollectible Rate After Income Taxes		0.12477%
	Revenue Reconciliation:		
17	Recommended Increase in Revenue (from REL-1, L8)	$ 325,633	
18	Uncollectible Rate	0.203200%	
19	Required Increase in Revenue to Provide for Uncollectibles		$ 662
20	Recommended Increase in Revenue (from REL-1,L8)	$ 325,633	
21	Required Increase in Revenue to Provide for Uncollectibles	662	
22	Incremental Taxable Income	$ 324,972	
23	Combined Federal and State Income Tax Rate	38.59888%	
24	Required Increase in Revenue to Provide for Income Taxes		125,435
25	Required Operating Income	$ 205,633	
26	Adjusted Test Year Operating Income (Loss)	6,097	
27	Required Increase in Operating Income		199,536
28	Total Required Increase In Revenue		$ 325,633

Line No.	*Calculation of Income Tax:*	Test Year		STAFF Recommended	
29	Revenue	$ 698,589		$ 1,024,222	
30	Less: Operating Expenses Excluding Income Taxes	$ 728,046		$ 728,708	
31	Less: Synchronized Interest	$ 62,655		$ 62,655	
32	Arizona Taxable Income	$ (92,112)		$ 232,859	
33	Arizona State Income Tax Rate	6.968%		6.968%	
34	Arizona Income Tax		$ (6,418)		$ 16,226
35	Federal Taxable Income	$ (85,694)		$ 216,634	
36	Federal Income Tax @ 34%		$ (29,136)		$ 73,655
37	Combined Federal and State Income Tax		$ (35,554)		$ 89,881
				$ 125,435	

Line No.	*Calculation of Interest Synchronization:*	
38	Rate Base	$ 2,400,573
39	Weighted Average Cost of Debt	2.610%
40	Synchronized Interest	$ 62,655

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Schedule REL-3

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 4,327,525	$ (28,473)	$ 4,299,052
2	Less: Accumulated Depreciation	(986,086)	(80,890)	(1,066,976)
3	Net Plant in Service	$ 3,341,439	$ (109,363)	$ 3,232,076
	LESS:			
4	Advances in Aid of Construction (AIAC)	(384,759)	-	(384,759)
5	Contributions in Aid of Construction (CIAC)	$ (82,088)	$ -	$ (82,088)
6	Less: Accumulated Amortization	11,961	-	11,961
7	Net CIAC	(70,127)	-	(70,127)
8	Total Advances and Contributions	(454,886)	-	(454,886)
9	Customer Deposits	-	-	-
10	Meter Advances	-	-	-
11	Deferred Income Tax Credits	(332,521)	-	(332,521)
	ADD:			
12	Working Capital	27,886	(81,312)	(53,426)
13	Phoenix Office Allocation	89,788	(80,665)	9,123
14	Meter Shop Allocation	1,870	(1,663)	207
15		-	-	-
18	**Total Rate Base**	$ 2,673,576	$ (273,003)	$ 2,400,573

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Schedule REL-4

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ No. 8	[J] ADJ No. 9	[K] ADJ No. 10	[L] STAFF ADJUSTED
	PLANT IN SERVICE:												
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	4,209	-	-	-	-	-	-	-	-	-	-	4,209
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	24,009	-	-	-	-	-	-	-	-	-	-	24,009
5	Other Source of Supply Land	13,752	-	-	-	-	-	-	-	-	-	-	13,752
6	Wells	137,393	-	-	-	-	-	-	-	-	-	-	137,393
7	Pumping Plant Land	-	-	-	-	-	-	-	-	-	-	-	-
8	Pumping Plant Structures & Improvements	47,905	-	-	-	-	-	-	-	-	-	-	47,905
9	Electric Pumping Equipment	583,864	-	-	-	-	-	-	-	-	-	-	583,864
10	Gas Engine Equipment	-	-	-	-	-	-	-	-	-	-	-	-
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	8,061	-	-	-	-	-	-	-	-	-	-	8,061
13	Water Treatment Equipment	127,455	-	-	-	-	-	-	-	-	-	-	127,455
14	Transmission and Distribution Land	1,975	-	-	-	-	-	-	-	-	-	-	1,975
15	Storage Tanks	180,378	-	-	-	-	-	-	-	-	-	-	180,378
16	Transmission and Distribution Mains	1,988,797	-	-	-	-	-	-	-	-	-	-	1,988,797
17	Fire Sprinkler Taps	8,318	-	-	-	-	-	-	-	-	-	-	8,318
18	Services	507,179	-	-	-	-	-	-	-	-	-	-	507,179
19	Meters	97,206	-	-	-	-	-	-	-	-	-	-	97,206
20	Hydrants	104,732	-	-	-	-	-	-	-	-	-	-	104,732
21	General Plant Land	-	-	-	-	-	-	-	-	-	-	-	-
22	General Plant Structures	17,311	-	-	-	-	-	-	-	-	-	-	17,311
23	Leasehold Improvements	1,609	-	-	-	-	-	-	-	-	-	-	1,609
24	Office Furniture and Improvements	56,051	-	-	-	-	-	-	-	-	-	-	56,051
25	Warehouse Equipment	59	-	-	-	-	-	-	-	-	-	-	59
26	Tools, Shop and Garage Equipment	39,884	-	-	-	-	-	-	-	-	-	-	39,884
27	Laboratory Equipment	3,725	-	-	-	-	-	-	-	-	-	-	3,725
28	Power Operated Equipment	5,261	-	-	-	-	-	-	-	-	-	-	5,261
29	Communication Equipment	62,109	-	-	-	-	-	-	-	-	-	-	62,109
30	Miscellaneous Equipment	2,406	-	-	-	-	-	-	-	-	-	-	2,406
31	Total Plant in Service - Actual	4,023,648	-	-	-	-	-	-	-	-	-	-	4,023,648
	Pro-forma Adjustment - Post TY Plant	303,877	(27,773)	-	-	-	-	-	-	-	-	-	276,104
32	Post Test Year Retired Plant	-	-	(700)									(700)
33	Total Plant in Service - Adjusted	$ 4,327,525	$ (27,773)	$ (700)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 4,299,052
34	Less: Accumulated Depreciation - Actual	$ (970,047)	-	-	5,364	-	-	-	-	-	-	-	(964,683)
35	Less: Accumulated Depreciation - Pro Forma	(6,515)	-		-	2,769	-	-	-	-	-	-	(3,746)
36	Less: Accumulated Depreciation - 12 Mos TY	(9,524)					(93,550)						(103,074)
37	Less: Accumulated Depreciation - Pro Forma	-	-	-	-	-	-	4,527	-	-	-	-	4,527
38	Total Accumulated Depreciation - Adjusted	$ (986,086)	$ -	$ -	$ 5,364	$ 2,769	$ (93,550)	$ 4,527	$ -	$ -	$ -	$ -	$ (1,066,976)
39	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-	-
40	Net Plant in Service	$ 3,341,439	$ (27,773)	$ (700)	$ 5,364	$ 2,769	$ (93,550)	$ 4,527	$ -	$ -	$ -	$ -	$ 3,232,076
	LESS:												
41	Advances in Aid of Construction (AIAC)	$ (384,759)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (384,759)
42	Contributions in Aid of Construction (CIAC)	(82,088)	-	-	-	-	-	-	-	-	-	-	(82,088)
43	Less: Accumulated Amortization	11,961	-	-	-	-	-	-	-	-	-	-	11,961
44	Net CIAC (L25 - L26)	(70,127)	-	-	-	-	-	-	-	-	-	-	(70,127)
45	Total Advances and Contributions	(454,886)	-	-	-	-	-	-	-	-	-	-	(454,886)
46	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-	-
47	Meter Advances	-	-	-	-	-	-	-	-	-	-	-	-
48	Deferred Income Tax Credits	(332,521)	-	-	-	-	-	-	-	-	-	-	(332,521)
	ADD:												
49	Working Capital Allowance	27,886	-	-	-	-	-	-	(81,312)	-	-	-	(53,426)
50	Phoenix Office Allocation	89,788	-	-	-	-	-	-	-	(80,665)	-	-	9,123
51	Meter Shop Allocation	1,870	-	-	-	-	-	-	-	-	(1,663)	-	207
52	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-	-
53	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-	-
54	Other Additions	-	-	-	-	-	-	-	-	-	-	-	-
55	**Total Rate Base**	$ 2,673,576	$ (27,773)	$ (700)	$ 5,364	$ 2,769	$ (93,550)	$ 4,527	$ (81,312)	$ (80,665)	$ (1,663)	$ -	$ 2,400,573

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Schedule REL-5

RATE BASE ADJUSTMENT NOS. 1 and 2 - PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Actual Test Year Plant	$ 4,023,648	$ -	$ 4,023,648
2	Post-Test Year Plant	$ 303,877	$ (27,773)	$ 276,104
3	Post Test Year Retired Plant	$ -	$ (700)	$ (700)
4	**Adjusted Test Year Plant**	**$ 4,327,525**	**$ (28,473)**	**$ 4,299,052**

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Schedule REL-6

RATE BASE ADJUSTMENT NOS. 3, 4, 5 and 6 - ACCUMULATED DEPRECIATION

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Accumulated Depreciation, Actual	$ (970,047)	$ 5,364	$ (964,683)
2	Accumulated Depreciation, Post-Test Year Plant	$ (6,515)	$ 2,769	$ (3,746)
3	Accumulated Depreciation, 12 Mos Test Year	$ (9,524)	$ (93,550)	$ (103,074)
4	Accumulated Depreciation, Retired Plant	$ -	$ 4,527	$ 4,527
		$ (986,086)	**$ (80,890)**	**$ (1,066,976)**

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Schedule REL- 7

OPERATING INCOME ADJUSTMENT NO. 7 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ 7,767	$ (82,947)	$ (75,180)
2	Materials and Supplies Inventory	443	1,635	2,078
3	Required Bank Balances	12,510	-	12,510
4	Prepayments and special Deposits	7,167	-	7,167
5	Total	$ 27,887	$ (81,312)	$ (53,425)

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Schedule REL-8

RATE BASE ADJUSTMENT NOS. 8 and 9 - PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 89,788	$ (76,838)	$ 12,950
2	Meter Shop Allocations	$ 1,870	$ (1,663)	$ 207
3	Phoenix Office Allocation - Retirements	$ -	$ (3,827)	$ (3,827)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 91,658**	**$ (82,328)**	**$ 9,330**

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Schedule REL-9

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:					
1	Total Operating Revenues	$ 698,968	$ (379)	$ 698,589	$ 325,633	$ 1,024,222
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ -	$ -	$ -	$ -	$ -
3	Other	4,729	-	4,729	-	4,729
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	76,290	-	76,290	-	76,290
5	Purchased Gas	-	-	-	-	-
6	Other	54,189	-	54,189	-	54,189
7	Water Treatment Expenses	30,792	(8,847)	21,945	-	21,945
8	Transmission and Distribution Expenses	159,574	(1,639)	157,935	-	157,935
9	Customer Account Expenses	114,326	(4)	114,322	662	114,984
10	Sales Expenses	872	-	872	-	872
11	Administrative and General Expenses	98,965	(3,527)	95,438	-	95,438
12	Total Operation and Maintenance	$ 539,737	(14,017)	525,720	662	526,382
13	Depreciation and Amortization	118,817	(2,715)	116,102	-	116,102
15	Ad Valorem (Property)	64,071	10,805	74,876	-	74,876
	Taxes:					
14	Federal & State Income Tax	(28,101)	(7,453)	(35,554)	125,435	89,881
16	Other	11,348	-	11,348	-	11,348
17	**Total Operating Expenses**	$ 705,872	$ (13,380)	$ 692,492	$ 126,097	$ 818,589
18	**Operating Income (Loss)**	$ (6,904)	$ 13,001	$ 6,097	$ 199,536	$ 205,633

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SUMMARY OF OPERATING INCOME ADJUSTMENTS - TEST YEAR

Schedule REL-10

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] STAFF ADJUSTED
	REVENUES:																
1	**Total Operating Revenues**	$ 698,968	$ (379)		$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 698,589
	EXPENSES:																
	Source of Supply Expenses:																
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	4,729	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4,729
	Pumping Expenses:																
4	Purchased Power	76,290	-	-	-	-	-	-	-	-	-	-	-	-	-	-	76,290
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	54,189	-	-	-	-	-	-	-	-	-	-	-	-	-	-	54,189
7	*Water Treatment Expenses*	30,792	-	(8,340)	(507)	-	-	-	-	-	-	-	-	-	-	-	21,945
8	Transmission and Distribution Expenses	159,574	-	-	-	(1,635)	(4)	-	-	-	-	-	-	-	-	-	157,935
9	Customer Account Expenses	114,326	-	-	-	-	-	(4)	-	-	-	-	-	-	-	-	114,322
10	Sales Expenses	872	-	-	-	-	-	-	-	-	-	-	-	-	-	-	872
11	Administrative and General Expenses	98,965	-	-	-	-	-	-	(2,722)	(805)	-	-	-	-	-	-	95,438
12	Total Operation and Maintenance	539,737	-	(8,340)	(507)	(1,635)	(4)	(4)	(2,722)	(805)	-	-	-	-	-	-	525,720
13	Depreciation and Amortization	118,817	-	-	-	-	-	-	-	-	(2,715)	-	-	-	-	-	116,102
15	Ad Valorem (Property)	64,071	-	-	-	-	-	-	-	-	-	10,805	-	-	-	-	74,876
	Taxes:																
14	Federal & State Income Tax	(28,101)	-	-	-	-	-	-	-	-	-	-	(6,509)	(944)	-	-	(35,554)
16	Other	11,348	-	-	-	-	-	-	-	-	-	-	-	-	-	-	11,348
17	**Total Operating Expenses**	$ 705,872	$ -	$ (8,340)	$ (507)	$ (1,635)	$ (4)	$ (4)	$ (2,722)	$ (805)	$ (2,715)	$ 10,805	$ (6,509)	$ (944)	$ -	$ -	$ 692,492
18	**Operating Income (Loss)**	$ (6,904)	$ (379)	$ 8,340	$ 507	$ 1,635	$ 4	$ 4	$ 2,722	$ 805	$ 2,715	$ (10,805)	$ 6,509	$ 944	$ -	$ -	$ 6,097

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Schedule REL-10

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] STAFF ADJUSTED
	REVENUES:																
1	**Total Operating Revenues**	$ 698,968	$ (379)		$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 698,589
	EXPENSES:																
	Source of Supply Expenses:																
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	4,729	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4,729
	Pumping Expenses:																
4	Purchased Power	76,290	-	-	-	-	-	-	-	-	-	-	-	-	-	-	76,290
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	54,189	-	-	-	-	-	-	-	-	-	-	-	-	-	-	54,189
7	Water Treatment Expenses	30,792	-	(8,340)	(507)	-	-	-	-	-	-	-	-	-	-	-	21,945
8	Transmission and Distribution Expenses	159,574	-	-	-	(1,635)	(4)	-	-	-	-	-	-	-	-	-	157,935
9	Customer Account Expenses	114,326	-	-	-	-	-	(4)	-	-	-	-	-	-	-	-	114,322
10	Sales Expenses	872	-	-	-	-	-	-	-	-	-	-	-	-	-	-	872
11	Administrative and General Expenses	98,965	-	-	-	-	-	-	(2,722)	(805)						-	95,438
12	Total Operation and Maintenance	539,737	-	(8,340)	(507)	(1,635)	(4)	(4)	(2,722)	(805)	-	-	-	-	-	-	525,720
13	Depreciation and Amortization	118,817	-	-	-	-	-	-	-	-	(2,715)	-	-	-	-	-	116,102
15	Ad Valorem (Property)	64,071	-	-	-	-	-	-	-	-	-	10,805	-	-	-		74,876
	Taxes:																
14	Federal & State Income Tax	(28,101)	-	-	-	-	-	-	-	-	-	-	(6,509)	(944)	-	-	(35,554)
16	Other	11,348															11,348
17	**Total Operating Expenses**	$ 705,872	$ -	$ (8,340)	$ (507)	$ (1,635)	$ (4)	$ (4)	$ (2,722)	$ (805)	$ (2,715)	$ 10,805	$ (6,509)	$ (944)	$ -	$ -	$ 692,492
18	**Operating Income (Loss)**	$ (6,904)	$ (379)	$ 8,340	$ 507	$ 1,635	$ 4	$ 4	$ 2,722	$ 805	$ 2,715	$ (10,805)	$ 6,509	$ 944	$ -	$ -	$ 6,097

Arizona Water Company - Superior
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Schedule REL- 11

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	$ (7)		$ (7)
2	Avg Annual Bill Per Customer for TY	481		535
3	Avg Annual Revenue for Additional Customers	$ (3,367)	$ (379)	$ (3,746)

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Schedule REL- 12

OPERATING INCOME ADJUSTMENT NO. 2 - WATER TREATMENT EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Water Treatment Expense	$ 30,792	$ (1,236)	$ 29,556
2	Water Treatment - Chlorine	-	(7,104)	(7,104)
		$ 30,792	$ (8,340)	$ 22,452

Pro-forma adjustment to actual

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Schedule REL-13

OPERATING INCOME ADJUSTMENT NO. 3 - WATER TESTING EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Annual Water Testing Expense	$ 2,125	$ (507)	$ 1,618

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Schedule REL-14

OPERATING INCOME ADJUSTMENT NO. 4 - TRANSMISSION AND DISTRIBUTION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Transmission and Distribution	$ 159,574	$ (1,635)	$ 157,939

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OPERATING INCOME ADJUSTMENT NOS. 5 and 6 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ (26)	$ -	$ (26)
2	Purchased Pumping Power	(706)	-	(706)
3	Water Treatment Expense	(106)	-	(106)
4	Transmission & Distribution Expense	(665)	(4)	(669)
5	Customer Accounting	(618)	(4)	(622)
6	Total	$ (2,121)	$ (8)	$ (2,129)

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Schedule REL- 16

OPERATING INCOME ADJUSTMENT NO. 7 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.05480		0.05480
3	Annual Rate Case Expense for Eastern Group	$ 14,114	$ (4,200)	$ 9,914
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 4,705	$ (2,722)	$ 1,983

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Schedule REL-17

OPERATING INCOME ADJUSTMENT NO. 8 - CHARITABLE CONTRIBUTIONS

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 805	$ (805)	$ -

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Schedule REL-18

OPERATING INCOME ADJUSTMENT NO. 9 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Depreciation Expense	$ 118,817	$ (458)	$ 118,359
2	CIAC Amortization	-	(2,257)	(2,257)
		$ 118,817	$ (2,715)	$ 116,102

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Schedule REL- 19

OPERATING INCOME ADJUSTMENT NO. 10 - PROPERTY TAX EXPENSE

		(A)	(B)	(C)
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 744,641
2	2001 Annual Gross Revenues			$ 698,408
3	2002 Annual Gross Revenues			$ 733,703
4	Plus Staff's Recommended Increase			$ 325,633
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 2,502,385
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 834,128
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 1,668,257
10	Plus: 10% of 2001 CWIP			-
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$ 2,768
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 1,665,489
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 416,372
15	*Composite Property Tax Rate (See Note B Below)*			0.17983
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 64,071	$ 10,805	$ 74,876

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 20

OPERATING INCOME ADJUSTMENT NOS. 11 and 12 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ (22,627)	$ (6,509)	$ (29,136)
2	State Income Taxes	(5,474)	$ (944)	(6,418)
3	Total Income Taxes	$ (28,101)	$ (7,453)	$ (35,554)

RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 18.13	$ 18.13	$ 20.05
1" Meter	$ 38.84	$ 40.79	$ 70.20
2" Meter	$ 103.58	$ 117.85	$ 150.26
3" Meter	$ 155.37	$ 211.58	$ 432.93
4" Meter	$ 207.16	$ 377.65	$ 519.52
6" Meter	$ 362.53	$ 717.59	$ 623.42
8" Meter	$ 362.53	$ 989.54	$ 748.10
10" Meter	$ 673.27	$ 1,624.09	$ 935.13
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 4.0600	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 4.0600	$ 4.0600	$ 5.1040
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 4.0600	$ 4.0600	$ 6.3800
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 4.0600	$ 4.0600	$ 7.6560
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	
1" Meter	(a)	(a)	
2" Meter	(b)	(b)	
3" Meter	(b)	(b)	
4" Meter	(b)	(b)	
6" Meter	(b)	(b)	

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

RATE DESIGN
CONTINUED

	Present	---Proposed Rates---	
Service Charges:	**Rates**	**Company**	**Staff**
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

WINKELMAN SYSTEM

Summary of Proposed Revenue - Winkelman

Q. **Did Staff prepare a schedule representative of the Company's proposed increase and Staff's recommended revenue requirement?**

A. Yes, please refer to schedule REL-1. The Company proposes total annual operating revenue of $129,358 as shown on Schedule REL–1. This represents an increase of $32,343, or 31.97 percent, over the Company adjusted test year revenue of $98,022.

Staff recommends total annual operating revenue for the Winkelman system of $115,659. Staff's recommendation represents an increase of $16,935 or 17.15 percent, over its adjusted test year revenue of $98,724.

Rate Base - Winkelman

Original Cost Rate Base

Q. **Did Staff prepare an Original Cost Rate Base schedule?**

A. Yes, shown on Schedule REL-3, Staff's recommends a rate base of $232,924. Staff's recommended rate base is a decrease of $32,975 from the Company's proposal of $265,899. Staff's rate base adjustments are described below

Rate Base Adjustment No. 1 – Addition of Post-Test Year Plant

Q. **Does Staff's recommended rate base include plant placed into service after the test year?**

A. Yes. Staff included $21,541 of plant in rate base that the Company placed into service after the end of the test year but no later than December 31, 2002 as shown on REL-5. Staff increased the Company's post-test year plant additions by $4,675, from $17,166 to $21,541.

Rate Base Adjustment No. 1 –Post-Test Year Retired Plant

Q. Did the Company make any adjustment for plant retired during the 2002 post-test year period?

A. No, since the Company had requested the Plant In Service additions of certain plant, it is proper to remove the corresponding plant that was replaced by post-test year plant additions. Staff therefore removed $11,669 from Plant In Service also shown on Schedule REL-5, and from Accumulated Depreciation.

Q. **Please summarize Staff's recommendations regarding Plant In Service.**

A. Staff recommended $421,127 for Plant In Service, a $7,294 decrease from the Company's proposed $428,421.

Rate Base Adjustment Nos. 3, 4, 5 and 6 – Accumulated Depreciation

Q. What pro forma adjustments did the Company propose for Accumulated Depreciation?

A. The Company proposed two pro forma adjustments for Accumulated Depreciation. The Company's pro forma adjustment no. 2, as shown on Schedule B-2, page 8 of 11 of the filing, increased Accumulated Depreciation by $516 to reflect twelve months of depreciation expense on the Company's proposed post-test year plant additions that were expected to be completed by December 31, 2002. The Company's pro forma adjustment no. 3, as shown on Schedule B-2, page 8 of 11 of the filing, increased Accumulated Depreciation by $2,532 and represents six months of depreciation expenses on test year plant additions.

Q. Does the Company's pro forma adjustments to Accumulated Depreciation provide proper matching with the Company's pro forma adjustment to include all plant to be in service by December 31, 2002?

A. No. Proper matching of Plant In Service and Accumulated Depreciation requires recognition of depreciation expense accumulated to the cut-off date for all plant that is in service. The Company's pro forma adjustment no. 2 reflects 12 months of depreciation expense but only for the post-test year plant. Using the mid-year convention, this adjustment should represent six months depreciation expense only. Pro forma adjustment no. 3 increased accumulated depreciation by only six months for plant placed in service during the test year and remaining in service through the December 31, 2002, cut-off date.

Q. What is the consequence of the Company's proposal that fails to match Plant In Service and Accumulated Depreciation cut-off dates?

A. The Company's proposal violates the matching principle. It overstates rate base and allows the Company to earn on investment it has already recovered from ratepayers via depreciation expense.

Q. How did Staff calculate its recommended Accumulated Depreciation balance?

A. To provide a proper matching of Plant In Service with Accumulated Depreciation, Staff used the same cut-off date, December 31, 2002, for calculating Accumulated Depreciation as it used for recognizing post-test year plant additions. Staff calculated the accumulation of depreciation expense on all plant included in rate base using the half-year convention adopted by the Company. The depreciation accruals are calculated on plant balances that are known and measurable, have been transferred out of the Construction Work in Progress ("CWIP") accounts to the appropriate plant accounts, and have been sufficiently examined.

Q. What adjustment is Staff recommending for Accumulated Depreciation?

A. Calculation of Staff's recommendation is shown on Schedule REL-6. Staff decreased Accumulated Depreciation by $4,934, from $119,404 to $114,470. This adjustment is made up of several components including a $620 (adjustment no. 3) reduction as a result of Staff's analysis. Staff recommends increasing the pro forma adjustment for Accumulated Depreciation on test year plant by $8,044 (adjustment no. 5) from $2,532 to $10,576, and it recommends decreasing the pro forma adjustment for Accumulated Depreciation on post-test year plant additions by $216 (adjustment no. 4) from $516 to $300. Additionally, Staff removed $12,142 (adjustment no. 6) in retired post-test year plant from Accumulated Depreciation in accordance with NARUC – USOA accounting procedures.

<u>Rate Base Adjustment No. 7 – Cash Working Capital Allowance</u>

Q. What did the Company propose for its working capital allowance?

A. The Company proposed $2,906 for working capital Schedule B-5, page 2 of 2, of the filing shows that the proposed amount is composed of cash working capital, materials and supplies, required bank balances, and prepayments.

Q. Does Staff agree with the Company calculation?

A. No. Staff does not agree with the Company's proposed zero cash working capital component of the working capital allowance.

Q. Why does Staff disagree with the Company's proposed cash working capital component of the working capital?

A. The Company's proposed cash working capital is based on a lead-lag analysis that contains several conceptual and methodological errors.

Q. What is the result of Staff's lead-lag analysis?

A. Staff's lead-lag analysis indicates a negative $22,134 cash working capital component or a reduction of $22,134 compared to the Company's zero amount. In other words, ratepayers are providing working capital to the system.

Q. How else did Staff adjust Working Capital?

A. Staff increased the Materials and Supply Inventory by $235, from $476 to $711 as a result of materials that were transferred from Transmission and Distribution Expense to Working Capital.

Q. What Working Capital allowance is Staff recommending?

A. Staff recommends a working capital allowance of negative $18,993, as shown on Schedule REL-7.

<u>Rate Base Adjustment No. 8 – Allocated Post-Test Year Additions</u>

Q. Did Staff adjust the Company's Phoenix Office and Meter Shop post-test year additions?

A. Using the Company's allocation factors, Staff increased the Phoenix Office allocation by $1,600, and decreased the allocation by $473 which represents retired post-test year plant. Staff increased the Meter Shop allocation by $25. Staff's total adjustment increased the Phoenix Office and Meter shop allocations by $1,625, from $11,320 to $12,945. Staff's analysis is shown on Schedule REL-8.

Operating Income - Winkelman

Operating Income Summary

Q. What are Staff's recommended test year revenue, expenses, and operating income?

A. Staff's analysis resulted in test year revenue of $98,724 as adjusted by Staff, expenses of $89,149 and an operating income of $9,575 as shown on Schedules REL-9. Staff's adjustments are discussed below.

Operating Income Adjustment No. 1 – Revenue Annualization Adjustment

Q. How did the Company annualize revenue?

A. The Company multiplied 3 (that represent the average growth in customers on the Winkelman system during the test year) by $281 (which is the Company's determination of annual revenue per customer) which resulted in a revenue increase of $843.

Q. Did Staff make an adjustment to annual revenue in the Company's calculation?

A. Yes. Staff made a $702 adjustment to increase the Company's proposed annualization from $843 to $1,545. Staff's calculation of the adjustment is shown on Schedule REL-11. Staff's recalculation recognizes revenue from all meter sizes and calculates the average annual revenue per customer to be $515 rather than the Company's $281.

Operating Income Adjustment No. 2 – Purchased Pumping Power

Q. Did Staff adjust Purchased Pumping Power?

A. Yes. Staff accepted the Company's Purchased Pumping Power with the exception of a repaired pump inadvertently allocated and posted to Winkelman's expense. The $123 was reclassified and transferred to San Manuel's Plant In Service, Electric Pumping Equipment.

Operating Income Adjustment No. 3, 6 and 7 – Expense Annualization Adjustment

Q. Did Staff recalculate annualized expenses?

A. Yes. Staff's calculations for adjustments nos.3, 6 and 7and are shown on Schedule REL-13. Staff recommends an expense annualization adjustment of a $605, decreasing expenses by $4 compared to the Company's proposed adjustment of $609.

Operating Income Adjustment No. 4 – Water Treatment Expense

Q. Has Staff reviewed the Company's pro forma Chlorination Labor and Wages Expense?

A. Yes, Staff reviewed the Company's pro forma Chlorination Labor and Wages Expenses and found them not to be "known and measurable." Because of the uncertainties of the Company estimates, Staff used actual 2002 expenses. The amount applicable to Winkelman was increased from the Company's pro forma expense adjustment by $620, from $2,994 to $3,614, as shown on Schedule REL-14.

Operating Income Adjustment No. 5 – Water Testing Expense

Q. What is Arizona Water's proposed Water Testing Expense?

A. Arizona Water's proposed Water Testing Expense is $1,600 for the Winkelman system. Water Testing Expense is a component of the Company's $2,994 Water Treatment Expense shown on Schedule REL -9.

Q. Did Staff agree with the Company's Water Testing Expense?

A. No. Staff recommends this expense be based on Staff's water testing expense analysis of $1,222, which decreases annual operating expenses by $378. The adjustment is discussed in greater detail in the testimony of Staff witness Lyndon Hammon.

Operating Income Adjustment No. 7 – Transmission and Distribution Expense

Q. What adjustment did Staff make to Transmission and Distribution Expense?

A. Staff adjusted Transmission and Distribution Expense downward by $235. The Company inadvertently posted $235 to Transmission and Distribution Expense that should have been posted to Materials and Supplies Inventory. This entry reduces Transmission and Distribution Expense from $14,855 to $14,620, as shown on Schedule REL-16.

Operating Income Adjustment No. 9 – Rate Case Expense

Q. What Rate Case Expense did Arizona Water propose for the Winkelman system?

A. The Company proposed total Rate Case Expense of $1,751 for the Winkelman system. Rate Case Expense is a component of the Company's proposed $13,395 Administrative and General Expense shown on Schedule REL-9.

Q. Does Staff agree that the Company's Rate Case Expense for the Winkelman system is reasonable?

A. No. Staff does not agree that the Company's proposed Rate Case Expense amount is reasonable.

Q. What amount does Staff recommend allocating to the Winkelman system?

A. Staff recommends allocating $1,230 to the Winkelman system. Staff's recommended allocation uses the Company-proposed allocation factor of 0.00680 percent ($180,913 x 0.00680 = $1,230). Staff's recommended annual Rate Case Expense of $246 ($1,230 amortized over five years), is a decrease of $338 from the Company's request, as shown on Schedule REL-17.

Operating Income Adjustment No. 10 – Charitable Contributions Expense

Q. Did the Company remove charitable contributions from its test year expenses?

A. No, even though charitable contributions bear no relationship to the provision of water service. Therefore, Staff removed $99 from the Administrative and General account as shown on REL-18.

Operating Income Adjustment Nos. 11 – Depreciation and Amortization Expense

Q. What did the Company propose for depreciation expense?

A. The Company proposed $13,888 for depreciation expense. The Company's proposal includes two pro forma adjustments. The Company's pro forma adjustment no. 17, as shown on Schedule C-2, page 31 of 36 of the filing, increased depreciation expense by $2,532 provide an additional six months of depreciation expense on test year plant additions. The Company's pro forma adjustment no. 18, also shown on Schedule C-2, page 32 of 36 of the filing, increased depreciation expense by $516 to provide twelve months of depreciation expense on the Company's proposed post-test year plant additions that were projected to be completed by December 31, 2002.

Q. Does Staff agree with the Company's proposed depreciation expense?

A. No. Depreciation expense should reflect application of the depreciation rate applicable to the authorized balance for each plant account. Previously, Staff recommended disallowing a portion of the Company's proposed post-test year plant additions to remove plant that was not in service by Staff's cut-off date, December 31, 2002, or was not revenue neutral. The difference between Staff's plant recommendation and the Company's causes a corresponding difference in depreciation expense. In addition, the Company calculated its depreciation expense using dated component depreciation rates that it later corrected. Staff reviewed and accepted the new depreciation rates which were used in calculating rates.

Q. Please summarize Staff's recommendations for depreciation expense.

A. Staff recommends $13,706 for depreciation expense, a $182 decrease from the Company's proposed $13,888. Staff's calculation includes the amortization of CIAC at the weighted proposed depreciation rates. Staff's recommendation is shown on Schedule REL-19.

Operating Income Adjustment No. 14– Property Taxes

Q. What is Arizona Water proposing for property tax expense?

A. The Company is proposing property tax expense of $15,730.

Q. Does Staff agree with the Company's amount?

A. No. The Department of Revenue Property Valuation and Equalization Section developed a new method to calculate property taxes. Staff adopted this new method of calculating property taxes.

Q. What amount of property tax expense does Staff recommend?

A. Staff recommends property tax expense of $16,751, an increase of $1,021 from the Company's proposal of $15,730, as shown on Schedule REL-20.

Operating Income Adjustment No. 13 – Income Taxes

Q. What income tax expense does Arizona Water propose?

A. The Company proposed $1,732 in federal taxes and $126 in state income tax for a combined federal and state income tax of $1,858.

Q. Does Staff agree with the Company's amount?

A. No. Staff does not agree with the Company's calculation because income tax expense is a function of taxable income, and Staff's recommended taxable income is different from the Company's.

Q. What amount is Staff recommending for test year income tax expense?

A. As shown on Schedules REL-21, Staff recommends a federal income tax of $1,801 and state income tax of $397 for a combined income tax of $2,198.

Q. What amount of income tax expense has Staff calculated for its recommended revenue?

A. As shown on Schedules REL-2, Staff recommends federal income tax of $7,147 and state income tax of $1,574 for a combined income tax of $8,721.

Rate Design - Winkelman

Rate Design

Q. Did Staff prepare a schedule summarizing the present, Company-proposed, and Staff's recommended rates and charges?

A. Yes. Schedule REL-22 provides a summary of the present rates, Company-proposed rates, and Staff's recommended rates.

Q. Please summarize the present rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include 1,000 gallons and one commodity rate applies to all use.

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

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons and one commodity rate applies to all use.

Q. Please summarize Staff's rate design.

A. Customer class is distinguished by meter size. The monthly minimum charges vary by meter size and include no gallons. The commodity rates are based on an inverted tier rate design that includes three tiers with the first break-point at 3,000 gallons and the second break-point at 50,000 gallons. The three-tier rate structure applies to all metered customers.

Arizona Water Company - Winkelman
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Schedule REL-1

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION		[A] COMPANY ORIGINAL COST		[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	$	265,899	$	232,924
2	Adjusted Operating Income (Loss)	$	9,436	$	9,575
3	Current Rate of Return (L2 / L1)		3.55%		4.11%
4	Required Rate of Return		11.0000%		8.5660%
5	Required Operating Income (L4 * L1)	$	29,249	$	19,952
6	Operating Income Deficiency (L5 - L2)	$	19,813	$	10,377
7	Gross Revenue Conversion Factor		1.63241		1.63195
8	Increase In Gross Revenue (L7 • L6)	$	32,343	$	16,935
9	Adjusted Test Year Revenue	$	98,022	$	98,724
10	Proposed Annual Revenue (L8 + L9) Note A	$	129,358	$	115,659
11	Require Increase in Revenue (%) (L8/L9)		31.97%		17.15%

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Schedule REL- 2

Line No.					
	Calculation of Gross Revenue Conversion Factor:				
1	Recommended Revenue Increase:				
2	Billings		1.000000		
3	Combined Federal and State Income Tax Rate	38.59888%			
4	Uncollectible Rate After Income Taxes	0.12477%			
5	Total Tax Rate		38.72365%		
6	Gross Revenue Conversion Factor		**1.631951**		
	Calculation of Effective Income Tax Rate:				
7	Operating Income Before Taxes (Arizona Taxable Income)	100.00000%			
8	Arizona State Income Tax Rate	6.96800%			
9	Federal Taxable Income (L5 - L6)	93.03200%			
10	Applicable Federal Income Tax Rate (Line 32)	34.00000%			
11	Effective Federal Income Tax Rate (L7 x L8)	31.63088%			
12	Combined Federal and State Income Tax Rate (L6 +L9)	38.59888%			
	Calculation of Uncollectible Rate After Income Taxes:				
13	Uncollectible Rate		0.20320%		
14	Combined Federal and State Income Tax Rate	38.59888%			
15	1 minus Combined Federal and State Income Tax Rate		61.40112%		
16	Uncollectible Rate After Income Taxes		0.12477%		
	Revenue Reconciliation:				
17	Recommended Increase in Revenue (from REL-1, L8)	$ 16,935			
18	Uncollectible Rate	0.203200%			
19	Required Increase in Revenue to Provide for Uncollectibles		$ 34		
20	Recommended Increase in Revenue (from REL-1,L8)	$ 16,935			
21	Required Increase in Revenue to Provide for Uncollectibles	34			
22	Incremental Taxable Income	$ 16,900			
23	Combined Federal and State Income Tax Rate	38.59888%			
24	Required Increase in Revenue to Provide for Income Taxes		6,523		
25	Required Operating Income	$ 19,952			
26	Adjusted Test Year Operating Income (Loss)	9,575			
27	Required Increase in Operating Income		10,377		
28	Total Required Increase In Revenue		$ 16,935		
	Calculation of Income Tax:	Test Year		STAFF Recommended	
29	Revenue	$ 98,724		$ 115,659	
30	Less: Operating Expenses Excluding Income Taxes	$ 86,951		$ 86,986	
31	Less: Synchronized Interest	$ 6,079		$ 6,079	
32	Arizona Taxable Income	$ 5,694		$ 22,594	
33	Arizona State Income Tax Rate	6.968%		6.968%	
34	Arizona Income Tax		$ 397		$ 1,574
35	Federal Taxable Income	$ 5,297		$ 21,020	
36	Federal Income Tax @ 34%		$ 1,801		$ 7,147
37	Combined Federal and State Income Tax		$ 2,198		$ 8,721
				$ 6,523	
	Calculation of Interest Synchronization:				
38	Rate Base	$ 232,924			
39	Weighted Average Cost of Debt	2.610%			
40	Synchronized Interest	$ 6,079			

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Schedule REL-3

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	Plant in Service	$ 428,421	$ (7,294)	$ 421,127
2	Less: Accumulated Depreciation	(119,404)	(4,934)	(124,338)
3	Net Plant in Service	$ 309,017	$ (12,228)	$ 296,789
	LESS:			
4	Advances in Aid of Construction (AIAC)	(20,855)	-	(20,855)
5	Contributions in Aid of Construction (CIAC)	$ (1,835)	$ -	$ (1,835)
6	Less: Accumulated Amortization	264	-	264
7	Net CIAC	(1,571)	-	(1,571)
8	Total Advances and Contributions	(22,426)	-	(22,426)
9	Customer Deposits	-	-	-
10	Meter Advances	-	-	-
11	Deferred Income Tax Credits	(34,918)	-	(34,918)
	ADD:			
12	Working Capital	2,906	(21,899)	(18,993)
13	Phoenix Office Allocation	11,089	1,127	12,216
14	Meter Shop Allocation	231	25	256
17		-	-	-
18	**Total Rate Base**	$ 265,899	$ (32,975)	$ 232,924

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Schedule REL-4

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ. No. 8	[J] ADJ. No. 9	[L] STAFF ADJUSTED
	PLANT IN SERVICE:											
1	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Franchises	2,072	-	-	-	-	-	-	-	-	-	2,072
3	Other Intangibles	-	-	-	-	-	-	-	-	-	-	-
4	Water Rights	432	-	-	-	-	-	-	-	-	-	432
5	Other Source of Supply Land	422	-	-	-	-	-	-	-	-	-	422
6	Wells	48,327	-	-	-	-	-	-	-	-	-	48,327
7	Pumping Plant Land	-	-	-	-	-	-	-	-	-	-	-
8	Pumping Plant Structures & Improvements	6,073	-	-	-	-	-	-	-	-	-	6,073
9	Electric Pumping Equipment	89,117	-	-	-	-	-	-	-	-	-	89,117
10	Gas Engine Equipment	-	-	-	-	-	-	-	-	-	-	-
11	Water Treatment Land	-	-	-	-	-	-	-	-	-	-	-
12	Water Treatment Structures & Improvmnts	3,906	-	-	-	-	-	-	-	-	-	3,906
13	Water Treatment Equipment	16,417	-	-	-	-	-	-	-	-	-	16,417
14	Transmission and Distribution Land	-	-	-	-	-	-	-	-	-	-	-
15	Storage Tanks	28,861	-	-	-	-	-	-	-	-	-	28,861
16	Transmission and Distribution Mains	116,404	-	-	-	-	-	-	-	-	-	116,404
17	Fire Sprinkler Taps	-	-	-	-	-	-	-	-	-	-	-
18	Services	51,591	-	-	-	-	-	-	-	-	-	51,591
19	Meters	19,182	-	-	-	-	-	-	-	-	-	19,182
20	Hydrants	16,294	-	-	-	-	-	-	-	-	-	16,294
21	General Plant Land	-	-	-	-	-	-	-	-	-	-	-
22	General Plant Structures	127	-	-	-	-	-	-	-	-	-	127
23	Leasehold Improvements	-	-	-	-	-	-	-	-	-	-	-
24	Office Furniture and Improvements	-	-	-	-	-	-	-	-	-	-	-
25	Warehouse Equipment	-	-	-	-	-	-	-	-	-	-	-
26	Tools, Shop and Garage Equipment	1,296	-	-	-	-	-	-	-	-	-	1,296
27	Laboratory Equipment	-	-	-	-	-	-	-	-	-	-	-
28	Power Operated Equipment	-	-	-	-	-	-	-	-	-	-	-
29	Communication Equipment	10,734	-	-	-	-	-	-	-	-	-	10,734
30	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-	-	-
31	Total Plant in Service - Actual	411,255	-	-	-	-	-	-	-	-	-	411,255
	Pro-forma Adjustment - Post TY Plant	17,166	4,375		-	-	-	-	-	-	-	21,541
32	Post Test Year - Retired Plant	-		(11,669)								(11,669)
33	Total Plant in Service - Adjusted	$ 428,421	$ 4,375	$ (11,669)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 421,127
34	Less: Accumulated Depreciation - Actual	$ (116,356)		-	(620)	-	-	-	-	-	-	(116,976)
35	Less: Accumulated Depreciation - Post T Y	(516)		-	-	(216)	-	-	-	-	-	(732)
36	Less: Accumulated Depreciation - 12 Mos T Y	(2,532)		-	-	-	8,044	-	-	-	-	5,512
37	Less: Accumulated Depreciation - Retired Plant	-						(12,142)				(12,142)
38	Total Accumulated Depreciation - Adjusted	$ (119,404)	$ -	$ -	$ (620)	$ (216)	$ 8,044	$ (12,142)	$ -	$ -	$ -	$ (124,338)
39	Plus: Construction Work In Progress	-	-	-	-	-	-	-	-	-	-	-
40	Net Plant in Service	$ 309,017	$ 4,375	$ (11,669)	$ (620)	$ (216)	$ 8,044	$ (12,142)	$ -	$ -	$ -	$ 296,789
	LESS:											
41	Advances in Aid of Construction (AIAC)	$ (20,855)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	(20,855)
42	Contributions in Aid of Construction (CIAC)	(1,835)	-	-	-	-	-	-	-	-	-	(1,835)
43	Less: Accumulated Amortization	264	-	-	-	-	-	-	-	-	-	264
44	Net CIAC (L25 - L26)	(1,571)	-	-	-	-	-	-	-	-	-	(1,571)
45	Total Advances and Contributions	(22,426)	-	-	-	-	-	-	-	-	-	(22,426)

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Schedule REL-4

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	[G] ADJ No. 6	[H] ADJ No. 7	[I] ADJ. No. 8	[J] ADJ. No. 9	[L] STAFF ADJUSTED
46	Customer Deposits	-	-	-	-	-	-	-	-	-	-	-
47	Meter Advances	-	-	-	-	-	-	-	-	-	-	-
48	Deferred Income Tax Credits	(34,918)	-	-	-	-	-	-	-	-	-	(34,918)
	ADD:											
49	Working Capital Allowance	2,906	-	-	-	-	-	-	(21,899)	-	-	(18,993)
50	Phoenix Office Allocation	11,089	-	-	-	-	-	-	-	1,127	-	12,216
51	Meter Shop Allocation	231	-	-	-	-	-	-	-	-	25	256
52	Projected Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-
53	Deferred Debits	-	-	-	-	-	-	-	-	-	-	-
54	Other Additions	-	-	-	-	-	-	-	-	-	-	-
55	**Total Rate Base**	$ 265,899	$ 4,375	$ (11,669)	$ (620)	$ (216)	$ 8,044	$ (12,142)	$ (21,899)	$ 1,127	$ 25	$ 232,924

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Schedule REL-5

RATE BASE ADJUSTMENT NOS. 1 and 2 - PLANT IN SERVICE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Actual Test Year Plant	$ 411,255	$ -	$ 411,255
2	Post-Test Year Plant	$ 17,166	$ 4,375	$ 21,541
3	Post-Test Year Retired Plant	$ -	$ (11,669)	$ (11,669)
	Adjusted Test Year Plant	**$ 428,421**	**$ (7,294)**	**$ 421,127**

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Schedule REL-6

RATE BASE ADJUSTMENT NOS.3, 4, 5 AND 6 - ACCUMULATED DEPRECIATION

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Accumulated Depreciation, Actual	$ (116,356)	$ 620	$ (115,736)
2	Accumulated Depreciation, Post-Test Year Plant	$ (516)	$ 216	$ (300)
3	Accumulated Depreciation, Test Year Plant	$ (2,532)	$ (8,044)	$ (10,576)
4	Accumulated Depreciation, Retired Plant	$ -	$ 12,142	$ 12,142
		$ (119,404)	**$ 4,934**	**$ (114,470)**

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Schedule REL- 7

OPERATING INCOME ADJUSTMENT NO. 7 - CASH WORKING CAPITAL

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Cash Working Capital	$ -	$ (22,134)	$ (22,134)
2	Materials and Supplies Inventory	476	235	711
3	Required Bank Balances	1,545	-	1,545
4	Prepayments and special Deposits	885	-	885
5	Total	$ 2,906	$ (21,899)	$ (18,993)

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Schedule REL-8

RATE BASE ADJUSTMENT NOS. 8 and 9 - PLANT IN SERVICE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF AS ADJUSTED
1	Phoenix Office Allocation	$ 11,089	$ 1,600	$ 12,689
2	Meter Shop Allocations	$ 231	$ 25	$ 256
3	Phoenix Office Allocation - Retirements	$ -	$ (473)	$ (473)
4	Meter Shop Allocation - Retirements	$ -	$ -	$ -
	Adjusted Test Year Plant	**$ 11,320**	**$ 1,152**	**$ 12,472**

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Schedule REL-9

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:					
1	Total Operating Revenues	$ 98,022	$ 702	$ 98,724	$ 16,935	$ 115,659
	EXPENSES:					
	Source of Supply Expenses:					
2	Purchased Water	$ -	$ -	$ -	$ -	$ -
3	Other	759	-	759	-	759
	Pumping Expenses:	-	-	-	-	-
4	Purchased Power	7,793	(122)	7,671	-	7,671
5	Purchased Gas	-	-	-	-	-
6	Other	4,034	-	4,034	-	4,034
7	Water Treatment Expenses	2,994	242	3,236	-	3,236
8	Transmission and Distribution Expenses	14,855	(237)	14,618	-	14,618
9	Customer Account Expenses	11,844	(2)	11,842	34	11,876
10	Sales Expenses	56	-	56	-	56
11	Administrative and General Expenses	13,395	(437)	12,958	-	12,958
12	Total Operation and Maintenance	55,730	(556)	55,174	34	55,209
13	Depreciation and Amortization	13,888	(242)	13,646	-	13,646
15	Ad Valorem (Property)	15,730	1,021	16,751	-	16,751
	Taxes:					
14	Federal & State Income Tax	1,858	340	2,198	6,523	8,721
16	Other	1,380	-	1,380	-	1,380
17	**Total Operating Expenses**	$ 88,586	$ 563	$ 89,149	$ 6,558	$ 95,707
18	**Operating Income (Loss)**	$ 9,436	$ 139	$ 9,575	$ 10,377	$ 19,952

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Schedule REL-10

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] ADJ #8	[J] ADJ #9	[K] ADJ #10	[L] ADJ #11	[M] ADJ #12	[N] ADJ #13	[O] ADJ #14	[P] STAFF ADJUSTED
	REVENUES:																
1	**Total Operating Revenues**	$ 98,022	$ 702	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 98,724
	EXPENSES:																
	Source of Supply Expenses:																
2	Purchased Water	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Other	759	-	-	-	-	-	-	-	-	-	-	-	-	-	-	759
	Pumping Expenses:																
4	Purchased Power	7,793	-	(123)	1	-	-	-	-	-	-	-	-	-	-	-	7,671
5	Purchased Gas	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Other	4,034	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4,034
7	Water Treatment Expenses	2,994	-	-	-	620	(378)	-	-	-	-	-	-	-	-	-	3,236
8	Transmission and Distribution Expenses	14,855	-	-	-	-		(2)	(235)	-	-	-	-	-	-	-	14,618
9	Customer Account Expenses	11,844	-	-	-	-	-	-	-	(2)	-	-	-	-	-	-	11,842
10	Sales Expenses	56	-	-	-	-	-	-	-	-	-	-	-	-	-	-	56
11	Administrative and General Expenses	13,395	-	-	-	-	-	-		-	(338)	(99)	-	-	-	-	12,958
12	Total Operation and Maintenance	55,730	-	(123)	1	620	(378)	(2)	(235)	(2)	(338)	(99)	-	-	-	-	55,174
13	Depreciation and Amortization	13,888	-	-	-	-	-						(242)				13,646
15	Ad Valorem (Property)	15,730	-	-	-	-	-	-	-	-		-	-	1,021	-	-	16,751
	Taxes:																
14	Federal & State Income Tax	1,858	-	-	-	-	-	-	-	-		-	-	-	69	271	2,198
16	Other	1,380															1,380
17	**Total Operating Expenses**	$ 88,586	$ -	$ (123)	$ 1	$ 620	$ (378)	$ (2)	$ (235)	$ (2)	$ (338)	$ (99)	$ (242)	$ 1,021	$ 69	$ 271	$ 89,149
18	**Operating Income (Loss)**	$ 9,436	$ 702	$ 123	$ (1)	$ (620)	$ 378	$ 2	$ 235	$ 2	$ 338	$ 99	$ 242	$ (1,021)	$ (69)	$ (271)	$ 9,575

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Schedule REL- 11

OPERATING INCOME ADJUSTMENT NO. 1 - REVENUE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Avg No. of Additional Cust. Served During TY	3		3
2	Avg Annual Bill Per Customer for TY	281		515
3	Avg Annual Revenue for Additional Customers	$ 843	$ 702	$ 1,545

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Schedule REL-12

OPERATING INCOME ADJUSTMENT NO. 2 - PURCHASED PUMPING POWER EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Purchased Pumping Power Expense	$ 7,793	$ (123)	$ 7,670

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Schedule REL- 13

OPERATING INCOME ADJUSTMENT NOS. 3, 6 and 8 - EXPENSE ANNUALIZATION

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Source of Supply	$ 12	$ -	$ 12
2	Purchased Pumping Power	188	1	189
3	Water Treatment Expense	55	-	55
4	Transmission & Distribution Expense	166	(2)	164
5	Customer Accounting	188	(2)	186
6	Total	$ 609	$ (3)	$ 606

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Schedule REL- 14

OPERATING INCOME ADJUSTMENT NO. 4 - WATER TREATMENT EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Water Treatment	$ 2,994	$ 620	$ 3,614

1 Actual 2002 chlorine expense - supercedes company pro-forma.

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Schedule REL-15

OPERATING INCOME ADJUSTMENT NO. 5 - WATER TESTING EXPENSE

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Annual Water Testing Expense	$ 1,600	$ (378)	$ 1,222

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Schedule REL-16

OPERATING INCOME ADJUSTMENT NO. 7 - TRANSMISSION AND DISTRIBUTION EXPENSE

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENTS**	**STAFF AS ADJUSTED**
1	Transmission and Distribution Expense	$ 14,855	$ (235)	$ 14,620

1 Expense reclassed to Materials and Supplies Inventory.

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Schedule REL- 17

OPERATING INCOME ADJUSTMENT NO. 9 - RATE CASE EXPENSE

		(A)	(B)	(C)
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Rate Case Expense for Eastern Group	$ 257,550	$ (76,637)	$ 180,913
2	Allocation Factor	0.00680		0.00680
3	Annual Rate Case Expense for Eastern Group	$ 1,751	$ (521)	$ 1,230
4	Number of Years Amortized	3		5
5	Annual Rate Case Expense	$ 584	$ (338)	$ 246

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Schedule REL-18

OPERATING INCOME ADJUSTMENT NO. 10 - CHARITABLE CONTRIBUTIONS

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Charitable Contributions, Gifts, Awards, Etc.	$ 99	$ (99)	$ -

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Schedule REL-19

OPERATING INCOME ADJUSTMENT NO. 11 - DEPRECIATION EXPENSE INCL. POST-TEST YEAR PLANT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Depreciation Expense	$ 13,888	$ (182)	$ 13,706
2	CIAC Amortization		(60)	(60)
		$ 13,888	$ (242)	$ 13,646

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Schedule REL 20

OPERATING INCOME ADJUSTMENT NO. 12 - PROPERTY TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTMENT
1	2000 Annual Gross Revenues			$ 88,776
2	2001 Annual Gross Revenues			$ 97,628
3	2002 Annual Gross Revenues			$ 93,460
4	Plus Staff's Recommended Increase			$ 16,935
5	Subtotal (Lines 1 + 2 + 3 + 4)			$ 296,799
6	Three Year Average Calculation			3
7	Three Year Average (Line 5 / Line 6)			$ 98,933
8	Department of Revenue Multiplier			2
9	Revenue Base Value (Line 7 x Line 8)			$ 197,866
10	Plus: 10% of 2001 CWIP			
11	Less: Net Book Vaule of Leased Vehicles (See Note A Below)			$
12	Full Cash Value (Line 9 + Line 10 - Line 11)			$ 197,866
13	Assessment Ratio			0.25
14	Assessed Value (Line 12 x Line 13)			$ 49,467
15	Composite Property Tax Rate (See Note B Below)			0.33863
16	**Staff Proposed Property Tax Expense (Line 14 x Line 15)**	$ 15,730	$ 1,021	$ 16,751

Note A: Net Book Value of Licensed Vehicles provided by Arizona Water in Data Request REL 24-1.

Note B: Property tax rate provided by Arizona Dept. of Revenue.

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Schedule REL- 21

OPERATING INCOME ADJUSTMENT NOS.13 and 14 - INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENT	(C) STAFF AS ADJUSTED
1	Federal Income Taxes	$ 1,732	$ 69	$ 1,801
2	State Income Taxes	126	271	397
3	Total Income Taxes	$ 1,858	$ 340	$ 2,198

ARIZONA WATER COMPANY - WINKELMAN
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RATE DESIGN

	Minimum Monthly Usage Charge		
	Present	---Proposed Rates---	
Monthly Usage Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$ 12.95	$ 17.30	$ 12.95
1" Meter	$ 24.86	$ 38.23	$ 39.66
2" Meter	$ 62.15	$ 110.72	$ 57.90
3" Meter	$ 103.58	$ 198.95	$ 227.22
4" Meter	$ 207.16	$ 354.65	$ 494.41
6" Meter	$ 362.53	$ 674.70	$ 616.16
8" Meter	$ 362.53	$ 934.20	$ 764.18
10" Meter	$ 673.27	$ 1,530.88	$ 935.02
Gallons Included In Minimum Charge:			
5/8" x 3/4" Meter	1,000	0	0
1" Meter	1,000	0	0
2" Meter	1,000	0	0
3" Meter	1,000	0	0
4" Meter	1,000	0	0
6" Meter	1,000	0	0
8" Meter	1,000	0	0
10" Meter	1,000	0	0
Fire Hydrants Used For Construction Water	1,000	0	0
Commodity Rates :			
Per 1,000 Gallons (In Excess of Minimum)	$ 1.2330	N/A	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	$ 1.2330	$ 1.4910	$ 1.0240
Per 1,000 Gallons for 3,001 to 50,000 Gallons	$ 1.2330	$ 1.4910	$ 1.2800
Per 1,000 Gallons for Gallons in Excess of 50,000	$ 1.2330	$ 1.4910	$ 1.5360
Service Line and Meter Installation Charge:			
5/8" x 3/4" Meter	(a)	(a)	(a)
1" Meter	(a)	(a)	(a)
2" Meter	(b)	(b)	(b)
3" Meter	(b)	(b)	
4" Meter	(b)	(b)	(b)
6" Meter	(b)	(b)	(b)

(a) No charge for 5/8" and 1" if on existing pipelines. Full cost for 5/8" and 1" if if on new pipelines.
(b) Full cost for 2"and larger if on existing or new pipelines.

ARIZONA WATER COMPANY - WINKELMAN
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RATE DESIGN
CONTINUED

	Present Rates	---Proposed Rates--- Company	Staff
Service Charges:			
Establishment	$ 16.00	$ 16.00	$ 16.00
Guarantee Deposit	**(c)**	**(c)**	**(c)**
Reconnection for Delinquency (per disconnection)	$ 16.00	$ 16.00	$ 16.00
Re-establishement	**(d)**	**(d)**	**(d)**
Service Call Out (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Returned Check Charge	$ 10.00	$ 25.00	$ 25.00
Meter Re-read (After Regular Working Hours Only)	$ 35.00	$ 35.00	$ 35.00
Meter Test	$ 50.00	$ 50.00	$ 50.00
Late Charge	N/A	**(e)**	**(e)**

(c) Per Commission Rule A.A.C. R14-2-403B
(d) Eight (8) times the customer's monthly minimum charge,
or payment of the minimums since disconnection, whichever is less.
N/A No current tariff.
(e) 1.5 percent after 15 days

ARSENIC REMOVAL RECOVERY MECHANISM

ARSENIC

Q. Has Staff addressed the Arsenic issues associated with certain systems within the Eastern Group?

A. Yes, as noted in Mr. Hammon's direct testimony, no post-test year plant or test year capital additions for arsenic were included in this case, and there is currently no arsenic removal plant constructed in the Eastern Group. However, the recommended order for the Northern Group is pending and therefore Staff's recommendation regarding a arsenic cost recovery system can not be finalized until the Commission determines what action it accepts in dealing with this issue for the Northern Group.

Q. Does this conclude Staff's direct testimony?

A. Yes, it does.