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BEFORE THE ARIZONA CORPORATION COMMISSION

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2007 NOV 20 P 1:27
AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA WATER COMPANY, AN ARIZONA
CORPORATION, FOR AUTHORITY TO
IMPLEMENT ARSENIC COST RECOVERY
MECHANISM FOR ITS SAN MANUEL
SYSTEM IN ITS EASTERN GROUP.

Docket No. W-01445A-02-0619

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides its Audit Report of Arizona Water Company's September 4, 2007 filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 1 rate increase for its Eastern Group San Manuel System.

RESPECTFULLY SUBMITTED this 20th day of November 2007.

Arizona Corporation Commission
DOCKETED
NOV 20 2007

Scott S. Wakefield
Chief Counsel

DOCKETED BY nr

1 AN ORIGINAL AND THIRTEEN COPIES
2 of the foregoing filed this 20th day
3 of November 2007 with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
6 Phoenix, Arizona 85007

6 COPIES of the foregoing hand delivered/
7 mailed this 20th day of November 2007 to:

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TO: Stephen Ahearn, Director
Scott Wakefield, Chief Counsel
Marylee Diaz Cortez, Chief of Accounting and Rates

FROM: William A. Rigsby

DATE: November 20, 2007

RE: Report on RUCO's audit of Arizona Water Company's September 4, 2007 filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 1 rate increase for its Eastern Group San Manuel System.

AUDIT OBJECTIVE: The purpose and objective of this audit was to verify the capital expenditures of Arizona Water Company's ("Arizona Water" or "Company") recently completed arsenic removal facilities in the Company's Eastern Group San Manuel System, to verify that the facilities are actually in service, to verify compliance with Decision Nos. 68310 and 66400 (which authorized the ACRM), and to verify the accuracy of the Company-requested ACRM surcharge. Arizona Water is seeking recovery of \$1,132,128 in capital expenditures related to the Company's Superstition system which provides service to customers in San Manuel in Southern Arizona.

AUDIT PROCEDURES: The following audit procedures were performed:

- 1) Verified that all schedules that are required by Decision No. 66400 are included in the application.
- 2) Reviewed Earnings Test for compliance, accuracy, and determined if the Company had passed the Earnings Test.
- 3) Reviewed all arsenic plant invoices, looking for such things as misallocations, unreasonable costs, non-arsenic plant costs, double billings etc.
- 4) Verified accuracy of Work Authorization Order totals and grand total.
- 5) Reviewed Revenue Requirement calculations for accuracy and compliance.

- 6) Reviewed rate design for compliance with 50/50 requirement, accuracy of calculations, and checked the reasonableness of the billing determinants by comparing to the prior rate case.
- 7) Traveled to San Manuel and verified that the Company's arsenic removal facilities are actually in service.

AUDIT FINDINGS:

Unlike the Company's previous filing for its Northern Group Sedona and Rimrock Systems, none of the Eastern Group San Manuel System facilities are leased. The arsenic recovery facilities serving San Manuel are owned by Arizona Water.

The arsenic removal facility serving San Manuel was in operation at the time of my visit on November 16, 2007. According to Arizona Water personnel, who provided me with a tour of the plant, the arsenic removal equipment was placed into service on August 22, 2007.

The San Manuel plant uses the coagulation/filtration method for removing arsenic from water that the Company purchases from a former copper mining concern.

The majority of the funds that the Company is seeking recovery for are associated with the actual arsenic removal plant itself, as opposed to site preparation and peripheral type improvements that were a large part of the Company's prior Sedona/Rimrock filing.

The Company applied the 2.58 percent rate of depreciation that was ordered in Decision No. 66849.

RUCO has not found any discrepancies in the Company's ACRM Application.

AUDIT RECOMMENDATIONS:

The Company's ACRM request should be adopted by the Arizona Corporation Commission.