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BEFORE THE ARIZONA CORPORATION COMMISSION
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8 IN THE MATTER OF THE APPLICATION OF
9 ARIZONA-AMERICAN WATER COMPANY,
10 INC., AN ARIZONA CORPORATION, FOR A
11 DETERMINATION OF THE CURRENT FAIR
12 VALUE OF ITS UTILITY PLANT AND
13 PROPERTY AND FOR INCREASES IN ITS
14 RATES AND CHARGES BASED THEREON
15 FOR UTILITY SERVICE BY ITS PARADISE
16 VALLEY WATER DISTRICT.

Docket No. W-01303A-05-0405

12 IN THE MATTER OF THE APPLICATION OF
13 ARIZONA-AMERICAN WATER COMPANY
14 FOR APPROVAL OF AN AGREEMENT
15 WITH THE PARADISE VALLEY COUNTRY
16 CLUB.

Docket No. W-01303A-05-0910

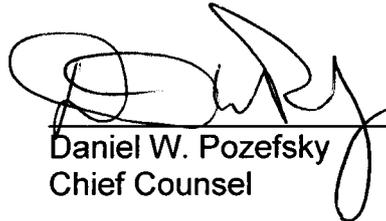
**NOTICE OF FILING RUCO'S REPORT ON
STEP TWO ARSENIC FILING - PARADISE VALLEY DISTRICT**

On March 13, 2008, Arizona American Water Company filed its Step Two ACRM filing for its Paradise Valley Water District, seeking a surcharge of \$2.41 to the monthly minimum charge, and \$0.0746 per 1,000 gallons to the commodity rate.

The Residential Utility Consumer Office ("RUCO") hereby files its Report on its audit of the ACRM filing. RUCO recommends a surcharge of \$0.72 to the monthly minimum

1 charge and \$0.0222 per 1,000 gallons to the commodity rate, as presented in the
2 Company's Step Two ACRM Schedules filed on March 13, 2008.

3
4 RESPECTFULLY SUBMITTED this 8th day of July 2008.

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6 
7 Daniel W. Pozefsky
8 Chief Counsel

9 AN ORIGINAL AND FIFTEEN
10 COPIES of the foregoing filed this
11 8th day of July 2008 with:

12 Docket Control
13 Arizona Corporation Commission
14 1200 West Washington Street
15 Phoenix, Arizona 85007

16 COPY of the foregoing hand delivered/
17 mailed this 8th day of July 2008 to:

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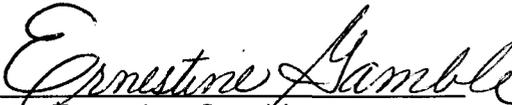
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9 By 
Ernestine Gamble

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TO: Stephen Ahearn, Director
Marylee Diaz Cortez, CPA, Chief of Accounting and Rates

FROM: William A. Rigsby, Public Utilities Analyst V

RE: Report on RUCO's audit of the Arizona-American Water Company filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 2 rate increase for its Paradise Valley system.

AUDIT OBJECTIVE: The purpose and objective of this audit was to verify the operations and maintenance ("O&M") expenditures of the completed arsenic plant in the Paradise Valley Water District ("Paradise Valley" or "Company"), to verify the prior 12 months of deferred O&M costs and the ongoing O&M costs, verify compliance with Decision Nos. 68310 and 66400 authorizing the ACRM, and verify the accuracy of the requested ACRM surcharge.

AUDIT PROCEDURES: I performed the following audit procedures:

- 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 O&M invoices, looking for such things as misallocations, unreasonable costs, non-arsenic O&M costs, double billings etc.
- 4) Verified accuracy of invoice totals and grand total.
- 5) Reviewed Revenue Requirement calculations for accuracy and compliance.
- 6) Reviewed rate design for accuracy of calculations, and checked the reasonableness of the billing determinants by comparing to the instant rate case.

AUDIT FINDINGS:

The Paradise Valley ACRM filing is accurate and in compliance with Decision Nos. 68310 and 66400 with the following two exceptions:

- 1) Contrary to Decision No. 68310, the Company is requesting recovery of additional arsenic plant. Under Decision No. 68310 the Company is authorized to recover only O&M costs and not capital costs.

Decision No. 68310 authorizes the implementation of an ACRM to the extent described within the Order.

- 2) On page 8 of Decision No. 68310, Mr. Broderick describes in-depth what costs would be recoverable in each step of the ACRM. Item a) on page 8 states: "In the first step filing.....the Company could seek recovery of capital costs for arsenic treatment facilities that are up and running. Item c) on page 8 states: "In the second step filing.....the Company could seek recognition of the prior 12 months of deferred O&M costs, as well as ongoing O&M costs.

- 2) Through discovery, discrepancies in the amounts of \$5,390.75 and \$888.73 were uncovered in the costs of chemicals and sludge removal respectively. Therefore, the actual O&M cost for chemicals was reduced \$6,279 from \$74,593 to \$68,314. The adjustment for \$5,390.75 represented the difference between what the Company sought recovery for and the total of the invoices that were provided in support of chemicals expense during 2007. The adjustment for \$888.73 represented a purchase of \$797.08 that was incurred outside of the 12 month period used to collect O&M data, and a math error of \$91.65.

AUDIT RECOMMENDATIONS:

The Company's ACRM request should be adjusted to remove the request for recovery of additional arsenic plant in service not recovered by the existing Step 1 Surcharge and only reflect the recovery of the eligible arsenic O&M costs. These recommended adjustments and the resultant RUCO recommended ACRM step 2 rate increases are displayed on the attached Schedule RUCO ACRM-2.

RUCO ADJUSTMENT TO ACRM - PARADISE VALLEY WATER DISTRICT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] RUCO ADJUSTMENT	[C] RUCO AS ADJUSTED
1	Arsenic Plant Revenue Requirement			
	Gross Arsenic Plant in Service/Rate Base	\$ 2,587,299	\$ (2,587,299)	\$ -
	Accumulated Depreciation Of Arsenic Plant (Step 1)	\$ (636,636)	\$ 636,636	\$ -
2	Net Arsenic Plant in Service/Rate Base	\$ 1,950,663	\$ (1,950,663)	\$ -
3	Depreciation rate	3.08%		
4	Depreciation expense	79,616	(79,616)	-
5	Depreciation expense net of tax savings ¹	48,885	(48,885)	-
6	Recoverable O&M costs - Ongoing	74,593	(6,279)	68,314
7	Recoverable O&M costs - Ongoing Net Of Tax Savings	45,801	(3,856)	41,945
8	Arsenic Operating Income	\$ (94,686)		\$ (41,945)
9	Rate of return	-4.85%		
10	Required Rate of Return ²	7.24%		
11	Required Operating Income	141,228	(141,228)	-
12	Operating Income deficiency	235,914		41,945
13	Gross revenue conversion factor ²	1.62863	-	1.62863
14	Revenue deficiency	\$ 384,217	\$ -	\$ 68,313

¹ 38.5986 % tax rate per Dec. 67093

² Decision No. 67093

COMPANY PROPOSED

RATES	CURRENT RATES FOLLOWING ACRM STEP 1	PROPOSED ACRM STEP 2 BASE SURCHARGE	PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE	TOTAL PROPOSED
Basic Monthly Minimum Service Charge				
5/8" Meter	\$ 24.34	\$ 2.02	\$ 0.39	\$ 26.76
Commodity Rates Per 1,000 Gallons				
0 to 25,000 gallons	\$ 1.2134	\$ 0.0625	\$ 0.0121	\$ 1.29
25,001 to 80,000 gallons	3.1034	0.0625	0.0121	\$ 3.18
80,001 gallons and over	5.7834	0.0625	0.0121	\$ 5.86

RUCO PROPOSED

RATES	CURRENT RATES FOLLOWING ACRM STEP 1	PROPOSED ACRM STEP 2 BASE SURCHARGE	PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE	TOTAL PROPOSED
Basic Monthly Minimum Service Charge				
5/8" Meter	\$ 24.34	\$ 0.36	\$ 0.36	\$ 25.06
Commodity Rates Per 1,000 Gallons				
0 to 25,000 gallons	\$ 1.2134	\$ 0.0111	\$ 0.0111	\$ 1.24
25,001 to 80,000 gallons	3.1034	0.0111	0.0111	\$ 3.13
80,001 gallons and over	5.7834	0.0111	0.0111	\$ 5.81

Arizona-American Water Company
Paradise Valley Water District
Docket No. W-07303A-05-0405 et. al.
12 Months Ending December, 2007
Arsenic O&M Surcharge Calculation

[A] [B] [C] [D] [E] [F] [G] [H] [I] [J]

Line No.	Growth	Customers	Total Gallons Sold	Gallons Sold Per Cust.	Average Customers at 31-Dec-07	Estimated Customers at 31-Dec-08	Estimated Average Customers	Monthly Minimum	Minimum Multiples	Equivalent Meters	Monthly Base	Base Total	Monthly Deferred	Deferred Total
1	Dec. 2006 (Year 1)	4,726	3,077,899	651.27	2,396	2,396	2,396	\$ 24.34	1.0	2,396	\$ 0.36	\$ 10,350	\$ 0.36	\$ 10,350
2	Dec. 2007 (Year 2)	4,750	3,065,644	645.40	32	32	32	25.18	1.0	32	0.37	143	0.37	143
3	Year 2 minus Year 1	24	(12,255)	(6)	2,019	2,029	2,024	40.60	1.7	3,376	0.60	14,584	0.60	14,584
4	Percentage Change	0.51%	-0.40%	-0.90%	75	75	75	81.98	3.4	253	1.21	1,094	1.21	1,094
5	Avg Gallons (Col B Ln 1 + Col B Ln 2 + 2)		3,071,772		267	268	268	130.65	5.4	1,437	1.93	6,206	1.93	6,206
6					23	23	23	242.09	9.9	229	3.58	991	3.58	991
7					1	1	1	402.85	16.6	17	5.96	72	5.96	72
8					5	5	5	806.97	33.2	166	11.93	718	11.93	718
9					4,812	4,836	4,824			7,908		\$ 34,157		\$ 34,157
10	Meter Size													
11	5/8-inch													
12	3/4-inch													
13	1-inch													
14	1.5-inch													
15	2-inch													
16	3-inch													
17	4-inch													
18	6-inch													
19	Total													
20														
21														
22														
23														
24														
25	Calculation of Surcharge													
26	Total costs to be recovered (RUCO ACRM-2, Page 1 Col (C) Line 14)													
27	Minimum Revenue (Col B Ln 26 + 2)							\$ 34,157						
28	Commodity Revenue (Col B Ln 26 + 2)							\$ 68,313						
29														
30	Monthly Increment Per Equivalent Meter													
31	Equivalent Meters (Col F Ln 22 x 12 Months)													
32														
33	Minimum Surcharge (Col C Ln 27 + Ln 31)							\$ 0.36						
34														
35	Average Gallons (Col B Ln 5)													
36														
37	Commodity Surcharge (Col D Ln 28 + Ln 35)													
38														
39														
40	Calculation of Deferred O&M Surcharge													
41	Total costs to be recovered (RUCO ACRM-2, Page 1 Col (C) Line 14)													
42	Monthly Minimum Revenue (Col B Ln 41 + 2)													
43	Commodity Revenue (Col B Ln 41 + 2)													
44														
45	Monthly Increment Per Equivalent Meter													
46	Equivalent Meters (Col F Ln 22 x 12 Months)													
47														
48	Minimum Surcharge (Col C Ln 42 + Ln 46)													
49														
50	Average Gallons (Col B Ln 5)													
51														
52	Commodity Surcharge (Col D Ln 43 + Ln 50)													

Minimum Surcharge

Commodity Surcharge

Minimum Surcharge

Commodity Surcharge

Minimum Surcharge

Commodity Surcharge