



0000151733

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

- BOB STUMP, CHAIRMAN
- GARY PIERCE
- BRENDA BURNS
- BOB BURNS
- SUSAN BITTER SMITH

RECEIVED
AZ CORP COMMISSION
DOCKET CONTROL

2014 MAR 12 PM 2:00

ORIGINAL

IN THE MATTER OF THE APPLICATION OF
FARMERS WATER COMPANY FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES FOR UTILITY
SERVICE.

DOCKET NO. W-01654A-13-0267

**NOTICE OF FILING
STAFF'S DIRECT TESTIMONY**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Direct Testimony of Crystal S. Brown, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 12th day of March, 2014.

Charles H. Hains
Matthew Laudone
Attorneys, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies of the foregoing filed this 12th day of March, 2014, with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission

DOCKETED

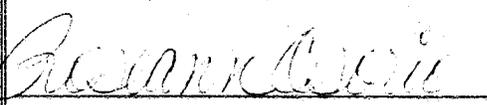
MAR 12 2014

DOCKETED BY

1 Copy of the foregoing mailed this
2 12th day of March, 2014, to:

3 Robert J. Metli, Esq.
4 MUNGER CHADWICK, PLC
5 2398 East Camelback Road, Suite 240
6 Phoenix, Arizona 85016
7 rjmetli@mungerchadwick.com

8 Matthew Bailey, Vice President
9 FARMERS WATER CO.
10 1525 East Sahuarita Road
11 Sahuarita, Arizona 85629
12 Mbailey@greenvalleypecan.com

13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28


BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP

Chairman

GARY PIERCE

Commissioner

BRENDA BURNS

Commissioner

BOB BURNS

Commissioner

SUSAN BITTER SMITH

Commissioner

IN THE MATTER OF THE APPLICATION OF)
FARMERS WATER CO., AN ARIZONA)
CORPORATION, FOR A DETERMINATION)
OF THE CURRENT FAIR VALUE OF ITS)
UTILITY PLANT AND PROPERTY AND FOR)
INCREASES IN ITS RATES AND CHARGES)
FOR UTILITY SERVICE.)
_____)

DOCKET NO. W-01654A-13-0267

DIRECT

TESTIMONY

OF

CRYSTAL S. BROWN

PUBLIC UTILITIES ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MARCH 12, 2014

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	2
CONSUMER SERVICE.....	3
COMPLIANCE.....	3
SUMMARY OF PROPOSED REVENUES	3
<i>Operating Income Adjustments</i>	4
RATE BASE.....	5
<i>Fair Value Rate Base</i>	5
<i>Rate Base Summary</i>	6
OPERATING INCOME	6
<i>Operating Income Summary</i>	6
<i>Operating Income Adjustment No. 1 – Other Operating Revenue</i>	6
<i>Operating Income Adjustment No. 2 – Salaries and Wages</i>	7
<i>Operating Income Adjustment No. 3 – Water Testing</i>	8
<i>Operating Income Adjustment No. 4 – Transportation Expense</i>	9
<i>Operating Income Adjustment No. 5 – Miscellaneous Expense, Banking Fees</i>	9
<i>Operating Income Adjustment No. 6 – Miscellaneous Expense, Other</i>	10
<i>Operating Income Adjustment No. 7 – Property Taxes</i>	10
<i>Operating Income Adjustment No. 8 – Income Taxes</i>	11
<i>\$95,023 Receivable from Associated Company</i>	12
EQUITY IMPROVEMENT PLAN.....	12
<i>Review of Amount of Equity Used to Fund Plant Additions</i>	12
<i>Review of Amount of Plant Additions Funded With AIAC and CIAC</i>	14
<i>Review of Equity Improvement Plan</i>	16
<i>Modification of Equity Improvement Plan to Include a Rate Base Improvement Plan</i>	19
OPERATING MARGIN.....	20
RATE DESIGN	22
SERVICE CHARGES	23

SCHEDULES

Revenue Requirement	CSB-1
Gross Revenue Conversion Factor	CSB-2
Rate Base – Original Cost	CSB-3
Summary of Original Cost Rate Base Adjustments	CSB-4
Operating Income Statement – Test Year and Staff Recommended	CSB-5
Summary of Operating Income Adjustments – Test Year.....	CSB-6
Operating Income Adjustment No. 1 – Other Operating Revenues	CSB-7
Operating Income Adjustment No. 2 – Salaries and Wages.....	CSB-8
Operating Income Adjustment No. 3 – Water Testing Expense.....	CSB-9
Operating Income Adjustment No. 4 – Transportation Expense.....	CSB-10
Operating Income Adjustment No. 5 – Miscellaneous Expense, Banking Fees.....	CSB-11
Operating Income Adjustment No. 6 – Miscellaneous Expense, Other	CSB-12
Operating Income Adjustment No. 7 – Property Tax Expense	CSB-13

Operating Income Adjustment No. 8 – Income Taxes CSB-14
Rate Design CSB-15
Typical Bill Analysis..... CSB-16

**EXECUTIVE SUMMARY
FARMERS WATER COMPANY
DOCKET NO. W-01654A-13-0267**

Farmers Water Company (“Farmers Water” or “Company”) is an Arizona Class B utility engaged in the business of providing water service in portions of Pima County, Arizona. Farmers Water serves approximately 2,725 customers. Farmers Water’s current rates were approved in Decision No. 71510, dated March 17, 2010.

The Company proposes an \$186,158, or 22.68 percent revenue increase from test year revenue of \$820,815 to \$1,006,973. The proposed revenue increase would produce an operating income of \$100,697 for a 10.00 percent operating margin. The Company’s original cost rate base (“OCRB”) is a negative \$15,143. The Company’s proposed rates would increase the typical residential bill with a median usage of 3,500 gallons from \$12.98 to \$15.29, for an increase of \$2.31 or 17.80 percent.

Staff recommends a \$150,829 or 18.26 percent revenue increase from a Staff adjusted test year revenue of \$825,929 to \$976,757. Staff’s recommended revenue increase would produce an operating income of \$97,700 for a 10.00 percent operating margin. Staff’s recommended OCRB is a negative \$15,143 as shown on Schedule CSB-1. Staff’s recommended rates would increase the typical residential bill with a median usage of 3,500 gallons from \$12.98 to \$13.73, for an increase of \$0.75 or 5.78 percent.

In addition Staff recommends:

1. That the Company discontinue the practice of recording receivables to Farmers Water Investment Company (“FICO”). Further, Staff recommends that the parent Company repay the receivable in no more than two years.
2. That the Commission direct the Company to include the following specific equity level improvement targets.
 - The Company’s rate base should have 20 percent equity within five years
 - The Company’s rate base should have 30 percent equity within seven years
 - The Company’s rate base should have 40 percent equity within ten years
3. That the Commission direct the Company to specifically include paid-in-capital, in addition to the internally generated retained earnings, as part of its future plan to build equity and fund plant additions.
4. That the Equity Improvement Plan be modified such that it includes a plan to improve rate base. The Company should file the plan within 90 days of the date of the Decision resulting from this rate proceeding.

5. That if the Company has a negative or zero rate base in its next rate case, that the Company's revenue requirement should be set to break-even, i.e., zero percent operating margin. If the Company has a small rate base, the revenue requirement should be based on operating margin or rate-of-return, whichever is less. The Company's revenue requirement should be based on rate-of-return if the Company has sufficient rate base.

1 **INTRODUCTION**

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

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

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

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

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

15 A. I received a Bachelor of Science Degree in Business Administration from the University
16 of Arizona and a Bachelor of Science Degree in Accounting from Arizona State
17 University.

18
19 Since joining the Commission in August 1996, I have participated in numerous rate cases
20 and other regulatory proceedings involving electric, gas, water, and wastewater utilities. I
21 have testified on matters involving regulatory accounting and auditing. Additionally, I
22 have attended utility-related seminars sponsored by the National Association of
23 Regulatory Utility Commissioners ("NARUC") on ratemaking and accounting designed to
24 provide continuing and updated education in these areas.

25

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

2 A. I am presenting Staff's analysis and recommendations in the areas of rate base and
3 operating revenues, expenses, and rate design regarding the Farmers Water Company, Inc.
4 ("Farmers Water" or "Company") application for a permanent rate increase. Staff
5 witness, Jian Liu, is presenting Staff's engineering analysis and recommendations.

6
7 **Q. What is the basis of your recommendations?**

8 A. I performed a regulatory audit of the Company's application to determine whether
9 sufficient, relevant, and reliable evidence exists to support the Company's requested rate
10 increase. The regulatory audit consisted of examining and testing the financial
11 information, accounting records, and other supporting documentation and verifying that
12 the accounting principles applied were in accordance with the Commission-adopted
13 NARUC Uniform System of Accounts ("USoA").

14
15 **BACKGROUND**

16 **Q. Please provide a brief description of Farmers Water and the service it provides.**

17 A. Farmers Water is an Arizona Class B utility engaged in the business of providing water
18 service in portions of Pima County, Arizona. Farmers Water serves approximately 2,725
19 customers. Farmers Water's current rates were approved in Decision No. 71510, dated
20 March 17, 2010.

21
22 **Q. What are the primary reasons for Farmers Water's requested permanent rate
23 increase?**

24 A. According to the Company, the primary reasons for the requested increase is to recover
25 increased operating expenses, to obtain a 10 percent operating margin and to address the
26 effluent rates that the golf course pays.

1 **CONSUMER SERVICE**

2 **Q. Please provide a brief history of customer complaints received by the Commission**
3 **regarding Farmers Water.**

4 A. A review of the Commission's records from January 1, 2011 through January 30, 2014,
5 reflects that only one complaint was filed in the month of April 2011. This complaint was
6 a billing dispute and has been resolved and closed.

7
8 **COMPLIANCE**

9 **Q. Please provide a summary of the compliance status of Farmers Water.**

10 A. A check of the Compliance database indicates that there are currently no delinquencies for
11 Farmers Water.

12
13 **SUMMARY OF PROPOSED REVENUES**

14 **Q. Please summarize the Company's filing.**

15 A. The Company proposes an \$186,158, or 22.68 percent revenue increase from test year
16 revenue of \$820,815 to \$1,006,973. The proposed revenue increase would produce an
17 operating income of \$100,697 for a 10.00 percent operating margin. The Company's
18 original cost rate base ("OCRB") is a negative \$15,143. The Company's proposed rates
19 would increase the typical residential bill with a median usage of 3,500 gallons from
20 \$12.98 to \$15.29, for an increase of \$2.31 or 17.80 percent.

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

23 A. Staff recommends a \$150,829 or 18.26 percent revenue increase from a Staff adjusted test
24 year revenue of \$825,929 to \$976,757. Staff's recommended revenue increase would
25 produce an operating income of \$97,700 for a 10.00 percent operating margin. Staff's
26 recommended OCRB is a negative \$15,143 as shown on Schedule CSB-1. Staff's

1 recommended rates would increase the typical residential bill with a median usage of
2 3,500 gallons from \$12.98 to \$13.73, for an increase of \$0.75 or 5.78 percent.

3

4 **Q. What test year did Farmers Water utilize in this filing?**

5 A. Farmers Water's test year is based on the twelve months ended September 30, 2012.

6

7 **Q. Please summarize Staff's rate base and operating income adjustments for Farmers**
8 **Water.**

9 A. Staff made no adjustments to rate base. Staff's adjustments to operating revenue and
10 expenses address the following:

11

12 *Operating Income Adjustments*

13 Other Revenue – This adjustment increases other revenue by \$5,114 to reflect revenue
14 derived from the sale of water usage data and other services to Pima County, that were
15 incorrectly classified as non-utility income.

16

17 Salaries and Wages, Directors – This adjustment decreases salaries and wages expense by
18 \$7,996 to reflect only the salary and wage increases that took effect within one year after
19 the test year.

20

21 Water Testing Expense – This adjustment increases water testing expenses by \$6,070 to
22 reflect Staff's recommended annual water testing costs.

23

24 Transportation Expense – This adjustment decreases transportation expense by \$5,991 to
25 remove the cost of personal and commute mileage.

1 Miscellaneous Expense, Banking Fees – This adjustment decreases miscellaneous expense
2 by \$8,530 to reflect only the banking fee increases that were incurred within one year after
3 the test year.

4
5 Miscellaneous Expense, Other – This adjustment decreases miscellaneous expense by
6 \$8,311 to reclassify costs incurred for water testing to the water testing account and to
7 remove costs that are not needed in the provision of service.

8
9 Property Tax Expense – This adjustment decreases property tax expense by \$1,459 to
10 reflect Staff's calculation of the Company's property tax expense.

11
12 Income Tax Expense – This adjustment increases income tax expenses by \$3,864 to
13 reflect the income tax calculation on Staff's adjusted test year operating loss.

14
15 **RATE BASE**

16 *Fair Value Rate Base*

17 **Q. Did the Company prepare schedules showing the elements of Reconstruction Cost**
18 **New Rate Base?**

19 **A.** No, the Company did not. The Company's filing treats the OCRB the same as the fair
20 value rate base.

21

1 *Rate Base Summary*

2 **Q. Please summarize Staff's recommendation for Farmers Water's rate base shown on**
3 **Schedules CSB-3 and CSB-4.**

4 A. Staff audited the Company's rate base and found that the amounts reported therein were
5 supported with adequate cost documentation. Therefore, Staff recommends a rate base of
6 a negative \$15,143.

7
8 **OPERATING INCOME**

9 *Operating Income Summary*

10 **Q. What are the results of Staff's analysis of test year revenues, expenses and operating**
11 **income?**

12 A. As shown on Schedules CSB-5 and CSB-6, Staff's analysis resulted in test year revenues
13 of \$825,929, expenses of \$858,757 for an operating loss of \$32,829.

14
15 *Operating Income Adjustment No. 1 – Other Operating Revenue*

16 **Q. During the course of the audit did Staff identify revenue that the Company had**
17 **incorrectly classified as non-utility revenue?**

18 A. Yes.

19
20 **Q. What was the source of the revenue?**

21 A. According to the Company's response to data request CSB 3.10, Pima County pays
22 Farmers Water for providing customer consumption and turn-on/turn-off data for use in
23 establishing sewer rates for those customers.

24

1 **Q. What is Staff's recommendation?**

2 A. Staff recommends increasing other revenue by \$5,114 as shown on Schedules CSB-6 and
3 CSB-7.

4
5 *Operating Income Adjustment No. 2 – Salaries and Wages*

6 **Q. What is the Company proposing for salaries and wages expense?**

7 A. The Company is proposing salaries and wages expense of \$255,887. The amount is
8 composed of \$223,212 in actual test year (i.e. 2012) expense plus a \$32,675 pro forma
9 adjustment that reflects salaries and wages increases for the years 2013 and 2014.

10

11 **Q. What was the salaries and wages increase from the test year to 2013?**

12 A. Salaries and wages increased by \$24,679, from \$223,212 in the test year to \$247,891 in
13 2013.

14

15 **Q. Did Staff allow the \$24,679 increase?**

16 A. Yes. The increase primarily reflects the addition of one full time employee, an executive
17 office manager, who was employed within one year after the test year.

18

19 **Q. What was the salary and wage increase from 2013 to 2014?**

20 A. Salary and wages increased by \$7,996, from \$247,891 in 2013 to \$255,887 in 2014.

21

22 **Q. Is recognition of the increases that were incurred in 2014 appropriate?**

23 A. No, it is not.

24

1 **Q. What guidance does the Administrative Code provide concerning pro forma**
2 **adjustments such as the 2014 salaries and wages increase?**

3 A. The Administrative Code states that pro forma adjustments are “adjustments to actual test
4 year results to obtain a normal or more realistic relationship between revenues, expenses
5 and rate base.”

6
7 **Q. Does the Company’s pro forma adjustment to include the 2014 salaries and wages**
8 **increases create a more realistic relationship between revenues, expenses, and rate**
9 **base?**

10 A. No, it does not. The additional expense was incurred two years after the test year (i.e.
11 2014) and as such creates an unrealistic relationship between revenues and expenses.
12 Further, the additional salary and wage increase actually incurred in 2014 would likely be
13 offset by additional revenue generated in 2014. Therefore, according to the guidance
14 provided by the Administrative Code, the adjustment is inappropriate.

15
16 **Q. What is Staff’s recommendation?**

17 A. Staff recommends decreasing salaries and wages expense by \$7,996 as shown on
18 Schedules CSB-6 and CSB-8.

19
20 *Operating Income Adjustment No. 3 – Water Testing*

21 **Q. What did the Company propose for water testing expense?**

22 A. The Company proposed \$5,432 for water testing expense.

23
24 **Q. What adjustment did Staff make?**

25 A. Staff adjusted annual water testing costs to reflect Staff’s recommended \$11,502 water
26 testing expense as discussed in greater detail by Staff witness Jian Liu.

1 **Q. What is Staff's recommendation?**

2 A. Staff recommends increasing water testing expense by \$6,070 as shown on Schedules
3 CSB-6 and CSB-9.

4

5 *Operating Income Adjustment No. 4 – Transportation Expense*

6 **Q. What did the Company propose for transportation expense?**

7 A. The Company proposed \$28,707 for transportation expense.

8

9 **Q. What adjustment did Staff make?**

10 A. Staff removed personal and commute mileage costs from transportation expense as these
11 costs are not needed in the provision of service.

12

13 **Q. What is Staff's recommendation?**

14 A. Staff recommends decreasing transportation expense by \$5,991 as shown on Schedules
15 CSB-6 and CSB-10.

16

17 *Operating Income Adjustment No. 5 – Miscellaneous Expense, Banking Fees*

18 **Q. What did the Company propose for miscellaneous expense, banking fees?**

19 A. The Company proposed \$22,882 for miscellaneous expense, banking fees. The amount is
20 composed of \$4,674 in actual test year (i.e. 2012) expense plus an \$18,208 pro forma
21 adjustment that reflects the Company's projection of credit card and web based fees.

22

23 **Q. Were web based fees included in test year expenses?**

24 A. No. According to the Company's response to CSB 2.16, the website became operational
25 in February 2013, therefore the cost of the website and the new payment options made
26 available through the website were not included in test year expenses. The Company's

1 proforma adjustment includes projected web based costs as well as projected increases
2 related to customers paying their water bills with credit cards.

3

4 **Q. What adjustment did Staff make?**

5 A. Staff reduced the proforma adjustment by \$8,530 to reflect the actual web fees and credit
6 card fees that were incurred in 2013.

7

8 **Q. What is Staff's recommendation?**

9 A. Staff recommends decreasing miscellaneous expense, banking fees by \$8,530 as shown on
10 Schedules CSB-6 and CSB-11.

11

12 *Operating Income Adjustment No. 6 – Miscellaneous Expense, Other*

13 **Q. Did Staff make any other adjustment to miscellaneous expense?**

14 A. Yes. Staff reclassified \$7,687 of costs incurred for water testing to the water testing
15 account. Staff also removed \$624 for meals and entertainment since these costs are not
16 necessary to provide service, Staff recommends that they be recognized as below-the-line
17 costs for ratemaking purposes.

18

19 **Q. What is Staff's recommendation?**

20 A. Staff recommends decreasing miscellaneous expense, other by \$8,311, as shown on
21 Schedules CSB-6 and CSB-12.

22

23 *Operating Income Adjustment No. 7 – Property Taxes*

24 **Q. Did Staff review the Company's property tax calculation?**

25 A. Yes.

26

1 **Q. What assessment ratio did the Company use in the calculation of property tax?**

2 A. The Company used a 21 percent assessment ratio.

3

4 **Q. Does Staff agree with the Company?**

5 A. No, the correct assessment ratio to be used in the calculation of property taxes is 19
6 percent. According to the Arizona Revised Statute 42-15001, the assessment ratio is 19
7 percent from and after December 31, 2013 through December 31, 2014.

8

9 **Q. What is Staff's recommendation?**

10 A. Staff recommends decreasing property tax expense by \$1,459 as shown on Schedules
11 CSB-6 and CSB-13.

12

13 *Operating Income Adjustment No. 8 – Income Taxes*

14 **Q. What is Farmers Water proposing for test year income tax expense?**

15 A. Farmers Water is proposing a negative \$8,481 for income tax expense.

16

17 **Q. Did Staff make any adjustments to test year income tax expense?**

18 A. Yes. Staff's adjustment reflects its calculation of the income tax expense based upon
19 Staff's adjusted test year taxable loss.

20

21 **Q. What is Staff's recommendation?**

22 A. Staff recommends increasing income tax expense by \$3,864 as shown on Schedules CSB-
23 6 and CSB-14.

24

1 *\$95,023 Receivable from Associated Company*

2 **Q. During the course of the audit, did Staff find that Farmers Water Investment**
3 **Company (“FICO”) owes Farmers Water \$95,023?**

4 A. Yes. Schedule E-1 shows a Receivable from Associated Company in the amount of
5 \$95,023. Staff found through the Company’s response to data request CSB 3.5 that the
6 parent company, FICO, effectively owes the \$95,023 to Farmers Water.

7
8 **Q. What is Staff’s recommendation concerning the receivable?**

9 A. Staff recommends that the Company discontinue the practice of recording receivables to
10 FICO. Further, Staff recommends that the parent Company repay the receivable in no
11 more than two years.

12
13 **EQUITY IMPROVEMENT PLAN**

14 *Review of Amount of Equity Used to Fund Plant Additions*

15 **Q. In the Company’s last rate case, did the Commission require the Company to file an**
16 **equity improvement plan?**

17 A. Yes, the Commission in Decision No. 71510 stated on page15, line 9,

18
19 Because this Company has a negative rate base, the Commission is
20 unable to set rates based on fair value. In order to reach a more
21 balanced capital structure, we direct the Company to develop and
22 file with the Commission an equity improvement plan.

23
24 **Q. Did the Company file that plan?**

25 A. Yes.

26

1 **Q. Did the Company state that it had funded \$1.9 million of plant with equity in the**
2 **instant rate case?**

3 A. Yes. On page 3, beginning at line 14 ½ of Mr. Bourassa's direct testimony he states, "The
4 improvement stems from the Company's investment in plant-in-service of over \$1.9
5 million. This is net of plant-in-service funded with new advances-in-aid of construction
6 and contributions in-aid construction."
7

8 **Q. In general, how is equity increased or decreased?**

9 A. Generally, equity is increased when a company earns a "profit" or pays in additional
10 capital (i.e. paid in capital). Equity is decreased when a company loses money (i.e. incurs
11 a loss) or pays dividends. Other miscellaneous adjustments such as stock transactions,
12 prior period adjustments, and certain changes in accounting principle can also increase or
13 decrease equity.
14

15 **Q. Would you expect to see the \$1.9 million in equity that the Company claims it paid to**
16 **fund plant additions recorded and accumulated in the equity account during the**
17 **intervening years since its last rate case?**

18 A. Yes. Since the balance in the equity account is an accumulation of the Company's net
19 income and losses, one would expect to see some type of combination of net income (i.e.
20 profit), paid in capital, and miscellaneous adjustments totaling \$1.9 million that was
21 recorded and accumulated in the Company's equity account from the end of the
22 Company's last test year to the end of the current test year to support the Company's
23 claimed \$1.9 million in equity.
24

1 **Q. What did Staff find from a review of the Company's equity account?**

2 A. Based on the Company's response to CSB 4-3, Staff found that except for 2011 Farmers
3 Water has sustained losses from operations for each year from 2008 to 2012. Further, the
4 Company's response to CSB 4-2 indicates that none of the \$1.9 million in plant was
5 funded with paid in capital. Moreover, there were no miscellaneous adjustments to equity
6 that totaled \$1.9 million. Therefore, Staff found that the Company's actual equity was far
7 less than \$1.9 million.

8
9 **Q. Based on Staff's analysis, did the Company fund its plant additions since the last rate
10 case with \$1.9 million in equity?**

11 A. Based upon Staff's analysis of the Company's equity account, the Company did not fund
12 its plant additions since the last rate case with \$1.9 million in equity. As Staff will discuss
13 in the next section "Review of Amount of Plant Additions Funded With AIAC and
14 CIAC," it is likely that the majority of the plant was funded with AIAC.

15
16 *Review of Amount of Plant Additions Funded With AIAC and CIAC*

17 **Q. Did Farmers Water have a negative equity balance and a negative rate base in its last
18 rate case?**

19 A. Yes. The Company had a negative equity balance of \$440,202 and a negative rate base of
20 \$748,646.

21
22 **Q. What was the major cause of the negative rate base?**

23 A. The major cause was the Company's reliance on advances in aid of construction ("AIAC")
24 to fund plant additions.

25

1 **Q. How has the amount of AIAC, contributions in aid of construction (“CIAC”), and**
2 **equity changed since the Company’s last rate case?**

3 A. The Company’s equity position has not improved and it continues to rely on AIAC and
4 CIAC for plant additions. Staff’s analysis shows that the net amount of AIAC and CIAC
5 has increased by \$1,886,060 (\$2,690,314 - \$804,254) and the amount of equity has
6 decreased by \$288,714, from a negative \$440,202 to a negative \$728,916¹:

	%	Last Rate Case As of 9/30/2007	Difference	Instant Rate Case As of 9/30/2012	%
AIAC	106.84%	\$6,874,915	\$ (804,254)	\$6,070,661	75.58%
CIAC	0%	\$0	\$2,690,314	\$2,690,314	33.49%
Equity	(6.84)%	\$(440,202)	\$ (288,714)	\$(728,916)	(9.07)%
Debt	0%	\$ 0	\$ 0	\$ 0	0%
	100.00%	\$6,434,713	\$1,597,346	\$8,032,059	100.00%

8
9 **Q. For the years 2008 to 2012, how does the total amount of AIAC additions compare to**
10 **the total amount of plant additions placed in service?**

11 A. The total amount of AIAC additions (i.e. \$5,867,001) exceeds the total amount of plant
12 additions placed in service (i.e., \$3,512,150) by \$2,354,951:

Year	Total Plant Additions (CSB 4-1)	Difference	AIAC Contracts (CSB 4-5)
2008	\$ 89,152		\$2,122,135.67
2009	\$1,310,307		\$509,582.48
2010	\$ 25,175		\$2,741,028.00
2011	\$1,941,329		\$380,256.00
2012	\$ 146,187		\$114,000.00
Total	\$3,512,150	\$2,354,951.15	\$5,867,001.15

14

¹ Staff’s test year equity balance of a negative \$728,916 was calculated by subtracting \$854,343 from the Company proposed equity balance of \$125,427. The Company’s positive equity balance of \$125,427 was created, in substantial part, by the Company recording an \$854,343 “one-time transaction to record aggregate financial adjustment resulting from the March 2010 Rate Case decision.” See Company’s response to CSB 3.12. Staff removed the \$854,343 “one time transaction” in order to analyze the equity improvement from actual operations.

1 **Q. Is it likely that the majority of the Company's 3.5 million in plant additions was**
2 **funded with AIAC?**

3 A. Yes. In the Company's response to data request CSB 3-8, the Company stated that only
4 \$272,667 of the plant additions was equity funded plant and the remaining \$2.8 million
5 was AIAC funded plant. Later, in response to data request CSB 4-1, the Company stated
6 that \$1.58 million was equity funded plant and the remaining \$1.9 million was AIAC
7 funded plant. Based on Staff's analysis of the Company's equity account, the Company's
8 response that \$272,667 in plant additions was funded with equity is more accurate.
9

10 *Review of Equity Improvement Plan*

11 **Q. Has the Company's implementation of its Equity Improvement Plan required by**
12 **Decision No. 71510 helped to resolve the Commission's concerns about the**
13 **Company's negative equity which, in turn, led to the Company's negative rate base?**

14 A. No. The Company indicated that it would limit its reliance on developer funded plant
15 (AIAC and CIAC) and invest its own capital where feasible. However, the Company also
16 made clear its expectation that "all equity growth will come from internally generated
17 retained earnings derived from operating income." The Company further promised to file
18 new rate applications as often as practical and necessary, presumably to assure that all
19 equity growth came from the net income effectively provided by ratepayers.
20

21 While Farmers Water did submit "a plan" as required by Commission Order, Staff
22 believes that this plan failed to meet the spirit of the Commission's directive. The
23 Commission's intent is clarified in paragraph 61 of Decision No. 71510, where the
24 Commission's decision to direct the Company to develop and file an equity improvement
25 plan is specifically linked to the issue of attempting to set rates when a negative rate base
26 exists and upon concerns regarding the need for the Company "to reach" a more balanced

1 capital structure. Staff believes that it is accurate to conclude that the equity improvement
2 plan developed and apparently followed by Farmers Water has failed to successfully
3 address either of the underlying Commission concerns.

4
5 As a result, Staff believes that the Commission needs to issue a more specifically defined
6 decree in order to make its expectations clear that the Company is to identify specific
7 equity improvement targets. Staff believes that the Commission's directive should include
8 the following specific equity level improvement targets:

- 9
- 10 • The Company's rate base should have 20 percent equity within five years
 - 11 • The Company's rate base should have 30 percent equity within seven years
 - 12 • The Company's rate base should have 40 percent equity within ten years

13
14 **Q. Did the Company's equity improvement plan appear to rule out any plans for**
15 **contributing more paid-in capital as a means of building equity?**

16 **A. Yes, the Company stated in paragraph 3 of page 1:**

17
18 . . . the Company is expected to have additional annual retained
19 earnings of approximately \$47,248 annually (\$72,689 minus
20 \$25,441). At this rate of additions to retained earnings and
21 **assuming no additional equity through** the issuance of common
22 stock or **paid-in-capital**, the Company is expected to achieve a
23 positive equity balance by the end of its current fiscal year ended
24 September 30, 2011. Emphasis added.

25 Further on page 2 of the equity plan it states:

- 26
27 1. Because **all equity growth will come from internally**
28 **generated Retained Earnings** derived from Operating Income,
29 the Company will attempt to maintain the operating margin
30 authorized by the Commission by filing new rate applications as
31 often as practical and necessary. Emphasis added.

1 Additionally, the Company indicated that it planned to continue to rely almost exclusively
2 on CIAC and AIAC to fund 2013 plant additions (see Application Schedule F-2 which
3 indicates that 2013 capital expenditures are projected to be \$370,498 whereas cash
4 receipts related to AIAC and CIAC total \$365,426), and that the Company apparently only
5 expects to increase its level of equity through operational-driven retained earnings. These
6 elements will frustrate the Commission's ability to apply rate-of-return rate setting
7 methods, and increase the Company's exposure to possible future cash flow challenges.

8
9 **Q. Considering that the Company's actual equity position has not improved since the**
10 **Company provided the Commission with its equity improvement plan, what does**
11 **Staff recommend?**

12 A. Staff recommends that the Commission direct the Company to specifically include paid-
13 in-capital, in addition to the internally generated retained earnings, as part of its future
14 plan to build equity and fund plant additions. Such plan could include:

- 15
- 16 • A requirement that the Company fund AIAC refunds through additional paid-in-
17 capital,
- 18 • A requirement to add paid-in-capital each year equivalent to the annual level of
19 CIAC amortization,
- 20 • A requirement that these paid in capital commitments continue until equity reaches
21 40 percent.
- 22

1 *Modification of Equity Improvement Plan to Include a Rate Base Improvement Plan*

2 **Q. Is Staff concerned about the Company's negative rate base and its prospects of**
3 **growing a rate base large enough to earn a \$100,000 operating income within five to**
4 **seven years?**

5 A. Staff continues to be concerned about the fact that Farmers Water's rate base is negative.
6 Staff believes that establishing a positive rate base within a set period of time, upon which
7 rates can be set using the traditional rate-of-return revenue requirement formula, is a
8 reasonable goal for Farmers Water. Staff has noted that the absence of a positive rate base
9 has led to a continuing, but non-preferred, reliance on an operating margin approach to
10 setting rates in the instant docket. Further an over-reliance on AIAC and CIAC to fund
11 additions to plant-in-service can severely restrict the level of cash flows available to fund
12 operational needs since AIAC carries with it refund obligations for an extended period of
13 time, and the amortization of recorded CIAC reduces the level of depreciation expense
14 that can be recovered through rates.

15
16 Sound business planning for Farmers Water needs to give complete consideration to the
17 potentially preferable future cash flow implications resulting from a reliance on alternative
18 financing options. Such financial and business planning needs to be undertaken over a
19 multi-year time horizon so as to allow management to responsibly respond to, and manage
20 financial challenges that could surface under the various options available to the
21 Company.

22
23 The level of permanent equity relied upon by the Company is also extremely important.
24 Having a reasonable level of equity (expressed as a percent of total capitalization
25 supporting rate base) reduces the risk associated with an over-leveraged reliance on non-
26 equity supplied capital. Staff understands that financial leverage is a multi-faceted

1 concept and Staff believes that a regulated utility's management has a responsibility to
2 understand and manage all of these possible implications. For purpose of developing
3 Staff's current recommendations, Staff's concern is that an absence of a reasonable level
4 of permanent equity increases the possibility that future financial challenges will present
5 themselves and when this happens, responsive actions may be very limited and possibly
6 costly to the Company and its ratepayers.

7
8 **Q. Does Staff have any recommendation concerning the Company's current Equity**
9 **Improvement Plan?**

10 A. Yes, Staff recommends that the Equity Improvement Plan be modified such that it
11 includes a plan to improve rate base. The Company should file the plan within 90 days of
12 the date of the Decision resulting from this rate proceeding.

13
14 **OPERATING MARGIN**

15 **Q. What operating income did the Company propose?**

16 A. The Company proposed an operating income of \$100,697. This operating income was
17 determined using a 10 percent operating margin as the Company has a negative rate base.

18
19 **Q. How does the Company's proposed operating income of \$100,697 compare to other**
20 **companies with positive rate bases?**

21 A. As can be seen from the table below, Farmers Water would need a positive rate base of
22 more than \$1 million in order to earn an operating income of \$100,000 using a rate base /
23 rate-of-return approach.

24

Comparison of ROR's and Operating Incomes				
Docket No.	Company Name	FVRB/OCRB	ROR	Operating Income
13-0267	Farmers Water	(\$15,143)	10.0%	\$100,697
12-0254	Ray Water	\$1,075,288	9.1%	\$97,851
12-0195	Valley Utilities	\$2,109,695	6.5%	\$137,130
12-0196	Rio Rico (Water Division)	\$7,731,209	8.5%	\$657,153
11-0329	Pima Utility (Water Division)	\$9,122,677	7.6%	\$696,060

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16

Q. What is Staff's recommendations concerning Farmers Water's operating margin?

A. Staff recommends a ten percent operating margin which results in an operating income of \$97,700. Farmers Water's operating income of \$97,700 and depreciation of \$255,898 generates cash flow of \$353,598 as shown on Schedule CSB-1. Staff believes that this level of cash flow will help to fund plant additions, meet contingencies, and grow equity.

Q. What are Staff's recommendations regarding how revenue requirement should be determined in the Company's next rate case?

A. Staff recommends that if the Company has a negative or zero rate base in its next rate case, that the Company's revenue requirement should be set to break-even, i.e., zero percent operating margin. If the Company has a small rate base, the revenue requirement should be based on operating margin or rate-of-return, whichever is less. The Company's revenue requirement should be based on rate-of-return if the Company has sufficient rate base.

1 **RATE DESIGN**

2 **Q. Has Staff prepared a schedule summarizing the present, Company proposed, and**
3 **Staff recommended rates and service charges?**

4 A. Yes. Schedule CSB-15 provides a summary of the Company's present, Company's
5 proposed, and Staff's recommended rates.

6
7 **Q. Please summarize the present rate design.**

8 A. Customer class is distinguished by meter size. The monthly minimum charges vary by
9 meter size and include no gallons. The commodity rates are based on an inverted three-
10 tiered rate design.

11
12 **Q. Please summarize the Company's proposed rate design.**

13 A. Customer class is distinguished by meter size. The monthly minimum charges vary by
14 meter size and include no gallons. The commodity rates are based on an inverted three -
15 tier rate design. The Company's proposed rates would increase the typical residential 5/8
16 x 3/4-inch meter bill with a median usage of 3,500 gallons from \$12.98 to \$15.29, for an
17 increase of \$2.31 or 17.80 percent, as shown on Schedule CSB-16.

18
19 **Q. Please summarize Staff's recommended rate design.**

20 A. Customer class is distinguished by meter size. The monthly minimum charges vary by
21 meter size and include no gallons. The commodity rates are based on an inverted three-
22 tier rate design. Staff's recommended rates would increase the typical residential 5/8 x
23 3/4-inch meter bill with a median usage of 3,500 gallons from \$12.98 to \$13.73, for an
24 increase of \$0.75 or 5.78 percent, as shown on Schedule CSB-16.

25

1 **Q. Did the Company propose any changes to its Meter and Service Line Charges?**

2 A. Yes. Staff recommends approval of its recommended service charges which are the same
3 as the Company's. Both the Company-proposed and the Staff-recommended changes are
4 shown on Schedule CSB-16 and are discussed in the testimony of Staff witness, Jian Liu.

5

6 **SERVICE CHARGES**

7 **Q. Did the Company propose any changes to the service charges?**

8 A. Yes. The Company proposes to discontinue the Re-establishment (After Hours) charge
9 and the Reconnection (Delinquent – After Hours) and to add an After Hours Charge of
10 \$35.

11

12 **Q. Does Staff agree with the Company's proposal to discontinue the \$50.00 Re-**
13 **establishment (After Hours) Charge and the \$55 Reconnection (Delinquent – After**
14 **Hours) and to add a \$35 After Hours Charge?**

15 A. Yes.

16

17 **Q. Does this conclude Staff's direct testimony?**

18 A. Yes, it does.

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	[A] COMPANY ORIGINAL COST	[B] STAFF ORIGINAL COST
1	Adjusted Rate Base	\$ (15,143)	\$ (15,143)
2	Adjusted Operating Income (Loss)	\$ (60,295)	\$ (32,829)
3	Current Rate of Return (L2 / L1)	Not Meaningful	Not Meaningful
4	Current Operating Rate of Return Percentage	Not Meaningful	Not Meaningful
5	Operating Income	\$ 100,697	\$ 97,700
6	Operating Income Deficiency/(Excess) (L5 - L2)	\$ 160,992	\$ 130,529
7	Gross Revenue Conversion Factor	1.15632	1.15552
8	Increase (Decrease) In Gross Revenue (L7 * L6)	\$ 186,158	\$ 150,829
9	Adjusted Test Year Revenue	\$ 820,815	\$ 825,929
10	Proposed Annual Revenue (L8 + L9)	\$ 1,006,973	\$ 976,757
11	Required Increase/(Decrease in Revenue) (%) (L8/L9)	22.68%	18.26%
12	Proposed Operating Margin	10.00%	10.00%
13	Depreciation Expense	\$ 255,898	\$ 255,898
14	Cash Flow (L5 + L13)	\$ 356,595	\$ 353,598

References:

Column [A]: Company Schedule A-1

Column [B]: Staff Schedules

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Income Tax and Property Tax Rate (Line 23)	13.4590%			
5	Subtotal (L3 - L4)	86.5410%			
6	Revenue Conversion Factor (L1 / L5)	1.155521			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	12.3310%			
9	One Minus Combined Income Tax Rate (L7 - L8)	87.6690%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0.0000%			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	2.5900%			
14	Federal Taxable Income (L12 - L13)	97.4100%			
15	Applicable Federal Income Tax Rate (Line 53)	10.0000%			
16	Effective Federal Income Tax Rate (L14 x L15)	9.7410%			
17	Combined Federal and State Income Tax Rate (L13 + L16)		12.3310%		
<u>Calculation of Effective Property Tax Factor:</u>					
18	Unity	100.0000%			
19	Combined Federal and State Income Tax Rate (L17)	12.3310%			
20	One Minus Combined Income Tax Rate (L18-L19)	87.6690%			
21	Property Tax Factor	1.2866%			
22	Effective Property Tax Factor (L20*L21)		1.1280%		
23	Combined Federal and State Income Tax and Property Tax Rate (L17+L22)			13.4590%	
24	Required Operating Income	\$ 97,700			
25	Adjusted Test Year Operating Income (Loss)	(32,829)			
26	Required Increase in Operating Income (L24 - L25)		\$ 130,529		
27	Income Taxes on Recommended Revenue (Col. [C], L52)	\$ 13,742			
28	Income Taxes on Test Year Revenue (Col. [A], L52)	(4,617)			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		18,359		
30	Recommended Revenue Requirement	\$ 976,757			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L30*L31)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32-L33)				
35	Property Tax with Recommended Revenue	\$ 33,617			
36	Property Tax on Test Year Revenue	31,677			
37	Increase in Property Tax Due to Increase in Revenue (L35-L36)		1,941		
38	Total Required Increase in Revenue (L26 + L29 + L34 + L37)		\$ 150,829		
<u>Calculation of Income Tax:</u>					
39	Revenue	\$ 825,929	\$ 150,829	\$ 976,757	
40	Operating Expenses Excluding Income Taxes	\$ 863,374	\$ 1,941	\$ 865,315	
41	Synchronized Interest (L56)	\$ -		\$ -	
42	Arizona Taxable Income (L39 - L40 - L41)	\$ (37,445)		\$ 111,443	
43	Arizona State Income Tax Rate	2.5900%		2.5900%	
44	Arizona Income Tax (L42 x L43)	\$ (970)		\$ 2,886	
45	Federal Taxable Income (L42 - L44)	\$ (36,476)		\$ 108,556	
46	Federal Tax on First on all Income @ 10%	\$ (3,648)		\$ 10,856	
47		\$ -		\$ -	
48		\$ -		\$ -	
49		\$ -		\$ -	
50		\$ -		\$ -	
51	Total Federal Income Tax	\$ (3,648)		\$ 10,856	
52	Combined Federal and State Income Tax (L44 + L51)	\$ (4,617)		\$ 13,742	
53	Applicable Federal Income Tax Rate [Col. [C], L51 - Col. [A], L51] / [Col. [C], L45 - Col. [A], L45]				10.0000%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base	\$ (15,143)			
55	Weighted Average Cost of Debt	0.0000%			
56	Synchronized Interest (L45 X L46)	\$ -			

RATE BASE - ORIGINAL COST

LINE NO.	(A)	(B)	(C)
	COMPANY AS FILED	STAFF ADJUSTMENTS ADJ NO.	STAFF AS ADJUSTED
1	\$ 11,992,012	\$ -	\$ 11,992,012
2	3,246,181	-	3,246,181
3	<u>\$ 8,745,831</u>	<u>\$ -</u>	<u>\$ 8,745,831</u>
<u>LESS:</u>			
4	\$ 5,650,367	\$ -	\$ 5,650,367
5	\$ 420,294	\$ -	\$ 420,294
6	<u>\$ 6,070,661</u>	<u>\$ -</u>	<u>\$ 6,070,661</u>
7	\$ 3,012,974	\$ -	\$ 3,012,974
8	322,660	-	322,660
9	<u>\$ 2,690,314</u>	<u>-</u>	<u>\$ 2,690,314</u>
10	\$ 8,760,975	\$ -	\$ 8,760,975
11	\$ -	\$ -	\$ -
12	\$ -	\$ -	\$ -
<u>ADD:</u>			
13	\$ -	\$ -	\$ -
14	\$ -	\$ -	\$ -
15	\$ 1	\$ -	\$ 1
16	<u>\$ (15,143)</u>	<u>\$ -</u>	<u>\$ (15,143)</u>

References:

Column [A]: Company Schedule B
Column [B]: Schedule CSB-4
Column [C]: Column [A] + Column [B]

SUMMARY OF RATE BASE ADJUSTMENTS

		[A]	[B]	[C]	[D]
LINE NO.	<u>PLANT IN SERVICE</u>				
	Acct. No. - I Plant Description	COMPANY AS FILED		STAFF AS ADJUSTED	
1	301 Organization	\$ 6,893	\$ -	\$ -	\$ 6,893
2	303 Land and Land Rights	-	-	-	-
3	304 Structures and Improvements	173,667	-	-	173,667
4	305 Collecting and Impound Reservoirs	-	-	-	-
5	307 Wells and Springs	695,019	-	-	695,019
6	309 Supply Mains	-	-	-	-
7	311 Pumping Equipment	578,087	-	-	578,087
8	320.1 Water Treatment Plants	-	-	-	-
9	320.2 Water Treatment, Solution Chemical Feeders	1,060	-	-	1,060
10	330.1 Distr Reserv & Stndpipes - Storage Tanks	892,565	-	-	892,565
11	330.2 Distr Reserv & Stndpipes - Pressure Tanks	51,164	-	-	51,164
12	331 Transmission and Distribution Mains	7,563,919	-	-	7,563,919
13	333 Services	912,023	-	-	912,023
14	334 Meters and Meter Installations	639,567	-	-	639,567
15	335 Hydrants	318,441	-	-	318,441
16	336 Backflow Prevention Devices	-	-	-	-
17	339 Other Plant and Miscellaneous Equipment	-	-	-	-
18	340 Office Furniture and Equipment	1,170	-	-	1,170
19	340.1 Computers and Software	108,718	-	-	108,718
20	341 Transportation Equipment	49,719	-	-	49,719
21	343 Tools, Shop, and Garage Equipment	-	-	-	-
22	345 Power Operated Equipment	-	-	-	-
23	346 Communication Equipment	-	-	-	-
24	347 Miscellaneous Equipment	-	-	-	-
25	Rounding	-	-	-	-
26	Total Plant in Service	\$ 11,992,012	\$ -	\$ -	\$ 11,992,012
27	Less: Accumulated Depreciation	\$ 3,246,181	\$ -	\$ -	\$ 3,246,181
28	Net Plant in Service	\$ 8,745,831	\$ -	\$ -	\$ 8,745,831
29					
30	<u>LESS:</u>				
31	Advances in Aid of Construction (AIAC)	\$ 5,650,367	\$ -	\$ -	\$ 5,650,367
32	Meter Deposits - Service Line & Meter Advances	\$ 420,294	-	-	420,294
33	Total AIAC	\$ 6,070,661	\$ -	\$ -	\$ 6,070,661
34					
35	Contributions in Aid of Construction (CIAC)	\$ 3,012,974	-	-	\$ 3,012,974
36	Less: Accumulated Amortization of CIAC	\$ 322,660	-	-	322,660
37	Net CIAC	\$ 2,690,314	\$ -	\$ -	\$ 2,690,314
38					
39	Total Advances and Net Contributions	\$ 8,760,975	\$ -	\$ -	\$ 8,760,975
40					
41	Customer Deposits	\$ -	-	-	\$ -
42	Accumulated Deferred Taxes	\$ -	-	-	\$ -
43					
44	<u>ADD:</u>				
45	Cash Working Capital Allowance	\$ -	-	-	\$ -
46	Materials and Supplies Inventories	\$ -	-	-	\$ -
47	Rounding	\$ 1	-	-	\$ 1
48	Total Rate Base	\$ (15,143)	\$ -	\$ -	\$ (15,143)

OPERATING INCOME - TEST YEAR AND STAFF RECOMMENDED

Line No.	Acct. No.	DESCRIPTION	[A] COMPANY TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	ADJ NO.	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF ADJUSTED
1		<u>REVENUES:</u>						
2	461	Metered Water Revenue	\$ 810,840	\$ -		\$ 810,840	\$ 150,829	\$ 961,669
3	460	Unmetered Water Revenue	-					
4	474	Other Water Revenues	9,975	5,114	1	15,089	-	15,089
5		Total Revenues	<u>\$ 820,815</u>	<u>\$ 5,114</u>		<u>\$ 825,929</u>	<u>\$ 150,829</u>	<u>\$ 976,757</u>
6								
7		<u>EXPENSES:</u>						
8	601	Salaries and Wages	\$ 255,887	\$ (7,996)	2	\$ 247,891	\$ -	\$ 247,891
9	610	Purchased Water	-	-		-	-	-
10	615	Purchased Power	80,882	-		80,882	-	80,882
11	618	Chemicals	-	-		-	-	-
12	620	Repairs & Maint	8,836	-		8,836	-	8,836
13	621	Office Supplies & Expenses	8,007	-		8,007	-	8,007
14	630	Outside Services	83,317	-		83,317	-	83,317
15	635	Water Testing	5,432	6,070	3	11,502	-	11,502
16	641	Rents	-	-		-	-	-
17	650	Transportation Expenses	28,707	(5,991)	4	22,716	-	22,716
18	657	Insurance - General Liability	5,848	-		5,848	-	5,848
19	659	Insurance - Health and Life	30,261	-		30,261	-	30,261
20	666	Reg. Comm. Exp. - Rate Case	12,500	-		12,500	-	12,500
21	670	Bad Debt Expense	-	-		-	-	-
22	675	Miscellaneous Expense	61,385	(16,841)	5, 6	44,544	-	44,544
23	403	Depreciation	255,898	-		255,898	-	255,898
24	408	Taxes Other Than Income	19,495	-		19,495	-	19,495
25	408.1	Property Taxes	33,136	(1,459)	7	31,677	1,941	33,617
26	409	Income Taxes	(8,481)	3,864	8	(4,617)	18,359	13,742
27	427.4	Interest on Customer Security Deposits	-	1		1	-	1
28		Total Operating Expenses	<u>881,110</u>	<u>(22,353)</u>		<u>858,757</u>	<u>20,300</u>	<u>879,057</u>
29								
30		Operating Income (Loss)	<u>\$ (60,295)</u>	<u>\$ 27,467</u>		<u>\$ (32,829)</u>	<u>\$ 130,529</u>	<u>\$ 97,700</u>

References:

- Column (A): Company Schedule C-1
- Column (B): Schedule CSB-6
- Column (C): Column (A) + Column (B)
- Column (D): Schedules CSB-1 and CSB-2
- Column (E): Column (C) + Column (D)

OPERATING INCOME ADJUSTMENT NO. 1 - OTHER OPERATING REVENUE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS (Col A + Col B)	STAFF AS ADJUSTED
1	Other Revenue	\$ 9,975	\$ -	\$ 9,975
2	Providing Sewer Consumption Data to Pima County	\$ -	\$ 4,316	\$ 4,316
3	Providing Turn On & Off Data to Pima County	\$ -	\$ 797	\$ 797
		\$ 9,975	\$ 5,114	\$ 15,089

References:

- Column A: Company Schedule C-2
- Column B: Testimony, CSB; Data Request CSB 3.10
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 2 - SALARIES AND WAGES

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS (Col C - Col A)	STAFF AS ADJUSTED
1	2012 Actual Salaries and Wages	\$ 223,212	\$ -	\$ 223,212
2	2013 Salaries and Wages Increase	\$ 24,679	\$ -	\$ 24,679
3	2014 Salaries and Wages Increase	\$ 7,996	\$ (7,996)	\$ -
4		\$ 255,887	\$ (7,996)	\$ 247,891
5				
6				
7				
8		Salaries and Wages as of		Salaries and Wages as of
9		9/30/2014		9/30/2013
10		CSB 2.13 (b)	Difference	CSB 2.13 (b)
11	Executive VP	\$ 65,000	\$ -	\$ 65,000
12	Operator	\$ 41,612	\$ (1,198)	\$ 40,414
13	Operator	\$ 33,578	\$ (991)	\$ 32,587
14	Executive Office Manager	\$ 41,200	\$ (1,200)	\$ 40,000
15	Operations Manager	\$ 71,997	\$ (2,107)	\$ 69,890
16	Part Time	\$ 2,500	\$ (2,500)	\$ -
17	Total	\$ 255,887	\$ (7,996)	\$ 247,891

References:

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

OPERATING INCOME ADJUSTMENT NO. 3 - WATER TESTING EXPENSE

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Water Testing Expense	\$ 5,432	\$ -	\$ 5,432
2	To reclassify MAP Fees from the Misc. Exp Acct.	\$ -	\$ 7,687	\$ 7,687
3	To reconcile to Staff's recommended water testing exp	\$ -	\$ (1,617)	\$ (1,617)
4		\$ 5,432	\$ 6,070	\$ 11,502

References:

- Column A: Company Schedule C-1
- Column B: Testimony, CSB; Data Request Response CSB 2.26
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 4 - TRANSPORTATION EXPENSE

LINE NO.	DESCRIPTION	[A]	[B]	[C]	
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED	
1	Transportation Expense	\$ 22,716	\$ 0	\$ 22,716	From Line 18
2	To Remove Commute & Personal Mileage Cost	5,991	(5,991)	-	
3		\$ 28,707	\$ (5,991)	\$ 22,716	

Calculation of \$22,716 Transportation Expense

	Milage for Jack Miller	Milage for Juan Martin	Milage for Gonzalo Ibarra	Milage for Matthew Bailey	Total Miles	
7/1/12 to 9/30/12	4,688	6,299	4,865	3,190	19,042	CSB 2.10 b
4/1/12 to 6/30/12	5,247	7,851	5,049	3,965	22,112	CSB 2.10 b
1/1/12 to 3/31/12	4,514	5,977	5,208	3,319	19,018	CSB 2.10 b
10/1/12 to 12/31/12	5,137	6,351	4,830	-	16,318	CSB 2.10 b
	19,586	26,478	19,952	10,474	76,490	CSB 2.10 b
Less: Commute & Personal Miles	240	3,600	240	4,600		From Line 26
	19,346	22,878	19,712	5,874		
Multiplied by Reimbursement Rate	\$ 0.335	\$ 0.335	\$ 0.335	\$ 0.335		CSB 2.10 b
Total Travel Expense	\$ 6,481	\$ 7,664	\$ 6,604	\$ 1,968	\$ 22,716	
Daily Commute Miles	1	15	1	15		CSB 2.23 f
Multiplied by No. of Work Days in Month	20	20	20	20		
	20	300	20	300		
Multiplied by 12 Months	12	12	12	12		
Total Annual Commute Miles	240	3,600	240	3,600		
Personal Miles	-	-	-	1,000		CSB 3.3 e
Personal & Commute Miles	240	3,600	240	4,600		

References:

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

OPERATING INCOME ADJUSTMENT NO. 5 - MISCELLANEOUS EXPENSE, BANKING FEES

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF AS ADJUSTED
1	Miscellaneous Expense	\$ 38,503	\$ -	\$ 38,503
2	Banking Fees - Web Based	\$ 18,208	\$ (14,622)	\$ 3,586
3	Banking Fees - Non Web Based	\$ 4,674	\$ 6,092	\$ 10,766
4	Total Miscellaneous Expense	\$ 61,385	\$ (8,530)	\$ 52,855
5				
6		Per Company		Per Staff
7		Co. Sch C-2, P. 11 CSB 2.16(b) & 2.26(e)		Banking Fees
8				as of
9				9/30/2013
10		CSB 2.16(b) & 2.26(e)		
11	Banking Fees - Web Based	\$ 18,208	\$ (14,622)	\$ 3,586
12	Banking Fees - Non Web Based	\$ 4,674	\$ 6,092	\$ 10,766
13	Total	\$ 22,882	\$ (8,530)	\$ 14,352

References:

- Column A: Company Schedule C-2
- Column B: Testimony, CSB; Data Request CSB 2.16 (b) and CSB 2.26 (e)
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 6 - MISCELLANEOUS EXPENSE, OTHER

LINE NO.	DESCRIPTION	[A]	[B]	[C]
		COMPANY AS FILED	STAFF ADJUSTMENTS	STAFF S ADJUSTED
1	Miscellaneous Expense	\$ 53,074	\$ -	\$ 53,074
2	To reclassify MAP Fees to the water testing acct	\$ 7,687	\$ (7,687)	\$ -
3	To remove meals & entertainment (CSB 2.26)	\$ 624	\$ (624)	\$ -
4	Total Miscellaneous Expense	\$ 61,385	\$ (8,311)	\$ 53,074

MAP Fees CSB 2.26	
\$	458.17
\$	3,159.24
\$	3,719.50
\$	350.23
\$	7,687

References:

- Column A: Company Schedule C-2
- Column B: Testimony, CSB; Data Request CSB 2.26
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 7 - PROPERTY TAX EXPENSE

LINE NO.	Property Tax Calculation	[A] STAFF AS ADJUSTED	[B] STAFF ADJUSTED TO DECREASE
1	Staff Adjusted Test Year Revenues	\$ 825,929	\$ 825,929
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	1,651,858	\$ 1,651,858
4	Staff Recommended Revenue, Per Schedule CSB-1	825,929	\$ 976,757
5	Subtotal (Line 3 + Line 4)	2,477,786	2,628,615
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	825,929	\$ 876,205
8	Department of Revenue Mutilplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	1,651,858	\$ 1,752,410
10	Plus: 10% of CWIP -	-	-
11	Less: Net Book Value of Licensed Vehicles	10,493	\$ 10,493
12	Full Cash Value (Line 9 + Line 10 - Line 11)	1,641,365	\$ 1,741,917
13	Assessment Ratio	19.0%	19.0%
14	Assessment Value (Line 12 * Line 13)	311,859	\$ 330,964
15	Composite Property Tax Rate	10.1574%	10.1574%
16	Staff Test Year Adjusted Property Tax (Line 14 * Line 15)	\$ 31,677	\$ -
17	Company Proposed Property Tax	33,136	
18	Staff Test Year Adjustment (Line 16-Line 17)	\$ (1,459)	
19	Property Tax - Staff Recommended Revenue (Line 14 * Line 15)		\$ 33,617
20	Staff Test Year Adjusted Property Tax Expense (Line 16)		\$ 31,677
21	Increase in Property Tax Expense Due to Increase in Revenue Requirement		\$ 1,941
22	Increase to Property Tax Expense		\$ 1,941
23	Increase in Revenue Requirement		150,829
24	Increase to Property Tax per Dollar Increase in Revenue (Line19/Line 20)		1.286604%
25			

OPERATING INCOME ADJUSTMENT NO. 8 - TEST YEAR INCOME TAXES

LINE NO.	<u>DESCRIPTION</u>	(A)	(B)
	<i>Calculation of Income Tax:</i>		
		<u>Test Year</u>	
1	Revenue	\$ 825,929	
2	Less: Operating Expenses - Excluding Income Taxes	\$ 863,374	
3	Less: Synchronized Interest (L17)	\$ -	
4	Arizona Taxable Income (L1- L2 - L3)	\$ (37,445)	
5	Arizona State Income Tax Rate	2.590%	
6	Arizona Income Tax (L4 x L5)		\$ (970)
7	Federal Taxable Income (L4 - L6)	\$ (36,476)	
8	Federal Tax on First on all Income @ 10%	\$ (3,648)	
9		\$ -	
10		\$ -	
11		\$ -	
12		\$ -	
13	Total Federal Income Tax		\$ (3,648)
14	Combined Federal and State Income Tax (L6 + L13)		<u>\$ (4,617)</u>
	<i>Calculation of Interest Synchronization:</i>		
15	Rate Base	\$ (15,143)	
16	Weighted Average Cost of Debt	0.00%	
17	Synchronized Interest (L16 x L17)	<u>\$ -</u>	
18		Income Tax - Per Staff \$ (4,617)	
19		Income Tax - Per Company \$ (8,481)	
20		Staff Adjustment \$ 3,864	

Monthly Minimum Charge	Present	Company Proposed Rates	Staff Recommended Rates
Meter Size (All Classes):			
5/8 x 3/4 Inch	\$ 8.25	\$ 10.07	\$ 9.00
3/4 Inch	9.28	11.32	13.50
1 Inch	10.32	12.59	22.50
1 1/2 Inch	20.64	25.18	45.00
2 Inch	33.02	40.28	72.00
3 Inch	66.04	80.57	144.00
4 Inch	103.19	125.89	225.00
6 Inch	206.38	251.78	450.00
2 Inch Construction/Standpipe (Assigned)	33.02	40.28	72.00
3 Inch Construction/Standpipe (Assigned)	NT	80.57	144.00
6 Inch Construction/Standpipe (Assigned)	206.38	251.78	450.00
Gallons Included In Monthly Minimum Charge	0	0	0
Commodity Charge - Per 1,000 Gallons			
<u>5/8" x 3/4" Meter Residential</u>			
First 4,000 gallons	\$ 1.3500	\$ 1.4900	N/A
4,001 to 10,000 gallons	1.9000	2.3400	N/A
Over 10,000 gallons	2.4500	3.1900	N/A
First 3,000 gallons	N/A	N/A	\$ 1.3500
3,001 to 10,000 gallons	N/A	N/A	2.0500
Over 10,000 gallons	N/A	N/A	3.0100
<u>5/8" x 3/4" Meter Commercial & Industrial</u>			
First 10,000 gallons	N/A	N/A	N/A
Over 10,000 gallons	N/A	N/A	N/A
<u>5/8" x 3/4" Meter Commercial, Industrial, Irrigation</u>			
First 10,000 gallons	N/A	2.3400	2.0500
Over 10,000 gallons	N/A	3.1900	3.0100
<u>3/4" Meter Residential</u>			
First 4,000 gallons	N/A	N/A	\$ 1.3500
4,001 to 10,000 gallons	N/A	N/A	2.0500
Over 10,000 gallons	N/A	N/A	3.0100
<u>3/4" Meter Commercial, Industrial, Irrigation</u>			
First 10,000 gallons	N/A	N/A	\$ 2.0500
Over 10,000 gallons	N/A	N/A	3.0100
<u>1" Meter (all classes, except construction/standpipe)</u>			
First 12,500 gallons	N/A	N/A	\$ 2.0500
Over 12,500 gallons	N/A	N/A	3.0100
<u>1 1/2" Meter (all classes, except construction/standpipe)</u>			
First 25,000 gallons	N/A	N/A	\$ 2.0500
Over 25,000 gallons	N/A	N/A	3.0100
<u>2" Meter (all classes, except construction/standpipe)</u>			
First 40,000 gallons	N/A	N/A	\$ 2.0500
Over 40,000 gallons	N/A	N/A	3.0100

<u>3" Meter (all classes, except construction/standpipe)</u>			
First 80,000 gallons	N/A	N/A	\$ 2.0500
Over 80,000 gallons	N/A	N/A	3.0100
<u>4" Meter (all classes, except construction/standpipe)</u>			
First 126,000 gallons	N/A	N/A	\$ 2.0500
Over 126,000 gallons	N/A	N/A	3.0100
<u>6" Meter (all classes, except construction/standpipe)</u>			
First 250,000 gallons	N/A	N/A	\$ 2.0500
Over 250,000 gallons	N/A	N/A	3.0100
<u>2" Inch Construction or Standpipe (Individually Assigned Customer)</u>			
First 40,000 gallons	N/A	N/A	\$ 2.0500
Over 40,000 gallons	N/A	N/A	3.0100
<u>2" Inch Construction or Standpipe (No Assigned Customer)</u>			
All gallons	N/A	N/A	3.0100
<u>3" Inch Construction or Standpipe (Individually Assigned Customer)</u>			
First 80,000 gallons	N/A	N/A	\$ 2.0500
Over 80,000 gallons	N/A	N/A	3.0100
<u>3" Inch Construction or Standpipe (No Individually Assigned Customer)</u>			
All gallons	N/A	N/A	\$ 3.0100
<u>6" Inch Construction or Standpipe (Individually Assigned Customer)</u>			
First 250,000 gallons	N/A	N/A	\$ 2.0500
Over 250,000 gallons	N/A	N/A	3.0100
<u>6" Inch Construction or Standpipe (No Individually Assigned Customer)</u>			
All gallons	N/A	N/A	\$ 3.0100
Other Service Charges			
Establishment	\$ 35.00	\$ 35.00	\$ 35.00
Reestablishment (After Hours)	\$ 50.00	Remove***	Remove***
Reestablishment within 12 months	*	*	*
Reconnection (Delinquent)	\$ 40.00	\$ 40.00	\$ 40.00
Reconnection (Delinquent - After Hours)	\$ 55.00	Remove***	Remove***
Meter Test (If Correct)	\$ 25.00	\$ 40.00	\$ 40.00
Meter Re-read (if correct)	\$ 20.00	\$ 20.00	\$ 20.00
Deposit	**	**	**
Deposit Interest	6%**	6%**	6%**
NSF Check	\$ 20.00	\$ 20.00	\$ 20.00
Deferred Payment	1.5% per month	1.5% per month	1.5% per month
Late Payment Fee (per month)	1.5% per month	1.5% per month	1.5% per month
After Hours Service Charge (at customer request)	Cost	\$ 35.00	\$ 35.00
Meter Tampering Charge	Cost	Cost	Cost
Meter Box "Cut Lock" Charge	Cost	Cost	Cost

* Per Commission Rule A.A.C. R-14-2-403(D) - Number of months off the system times the monthly minimum.

** Per Commission Rule A.A.C. R-14-2-403(B)

*** See After Hours Service Charge

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per commission rule 14-2-409D(5).

Typical Bill Analysis
General Service 5/8 x 3/4-Inch Meter

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,336	\$ 16.19	\$ 19.16	\$ 2.97	18.33%
Median Usage	3,500	12.98	15.29	\$ 2.31	17.80%
Staff Recommended					
Average Usage	5,336	\$ 16.19	17.14	\$ 0.95	5.87%
Median Usage	3,500	12.98	13.73	\$ 0.75	5.78%

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

Gallons	Present		Company Proposed		Staff Recommended	
	5/8"		5/8"	%	5/8"	%
Consumption	Rates		Rates	Increase	Rates	Increase
-	\$ 8.25		\$ 10.07	22.06%	\$ 9.00	9.09%
1,000	9.60		11.56	20.42%	10.35	7.81%
2,000	10.95		13.05	19.18%	11.70	6.85%
3,000	12.30		14.54	18.21%	13.05	6.10%
4,000	13.65		16.03	17.44%	14.40	5.49%
5,000	15.55		18.37	18.14%	16.45	5.79%
6,000	17.45		20.71	18.68%	18.50	6.02%
7,000	19.35		23.05	19.12%	20.55	6.20%
8,000	21.25		25.39	19.48%	22.60	6.35%
9,000	23.15		27.73	19.78%	24.65	6.48%
10,000	25.05		30.07	20.04%	26.70	6.59%
11,000	27.50		33.26	20.95%	29.71	8.04%
12,000	29.95		36.45	21.70%	32.72	9.25%
13,000	32.40		39.64	22.35%	35.73	10.28%
14,000	34.85		42.83	22.90%	38.74	11.16%
15,000	37.30		46.02	23.38%	41.75	11.93%
16,000	39.75		49.21	23.80%	44.76	12.60%
17,000	42.20		52.40	24.17%	47.77	13.20%
18,000	44.65		55.59	24.50%	50.78	13.73%
19,000	47.10		58.78	24.80%	53.79	14.20%
20,000	49.55		61.97	25.07%	56.80	14.63%
25,000	61.80		77.92	26.08%	71.85	16.26%
30,000	74.05		93.87	26.77%	86.90	17.35%
35,000	86.30		109.82	27.25%	101.95	18.13%
40,000	98.55		125.77	27.62%	117.00	18.72%
45,000	110.80		141.72	27.91%	132.05	19.18%
50,000	123.05		157.67	28.13%	147.10	19.54%
75,000	184.30		237.42	28.82%	222.35	20.65%
100,000	245.55		317.17	29.17%	297.60	21.20%