

Exhibit No. _____
Issue: Maintenance and Repair, Audit and Tax
Preparation, Corporate Allocations
Witness: Phil Macias
Type of Exhibit: Direct Testimony
Sponsoring Party: Indian Hills
Case No.: WR-2017-0259
Date: October 13, 2017

Missouri Public Service Commission

Direct Testimony

of

Phil Macias

On Behalf of

Indian Hills Utility Operating Company, Inc.

October 13, 2017

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STATE OF MISSOURI)
)
COUNTY OF St Charles) ss

I, Phil Macias, state that the answers to the questions posed in the attached Direct Testimony are true to the best of my knowledge, information and belief.



Subscribed and sworn to before me this 13th day of October, 2017.



Notary Public

My Commission Expires: 01/31/2021

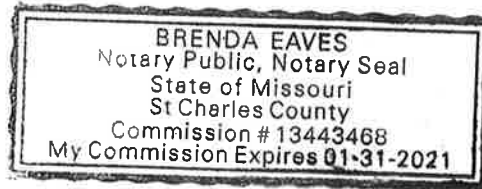


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**DIRECT TESTIMONY OF
PHIL MACIAS
INDIAN HILLS UTILITY OPERATING COMPANY, INC.**

WITNESS INTRODUCTION

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Phil Macias. My business address is 500 Northwest Plaza Drive
Suite 500. St. Ann MO, 63074

**Q. WHAT IS YOUR POSITION WITH INDIAN HILLS UTILITY OPERATING
COMPANY, INC. (INDIAN HILLS OR COMPANY)?**

A. I hold the position of Chief Financial Officer of First Round CSWR, LLC, the
ultimate parent company of Indian Hills, which is managed by Central States
Water Resources, Inc. We collectively refer to the family of companies ultimately
managed by Central States Water Resources, Inc. as Central States Water
Resources, CSWR, and Central States.

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL
EXPERIENCE.**

A. The first thirteen years of my career were spent with the U.S. Coast Guard. I
served at various duty stations including over 4 years in the accounting &
contracting function of the Central Regional Recruiting Command. I departed the
Service as a Senior Chief Petty Officer (E8), and joined The Anheuser-Busch
Eye Institute (Saint Louis University) as the Purchasing Manager in the Financial
Services department. My responsibilities included managing the acquisition of

1 construction materials and services as well as the sourcing and purchase of
2 capital equipment and the acquisition of operational materials and services. I left
3 Anheuser Busch to attend Saint Louis University full time and graduated with a
4 Bachelor of Science in Business Administration (Accounting). After graduation, I
5 joined Ernst & Young, LLP (a public accounting firm), in assurance and advisory
6 services. In my role at E&Y, I provided audit and advisory services to clients
7 engaged in manufacturing, banking and brokerage, not for profit,
8 communications, technology & software development. From E&Y, I joined
9 Washington University in St. Louis as the Accounting Operations Project
10 Manager in the Accounting Services Department where I prepared analysis on
11 the Financial Services division's management activities for the Vice Chancellor
12 for Financial Affairs, the Controller and other members of the Senior
13 Management team. I also served as the interim manager of the Sponsored
14 Projects Department where I managed the financial compliance and reporting
15 process pertaining to grants and awards from the National Institutes of Health
16 (NIH) and National Science Foundation (NSF). From Washington University I
17 joined CoreExpress, Inc, as the Senior Financial Project Manager. While at
18 CoreExpress I managed the finance and accounting process related to
19 approximately \$475 million in fiber optics related capital acquisitions. I also
20 managed the operational relationships with finance and credit partners involving
21 the credit facilities and vendor financing agreements. In addition, my
22 responsibilities included the preparation & presentation of internal/external
23 financial reporting information to senior management, equity stakeholders and

1 selected strategic business partners. From CoreExpress I joined GKN
2 Aerospace Services (GKN) as a Senior Financial Planning Analyst and Controller
3 of the Engineering Development Corporation (EDC), a subsidiary of GKN. I
4 directed the finance and accounting functions as the EDC transitioned from an
5 integrated business unit with all accounting duties executed offsite at the
6 corporate level to a legally separate, stand-alone business entity with all finance
7 and accounting operations performed internally, on-site. This included working
8 closely with the General Manager and the project management team to
9 restructure complex percent-of-completion revenue recognition procedures, the
10 accounts receivable recording process and inventory/cost-of-goods-sold (COGS)
11 reporting to ensure compliance with GAAP (generally accepted accounting
12 principles). At the corporate level, I developed financial analysis and forecasting
13 tools to enhance the cash management and inventory modeling functions,
14 assisted in the monthly accounting close process and developed various policies
15 and procedures including capitalization. At the time I joined GKN/EDC, I also
16 began a private CPA practice where I provided a range of accounting, audit and
17 tax services to both domestic and international, private and publicly traded/SEC
18 clients. In December of '02 I left GKN/EDC and began working full time in private
19 practice where I continued for the next ten years. In 2006, I was asked to join
20 adjunct faculty at Columbia College (accredited by the Higher Learning
21 Commission) where I have now been teaching introductory accounting (Financial
22 Accounting 280) for the past eleven years. In 2011, I joined the U.S. Soybean
23 Export Council (USSEC) as the Controller and ended my tenure as the Chief

1 Financial Officer (CFO). USSEC is a \$37MM international not for profit
2 organization led by, and working on behalf of, America's soybean farmers. As
3 CFO I partnered with the CEO and fellow members of the senior leadership team
4 on all strategic and operational issues and provided support, guidance and
5 recommendations to the Board of Directors and CEO on a wide range of financial
6 and operational matters. I provided both strategic and tactical direction to the
7 domestic & international accounting, finance, information technology, human
8 resources, budget, legal, contracting, compliance and project management
9 functions. Annually as the CFO I managed the independent third party financial
10 audit in addition to, as a federally funded organization, I managed a United
11 States Department of Agriculture, Foreign Agricultural Services, audit and a
12 Circular A133 audit. Annually I also had to adhere to an United Soybean Board
13 agreed upon procedures finance and compliance audit which required materiality
14 of internal financial reporting of not to exceed 0.01 cents on a \$37MM budget.
15 For USSEC's foreign operations I was in charge of another annual Singapore
16 based foreign subsidiary independent third party financial audit by E&Y, a foreign
17 subsidiary tax compliance audit by the Government of Mexico, and a full financial
18 and regulatory compliance audit by the Government of China pertaining to
19 operations conducted within the respective countries.

20
21 **Q. PLEASE DESCRIBE YOUR POSITION.**

22 **A.** I have been the Chief Financial Officer of Central States since March of 2017.

23

1 **PURPOSE**

2 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

3 A. I will provide the Missouri Public Service Commission (Commission) with
4 testimony concerning maintenance and repair expense, audit and tax preparation
5 fees, and corporate allocations to Indian Hills as they relate to the revenue
6 requirement.

7 **MAINTENANCE AND REPAIR EXPENSE**

8 **Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE**
9 **COMMISSION STAFF IN REGARD TO ITS PROPOSED TREATMENT OF**
10 **MAINTENANCE AND REPAIR EXPENSE?**

11 A. The Staff characterized selected repair costs as one-time expenses and
12 amortized them over a five-year period. In addition, the test year selected by
13 Staff includes a significant period of time prior to the point when the facility
14 became fully operational. As a result, that period that does not accurately reflect
15 the actual, on-going level of maintenance and repair expense incurred by the
16 Company.

17
18 **Q. WHY SHOULD THESE REPAIR EXPENSES NOT BE CONSIDERED “ONE**
19 **TIME”?**

20 A. As explained in greater detail by Indian Hills witness Thomas, these repair
21 expenses continue to be a part of our on-going operational requirement to
22 provide safe, adequate service. The repair expenses do not represent new

1 capitalized investments, but rather they are fixes inside antiquated, critical water
2 infrastructure.

3 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THIS ISSUE?**

4 **A.** The proper treatment for activity characterized as maintenance and repair is to
5 ensure the expense is recorded in the period incurred and reflected in the
6 Company's revenue requirement at the level it is expected to be incurred going
7 forward. Amortization is inappropriate. In addition, if maintenance and repair
8 expenses included in the revenue requirement were updated to reflect actual
9 expenses from the current year (12 months ended 09/17), which more fully
10 covers the period when the new plant additions were in operation, they would
11 total \$189,300 (See **Schedule PM S-1**). This amount accurately reflects the
12 Company's actual costs. \$189,300 is \$89,997 more than the amount the
13 Company has agreed to with Staff in the partial Stipulation agreement.

14
15 **Q. WHAT AMOUNT SHOULD THE COMMISSION INCLUDE IN INDIAN HILLS'
16 REVENUE REQUIREMENT FOR MAINTENANCE AND REPAIR EXPENSE?**

17 **A.** \$99,303
18

19 **AUDITING AND INCOME TAX PREPARATION FEES**

20 **Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE
21 COMMISSION STAFF IN REGARD TO AUDITING AND TAX PREPARATION
22 FEES?**

1 **A.** Staff excluded both the audit and tax preparation fees for Indian Hills and the
2 pro-rata share of audit & tax fees from First Round.

3

4 **Q. WHAT IS INDIAN HILLS'S ANNUAL SHARE OF THOSE COSTS?**

5 **A.** Indian Hill's direct costs of \$14,000 (\$10,000, financial audit and \$4,000, tax
6 preparation) combined with an 18% allocation of CSWR's audit and tax fees of
7 \$20,158.76, 18% of which is \$3,628.58, for a total \$21,628.58.

8

9 **Q. WHY IS IT NECESSARY FOR INDIAN HILLS AND ITS PARENT TO HIRE AN
10 OUTSIDE ACCOUNTANT OR FIRM TO PERFORM THESE SERVICES?**

11 **A.** As a CFO and C.P.A. I believe financial audit and tax preparation fees are a
12 routine cost of doing business for a professionally managed utility. This is
13 particularly important for a utility, or group of utilities, that is actively engaged in
14 attempting to raise capital. In fact, CSWR has been denied equipment financing
15 based on a lack of audited financials for the respective utility. One of the issues
16 facing a number of smaller utilities (water & sewer) is that the owners/managers
17 frequently fail to maintain accurate financial records and/or compliant tax filings.
18 It is another example of a disregard for regulatory/statutory requirements in the
19 companies we are acquiring.

20

21 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THIS ISSUE?**

22 **A.** The Commission should order that Indian Hills' tax fees, Indian Hill's audit fees,
23 and Indian Hills' corporate allocation of the actual audit and tax preparation fees

1 of First Round CSWR, LLC and Central States Water Resources, Inc. be
2 included in its revenue requirement.
3

4 **CORPORATE ALLOCATIONS**

5 **Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE**
6 **COMMISSION STAFF IN REGARD TO THE STAFF'S PROPOSED**
7 **TREATMENT OF CORPERATE ALLOCATIONS?**

8 A. The Staff uses a corporate allocation factor of 16.5%, based on its interpretation
9 of time sheets instead of the 18% allocation proposed by the Company, based on
10 customers.
11

12 **Q. HOW DID YOU DERIVE THIS CUSTOMER BASED ALLOCATION?**

13 A. During the test year, CSWR provided water service to 1,064 water customers
14 (238 at Hillcrest, 725 at Indian Hills, 101 at Smithview) and CSWR had another
15 121 in the acquisition process associated with Elm Hills (the current water
16 customers at Missouri Utilities), for a total of 1,185 water customers. During the
17 test year CSWR provided sewer service to 736 sewer customers (237 at Hillcrest
18 and 499 at Raccoon Creek) and CSWR had another 299 in the acquisition
19 process associated with Elm Hills (the sewer customers at Missouri Utilities and
20 State Park Village), for a total of 1,035 sewer customers.
21

22 **Q. IS THAT THE CUSTOMER TOTAL THE COMPANY USED FOR ITS**
23 **CALCULATION?**

1 A. No. If we only used the resulting 2,220 water and sewer customer count present
2 in the test year, Indian Hills' customers would have amounted to 32.66% of the
3 CSWR customer base.

4
5 **Q. WHAT DID THE COMPANY DO INSTEAD?**

6 A. In order to account for all of the potential acquisitions CSWR also included the
7 potential water and sewer customers of Alpine Village (162 water and 162 sewer
8 PSC regulated system under contract), Confluence Rivers (the 727 water
9 customers and 643 sewer customers mentioned in Josiah Cox's testimony made
10 up distressed regulated and unregulated MO systems under contract), and 185
11 other sewer customers we planned on acquiring. Of the 3,998 current and
12 planned water and sewer customers, Indian Hills customers represent 18.13% of
13 the customer base. This was rounded down to 18%. We believe this allocation
14 percentage correctly accounts for CSWR corporate overhead to existing
15 Commission regulated customers and currently unregulated work in process.

16

17 **Q. HOW DID STAFF CREATE ITS 16.5% CORPORATE ALLOCATION FACTOR?**

18 A. Staff used selected labor hours as the cost driver in a multi-step model.

19

20 **Q. WHAT IS UNREASONABLE ABOUT THIS METHODOLOGY?**

21 A The Staff's model relies on applying accurately recorded labor hours in a 5 step
22 process. While the correct hours are recorded company wide, that information is
23 not used consistently by Staff in step 1 (IH direct hours). Staff uses actual hours

1 for three of six employees, while the remaining three are averaged together. Staff
2 calculation Step 2 captures the administrative hours by individual employee but,
3 as with Step 1, the actual hours are used for only three of the six employees.
4 Staff calculation Step 3 builds on the result of #2 and applies it against a ratio of
5 total non-regulated company hours over total regulated company hours, by
6 individual. However, the actual ratio used for three of the six positions (a
7 different mix of employees than in steps one or two) is an unsupported value (not
8 linked or agreed to data table or other information supporting the value). The
9 ratios for the remaining employees agree to a supporting data table prepared by
10 Staff. Staff Step 4 uses the incorrect calculation from #3 and applies it against
11 another ratio (IH hours over total regulated company hours on a First Round –
12 CSWR basis). Staff calculation step 5 is simply the sum of the results of steps 1
13 and 4. However, since each of the four steps is inconsistently/incorrectly
14 calculated, the end result is also in error. In simple terms, the Staff model
15 contains errors at each step in the process by using actual time for only three
16 employees for the first two steps, using a ratio which uses hours of all employees
17 but applying it to only three employees (a different mix of employees than in
18 steps one and two) and then applies different ratios (that are not supported by
19 Staff's data) to the remaining three employees.

20
21 **Q. IF YOU FOLLOW STAFF'S METHODOLOGY AND UTILIZE ACTUAL HOURS**
22 **FOR ALL SIX EMPLOYEES, WHAT ALLOCATION DO YOU CALCULATE?**

1 A. If you use actual hours for each employee and follow Staff's methodology, the
2 resulting corporate allocation is 17.6%

3

4 **Q. WHAT IS THE APPROPRIATE TREATMENT OF THIS ISSUE?**

5 A. A per customer allocation is a more accurate allocation. This would result in an
6 18% allocation for IH, which on a per customer per service basis, would also
7 match previous allocations CSWR has in place.

8

9 **PAYROLL AS A PART OF CORPORATE ALLOCATIONS**

10 **Q. WHAT LABOR COSTS ARE RELEVANT TO THIS RATE CASE?**

11 A. Indian Hills has no employees. Several functions related to its operation are
12 provided by six employees of Central States --, a financial manager, chief
13 executive; operations manager, senior accountant, accountant and a customer
14 service manager. A portion of the costs associated with those employees is then
15 allocated to Indian Hills.

16

17 **Q. WHAT PORTION DO YOU PROPOSE TO ALLOCATE TO INDIAN HILLS?**

18 A. Eighteen percent (18%). This was based on a per customer basis, as described
19 above.

20

21 **Q. WHAT DISAGREEMENT DOES INDIAN HILLS HAVE WITH THE**
22 **COMMISSION STAFF IN REGARD TO PAYROLL?**

1 A. I do not agree with the method Staff used to derive the base labor costs to be
2 allocated.

3

4 **Q. HOW DID THE COMMISSION STAFF DEVELOP THOSE LABOR COSTS?**

5 A. In order to develop the labor costs associated with the Central States'
6 employees, the Commission Staff has used Missouri Economic Research and
7 Information Center (MERIC) wage estimates based on the St. Louis region and a
8 2016 study that has not been adjusted using U.S. Department of Labor,
9 Employment Cost Index (EPI) inflation rates. In addition, the Commission Staff
10 assumed that the employees possessed mean (or average) experience levels.
11 The salaries developed by the Staff are lower than the actual salaries paid for
12 Central States employees.

13

14 **Q. HOW DOES INDIAN HILLS BELIEVE THESE LABOR COSTS SHOULD BE**
15 **DEVELOPED?**

16 A. Indian Hills finds the Staff's general approach to be acceptable. However, in
17 working through that process, the Commission should use EPI inflation adjusted
18 salaries for "experienced" personnel at each category for rate making purposes.

19

20 **Q. WHY IS INDIAN HILLS' APPROACH MORE APPROPRIATE?**

21 A. All the salaries should be adjusted using the EPI in order to accurately reflect
22 current market conditions, rather than utilizing data that is two years old.
23 Moreover, in the case of the Central States employees, each employee's actual

1 experience, education levels, and current job roles demand that the individual be
2 recognized as "experienced."

3
4 **Q. PLEASE DESCRIBE THE EXPERIENCE OF THOSE CENTRAL STATES**
5 **EMPLOYEES.**

6 A. As CFO of the company I have a BS in Business Administration from St. Louis
7 University and am a CPA. I currently teach colligate level accounting. My
8 previous tenures have brought me experience in accounting beginning with 4 of
9 my 13 years in the armed services, I worked inside one of the big four accounting
10 firms, I have worked on hundreds of millions of dollars of telecommunications
11 infrastructure projects, run my own private accounting practice, managed multiple
12 types of federal government audits, managed third party audits on overseas
13 foreign subsidiaries, managed audits by the governments of Mexico and China,
14 and had to manage the materiality of internal financial reporting of not to exceed
15 0.01 cents on a \$37MM budget.

16 Our president and the founder of CSWR has accomplished the utility acquisition
17 work including evaluation of the existing utility assets for acquisition,
18 determination of existing net book value of acquisition targets, engineering
19 design/technology selection for new improvements, construction contractor
20 selection, construction management (since 2015 Central States has completed
21 approximately \$6MM in new plant investment with an additional \$1.5MM
22 currently part of an approved acquisition case), ongoing O&M management
23 including monitoring all plant remote operations and emergency responses, new

1 utility rate design/pro-forma financial models, and overall companywide
2 management across multiple states.. This myriad current job responsibility is
3 more than almost any executive I know inside or outside the water and
4 wastewater utility industry. Before CSWR he held director level positions inside
5 an engineer firm and was the CEO of an engineering and construction firm. His
6 education includes a Bachelor of Science in Environmental Science from the
7 University of Kansas and a Master of Business Administration from Washington
8 University in St. Louis.

9 Our Senior Vice President, who is responsible for running the operations and
10 some development, was previously President of Brotcke Well and Pump (the 2nd
11 largest well driller and service provider in the Midwest), Vice President of
12 Operations and Business Development of the Midwest for American Water
13 Contract Operations, and General Manager of Midwest operations for
14 Environmental Management Corporation. At one time as an operations manager
15 he was responsible for the operations and maintenance of water and wastewater
16 systems servicing 64,000 households across multiple states and systems. He
17 currently serves on the Technical Advisory Team for the Public Water Supply
18 District 2 of St. Charles County, MO the largest water district in MO. His
19 education includes a Bachelor of Science in Civil Engineering from The Missouri
20 University of Science and Technology, and a Masters of Business Administration
21 from Washington University in St. Louis.

22 Our customer service manager holds a Bachelor of Arts from Washington
23 University of St. Louis. She has over 30 years of director experience managing

1 large financial institution offices and most recently managed the office of the
2 largest drinking water well services company in Missouri before coming to
3 Central States for the last two and a half years.

4

5 **Q. WHAT SHOULD THE COMMISSION DO IN REGARD TO THIS ISSUE?**

6 A. The Commission should find that salaries, for purposes of establishing the
7 revenue requirement in this case, be adjusted to reflect MERIC "Experienced"
8 employees for the St. Louis area, and be adjusted to the most recent reporting
9 period of the Employment Cost Index for the US Bureau Labor of Statistics for
10 the following SOC codes and titles:

- 11 a. 11-1011 Experience Chief Executive;
- 12 b. 11-3031 Experience Financial Manager;
- 13 c. 11-1021 Experienced General and Operations Manager,
- 14 d. 11-9199 Customer Service Manager.

15

16 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

17 A. Yes, it does.