

MEMORANDUM

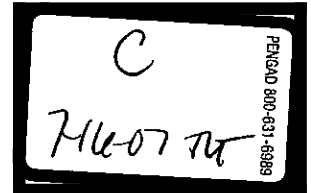
TO: Dale Johansen
Water & Sewer Department

THROUGH: Joan Wandel, Auditing Department Manager
Mark Oligschlaeger, Auditor V, Auditing Department

FROM: Dana Eaves & Agyenim "Kofi" Boateng
Auditing Department Staff

SUBJECT: Auditing Department's Recommendation
Case No. QW-2005-0001
Suburban Water & Sewer Company

Co Exhibit No. 62
Case No(s) WC-2007-0452
Date 7-26-07 by PF



DATE: February 14, 2005

BACKGROUND

The Missouri Public Service Commission (MoPSC) on September 30, 1972 granted Suburban Water & Sewer Company, Incorporated (the Company) a certificate of public convenience and necessity to provide water supply and distribution services in Boone County, Missouri. The principal stockholders of the Company are Gordon Burnam and Bonnie Burman. In 1980, the Boone County Regional Sewer District took over the operation of the sewer system. The Company currently serves approximately 152 residential water customers at Bon-Gor Lake Estates. The Company last received a water rate increase in September 1993 as result of Case No. WR-93-100. The Company is current on payment of their MoPSC annual assessment fee for 2004 and filing of 2003 annual report.

On December 1, 2004 the Company filed for an approximate 226% increase in annual water operating revenue through the MoPSC's informal rate case procedure, and the application was docketed as Case No. QW-2005-0001. The Company seeks this increase to improve the quality of water and operating capacity of the system. In the application, the Company proposes to retire the existing well and standpipe, then purchase water from the Boone County Consolidated Water District #1 (Water District). The owners of the Company live part-time in Florida and currently use outside contractors for all customer billing and maintenance of the water system.

The Company, without seeking MoPSC approval, arbitrarily and improperly increased its water rates from April 2004 through October 2004. The Company rescinded the rate increase in November 2004 after the MoPSC Staff became aware of the unauthorized rate change. The Company has not yet refunded the over-charges for the period April - October 2004 back to its customers.

During 2004, the Company contracted with Marshall Engineering and Surveying, Inc. (Marshall Engineering) to evaluate options for the future operations of the water system

based upon a report of inspection issued by the Department of Natural Resources (DNR) in September 2003. The Company states that the purpose of this evaluation was to explore installation of the best operating system that will bring the system into compliance with DNR requirements.

On July 9, 2004, Marshall Engineering presented the following three options to the Company for consideration:

- 1) The first of the options was to retain the ownership of the system while improving or upgrading the system to meet the DNR requirements. This option, which includes the upgrading the standpipe and chlorinator, was estimated at a minimum to cost the Company approximately \$26,500.
- 2) The second option was to retain ownership of the system; however, the Company would abandon the existing well and standpipe and purchase all water from the Water District. Under this option, the Company would pass along to customers the cost of water taken from the Water District; this option would limit the Company's responsibility to contracting out for billing services, meter reading and maintenance of the distribution system. All of the existing pumping and storage equipment would be retired and removed from rate base under this option. The Company's requested amount of rate relief was premised upon this option.
- 3) The third option was to transfer ownership of the system to a prospective owner. The Marshall Engineering report alleges the Water District has offered to assume the ownership of the system on condition that the system is upgraded. The estimated construction cost to the Company for the required upgrades is approximately \$80,000, according to Marshall Engineering. The Auditing Department Staff has not considered this option by Marshall Engineering based upon discussions with the Company. During these discussions, it was made known that a substantial investment would be required from the Company and property owners in order to redesign the water distribution system before a purchase arrangement could be discussed with the Water District. There remains a degree of uncertainty that the Water District would purchase the system even after the upgrade was completed. The Company and the Auditing Department Staff do not consider this as a viable economic option at this time.

RATE BASE

The Staff's proposed rate base represents the Company's net investment in plant as of December 31, 2004 not including the Marshall Engineering's estimated cost of improving the water treatment equipment (chlorinator) and standpipe in the amount of \$ 26,500. The total rate base amount as of December 31, 2004 was \$14,270.

PLANT

The plant and depreciation reserve balances used to develop the revenue requirement for the Company, as well as the depreciation rates used by Staff, were carried forward from the Company's informal rate case from September 1993, Case No. WR-93-100. The Staff then updated these account balances for any additions and/or retirements of plant shown in the Company's 2003 income tax returns and its 2004 financial statements. These balances were then brought forward through December 31, 2004.

REVENUES

Revenues were annualized using estimated water usage of 6,000 gallons per customer for 46-metered residential customers using the current tariff rates and using 4,800 gallons per customer for 106-unmetered rental units. The current tariff commodity rate is \$1.53 per 1,000 gallons plus a minimum/service charge of \$2.42 for all customers. The annualized gallons were then converted to commodity revenue by applying the tariff rate of \$1.53 per 1,000 gallons and the monthly service charge of \$2.42. This annualization approach resulted in an annual revenue amount of \$18,823. Reliance on estimated usage amount was necessary because, during the audit, the Staff discovered that majority of the duplexes and fourplexes were not metered. Instead, the owners of these duplexes and fourplexes were charged a monthly flat rate of \$7.50 per unit. However, the \$7.50 rate is not approved or contained in their current tariff. The Staff has analyzed this rate and finds that the Company was generally slightly under charging for actual water service taken under this unapproved rate. Also, among the four customers (property owners) being billed for this flat rate water service are the principal owners, Gordon and Bonnie Burnam of Suburban Water Company. Therefore, the Staff does not see a need to make any recommendation on the treatment of these charges, as they do not have any meaningful or direct impact on ratepayers. The audit also indicates about 38% of the total water pumped from the Company's well was lost through leakage or as the result of poor metering of water usage.

EXPENSES

The expense amount used to develop revenue requirement in this case was the total amount of expenses booked by the Company during the test year and contained in its 2004 financial statement, with several adjustments. The Staff during the audit examined invoices, receipts and other relevant documentation, and our review disclosed the level of expenses appeared to be consistent and representative of the costs for the Company on a going forward basis. Adjustments of 20% were made to decrease the test year expense level of purchase power and chemicals to reflect the large percentage of water loss experienced by the Company. These adjustments would bring the expense levels for these categories in line with a reasonable water loss percentage.

RECOMMENDATIONS

The Auditing Department's recommendations are the following:

- 1) The Audit Staff is recommending a rate increase of \$4,192 be granted to the Company as detailed in the Staff's accounting schedules attached herein.

- 2) The Auditing Department Staff believes that the first option outlined by Marshall Engineering is the most appropriate course of action by the Company at this time. The Marshall Engineering's estimated cost of improving the water treatment equipment (chlorinator) and standpipe in the amount of \$ 26,500 should be considered. This, the Audit Staff believes will effectively improve the operating capacity of the system in the provision of quality water and adequate service to the Company's customers. It will also result in a lower rate increase for customers and a lower financial risk for the Company compared with the option of purchasing water from the Water District. Upon the completion of the recommended proposed upgrade to the system, the Company should file for an informal rate proceeding based upon but not limited to the increase in additional plant.
- 3) The Auditing Department Staff does not recommend that the Company undertake the option of purchasing water from the Water District to supply its customers in the future. The purchase of water from the Water District will result in substantial higher monthly rates for customers and increased financial risks for the Company. Given the high commodity charge on water of \$4.10/1,000 gallons from the Water District, and the fact that the Company has a high volume of water loss as a result of lack of meters, inconsistent meter reading and leaks in the distribution system, the Auditing Department Staff believes that the Company will not be able to bill customers properly and ultimately could not recoup the cost of water that is billed from the Water District's master meter. During the test year, our audit showed the Company pumped a total of 12,274,000 gallons and sold an estimated 7,761,346 gallons, resulting in 4,512,654 gallons of lost water. If this loss occurred under the Company's proposal (\$4.10 per 1,000 gallons) the Company would have an \$18,502 expense that could not be recovered in rates. In the long run, this may render the Company incapable of living up to its financial and contractual obligations both to the Water District and its customers.
- 4) The Company should install and maintain meters in order to record the correct amount of water usage by individual customers.
- 5) The Company should conduct routine checks and maintenance work on the system to mitigate the high loss of water and to improve the efficiency of the system.
- 6) The Company should maintain a continuing property record (CPR) system. This CPR system should include a record of the dates plant is placed in service, purchase price of the property, and dates of retirement of property.
- 7) The Company should begin keeping proper depreciation schedules based on Commission approved depreciation rates.
- 8) The Company should refund all overcharges plus interest collected from April–October of 2004 associated with the unapproved rate increase, in the form of a rate credit. This credit should commence immediately after an order is granted in this case and should be issued to customers during the earliest 3-month continuous period following this order.