MISSOURI PUBLIC SERVICE COMMISSION

STAFF REPORT

REVENUE REQUIREMENT
COST OF SERVICE

LAKE REGION WATER & SEWER COMPANY

CASE NO. WR-2013-0461

Jefferson City, Missouri
November 15, 2013

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I. Executive Summary

Staff of the Missouri Public Service Commission ("Staff") has conducted a review in Case Nos. WR-2013-0461 and SR-2013-0459 of all cost of service components (capital structure and rate of return, rate base, depreciation expense, and operating expenses) which comprise Lake Region Water & Sewer Company's ("Lake Region" or "Company") revenue requirement for its water and sewer operations, respectively. This audit was in response to Lake Region's application to increase its gross annual water revenues in the amount of $74,197 and its gross annual sewer revenues for Horseshoe Bend sewer operations in the amount of $142,892 and $1,673 for its Shawnee Bend sewer operations. The application was filed with the Missouri Public Service Commission ("Commission") on July 17, 2013.

Staff's recommended increase in revenue requirement is based upon a test year of the twelve (12) months ending June 30, 2013. Staff's recommended revenue requirement for Lake Region at its recommended return on equity (ROE) of 13.89 percent is as follows:

Lake Region Operating Entity	Annual Revenue Requirement Staff ROE of 13.89%	Rate Base at June 30, 2013
Horseshoe Bend Sewer	$39,912	$1,274,431
Shawnee Bend Sewer	($195,641)	$276,864
Shawnee Bend Water	($103,683)	$1,084,271

The impact of Staff's recommended revenue requirement for each retail rate customer class will be proposed in the Staff's rate design testimony that is to be filed on November 22, 2013.

Staff Expert/Witness: Kimberly K. Bolin

II. Background of Lake Region Water & Sewer Company

Lake Region is a water and sewer company providing regulated water and sewer services to the Horseshoe Bend and Shawnee Bend areas at the Lake of the Ozarks. Horseshoe Bend has approximately 243 sewer customers and Shawnee Bend has approximately 654 water customers and 632 sewer customers. The Company operates and maintains two wells and an elevated water storage facility for its water operations, and sewage pumping (lift) stations and waste water sewer lines connected to waste water treatment facilities for its sewer operations.

The Company was originally named Four Seasons Lake Sites Water & Sewer Company ("Four Seasons") and was part of the original Lodge of the Four Seasons resort community. These properties were sold over various periods of time. The Commission granted the original owners a certificate of convenience and necessity on December 31, 1973, in Case No. 17,954. This certificate was amended in Case No. 18,001 on May 16, 1974, to expand water service in an area immediately adjacent to the previously authorized certificated area. The service area was expanded again in Case No. SA-89-135.

Four Seasons sold the water system on Horseshoe Bend to Ozark Shores Water Company ("Ozark Shores") in 1992. After this sale transaction, Four Seasons changed its name to Four Seasons Water and Sewer Company in Case No. SA-98-248. A name change was approved again on March 18, 1999, to Lake Region Water & Sewer Company. Lake Region Water & Sewer Company was granted a certificate to provide water and sewer service in the Shawnee Bend area on October 26, 1999, in Case No. SA-2000-295.

Lake Region is currently owned by RPS Properties, LP ("RPS" or "RPS Properties") a partnership between the Schwermann family, with Robert Schwermann being the general partner, and Vernon Stump. Vernon Stump is the President of the Company. Brian Schwermann is the secretary for Lake Region. On December 31, 2012, Sally Stump, wife of Vernon Stump, transferred her shares of Lake Region stock to Vernon Stump. Vernon Stump and Brian Schwermann are also the President and Secretary, respectively, of another company, Ozark Shores which provides water service to customers in Lake Region's Horseshoe Bend Sewer service area. Ozark Shores is owned by North Suburban Public Utility Company, which is owned by Robert Schwermann and Sally Stump.

Another company owned by RPS Properties and Sally Stump is Lake Utility Availability Fees. This entity collects the availability fees paid by owners of undeveloped lots within the service area of Lake Region and Ozark Shores for the privilege of the future ability to connect to Lake Region's water and sewer systems

Lake Region is one of three operating utilities co-located in the same office and sharing common cost. The other two utilities are Ozark Shores, also a Missouri Public Service Commission regulated utility, and Camden County Public Water Supply District #4 ("PWSD4"), a non-regulated utility.

Staff Expert/Witness: Kimberly K. Bolin

III. True-Up

The purpose of a true-up audit is to establish a cut-off point to which major elements of a utility's revenue requirement are to be updated, beyond the test year. When ordered, true-up audits involve the filing of additional sets of testimony and the scheduling of additional evidentiary hearings ordered by the Commission.

The Commission ordered a test year in this proceeding based upon twelve (12) months ending June 30, 2013, with a true-up audit through December 31, 2013. The parties to this case (Lake Region, Staff, and the Office of the Public Counsel (OPC)) have agreed the true-up audit be limited to the following items:

RATE BASE:

Plant in Service
Accumulated Depreciation Reserve
Accumulated Deferred Income Taxes
Customer Advances
Contributions in Aid of Construction
Materials and Supplies

INCOME STATEMENT:

Revenue - Customer Growth
Availability Fees
Payroll – Employee levels, wage rate and related benefits

Contracted Labor
Management Fees
Executive Management Oversight
Insurance
Rate Case Expense
Depreciation and Amortization Expense
Property Taxes
Related Income Tax Impact
Support Services Expense

Staff Expert/Witness: Kimberly K. Bolin

IV. Rate of Return

A. Summary

The Financial Analysis Staff (Shana Atkinson) recommends that the Commission authorize an overall Rate of Return (ROR) of 7.22 percent for Lake Region. This rate of return recommendation is based on a recommended return on common equity of 13.89 percent applied to a hypothetical, common equity ratio of 25.00 percent and a 5.00 percent embedded cost of debt applied to a 75.00 percent debt ratio.

The Staff's embedded cost of debt is based on the cost of debt outstanding as of June 30, 2013, for debt issued at the Lake Region level and debt incurred to acquire Lake Region. Staff relied on Lake Region's responses to Staff Data Request Nos. 0021, 0064 and 0070 to determine the embedded cost of debt.

Staff used a hypothetical capital structure consisting of 75.00 percent debt and 25.00 percent common equity. This is a deviation from Staff's recommendation in Lake Region's last rate case, Case No. SR-2010-0110, in which Staff used an estimate of the actual capital supporting Lake Region's rate base. Staff will explain later in its testimony why it is recommending the use of a hypothetical capital structure in this case. Staff assumed that the current value of equity invested in rate base is Staff's rate base recommendation of $2,635,566 less the $2,850,000 acquisition debt and the June 30, 2013, outstanding balance of debt issued at Lake Region of $1,396,731.04. This illustrates that Lake Region's capital structure consists of 100.00 percent debt, but Staff recommends a hypothetical capital structure consisting of 75.00 percent debt and 25.00 percent common equity. Staff believes this is the most appropriate approach given the information Staff was able to analyze. The lack of financial information is due to Lake Region's objections to Staff Data Request Nos. 0064 and 0065, which requested the outstanding balance of the acquisition loan as of June 30, 2013, and the current terms and conditions associated with this loan. Lake Region provided information on this loan in the previous rate case and in fact, even supported including it in developing a rate of return in the last rate case.

B. Background of Lake Region Operations, Ownership and Financing Arrangement

Lake Region is engaged in providing public utility water and sewer service to residential and commercial customers in Camden County, Missouri. The Company's organizational/ownership structure is as follows:

Lake Region is owned equally by RPS Properties and Vernon Stump. Vernon Stump acquired his Lake Region shares from Sally Stump (Vernon Stump's wife) on December 31, 2012. Vernon Stump is the President of both Lake Region and Ozark Shores Water Company. RPS Properties is a limited partnership for the Schwermann family with Robert Schwermann being the General Partner. Mr. Schwermann was also the former President of Lake Region. Members of the Schwermann family are limited partners (generally limited partners are financial contributors, but not active in the operations); one of those family members is Brian Schwermann who is the Secretary of Lake Region and Ozark Shores Water Company. Ozark Shores Water Company is wholly owned by North Suburban Public Utilities, Inc. North Suburban Public Utilities, Inc. is owned 51.76% by Robert Schwermann and 48.24% by Sally Stump.

The debt issued to fund the acquisition of Lake Region was specifically issued by RPS and Sally Stump. According to loan documents provided by Lake Region in response to Staff Data Request No. 0001.1 in the Company's most recent finance case, Case No. WF-2013-0118, this loan is primarily secured by the assignment of RPS's and Sally Stump's investment property/securities in Lake Region. The lender, Alterra Bank, also required a Negative Pledge Agreement, which states that assets of Lake Region shall not be pledged as collateral on any other indebtedness.

C. Capital Structure and Embedded Costs

Unlike the last rate case, Staff recommends the use of a hypothetical capital structure of 75 percent debt and 25 percent equity. Staff determined the equity ratio to be 0.00 percent by subtracting the long-term debt amount from the total capital amount (rate base) and then dividing that equity amount by the total capital. (*see* Schedule SA-1 of Appendix 2) However, Staff recommends a capital structure of 75.00 percent debt and 25.00 percent equity. Based on Staff's discovery in Lake Region's last rate case and its recent finance case, the evidence showed that Lake Region's assets could support a highly leveraged capital structure regardless of who or what entity issued the debt to capitalize the assets. Lake Region's owners communicated to Staff in the last rate case they simply decided to issue all of the debt at the partnership level rather than at the Lake Region level for their own personal reasons. Although the owners have now issued some debt at Lake Region, they still have an unidentified balance on the original acquisition loan.

While Staff believes Lake Region's lack of transparency during discovery could support Staff's continued use of a more leveraged actual capital structure as recommended by Staff and accepted by the Company in the last rate case, there are practical limitations on estimating the cost of equity at extreme levels of leverage. Therefore, Staff decided to cap the leverage ratio at 75 percent debt.

Staff's embedded cost of debt recommendation is 5.00 percent for debt associated with Lake Region, as of June 30, 2013. This cost of debt is based on the cost of the acquisition debt and the amount of debt held at Lake Region. Both the acquisition debt and the amount of debt held at Lake Region are loans with Alterra Bank. In this testimony, the acquisition debt will be referred to as the acquisition loan and the debt held at Lake Region will be referred to as the Lake Region loan. The outstanding balance of the Lake Region loan was $1,396,731.04 as of June 30, 2013, with a maturity date of August 10, 2014. Lake Region indicated in the Company's "Lake Region Water & Sewer Company's Response to Order Directing Filing and Contingent Motion for Leave to File Response Out of Time" filing in Case No. WF-2013-0118, that on or about June 18, 2013, a disbursement from the Lake Region loan of $1,392,339.21 was authorized to pay down Loan 7016782. Loan 7016782 is the acquisition loan, which was issued on October 8, 2004, in the amount of $2,700,000 and was renewed on October 10, 2005, for $2,876,281.29. The balance of this loan increased due to the need for new funds for equipment, legal fees and engineering. The loan was renewed again in 2006, 2008, 2009 and 2011. The balance on this loan has continued to be high due to the fact that the balloon payment due at maturity continues to be refinanced. The most recent loan documents Lake Region made available to Staff in regards to the acquisition loan shows a maturity date of August 10, 2014, and a principal amount of $2,850,000. Staff was unable to verify the amount outstanding on this loan as of the update period due to objections to Staff Data Request Nos. 0064 and 0065. Lake Region also stated in response to Staff Data Request No. 0070 that they do not know if the acquisition loan documents that they did provide to Staff were current as of June 30, 2013. Staff has issued a subpoena to RPS Properties to try and obtain the current loan documents and the amount outstanding as of the update period, June 30, 2013, for the acquisition loan. However, the information was not available to Staff in time for filing direct testimony. The acquisition loan documents provided to Staff were provided in response to Data Request No. 0001.1 in Case No. WF-2013-0118, and Data Request No. 0061 in Case No. SR-2010-0110. The Lake Region loan documents were provided in response to Staff Data Request No. 0021 in this case.

In response to Staff Data Request No. 0064, Lake Region stated that the Company has not done any calculations regarding weighted average interest as the interest charged has been the minimum allowed during the period for all loans made to the Company. Therefore, Staff recommends 5.00 percent, which is the stated minimum allowed in the loan documents available to Staff, for both the acquisition loan and the Lake Region loan.

D. Cost of Common Equity

Staff used their “Small Utility Return on Equity (ROE)/Rate of Return (ROR) Methodology” to estimate Lake Region’s cost of common equity (*see* Appendix 2, Schedule SA-2). Staff’s ROE recommendation is 13.89 percent. Staff estimated Lake Region’s cost of common equity by adding a 4 percent risk premium to the public utility bond yield average for August, September and October 2013. Staff used an average of ‘B+’ rated public utility bonds. Staff estimated a ‘B+’ rating for Lake Region based on assigning a ‘Strong’ Business Risk Profile (BRP) estimate with a ‘Highly Leveraged’ Financial Risk Profile (FRP) estimate. The ‘Strong’ BRP was based on the Company’s ability to attract debt capital through commercial loans. The ‘Highly Leveraged’ FRP was based on the Debt/Capital ratio of

Lake Region and comparing that to the financial benchmark ratios in *Standard & Poor's* "Critiera Methodology: Business Risk/Financial Risk Matrix Expanded" (*see* Appendix 2, Schedule SA-3).

E. Conclusion

It is the Staff's responsibility to calculate and recommend a rate of return that should be authorized on the water utility rate base and sewer utility rate base of Lake Region. Under the cost of service ratemaking approach, a weighted cost of capital of 7.22 percent was developed for Lake Region's water and sewer utility operations (*see* Schedule SA-1 of Appendix 2). This rate was calculated by applying an embedded cost of long-term debt of 5.00 percent and a cost of common equity of 13.89 percent, to a hypothetical capital structure consisting of 75 percent long-term debt and 25 percent common equity. Therefore, from a financial perspective, Staff is recommending to the Commission that Lake Region's water and sewer utility operations be allowed to earn a return on its original cost rate base of 7.22 percent.

Staff Expert/Witness: Shana Atkinson

V. Rate Base

A. Plant in Service and Depreciation Reserve

To ensure accuracy of the Company's plant in service and accumulated depreciation reserve, Staff examined plant levels, additions and retirements using the Company's General Ledger from 1999 to June 30, 2013, for each of the three separate operating systems that Lake Region runs; Shawnee Bend water operations, Shawnee Bend sewer operations, and Horseshoe Bend sewer operations. This process was used to determine the proper level of plant in service that should be included in the Company's rate base for three separate water and sewer revenue requirements. Depreciation reserve reflects the rate base value of Lake Region's depreciation reserve for each of the operating entities, as of June 30, 2013, by account.

Staff Witness Arthur W. Rice of the Commission's Engineering and Management Services Unit (EMSU) will be sponsoring adjustments to Lake Region's test year ending plant in service and depreciation reserve balances, which he will address in Section(s) VII, G of the Report.

Staff Expert/Witness: Ashley Sarver

B. Materials and Supplies - Inventory

The Company holds a variety of materials and supplies in inventory so as to be readily available in performing its utility operations. Staff reviewed all test year invoices related to materials and supplies and Lake Region's general ledgers to determine the materials and supplies inventory levels to include in rate base.

The current practice for Lake Region is to place all the expenses for Materials and Supplies – Inventory into Account 151.00, Inventory Other, then at the end of the calendar year the Company's auditor will make an adjustment from Inventory Other to separate the materials and supplies between Account 151.00 Inventory Sewer and Account 151.20 Inventory Water. In most cases, Staff uses a thirteen-month average to calculate Materials and Supplies – Inventory; however in this case, due to fluctuations in the materials and supplies inventory balances over time Staff determined that a thirteen-month average is not appropriate. Instead, Staff used a three-year average for the calendar year ending December 31, 2012. Staff was not able to use more updated information regarding this item because 2013 materials and supplies balances are not yet separated between Lake Region's water and sewer operations. The inventory levels were allocated to all three entities using the plant allocation factor as of June 30, 2013.

Staff Expert/Witness: Ashley Sarver

C. Customer Advances

Customer advances are funds provided by individual customers of the Company to assist in the costs of provision of water and sewer service to them. These funds represent interest-free money to the Company. Therefore, it is appropriate to include these funds as an offset to rate base. No interest is paid to customers for the use of their money. The amount of customer advances were reflected on the June 30, 2013, total.

Staff Expert/Witness: Ashley Sarver

D. Contributions in Aid of Construction

Contributions in Aid of Construction (CIAC) are funds provided by individual customers of the Company to assist in the construction and extension of mains in order to receive provisions of water and/or sewer service to them. Since customers ultimately provide the investment in this portion of the utility water and sewer infrastructures, utility companies do not have any investment in CIAC and are not entitled to earn a return on the property or a return of the CIAC property. CIAC is usually a significant source of financing for water and sewer utilities. As a result, a deduction must be made to rate base to account for these contributions to recognize that the utilities does not have investment dollars in that portion of the water and sewer plant. The Staff's ending CIAC is based on June 30, 2013.

Staff Expert/Witness: Ashley Sarver

E. Deferred Income Taxes

Staff included an amount in rate base to subtract Lake Region's accumulated deferred tax balance as of June 30, 2013, from plant. Staff used its plant-in-service allocation factor to allocate Lake Region's deferred tax reserve balance between Shawnee Bend Water, Shawnee Bend Sewer, and Horseshoe Bend Sewer.

Staff Expert/Witness: Keith D. Foster

VI. Allocations

Lake Region is one of three operating utilities co-located in the same facility and sharing common cost structures. The other two utilities are Ozark Shores, a Missouri Public Service Commission regulated utility, and PWSD4, a non-regulated utility. The PWSD4 provides management oversight and operational support to Ozark Shores and Lake Region, supplying various services to each company at contracted rates. In addition to management oversight, including a common General Manager, some of the services provided to Ozark Shores and Lake Region by the PWSD4 are labor, meter reading, billing and collection functions, customer service, and access to heavy equipment and trucks for operator use. Because of the close interrelationship of the three operating utilities, common costs are allocated between each utility. Most of the costs for each of the operating companies are direct-assigned, while some, particularly office functions, are allocated equally. In most cases, Staff did not propose adjustments to costs allocated between operating companies.

Within Lake Region, common costs assigned to it must be further allocated among the company's three operating systems: Horseshoe Bend Sewer, Shawnee Bend Sewer, and Shawnee Bend Water. Each operating system has specific costs that are direct-assigned requiring no further allocation. For example, expenses for maintenance of a well apply only to the water system while sludge removal applies to the two sewer systems. However, there are common costs among the three operating systems that must be allocated among them. Staff used several allocation factors to determine the appropriate cost for each operating system. The nature of each expense item requiring allocation determined what factor was applied to allocate the expense. The allocation factors include number of customers, rate revenue, payroll, plant-in-service, and, in some cases, a blend of the number of customers and revenue. Attached as Schedule KDF–1, in Appendix 3 is a table of all the allocation factors used by Staff and the percentages allocated to each of the operating systems for each factor.

Staff Expert/Witness: Keith D. Foster

VII. Income Statement

A. Revenues

1. Rate Revenues

Lake Region has two operating divisions for its water and sewer operations: Shawnee Bend and Horseshoe Bend. The operating divisions are then broken down into three specific operating entities: Shawnee Bend Water, Shawnee Bend Sewer, and Horseshoe Bend Sewer.

Shawnee Bend Water customers are charged a tariff rate based upon meter size. In addition to this flat rate amount, residential and commercial customers are charged a commodity charge of $2.49 for every thousand gallons used above the amount included in the designated flat rate. (Please see chart below for more detailed information):

continued on next page

Meter Size	Gallons Included	Flat Rate
5/8”	3,000 gal/month	$12.99
3/4”	4,500 gal/month	$16.72
1”	7,500 gal/month	$24.18
1.5”	15,000 gal/month	$42.82
2”	24,000 gal/month	$65.19
4”	75,000 gal/month	$191.95
6”	150,000 gal/month	$378.37

Per the tariff, the commodity charge is to be prorated to the actual volume of consumption for all usage that exceeds the minimum included in the monthly flat rate. Shawnee Bend commercial sewer customers are handled in a similar manner as the water customers. They are charged a monthly flat rate of $36.19 as well as a commodity charge. The sewer commodity charge is $6.03 per thousand gallons used over 6,000 gallons per month. The commodity charge is based on the monthly water meter reading at each customer location. Shawnee Bend Sewer residential customers are not charged a commodity charge; they are charged the flat fee of $36.19 per month for their sewer service. Horseshoe Bend commercial sewer customers are also charged a commodity charge in addition to the monthly flat rate. Commercial sewer customers are charged a monthly flat rate of $29.39. The commercial sewer commodity charge is $5.26 per thousand gallons used per month. The monthly usage values are determined from flow meters, water meters, or off of the pumps at the lift stations. Horseshoe Bend Sewer residential customers are not charged a commodity charge; they are charged the flat fee of $29.39 per month for their sewer service.

To determine the level of revenues that Lake Region needs to collect to maintain safe and adequate service for their customers, Staff examined three years’ worth of billing data ending June 30, 2013, for all customers. To examine this data, Staff was given access to the Company’s accounting/billing program “Thoroughbred.” Using the information provided in the Thoroughbred program, Staff was able to review each customer’s monthly payment as well as the customer’s usage amount when applicable for all three systems. Staff was then able to determine the appropriate level of flat rate revenue to include for each system by using the current tariff rate applied to the level of customers as of June 30, 2013, for each customer class and meter size. To determine the appropriate level of commodity charge, Staff used a three-year monthly usage average applied to the applicable tariffed commodity rate. Please see the table below for the number of customers, meter size, flat rate revenues, and commodity revenues for the Shawnee Bend water and sewer customers:

Meter Size/Service	Number of Customers	Flat Rate Fee	Annualized Water Flat Rate	Annualized Water Commodity	Annualized Sewer Flat Rate	Sewer Commodity	Annualized Sewer Commodity
Residential 5/8”	581	$12.99	$91,190	$71,889	$252,317	N/A	N/A
Residential 5/8” No Sewer	4	$12.99	Included in above value	Included in above value	N/A	N/A	N/A
Residential 1”	13	$24.18	$3,772	$1,622	$5,646	N/A	N/A
Residential 1.5”	18	$42.82	$9,249	$1,986	$7,817	N/A	N/A
Residential 2”	8	$65.19	$6,258	$7	$3,474	N/A	N/A
Commercial 5/8” No Sewer	5	$12.99	$779	$1,292	N/A	N/A	N/A
Commercial 1” No Sewer	7	$24.18	$2,031	$1,937	N/A	N/A	N/A
Commercial 1.5” No Sewer	2	$42.82	$1,028	$899	N/A	N/A	N/A
Commercial 2” No Sewer	4	$65.19	$3,129	$2,349	N/A	N/A	N/A
Commercial 5/8”	4	$12.99	$624	$48	$1,737	$6.03 per 1,000 gal/month over 6,000 gal/month	$43
Commercial 1.5”	1	$42.82	$514	$860	$434		$2,437
Commercial 2”	3	$65.19	$2,347	$557	$1,303		$2,608
Commercial 4”	3	$191.95	$6,910	$723	$1,303		$10,486
Commercial 6”	1	$378.37	$4540	$16	$434		$4,022
Total	654		**$132,371**	**$84,185**	**$274,465**		**$19,597**

The monthly flat rate and commodity charges will result in revenues of approximately $510,619 for Shawnee Bend operations. The table below illustrates the monthly flat rate and commodity revenues for Horseshoe Bend Sewer:

	Number of Customers	Monthly Flat Rate	Annualized Sewer Flat Rate	Sewer Commodity	Annualized Sewer Commodity
Residential	225	$29.39	$79,353	N/A	N/A
Commercial	18	$29.39	$6,348	$5.26 per 1,000 gal/month	$359,434
Total	243		**$85,701**		**$359,434**

The monthly flat rate and commodity charges will result in revenues of approximately $445,136 for Horseshoe Bend sewer operations, resulting in overall revenues of $955,753 for Lake Region.

Staff Expert/Witness: Erin M. Carle

2. Miscellaneous Revenues

In addition to collecting rate revenues, Lake Region also collects various miscellaneous revenues. For Lake Region, miscellaneous revenues are made up of non-utility income (acct 421), other water revenue (acct 474), late fees (accts 470.10 and 532.15), water connection fees and sewer connection fees (accts 471 and 536, respectively). Staff analyzed three years' of data ending June 30, 2013, for each of the prior mentioned accounts. Staff found that the late charges for water have steadily decreased, while the late charges for sewer were steadily increasing. Therefore the test year ending value was the most appropriate amount to include in rates for both water and sewer. Accounts 421.00 and 474.00 did not have a discernible trend; therefore, Staff used a three year average to determine the most appropriate amount of revenues to include in rates for these two accounts. Accounts 471 and 536 are clearing accounts for miscellaneous revenues that zero out on a calendar year basis. Due to the test year not being a calendar year, Staff included an adjustment that zeroes out the test year value to reflect the clearing purpose of these two accounts.

Staff Expert/Witness: Erin M. Carle

3. Availability Fees

Staff is including revenue in its case that is derived from "availability charges," also called "availability fees." Availability charges are monthly payments that lot owners agree to pay after the water or sewer systems become available to their unimproved lots but prior to the time they construct homes and connect to the water or sewer systems. The amount of revenue that Staff is including in its case for availability charges is an estimate of $342,090. Staff's calculation of the availability fees is based upon the number of unimproved lots sold as of March 31, 2010, information that was provided by the Four Seasons Lakesites Property Owners Association in Lake Region's last rate case, SR-2012-0110. Staff then subtracted the number of new connections that have been made to Lake Region Water & Sewer in its Shawnee Bend operating area since March 31, 2010, through June 30, 2013, to arrive at an estimated number of unimproved sold lots. The annual per lot availability charge is $120 for water and $180 for sewer.

The availability charges applicable to most lot owners in Lake Region's service area are specified and required to be paid to the owner of the utility system in two subdivision documents: 1) the *Fourth Amended and Restated Declaration of Restrictive Covenants*, which is dated October 1, 2009, and recorded in the Camden County Recorder's Office on October 06, 2009, in Book 684, Page 544, and 2) the *Amendment to Third Amended and Restated Declaration of Restrictive Covenants Relating to Water and Sewer Systems*, which is dated July 22, 2009, and recorded in the Camden County Recorder's office on July 29, 2009, in Book 681, Page 760. Other subdivision documents and amendments relating to availability fees exist and are referred to within these specific documents.

Currently, availability fees are being paid by lot owners to Lake Utility Availability 1, an unregulated affiliate of Lake Region Water & Sewer Company. Prior to August 17, 1998, lot owners in the Lake Region service territory paid availability fees directly to the utility company.

Staff's proposed treatment of funds derived from availability charges – that they be included as Lake Region revenue – is substantially consistent with treatment of such funds in past cases including Case No. 17,954, the Company's original certificate case in 1972; Case No. WR-99-183, a rate case filed by Ozark Shores Water Company, Inc. a successor owner of some of the Company's past assets; Staff's stated intentions in Case No. WA-95-164, a certificate expansion case filed by Four Seasons Lakesites Water & Sewer Company, which was Lake Region's original name; Staff's recommendation in Case No. SR-2010-0110, Lake Region's previous rate case; and treatment of availability charges applicable to lots in service areas of at least two (2) other regulated water or sewer utilities.

Staff believes that, since Lake Region is the entity that is providing a guarantee of water and sewer service availability to lot owners in Lake Region's service territory, the availability fee revenue should be included in Lake Region's cost of service. Lake Utility Availability 1 is a fictitious name used by RPS Properties and Sally Stump and serves merely as a collection entity for these charges, and the funds it collects are for no other service than that which is provided by Lake Region. RPS Properties is also an owner of Lake Region and Sally Stump was also an owner of Lake Region until December 31, 2012. Now, Vernon Stump, Sally Stump's husband, and RPS Properties are the owners of Lake Region. Lake Utility Availability 1 is not the entity that owns the water works system and central sewer system that make it possible for the customers to connect and receive water and sewer utility service in the future, and Lake Utility Availability 1 does not have a certificate to serve this area.

Staff Experts/Witnesses: Kimberly K. Bolin and James A. Merciel, Jr.

B. Operations Expense

1. Purchased Power

In order to provide water and sewer utility service Lake Region must purchase electricity from AmerenUE and Co-Mo Electric Cooperative, Inc. (CMEC). Staff has reviewed the electric bills from AmerenUE and CMEC to determine the annualized amount of electricity expense to include in the current rates. Staff annualized this expense using kilowatt hour usage data from the test year, the twelve (12) months ending June 30, 2013, and the current rates charged by the electric companies.

Staff made adjustments to remove amounts paid to Ozark Shores Water for water usage for the Horseshoe Bend sewer) operations. These amounts were incorrectly booked as purchased power. Staff has included an amount for this water usage (refer to Section VII, C.5. of the COS Report). Staff also made adjustments to remove an amount (bill) from Lake Region to PWSD4. This bill should have been paid by PWSD4, not Lake Region. Finally, Staff made adjustments to move electric expenses that were incorrectly booked for the wrong systems (Horseshoe Bend Sewer and Shawnee Bend Sewer) to the right systems.

Staff Expert/Witness: Ashley Sarver

2. Chemicals

Staff analyzed historical data regarding chemical expense beginning January 1, 2010, through June 30, 2013. Based on the analysis, Staff utilized the test year ending June 30, 2013, level of this expense as the appropriate level of chemicals that is currently required to maintain the water and sewer systems.

Staff Expert/Witness: Ashley Sarver

3. Testing Expense

The Staff reviewed all invoices within the test year related to the water and sewer testing expense. Staff made adjustments to change amounts for Water Pollution Control Services invoices that were incorrectly or inconsistently booked to the wrong accounts.

Staff Expert/Witness: Ashley Sarver

4. Payroll, Employee Benefits, Payroll Taxes and Workers' Compensation

Staff has adjusted Lake Region's test year payroll expense to reflect an annualized level of payroll, employee benefits, payroll taxes, and workers' compensation as of June 30, 2013, which is the endpoint of the test year period ordered for this case by the Commission.

All employees working on the Lake Region operations are employed by the PWSD4, with a fixed contracted monthly labor fee paid by Lake Region to PWSD4. The monthly labor fee is inclusive of each PWSD4 employee's pay (including overtime pay), payroll taxes, workers' compensation, and employee benefit costs including health and dental insurance and retirement plan (100% funded) costs. Each year, the General Manager prepares a budget that determines the monthly labor fee that will be charged to Lake Region as well as the fee that will be charged to Ozark Shores. With the exception of two employees, labor costs are allocated to each of the three utilities (PWSD4, Lake Region, and Ozark Shores) by the percentage of actual total employee cost charged to each utility in a prior period. For the Accountant and the General Manager's base pay, the labor costs are split evenly across all three utilities. There is an additional consulting fee of $38,896 (excluding payroll taxes and retirement plan costs) included for the General Manager that is allocated 30% to Ozark Shores and 70% to Lake Region. This fee has not previously been included in rates. Staff compared the General Manager's base salary against the annual wage for General and Operations Managers for the Central Region as published by the Missouri Economic Research an Information Center (MERIC) and found that the base salary was comparable to the annual wage for an experienced individual. Based on Staff's investigation, Staff determined that the consulting fee was neither a necessary nor reasonable additional expense to be funded by ratepayers and, therefore, Staff excluded this fee in the calculation of payroll adjustments.

PWSD4 employees, with the exception of the General Manager, are required to complete detailed timesheets for each two-week pay period. With the exception of the two other office employees, the timesheets have sections to be completed for each of the three utilities. Staff reviewed, in detail, the timesheets for all PWSD4 employees for the test year period. Using the timesheet entries, Staff calculated the actual recorded hours for each employee and, where appropriate, the utility for which time was reported. Some adjustments were made by Staff to these reported hours, primarily for overtime hours claimed in weeks when an employee claimed vacation and/or sick leave. Staff's total calculated hours for the twelve (12) months within the test year were then applied to the current pay amounts for each employee to determine an annualized total payroll amount for the PWSD4. The General Manager's base salary was included in the annualized total payroll amount. Staff then used the actual percentage of hours each employee reported on the timesheets for each utility and applied it to the corresponding employee's total pay to allocate the costs to each utility. Staff used the percentage of total customers at June 30, 2013, for each utility to allocate the Billing Clerk's pay. The General Manager's and Accountant's pay were allocated equally across the three utilities. With payroll costs now allocated to Lake Region, Staff then allocated the costs to each of Lake Region's three operating systems. The actual time reported on the timesheets by the operations staff for each operating system was used to allocate the Lake Region payroll to each system. For the General Manager and two office staff, the pay was allocated based on the number of customers for each operating system.

Staff followed the same approach to calculate payroll taxes at current tax rates, health and dental insurance at the current rate (effective October 2013), retirement cost at the rate effective January 1, 2014, and current workers' compensation cost. All these costs were allocated in the same manner as the payroll and added to the payroll costs to determine Staff's adjustment for each Lake Region operating system.

Staff Expert/Witness: Keith D. Foster

C. Maintenance Expense

1. Supplies and Materials

The Staff reviewed all invoices within the test year related to supplies and materials expense. Based on the review, Staff utilized the test year to determine the most appropriate level of supplies and materials expense to be included in the cost of service. Staff made adjustments to remove items not necessary to provide service to customers and also to move amounts related to testing, transportation, and tools and shop supplies expense.

Staff Expert/Witness: Ashley Sarver

2. Tools and Shop Supplies Expense

Staff analyzed historical data regarding this expense beginning January 1, 2010 through June 30, 2013. Based on the analysis, Staff utilized the test year level of expense as the most appropriate level of tools and shop supplies expense to be included in the cost of service. Staff made adjustments to remove amounts booked in the wrong account.

Staff Expert/Witness: Ashley Sarver

3. Equipment Rental

Lake Region has an ongoing rental contract with PWSD4 a related entity, for access to multiple pieces of equipment that may be needed for new services, repairs, and maintenance. The contract began in February 2006 with a monthly fee of $1,500 to be split between Horseshoe Bend Sewer, Shawnee Bend Water and Shawnee Bend Sewer systems. In August 2013, the monthly rental rate was increased to $1,575 to accommodate the cost of a new blade for the skid loader already included in the rental agreement. Ozark Shores, PWSD4, and Lake Region all have equal access to the equipment included in the rental agreement.

Lake Region does not maintain any type of usage logs documenting the frequency of its use of the equipment it rents from PWSD4. The Company also informed Staff that PWSD4 does not maintain usage logs for the equipment; therefore, Staff was not able to do a cost analysis by determining the portion of the monthly rental cost that is applicable to the amount of Lake Region's actual usage of the rental equipment and comparing that to the cost to Lake Region of renting the equipment from a third party provider. In order to determine the reasonableness of the current expense associated with Lake Region's rental of this equipment from a related company, Staff compared the annual rental amount for the Company to the annual cost if the Company owned the equipment and then rented the equipment to Ozark Shores and PWSD4. To calculate the annual expense to the ratepayers if the Company owned the equipment, Staff began with the original purchase price of the equipment paid by PWSD4, and assumed that Lake Region could have obtained this equipment at the same value. Staff then calculated the annual depreciation expense based upon this original cost value, as well as the accrued depreciation associated with the equipment since the time it was purchased. Staff then offset the purchase price with the accrued depreciation to derive the current net plant value of the equipment. To calculate the return on plant, Staff used the rate of return ordered from Case No. SR-2011-0110, and multiplied that return by the net plant amount. This value was added to the annual depreciation expense to calculate the annual revenue requirement associated with ownership of this equipment. Staff then made an adjustment to remove two-thirds of this value to represent rental revenue from Ozark Shores and PWSD4 for their use and access of the equipment under the Lake Region ownership assumption. Based upon this comparison, it appears that Lake Region's revenue requirement associated with use of this system would be significantly less under the ownership option as compared to the current rental arrangement. After performing this analysis, and considering the lack of equipment log information that would be necessary to perform an analysis of the cost to Lake Region of renting this equipment from an unrelated third party vendor, Staff has determined that it would be more economical to include the cost of the equipment in Lake Region's cost of service as if the Company had ownership of it and rented it out to Ozark Shores and PWSD4.

Staff recommends that the Company maintain equipment logs going forward regarding its use of the equipment it currently rents from PWSD4. This will enable Staff to do an analysis on the actual usage of the equipment in future rate cases.

Staff Expert/Witness: Erin M. Carle

4. Water Maintenance Expense

The Audit Staff reviewed all invoices related to repairs and maintenance expense booked to water accounts 645.10, 645.11, 645.30 and sewer accounts 710 and 745.10. Staff analyzed historical data for these accounts beginning January 1, 2010, through June 30, 2013. Based on the analysis, Staff utilized a three-year average to determine the most appropriate level of maintenance expense to be included in the cost of service for the water accounts.

Staff noticed that the balance in the above mentioned sewer accounts is continually declining or had a zero balance during the past three years, while the balances in sewer maintenance accounts 720.5, 721.1, 721.2, 745.9, and 745.95 is increasing. It appears that the Company is discontinuing the use of accounts 710 and 745.10 and is instead using accounts 720.5, 721.1, 721.2, 745.9 and 745.95 to book its sewer maintenance expenses. Staff determined that an adjustment to remove all expenses from accounts 710 and 745.1 is the most appropriate method to reflect the discontinued use of these accounts. Sewer maintenance expense will be reflected at normalized levels in sewer operating accounts 720.5, 721.1, 721.2, 745.9, and 745.95. Please see the testimony from Staff Witness Kimberly K. Bolin of the Commission's Auditing Unit for further detail on this adjustment.

Staff Expert/Witness: Erin M. Carle

5. Sewer Operating Expense

Staff removed from the test year sewer operating expense, amounts for Water Pollution Control Services that were incorrectly or inconsistently booked to the wrong accounts. Staff also included in the sewer operating expense account an annualized water expense. The Company purchases water from PWSD4 for the operation of its sewer facilities. During the test year, the Company booked this expense in various accounts. Staff has removed these amounts from the various accounts and has included the annualized water expense in account number 721.1 for the Horseshoe Bend Sewer service area.

Staff Expert/Witness: Kimberly K. Bolin

6. Sewer Equipment Maintenance Expense

Staff removed from sewer equipment maintenance expense Account No. 745.95 two expenses that should have been capitalized and included in plant in service for the Shawnee Bend system. The two expenses related to the reconditioning of the lift station pump at Murfield Court and the replacement of the duplex control at the Shawnee Bend treatment plant. Staff included both of these amounts in its plant in service. Staff then used a three-year average of the sewer equipment maintenance expense minus the incorrectly booked capitalized items as its normalized sewer equipment maintenance expense. Staff also used a three-year average of sewer equipment maintenance expense for the Horseshoe Bend Sewer service area.

Staff Expert/Witness: Kimberly K. Bolin

D. Customer Account Expense

1. Billing Expense

Lake Region mails bills to its customers monthly. Staff reviewed all the invoices for billing expense incurred by Lake Region during the test year, and recorded the total number of bills processed by the U.S. Postal Service each month, noting the number sent at a presorted rate, and the number sent at a single piece rate. Staff annualized the number of bills calculating the postage cost at the current postal rates to determine an annualized cost for mailing the bills. In addition, Staff annualized the cost to print the card stock for the number of bills sent in the test year based on the Lake Region supplier's last bill. The sum of these two annualized expenses was used as the basis of the Staff's adjustment to the billing expense account. Staff used the customer allocation factor to allocate the billing expense adjustment to each operating system (Horseshoe Bend Sewer, Shawnee Bend Sewer, and Shawnee Bend Water).

Staff Expert/Witness: Keith D. Foster

2. Uncollectible Expense

Uncollectible expense is the portion of retail revenues that Lake Region is unable to collect from retail customers by reason of bill non-payment. Staff reviewed account 950 to analyze the bad debt expense that Lake Region has incurred for the past three years. There was no discernible trend from year to year; therefore, Staff determined that a three year average of bad debt expense was the most appropriate level to include in the cost of service.

Staff Expert/Witness: Erin M. Carle

E. Administrative and General Expense

1. Legal Fees

Staff reviewed all the invoices for legal fees incurred by Lake Region during the test year. Staff adjusted out all legal fees related to the Shawnee Bend Development Company, LLC v. Lake Region Water & Sewer (09CM-CC00372) appeal, as this is a litigated issue between the developer and Lake Region that has no impact on the provision of utility service to the ratepayers and, therefore, is a cost that should not be borne by the ratepayers. Staff also removed all legal fees related to the Company's 2012 Finance Case (Commission Case No. WF-2013-0018), and then adjusted back in one-third of the cost to allow the Company to recover the incurred legal fees at a normalized three-year average level. Staff also removed fees related to the Maywood Estates Wastewater Treatment Plant acquisition that belong in plant acquisition costs. Staff adjustments did not require allocation to the three different operating systems, because each operating system has its own unique account number for Legal Fees.

Staff Expert/Witness: Keith D. Foster

2. Insurance

Insurance expense is the cost of protection obtained from third parties by utilities against the risk of financial loss associated with unanticipated events or occurrences.

Utilities, like non-regulated entities, routinely incur insurance expense in order to minimize their liability (and, potentially, that of their customers) associated with unanticipated losses.

Staff proposed an adjustment to annualize Lake Region's insurance expense to reflect the premiums paid as of June 30, 2013, the end of the test year. Staff used an allocation based on plant in service as of June 30, 2013, to assign this cost among Lake Region's operating districts.

Staff Expert/Witness: Ashley Sarver

3. Office Supplies

Staff analyzed historical data regarding office supplies expense beginning January 1, 2010, through June 30, 2013. Based on the analysis, Staff utilized the test year ending June 30, 2013, level of this expense as the most appropriate level of office supplies expense to be included in the cost of service. Staff made adjustments to remove Alterra Bank's Account Analysis Charge because this charge was excessive and beyond normal bank service charges. Staff also removed office supplies expense, which was already included in Staff's payroll annualization, non-recurring expenses, and amounts booked in incorrectly in office supplies expense accounts. Staff moved a total of $2,610.24 for one computer, three laptops, and software training services from office supplies expense to be capitalized into Account 391.10, Office Electronic Equipment.

Staff Expert/Witness: Ashley Sarver

4. Executive Management Fees

Lake Region does not have any employees. Lake Region contracts with the PWSD4 to operate and manage the day-to-day operations of the Company, and PWSD4 also acts in the same capacity for Lake Region's affiliate, Ozark Shores. PWSD4 staff performs normal day-to-day administrative and operational functions and consists of a General Manager, an accountant, a billing clerk, a field supervisor, and six field operators.

The General Manager for PWSD4 oversees the day-to-day operations of both Lake Region and Ozark Shores and approves the payment of routine bills. He also recommends expenditures for the repair, maintenance, capital additions, and expansions of Lake Region and Ozark Shores plant and certificated service areas. The Executive Management Group, serving Lake Region and Ozark Shores, must then approve, amend or reject the proposed expenditures and expansions.

The Executive Management Group provides executive oversight for Lake Region and Ozark Shores and consists of Vernon Stump, Robert Schwermann, and Brian Schwermann. Vernon Stump is the President for both Lake Region and Ozark Shores. Brian Schwermann is the Secretary for both Lake Region and Ozark Shores. Robert Schwermann of RPS Properties, is on the Board of Directors for both Lake Region and Ozark Shores. Kelly Stump, who has attended PWSD4 board meetings but who otherwise acts in an unknown capacity in relation to Lake Region, may be another member of this group. Among other duties, Executive Management attends the monthly PWSD4 board meetings to represent Lake Region and/or Ozark Shores, and to determine if there are any issues affecting these two utilities.

Lake Region pays a flat monthly management fee for the Executive Management Group, and records this expense on its books to a Lake Utility Availability 1 account. Staff has adjusted the test year management fee to an annualized amount of expense associated with a reasonable estimate of the actual costs of this group to provide executive oversight and management of Lake Region. Staff is not aware of any significant changes in the duties and responsibilities of the Executive Management Group since the last rate case and has examined the costs that Staff included in that case for Executive Management oversight. As in the previous case, Staff has calculated an allowance for members of the group based on time spent to attend the monthly PWSD4 board meetings and at the home office related to conducting Lake Region and Ozark Shores business, recognizing that the total cost would be split evenly between Lake Region and Ozark Shores. Staff's adjustment to the Executive Management fee took into account executive pay for the monthly hours, travel-related costs to attend the board meetings, including air travel for Vernon Stump, corporate office lease costs, and communications expense. Staff's adjustments are based on the current annual wage for Chief Executives for the Central Region as published by the MERIC, current General Service Administration (GSA) per diem and mileage reimbursement rates, and averages of more recent lodging costs. Staff allocated the Executive Management costs equally between Lake Region and Ozark Shores. Staff further allocated its adjustment to the three Lake Region operating systems according to Staff's payroll allocation factor.

Staff Expert/Witness: Keith D. Foster

5. Telephone

Staff examined the amounts of AT&T Wireless payments made by Lake Region to PWSD4 during the test year. PWSD4 allocates the bill to Lake Region, PWSD4, and Ozark Shores. The AT&T Wireless bill to PWSD4 was adjusted to reflect the payroll allocations between PWSD4, Ozark Shores, and Lake Region. Other adjustments include removal of wireless accounts no longer active and disallowance of wireless service not necessary to provide services to the customers.

Staff Expert/Witness: Ashley Sarver

6. Travel and Entertainment Expense

Staff reviewed all the Travel & Entertainment Expense invoices allocated to Lake Region during the test year. The vast majority of expense was credit card bills for the Executive Management Group. Staff adjusted out all expenses attributed to the Executive Management Group because any allowable travel and entertainment costs are included in Staff's adjustment for Executive Management oversight in the Executive Management Fees account. In addition to other miscellaneous adjustments, Staff adjusted out expenses claimed by the General Manager related to the Shawnee Bend Development lawsuit, and two-thirds of expenses related to the Company's 2012 Finance Case (Commission Case No. WF-2013-0018) to allow the Company to recover the incurred expenses at a normalized three-year level. This treatment is consistent with how Staff handled adjustments to other accounts containing expenses related to these two issues. Staff used the Revenue Allocation Factor to allocate the remaining Travel & Entertainment Expense adjustments to each operating system (Horseshoe Bend Sewer, Shawnee Bend Sewer, and Shawnee Bend Water).

Staff Expert/Witness: Keith D. Foster

7. Transportation Expense

Staff reviewed all of the transportation expense account transactions in the General Ledger allocated to Lake Region during the test year. Expenses in this account primarily include (1) PWSD4 charges to Lake Region for its portion of fuel costs and vehicle expense, (2) maintenance costs for vehicles owned by Lake Region, (3) bridge tolls to access the Shawnee Bend service areas, and (4) mileage reimbursements to the General Manager. Staff made adjustments primarily to remove misapplied expenses, and to remove any mileage expenses related to the Shawnee Bend Development lawsuit. Staff used the revenue allocation factor to allocate the transportation expense adjustments to each operating system (Horseshoe Bend Sewer, Shawnee Bend Sewer, and Shawnee Bend Water).

Staff Expert/Witness: Keith D. Foster

8. Miscellaneous Expense

During the test year, the Company had numerous miscellaneous costs booked to expense account 975.00 – miscellaneous general expenses. After reviewing these expenses, Staff removed costs associated with charitable contributions and items that had no supporting invoice. After these adjustments were made, Staff determined that a three-year average was required to calculate the most appropriate level of miscellaneous expense that should be included in the cost of service, as there was no discernible trend from year to year.

Staff Expert/Witness: Erin M. Carle

9. Rate Case Expense

In the previous case, Staff included the costs actually incurred by the Company to process the case and normalized that cost over a three-year period. At the time of direct filing for this current case, Lake Region had incurred minimal rate case expense during the test year and has provided a set of invoices to update the cost through mid-October, 2013. Staff is proposing to evenly spread this expense across the three operating systems and then to normalize the cost over a three-year period. Rate case expense will be included in the true-up portion of this case. Accordingly, Staff will continue to examine the actual costs relating to the processing of the rate cases filed by Lake Region and include all prudently incurred expenses in the cost of service analysis.

Staff supports the use of the small company rate case procedures for all companies that qualify, which Lake Region does. The Commission developed the small rate case procedures in a manner that allows the process to be stream-lined. This process enables the companies to file rate cases while incurring minimal rate case expense. If certain issues within the case are not able to be settled between all parties, the small company procedures still allows the Company the option to take specific items to hearing. For future cases, Staff encourages Lake Region to consider use of the small company rate case procedures for filing purposes in order to minimize rate case expense.

Staff Expert/Witness: Erin M. Carle

F. Other Operating Expenses

1. Licenses and Permits

Staff examined all invoices regarding license and permit expense beginning January 1, 2010 through June 30, 2013, to verify the renewal frequency of all licenses and permits and determined an annual expense for all licenses and permits that the Company is required to obtain in order to provide service to its customers. Staff then made adjustments to the test year to reflect these normal, ongoing cost incurred by Lake Region. One expense was a construction permit for the lodge UV treatment plant; therefore it was moved/capitalized to Treatment and Disposal Equipment HB Account 372.10. Staff made other adjustments to the test year to remove non-recurring expenses and other expenses booked to the wrong account.

Staff Expert/Witness: Ashley Sarver

2. PSC/OPC Assessment

On an annual basis, the Company is assessed a fee from the Commission based upon its revenues from the previous calendar year. This assessment is issued to the Company in July of each year and payable either as one sum or in quarterly installments due in July, October, January, and April. In July of 2013, the Company was assessed a total of $79,287 for the fiscal year ending June 30, 2014. This value is split between a water and sewer assessment on the invoice. To determine the appropriate amount for each sewer system to be billed, Staff used a percentage based on the Company's annualized sewer revenues to allocate the sewer portion of the PSC and OPC assessments. Included in the $79,287 assessment is the amount of $11,172 to fund OPC. Missouri House of Representatives Bill 7, section 7.185, approved on June 10, 2011, established that OPC should be funded through the PSC budget. Therefore, the total assessment amount includes amounts to fund OPC as well as the PSC. Previously, the OPC was funded through the general revenue fund and therefore, was not included in the PSC assessment. Staff has included this most recent total assessment amount as the ongoing annual expense level to include in the cost of service.

Staff Expert/Witness: Erin M. Carle

G. Depreciation and Depreciation Rate Overview

Staff's recommended depreciation rates for Lake Region's water and sewer operations are shown in Appendix 3, Schedule AWR–1 and AWR–2. The rules followed by Staff as a basis for applying depreciation to Lake Region's water and sewer utility plant accounts are: For water, the Code of State Regulations, 4 CSR 240-50.030 specifies the use of the Uniform System of Accounts (USOA) issued by the National Association of Regulatory Utility Commissioners (NARUC) in 1973, as revised in 1976. For sewer, 4 CSR 240-61.020 specifies the use of the USOA issued by the NARUC in 1976.

For Lake Region, the basis for Staff's recommended depreciation rates are the Staff's standard depreciation rates schedules for small water and sewer companies. Staff's standard depreciation schedules were created decades ago by engineering experts in the Commission Staff Water and Sewer Unit. Depreciation rates from depreciation studies of large water and sewer companies in St. Louis, Kansas City, and St. Joseph areas were used as a basis and were subsequently modified over years of observations by Staff experienced in the operation and maintenance of small water and sewer companies. Periodic reviews of these schedules are conducted by engineering experts from EMSU and the Water and Sewer Unit. The most recent review was conducted in March of 2013, with an emphasis on the net salvage component of the standard depreciation rates for each class of small water and sewer company.

The general USOA definition of depreciation is:

> The loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of providing service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and requirements of public.

This broad definition does not provide guidance as to the practice of computing a regulatory depreciation rate and applying depreciation expense as a component of customer rates. The basic formula for Missouri regulatory depreciation utilized by staff was defined by the Commission in a Report and Order issued March 10, 2005, for Empire District Electric Company in rate case, Case No. ER-2004-0570. The Commission-defined depreciation rate equation and component definitions are consistent with the USOA definitions and are represented as follows:

$$\text{Depreciation Expense} = (\text{Depreciation Rate}) * (\text{Total Original Cost of Plant in Service})$$

$$\text{Depreciation Rate \%} = \frac{100 - (\text{Net Salvage \%})}{\text{ASL}} = \frac{100}{\text{ASL}} - \frac{\text{Net Salvage \%}}{\text{ASL}}$$

The average service life (ASL) is the average number of years the dollars in a specific account are expected to remain in service. ASL is determined using past plant retirement history from the utility in question if sufficient history is available from that utility. If sufficient plant retirement history is unavailable, Staff reviews and considers the retirement histories of utilities with similar operations. Net salvage (also referred to as Salvage Value) is gross salvage minus the cost of removal. Cost of Removal is the cost of demolishing, dismantling, tearing down or otherwise removing utility plant, including the cost of transportation and handling incidental thereto. Net salvage is also determined using past retirement history from the utility in question if sufficient history is available from that utility, or if that history is unavailable, from the retirement histories of utilities with similar operations. Net salvage percentage is computed as follows:

$$\text{Net Salvage} = \text{gross salvage} - \text{cost of removal}$$

$$\text{Salvage \%} = \frac{\text{Net Salvage \$}}{\text{Retirement \$}} * 100$$

Gross salvage and cost of removal information is collected whenever plant and equipment is retired. This includes interim net salvage where equipment is replaced in an ongoing “living” utility system or terminal net salvage when an entire facility is removed from service and disposed.

Under the above traditional depreciation rate equation, the depreciation rate is applied to the total plant account’s original cost. Net salvage is thus applied to the total plant in service in a straight line method over the expected life of the dollars in service. If the expected cost of removal exceeds the expected gross salvage, (producing a negative net salvage), the amount that should be in the accumulated reserves at the end of the ASL will be greater than the original cost. Example: If net salvage is a negative 10%, then at the end of the average service life, the accumulated reserves should exceed the original cost by 10%. And yes, as the physical equipment approaches its average expected service life for an account, that account will contribute a negative rate base component to the computation of customer rates. It is in this manner that customers are compensated for accrued depreciation expense funds being held by the company for future use.

1. Staff's Depreciation Issues

a. Lake Region plant in service bookings for Shawnee Bend water well number 2 legal settlement with Shawnee Bend Development Company.

b. Retirement, disposal and cost of removal of the Shawnee Bend waste water treatment lagoon system.

c. Water well number 2 lighting strike insurance and cost of removal.

d. Fire Hydrants improperly recorded as Transmission and Distribution Plant.

e. Pumping and Water Treatment Plant improperly recorded as Wells and Springs.

f. Original cost plant of $240,000 in 2002 and $38,535 in 2007 recorded as plant in service in the Horseshoe Bend accounts that is actually installed in the Shawnee Bend system.

g. Rebalancing of accumulated reserves between plant accounts to correct for over and under accrual for some accounts.

h. Staff's review of the Lake Region 2010 rate case found the depreciation rates used in the Staff Accounting Schedules were not consistent with the Depreciation Schedules attached to the Staff Report filed as Direct Testimony.

i. Staffs recommended depreciation rates for Lake Region's water and sewer plant in service.

a) Shawnee Bend Water Well Number 2 Recorded Cost Of Plant In Service Issues

Shawnee Bend water well number 2 was drilled (with pumping equipment and well house installed) in 1998 for a development called The Villages at Shawnee Bend by Shawnee Bend Development Company LLC (SBDC) and later placed in utility service by Four Seasons Water and Sewer Company (Four Seasons). An agreement existed between Four Seasons and SBDC regarding payment by Four Seasons to SBDC for the transfer of the well installation, plus other water and sewer infrastructure to the Utility. Lake Region acquired the assets of Four Seasons, including the well number 2, a water distribution system and a sewer collection system at The Villages. The original cost plant records of Lake Region show estimated cost additions for "well connections," "street crossings" and "service connects" that were installed by SBDC and not paid for by Four Seasons or subsequently by Lake Region as of the True-Up date of the prior Rate Cases WR-2010-0111 and SR-2010-0110. Subsequent to these last rate cases, payments as a result of court settlements have been made by

Lake Region to SBDC for these assets that include court imposed penalties for late payment. Staff obtained documentation describing the original cost of the water well installation but not the water distribution or sewer collection assets. Lake Region entered into its plant records estimated costs due SBDC as plant in service at various dates from 2000 to 2009. Lake Region also entered as plant in service the payments made in 2010 and 2012 as ordered by the courts that included court imposed penalties. These book entries need adjustment to correct the books to actual original cost because these estimated cost entries and the court imposed penalties do not represent actual installed cost.

First, Staff made adjustments to remove (reverse) all identifiable prior Company plant addition entries related to estimated plant entries for SBDC “The Villages” recorded as “well connects,” “street crossings,” and “service connects” for The Villages. Staff also made adjustments to reverse the plant addition entries made by the Company in 2010 and 2012 that represented payments to SBDC as a result of the Court settlement because these payments included Court imposed penalties as well as original cost. Staff then made adjustments to replace the Company’s 2010 and 2012 entries with original costs as defined below. All of these reversals and the replacement entries were made as Staff adjustments at the end of test year date (6/30/2013) in the Staff Accounting Schedules. Staff’s evaluated original cost is as follows:

i. The Well: Staff obtained a copy of a 1998 letter from SBDC to Four Seasons describing the original $111,673 cost for the well, the pumping equipment, and the pump house structure. Staff recorded the $111,673 as original cost to Lake Region’s plant in service within the Shawnee Bend accounts. The Court ruling defined original cost of these assets as “well connects” at $107,000. Thus, Lake Region paid $4,673 less than Staff recorded as the original cost of plant in service. This $4,673 difference was recorded by Staff as a contribution by the developer to the Shawnee bend accounts, (such costs are otherwise known as CIAC) to offset this difference for rate making.

ii. The Water Distribution System: The court defined Transmission and Distribution system assets as “street crossings” at an original cost of $42,375. Staff recorded the $42,375 as original cost to the transmission and distribution mains plant account.

iii. The Sewer Collection System: The court defined sewer collection system assets as "sewer line upgrade" at an original cost of $28,950. Staff recorded the $28,950 as original cost to the Shawnee Bend transmission and distribution mains plant account.

Staff made no adjustments to the accumulated reserves associated with the assets described in i., ii. and iii. above. The estimated cost entries made by the Company resulted in depreciation expense accrued by the Company. Staff included the estimated cost in prior ratemaking as plant and as contributing to depreciation expense.

b) Retirement, Disposal and Cost Of Removal Of The Shawnee Bend Waste Water Treatment Lagoon System

The Shawnee Bend waste water treatment lagoon and irrigation disposal system was removed from service, the waste sludge removed under Missouri Department of Natural Resources (DNR) permits, and the earthen structure leveled with new vegetation planted. The majority of this activity occurred in 2012. Staff's review of the Company Fixed Asset Record found a plant addition of $52,186 for the lagoon cost of removal as if it represented an original cost of plant in service. Staff also found a retirement entry of $198,886 for the lagoon removal, reducing the plant in service and reserves by $198,886. This $198,886 retirement included the $52,186 cost of removal.

Staff disagrees with these entries. Cost of removal is not an addition to plant in service. Cost of removal is charged to accumulated reserves. Staff's review of the Company Fixed Asset Record found a total of $54,376 in cost of removal and $151,290 in lagoon plant retirements, for a total reduction in accumulated reserves of $205,666.

The lagoon system's initial in service date vintage is 1998. The 4.5% Commission ordered depreciation rate applied over the 13.5 year actual life of this lagoon system results in approximately $87,000 in depreciation accruals. This is far short of the actual lifetime cost of $205,666. Due to another error in the recording of original cost for sewer collection system receiving wells as higher depreciable pumping equipment, the pumping equipment account has an over accrual of depreciation reserves sufficient to offset the deficiency in reserves for this lagoon system. Staff has included adjustments in the Staff Accounting Schedules to transfer $125,000 of reserves from the sewer Pumping Equipment account 363 to the Treatment and Disposal Equipment account 372.

Staff has not completed its investigation of the origin of the $135,756 original cost shown on the Company books for the lagoon treatment system in 1999. Staff questions that the lagoon system original cost would be as high as $135,756. Staff suspects that the cost of the land is included in this $135,756. Staff notes that the total amount of land and land rights recorded for all of Shawnee Bend and Horseshoe Bend is low, at only $5,985. If the cost of this land was recorded as Treatment and Disposal plant in service, then for rate making purposes, the land became depreciable plant with depreciation expenses included in customer rates. All depreciable plant when sold is treated as salvage, and the proceeds of the sale are to be recorded to reserves as salvage. If further investigation shows the sale or transfer of this land should be treated as salvage, the recording of the sale proceeds to the accumulated depreciation reserve should significantly reduce the deficiency created in reserves by the lagoon system retirement. Land is not normally a depreciable utility asset, but if the Company includes land in depreciable plant account, then the rate payers are due compensation when the land is sold.

c) Water Well Number 2 Lighting Strike Insurance And Cost Of Removal

In 2012, the well number 2 electrical system and submersible pump motor was damaged by lighting. The Company recorded the total cost to repair, $15,239.86, as new plant in service to USOA account 325, Pumping Equipment. Staff estimated the cost of removal at $1,000. Staff adjusted this amount by removing cost of removal from the plant addition and reducing depreciation reserves by $1000.

The Company also recorded a reduction in plant for retirements and insurance proceeds of $13,546. Using the Company's accountant's work papers, Staff found the retirement for the damaged equipment to be $10,870 and the insurance proceeds to be $9,200. Staff made adjustments to reverse the Company entry of $13,546 and record a $10,870 retirement to reduce plant and reserves. For regulatory rate making purposes, insurance proceeds are generally treated as salvage and credited to reserves. (This treatment of insurance proceeds serves to recognize the compensation the Company has received for the insured plant and give customers credit for the payment in the reserves.) Staff applied the $9,200 of insurance proceeds to increase the accumulated reserves for the account. In summary, Staff's entries resulted in an increase in Pumping Plant in service of $14,239.86 and a decrease in accumulated reserves of $2,670, ($9,200 insurance minus $10,870 retirement and minus $1,000 cost of removal).

d) Fire Hydrants Improperly Recorded As Transmission And Distribution Plant

Staff noted an entry in the Company books ($1,187 in Structure and Improvements for 2012) for the replacement of the internal parts of a fire hydrant. Staff also noted that the Company did not have a plant account for fire hydrants and did not show fire hydrants as an item in any plant account. Staff inquired as to the quantity and nature of fire hydrants in the Lake Region system. John Summers, Lake Region's General Manager, responded by email that the cost of fire hydrants were included as lump sum book entries for new distribution plant in service. Mr. Summers also stated the quantity and cost of fire hydrants as: one (1) installed in 1997, three (3) in 2004, and four (4) in 2007 at an estimated cost of $2,500 to $3,500 each.

Staff introduced the use of USOA account 348 for Hydrants and transferred $24,000 ($3,000 multiplied by 8 hydrants) from Transmission and Distribution, plus the $1,187 from Structures and Improvements, to the Hydrants Account 348. Staff recorded an adjustment to retire $594, (estimated by Staff) for the replaced fire hydrant internal parts. Staff also made adjustments to transfer the associated accumulated reserves ($3,840) to the newly created Hydrant account.

e) Pumping And Water Treatment Plant Improperly Recorded As Wells And Springs

Company records for the number 1 water well show pumping equipment and treatment equipment recorded improperly as USOA Account 314, Wells. Account 314 is only for such costs as DNR water well permits, geological engineering, well drilling, and the well casing. Account 314 is assigned a depreciation rate of 2.0%. The cost for items, such as the associated pipe and valves, pumps and motors, electrical supply, and instrumentation and controls, should be recorded in USOA Pumping Equipment Account 325. Pumping equipment is assigned a depreciation rate of 10%. USOA Water Treatment Account 332 is for the cost of any water treatment such as chlorination supply, mixing and associated controls. Account 332 is assigned a depreciation rate of 2.9%. Thus, the recording of plant cost to improper plant accounts results in depreciation expense accruals for rate making that do not accomplish the goal of approximating actual consumption of installed plant.

For well number 1, Staff made adjustments, effective at the end of the test year (6/30/2013) to transfer costs identified by Staff as improperly recorded in USOA Account 314. Staff made adjustments for plant and depreciation reserves as follows:

Plant Amount	Reserve Amount	From Account	To Account
$53,379	$7,774	USOA 314	USOA 325
$ 2,676	$225	USOA 314	USOA 332

The reserve amounts appear low because they are low. The Wells Account 314 that these assets have been recorded in only carries a 2.0% depreciation rate.

For the well number 2 system, a similar situation exists in that many of the Company's estimated cost plant bookings were also recorded in improper accounts. As noted in issue a) above, the actual installed cost for the well number 1 system is entered by Staff as adjustments at the end of test year date June 30, 2013. Staff also made adjustments at the end of test year date to reverse all of the Company's well number 2 estimated cost entries identifiable by Staff.

Depreciation expense for well number 2 equipment was recorded by the Company as "well connects" in its plant in service costs, and Staff relied upon those records in prior rate cases to determine customer rates. Staff concluded that any reversal of accumulated reserves associated with the plant adjustments made by Staff for the Company's recorded "well connects" and also any imputation of reserve adjustments for the well number 2 costs by Staff at the June 30, 2013 date would be a form of retroactive rate making. Therefore, Staff made no attempt to evaluate or make adjustments to depreciation reserves for well number 2 original cost or any adjustments to reserves associated with the plant assets involved in the SBDC law suit(s).

f) Original Cost Plant Of $240,000 In 2002 And $38,535 In 2007 Recorded As Plant In Service In The Horseshoe Bend Accounts That Is Actually Installed In The Shawnee Bend System

In 2002, the Company mistakenly recorded $240,000 of Shawnee Bend Sewer lift station pumping equipment to Horseshoe Bend Sewer Pumping Equipment. In addition,

$240,000 of CIAC was also recorded to the Horseshoe Bend Sewer accounts. Staff entered adjustments in this case at the test year end date (June 30, 2013) to transfer $240,000 of plant and $240,000 of CIAC from Horseshoe Bend Sewer to Shawnee Bend Sewer. In addition, Staff made adjustments to transfer the associated depreciation reserves, 12 ½ years of accrued depreciation at 10% ($300,000), and $44,895 of amortized CIAC.

Staff's review of the Company Fixed Asset Records identified $305,649 of collection sewers improperly recorded in 2007 as Horseshoe Bend "Plant Sewers" and subsequently depreciated at 4.5% as if it was Treatment and Disposal Equipment. This collection sewer piping should have been recorded as Collection Sewer Account 352 with a depreciation rate of 2.0%. The Company and Staff in the prior rate case used the 4.5% depreciation rate for this equipment. Further review by Staff identified that $38,535 of this plant was installed in the Shawnee Bend Sewer collection system, not the Horseshoe Bend Sewer collection system. The new plant addition included both force mains and gravity mains. The information Staff has indicates that part of this $305,649 plant addition may have CIAC associated with it. At this time, the adjustments Staff shows in the Staff Accounting Schedules assume there is no CIAC associated with this $305,649. Staff will continue to seek information to determine if the $38,535 attributable to Shawnee Bend Sewer plant in service has CIAC that was also recorded to the Horseshoe Bend Sewer accounts. Staff made adjustments at the end of test year date (6/30/2013) to transfer this $305,649 and its associated accumulated reserves as follows:

Plant Amount	Accumulated Depreciation Reserve Amount	From Account	To Account
$38,535	$9,537	Horseshoe Bend USOA 372	Shawnee Bend USOA 352.1
$207,341	$51,317	Horseshoe Bend USOA372	Horseshoe Bend USOA 352.2
$59,744	$14,794	Horseshoe Bend USOA372	Horseshoe Bend USOA 352.1

USOA Account 352.1 is force (pressurized) collection mains, and Account 352.2 is gravity collection mains.

g) Rebalancing Of Accumulated Reserves Between Plant Accounts To Correct For Over And Under Accrual For Some Accounts

In addition to the $125,000 reserve transfer to rebalance reserves in the Shawnee Bend Waste Water Treatment and Pumping accounts described in the Shawnee Bend lagoon retirement section above, a $25,000 reserve transfer is recommended to rebalance reserves in the Horseshoe Bend accounts. Staff identified improper recording of lift station receiving well equipment as lift station pumping equipment by both the Company and by Staff in the prior rate case. The result is that the receiving well equipment, depreciable at 4.0%, was recorded as pumping equipment and depreciated at 10%. Transfer adjustments were made by Staff at the test year end date to move approximately $77,000 plant and $44,000 of associated reserves from the Pumping Equipment account (USOA 363) to the Receiving Wells account (USOA 362). This transfer resulted in reserves balances for these two accounts that are not consistent with the realized life and depreciation rates for these accounts. Staff made an additional adjustment to transfer $25,000 of reserves from Account 362 back to Account 363 to restore the reserves for these accounts to a more reasonable level consistent with the equipment ages within the accounts.

h) Staff's Review Of The Lake Region 2010 Rate Case Found The Depreciation Rates Used In The Staff Accounting Schedules Were Not Consistent With The Depreciation Schedules Attached To The Staff Report Filed As Direct Testimony

Depreciation Schedules for water and sewer were attached to the Staff report submitted as Direct Testimony. A review of the Staff Accounting Schedules show that the Depreciation Rate Schedules attached to the Staff report were not incorporated as the depreciation rates used to determine the revenue requirements for the 2010 water and sewer rate cases.

The Commission Report and Order for the 2010 rate case did not specify or reference depreciation rates. The Commission Report and Order did reference and specify under section D. Stipulations: item 1, "The Parties do not dispute the information contained within the Staff Accounting Schedules-Utility Service, filed on January 14, 2010, and subsequently updated as of February 8, 2010."

Staff's interpretation of this is that the depreciation rates used in the January 14, 2010, accounting schedules are the appropriate depreciation rates to use for Staff's review and audit of depreciation expenses and accruals includable in determining revenue requirement for the current rate case.

i) Staff's Recommended Depreciation Rates For Lake Region's Plant In Service

Staff's recommended depreciation rates are the Staff's Standard Small Water and Sewer company depreciation rates with modifications to two of the General Plant accounts.

For sewer, plant Account 392, Transportation Equipment, is over accrued by approximately 200% and has been assigned a depreciation rate of 0.0%.

Plant account 392.1, Transportation Equipment (Pump Truck), is an account for heavy trucks that is not normally used for small companies. A depreciation rate of 5.3% is recommended for this account. This 5.3% rate was derived for heavy truck equipment in a recent deprecation study conducted by Kansa City Power & Light (KCPL) on KCPL Greater Missouri Operations heavy truck equipment.

For small water and sewer companies, General Plant consists of equipment that is often shared between the water and sewer operations. It has become common practice to assign the same depreciation rates to the same USOA numbered accounts for both water and sewer. Thus, even though currently the water plant in service has no assigned plant for accounts 392.0 and the 392.1, the same rates (0.0% and 5.3%) are listed on the water depreciation schedules.

Staff's recommended depreciation rates for Lake Region's water and sewer operations are shown in Appendix 3, Schedule AWR–1 and AWR–2.

Staff Expert/Witness: Arthur W. Rice

H. Property Tax

Property taxes are those taxes assessed by state and local county taxing authorities on a utility's "real property" as of January 1st of each year. On the first of each year, utilities are required to file with the taxing authorities a valuation of its utility property owned as of the January 1 assessment date. Property tax bills are issued to the utilities with "due dates" by December 31 of the same year.

Staff determined its adjustment for property taxes by developing a property tax rate to be applied to total plant in service as of January 1, 2013. To develop the property tax rate for this case, the Staff divided the amount of total property taxes due in calendar year 2012 by the total plant in service for January 1, 2012. This property tax rate was then applied to total plant in service on January 1, 2013, to arrive at annualized property taxes. The annualized property tax expense was then subtracted from test year property tax expense to derive the adjustment.

Staff Expert/Witness: Ashley Sarver

I. Income Tax

1. Current Income Tax

The calculation of current income tax expense is necessary to include as part of the revenue requirement to ensure that any given dollar increase in revenues is actually collected in rates. In other words, because the Company has to pay some portion of its earnings as income taxes to the state and federal taxing authorities, a level of income tax expense has to be collected in rates. If income taxes were not considered in rates, then the Company would not fully collect sufficient revenues to cover all its costs and would not have an opportunity to earn its authorized rate of return. For the utility to recover the full revenue increase, it has to collect a portion of revenue for income taxes in its rate structure in addition to the revenue amount determined by the Commission to be appropriate before factoring up for income taxes.

Current income tax expense is calculated by applying the statutory state and federal tax rates to Staff's taxable income amount. Expenses, as adjusted by Staff, are deducted from revenues to arrive at the net operating income before income taxes. Then, adjustments are made to convert net operating income to taxable income. These adjustments include deductions for tax depreciation and interest expense. The interest tax deduction was calculated using the interest synchronization method of applying the weighted cost of debt in the capital structure (that was determined by Staff Witness Shana Atkinson of the Commission's Financial Analysis Unit) to the Staff's rate base. The depreciation deduction is derived by reflecting within the taxable income calculation the higher amount of depreciation expense using "accelerated tax depreciation" methods the Company can reflect on its income tax returns, compared to the amount of straight-line book depreciation expense included in Staff's net operating income calculation. After all the expenses and tax deductions are made, the resulting amount is the taxable income to which the income tax rates are applied.

Staff Expert/Witness: Keith D. Foster

2. Deferred Income Tax

When a tax timing difference is reflected for ratemaking purposes consistent with the timing used in determining the taxable income amount for current income tax due under the Internal Revenue Code (IRC), the timing difference is given "flow-through" treatment. When a current year timing difference is deferred and recognized for ratemaking purposes in a way that is consistent with the timing used in calculating pre-tax operating income in the financial statements, then that timing difference is given "normalization" treatment for ratemaking purposes. Deferred income tax expense for a regulated utility reflects the tax impact of "normalizing" tax timing differences for ratemaking purposes. IRS rules for regulated utilities require normalization treatment for the timing difference related to accelerated tax depreciation.

The Exhibit Modeling System (EMS) used by Staff to calculate income taxes in small water and sewer cases calculates income tax expense as a whole and does not break out this amount between current income tax and deferred income tax.

Staff Expert/Witness: Keith D. Foster

VIII. Service Quality

A. Customer Service and Business Operations Review

The EMSU staff examined the Company's tariffs, Commission complaint and inquiry records, and other documentation related to the Company's customer service and business operations. In preparation of this testimony, the EMSU staff submitted data requests to the Company on August 21, 2013, and conducted interviews with Company personnel located in Lake Ozark, Missouri, on September 17, 2013.

The purpose of the EMSU is to promote and encourage efficient and effective utility management. This purpose contributes to the Commission's overall mission to ensure that customers receive safe and adequate utility service at reasonable rates while providing utilities the opportunity to earn a fair return on their investment.

The objectives of this review were to analyze and document the management control processes, procedures, and practices used by the Company to ensure that its customers' service needs are met and to make recommendations, where appropriate, by which the Company may improve the quality of services provided to its customers. The findings of this review will also provide the Commission with information regarding the Company's customer service and business operations.

The scope of this review focused on processes, procedures, and practices related to:

- Meter Reading
- Customer Billing
- Payment Remittance
- Credit and Collections
- Complaints and Inquiries
- Customer Communication
- Records and Documentation Retention

This section of the Cost of Service Report contains the results of the EMSU staff's review.

B. Overview

The Company has an office located at 62 Bittersweet Road in Four Seasons, Missouri, which is open from 8:00 a.m. to 4 p.m. Monday through Friday. The office is staffed during that time with one (1) to three (3) employees. Office personnel are responsible for all administrative functions associated with Lake Region such as billing, payment remittance, financial account posting, and credit and collection functions. Seven (7) field personnel are available for outside construction, maintenance and service calls. The employees that complete activities for Lake Region are actually employed by the PWSD4. These same employees also perform work for Ozark Shores. Employees do not have written job descriptions and, with the exclusion of the General Manager, complete time sheets which are submitted every two (2) weeks for payroll processing. Time sheets are reviewed by the General Manager or Accountant who may make alterations to the time sheets. Contracts are formalized between Lake Region and the PWSD4 for the labor and equipment utilized by Lake Region. Other external contractors are paid on a per project basis. Vehicle logs are not used to track vehicle miles associated with performing work activities. The rates for PWSD4 are not regulated by the Commission since it is a public water supply district.

Outside of normal office hours, the Company utilizes an automated attendant to answer calls and gives instructions for the customer to leave a message if it is not an emergency situation. For emergency service, the customer is prompted to input their phone number, and they will be contacted by service personnel. The Company forwards these calls to a pager because of unreliable cell phone service in the area. Pager rotation is weekly for all field employees. Field operators perform maintenance and repairs, as needed, on holidays and weekends. In addition, the Camden County Sheriff's office and a property management company have mobile phone numbers for a number of the Company personnel.

C. Meter Reading

The Company installed Hersey Easy Reader automated meter reading software in 2009. A Company employee is able to drive by service locations to obtain radio reads of the meters. Reports generated by Easy Reader software are in Crystal Reports, QuickBooks Pro and Microsoft. Less than ten (10) meters each month require a manual read for various reasons. The Company attempts to read meters around the 25th of each month.

The Company currently does not have bill estimation procedures in its tariff. Lake Region indicated that the need to estimate usage is rare and that bad weather such as snow or ice would be an instance in which estimation would be necessary.

D. Customer Billing

Customers may initiate service by visiting or calling the office. If the customer visits the office, they will be required to complete an application for service at that time. Callers will be sent an application via mail, email, or fax which must be returned to the Company. The Company has received and processed the following number of applications over the last several years and believes that increases in housing construction have caused the number of new applications to slightly increase.

Year	Water	Sewer
2011	1	1
2012	5	6
2013 (ytd 8/28/2013)	5	5

Source: Company response to Data Request #40

Company personnel indicated they do not require a security deposit as a condition for providing service. The Company's tariff includes procedures allowing a credit check and security deposit in the event it is necessary. At this time, the Company is holding only one customer deposit of a commercial customer.

Continental Utility Billing Solutions, Inc. is the billing software utilized by the Company to maintain customer account records and prepare monthly billing statements. Hersey Easy Reader is used for reading meters. The current process used by the Company for billing requires the Billing Clerk to download the meter information from the automated Easy Reader which can take approximately three (3) to four (4) hours. Once the download is complete, the file is loaded into the billing system at which time any unread meters are compiled in an exception report for the field technician to manually read meters as close as possible to the 25th day of the month. A pre-billing report is generated once all meter information has been collected and is reviewed by the Billing Clerk. Discrepancies are provided to the field technician who verifies the data for accuracy prior to printing and mailing of customer bills. The Company does not use preset parameters to flag abnormalities. Large fluctuations in usage may occur as many homes are seasonal homes and do not exhibit normal usage patterns. Bills are generally mailed prior to the first day of the month.

E. Payment Remittance

Customers' payment options include cash, check, money order and Auto Pay Company management estimates that approximately 65% of the customers pay by check. The Auto Pay option allows the customer to have the total due deducted from their checking account on the 20th of each month, or the first business day thereafter. Currently, 105 or approximately 20% of total customers are participating in the Auto Pay option. Payments may be received at the office location, and a drop box is available for payments during non-business hours. Customers may also remit payment by mail. The Company picks up mail and checks the drop box daily. Payments are normally posted the day received. After the payments have posted, any payments that are received will be posted the following business day. Payments may be held during the billing period for up to one (1) to two (2) days, but all payments will be deposited and recorded prior to generating new bills to reflect the correct amount due.

F. Credit and Collections

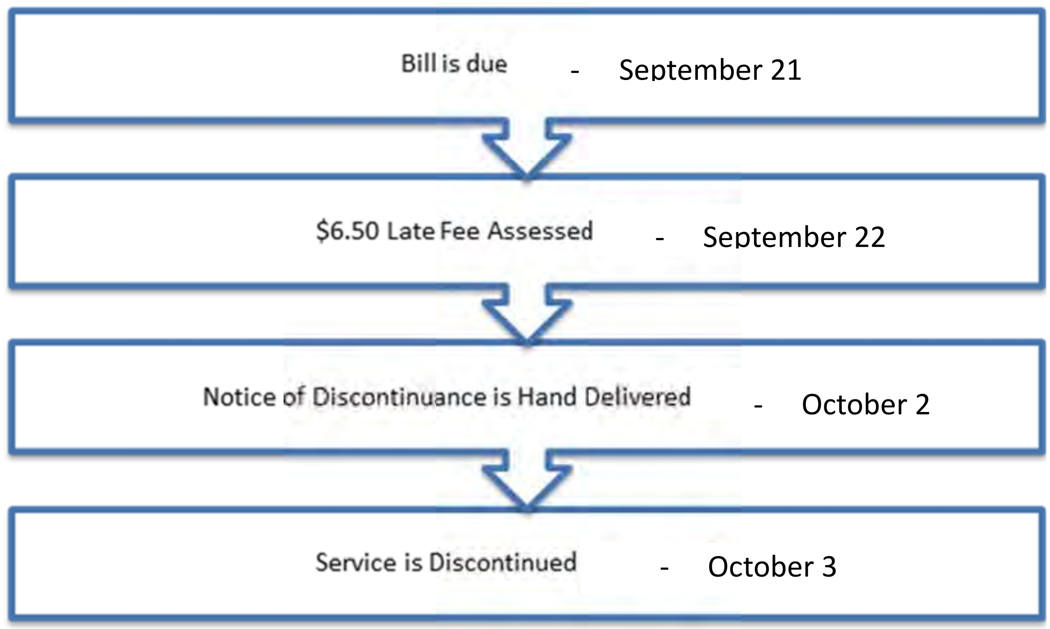
Customers are allowed a minimum of twenty-one (21) days from the rendition of the bill to pay the utility charges before they are considered delinquent each month. A late fee of $6.50 is added per notice per month and only applies when the discontinuance notice is mailed. Only one charge applies to a customer that is billed for water and sewer on the same bill. A letter is sent with a due date of ten (10) days from the date mailed for customers to pay 100% of past due balance. The Company indicates it works with customers on a case-by-case basis if the customer contacts them. If the Company has not received payment by the 10th day, the Company will deliver to the customer a notice that service will be discontinued in 24 hours if the balance is not paid. If payment is not received within 24 hours of the notice, service is discontinued and a final shut-off notice is delivered. Reconnection fees per the tariff will be added to the balance due. Once payment is received or an agreement on a payment schedule is reached, service is restored.

Lake Region currently hand delivers a Notice of Discontinuance that is prepared after the delinquent date has passed and at least twenty-four (24) hours before discontinuance of service. This notice includes information regarding all fees associated with discontinuance of service and restoration of service, the date on which services will be terminated for non-payment, and instructions to avoid discontinuance of service. The Company technician is authorized to accept a check for the full amount that the customer owes. If a customer pays the technician at the time of disconnection, the customer would avoid the discontinuance of service and the associated fee of $31. Under its tariffs, the Company is allowed to collect a $31 disconnect fee and a $31 reconnect fee.

A notice is left at the premise whenever service is discontinued. When service is discontinued due to a delinquent non-pay account, the customer is required to pay the balance due including the late fee that was previously applied, a $31 disconnect fee, and a $31 reconnect fee during normal business hours. During non-business hours, the customer will be assessed a reconnect fee of $70.00. Service is restored as soon as possible once payment has been received. There is no charge to customers for routine requests of termination or reconnection that allows the company a lead time of five (5) business days.

The following illustrates the actions the Company would follow on a delinquent account. This illustration reflects a bill that was mailed August 30, 2013, with a due date of

September 21, 2013. The Company's billing system automatically adds 21 days to the statement date in order to establish the due date at least 21 days out.



The Company indicated it attempts to avoid discontinuance of service late in the week to ensure customers are not without service on non-business days. Lake Region does not track the number of disconnection notices delivered for non-payment. Notices are discarded once the account is settled and appropriate notes are made in the billing system. The Company indicated approximately 90-100 late fees are assessed per month and that delinquent paying customers generally pay before the discontinuance notice is delivered. Of the mailed notices, approximately 20 are for customers who are two (2) months behind and generally half of those will respond with payment after the letter.

The Company indicated it received two (2) insufficient funds checks in 2010, one (1) in 2011, and one (1) in 2013. The Company tariff allows for a $25.00 returned check fee. The Company reported $9,115 in bad debt write-offs for the period of February 2011 through August 2013. A log is kept in a Microsoft Excel spreadsheet that details account numbers, names, amounts, gallons and reasons for adjustments. The Company does not use a collection agency and does not have plans to pursue the use of one.

G. Complaints and Inquiries

Customers may call, mail, fax or email complaints or inquiries to the Company. Most contacts begin with a phone call. Calls are generally answered by the Billing Clerk who can access customers' billing history and attempt to resolve their inquiries. If the Billing Clerk is unable to resolve the issue, the call is transferred to the General Manager. If the General Manager is unable to resolve the issue, the number to the Commission's Utility Consumer Hotline is provided. The Company currently does not maintain a customer complaint log.

H. Customer Communication

The Company has a written information brochure which contains necessary information required by Commission Rule 4 CSR 240-13.040. Brochures are available to customers at the office and new customers are given one when applying for service.

I. Records and Documentation Retention

Lake Region maintains a folder on each service location containing the applications received. Customer history, payments, and meter information is maintained in the billing system. The Company indicated it follows the guidelines found in 4 CSR 240-50.020 for record preservation. The Company indicated it has not discarded any records since October 2004 except paper records which duplicate information kept electronically.

J. Findings, Conclusions, and Recommendations

The following discussion presents a summary of the findings, conclusions, and recommendations pertaining to the Company's customer service operations. The information presented in this section focuses on the following issues that require Company management's attention:

- Job Descriptions
- Time Records
- Vehicle Logs
- Billing Estimation Procedures
- Customer Complaint/Inquiry Log
- Credit and Collections

1. Job Descriptions

Employees that complete the work activities for Lake Region do not have written job descriptions defining their activities and responsibilities. It is a basic business practice to have job descriptions for each position as they provide employees and supervisors a framework for understanding each employee's role at the Company. The job description can assist in employee training and development, workflow analysis, the clarification of relationships between jobs and work assignments, as well as determining appropriate staffing levels. Other factors to be considered in a job description include the employee evaluation process, promotion and disciplinary action, and salary structure. The lack of job descriptions makes it more difficult to determine each employee's job functions. Written job descriptions become even more important within companies that perform regulated and unregulated activities to document expectations and responsibilities.

The EMSU staff encourages the Company to develop job descriptions for all personnel to adequately reflect the employees' current job duties and responsibilities.

THE EMSU STAFF RECOMMENDS THAT COMPANY MANAGEMENT:

<u>*Develop written job descriptions for each position at the Company that adequately reflects the employees' current job duties and responsibilities. This recommendation should be completed within ninety (90) days of the effective date of any Commission order issued in this case, WR-2013-0461.*</u>

2. Time Records

Time records are not kept by all employees conducting work activities for Lake Region and records are routinely altered by supervisors during the review process. The Company's General Manager does not maintain time records to document his time to complete his work activities for the Company. A time record provides an important method to document the specific work and time attributable to it and should be utilized by all employees.

Maintaining accurate time records can serve and support several purposes such as planning, budgeting, and staffing. Time records assist in tracking the amount of time employees expend on all projects, enabling schedules of required work to increase operational efficiencies. Accurate and detailed time sheets create a record and serve as visual feedback to personnel and the employees of the work and projects that have been accomplished. Data contained in time records should be linked to accounting records and provide the necessary support for financial reporting and allocation of costs. Employee time records are useful in the regulatory process to support the salaries and benefits that regulated utilities will receive in customer rates. In situations where employees' work activities are shared among several different companies, it becomes even more important to utilize time sheets that reflect the actual work performed.

It is the opinion of the EMSU staff that the Company could improve the accuracy and usefulness of its employee time records by using a standard form time sheet to track the specific work activities of employees with the hours and location of those activities. Time sheets should include a signature certifying that the information is true and correct. If any corrections are made to the sheet by supervisors, this should be verified by the employee with an additional signature.

THE EMSU STAFF RECOMMENDS THAT COMPANY MANAGEMENT:

Develop and utilize time sheets for all employees to record work assignments and the time associated with each work assignment. Incorporate signatures to verify the accuracy of the information recorded. This recommendation should be completed within ninety (90) days of the effective date of any Commission order issued in this case, WR-2013-0461.

3. Vehicle Logs

Company employees do not currently log the mileage associated with jobs while using Company vehicles. This lack of written documentation makes it difficult to ensure that Company vehicles are being used for Company-related activities. An appropriate vehicle log would provide useful information including the vehicle type, date, a general description and location of the task, and the miles driven attributable to the task.

THE EMSU STAFF RECOMMENDS THAT COMPANY MANAGEMENT:

Develop and utilize a written vehicle log to maintain information regarding vehicle usage. The log should include information regarding the date, description and location of the task and the miles attributable to it. This recommendation should be completed within ninety (90) days of the effective date of any Commission order issued in this case, WR-2013-0461.

4. Billing Estimation Procedures

The Company has not submitted its billing estimation procedures for approval to the Commission per CSR 240-13-020 (2), which states:

> (2) Each billing statement rendered by a utility shall be computed on the actual usage during the billing period except as follows:
>
> (C) Under no circumstances shall a utility render a bill based on estimated usage –
>
> 1. Unless the estimating procedures employed by the utility and any substantive changes to those procedures have been approved by the commission;

The Company indicated it seldom has a need to estimate bills except under conditions of extreme weather. However, there are benefits to having an approved procedure in the event the Company is forced to estimate bills. Given the existence of the rule requiring Commission approval of the procedures, the Company needs to address formalizing a procedure and submitting it for Commission approval.

THE EMSU STAFF RECOMMENDS THAT COMPANY MANAGEMENT:

Develop and maintain billing estimation procedures for Commission approval which would ensure the Company adheres to Commission Rule 4 CSR 240-13.020(2)(C. This recommendation should be completed within (30) days of the effective date of any Commission order issued in this case, WR-2013-0461.

5. Customer Complaint/Inquiry Contact Log

The Company does not maintain a record of customer contacts regarding complaints or inquiries. The Commission's Utility Billing Practices 4 CSR 240-13.040 specifies that utilities are required to maintain records on their customers for at least two (2) years relating to "The number and general description of complaints registered with the utility."

In addition to the Commission rule which applies to water utilities, Commission Rule 4 CSR 240-60.010(4) applicable to sewer companies' states:

> The utility shall maintain a file of customer complaints received on the service it provides. The file shall include the name and address, as well as the nature of the complaint and date of occurrence. A detailed explanation of what the utility did to correct the trouble which originated the complaint shall be recorded.

The availability of documented complaint information is a good tool which would enable Company management to evaluate the reasons customers contact the Company and determine if any measures could be taken to improve customer satisfaction. This would also illustrate the Company's responsiveness in addressing customer issues.

THE EMSU STAFF RECOMMENDS THAT COMPANY MANAGEMENT:

Develop and implement a process to ensure all customer complaints received by Company personnel are documented and maintained for at least two (2) years. Documentation requirements shall adhere to Commission Rules 4 CSR 240-13.040 and 4 CSR 240-60.010(4) and include the customer name, address, nature of the complaint, date of occurrence, as well as an explanation of what the Company has done to address the complaint. This recommendation should be completed within thirty (30) days of the effective date of any Commission order issued in case WR-2013-0461.

6. Credit and Collections

The Company does not assess the customer fees and charges that have been approved in its tariffs in instances where the customer has caused a trip to the premise for a non-pay discontinuance of service. Once all of the appropriate actions have been taken prior to a non-pay discontinuance of service, the Company will send a serviceman to the residence with the intent to discontinue service. A notice is left at the residence to inform the customer what has occurred. In some instances, the customer will pay the Company the balance due at this time in order to avoid the discontinuance of service. The Company employee is authorized to accept the total amount in a check and forgo discontinuing the service. However, the customer is not charged for the trip the employee made to the residence to discontinue the service. Customers causing the costs of the trip to discontinue service due to delinquent nonpayment should be held responsible for the costs. The customers who cause the costs bear the expense if such an arrangement is specifically provided for in the Company's tariffs, which is the case with Lake Region.

THE EMSU STAFF RECOMMENDS THAT COMPANY MANAGEMENT:

Utilize the Company's tariffs to charge customers the disconnect charge when the Company makes a trip to the location to discontinue service and the customer then pays the total due to avoid the discontinuance of service. This recommendation should be completed within thirty (30) days of the effective date of any Commission order issued in this case, WR-2013-0461.

K. Implementation Review

The EMSU staff will conduct a review of the Company's progress regarding the implementation of the recommendations made in this report.

Staff Expert/Witness: Deborah A. Bernsen

IX. Appendices

Appendix 1: Staff Credentials

Appendix 2: Support for Staff Cost of Capital Recommendation – Shana Atkinson

Appendix 3: Allocation Factors Used – Keith D. Foster

Depreciation Rates – Arthur Rice

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF SHANA ATKINSON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Shana Atkinson

Shana Atkinson

Subscribed and sworn to before me this 14th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF DEBORAH A. BERNSEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Deborah A. Bernsen, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Deborah A. Bernsen

Deborah A. Bernsen

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF KIMBERLY K. BOLIN

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Kimberly K. Bolin, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Kimberly K. Bolin

Kimberly K. Bolin

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF ERIN M. CARLE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Erin M. Carle, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Erin M. Carle
Erin M. Carle

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF KEITH D. FOSTER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Keith D. Foster, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Keith D. Foster

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF JAMES A. MERCIEL, JR., P.E.

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

James A. Merciel, Jr., P.E., of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

James A. Merciel, Jr., P.E.

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF ARTHUR W. RICE, PE

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Arthur W. Rice, PE, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Arthur W Rice

Arthur W. Rice, PE

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water & Sewer Service	))))	Case No. WR-2013-0461

AFFIDAVIT OF ASHLEY SARVER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Ashley Sarver, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report as identified in the individual sections as identified in the Table of Contents of said Report; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Ashley Sarver

Ashley Sarver

Subscribed and sworn to before me this 15th day of November, 2013.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public