

California Water Association Small Company Workshop

“Keeping the Shoebox in Order”
CWA Spring Meeting
Radisson Hotel - Sacramento
June 4, 2008

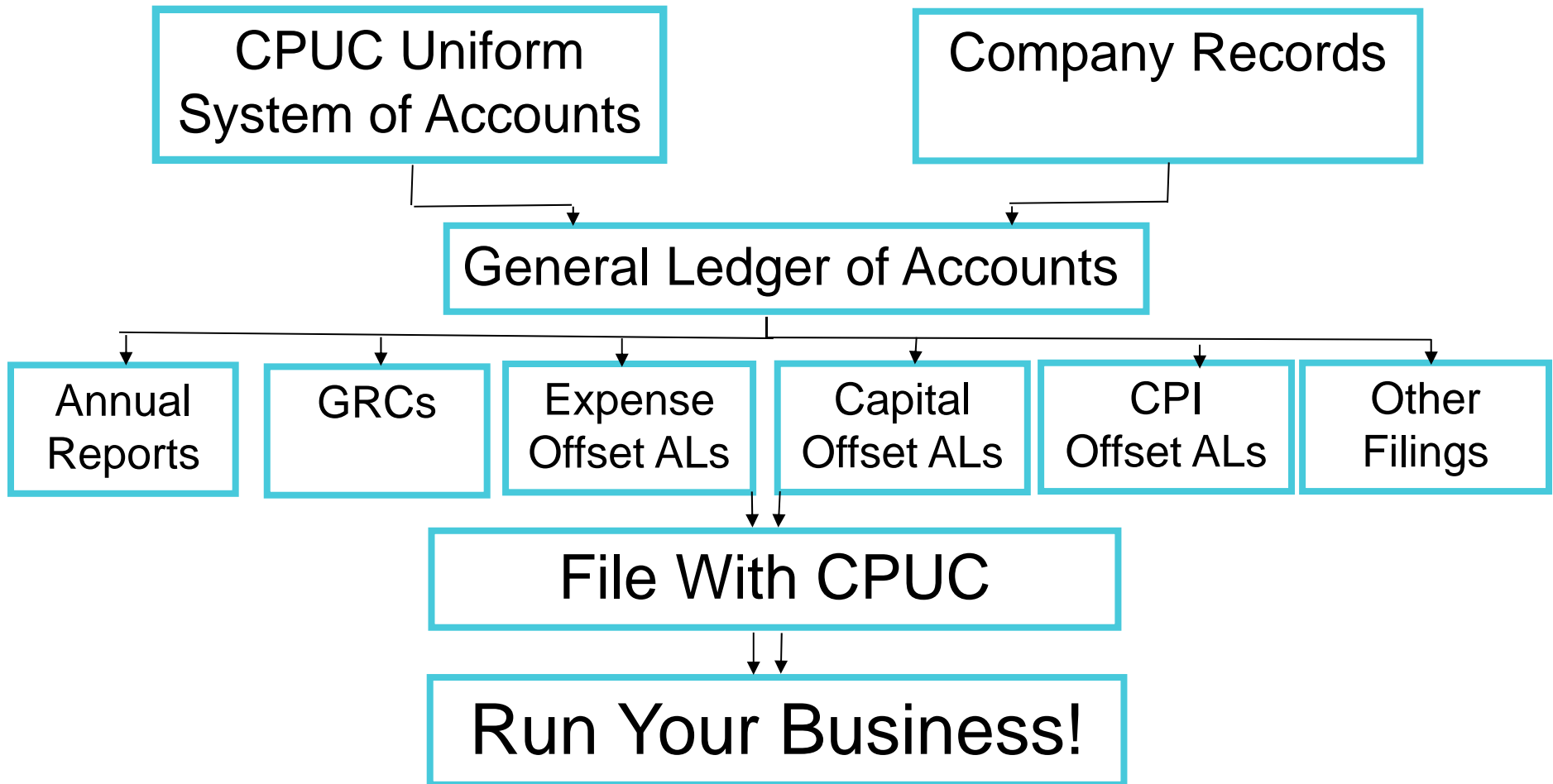


Scope of Workshop

- Review of California PUC Accounting Practices for Small Systems
- Objectives
 - Increase understanding and comfort level with CPUC accounting procedures
 - Assist in preparation of annual reports, general rate cases and rate increase advice letters
 - Provide answers to questions that may arise
- Agenda Highlights
 - Overview of Ratemaking
 - Importance of Drudgery
 - Opportunities for Cost Recovery
 - CPUC Perspective



Accounting Flowchart



Competing Objectives Of Water Rates

- Water Utility Wants Rates That Are . . .
 - Financially Viable, Provide Stable Revenue
- Customers Want Rates That Are . . .
 - Equitable
 - Affordable
 - Easily Understood
- Society Wants Rates That Are . . .
 - Economically Efficient
 - Designed To Promote Public Health And Safety



Criteria For A Sound Rate Structure

- Simple, Understandable
- Freedom From Controversy
- Effective In Yielding Total Revenue Requirement
- Revenue Stability For The Utility
- Revenue Stability For Customers
- Fairness Among Customer Classes
- Avoid “Undue Discrimination”
- Efficient (Discourages Wasteful Use)



How Small Company Revenue Requirement Is Established Return On Investment Method

- + Allowable Expenses \$ _____
- + Taxes Other Than Income \$ _____
- + Income Taxes \$ _____
- + Depreciation \$ _____
- + Return On Investment \$ _____

- = Revenue Requirement \$ _____



Small Company Rate Of Return Method

- + Allowable Expenses
- + Taxes Other Than Income
- + Income Taxes
- + Depreciation
- + Return On Investment

- = Revenue Requirement

How Return On Investment Is Calculated

- + Avg. Plant
- + Allowance For Working Capital
- + Materials & Supplies
- Avg. Accumulated Depreciation
- Avg. Contributions In Aid Of Construction
- Avg. Advances For Construction

= Rate Base

x Authorized Rate Of Return

(Class C = 12% to 13%, Class D = 12.75 to 13.75%)

= Return On Investment



How Small Company Revenue Requirement Is Established Rate Of Margin Method

- + Allowable Expenses \$ _____
- + Taxes Other Than Income \$ _____
- + Income Taxes \$ _____
- + Depreciation \$ _____
- + Rate Of Margin \$ _____

- = Revenue Requirement \$ _____



Small Company Rate Of Margin Method

- + Allowable Expenses
- + Taxes Other Than Income
- + Depreciation
- + Rate Of Margin (\$)
- + Income Taxes

- = Revenue Requirement

How Rate Of Margin Amount Is Calculated

+ Allowable expenses
+ Taxes Other Than Income
+ Depreciation

= Operating Expenses

x Authorized Rate Of Margin (%)
(Class C = 19%, Class D = 20%)

= Rate of Margin (\$)



Income Statement vs. Revenue Requirement

Income Statement (Unregulated Business)

+ Revenue
- Expenses
- Depreciation
- Taxes
= Net Operating Income
- Interest
= Net Income

Revenue Requirement (Regulated Utility)

= Revenue Requirement
+ Expenses
+ Depreciation
+ Taxes
= Net Operating Income
+ Interest
+ Net Income



CPUC System Of Accounts – Formal Version

- Balance Sheet Accounts
 - Assets (e.g., plant in service, depreciation, cash, accounts receivable, materials and supplies, etc.)
 - Equity and Liabilities (e.g., common stock, paid-in capital, retained earnings, long-term debt, accounts payable, accrued taxes and interest, current liabilities, advances for construction, etc.)
- Plant Accounts
 - Non-Depreciable (land, intangible plant)
 - Depreciable (structures, wells, pumping equipment, water treatment plant, reservoirs, tanks, mains, meters, hydrants, etc.)
- Income Accounts (revenues, expenses, taxes)
- Operating Revenue Accounts (metered and unmetered revenue, fire protection revenue, irrigation revenue)
- Operating Expense Accounts (plant O&M, administrative and general)



CPUC System Of Accounts – “What You Really Need” Version

- Operating Revenue Accounts
 - 460: Unmetered water revenue
 - 462: Fire Protection revenue
 - 465: Irrigation revenue
 - 470: Metered water revenue
 - 480: Other water revenue
- Operating Expense Accounts
 - 610: Purchased water
 - 615: Purchased power
 - 618: Other volume-related expenses
 - 630: Employee labor
 - 640: Materials
 - 650: Contract work (exclude water testing)
 - 660: Transportation expense
 - 664: Other plant maintenance
 - 670: Office salaries
 - 671: Management salaries
 - 674: Employee pensions & benefits
 - 676: Uncollectibles expense
 - 678: Office services and rentals
 - 681: Office supplies and expenses
 - 682: Professional services
 - 684: Insurance
 - 688: Regulatory Commission expense
 - 689: General expenses
 - 403: Depreciation expenses
 - 408: Taxes other than income taxes
 - 409: Income tax on proposed net income



Small Company Standard Practices

- SP U-03-SM** Preparing Results of Operation Reports for General Rate Increase Requests of Water Utilities other Than Major Companies
- SP U-04-SM** Depreciation Procedures for Small Water and Sewer System Utilities
- SP U-05-SM** Determining Fixed Capital and Rate Base of Class B, C, & D Water Utilities
- SP U-08-W** Creating and Processing Water and Sewer System Advice Letter Filings and Resolutions; and Maintaining Tariffs Under General Order No. 96-B
- SP U-09-SM** Processing Informal General Rate Cases of Class B, C and D Water and Sewer Utilities and the Service Guarantee Plan
- SP U-13-W** Preparing and Processing Small Water Company Advice Letter Filings for Financing
- SP U-27-W** Processing Rate Offsets; Establishing and Amortizing Memorandum Accounts
- SP U-28-W** Collecting and Processing Customer Rates, Fees and Charges Under General Order 96-B
- SP U-39-W** Uniform System of Accounts for Class B, C, and D Water Utilities



On the Importance of Drudgery

How some small steps will improve
your bottom-line and make the
Commission staff happy, too!



Outline

- Record-Keeping
- Time-Keeping
- Management Salaries
- Capital Investment vs. Expenses
- Depreciation



Record-Keeping

- Regulation is fact-based
 - You are in a better position when you can prove you've spent the money in the past
- Keep records on all your expense items
- Keep receipts
- Keep your general ledger by system of accounts
- Code properly



Non-Dollar Data Is Important

- Water sales units, production, customers in service, kilowatt-hours of electricity
 - Accurate production meters are key
- Records of water quality tests and correspondence with DPH



Keep Tariff Book Handy (It is your friend)

- Not just rates and schedules
- Not just terms and conditions of service
- Not just operating rules (e.g.)
 - Rule 11 – Discontinuance of Service
 - Rule 16 – Backflow prevention
- It's the roadmap for running your business



Complaint File

- Commission is revising GO 103
- Inquiries versus complaints
 - *A complaint is a request requiring an investigation or action on the part of the utility. A customer that makes an inquiry to the utility requiring neither investigation nor action is therefore not making a complaint.*
- For complaints, you should document:
 - What the complaint was
 - When it occurred
 - Resolution



Consider All Costs of Your Business – Do Not Subsidize

- Customers should pay true cost of providing water service
- Subsidies may encourage people to use more water – costs the utility more in power, maintenance and supply improvements
- Commission is promoting water conservation in the Water Action Plan



Examples of Common Under-Reported Costs

- If you use your personal car on utility business, keep track of the mileage and charge an expense (IRS allows \$0.505 per mile).
- If you have several businesses, review how you use common equipment.
 - Formalize these relationships with records
 - e.g., use of the copier, telephone, etc.
- Management salaries



Management Salaries

- Under CPUC regulation, the rate of return is based only on your investment in utility plant
- Time you spend operating the water system is in addition to return on investment
 - Account for your time and your spouse/family's time
- Rate of return is the cost of borrowing money to operate the system
- Should charge a reasonable wage for work you could have hired someone to do



ACWA Salary Survey

- Available from CWA
- Gives salary information for all water system employment in by
 - Region
 - Size of company
 - Type of job



Time-Keeping

- Need to be able to defend your estimated management salary
- Keep a record of time you spend on the system (Don't shortchange your hours)
 - How many hours
 - Time operating the system
 - Dealing with regulators and local government officials
 - Training sessions
 - When
 - What were you doing



Capital Investment vs. Expenses

- What is a Capital Investment?
 - Generally anything that will benefit the customer for multiple (>2) years
 - Anything that extends the life of an asset
 - Coating a storage tank
 - Even small things, for example:
 - Laptop computer (\$1,000)
 - Chlorinator pump (\$300)



What is Included in a Capital Cost?

- Everything necessary to put an asset into service
- Example: New section of main to replace an old leaking section
 - Cost material of new main
 - Labor to install
 - Rental of equipment if not in rate base
 - Permits
 - Construction material and disposal
 - Traffic control



Another Capital Cost Example

- New Tank
 - Cost of material
 - Cost of fabrication
 - Cost of installation
 - Permits, rental equipment, etc.
 - Site preparation



Capitalize, Capitalize, Capitalize

- Why?
 - Match the expense with the useful life of the asset
 - Maintain the integrity of your plant in service
 - Smooth out rate impact
 - If an event occurs between rate cases, a capital investment will still be mostly recovered. An expense is lost unless it will recur in the future.



Depreciation

- The purpose of depreciation is to recover the original cost of utility plant (your investment) over the useful life of the property
 - You must make certain ratepayers are funding depreciation or you are losing your investment
- Depreciation will never cover full replacement
 - Costs of materials and labor have increased, so replacement plant will be more costly



Source of Your Cash Flow

- If there is a mismatch between principal payments on debt and cash flow from your business, you will have difficulty making payments or getting a loan



Problems with Depreciation

- Depreciation rate is too low:
 - Plant will begin to break down before you have collected your investment
- Depreciation rate is too high:
 - Your investment dwindles while the plant is still useful



Opportunities for Cost Recovery

- The Commission gives small water companies many opportunities to recover their costs



General Rate Cases

- General rate case sets rates to recover your total revenue requirement
 - Can be set either on a rate of return or rate of margin
 - Simplified rate case worksheets for a Class D utility
 - Example in your reference “shoebox”

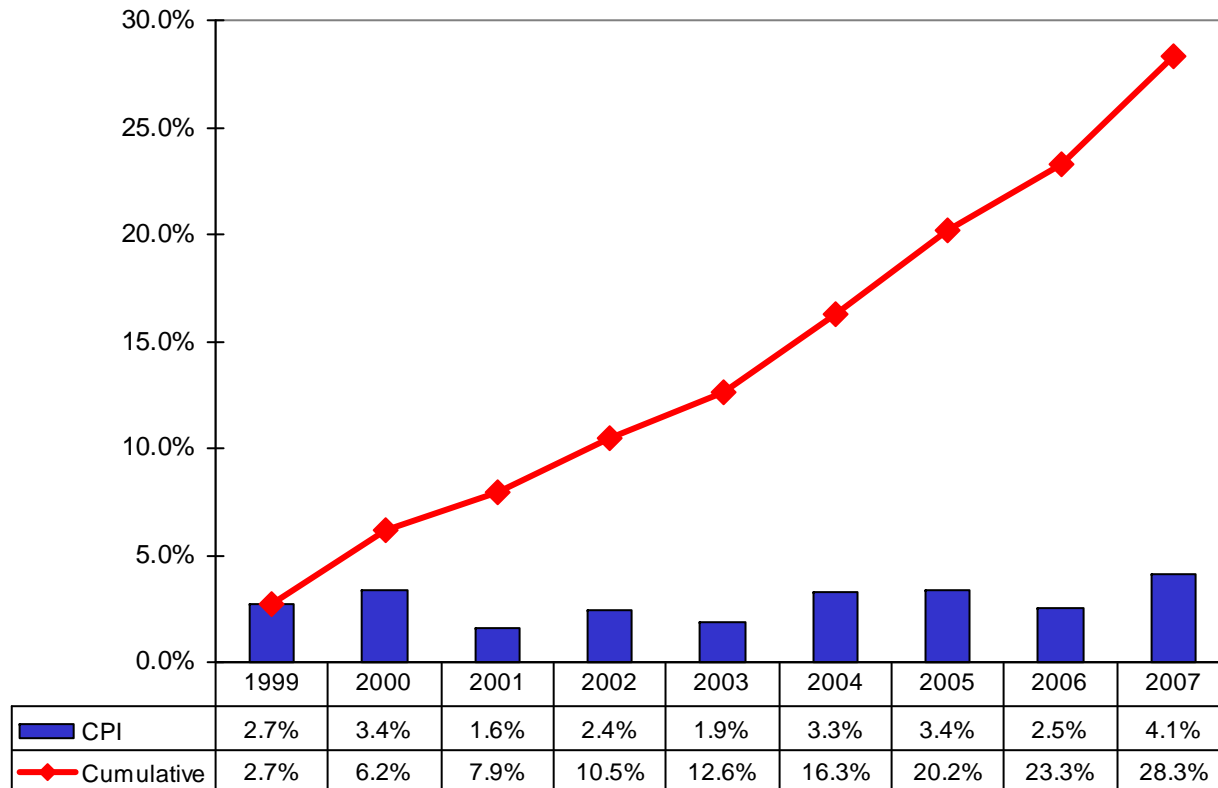


Annual CPI-U Adjustment

- Automatic adjustment to adjust for increases in the Consumer Price Index - Urban
- Requires you show your annual earnings were at or below the authorized rate of return



Cumulative Rate Increase After 9 Consecutive Years of CPI Increases – 28.3%



Offsets

- Offsets allow recovery on a one-for-one basis of an expense increase
- For Class C and Ds, the Commission has allowed offsets for:
 - Purchased water
 - Power cost changes
 - New plant and equipment
 - Other expenses



Available Tariff Conditions

- **Facilities Fees**
 - Developers pay for expansion
- **Late Fees**
 - Ensure customers pay for service
- **Charges for private fire protection service**



Memorandum Accounts

- Extraordinary maintenance
- DPH Fees
- Catastrophic Events
- Changes in Water Quality



Remarks from CPUC Division of Water & Audits



Concluding Remarks & Questions

