

# Rate Case Auditing – Part 2

Danny Kermode, CPA (retired)  
INSTITUTE OF PUBLIC UTILITIES | MSU



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# Course Information

- **Course Overview** – In this course, attendees will learn about regulatory auditing. It covers the foundation of auditing in general, and approaches and methods unique to regulatory accounting. This course also covers the regulatory challenges that are faced by auditors in the collection and analysis of public utility financial and operating data. This course is intended for students with an interest in regulatory audits their purpose and use by regulatory agencies.
- **Intended Audience** – Accountants and analyst that need a broader understanding of the process of regulatory auditing.
- **Learning Objectives** – After this course the student will have a foundational understanding of the foundations of general auditing and how distinctive approaches and techniques are used when reviewing the books and records of an economically regulated entity.
- **Course Level** – Advanced
- **Course Prerequisites** – A working understanding of accounting and regulatory reporting standards and report forms.
- **Advance Prep** – None
- **Delivery Method** – Online Group Live
- **NASBA National Registry Statement** -- The Institute of Public Utilities is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State Boards of Accountancy have the final authority on the acceptance of individual course for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: [www.nasbaregistry.org](http://www.nasbaregistry.org).
- **This course is eligible for CPE credit.**

“...the problem of ratemaking is one which has taxed, and will continue to tax, the ingenuity of man to the extent of time.”

Commissioner John V. Smith of Alabama July 16, 1903,  
to the fifteenth annual convention of NARUC





## CWIP in Rate Base vs AFUDC

### Construction Work in Progress (CWIP)

- Includes costs of construction for projects that extend for more than a year and are not considered Used and Useful.
- **Audit issue: Financing Costs**

ASSETS		December 31, 2022
UTILITY	105. Construction Work in Progress	249,153
	A. This account shall include the total of balances of work in progress but not ready for service	735,138
		97,581
		53,570
		1,135,442
		214,891
		920,551
		3,828
		16,018
		—
		8,659

### Regulatory Methods of handling Financing Costs

- **AFUDC – Allowance for Funds used During Construction.**
  - Financing costs are accrued and added to CWIP
  - Includes both Equity and Debt costs
  - **ISSUE:** Deferred Financing Costs earn a return, so there is a compounding impact that is also deferred for later recovery.

### Regulatory Methods of handling Financing Costs

- **Include CWIP account balance in Rate Base**
  - Financing costs are recovered currently in rates and no financing costs are accrued and added to CWIP
  - Includes both Equity and Debt costs
  - **ISSUE:** Rate Payers are paying for plant that is not providing service.
  - Some states prohibit this approach (used and useful)

	Repayments
	TOTAL CURRENT
<b>OTHER ASSETS:</b>	Operating Lease Rig
	Preliminary Survey
	Regulatory Assets
	Non-utility Assets -
	Employee Benefit P
	Other
	TOTAL OTHER AS
	TOTAL ASSETS



## Use of allowance for funds used during construction (AFUDC)

- The auditor should become familiar with the formula used by the utility to compute AFUDC to assure the utility has computed the rate correctly.
- The utility most likely uses the FERC approach or some approach similar found in the USoA Plant instructions (17).

ASSE  
UTIL

December 31,  
2022

Less Accumulated Depreciation

1	\$	249,153
2		735,138
3		97,581
6		53,570
2		1,135,442
		214,891
		920,551

CUI

(17) Allowance for funds used during construction (Major and Nonmajor Utilities) includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed in paragraph (a) of this subparagraph. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects which have been abandoned.

OTT

(a) The formula and elements for the shall be:

$$A_i = s(S/W) + d(D/D + P + C)(1 - S/W)$$

$$A_e = [1 - S/W][p(P/D + P + C) + c(C/D + P + C)]$$

$A_i$  = Gross allowance for borrowed funds used during construction rate.

$A_e$  = Allowance for other funds used during construction rate.

S = Average short-term debt.

s = Short-term debt interest rate.

**Audit Issue:** AFUDC stops when the project is complete Not when the project is (a) put into service or (b) recognized in rate base

	3,828
	16,018
	—
	8,659
	6,177
	2,624
	37,306
	3,826
	2,806
	90,046
	11,207
	8,689
	19
	116,593
\$	1,074,450

## Impact of AFUDC vs. CWIP

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Total
AFUDC (no CWIP in rate base)										
Capitalized cost (cumulative)	\$1,000	\$2,070	\$3,215							
AFUDC (7%)	\$70	\$145	\$225							
Total CWIP	\$1,070	\$2,215	\$3,440							
Plant in service				\$3,440	\$3,440	\$3,440	\$3,440	\$3,440	\$3,440	
Accumulated depreciation				\$573	\$1,147	\$1,720	\$2,293	\$2,867	\$3,440	
Rate base				\$2,867	\$2,293	\$1,720	\$1,147	\$573	\$0	
ROR (7%)				\$201	\$161	\$120	\$80	\$40	\$0	
Depreciation expense				\$573	\$573	\$573	\$573	\$573	\$573	
Rate impact				\$774	\$734	\$694	\$654	\$613	\$573	\$4,042
CWIP in rate base										
Total CWIP	\$1,000	\$2,000	\$3,000							
Plant in service	\$1,000	\$2,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	
Accumulated depreciation	\$0	\$0	\$0	\$500	\$1,000	\$1,500	\$2,000	\$2,500	\$3,000	
Rate base	\$1,000	\$2,000	\$3,000	\$2,500	\$2,000	\$1,500	\$1,000	\$500	\$0	
ROR (7%)	\$70	\$140	\$210	\$175	\$140	\$105	\$70	\$35	\$0	
Depreciation expense	\$0	\$0	\$0	\$500	\$500	\$500	\$500	\$500	\$500	
Rate impact of CWIP in RB	\$70	\$140	\$210	\$675	\$640	\$605	\$570	\$535	\$500	\$3,945

MIDDLESEX WATER COMPANY  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands)

		December 31, 2023	December 31, 2022
<b>ASSETS</b>			
<b>UTILITY PLANT:</b>	Water Production	\$ 303,791	\$ 249,153
	Transmission and Distribution	809,862	735,138
	General	100,593	97,581
	Construction Work in Progress	19,636	53,570
	<b>TOTAL UTILITY PLANT</b>	<b>1,233,882</b>	<b>1,135,442</b>
	Accounts Receivable	4,891	4,891
	Prepaid Expenses	10,551	10,551
	Other Current Assets	3,828	3,828
<b>CURRENT ASSETS</b>		<b>29,770</b>	<b>29,770</b>
	Materials and Supplies (at average cost)	6,972	6,177
	Prepayments	1,833	2,624
	<b>TOTAL CURRENT ASSETS</b>	<b>108,536</b>	<b>37,306</b>
<b>OTHER ASSETS:</b>	Operating Lease Right of Use Asset	3,185	3,826
	Preliminary Survey and Investigation Charges	1,932	2,806
	Regulatory Assets	90,694	90,046
	Non-utility Assets - Net	11,522	11,207
	Employee Benefit Plans	21,779	8,689
	Other	62	19
	<b>TOTAL OTHER ASSETS</b>	<b>129,174</b>	<b>116,593</b>
	<b>TOTAL ASSETS</b>	<b>\$ 1,236,052</b>	<b>\$ 1,074,450</b>

**Audit Issue:**

If CWIP is allowed to be included in Rate Base, the auditor should confirm the capitalization of financing costs through the **allowance for funds used during construction (AFUDC)** stops once rates are effective.





# Understanding Hypothetical Capital Structure

**CAPITALIZATION AND LIABILITIES**

<b>CAPITALIZATION:</b>	Common Stock, No Par Value	\$	246,764	\$	233,054
	Retained Earnings		176,227		167,274
	<b>TOTAL COMMON EQUITY</b>		<b>422,991</b>		<b>400,328</b>
	Preferred Stock		2,084		2,084
	Long-term Debt		358,153		290,280
	<b>TOTAL CAPITALIZATION</b>		<b>783,228</b>		<b>692,692</b>
<b>CURRENT LIABILITIES:</b>	Current Portion of Long-term Debt		7,740		17,462
	Notes Payable		42,750		55,500

If the utility's proportion or cost of debt is significantly different than that indicated as industry averages, the auditor may wish to consider using a *hypothetical* capital structure, in lieu of the actual capital structure. In doing this, one would look to base the capital structure on industry averages for similarly situated utilities, in effect, using a more normal capital structure for rates than that indicated by the actual capital structure. This is sometimes done when either the proportion of debt or proportion of equity is an unusually large portion of the capital structure.

*Source: NARUC Rate Case and Audit Manual*

	Other		592		919
	<b>TOTAL OTHER LIABILITIES</b>		<b>226,725</b>		<b>150,524</b>
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>			<b>122,270</b>		<b>113,375</b>
	<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	\$	<b>1,236,052</b>	\$	<b>1,074,450</b>

See Notes to Consolidated Financial Statements.

<b>CAPITALIZATION AND LIABILITIES</b>					
<b>CAPITALIZATION:</b>					
	Common Stock, No Par Value	\$	246,764	\$	233,054
	Retained Earnings		176,227		167,274
	<b>TOTAL COMMON EQUITY</b>		<b>422,991</b>		<b>400,328</b>
	Preferred Stock		2,084		2,084
	Long-term Debt		358,153		290,280
	<b>TOTAL CAPITALIZATION</b>		<b>783,228</b>		<b>692,692</b>
<b>CURRENT LIABILITIES:</b>					
	Current Portion		7,740		17,462
	Notes Payable		42,750		55,500
	Accounts Payable		27,618		24,847
	Litigation Settlements		6,237		—
	Accrued Taxes		10,535		12,162
	Accrued Interest		3,138		2,535
	Unearned Revenue		1,390		1,365
	Other		4,421		3,988
	<b>TOTAL CURRENT LIABILITIES</b>		<b>103,829</b>		<b>117,859</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES:</b>					
<b>OTHER LIABILITIES:</b>					
	Customer Advances		21,313		21,382
	Lease Obligations		3,063		3,706
	Accumulated Depreciation		88,736		77,783
	Regulatory Liabilities		113,021		46,734
	Other		592		919
	<b>TOTAL OTHER LIABILITIES</b>		<b>226,725</b>		<b>150,524</b>
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION:</b>					
	<b>TOTAL CONTRIBUTIONS IN AID OF CONSTRUCTION</b>		<b>122,270</b>		<b>113,375</b>
	<b>TOTAL CAPITALIZATION</b>		<b>1,236,052</b>	\$	<b>1,074,450</b>

**Capital Structure Computation**

Common Equity	422,991				
Preferred	2,084				
<b>Total Equity</b>	<b>425,075</b>		<b>38%</b>		
LT Debt	358,153				
Current Liab.	103,829				
Other Liab.	226,725				
<b>Total Liabilities</b>	<b>688,707</b>		<b>62%</b>		
<b>Total Capitalization</b>	<b>1,113,782</b>		<b>100%</b>		

See Notes to Consolidated Financial Statements.

**CAPITALIZATION AND LIABILITIES**

<b>CAPITALIZATION:</b>	Common Stock, No Par Value	\$ 246,764	\$ 233,054
	Retained Earnings	176,227	167,274
	<b>TOTAL COMMON EQUITY</b>	<b>422,991</b>	<b>400,328</b>
	Preferred Stock	2,084	2,084
	Long-term Debt	358,153	290,280

**Hypothetical Capital Structure Example  
Actual Capital Structure**

	Amount	Percent	Cost	Weighted	Net Income
Equity	422,991	38%	9.50%	3.6%	
Total Liabilities	688,707	62%	5.30%	3.3%	
<b>Total Capitalization</b>	<b>1,111,698</b>	<b>100%</b>		<b>6.9%</b>	<b>76,686</b>

**Hypothetical Capital Structure**

	Amount	Percent	Cost	Weighted	Net Income
Equity	422,991	45%	9.50%	4.3%	
Total Liabilities	688,707	55%	5.30%	2.9%	
<b>Total Capitalization</b>	<b>1,111,698</b>	<b>100%</b>		<b>7.2%</b>	<b>79,931</b>
			Change in Earnings		3,245
			Revenue Conversion Factor		1.35
			Change in Revenue Requirement		4,381

**Capital Structure Computation**

Common Equity	422,991	
Preferred	2,084	
<b>Total Equity</b>	<b>425,075</b>	<b>38%</b>
LT Debt	358,153	
Current Liab.	103,829	
Other Liab.	226,725	
<b>Total Liabilities</b>	<b>688,707</b>	<b>62%</b>
<b>Total Capitalization</b>	<b>1,113,782</b>	<b>100%</b>

	88,736	77,783
	113,021	46,734
	592	919
	226,725	150,524
	122,270	113,375
	\$ 1,236,052	\$ 1,074,450









## Types of Adjustments

# Adjustments

## What does adjustments have to do with auditing?

**Regulatory auditors are not financial auditors.**

The purpose of a regulatory auditor is to provide assurance to rate payers, companies and the regulators themselves that the rates approved will provide the company with a reasonable opportunity to earn a return on its investment while providing rate payers service at the least cost. Adjustments are one of the tools that the regulatory auditor uses to achieve that goal.



# Regulatory Adjustments

- Various adjustments are needed to adjust a test year to reflect costs and revenues that are reasonably expected to be incurred in the rate year. This is especially true when working with small companies.
- Adjustments are required when working with a **historically-based pro forma** test year as well as when preparing a **partial or fully projected** test year.
- Future changes in the economic environment must be recognized in order to develop a forward-looking income statement and rate base



# Regulatory Adjustments

## – Small Companies

In audits of small companies its not uncommon to find personal expenses while at the same time finding no costs for other items such as personal vehicles used in the business.

- ▶ Review of a small company's income taxes may provide addition information such as milage claimed for income taxes,
- ▶ Add regulatory costs such as legal costs of filing a case or expert consultant – not known at time of filing,
- ▶ Adjust for other reasonably estimated, costs that will be incurred in its rate year.

\*Remember, small companies serve small communities which deserve safe and reliable utility service.



# Restating Adjustments

- Out-of-period
  - ▶ Auditors when reviewing invoices must be aware of transactions that took place prior to the beginning of the year but paid during the test year.
    - *Issue: Are rates being set using a modified cash-basis of accounting or full accrual?*
  - ▶ Auditors must also look for transactions that belong in the test year but were paid outside the test year.
    - *The rental cost of a backhoe for a water main repair that was paid two months after the end of the test year.*



# Deferral Adjustments

Auditors routinely find expenses in a test year that are **material** but not expected to be recurring.

Auditors must decide to:

- a) Disallow the expense for future recovery or
- b) Defer and amortize, allowing recovery in the future

**What is a possible problem with a disallowance?**

What if there is a large one-time loss from flood damage, which, without recovery of the cost, may simply bankrupt the company?

# Deferral Adjustments

Auditors routinely find expenses in a test year that are **material** but not expected to be recurring.

Auditors must decide to:

- a) Disallow the expense for future recovery or
- b) Defer and amortize, allowing recovery in the future

## What is a possible problem with the deferral option?

A company normally requires authorization from its regulatory agency to defer costs incurred in one period to recovered in a later period.

The Problem: [Possible] Retroactive Ratemaking

# Deferral Adjustments

## Retroactive Ratemaking

The courts have described the Retroactive Ratemaking prohibition as “... imposing a rate increase for [electricity] already sold.” (Arkla, 453 U.S. at 578)

- That is, the company gets a second bit of the apple to recover costs of providing utility services in a prior period.
- **For Example:** Expenses that were allowed in a company’s prior case which were uncollected or incorrect cannot be recovered in a current case. Same regarding excess revenue cannot be “clawed back.”
- **DEPENDING on commission policy:** The question for the auditor: Is a deferral of a utility’s costs associated with a company’s response to catastrophic events, such as windstorms, earthquakes, etc., be considered retroactive recovery?

# Projected or Pro Forma Adjustments

## Annualization Adjustment

An auditor should be able to recognize changes in revenues or expenses through comparables. If a material change is identified,

The auditor should consider:

- Is the change durable, will it continue?
- If it will continue, is the cost measurable or reasonably predicted?

5% insurance premium increase

# Projected or Pro Forma Adjustments

## Normalization Adjustment

- ▶ Auditors must be able to think through the impact of unusual or abnormal events on revenue or expenses on the company's test year,

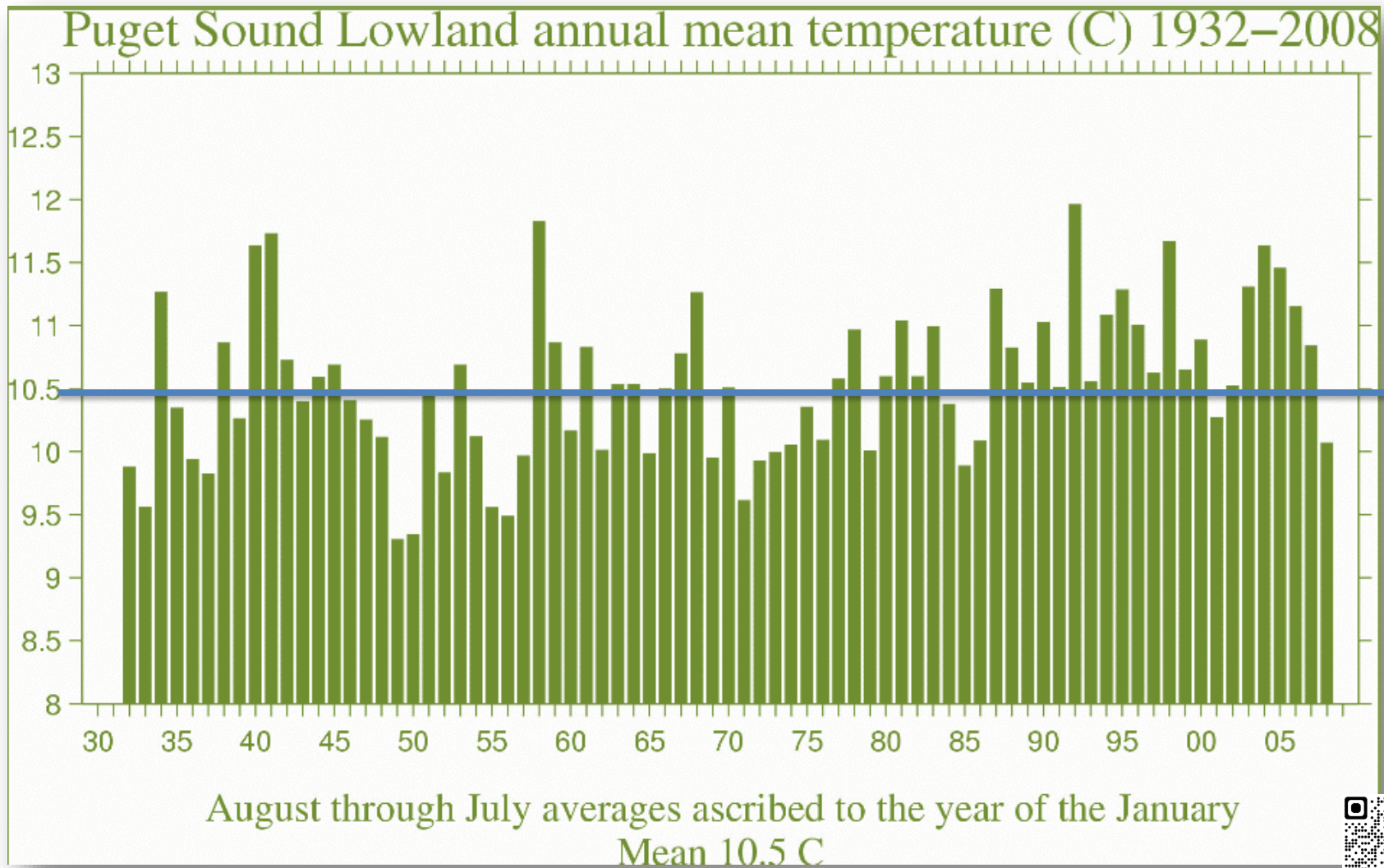
During the test year, there was a drought that dramatically increased the cost of electric power for a six-month period. The drought has ended, and hydro-provided power has returned to normal.

- ▶ Auditors need to adjust revenues or expenses in the test year to smooth variable annual data.

**weather normalization**



# Projected or Pro Forma Adjustments



Source: NOAA National Climatic Data Center



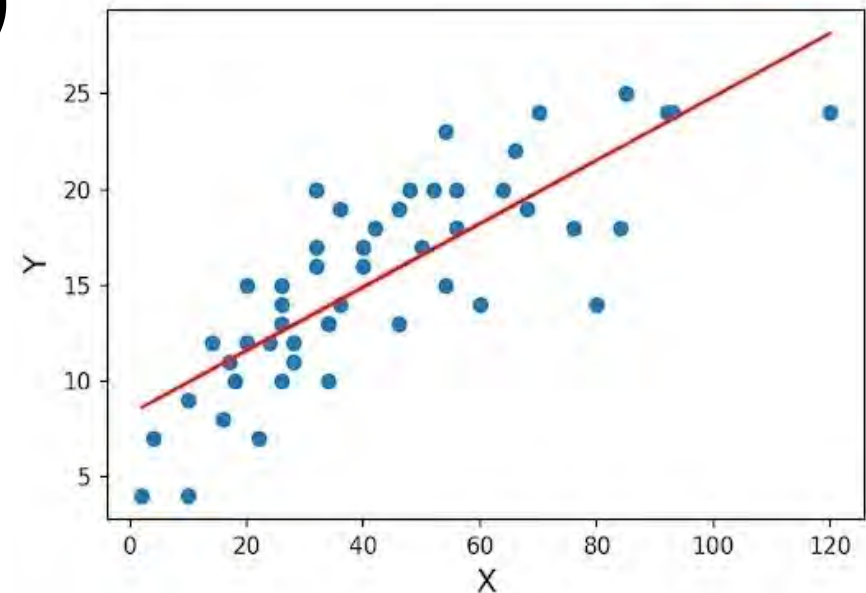
# Projected or Pro Forma Adjustments

Statistical Modeling to find trends or relationships

## Linear Regression

Linear regression is a tool that is used to model the relationship between two variables (independent and dependent) by fitting a linear equation to observed data.

The most common method for deriving a regression line is the least-squares method.



# Types of Adjustments

## Poll Question

Is there a difference between Precision and Accuracy?

1. Yes
2. No
3. Sometimes
4. Only Mammals



# Precision vs Accuracy

Do not confuse Precision with Accuracy.

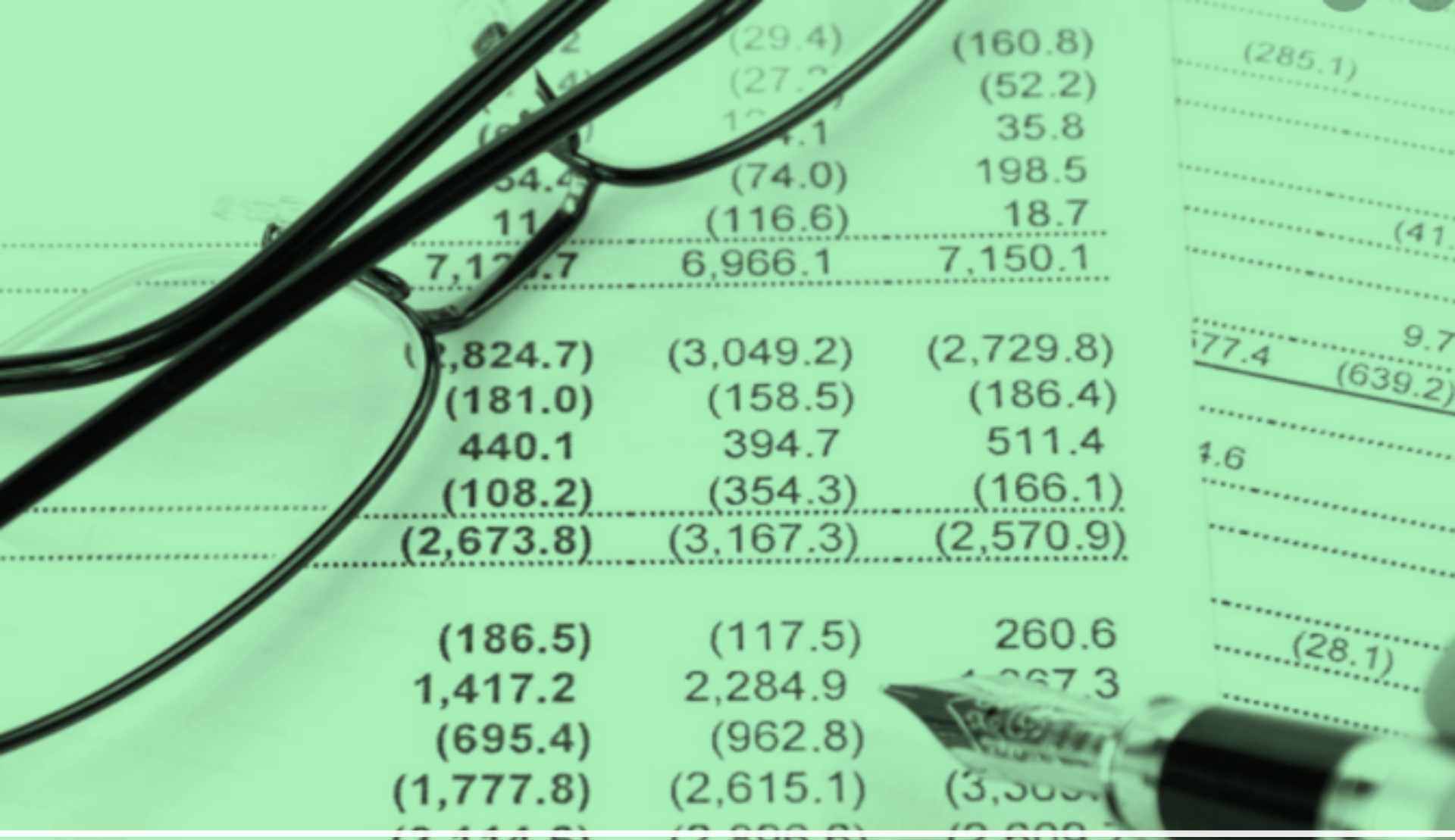
$$\sqrt{562} = 36.32546526$$

is precise

But incorrect.

$$\sqrt{562} = 23.7$$

23.7 is less precise but much more accurate!



# Audit of the Income Statement



# Review of the results of operations

Look at a multi-year comparison of annual revenue to obtain a view of the trend for the utility.

- Is it growing and if so, is the growth relatively consistent?
- Is the growth related to new customers or additional usage of existing customers?

*(NARUC Rate case & Audit Manual)*

Line No.		Results As filed Company
1	<u>Operating Revenue</u>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		
8		636,474
9	<u>Operating &amp; Maintenance Expenses</u>	
10		
11	Salary & Wages	372,000
12	Salary & Wages - Officers	62,000
13	Payroll taxes	52,080
14	Officer Pensions	23,252
15	Bank Service Charges	330
16	Materials and supplies	-
17	Rental Expense - Buildings/Real Property	32,525
18	Employee Pension	-
19	Insurance	12,562
20	Miscellaneous Expenses	876
21	Depreciation Expense	43,643
22	Amort of CIAC	-
23	Office Supplies	1,200
24	Other Tax & Licenses	341
25	Regulatory Expense	-
26	Postage Mailing	276
27	Contractual Services - CPA	1,200
28	Contractual Services - Legal	2,320
29	Contractual Services - Engineering	-
30	Legislative Expense	1,200
31	Charitable Contributions	3,666
32	Bad Debt	2,700
33	Repair & Maintenance	341
34	Telephone	655
		492
		1,690
		437
		7,192
		5,643
		628,620
42	<u>Operating income</u>	
43	<u>Before Interest and Taxes</u>	7,854
44		
45		-
46	<u>Net Operating Income</u>	7,854

The auditor will also want to make sure that any other rate changes that occurred during the test year are reflected in the adjusted revenues.

# Review of the results of operations

Fire Protection – should fire departments pay for water?

Ready-to-Serve – Service line installed

Stand-by – No Service line installed

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15	Bank Service Charges	330
16	Materials and supplies	-
17	Rental Expense - Buildings/Real Property	32,525

Auditors should be aware of the policy for ready-to-serve and stand-by service. It could require a limited group of people to pay for a common system.

27	Contractual Services - CPA	1,200
28	Contractual Services - Legal	2,320
29	Contractual Services - Engineering	-
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36	Fuel and Transportation	1,690
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38	Utility / Power	7,192
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40	Total Operating Expenses	628,620
41		
42	<b>Operating Income</b>	
43	Before Interest and Taxes	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854

# Review of the results of operations

## 601. Salaries and Wages - Employees

This account shall include the compensation (salaries, bonuses and other consideration for services) paid or accrued to employees of the utility company for work related to operation and maintenance of that utility.

*NARUC Water USoA*

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# Review of the results of operations

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9	<b>Operating &amp; Maintenance Expenses</b>	
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12	Salary & Wages - Officers	62,000

## Salaries and Wages

- Closely review wage increases which will become effective during or outside the test year.
  - During the test year – annualization of the increase must be accounting for in the calculation of labor costs
  - Look for *slippage* – when a highly paid individual retires or otherwise leaves and is replaced by a lower paid individual.

36	Fuel and Transportation	1,690
37	Supplies & Materials	437
38	Utility / Power	7,192
39	Water Treatment & Testing	5,643
40	Total Operating Expenses	628,620
41		
42	<b>Operating Income</b>	
43	<b>Before Interest and Taxes</b>	7,854
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# Review of the results of operations

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2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		
8		636,474
9	<u>Operating &amp; Maintenance Expenses</u>	
10		
11	Salary & Wages	372,000

An auditor may wish to look at the percentage of overtime worked during the past few years and compare it to the percentage of overtime in the test year.

If there is a large difference between the historical numbers and the test year numbers, one will want to obtain an explanation.

*(NARUC Rate case & Audit Manual)*

- Look for dis relatives on

place after rates are effective

non-contractual increases

employees received notice of increase,

has been issued. *require* notice be sent to

Consider using a multiple-year average percentage of overtime to use in the computation of the revenue requirement in order to normalize any test year [overtime] anomalies. *(NARUC Rate case & Audit Manual)*

44		
45		-
46	Net Operating Income	7,854



# Review of the results of operations

Line No.		Results As filed Company
1	<u>Operating Revenue</u>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		
8		636,474
9	<u>Operating &amp; Maintenance Expenses</u>	
10		
11	Salary & Wages	372,000
12	Salary & Wages - Officers	62,000

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## Salaries and Wages - Officers

- Owner Wages and Expenses
  - An owner that works in the company wears two hats
  - When reviewing questions of compensation for owners the auditor must clearly understand the role the person is in relative to the cost.
    - Owners do not get pension plans paid by ratepayers – employees do.
    - Disallowed owner-based costs are NOT prohibited from being incurred!

46	Net Operating Income	7,854
----	----------------------	-------

# Review of the results of operations

Line No.		2019 Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		

## Salaries and Wages - Officers

- Officer or management
  - What is the officer's salary and bonuses based on?
    - Economic benchmarks associated with the value of the company should be looked at closely since they normally benefit shareholders
    - Service satisfaction or other reliability operating benchmarks such as SAIDI and SAIFI normally benefit ratepayers.

35	Dues and Fees	492
36	Fuel and Transportation	1,690
37	Supplies & Materials	437

*System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI).*

43	<b>Before Interest and Taxes</b>	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854



# Review of the results of operations

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		
8		636,474
9	<b>Operating &amp; Maintenance Expenses</b>	

## Salaries and Wages - Officers

- Officer or management
  - Determination of Salaries and other compensation?
  - Transparency in reporting
    - Ratecase filing / Data Requests
    - Shareholders Proxy statement
      - Will always contain the breakdown of Salaries,
      - Stock awards,
      - Bonuses

42	<b>Operating Income</b>	
43	<b>Before Interest and Taxes</b>	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854

# Review of the results of operations

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		
8		636,474
9	<b>Operating &amp; Maintenance Expenses</b>	

## Rental of Building / Real Property

- Arms-Length transaction
  - Is rent market value?
  - Location?
    - Is the location re...
    - Growth ...
- Non Arms-L... (major shareholder owns property)
  - Is rent market value?
  - Imputed Asset approach
    - Impute depreciation expense
    - Impute return on Original Cost less Depreciation

Lower cost or market?

44		
45		-
46	<b>Net Operating Income</b>	7,854

# Review of the results of operations

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
7		
8		636,474
9	<b>Operating &amp; Maintenance Expenses</b>	
10		
11	Salary & Wages	372,000
12	Salary & Wages - Officers	62,000
13	Payroll taxes	52,080
14	Officer Pensions	23,252
15	Bank Service Charges	330
16	Materials and supplies	-

### 403. Depreciation Expense

A. This account shall be charged with depreciation credited to account 108 - Accumulated Depreciation of Water Plant and credited with amortization debited to account 272 - Accumulated Amortization of Contributions in Aid of Construction. Depreciation shall be accrued on a straight-line remaining life basis or straight-line basis, as required by the Commission. A single composite depreciation rate may be used if approval from the Commission is obtained.

31	Charitable Contributions	3,666
32	Bad Debt	2,700
33	Repair & Maintenance	341
34	Telephone	655
35	Dues and Fees	492
36	Fuel and Transportation	1,690
37	Supplies & Materials	437
38	Utility / Power	7,192
39	Water Treatment & Testing	5,643
40	Total Operating Expenses	628,620
41		
42	<b>Operating Income</b>	
43	<b>Before Interest and Taxes</b>	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854

## Depreciation Expense (Water)

*Journal Entry:*

	<i>Dr</i>	<i>Cr</i>
Depreciation Expense – Straight Line	XXX	
Accumulated Amortization of CIAC	XX	
Accumulated Depreciation		XXX
Amort. of CIAC		XX

*To record regulatory basis depreciation expense*

# Depreciation Computation - Water

## Analysis of Depreciation Expense

Plant in Service - Year End	\$ 54,240	OR
Less:		Average Plant in Service
Non-depreciable Plant e.g., Land	(2,500)	
Advances for Construction	(460)	Recoverable Plant
Depreciable Plant	51,280	
Composite Depreciation Rate	2%	
	<u>\$ 1,026</u>	\$ 1,026
Contribution in Aid of Construction	(1,100)	
Composite Amortization Rate	2%	
	<u>\$ (22)</u>	(22)
Net Regulatory Depreciation Expense		<u>\$ 1,004</u>

# Depreciation Computation

## 272. Accumulated Amortization of Contributions in Aid of Construction

A. This account shall reflect the amortization accumulated on account 271 - Contributions in Aid of Construction, if recognized by the Commission.

B. Specifically, balances in account 271 which represent contributions of depreciable plant shall be amortized by charges to this account over a period equal to the estimated service life of the related contributed asset. A group or overall composite rate may be used for contributed balances that cannot be directly related to a plant asset.

C. The concurrent credit for the amortization recorded in this account shall be made to account 403 - Depreciation Expense.

D. If a regulatory body allows the amortization of any portion of the monies collected to pay the tax obligation caused by the receipt of CIAC, such amortization shall also be reflected in a sub-account of this account. Specifically, balances in account 271 which represent monies collected for the gross-up of CIAC (See Definition 15.) shall be amortized by charges to this account over a period determined by the regulatory body.

Net Regulatory Depreciation Expense      \$ 1,004

# Review of the results of operations

## 421. Nonutility Income

This account shall contain all Revenue not includible in operating revenue.

*NARUC Water USoA*

<b>2. OTHER INCOME AND DEDUCTIONS</b>		
<b>A. OTHER INCOME</b>		
415	Revenues from merchandising, jobbing, and contract work.	222
416	Costs and expenses of merchandising, jobbing, and contract work.	474
417	Revenues from nonutility operations.	000
417.1	Expenses of nonutility operations.	000
418	<b>Nonoperating</b> rental income.	080
418.1	Equity in earnings of subsidiary companies (Major only).	252
419	Interest and dividend income.	330
419.1	Allowance for other funds used during construction.	-
420	Investment tax credits.	562
421	Miscellaneous <b>nonoperating</b> income.	876
421.1	Gain on disposition of property.	643
		-
		200
		341
		-
		276
		200
28	Contractual Services - Legal	2,320
29	Contractual Services - Engineering	-

**421. Nonutility Income**  
 In this account is entered all income not includible in operating revenue accounts 460 through 474 or in account 419 - Interest and Dividend Income. Items in this account shall include:

1. Gross income from nonutility operations; and
2. Net gain on sale of nonutility property.

39	water treatment & testing	5,045
40	Total Operating Expenses	628,620
41		
42	<b>Operating Income</b>	
43	<b>Before Interest and Taxes</b>	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854



# Review of the results of operations

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
		636,474
	<b>Operating &amp; Maintenance Expenses</b>	
	Salary & Wages	372,000
	Salary & Wages - Officers	62,000
	Payroll taxes	52,080
	Officer Pensions	23,252
	Bank Service Charges	330
	Materials and supplies	-
	Rental Expense - Buildings/Real Property	32,525
	Employee Pension	-
	Insurance	12,562
	Miscellaneous Expenses	876
	Depreciation Expense	43,643
	Amort of CIAC	-
		1,200
		341
		-
		276
		1,200
		2,320
		-
		1,200
		3,666
		2,700
		341
		655
		492
		1,690
		437
		7,192
		5,643
		628,620
		7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854

**Gross income from nonutility operations**  
 Nonutility income is an audit item because there is a regulatory question that must be answered. Is any of the ratepayer funded resources (plant or services) being used to subsidize the nonutility income?

The auditor should review prior workpapers to determine if there has been a prior determination as to cross-subsidy. Should consider talking to prior staff assigned to the case. If resources are being used than allocations must be derived to remove costs used for the nonregulated activity. The company may agree to include the nonutility revenue in revenue requirement in exchange of not allocating costs. This works only if there is positive income for the nonutility activity .

# Review of the results

**Net gain on sale of nonutility property**  
 When a utility that sales nonutility property any gain is not shared with the rate payer since the property was never dedicated to public service. The audit question is, is it true that the property was never utility property. IF it was, then rate payers may be entitled to all or a portion of the gain.

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmated Water Revenue	27,825
	r Revenue	634,252
	a Revenue	-
	e	2,222
		636,474
	<b>Maintenance Expenses</b>	
	es	372,000
	es - Officers	62,000
		52,080
	ns	23,252
	Charges	330
	supplies	-
	e - Buildings/Real Property	32,525
	sion	-
		12,562
	Expenses	876
	Expense	43,643
		-
		1,200
		341
		-
		276
		1,200
		2,320
		-
		1,200
		3,666
		2,700
		341
		655
		492
		1,690
		437
37	Supplies & Materials	437
38	Utility / Power	7,192
39	Water Treatment & Testing	5,643
40	Total Operating Expenses	628,620
41		
42	<b>Operating Income</b>	
43	<b>Before Interest and Taxes</b>	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854

The auditor should review prior workpapers to determine if there was any record of a transfer of the property out of regulation. Confirm that it was never included in rates. The account that could be useful is the *Plant Held for Future Use* account (103) NARUC (105) FERC

### Gain on reacquired Debt

When a utility reacquires high interest debt and replaces it with lower cost debt it can realize a gain on the transaction. GAAP allows the gain to be (1) amortized over the life of the original issuance (2) amortized over the life of the replacement debt or (3) flow-through the gain in the year of the transaction.

Regulatory accounting does not allow the flow-through of the gain in the year of the transaction since the rate payer would not see the benefit of the gain.

		Results As filed Company	
		company filing	
<b>Revenue</b>			
	Water Revenue	27,825	
	Water Revenue	634,252	
	Other Revenue	-	
	Other Revenue	2,222	
		636,474	
<b>&amp; Maintenance Expenses</b>			
	Salaries	372,000	
	Salaries - Officers	62,000	
	Salaries	52,080	
	Depreciation	23,252	
	Service Charges	330	
	Travel and supplies	-	
	Lease - Buildings/Real Property	32,525	
	Pension	-	
		12,562	
	Professional Expenses	876	
	Provision Expense	43,643	
	IAC	-	
	Supplies	1,200	
	Insurance & Licenses	341	
	Other Expense	-	
	Printing	276	
	Professional Services - CPA	1,200	
	Professional Services - Legal	2,320	
	Professional Services - Engineering	-	
	Other Expense	1,200	
	Charitable Contributions	3,666	
	Bad Debt	2,700	
		341	
		655	
		492	
		1,690	
		437	
		7,192	
		5,643	
		628,620	
43		Before Interest and Taxes	7,854
44			
45			-
46		Net Operating Income	7,854

The auditor should review prior GAAP based annual reports (10-K) since last rate filing to confirm either there were no retirements or that any gain is being amortized consistent with regulatory accounting.

# Review of open

426. Nonutility Expenses  
This account contains expenses that are not utility and is exper

## INCOME ACCOUNTS

income taxes shall be recorded in account 409.20, Income Taxes, Other Income and Deductions.

### 419. Interest and Dividend Income

This account shall include interest revenues on securities, loans, notes, advances, special deposits, tax refunds and all other interest bearing assets and dividends on stocks of other companies, whether the securities are carried as investments or included in sinking or other special funds accounts.

### 420. Allowance for Funds Used During Construction

This account shall include concurrent credits for allowance for funds used during construction based upon the net cost of funds used for construction purposes and a reasonable rate upon other funds when so used. Appropriate regulatory approval shall be obtained for "a reasonable rate" (See Accounting Instruction 19).

### 421. Nonutility Income

In this account is entered all income not includible in operating revenue accounts 460 through 474 or in account 419 - Interest and Dividend Income. Items in this account shall include:

1. Gross income from nonutility operations; and
2. Net gain on sale of nonutility property.

### 426. Miscellaneous Nonutility Expenses

This account shall contain all expenses other than expenses of utility operations and interest expense. Items which are included in this account are:

1. Expenses disallowed in a proceeding before the Commission.
2. Amortization of an Acquisition Adjustment not approved by the Commission.
3. Depreciation associated with plant not used and useful in the public service.
4. Depreciation of Nonutility Plant.
5. Imprudent expenses.
6. Donations for charitable, social or community welfare purposes.
7. Life insurance on officers and employees where utility is beneficiary (net premiums less increase in cash surrender value of policies).
8. Penalties or fines for violations of statutes pertaining to regulation.
9. Expenditures for the purpose of:
  - a. Influencing public opinion with respect to the election or appointment of public officials, or the adoption, repeal, revocation or modification of referenda, legislation or ordinances.
  - b. Influencing public opinion with respect to obtaining approval, modification or revocation of franchises.
  - c. Influencing the decisions of public officials not including such expenditures that are directly

	Results As filed Company
	company filing
	27,825
	634,252
	-
	2,222
	636,474
ses	
	372,000
	62,000
	52,080
	23,252
	330
	-
operty	32,525
	-
	12,562
	876
	43,643
	-
	1,200
	341
	-
	276
	1,200
	2,320
	-
	1,200
	3,666
	2,700
	341
	655
	492
	1,690
	437
	7,192
	5,643
	628,620
	7,854
	-
	46
	Net Operating Income
	7,854



# Review of the of operations

## 426. Miscellaneous Nonutility Expenses

This account contain all expenses other than expense utility operation and interest expense.

NARUC

Pt. 101

**421.1 Gain on disposition**

This account shall be the gain on the sale, or change, or transfer of ut property to another. Am to gains on land and lat for future use recorded i Electric Plant Held for F be accounted for as pres graphs B, C, and D ther tric plant instructions 5F Income taxes on gains re account shall be record 409.2, Income Taxes, Oth Deductions.

**421.2 Loss on disposition**

This account shall be the loss on the sale, or change or transfer of ut property to another. Am to losses on land and lat for future use recorded i Electric Plant Held for F be accounted for as pres graphs B, C, and D ther tric plant instructions 5F The reduction in income to losses recorded in this be recorded in account Taxes, Other Income and

**425 Miscellaneous amortiz**

This account shall incl tion charges not includi accounts which are properl determining the income before interest charges. C ible herein, if significant must be in accordance w and systematic amortizat

**ITEMS**

1. Amortization of utility g adjustments, or of intangil utility plant in service wha to be included in utility op by the Commission.

2. Other miscellaneous charges allowed to be incl count by the Commission.

**426 [Reserved]**

SPECIAL INSTRUCTIONS—A 426.2, 426.3, 426.4 A

These accounts shall incl expense items which are non utility but which are properly d

**426.1 Donations.**

This account shall include all pay- ments or donations for charitable, so- cial or community welfare purposes.

**426.2 Life insurance.**

This account shall include all pay- ments for life insurance of officers and employees where company is bene- ficiary (net premiums less increase in cash surrender value of policies).

**426.3 Penalties.**

This account shall include payments by the company for penalties or fines for violation of any regulatory statutes by the company or its officials.

**426.4 Expenditures for certain civic, po- litical and related activities.**

This account shall include expendi- tures for the purpose of influencing public opinion with respect to the elec- tion or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or or- dinances) or approval, modification, or revocation of franchises; or for the pur- pose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regu- latory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

**426.5 Other deductions.**

This account shall include other mis- cellaneous expenses which are nonop- erating in nature, but which are prop- erly deductible before determining total income before interest charges.

**ITEMS**

- 1. Loss relating to investments in securi- ties written-off or written-down.
- 2. Loss on sale of investments.

Results As filed Company	
	company filing
	27,825
	634,252
	-
	2,222
	636,474
	372,000
	62,000
	52,080
	23,252
	330
	-
	32,525
	-
	12,562
	876
	43,643
	-
	1,200
	341
	-
	276
	1,200
	2,320
	-
	1,200
	3,666
	2,700
	341
	655
	492
	1,690
	437
	7,192
	5,643
	628,620
	7,854
	-
	7,854

# Review of the results

Line No.		Results As filed Company
1	Operating Revenue	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252

## 426. Miscellaneous Nonutility Expenses

This account shall contain all expenses other than expenses of utility operations and interest expense. Items which are included in this account are:

1. Expenses disallowed in a proceeding before the Commission.
2. Amortization of an Acquisition Adjustment not approved by the Commission.
3. Depreciation associated with plant not used and useful in the public service.
4. Depreciation of Nonutility Plant.
5. Imprudent expenses.
6. Donations for charitable, social or community welfare purposes.
7. Life insurance on officers and employees where utility is beneficiary (net premiums less increase in cash surrender value of policies).
8. Penalties or fines for violations of statutes pertaining to regulation.
9. Expenditures for the purpose of:
  - a. Influencing public opinion with respect to the election or appointment of public officials, or the adoption, repeal, revocation or modification of referenda, legislation or ordinances.
  - b. Influencing public opinion with respect to obtaining approval, modification or revocation of franchises.
  - c. Influencing the decisions of public officials not including such expenditures that are directly

44		
45		
46	Net Operating Income	7,854



# Review of the results

Line No.		Results As filed Company
1	Operating Revenue	company filing
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  - c. Influencing the decisions of public officials not including such expenditures that are directly

44		
45		
46	Net Operating Income	7,854



# Review of the results of operations

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
		636,474
	<b>Maintenance Expenses</b>	
		372,000
	Officers	62,000
		52,080
		23,252
	arges	330
	opies	-
	Buildings/Real Property	32,525
	n	-
		12,562
	spenses	876
	ense	43,643
		-
		1,200
24	Other Tax & Licenses	341
25	Regulatory Expense	-
26	Postage Mailing	276
27	Contractual Services - CPA	1,200
28	Contractual Services - Legal	2,320
29	Contractual Services - Engineering	-
30	Legislative Expense	1,200
31	Charitable Contributions	3,666
32	Bad Debt	2,700
33	Repair & Maintenance	341
34	Telephone	655
35	Dues and Fees	492
		1,690
		437
		7,192
		5,643
		28,620
		7,854
45		-
46	<b>Net Operating Income</b>	7,854

## Disallowed Expenses from prior cases

The auditor should review prior orders of the commission related to the audited company to prevent the inadvertent allowance into rates of costs that have be disallowed in a prior preceding. The is especially true when it has been a number of years since the last preceding.

utility operations and interest expense.

*NARUC Water USoA*

The auditor should also consider talking to prior staff assigned to the case. It is not unusual that a prior auditor that has been reassigned will remember any issues or disallowances.

# Review of the results

Line No.		Results As filed Company
1	Operating Revenue	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252

## 426. Miscellaneous Nonutility Expenses

This account shall contain all expenses other than expenses of utility operations and interest expense. Items which are included in this account are:

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4. Depreciation of Nonutility Plant.
5. Imprudent expenses.
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7. Life insurance on officers and employees where utility is beneficiary (net premiums less increase in cash surrender value of policies).
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44		
45		-
46	Net Operating Income	7,854

# Review of the results of operations

Line No.		Results As filed Company
1	<b>Operating Revenue</b>	company filing
2	Unmetered Water Revenue	27,825
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		636,474
	<b>Maintenance Expenses</b>	
		372,000
	Officers	62,000
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	plies	-
	Buildings/Real Property	32,525
	n	-
		12,562
	spenses	876
	ense	43,643
		-
		1,200
	enses	341
	nse	-
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	ices - CPA	1,200
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	nse	1,200
	ibutions	3,666
		2,700
	nance	341
		655
		492
		1,690
		437
		7,192
		5,643
		28,620
		7,854
45		-
46	<b>Net Operating Income</b>	7,854

## Amortization into operating income of unauthorized acquisition adjustments.

If a company has on its regulatory books an acquisition adjustment for a prior purchase of a regulated system, it MAY NOT show up on its accounting records if it is a smaller system.

Many small systems will have a local accountant, which is not familiar with regulatory accounting maintain the company books on either a tax basis or GAAP. In that case the acquisition adjustment will not be reflected.

The Auditor should confirm no purchases of other systems. If there is a purchase was an acquisition adjustment determined and if so, was the recover allowed or disallow.



# Review of the results

Line No.		Results As filed Company
1	Operating Revenue	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252

## 426. Miscellaneous Nonutility Expenses

This account shall contain all expenses other than expenses of utility operations and interest expense. Items which are included in this account are:

1. Expenses disallowed in a proceeding before the Commission.
2. Amortization of an Acquisition Adjustment not approved by the Commission.
3. Depreciation associated with plant not used and useful in the public service.
4. Depreciation of Nonutility Plant.
5. Imprudent expenses.
6. Donations for charitable, social or community welfare purposes.
7. Life insurance on officers and employees where utility is beneficiary (net premiums less increase in cash surrender value of policies).
8. Penalties or fines for violations of statutes pertaining to regulation.
9. Expenditures for the purpose of:
  - a. Influencing public opinion with respect to the election or appointment of public officials, or the adoption, repeal, revocation or modification of referenda, legislation or ordinances.
  - b. Influencing public opinion with respect to obtaining approval, modification or revocation of franchises.
  - c. Influencing the decisions of public officials not including such expenditures that are directly

44		
45		
46	Net Operating Income	7,854

# Review of the results of operations

Line No.		Results As filed Company
1	Operating Revenue	company filing
2	Unmetered Water Revenue	27,825
3	Metered Water Revenue	634,252
4	Fire Protection Revenue	-
5	Ready to Serve	2,222
6		
		636,474
	Maintenance Expenses	
		372,000
	Officers	62,000
		52,080
		23,252
	Salaries	330
	Supplies	-
	Buildings/Real Property	32,525
	Depreciation	-
		12,562
	Expenses	876
	Insurance	43,643
		-
		1,200
	Expenses	341
	Interest	-
		276
	Profits - CPA	1,200
	Profits - Legal	2,320
29	Contractual Services - Engineering	-
30	Legislative Expense	1,200
31	Charitable Contributions	3,666
		2,700
		341
		655
		492
		1,690
		437
		7,192
		5,643
		28,620
		7,854
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**Depreciation associated with plant not used and useful in the public service**

**OR Depreciation of Nonutility Plant.**

Rates should not include the cost of either. Any plant purchased and on the books of the company that is not providing some form of service to the rate payer should be disallowed and charged to Account 426. This is the same with any form of nonutility plant.

expense.

NARUC Water U

These adjustments are commonly found in a site visit to the company. If possible, an auditor should schedule a site visit to a company any time there has been a number of years since the last review or if there has been a major change in asset or operating costs.

# Review of the results

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		-
		2,222
		636,474
	Expenses	
		372,000
		62,000
		52,080
		23,252
		330
		-
	Real Property	32,525
		-
		12,562
		876
		43,643
		-
23	Office Supplies	1,200
24	Other Tax & Licenses	341
25	Regulatory Expense	-
26	Postage Mailing	276
27	Contractual Services - CPA	1,200
		2,320
		-
		1,200
		3,666
		2,700
		341
		655
		492
		1,690
		437
		7,192
		5,643
		28,620
		7,854
		-
		7,854

## Disallowance of imprudent expenses.

Imprudent expenses are expenses that are lacking discretion, wisdom, or good judgment and can be one of the most difficult to detect in an audit. An auditor challenging an expense as imprudent must have a sound basis which can be documented. Salaries are a common expense found imprudent.

Imprudent costs can be detected in a site visit to the company. However, cost awareness is the best audit tool. Know the going costs can give the auditor clues as to spending abuses. If possible, if a company must make a large investment, an open sealed bidding process should be followed to assure a reasonable cost to the ratepayers.

426

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NARUC Water U

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		636,474
	<b>Maintenance Expenses</b>	
		000
		000
		080
		252
		330
		-
		525
		-
		562
		876
		643
		-
		200
		341
		-
		276
		200
		320
		-
		200
		666
		700
		341
		655
		492
		690
		437
		192
		643
	<b>Expenses</b>	628,620
	<b>Income</b>	
43	<b>Before Interest and Taxes</b>	7,854
44		
45		-
46	<b>Net Operating Income</b>	7,854

## Donations for charitable, social or community welfare purposes.

One of the most common small company audit adjustments. Charitable contributions are normally easy to find (income tax reasons) and auditors normally should have not difficulty in determining the amount.

The real issue normally is what the company would say is a lack of fairness on the auditor's side. It is not the intent to direct where the utility can spend its money, but rather, to decide how much of that expense should be paid by ratepayers rather than shareholders.

*(NARUC Rate case & Audit Manual)*

get lost in the political  
to eliminate donations  
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overall level of rates – one  
es about which to  
that can wait or move  
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*(NARUC Rate case & Audit Manual)*



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	n	-
		12,562
	spenses	876
	ense	43,643
		-
		1,200
	enses	341
	nse	-
		276
	ices - CPA	1,200
	ices - Legal	2,320
29	Contractual Services - Engineering	-
30	Legislative Expense	1,200
31	Charitable Contributions	3,666
32	Bad Debt	2,700
		341
		655
		492
		1,690
		437
		7,192
		5,643
		28,620
		7,854
45		-
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## Life insurance on officers and employees where utility is beneficiary

“Key Person” life insurance is a policy that will provide funds to the company if in the unfortunate event a senior level manager or employee dies allowing the company funds to continue operations will filling the position. Also called Corporate owned life insurance. The premiums are not recoverable in rates.

expense .

NARUC Water USoA

Although the premiums are disallowed, and amounts received by the company are not used to off-set revenue requirement. *This treatment is consistent with IRS income tax treatment of the cost.*

# Review of the results

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Review of operations

670. Bad Debt Expenses  
This amount can be charged to profit for loan uncollectible utilities

NARUC Waiver

SCHEDULE C-3

Restating Adjustment RA-8  
Bad Debt Expense

Line No. 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25

Per Books	\$	53,613
Average Method		18,526
Adjustment	\$	<u>(35,088)</u>
<u>Average Method</u>		
	Write-off	Amount
Year		
2016	-	
2017	-	
2018	-	
2019	57,540	
2020	-	
2021	53,613	
Total	<u>111,153</u>	
Average	<u>18,526</u>	
percent of revenue	3,075,000	0.60%

2022  
Results  
As filed  
Company

company filing		
	27,825	
	634,252	
	-	
	2,222	
	636,474	
	372,000	
	62,000	
	52,080	
	23,252	
	330	
	-	
	32,525	
	-	
	12,562	
	876	
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	-	
	1,200	
	341	
	-	
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		492
		690
		437
		192
		643
		620
		-
		854
45		-
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## Penalties or fines for violations of statutes pertaining to regulation

Penalties and fines are not allowed because they are not in the public interest and not used and useful. The disallowance “flows through” the cost to the shareholders maintaining the intent of the penalty or fine. (change behavior?)

utility operations and interest expense.

NARUC Water US

Penalties or fines of the commission are easily found in the record of the company. However, payments to other agencies may be found in a regulatory debit account (407) FERC or Regulatory Expense (667) NARUC. An auditor’s due diligence research may also find issues (penalties) with other regulators.



## Expenditures for certain civic, political and related activities

The auditor should identify two types of expenditures. Expenditures for direct lobby activities which includes payments to politicians or lobbyist. But there are also expenditures to organizations that spend a portion of the funds they receive on lobbying. Trade organisations or labor groups can be included in this category. The question the auditor must answer is what portion of dues or assessments from those organizations are reasonably included in rates relative to the provision of service.

	Results As filed Company
Revenue	company filing
Water Revenue	27,825
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on Revenue	-
ve	2,222
	636,474
<b>Maintenance Expenses</b>	
ges	372,000
ges - Officers	62,000
	52,080
ions	23,252
e Charges	330
d supplies	-
ase - Buildings/Real Property	32,525
ension	-
	12,562
as Expenses	876
Expense	43,643
AC	-
ies	1,200
Licenses	341
xpense	-
ing	276
Services - CPA	1,200
Services - Legal	2,320
Services - Engineering	-
xpense	1,200
ontributions	3,666
	2,700

NARUC Water USOA

Dues to trade organizations routinely support the provision of utility service but invoices should be reviewed for the dues paid, since they normally indicate what portion of the dues is for the support of political activity.

(NARUC Rate case & Audit Manual)

# ACRONYMS

## Poll Question

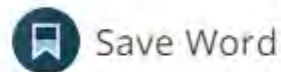
Which of the below is NOT an acronym?


1. NARUC
2. GAAP
3. AFUDC
4. All of the above are acronyms





# acronym noun



ac·ro·nym | \ 'a-kre-nim  \



## Definition of *acronym*

: a word (such as *NATO*, *radar*, or *laser*) formed from the initial letter or letters of each of the successive parts or major parts of a compound term

## Frequently Asked Questions About *acronym*

### What is the difference between an acronym and an initialism?

Both acronyms and initialisms are made up of the first letter or letters of the words in a phrase. The word *acronym* typically applies when the resulting thing can be read as a word; for example, *radar* comes from "radio detection and ranging" and *scuba* comes from "self-contained underwater breathing apparatus." The word *initialism* only applies when the resulting thing is read as an abbreviation; for example *DIY*, which comes from "do it yourself," is pronounced by saying the names of the letters.





# Final Steps – Finishing Up

## Small Companies

- A regulatory audit should result in an analysis and unbiased assessment of the information and collected evidence of filing before the commission.
  - Organize your workpaper making sure to remove anything not used. A bunch of papers may look impressive but are worthless when the workpapers are reviewed in two or three years.
  - Consider a “top of file” memo that describes (to the next auditor) issues or things to follow up on in the next case.
  - Meet with the company to share your recommendation –
    - Before the final report is submitted the auditor It is common to have a closing discussion with the utility representatives at the end of the audit. During the meeting the audit team needs to straighten up with the company and voice any concerns that might exist.
    - The company should already be aware of the adjustments recommended by the auditor since they should have already had the opportunity to rebut the individual conclusions of the auditor.
    - **Discuss what the issues are and what options are available!**

# Final Steps – Finishing Up

## Large Companies

- A regulatory audit should result in an analysis and unbiased assessment of the information and collected evidence of filing before the commission.
  - Begin the process of writing testimony and preparing exhibits.
  - Begin organizing the audit workpapers by labeling and indexing. – The workpaper structure may be a standard agency arrangement or you may have to create a system that works for your issues.
  - Any controversial adjustments should be supported by the audit workpapers.
  - Recognized that your workpapers associated with any controversial position that is contrary to any of the other parties in the case will be requested through data requests once your testimony is filed.
  - In large cases, the auditor will likely be assigned a relatively small portion of the total case, but it may have a material impact on the final results.
  - **STAY ORGANIZED!** Especially if you are responsible for confidential material. During settlement stages, positions and requests for information moves fast. Being organized from the start puts you on solid footing.



## Regulatory audit Exercises

## Exercise - Capital

A company files a case that includes an addition to plant in service that will come on line three months into the rate year. The project is currently using AFUDC to account for financing costs. The contractor is on schedule to completion and assures the auditor that it will meet the scheduled completion date. If the new plant is not included rates, it may cause a sharp drop in both the company's credit rating and possible drop in stock price.

**Discuss what the issues are and what options are available**

### Issues:

- Completion is not 100% assured
- Used and useful (state law)
- AFUDC stops accruing once the plant is complete.

### Options:

- Continue the use of AFUDC until next case
- Include only 9/12 (3/4) of the expense and return in rates
- Surcharge

# Exercise - Expenses

A water company finds out that a local asphalt plant has been storing asphalt over the local watershed and the company fears that the asphalt byproducts may, over time, leach into its water supply. The company has hired the top ecology law firm in the state to file a cease-and-desist order with the courts and prepare a case for damages. It has also hired a national engineering firm to test for contamination.

The company has filed to recover the costs of both the law firm and the engineering studies. After research, the auditor has found that the county has also begun its own legal actions and water contamination studies along with a local environmental protection group.

## Issues:

- Does the company have a duty to protect the water shed?
- Did they need to hire the most expensive available representation?
- Others are already doing the work to address the water contamination

## Options:

- Disallow all expenses
- Allow a portion of the expense



# Questions or Comments?



# Thank You!

