Rate Case Auditing – Part 1

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INSTITUTE OF PUBLIC UTILITIES | MSU

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Revised 10/24/2022
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.**
Auditing

financial examination of an individual's or organization's accounts to verify its worth.
Auditing is defined as:

A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

Auditing Concepts Committee, “Report of the Committee on Basic Auditing Concepts,”
Auditing is defined as:

A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

A systematic process: A logical, structured and organized series of steps or systematic method.
Auditing is defined as:

A systematic process of **objectively obtaining and evaluating evidence** regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

**Objectively obtaining and evaluating evidence**: A process that acquires and reviews evidence and support for a filing without bias or prejudice for or against the entity making the request.
Auditing is defined as:

A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

Regarding assertions about economic actions and events: Recognizes that a rate case is about the identifying, measuring, and the communication of complex financial and economic information.
Auditing is defined as:

*A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria* and communicating the results to interested users.

To ascertain the degree of correspondence between those assertions and established criteria: Requires an auditor to establish a relationship between what is filed and the audit evidence and conclusions, which can be either quantitative, e.g., the correct mathematical total for an account or qualitative, e.g., the proper application of regulatory policy.
Auditing is defined as:

A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

Communicating the results to interested users. In the regulatory arena this can mean the preparation of testimony with supporting exhibits and workpapers.
Auditing

1. Certified Financial Audit
2. Regulatory Audit
3. Performance Audits
4. Quality Audits
5. Project Management
6. CAM* Audits
7. Management Audits
8. Forensic Audits

* Cost Adjustment Mechanism

There are three different types of CPA issued financial statements:
• Compilation
• Review
• Certified Audit
1st CPA Provided
Financial Statements Type

Compilation

• CPA does not have to be independent.

• Compiles the financial statements from records provided by owners.

• Required to follow rules promulgated by AICPA - Intended for use by lenders and outside parties without requiring any level of assurance on the accuracy of financial statements.

• CPA issues compilation report not an opinion
Accountant’s Compilation Report

I have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements. My responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

I am (we are) not independent with respect to XYZ Company as during the year ended December 31, 20XX, I was employed by the parent corporation of XYZ Company, ABC Corp.
2\textsuperscript{nd} CPA Provided
Financial Statements Type

Review

• CPA must be independent (cannot review their own work).

• Required to follow AICPA standards for Accounting and review services. Includes some limited analysis and inquiries.

• Cannot be relied on to reveal fraud or misstatement.

• Provides level of assurance.
Accountant's Review Report

I have reviewed the accompanying financial statements of XYZ Partnership, which comprise the statement of assets, liabilities, and partners' capital—tax basis as of December 31, 20XX, and the related statements of revenue and expenses—tax basis, and partners' capital—tax basis for the year then ended, and the related notes to the financial statements.

A review includes primarily applying analytical procedures to management's (partners') financial data and making inquiries of partnership management (partners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I do not express such an opinion.

- Management’s Responsibility for the Financial Statements
- Accountant’s Responsibility
- Accountant’s Conclusion

Based on my review, I am not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the basis of accounting the partnership uses for income tax purposes.
Certified Independent Audit

- Must be done by a CPA, whom must also be independent. Must assure the accuracy and completeness of financials and adherence to a standard. i.e., GAAP, OCBOA,
- Utilizes testing, analysis, and interviews,
- Document and test internal controls.
- Verify balance sheet items. i.e., buildings inventory.
- Auditor’s Objective - derive an opinion regarding a company’s financials statements and the accompanying notes.

Audit opinions:
- Unqualified (clean) opinion,
- Qualified opinion
- Disclaimer of opinion
- Adverse opinion
We have audited the accompanying consolidated balance sheets of Avista Corporation and subsidiaries (the “Company”) as of December 31, 2020, and 2021, the related consolidated statements of income, comprehensive income, equity, and cash flows, for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the “financial statements”).

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020, and 2021, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2021, in conformity with accounting principles generally accepted in the United States of America.
We have audited the accompanying consolidated balance sheets of Avista Corporation and subsidiaries (the "Company") as of December 31, 2020, and 2021, the related consolidated statements of income, comprehensive income, equity, and cash flows, for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the "financial statements").

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020, and 2021, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2021, in conformity with accounting principles generally accepted in the United States of America.
Auditing

1. Certified Financial Audit
2. Regulatory Audit
3. Performance Audits
4. Quality Audits
5. Project Management
6. CAM* Audits
7. Management Audits
8. Forensic Audits

*A regulatory audit is not a certified audit.

* Cost Adjustment Mechanisms
Regulatory Audits - Types

**Economic** – Rate case - tariff filings
  - Finance filings

**Oversight** – Annual Reports - Spot Audits
  - Integrated Resource Plans

**Compliance** – Filings ordered by a regulatory authority
  - Trackers, Riders, Surcharges, & Decoupling
Regulatory Audits - Types

a) Desk Audits
   - Review of available or filed documents
   - Routinely requested additional data from company
   - Low cost! Pandemic Friendly!

b) Site Audits
   - Review supporting documents on site
   - Informal interaction and conversations with key personnel
   - Tour facilities or the focus of a filing or inquiry
     e.g., energy-storage facility, hydro dam site
Scope of Audit
Project Constraint Triangle

- **Scope**: Unlimited
- **Cost/Resources**: Constrained by annual or project budget.
- **Time**: Constrained by statute, order or regulation.
Project Constraint Triangle

- Time
- Cost/Resources
- Scope
Limiting Scope To:

1. Preliminary due diligence
2. Materiality
3. Political or social sensitivity, and
4. Application of regulatory accounting principles
Limiting Scope To:

1. Preliminary Due Diligence

- Due Diligence
  - Preliminary research and analysis
    - Review prior orders
    - Review prior audits (CPA and Staff)
    - Annual reports and proxies
    - Variance examination
  - Review filing for CCCA
    - Correctness, Completeness,
    - Consistency and Accuracy
  - Review for timeliness – test year
Limiting Scope To:

2. Materiality

• Material Items
  • Costs of new infrastructure
  • Officers' salaries
    (Named Executive officers)
  • Catastrophic expenses
  • Other major cost drivers

• Minimal focus on non-material operating costs
  • Postage Stamps
  • Coffee for office staff
  • Seasonal office parties
Limited Scope

3. Politically or Socially Sensitive Costs

• Non-material items
  • Charitable donations
  • Political contributions
  • Traffic or parking tickets
  • Miscellaneous expense
  • Gifts for board members
Limited Scope

4. Application of regulatory accounting principles

• Income Tax Basis of Accounting or Other Comprehensive Basis of Accounting (OCBOA)

• GAAP Accounting Treatment which Regulatory Accounting Prohibits

• Accounting Not Consistent with State adopted USoA, Rules or Orders

* USoA - Uniform System of Accounts
Beginning the Regulatory Audit

Preliminary Due Diligence

Review publicly available reports:

• Annual Report to Shareholders
• Annual Report to the SEC (10-K)
• Annual Report to the FERC (Form 1, 2 & 6)
• State Required Reports
### Annual Report to the Shareholders

Normally found in the investors section of a company's webpage.
Beginning the Regulatory Audit

Preliminary Due Diligence

Review publicly available reports:

• Annual Report to Shareholders
• **Annual Report to the SEC (10-K)**
• Annual Report to the FERC (Form 1, 2 & 6)
• State Required Reports
Annual Report Form to the SEC – Form 10-K

Normally found in the investors section of a company’s webpage
PART I
Item 1. Business
Item 1A. Risk Factors
Item 1B. Unresolved Staff Comments
Item 2. Properties
Item 3. Legal Proceedings
Item 4. Mine Safety Disclosures (SEC reserved)

PART II
Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Item 6. Selected Financial Data
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation
Item 7A. Quantitative and Qualitative Disclosures About Market Risk
Item 8. Financial Statements
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 9A. Controls and Procedures
Item 9B. Other Information
THE YORK WATER COMPANY

PART I

Item 1. Business.

The York Water Company (the “Company”) is the oldest investor-owned water utility in the United States and is duly organized under the laws of the Commonwealth of Pennsylvania. The Company has operated continuously since 1816. The primary business of the Company is to provide, furnish, and deliver safe drinking water and distribute water. The Company also owns and operates two wastewater collection systems and two wastewater collection and treatment systems. The Company operates within its franchised water territory, which covers 30 municipalities within York County, Pennsylvania, and nine municipalities within Adams County, Pennsylvania. The Company’s wastewater operations include portions of five municipalities in York County, Pennsylvania. The Company is regulated by the Pennsylvania Public Utility Commission, or PPUC, for both water and wastewater in the areas of billing, payment procedures, dispute processing, terminations, service territory, debt and equity financing and rate setting. The Company must obtain PPUC approval before changing any practices associated with the aforementioned areas.

The Company continuously looks for water and wastewater acquisition and expansion opportunities both within and outside its current service territory as well as additional opportunities to enter into bulk water contracts with municipalities and other entities to supply water.

The Company has agreements with several municipalities to provide sewer billing and collection services. The Company also has a service line protection program on a targeted basis in order to further diversify its business. Under this optional program, customers pay a fixed monthly fee, and the Company will repair or replace damaged customer service lines, as needed, subject to an annual maximum dollar amount. The Company continues to review and consider opportunities to expand both initiatives.

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REGULATORY RISKS

Our financial condition depends upon APS’s ability to recover costs in a timely manner from customers through regulated rates and otherwise execute its business strategy.

APS is subject to comprehensive regulation by several federal, state and local regulatory agencies that significantly influence its business, liquidity and results of operations and its ability to fully recover costs from utility customers in a timely manner. The ACC regulates APS’s retail electric rates and FERC regulates rates for wholesale power sales and transmission services. The profitability of APS is affected by the rates it may charge and the timeliness of recovering costs incurred through its rates. Consequently, our financial condition and results of operations are dependent upon the satisfactory resolution of any APS rate proceedings and ancillary matters which may come before the ACC and FERC, including in some cases how court challenges to these regulatory decisions are resolved. Arizona, like certain other states, has a statute that allows the ACC to reopen prior decisions and modify otherwise final orders under certain circumstances.

ITEM IB. UNRESOLVED STAFF COMMENTS

Neither Pinnacle West nor APS has received written comments regarding its periodic or current reports from the SEC staff that were issued 180 days or more preceding the end of its 2019 fiscal year and that remain unresolved.
PART I

Item 1. Business
Item 1A. Risk Factors
Item 1B. Unresolved Staff Comments
Item 2. Properties
Item 3. Legal Proceedings
Item 4. Mine Safety Disclosures

PART II

Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Item 6. Selected Financial Data
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation
Item 7A. Quantitative and Qualitative Disclosures About Market Risk
Item 8. Financial Statements
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 9A. Controls and Procedures
Item 9B. Other Information
PART II

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

(All dollar amounts are stated in thousands of dollars.)

Overview

The York Water Company (the “Company”) is the oldest investor-owned water utility in the United States, operated continuously since 1816. The Company also owns and operates two wastewater collection systems and two wastewater collection and treatment systems. The Company is a purely regulated water and wastewater utility. Profitability is largely dependent on water revenues. Due to the size of the Company and the limited geographic diversity of its service territory, weather conditions, particularly rainfall, economic, and market conditions can have an adverse effect on revenues. The Company experienced increased revenues in 2019 compared to 2018 primarily due to a rate increase effective March 1, 2019, the prior year effects of tax reform, and an increase in the number of customers served, which were partially offset by lower revenues from the Distribution Service Improvement Improvement, or DSIC.

The Company’s business does not require large amounts of working capital and is not dependent on any single customer or a very few customers for a material portion of its business. In 2019, operating revenue was derived from the following primarily from the provision for fire service, but includes other water and wastewater service-related income. The diverse customer mix helps reduce volatility in consumption.

The Company seeks to grow revenues by increasing the volume of water sold through increases in the number of customers served, making timely and prudent investments in infrastructure replacements, expansions and improvements, and timely filing for rate increases. The Company continuously looks for acquisition and expansion opportunities both within and outside of its current service territory as well as through contractual services and bulk water supply. The Company’s wastewater business provides additional opportunities to expand.
Annual Report to the SEC (10-K)

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

For the Stockholders and the Board of Directors
The York Water Company

Opinions on the Financial Statements and Internal Control over Financial Reporting

Basis for Opinion:
The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s financial statements and an opinion on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.
### Annual Report to the SEC (10-K)

#### Item 8. Financial Statements

**THE YORK WATER COMPANY**

**Balance Sheet**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Dec. 31, 2019</th>
<th>Dec. 31, 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Utility Plant</strong> (at original cost)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plant acquisition adjustments</td>
<td>(3,318)</td>
<td>(3,108)</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>(84,841)</td>
<td>(78,519)</td>
</tr>
<tr>
<td>Net utility plant</td>
<td>313,224</td>
<td>290,157</td>
</tr>
<tr>
<td><strong>Other Physical Property</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net of accumulated depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>of $435 in 2019 and $410 in 2018</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Accounts receivable, net of reserves of $305 in 2019 and $305 in 2018</td>
<td>4,421</td>
<td>4,811</td>
</tr>
<tr>
<td>Unbilled revenues</td>
<td>2,276</td>
<td>2,427</td>
</tr>
<tr>
<td>Recoverable income taxes</td>
<td>547</td>
<td>547</td>
</tr>
<tr>
<td>Materials and supplies inventories, at cost</td>
<td>1,007</td>
<td>876</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>1,131</td>
<td>895</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td>9,384</td>
<td>9,011</td>
</tr>
<tr>
<td><strong>Other Long-Term Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes receivable</td>
<td>253</td>
<td>253</td>
</tr>
<tr>
<td>Deferred regulatory assets</td>
<td>34,189</td>
<td>32,335</td>
</tr>
<tr>
<td>Other assets</td>
<td>5,708</td>
<td>3,650</td>
</tr>
<tr>
<td><strong>Total other long-term assets</strong></td>
<td>40,152</td>
<td>36,258</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$365,629</td>
<td>$345,140</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these statements.
Notes to Financial Statements:


(In thousands of dollars, except per share amounts)

1. Significant Accounting Policies

The primary business of The York Water Company, or the Company, is to impound, purify and distribute water. The Company also owns and operates two wastewater collection systems and two wastewater collection and treatment systems. The Company operates within its franchised territory located in York and Adams Counties, Pennsylvania, and is subject to regulation by the Pennsylvania Public Utility Commission, or PPUC.

The following summarizes the significant accounting policies employed by The York Water Company.

Utility Plant and Depreciation

The cost of additions includes contracted cost, direct labor and fringe benefits, materials, overhead and, for certain utility plant, allowance for funds used during construction. In accordance with regulatory accounting requirements, water and wastewater systems acquired are recorded at estimated original cost of utility plant when first devoted to utility service and the applicable depreciation is recorded to accumulated depreciation. The difference between the estimated original cost less applicable accumulated depreciation, and the purchase price and acquisition costs is recorded as an acquisition adjustment within utility plant as permitted by the PPUC. At December 31, 2019 and 2018, utility plant includes a net credit acquisition adjustment of $3,318 and $3,108, respectively. For those amounts approved by the PPUC, the net credit acquisition adjustment is accounted for as "acquisition adjustment within utility plant" in accordance with Accounting Principles Board Opinion No. 24, “Accounting for Computer Software.”

Upon normal retirement of depreciable property, the estimated or actual cost of the asset is credited to the utility plant account, and such amounts, together with the cost of removal less salvage value, are charged to the reserve for depreciation. To the extent the Company recovers costs of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is reported. Gains or losses from abnormal retirements are reflected in income currently.

The straight-line remaining life method is used to compute depreciation on utility plant cost, exclusive of land and land rights. Annual provisions for depreciation of transportation and mechanical equipment included in utility plant are computed on a straight-line basis over the estimated service lives. Such provisions are charged to clearing accounts and apportioned therefore to operating expenses and other accounts in accordance with the Uniform System of Accounts as prescribed by the PPUC.

The Company charges to maintenance expense the cost of repairs and replacements and renewals of minor items of property. Maintenance of transportation equipment is charged to cleaning accounts and apportioned therefrom in a manner similar to depreciation. The cost of replacements, renewals and betterments of units of property is capitalized to the utility plant accounts.

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Annual Report to the SEC (10-K)

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Item 11. Executive Compensation


Item 13. Certain Relationships and Related Transactions, and Director Independence

Item 14. Principal Accounting Fees and Services

PART IV

Item 15. Exhibits and Financial Statement Schedules

Item 16. Form 10-K Summary
PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Directors of the Registrant

The information set forth under the caption "Election of Directors" of the 2020 Proxy Statement is incorporated herein by reference.

Executive Officers of the Registrant

The information set forth under the caption “Executive Officers of the Company” of the 2020 Proxy Statement is incorporated herein by reference.

Compliance with Section 16(a) of the Exchange Act

The information set forth under the caption “Delinquent Section 16(a) Reports” of the 2020 Proxy Statement is incorporated herein by reference.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE OF PINNACLE WEST

Reference is hereby made to “Information About Our Board and Corporate Governance” and “Proposal 1—Election of Directors” in the Pinnacle West Proxy Statement relating to the Annual Meeting of Shareholders to be held on May 20, 2020 (the “2020 Proxy Statement”) and to the “Information about our Executive Officers” section in Part I of this report.

Pinnacle West has adopted a Code of Ethics for Financial Executives that applies to financial executives including Pinnacle West’s Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, Controller, Treasurer, and General Counsel, the President and Chief Operating Officer of APS and other persons designated as financial executives by the Chair of the Audit Committee. The Code of Ethics for Financial Executives is posted on Pinnacle West’s website (www.pinnaclewest.com). Pinnacle West intends to satisfy the requirements under Item 5.05 of Form 8-K regarding disclosure of amendments to, or waivers from, provisions of the Code of Ethics for Financial Executives by posting such information on Pinnacle West’s website.

ITEM 11. EXECUTIVE COMPENSATION

Reference is hereby made to “Director Compensation,” “Executive Compensation,” and “Human Resources Committee Interlocks and Insider Participations” in the 2020 Proxy Statement.
NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Avista will be held virtually by live webcast on Monday, May 11, 2020 at 8:15 a.m. Pacific Time. The purposes of the meeting are to:

1. elect eleven directors identified in the accompanying proxy statement to serve until the 2021 Annual Meeting of Shareholders;
2. ratify the appointment of Deloitte & Touche LLP, the member firms of Deloitte Touche Tohmatsu, Ltd., and their respective affiliates (collectively, “Deloitte”) as the Company’s independent registered public accounting firm for 2020;
3. hold an advisory (non-binding) vote on executive compensation; and
4. transact other business that may come before the meeting or any adjournment or postponement thereof.

While the Annual Meeting will be conducted “virtually,” solely by live webcast, shareholders of record or their proxies or other legal representatives are entitled to participate in the meeting and participants will be able to ask questions, make comments and vote on the matters brought before the meeting.

The website for the Annual Meeting is www.virtualshareholdermeeting.com/AVA2020.

If you are a holder of record of common stock at the close of business on March 10, 2020, the record date, and have your control number, then you are entitled to vote during the Annual Meeting by following the instructions available on the meeting website during the meeting. The 16-digit control number can be found on your proxy card or voting instructions form. If you do not have your control number, you may attend as a guest (non-shareholder), but will not have the option to vote your shares at the virtual meeting. Closed captioning will be provided for the duration of the Annual Meeting.

Whether or not you intend to participate in the Annual Meeting, shareholders are urged to vote and submit their proxies, prior to the Annual Meeting, by mail, telephone, or through the internet as promptly as possible. Please sign and date the proxy card and return it promptly or cast your vote via telephone or through the internet in accordance with the instructions on the proxy card and/or proxy notice.

By Order of the Board,

[Signature]

Marian M. Durkin
Senior Vice President, Chief Legal Officer
and Corporate Secretary
Spokane, Washington
March 31, 2020

THE YORK WATER COMPANY
130 EAST MARKET STREET
YORK, PENNSYLVANIA 17401
March 24, 2020

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
TO THE SHAREHOLDERS OF THE YORK WATER COMPANY

NOTICE IS HEREBY GIVEN that the Annual Meeting of the Shareholders of The York Water Company will be held at The Appell Center for the Performing Arts, 50 North George Street, York, Pennsylvania 17401, on Monday, May 4, 2020, at 1:00 p.m. local time for the purpose of taking action upon the following proposals:

1. To elect four (4) Directors to three-year terms of office;
2. To ratify the appointment of Baker Tilly Virchow Krause, LLP as the independent registered public accounting firm for the fiscal year ending December 31, 2020;
3. To approve, by non-binding vote, the compensation of the named executive officers; and
4. To transact such other business as may properly come before the meeting.

The Board of Directors has fixed the close of business on February 28, 2020, as the record date for the determination of shareholders entitled to notice of and to vote at the meeting, and at any adjournment or adjournments thereof.

It is important that your shares be represented and voted at the Annual Meeting regardless of the size of your holdings. Whether or not you plan to attend the Annual Meeting, we encourage you to vote your shares in advance of the Annual Meeting by using one of the methods described below:

- By mail – If you received a printed proxy card, mark, sign, date and mail the proxy card (see instructions on the Proxy Materials Notice on how to request a printed proxy card);
- By phone – Call the toll-free telephone number listed on your Proxy Materials Notice or on your proxy card;
- By internet – Visit the website shown on your Proxy Materials Notice or on the proxy card to vote via the Internet; or
- In Person – Shareholders of record may deliver their completed proxy card in person at the Annual Meeting of Shareholders or by completing a ballot available upon request at the meeting. Beneficial shareholders whose shares are held in the name of a bank, broker or other nominee must obtain a legal proxy from the holder of record (that is, your bank, broker or nominee) to be able to vote in person at the Annual Meeting.

If you plan on attending the meeting, a boxed lunch will be provided beginning at 12:00 p.m. Please RSVP to Molly Norton at (717) 718-2942 or e-mail molly@yorkwater.com if you will be joining us for lunch.

We intend to hold our annual meeting in person. However, we are actively monitoring the coronavirus (COVID-19); we are sensitive to the public health and travel concerns our shareholders may have and the protocols that federal, state, and local governments may impose. In the event it is not possible or advisable to hold our annual meeting in person, we will announce alternative arrangements for the meeting as promptly as practicable, which may include holding the meeting solely by means of remote communication. Please monitor our annual meeting website at www.yorkwater.com for updated information. If you are planning to attend our meeting, please check the website one week prior to the meeting date. As always, we encourage you to vote your shares prior to the annual meeting.

Thank you for your continued interest and support of The York Water Company!

By order of the Board of Directors,
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THIS PROXY STATEMENT AND THE 2019 ANNUAL REPORT ARE AVAILABLE ON THE INTERNET AT HTTP://PROXYVOTE.COM
Executive Compensation Tables

The table below provides summary compensation information for our NEOs: the CEO, the CFO, and the three other most highly compensated executive officers who were serving as such on December 31, 2021:

Summary Compensation Table—2021

<table>
<thead>
<tr>
<th>Name and Principal Position</th>
<th>Year</th>
<th>Salary ($)</th>
<th>Bonus ($)</th>
<th>Stock Awards ($)</th>
<th>Option Awards ($)</th>
<th>Non-Equity Incentive Plan Compensation ($)</th>
<th>Other Compensation ($)</th>
<th>Total Compensation ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>D. P. Vermillion, President &amp; CEO</td>
<td>2021</td>
<td>$769,038</td>
<td>$1,986,445</td>
<td>$855,587</td>
<td>$905,751</td>
<td>$60,718</td>
<td>$4,577,539</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2020</td>
<td>$737,693</td>
<td>$1,778,775</td>
<td>$184,423</td>
<td>$2,290,317</td>
<td>$12,875</td>
<td>$5,004,033</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2019</td>
<td>$526,100</td>
<td>$602,372</td>
<td>$534,056</td>
<td>$704,492</td>
<td>$15,600</td>
<td>$2,382,620</td>
<td></td>
</tr>
<tr>
<td>M. T. Thies, Executive Vice President, CFO &amp; Treasurer</td>
<td>2021</td>
<td>$461,615</td>
<td>$653,436</td>
<td>$333,818</td>
<td>$197,793</td>
<td>$17,400</td>
<td>$1,664,062</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2020</td>
<td>$452,615</td>
<td>$663,720</td>
<td>$73,550</td>
<td>$386,704</td>
<td>$17,100</td>
<td>$1,593,688</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2019</td>
<td>$443,154</td>
<td>$558,153</td>
<td>$342,629</td>
<td>$281,832</td>
<td>$91,800</td>
<td>$1,717,568</td>
<td></td>
</tr>
<tr>
<td>J. R. Thackston, Sr. Vice President &amp; Environmental Compliance Officer</td>
<td>2021</td>
<td>$343,463</td>
<td>$428,659</td>
<td>$229,270</td>
<td>$152,208</td>
<td>$15,196</td>
<td>$1,168,796</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2020</td>
<td>$332,692</td>
<td>$439,654</td>
<td>$49,904</td>
<td>$501,700</td>
<td>$14,611</td>
<td>$1,338,561</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2019</td>
<td>$319,692</td>
<td>$369,303</td>
<td>$247,173</td>
<td>$360,431</td>
<td>$89,516</td>
<td>$1,386,115</td>
<td></td>
</tr>
<tr>
<td>K. J. Christie, Sr. Vice President, External Affairs and Chief Customer Officer</td>
<td>2021</td>
<td>$343,461</td>
<td>$345,109</td>
<td>$229,269</td>
<td>$186,490</td>
<td>$13,050</td>
<td>$1,117,379</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2020</td>
<td>$333,462</td>
<td>$270,784</td>
<td>$50,019</td>
<td>$384,920</td>
<td>$12,825</td>
<td>$1,052,011</td>
<td></td>
</tr>
<tr>
<td>H. L. Rosentrater, Sr. Vice President, Energy Delivery and Shared</td>
<td>2021</td>
<td>$343,462</td>
<td>$345,109</td>
<td>$229,269</td>
<td>$147,079</td>
<td>$13,050</td>
<td>$1,077,969</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2020</td>
<td>$329,385</td>
<td>$270,784</td>
<td>$48,408</td>
<td>$403,216</td>
<td>$12,825</td>
<td>$1,064,618</td>
<td></td>
</tr>
</tbody>
</table>
Beginning the Regulatory Audit

Preliminary Due Diligence

Review publicly available reports:
• Annual Report to Shareholders
• Annual Report to the SEC (10-K)
• Annual Report to the FERC (Form 1,2 & 6)
• State Required Reports
FERC Form 1 - Annual Report

- Number of Pages
  - 260 Pages - 520 Pages

- Includes:
  - Operating Data
  - Financial Data

- Report Presents
  - Total Company
  - Over 10,000 data points
  - Does not include State-Only Information for multistate companies
**FERC Form 1 - Annual Report**

**Name of Respondent:** Puget Sound Energy, Inc.

**This Report Is:**
- [X] An Original
- [ ] A Resubmission

**Date of Report:** 04/17/2020

**Year/Period of Report**
- End of 2019/Q4

**Important Changes During the Quarter/Year**

Give particulars (details) concerning the matters indicated below. Make the statements explicit and precise, and number them in accordance with the inquiries. Each inquiry should be answered. Enter "none," "not applicable," or "NA" where applicable. If information which answers an inquiry is given elsewhere in the report, make a reference to the schedule in which it appears.

1. Changes in and important additions to franchise rights: Describe the actual consideration given therefore and state from whom the franchise rights were acquired. If acquired without the payment of consideration, state that fact.
2. Acquisition of ownership in other companies by reorganization, merger, or consolidation with other companies: Give names of companies involved, particulars concerning the transactions, name of the Commission authorizing the transaction, and reference to Commission authorization.

8. State the estimated annual effect and nature of any important wage scale changes during the year.

9. State briefly the status of any materially important legal proceedings pending at the end of the year, and the results of any such proceedings culminated during the year.

10. Describe briefly any materially important transactions of the respondent not disclosed elsewhere in this report in which an officer, director, security holder reported on Page 104 or 105 of the Annual Report Form No. 1, voting trustee, associated company or known associate of any of these persons was a party or in which any such person had a material interest.
Report of Independent Auditors

To the Board of Directors and Management of Puget Sound Energy, Inc.

We have audited the accompanying financial statements of Puget Sound Energy, Inc. which comprise the

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Puget Sound Energy, Inc. as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases described in Note 1.

Auditors’ Responsibility

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. As described in Note 1 to the financial statements, the financial statements are prepared by Puget Sound Energy, Inc. on the basis of the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Federal Energy Regulatory Commission. Our opinion is not modified with respect to this matter.
Basis of Accounting

- the financial statements... have been prepared in accordance with the accounting requirements of the Federal Energy Regulatory Commission (FERC)... which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (U.S. GAAP).

---

Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. As described in Note 1 to the financial statements, the financial statements are prepared by Puget Sound Energy, Inc. on the basis of the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Federal Energy Regulatory Commission. Our opinion is not modified with respect to this matter.
Basis of Accounting

- ...the financial statements have been prepared in accordance with the accounting requirements of the Federal Energy Regulatory Commission (FERC), which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (U.S. GAAP).

Other Comprehensive Bases of Accounting (OCBOA)
Special Purpose Financial Statements and Special Purpose Frameworks (Ref: par. .07)

.A6 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on a framework promulgated by an authorized or recognized standard-setting organization (for example, FASB or GASB), but does not include all of the requirements of that framework. Such frameworks are regulatory bases of accounting, as described in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]
If GAAP conflicts with the accounting and financial reporting needed by the Commission to fulfill its statutory responsibilities, then GAAP must yield.

Order No. 552, 62 FERC 61,299, (March 31, 1993)
...GAAP cannot control when it would prevent the Commission from carrying out its duty to provide jurisdictional companies with the opportunity to earn fair return on their investment and to protect ratepayers from excessive charges and discriminatory treatment.

Order No. 552, 62 FERC 61,299, (March 31, 1993)
Review of Data

Poll Question

Is it reasonable and acceptable for a regulatory auditor to rely on the work and certification of a certified public accountant?

1. Yes
2. No
3. Sometimes
4. All of the above
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company ... and the results of its operations and its cash flows ... in conformity with accounting principles generally accepted in the United States of America.

Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting...

**YES** - It is reasonable and acceptable for a regulatory auditor to rely on the work and certification of a certified public accountant.
Review of Data

Is it reasonable and acceptable for a regulatory auditor to rely on the work performed by a certified public accountant related to a compilation or review?

Compilation
No - A **compilation** does not provide any form of assurance. No testing is performed, and the accountant is not required to be independent.

“The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.”
Review of Data

Is it reasonable and acceptable for a regulatory auditor to rely on the work performed by a certified public accountant related to a compilation or review?

Review
No – All though a review conducts some degree of testing, it results in the conclusion:

“...the accountant is not aware of any needed material modification that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.”
Understand the Accounting System

Axiom

Regulatory accounting is not GAAP accounting with a few tweaks.

- The both use the same techniques, methods, and approaches for the vast majority of transactions differences have developed.
- Purpose of GAAP accounting is to protect investors whereas the purpose of regulatory accounting is to protect ratepayers and the company.
1. **Optional accounting.** GAAP may permit optional accounting for certain types of transactions but for regulatory purposes, a regulator may require a single uniform method or methods.

2. **Cost definition.** Under regulatory accounting certain costs can be deferred, and not expensed in the period incurred. For example, a deferred return on equity capital can be capitalized, and allow recovery in later recovery in rates. Under GAAP, equity return is not a cost and cannot be deferred *except* for regulated utilities!

3. **Time periods.** Certain types of cost can be allocated to different time periods for ratemaking purposes than provided for under GAAP.
Understand the Uniform System of Accounts

USoA establish:
- The first interstate USoA was established in 1922 by NARUC.
- In the 1930s the Federal Power Commission (predecessor of FERC) issued their own USoA.
Understand the Uniform System of Accounts

The Federal Energy Regulatory Commission (FERC)

Title 18 C.F.R. Conservation of Power and Water Resources

PART 101—UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR PUBLIC UTILITIES AND LICENSEES SUBJECT TO THE PROVISIONS OF THE FEDERAL POWER ACT

The Federal Energy Regulatory Commission (FERC)

PART 201--UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR NATURAL GAS COMPANIES SUBJECT TO THE PROVISIONS OF THE NATURAL GAS ACT

National Association of Regulatory Utility Commissioners (NARUC)

WATER UTILITY UNIFORM SYSTEM OF ACCOUNTS—Classes A, B & C

FEDERAL COMMUNICATIONS COMMISSION (FCC)

47 C.F.R. PART 32--UNIFORM SYSTEM OF ACCOUNTS FOR TELECOMMUNICATIONS COMPANIES
The Federal Energy Regulatory Commission (FERC)

Title 18 C.F.R. Conservation of Power and Water Resources

PART 101—UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR PUBLIC UTILITIES AND LICENSEES SUBJECT TO THE PROVISIONS OF THE FEDERAL POWER ACT

Title 18--Conservation of Power and Water Resources CHAPTER I-

PART 201--UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR NATURAL GAS COMPANIES SUBJECT TO THE PROVISIONS OF THE NATURAL GAS ACT
Structure of a Uniform System of Accounts

- Authority and Application
- Definitions
- Accounting Instructions
  - General Instructions
  - Utility Plant Instructions
  - Operating Expense Instructions
- Chart of Accounts (COA)
- Account Descriptions
Structure of a Uniform System of Accounts

- Authority and Application
- Definitions
- Accounting Instructions
  - General Instructions
  - Utility Plant Instructions
  - Operating Expense Instructions
- Chart of Accounts (COA)
- Account Descriptions
PART 101—UNIFORM SYSTEM OF ACCOUNTS, PRESCRIBED FOR PUBLIC UTILITIES AND LICENSEES SUBJECT TO THE PROVISIONS OF THE FEDERAL POWER ACT

AUTHORITY: 18 U.S.C. 71a, 2251a; 2251b; 7161, 7162; 7163; U.S.C. 7161; 7162, 7163.


EDITORIAL NOTE: For sections affecting part 101, see
CFR, Sections Affected, which is a part of section (13) of this subchapter and is available on the CFR website at www.fdsys.gov.

EFFECTIVE DATE NOTE: Act 16036, Apr. 7, 1943, p. 19, 19, 1944, re-designating Definitions 26 to 29 and adding new subparagraph 13 under the heading "Intimate Accounts," added paragraphs 5, 6, 7, and 8 under the heading "Intimate Accounts," added paragraphs 5, 6, 7, and 8 under the heading "Intimate Accounts," and added paragraphs 5, 6, 7, and 8 under the heading "Intimate Accounts." The added rules and regulations and requirements will be subject to approval by the Commission and will not become effective until approval has been given.

Authority and Application

Authority and Application

IPUMSU - ADV2022F-1

Note: Order 141, 12 FR 8003, Dec. 19, 1947, provides in part as follows:
Prescribing a system of accounts for public utilities and licensees under the Federal Power Act. The Federal Power Commission acting pursuant to authority granted by the Federal Power Act, particularly sections 301(a), 304(a), and 309, and paragraph (13) of section 3, section 4(b) thereof, and finding such action necessary and appropriate for carrying out the provisions of said act, hereby adopts the accompanying system of accounts entitled "Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act," and the rules and regulations contained therein; and It is hereby ordered:
(a) That said system of accounts and said rules and regulations contained therein be and the same are hereby prescribed and promulgated as the system of accounts and rules and regulations of the Commission to

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SUBCHAPTER C—ACCOUNTS, FEDERAL POWER ACT

PART 101—UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR PUBLIC UTILITIES AND LICENSEES SUBJECT TO THE PROVISIONS OF THE FEDERAL POWER ACT


EDITORIAL NOTE: For Federal Register citations affecting Part 101, see the List of CFR Sections Affected which appears in the Finding Aids section of the printed volume and at www.fdsys.gov.

EFFECTIVE DATE

Applicability of system of accounts. This system of accounts is applicable in principle to all licensees subject to the Commission’s accounting requirements under the Federal Power Act, and to all public utilities subject to the provisions of the Federal Power Act.

The Commission reserves the right, however, under the provisions of section 301(a) of the Federal Power Act to classify such licensees and public utilities and to prescribe a system of classification of accounts to be kept by and which will be convenient for and meet the requirements of each class.

This system of accounts is applicable to public utilities, as defined in this part, and to licensees engaged in the generation and sale of electric energy for ultimate distribution to the public.
Structure of a Uniform System of Accounts

- Authority and Application
- **Definitions**
- Accounting Instructions
  - General Instructions
  - Utility Plant Instructions
  - Operating Expense Instructions
- Chart of Accounts (COA)
- Account Descriptions
31. Regulatory Assets and Liabilities are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determination in one period under the general requirements of the Uniform System of Accounts but for it being probable:

A. that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services;
Structure of a Uniform System of Accounts

- Authority and Application
- Definitions
- Accounting Instructions
  - General Instructions
  - Utility Plant Instructions
  - Operating Expense Instructions
- Chart of Accounts (COA)
- Account Descriptions
4. Accounting Period.

Each utility shall keep its books on a monthly basis so that for each month all transactions applicable thereto, as nearly as may be ascertained, shall be entered in the books of the utility. Amounts applicable or assignable to specific utility departments shall be so segregated monthly. Each utility shall close its books at the end of each calendar year unless otherwise authorized by the Commission.

5. Submittal of Questions.

To maintain uniformity of accounting, utilities shall submit questions of doubtful interpretation to the Commission for consideration and decision.

100–199 Assets and other debits.
200–299 Liabilities and other credits.
300–399 Plant accounts.
400–432, 434–435 Income accounts.
433, 436–439 Retained earnings accounts.
440–459 Revenue accounts.
500–599 Production, transmission and distribution expenses.
Structure of a Uniform System of Accounts

- Authority and Application
- Definitions
- Accounting Instructions
  - General Instructions
  - Utility Plant Instructions
  - Operating Expense Instructions
- Chart of Accounts (COA)
- Account Descriptions
Federal Energy Regulatory Commission
accounts, and distributed therefrom to the appropriate account. If rents cover property used for more than one function, such as production and transmission, or by more than one department, the rents shall be apportioned to the appropriate rent expense or clearing accounts of each department on an actual, or, if necessary, an estimated basis.

Chart of Accounts and Account Descriptions

Balance Sheet Accounts

101 Electric plant in service (Major only).

101.1 Property under capital leases.

102 Electric plant purchased or sold.

103 Experimental electric plant unclassified (Major only).

103.1 Electric plant in process of reclassification (Nonmajor only).

104 Electric plant leased to others.

105 Electric plant held for future use.

Balance Sheet Chart of Accounts

ASSETS AND OTHER DEBITS

1. UTILITY PLANT

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Federal Energy Regulatory Commission

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104 Electric plant leased to others.

105 Electric plant held for future use.

Balance Sheet Accounts

101 Electric plant in service (Major only).

101.1 Property under capital leases.

102 Electric plant purchased or sold.

103 Experimental electric plant unclassified (Major only).

103.1 Electric plant in process of reclassification (Nonmajor only).

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Balance Sheet Chart of Accounts

ASSETS AND OTHER DEBITS

1. UTILITY PLANT

101 Electric plant in service (Major only).

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Balance Sheet Chart of Accounts

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104 Electric plant leased to others.

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1. POWER PRODUCTION EXPENSES
   A. STEAM POWER GENERATION
      Operation
      500 Operation supervision and engineering
      501 Fuel.
      502 Steam expenses (Major only).
      503 Steam from other sources.
      504 Steam transferred. Credits.
      505 Electric expenses.
      506 Miscellaneous (Major only).
      507 Rents.
      508 Operation supervision and engineering (Nonmajor only).
      509 Allowances.

      Maintenance
      510 Maintenance supervision and engineering (Major only).
      511 Maintenance of steam plant (Major only).
      512 Maintenance of boiler plant (Major only).
      513 Maintenance of boiler plant (Nonmajor only).
      514 Maintenance of plant (Major only).
      515 Maintenance of plant (Nonmajor only).

      501 Fuel.
      A. This account shall include the cost of fuel used in the production of steam for the generation of electricity, including expenses in unloading fuel from the shipping media and handling thereof up to the point where the fuel enters the first boiler plant bunker, hopper, bucket, tank or holder of the boiler-house structure. Records shall be maintained to show the quantity, B.t.u. content and cost of each type of fuel used.

   500 Operation supervision and engineering.
2. OTHER INCOME AND DEDUCTIONS

A. OTHER INCOME
415 Revenues from merchandising, jobbing, and contract work.
416 Costs and expenses of merchandising, jobbing, and contract work.
417 Revenues from nonutility operations.
417.1 Expenses of nonutility operations.
418 Nonoperating rental income.
418.1 Equity in earnings of subsidiary companies (Major only).
419 Interest and dividend income.
419.1 Allowance for other funds used during construction.
420 Investment tax credits.
421 Miscellaneous nonoperating income.
421.1 Gain on disposition of property.

B. OTHER INCOME DEDUCTIONS
421.2 Loss on disposition of property.
425 Miscellaneous amortization.
426 [Reserved]
426.1 Donations.
426.2 Life insurance.
426.3 Penalties.
426.4 Expenditures for certain civic, political and related activities.
426.5 Other deductions.
 Total other income deductions.
 Total Other Income and Deductions.

426.1 Donations.
 This account shall include all payments or donations for charitable, social or community welfare purposes.

426.2 Life insurance.
 This account shall include all payments for life insurance of officers and employees where company is beneficiary (net premiums less decrease 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, political and related activities.
 This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation
Preliminary Procedures

- Prepare an analysis of historical financial and operating data
  - Three to five years of data,
  - Identify significant changes in plant, investment, revenues, and expenses,
  - Identify significant changes in usage, customer counts by type, miles of transmission and generation capacity.
# MIDDLESEX WATER COMPANY CONSOLIDATED BALANCE SHEETS

(In thousands)

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>December 31, 2019</th>
<th>December 31, 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UTILITY PLANT:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water Production</td>
<td>$160,870</td>
<td>$156,423</td>
</tr>
<tr>
<td>Transmission and Distribution</td>
<td>556,517</td>
<td>512,202</td>
</tr>
<tr>
<td>General</td>
<td>83,043</td>
<td>74,371</td>
</tr>
<tr>
<td>Construction Work in Progress</td>
<td>75,520</td>
<td>32,878</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$875,950</td>
<td>$775,874</td>
</tr>
<tr>
<td>Less Accumulated Depreciation</td>
<td>170,220</td>
<td>157,387</td>
</tr>
<tr>
<td><strong>UTILITY PLANT • NET</strong></td>
<td>705,730</td>
<td>618,487</td>
</tr>
<tr>
<td><strong>CURRENT ASSETS:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>2,230</td>
<td>3,705</td>
</tr>
<tr>
<td>Accounts Receivable, net</td>
<td>11,908</td>
<td>11,762</td>
</tr>
<tr>
<td>Unbilled Revenues</td>
<td>7,183</td>
<td>7,293</td>
</tr>
<tr>
<td>Materials and Supplies (at average cost)</td>
<td>5,445</td>
<td>5,411</td>
</tr>
<tr>
<td>Prepayments</td>
<td>2,367</td>
<td>2,646</td>
</tr>
<tr>
<td><strong>TOTAL CURRENT ASSETS</strong></td>
<td>29,133</td>
<td>30,815</td>
</tr>
<tr>
<td><strong>AND OTHER ASSETS:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Lease Right of Use Asset</td>
<td>5,944</td>
<td>-</td>
</tr>
<tr>
<td>Preliminary Survey and Investigation Charges</td>
<td>2,054</td>
<td>5,254</td>
</tr>
<tr>
<td>Regulatory Assets</td>
<td>110,479</td>
<td>99,236</td>
</tr>
<tr>
<td>Restricted Cash</td>
<td>44,269</td>
<td>1,956</td>
</tr>
<tr>
<td>Non-utility Assets - Net</td>
<td>10,370</td>
<td>9,989</td>
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<tr>
<td>Other</td>
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<td>2,093</td>
</tr>
<tr>
<td><strong>TOTAL DEFERRED CHARGES AND OTHER ASSETS</strong></td>
<td>175,015</td>
<td>118,528</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$909,878</td>
<td>$767,830</td>
</tr>
</tbody>
</table>

## CAPITALIZATION AND LIABILITIES

| CAPITALIZATION: |                  |                  |
| Common Stock, No Par Value | $215,125 | 157,354 |
| Retained Earnings | 108,667 | 91,433 |
| **TOTAL COMMON EQUITY** | 323,792 | 248,787 |
| Preferred Stock | 2,684 | 2,433 |
| Long Term Debt | 230,777 | 152,851 |
| **TOTAL CAPITALIZATION** | 556,653 | 404,071 |

| CURRENT LIABILITIES: |                  |                  |
| Current Portion of Long-term Debt | 7,178 | 7,343 |
| Notes Payable | 20,980 | 48,500 |
| Accounts Payable | 23,306 | 19,325 |
| Accrued Taxes | 7,635 | 14,230 |
| Accrued Interest | 2,631 | 1,289 |
| Unearned Revenues and Advanced Service Fees | 1,231 | 1,036 |
| Other | 3,620 | 2,640 |
| **TOTAL CURRENT LIABILITIES** | 64,981 | 94,363 |

## COMMITMENTS AND CONTINGENT LIABILITIES (Note 6)

| DEFERRED CREDITS AND OTHER LIABILITIES: |                  |                  |
| Customer Advances for Construction | 23,905 | 22,572 |
| Lease Obligations | 5,732 | 5,500 |
| Accumulated Deferred Income Taxes | 54,408 | 47,270 |
| Employee Benefit Plans | 34,671 | 30,661 |
| Regulatory Liabilities | 69,152 | 79,112 |
| Other | 2,546 | 2,730 |
| **TOTAL DEFERRED CREDITS AND OTHER LIABILITIES** | 190,414 | 182,345 |

## CONTRIBUTIONS IN AID OF CONSTRUCTION

|                  |                  |
| Contributions in Aid of Construction | 97,830 | 87,051 |
| **TOTAL CAPITALIZATION AND LIABILITIES** | $909,878 | $767,830 |
# MIDDLESEX WATER COMPANY
## CONSOLIDATED BALANCE SHEETS
(In thousands)

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</table>
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<table>
<thead>
<tr>
<th>CAPITALIZATION:</th>
<th>2022</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Stock, No Par Value</td>
<td>$215,125</td>
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</tr>
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<td>152,851</td>
</tr>
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<td>404,071</td>
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<tr>
<th>CURRENT LIABILITIES:</th>
<th>2022</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Portion of Long-term Debt</td>
<td>7,178</td>
<td>7,343</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>20,000</td>
<td>48,500</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>23,306</td>
<td>19,325</td>
</tr>
<tr>
<td>Accrued Taxes</td>
<td>7,635</td>
<td>14,230</td>
</tr>
<tr>
<td>Accrued Interest</td>
<td>2,031</td>
<td>1,289</td>
</tr>
<tr>
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<td>1,211</td>
<td>1,036</td>
</tr>
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<td>2,640</td>
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<td>94,363</td>
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### COMMITMENTS AND CONTINGENT LIABILITIES (Note 4)

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<tr>
<th>DEFERRED CREDITS AND OTHER LIABILITIES:</th>
<th>2022</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Advances for Construction</td>
<td>23,905</td>
<td>22,572</td>
</tr>
<tr>
<td>Lease Obligations</td>
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<td>-</td>
</tr>
<tr>
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<td>47,270</td>
</tr>
<tr>
<td>Employee Benefit Plans</td>
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<td>30,661</td>
</tr>
<tr>
<td>Regulatory Liabilities</td>
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<td>79,112</td>
</tr>
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<td>2,730</td>
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</table>

### CONTRIBUTIONS IN AID OF CONSTRUCTION

<table>
<thead>
<tr>
<th>CONTRIBUTIONS IN AID OF CONSTRUCTION</th>
<th>2022</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$97,830</td>
<td>$87,051</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TOTAL CAPITALIZATION AND LIABILITIES</th>
<th>2022</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$909,878</td>
<td>$767,830</td>
</tr>
</tbody>
</table>

See Notes to Consolidated Financial Statements.
Historical Data Analysis

• Focused Analysis
  – Year to Year
    • Absolute change
    • Percentage change
    • Changes in trends
  – Current Year
    • Financial measures
    • Ratios
    • Benchmarks

• Depending on the size of the company much of this data can be obtained directly from the company using data requests.

• Results of the analysis can help focus the audit to significant issues or changes.
Poll Question

Is there a difference between Historic and Historical?

1. Yes
2. No
3. Sometimes
4. All of the above
Review of Data

Poll Question

Is there a difference between Historic and Historical?

1. Yes
2. No
3. Sometimes
4. All of the above
Trend Analysis

- Trends
  - declining sales
  - Increasing expenses

- Seasonal Expenses
  - Vegetation control,
  - Tree trimming,

- Expense Anomalies
  - Pandemic
  - Union strike,
  - Catastrophic Event

- Lumpy Investment Changes
  - Plant retirement,
  - Cash Flow.
Variance Analysis

COMPARISONS - yearly

Average Plant Per Customer
### Year-to-year analysis

#### AVISTA WASHINGTON OPERATIONS

<table>
<thead>
<tr>
<th>Electric Plant in Service</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangible</td>
<td>$28,528,246</td>
<td>$32,613,519</td>
<td>$33,280,638</td>
<td>$34,281,547</td>
</tr>
<tr>
<td>Tangible</td>
<td>$1,209,955,913</td>
<td>$1,655,132,420</td>
<td>$1,929,686,446</td>
<td>$2,022,543,617</td>
</tr>
<tr>
<td>Total Electric Plant in Service</td>
<td>$1,238,484,159</td>
<td>$1,885,775,939</td>
<td>$1,962,967,084</td>
<td>$2,056,825,166</td>
</tr>
</tbody>
</table>

| Accumulated Provision for Deprec. & Amort. | $960,938,581| $1,012,217,393| $1,065,032,018| $1,123,890,020|

#### NET OPERATING INCOME STATEMENT - ELECTRIC ONLY

<table>
<thead>
<tr>
<th>Operating Revenues</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential Sales</td>
<td>$25,292,415</td>
<td>$26,703,308</td>
<td>$25,880,485</td>
<td>$26,489,090</td>
</tr>
<tr>
<td>Commercial and Industrial Sales</td>
<td>$25,292,415</td>
<td>$26,703,308</td>
<td>$25,880,485</td>
<td>$26,489,090</td>
</tr>
<tr>
<td>Public Street and Highway Lighting</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
</tr>
<tr>
<td>Other Sales to Public Authorities</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
</tr>
<tr>
<td>Sales to Railroads and Railways</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
</tr>
<tr>
<td>Interdepartmental Sales</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
<td>$888,608</td>
</tr>
<tr>
<td>Unbilled Revenues *</td>
<td>$334,409,058</td>
<td>$471,390,152</td>
<td>$476,082,045</td>
<td>$495,839,246</td>
</tr>
<tr>
<td>Total Sales to Ultimate Consumers</td>
<td>$434,409,058</td>
<td>$471,390,152</td>
<td>$476,082,045</td>
<td>$495,839,246</td>
</tr>
<tr>
<td>Sales for Resale</td>
<td>$167,017,546</td>
<td>$76,990,883</td>
<td>$96,217,670</td>
<td>$93,476,309</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sales Asset Turnover</th>
<th>156%</th>
<th>54%</th>
<th>53%</th>
<th>53%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant</td>
<td>1,238</td>
<td>1,885</td>
<td>1,963</td>
<td>2,056</td>
</tr>
<tr>
<td>Acc Dep</td>
<td>960</td>
<td>1,012</td>
<td>1,065</td>
<td>1,124</td>
</tr>
<tr>
<td>Net Plant</td>
<td>278</td>
<td>873</td>
<td>898</td>
<td>932</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sales</th>
<th>434</th>
<th>471</th>
<th>476</th>
<th>496</th>
</tr>
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<td>Asset Turnover</td>
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<td>54%</td>
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Review of Data

Poll Question

Is there a difference between a cost and an expense?

1. Yes
2. No
3. Sometimes
4. 4,365
Review of Data

Poll Question

Is there a difference between a cost and an expense?

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2. No
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Best Practices – Rate Filings
Test Year Approaches

Please Note:

- A Test Year is sometimes described as the historical period which is used to derive a prospective rate base and income statement.

- Test Year is also described by some state commissions as the period in which rates will take effect.

- I will be using the first example, that is the Test Year here will be the historical period whereas the Rate Year will be the year in which rates take effect.
Test Year Approaches

Historical Test year –
Based only on historical data
No regulator currently used this approach

Pro Forma test year --
Historical data adjusted for known and measurable changes
Sometimes incorrectly referred to as an historical test year

Future, projected, forward, or forecasted test year --

Partially Projected – a portion of the period is historical, and the remaining is projected.

Fully Projected Future Test Year
12-month period beginning the first month new rates become effective – Pennsylvania
Appropriateness of Test Year

The test year selected by the company is a recent, partially projected, or fully-projected twelve-month period.

Audit Question: Does the proposed test year after adjustments provide a reasonable representation of the year in which rates will take effect, the rate year?
Appropriateness of Test Year

Is the test year stale?
Another way of saying, is the selected period too old?

A test year must be recent enough to provide enough relevant and timely information to confidentially develop an acceptable picture of the operating and financial position of the company when new rates take effect.

Question: How do we handle the Pandemic?
Appropriateness of Test Year

Criteria for assessing appropriateness of test year?
• Is more than a year old too old?
• Example: TY 2020 used for a 2023 rate year
Development of a Prospective Rate Year

- Test Year 2021
  - Historical Results of Operations - 2021
  - 2021 was impacted by COVID-19

- Preparation and ratecase Year(s)
  - Recognize and Project Cost Changes
    - 2022 - 2023

- Rate Year
  - Year new rates are effective
    - 2024
Auditing the Rate Base
Rate Base

“Determination of the rate base, the value of a utility's property used and useful in the public service minus accrued deprecation, is one of the most important and most difficult problems confronting both the commissions and the utilities.”

Charles Phillips, Jr., The Regulation of Public Utilities
Rate Base

• The utility’s rate base is the total of the investor funded or supplied plant, facilities, and other investments used by the utility in providing utility services to its customers.

• It is the investment base to which a fair rate of return is applied to arrive at the net operating income requirement (i.e., the amount of authorized return).
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• Original Cost Valuation
  • Plant in service is valued at the its cost at the time that it was first placed into utility service.
  • The original cost remains throughout the plant’s life.
  • Plant purchased from another utility - the original cost remains the recorded value.
Other Valuations Methods

- **Replacement Cost** – Updated Costs / Current Technology
- **Reproduction Cost** – Updated Costs / Original Equipment
- **Fair Value** – Fixing value at “Market Value”
### Plant-in-Service Measurement

- **End of Year Balances**
  Recognizes the plant-in-service balance that will be providing service during the rate year. Helps offset regulatory lag.

- **Average - 12 month / 13 month**
  Applies the matching principle to test year plant and income statement by matching plant-in-service to expenses and revenue.

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Expected Auditor Enquires

• Used and Useful
  Plant must be functioning, providing service and be necessary.

• Not excessive – size or capacity
  Some plant investments are naturally “lumpy” when building to meet a long-term demand.

Cost inefficiency can be created when plant is added in small increments.
Expected Auditor Enquires

- Prudence
  Plant in service may be used and useful but not prudent, *i.e.*, *placing in service a technology that will be (or is) obsolete.*

- Independent Transaction
  Cost is, or equivalent to, an arms length transaction (affiliated transactions).

- No Gold plating – Building beyond the actual need or extravagant facilities. (materiality)
## Accumulated Depreciation

- Recovery of investment
- Not required to reinvest!

### Expected Auditor Inquires

- Basis of accounting
  - Small companies
  - Tax basis
  - Removal of fully depreciated assets

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Acquisition Adjustment is

- **The *Excess Cost* greater than *Original Cost***
- NOT “Just like *Goodwill***
- Regulatory treatment of excess cost is not equivalent to treatment provided under GAAP
### ASC 350-20 (FASB 142)  GAAP – Goodwill

- **Glossary** - The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed.
- The excess cost over the fair value of identifiable Assets
- **Intangible Asset**

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350 Intangibles—Goodwill and Other
20 Goodwill
35 Subsequent Measurement

Table of Contents
Collapse | Expand

- 350 Intangibles—Goodwill and Other
  - 20 Goodwill
    - 35 Subsequent Measurement
      - General

General Note: The Subsequent Measurement Section provides guidance on an entity’s subsequent measurement and subsequent recognition of an item. Situations that may result in subsequent changes to carrying amount include impairment, fair value adjustments, depreciation and amortization, and so forth.

General

> Overall Accounting for Goodwill

35-1 Goodwill shall not be amortized. Instead, goodwill shall be tested for impairment at a level of reporting referred to as a reporting unit. (Paragraphs 350-20-35-33 through 35-46 provide guidance on determining reporting units.)

35-1 Goodwill shall not be amortized. Instead, goodwill shall be tested for impairment at a level of reporting referred to as a reporting unit. (Paragraphs 350-20-35-33 through 35-46 provide guidance on determining reporting units.)
114. Utility Plant Acquisition Adjustments
A. This account shall include the difference between (a) the cost to the accounting utility of utility plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated depreciation, accumulated amortization and contributions in aid of construction with respect to such property.

115. Other Utility Plant Adjustments
A. This account shall include the difference between the original cost, estimated if not known, and the book cost of utility plant to the extent that such difference is not properly includible in account 114 - Utility Plant Acquisition Adjustments (See Accounting Instruction 17C).
B. Amounts included in this account shall be classified in such manner as to show the origination of each amount and shall be disposed of as the Commission may approve or direct.
Note: The provisions of this account shall not be construed as approving or authorizing the recording of appreciation of utility plant.

Other Property and Investments

121. Nonutility Property
A. This account shall include the book cost of land, structures, equipment or other tangible or intangible property owned by the utility, but not used in utility service and not properly includible in account 103 - Property Held for Future Use.
B. This account shall be subdivided so as to show the amount of property used in operations which are nonutility in character but nevertheless constitute a distinct operating activity of the company (such as plant merchandising and repair where such activity is not classified as utility) and the amount of miscellaneous property not used in operations. The records in
C. The detailed electric plant accounts (301 to 399, inclusive) shall be stated on the basis of cost to the utility of plant constructed by it and the original cost, estimated if not.

The difference between the original cost, as above, and the cost to the utility of electric plant after giving effect to any accumulated provision for depreciation or amortization shall be recorded in account 114, Electric Plant Acquisition Adjustments.

Companies with respect to electric plant previously acquired as operating units or systems and the difference between the original cost so determined, less accumulated provisions for depreciation and amortization and the cost to the utility with necessary adjustments for retirements from the date of acquisition, shall be entered in account 114, Electric Plant Acquisition Adjustments. Any difference between the cost of electric plant and its book cost, when not properly includible in other accounts, shall be recorded in account 116, Other Electric Plant Adjustments.
Instructions for account 114 Acquisition Adjustments

C. Debit amounts recorded in this account related to plant and land acquisition may be amortized to account 425, Miscellaneous Amortization, over a period not longer than the estimated remaining life of the properties to which such amounts relate. Amounts related to the acquisition of land only may be amortized to account 425 over a period of not more than 15 years.
### Plant Held for Future Use

This category of plant generally contains plant that is owned and held for a future purpose, and thus not yet in active service.

- Many jurisdictions require that the property held in this account have a definite plan for use (e.g., the FERC) or even specify a time frame by which the property must be actively used (e.g., the FCC).
- Therefore, the auditor should specifically examine the list of items within this account and determine if there is a definite plan for use related to the provision of utility service.

**NOTE:** Some states completely disallow any inclusion of plant held for future use in rates, while others may allow some or all to be included in rate base. This is a jurisdictional specific decision.

*Source: NARUC Rate case and Audit Manual*

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|        | Total Deductions    | (259,448,220) |
|        | RATE BASE           | 570,188,644   |
**Prepayments**

The auditor should examine the nature of the prepayments as well as the amounts of each type of prepayment.

In looking at these items, one should look to see that they relate to the provision of utility service, and are the type of expense that is normally lumpy in nature, and therefore, paid periodically and then amortized over some number of months.

- An example of a commonly included prepayment is insurance. Watch the allocation of insurance as it often covers not only the regulated utility, but also affiliates and deregulated activities.

- Since the prepayment balance will vary during a period, the auditor may wish to consider using an average balance to reach a more normalized level for inclusion in rate base.

*Source: NARUC Rate case and Audit Manual*
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Materials and Supplies

- Review recent large purchases of Materials and Supplies and the reason for the large purchase. The auditor should look for ways to determine the reasonableness of the materials and supplies balance.

- Does it include obsolete material? Spare parts recovered through retirement booked at cost.

- An auditor may wish to look for anomalies in the month end balance during the period, to see if there is a need to normalize the balance included in rate base.

- Meters are traditionally not included in the Materials and Supplies inventory even when not used and still in the box but instead placed directly into the meters account!
334. Meters and Meter Installations

A. This account shall include the cost of meters, devices and appurtenances attached thereto, used for measuring the quantity of water delivered to users, whether actually in service or held in reserve. It shall also include the cost of labor employed, materials used and expenses incurred in connection with the original installation of a customer’s meters and devices and appurtenances attached thereto.
### Working Capital

- **Textbook definition:**
  \[
  \text{Net Working Capital} = \text{Current Assets} - \text{Current Liabilities}.
  \]

- **Working Capital** is the net current assets needed to pay the day to day operations of the company.

- **Cash Working Capital** is the cash and other liquid current assets. It is a subset of the grouping Working Capital.

- Working capital is a period concept and should be measure over the test year.

- Adam Smith identified working capital as “circulating capital” in his 1776 book, *Wealth of Nations*.

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Additions to Rate Base
Cash Working Capital

• **Lead-Lag Study**
  • Most common approach
  • Actual study of cash flows related to payments and receipts of cash
  • Time consuming / Expensive
  • 45-day Lag = 30 days service + 15 after billing

• **Expected Auditor Inquires**
  • Review worksheets / interview witness
  • Look for missing sources of working cap –
    • e.g., prepayments.
## CASH WORKING CAPITAL

**Purpose and Description:** Test Year Lead/Lag

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<td>45.79</td>
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<td>33.83</td>
<td>13,505,593</td>
<td>37,002</td>
<td>1,251,659</td>
</tr>
<tr>
<td>Regulatory Assessments</td>
<td>45.79</td>
<td>12.10</td>
<td>33.69</td>
<td>4,766,319</td>
<td>13,058</td>
<td>439,944</td>
</tr>
<tr>
<td>Insurance Expense &amp; Injuries &amp; Damages</td>
<td>45.79</td>
<td>(158.71)</td>
<td>204.50</td>
<td>2,372,376</td>
<td>6,500</td>
<td>1,329,244</td>
</tr>
<tr>
<td>Other O&amp;M &amp; Vegetation Management</td>
<td>45.79</td>
<td>45.95</td>
<td>(0.16)</td>
<td>83,827,945</td>
<td>229,666</td>
<td>(36,681)</td>
</tr>
<tr>
<td><strong>Total Operation and Maintenance</strong></td>
<td>162,800,543</td>
<td>2,376,878</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Taxes:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Property</td>
<td>45.79</td>
<td>(25.41)</td>
<td>71.20</td>
<td>47,117,521</td>
<td>129,089</td>
<td>9,191,514</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>45.79</td>
<td>11.98</td>
<td>33.82</td>
<td>4,745,354</td>
<td>13,001</td>
<td>439,632</td>
</tr>
<tr>
<td>Federal Income Taxes</td>
<td>45.79</td>
<td>30.01</td>
<td>15.78</td>
<td>9,915,092</td>
<td>27,165</td>
<td>428,673</td>
</tr>
<tr>
<td>NH Profit and Enterprise Taxes</td>
<td>45.79</td>
<td>31.99</td>
<td>13.80</td>
<td>4,089,975</td>
<td>11,205</td>
<td>154,627</td>
</tr>
<tr>
<td><strong>Total Taxes (above the line)</strong></td>
<td>65,867,941</td>
<td>10,214,446</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Weighted Net Lag Days**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>5.51%</td>
</tr>
</tbody>
</table>

**Test Year Distribution Working Capital**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$12,591,324</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll</td>
<td>45.79</td>
<td>11.97</td>
<td>33.82</td>
<td>$49,823,448</td>
<td>136,503</td>
<td>$4,617,005</td>
</tr>
</tbody>
</table>
Additions to Rate Base
Working Capital

• **Balance Sheet Method**
  
  • Standard accounting formula
  
  • Current Assets – Current Liabilities
  
  • L/T Liabilities – L/T Equity
  
  • Complex
  
  • Used by two states, each with a different approach
Additions to Rate Base Working Capital

Formula Method:

- Assumes 45-day lag in revenues.
- Assumes NO expense lead.
- $45/365 = 12.33\%$ of operating expenses
- Excludes depreciation, property tax and fuel.

- **Expected Auditor Inquires**
  
  Review workpaper (very simple)
  
  Note: method NEVER results in negative working capital .... Does it make sense.
This account shall include:
1. Any amount or item of money, services or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility’s property, facilities, or equipment used to provide utility services to the public.

3. Compensation received from governmental agencies and others for relocation of water mains or other plants.

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. The electric plant accounts shall not include the cost or other value of electric plant contributed to the company. Contributions in the form of money or its equivalent toward the construction of electric plant shall be credited to accounts charged with the cost of such construction. Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed when assembling cost data in work orders for posting to plant ledgers of accounts. The accumulated gross costs of the utility of electric plant after giving effect at the time or in accordance with the discretion of management as exercised under a uniform system of accounts, or under accounting practices previously followed:

<table>
<thead>
<tr>
<th>Line No.</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Federal Energy Regulatory Commission</td>
</tr>
<tr>
<td>2</td>
<td>Pt. 101</td>
</tr>
<tr>
<td>3</td>
<td>The utility of electric plant after giving</td>
</tr>
<tr>
<td>4</td>
<td>effect at the time or in accordance with the</td>
</tr>
<tr>
<td>5</td>
<td>discretion of management as exercised under a</td>
</tr>
<tr>
<td>6</td>
<td>uniform system of accounts, or under accounting</td>
</tr>
<tr>
<td>7</td>
<td>practices previously followed.</td>
</tr>
</tbody>
</table>

The utility of electric plant after giving effect at the time or in accordance with the discretion of management as exercised under a uniform system of accounts, or under accounting practices previously followed.
Expected Auditor Inquires

- Different CIAC type segregated
- CIAC related to plant not in service is removed from rate base
- Gross-up required to pay income taxes is accounted for.
<table>
<thead>
<tr>
<th>Line No.</th>
<th>Rate Base</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total Plant in Service</td>
<td>875,950,000</td>
</tr>
<tr>
<td>2</td>
<td>Accumulated Depreciation</td>
<td>170,220,000</td>
</tr>
<tr>
<td>3</td>
<td>Plant in Service Net of Accumulated Depreciation</td>
<td>705,730,000</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>570,188,644</strong></td>
</tr>
</tbody>
</table>

### Calculating the Rate Base: Additions

<table>
<thead>
<tr>
<th>Line No.</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>Plant Held for Future Use</td>
<td>200,000</td>
</tr>
<tr>
<td>13</td>
<td>Prepayments (insurance, property tax, other)</td>
<td>775,000</td>
</tr>
<tr>
<td>14</td>
<td>Materials and Supplies</td>
<td>650,000</td>
</tr>
<tr>
<td>15</td>
<td>Cash Working Capital (1/8 O&amp;M method)</td>
<td>57,018,864</td>
</tr>
<tr>
<td>16</td>
<td>Regulatory Assets (deferred)</td>
<td>68,125,000</td>
</tr>
<tr>
<td>17</td>
<td><strong>Total Additions</strong></td>
<td><strong>126,768,864</strong></td>
</tr>
</tbody>
</table>

### Calculating the Rate Base: Deductions

<table>
<thead>
<tr>
<th>Line No.</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>Accumulated Deferred Income Taxes</td>
<td>(203,453,000)</td>
</tr>
<tr>
<td>21</td>
<td>Accumulated Deferred ITC</td>
<td>(220,220)</td>
</tr>
<tr>
<td>22</td>
<td>Contributions in Aid of Construction (CIAC, net)</td>
<td>(20,000,000)</td>
</tr>
<tr>
<td>23</td>
<td>Advances for Construction</td>
<td>(12,025,000)</td>
</tr>
<tr>
<td>24</td>
<td>Customer Deposits</td>
<td>(6,500,000)</td>
</tr>
<tr>
<td>25</td>
<td>Regulatory Liabilities (deferred)</td>
<td>(15,000,000)</td>
</tr>
<tr>
<td>26</td>
<td>Other Deferred Credits</td>
<td>(2,250,000)</td>
</tr>
<tr>
<td>27</td>
<td><strong>Total Deductions</strong></td>
<td><strong>(259,448,220)</strong></td>
</tr>
</tbody>
</table>

**RATE BASE**: 570,188,644
Questions

Exercise time!!
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.

**Discuss what the issues are and what options are available**
Exercise - Capital

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
“...the corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it. How such compensation may be ascertained, and what are the necessary elements in such an inquiry, will always be an embarrassing question...”

US Supreme Court
Justice Harlan - Smyth v. Ames
171 U.S. 361 (1898)
Questions or Comments?
Thank You!