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RATEPAYERS APPEAL OF	§	BEFORE THE STATE OFFICE
THE DECISION BY WINDERMERE	§	
OAKS WATER SUPPLY	§	OF
CORPORATION TO CHANGE	§	
WATER AND SEWER RATES	§	ADMINISTRATIVE HEARINGS

SUPPLEMENTAL DIRECT TESTIMONY

OF

ROBERT GAINES

ON BEHALF OF

THE RATEPAYERS

**WITNESS FOR RATEPAYERS REPRESENTATIVES OF THE WINDERMERE OAKS
WATER SUPPLY CORPORATION**

ROBERT GAINES

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1 **INTRODUCTION, POSITION, AND QUALIFICATIONS**

2 Q. Please state your name and address.

3 A. Robert N. Gaines, PO Box 9, Temple, Texas 76503.

4 Q. Please summarize your professional credentials, training and expertise that qualify you to
5 perform the work requested in this Docket

6 A. I have been a Certified Public Accountant since 1975. I received a Bachelor of Business
7 Administration degree from the University of Texas McCombs School of Business in 1973.
8 I am currently self-employed as a CPA, having previously worked at Alton D. Thiele in
9 Belton Texas as an Audit Manager. My professional experience includes managing and
10 performing audits, primarily of rural Water Supply Corporations (WSCs) and Special
11 Utility Districts (SUDs). I authored "*An Introduction to WSC Exemption Status Under*
12 *501(c)12 Texas Rural Water Association Journal Quality on Tap.*

13 Q. Have you previously filed testimony in this case?

14 A. No

15 Q. What have you done to prepare for your testimony?

16 A. I have reviewed various year-end financial statements of Windermere Oaks Water Supply
17 Corporation, such as balance sheets, profit and loss statements, general ledgers, budgets
18 and tax returns for years 2017 through 2021. Additionally, I reviewed various provisions
19 of the Windermere Tariff..

20 Q. In your professional career as a CPA, have you prepared financial statements and/or audits
21 for any WSC's?

22 A. Yes, I have been involved in the preparation and/or review of financial statements for over
23 thirty different WSCs.

24 Q. If the answer above is yes, why type of work have you performed?

25 A. I have performed audits of financial statements, prepared and reviewed financial statements
26 and related reporting documents, and provided consultation on allowable expenses.

27 Q. Are you also a board member of a water supply corporation? If so, which one, for how long
28 and are you an officer?

29 A. Yes, I am a board member of the Armstrong Water Supply Corporation (Armstrong)
30 located in Holland, Texas. I am also an officer of the Corporation as the
31 Secretary/Treasurer. I have been a board member for Armstrong for over twenty-five
32 years. Armstrong has over one thousand water connections.

33

34 **I. PURPOSE OF TESTIMONY**

35

36 Q. Please summarize the matters you have been asked to address for purposes of your
37 testimony in this Docket?

38

39 A. I have been asked to analyze certain aspects of Windermere's appealed rates from an
40 accounting perspective for purposes of addressing in the initial inquiry all of the standards
41 prescribed under TWC § 13.043(j), as required by Remand Order signed June 30, 2022.

42

43 **II. SUPPLEMENTAL DIRECT TESTIMONY**

44

45 Q. Upon examining Windermere's financials is there anything which appears to be
46 problematic you have determined? If yes, please explain.

47 A. Yes. Windermere's balance sheets and profit and loss statements do not appear to be a fair
48 reflection of the company's operations. Specifically, it appears Windermere reports as

49 costs only expenses for which funds have actually been disbursed within a given period.
50 This is not a fair and accurate reflection of the company's actual costs, and therefore the
51 company's financial reporting would not be a reliable tool for rate analysis purposes. Also,
52 membership fees should be recognized as equity not liability. Also, during my many years
53 of reviewing financials for WSC's, I have never seen legal expense > 5% . Most WSC's
54 have legal expenses of < 2% or less. The documents presented to me for Windermere show
55 Windermere's incurred legal expenses percentages for each year as listed below.

56 2017 - \$2,247 1%

57 2018 - \$37,981 8.5%

58 2019 - \$166,583 31%

59 2020 - \$240,785 35%

60 2021 - \$265,402 37%

61 Q. Were you able to ascertain a revenue requirement amount that Windermere actually used
62 to determine the appealed rates?

63 [It does not appear that Windermere used a revenue requirement amount. Even if the
64 outside legal costs were somehow properly considered to be costs of service, there was no
65 proof that the \$20,000 per month figure Windermere's representative testified was used is
66 a reasonable and reliable approximation of the cost. On the contrary, according to the
67 testimony this figure was far less than the actual cost incurred by the company.]

68 Q. As a CPA, please explain fixed versus variable expense specific to legal expenses for a
69 WSC.

70 A. I have always considered legal fees to a variable expense. I have never seen a WSC or a
71 SUD have legal expenses which were based on a monthly retainer akin to a fixed expense.

72 Q. Based on your review of the 2019 Windermere financials does Windermere's legal
73 expenses appear to be fixed or variable expenses?

74 A. It appears Windermere's legal expense are variable in nature.

75 Q. In your experience with financials of WSC's how do these types of utilities recognize
76 incurred debt on financials?

77 A. Unpaid amounts to vendors are realized in the period (year) incurred and accrued as debt
78 to the various expense accounts and a credit to accounts payable.

79 Q. What are the benefits of using cash basis accounting for a WSC?

80 A. Easier for non-accountants to compile. Closely resembles a cash flow statement.

81 Q. When is it not beneficial to use cash basis accounting for a WSC?

82 A. Financial position and results of activities will not be fairly presented. Statements will be
83 misleading even with footnote disclosures.

84 Q. What form of accounting does Windermere use? Cash or Accrual?

85 A. The statements reviewed were cash basis.

86 Q. How does a Cash Basis Accounting affect test year expenses for a rate design?

87 A. If the cash basis year is historically aligned with prior years other than the "inflation creep"
88 cash basis would be acceptable, but not ideal.

89 Q. Have you prepared financials for a WSC which has utilized special assessments to recover
90 debt?

91 A. No, I have prepared and assisted with rate calculations for an unexpected major repair, and
92 it was only a one-time event.

93 Q. As a CPA and as a Secretary/Treasurer of a WSC what is your interpretation of how an
94 assessments/special assessments are utilized by these utilities?

95 A. Utilized rarely, expired after the assessment is achieved.

96 Q. Did you examine Windermere's tariff policy assessments?

97 A. Yes, item 11 in Section G of the tariff is the provision on Assessments. The section which
98 states "to be insufficient for the payment of all costs incident to the operation of the
99 Corporation's system" is only for the operation cost of providing water and sewer utility
100 services.

101 Q. Do you see issues with Windemere's financial reporting

102 A. You cannot report a true economic picture of water system when you are using a cash basis
103 accounting. Accrual is only the accounting properly to use to report an accurate report of
104 the operations on annual basis. Additionally, there are pitfalls with cash basis accounting.
105 It does not represent a true and accurate impression of their financials. The utility could
106 be dishonest with their reporting which would present a true representation of the financial
107 condition of the utility.

108 Q. How does Windermere's financial impact their Rate Design/Rate Making

109 When doing ratemaking and generating a revenue requirement difficulty to have a reliable
110 rate design when you rely on fictitious numbers. Additionally, attorney charges are variable
111 charges – they come and go so they are not fixed. Legal fees are not typically considered
112 ordinary and necessary otherwise. Therefore, legal expenses incurred can always be
113 manipulated with cash basis, hence on the rate design.

114

115 Q. Any other issues you see with Windermere accounting

116 A. Because of the way Windermere is doing their reporting, they only report amounts of
117 payments and therefore the financial reporting may or may not accurately reflect the cost
118 of any of the components of any of cost such as legal fees or treatment plant cost. Numbers
119 could be manipulated for the rates design and therefore categories on the rate design these
120 are not reliable for rate analysis purposes. These numbers might reflect expenses they
121 disperse but the not the actual true picture of the cost of the water system which makes
122 Windermere's financials as not ordinary and necessary expenses.

123 Q. What do you see as the impact to Windermere allowing customers to share water/sewer
124 service.

125 Infrastructure that is supposed to deliver water at 6/10 per minute per tap – demand delivery
126 is impacting when customers are allowed to share water service and effects the system, this
127 will impact the demand side and quite possible the financial side.

128 Share metering does not bare the cost of distribute cost of services as others who do not
129 share service. Hence the increase rates are not spread evenly across the one class.

130 Q. When have you seen legal fees included whether as fixed or variable for wsc's

131 A legal letter, TCEQ inquiries, responding to a site review (TCEQ complaint issues)
132 engineering issues, easements issues, overall attorney expenses never a big factor w/ wsc's.
133 Typical legal expenses are never material to the financial statements. With Windermere's
134 legal expense I have never seen this. These do not appear to be Ordinary and Necessary
135 expenses they do not provide any improve in services for water or sewer service.
136 Ordinary and necessary expenses do not include nefarious actions of board members.

137 These expenses are not tied to failures of Windermere to deliver water or sanitary service
138 to the customers.

139 Q. What do you see as an impact to Windermere with these continue legal expenditures

140 A. The legal fees have put Windermere in a position of growing concerns. Auditors growing
141 concerns issues what does that mean. They will cease operations if they continue. Always
142 say these statements present (don't understand what he is saying) sitting on big pile of legal
143 bills and decide to pay 25% that is what they pay. Retained earnings – no other equity
144 because they suck out it in legal fees. Nefarious activities of directors strongly suggest
145 these expenditures are not ordinary and necessary.

146 **III. CONCLUSION**

147 Q. Do have anything further to add?

148 A No