

CALIFORNIA PUBLIC UTILITIES COMMISSION
Water Branch

STANDARD PRACTICE FOR
ALLOCATION OF ADMINISTRATIVE AND GENERAL EXPENSES AND
COMMON UTILITY PLANT AND THE FOUR-FACTOR METHOD

Standard Practice U-6-W

SAN FRANCISCO, CALIFORNIA
Revised December 2003

The purpose of this Standard Practice is to set forth procedures for the allocation of administrative and general expenses and common utility plant among departments, districts and states. This memorandum relates to water companies.

A. ADMINISTRATIVE AND GENERAL EXPENSES

A. Initial Direct Assignments

Administrative and general expenses consist of both direct and indirect items of expense. The items applicable to specific operations are first segregated and assigned directly to those operations. It is especially important that effective measures be taken to assure that as many of these expenses as possible are assigned directly. The maintenance of timesheet records is the preferred basis for the direct assignment of salaries and related expenses of those employees who are engaged in work on more than one operation.

B. Indirect Allocations

Indirect general expenses, which have a significant relationship to a particular factor, such as pension expense to payroll, should be segregated and prorated on the basis of an appropriate single factor. The remaining indirect expenses may be so general in nature as to require pro-rations based on a combination of several pertinent factors. Considering the relative complexity and magnitude of the operations usually involved, it is believed that the application of the arithmetical average of the percentages derived from the use of four factors listed below produces results within the range of reasonableness in most instances. The four factors are as follows:

1. Direct operating expenses, excluding uncollectibles, general expenses, depreciation and taxes.
2. Gross plant.
3. Number of employees (using direct operating payroll, excluding general office payroll, as the best measure of this component).
4. Number of customers (subscribers for telephone).

The use of both operating expenses and gross plant as factors provides for the equitable allocation of indirect expenses where the commodity served may in some instances be purchases for resale and in other instances produced by utility plant. The gross plant factor appears more appropriate than net plant as general office activities are considered more closely related to total plant. The direct operating payroll factor gives effect to, and is used in lieu of, employee distribution. While payroll is also included in the operating expense factor, the additional weighting given this portion of expenses as the best measure of the employee factor seems proper. Gross revenues are not used, since the allocations are made for the purpose of fixing service rates and such revenues would change with a change in rates, thereby changing the allocated amounts.

The direct operating expenses and direct operating payroll factors will usually be based on data for the preceding year while the gross plant and customer factors will

ordinarily be based on data at the end of the preceding year. However, in deriving factors for use in the allocation of indirect general expenses for estimated future periods, data for a more recent 12-month period may be used if readily available. Naturally, judgment must be used if the company has an irrigation system with no end-of-year customers or if substantial changes in any of its operations have occurred between the period used for developing factors and the period during which expenses are being allocated. Typical examples of changes which have occurred are (1) changes in source of supply necessitating a sizeable change in plant and/or expenses, and (2) acquisition or disposal of one or more of the utility's systems. When such changes do occur, appropriate adjustments must be made in deriving allocation factors.

B. COMMON UTILITY PLANT AND ASSOCIATED EXPENSES

The allocation procedures applicable to common utility plant should also be used for depreciation expense, depreciation reserve, and ad valorem taxes related to common utility plant.

In general the staff recommends that allocations should be made on a use basis. Recognizing that often a use study involves considerable detailed work, it is recommended that the utilities be requested to make such a study at the time of a major rate proceeding or at intervals of three to five years unless, of course, major changes in common utility plant occur which indicate the need for a new study. Some information for a use study is available in the normal course of business from clearing account clearings and other sources, but much of the data must be worked up with each study. Briefly, the procedures contemplate that each item will be allocated between departments, districts, or states according to directly assignable use and that those portions which cannot be assigned directly will be allocated according to a use study or, where this is impracticable, according to the same factors used for administrative and general expenses. Buildings are to be considered according to floor space with appropriate weighting for basement and ground floors. Land is to be allocated according to the use of the buildings thereon. Office furniture and equipment are allocated in same ratios as buildings. Transportation equipment is allocated according to mileage and time records; communication equipment on a message unit or judgment basis; stores equipment, and materials and supplies according to last year's disbursements; and other equipment, when not directly assignable, allocated on basis of direct operation and maintenance, construction and plant removal labor.

Subject: Allocation of Administrative and General
Expenses and Common Utility Plant

1. The purpose of this memorandum is to set forth recommended procedures for the allocation of administrative and general expenses and common utility plant among departments, districts and states. This memorandum relates to gas, electric, telephone and water companies operating in California. See Section C for specific separation involving telephone and telegraph utilities for jurisdictional purposes.

A. ADMINISTRATIVE & GENERAL EXPENSES

Initial Direct Assignments

2. Administrative and general expenses consist of both direct and indirect items of expense. The items applicable to specific operations are first segregated and assigned directly to those operations. It is especially important that effective measures be taken to assure that as many of these expenses as possible are assigned directly. The maintenance of time records is recommended as a basis for the direct assignment of salaries and related expenses of those employees who are engaged in work on more than one operation.

Indirect Allocations

3. Indirect general expenses which have a significant relationship to a particular factor, such as pension expense to payroll, should be segregated and prorated on the basis of an appropriate single factor. The remaining indirect expenses may be so general in nature as to require prorations based on a combination of several pertinent factors. Considering the relative complexity and magnitude of the operations usually involved, it is believed that the application of the arithmetical average of the percentages derived from the use of four factors listed below produces results within the range of reasonableness in most instances. The four factors recommended by the staff are as follows:

- a. Direct operating expenses, excluding uncollectibles, general expenses, depreciation and taxes.
- b. Gross Plant.
- c. Number of employees (using direct operating payroll, excluding general office payroll, as the best measure of this component).
- d. Number of customers (subscribers for telephone).

4. The use of both operating expenses and gross plant as factors provides for the equitable allocation of indirect expenses where the commodity served may in some instances be purchased for resale and in other instances produced by utility plant. The gross plant factor appears more appropriate than not plant as general office activities are considered more closely related to total plant. The direct operating payroll factor gives effect to, and is used in lieu of, employee distribution. While payroll is also included in the operating expense factor, the additional weighting given this portion of expenses as the best measure of the employee factor seems proper. Gross revenues are not used, since the allocations are made for the purpose of fixing service rates and such revenues would change with a change in rates, thereby changing the allocated amounts.

5. The direct operating expenses and direct operating payroll factors will usually be based on data for the preceding year while the gross plant and customer factors will ordinarily be based on data at the end of the preceding year. However, in deriving factors for use in the allocation of indirect general expenses for estimated future periods, data for a more recent 12-month period may be used if readily available. Naturally, judgment must be used if the company has an irrigation system with no end-of-year customers or if substantial changes in any of its operations have occurred between the period used for developing factors and the period during which expenses are being allocated. Typical examples of changes which have occurred are (1) changes in source of supply necessitating a sizeable change in plant and/or expenses, and (2) acquisition or disposal of one or more of the utility's systems. When such changes do occur, appropriate adjustments must be made in deriving allocation factors.

B. COMMON UTILITY PLANT AND ASSOCIATED EXPENSES

6. The allocation procedures applicable to common utility plant should also be used for depreciation expense, depreciation reserve, and ad valorem taxes related to common utility plant.

7. In general the staff recommends that allocations should be made on a use basis. Recognizing that often a use study involves considerable detailed work, it is recommended that the utilities be required to make such a study at the time of a major rate proceeding or at intervals of three to five years unless, of course, major changes in common utility plant occur which indicate the need for a new study. Some information for a use study is available in the normal course of business from clearing account clearings and other sources, but much of the data must be worked up with each study. Briefly, the procedures contemplated that each item will be allocated between departments, districts, or states according to directly assignable use and that those portions which cannot be assigned directly will be allocated according to a use study of, where this is impracticable, according to the same factors used for administrative and general expenses. Buildings are to be considered according to floor space with appropriate weighting for basement and ground floors. Land is to be allocated according to the use of the buildings thereon. Office furniture and equipment are allocated in same ratios as buildings. Transportation equipment is allocated according to mileage and time records; communication equipment on a message unit or judgment basis; stores equipment, materials and supplies according to last year's disbursements; and other equipment, when not directly assignable, allocated on basis of direct operation and maintenance, construction and plant removal labor.

San Francisco, California

April 18, 1955

File No. S-1112

Subject: Allocation of Common Utility Plant and
Administrative and General Expenses

The attached tables have been prepared to summarize the utilities involved and the procedures being used to allocate common utility plant and administrative and general expenses between departments, districts, or states.

Table 1 presents allocation procedures for common utility plant. The same allocation method is also used for depreciation expenses, depreciation reserve, and ad valorem taxes related to common utility plant. In general the staff believes that allocations should be made on a use basis. Recognizing that often a use study involves considerable detailed work, it is proposed that the utilities be requested to make such a study at the time of a major rate proceeding or at intervals of three to five years unless, of course, major changes in common utility plant occur which indicate the need for a new study. Some information for a use study is available in the normal course of business from clearing account clearings and other sources, but much of the data must be worked up with each study. Briefly, the procedures contemplate that each item will be allocated between departments, districts, or states according to directly assignable use and that those portions which cannot be assigned directly will be allocated according to a use study or, where this is impracticable, according to the same factors used for administrative and general expenses. Buildings are to be considered according to floor space with appropriate weighting for basement and ground floors. Land is to be allocated according to the use of the buildings thereon. Office furniture and equipment are allocated in same ratios as buildings. Transportation equipment is allocated according to mileage and time records; communication equipment on a message unit or judgment basis; stores equipment and materials and supplies according to last year's disbursements; and other equipment, when not directly assignable, allocated on basis of direct operation and maintenance, construction and plant removal labor.

Table 2 presents a summary of procedures used in allocating certain indirect administrative and general expenses. General expenses consist of both direct and indirect items of expense. The items applicable to specific operations are first segregated and assigned directly to those operations. It is especially important that effective measures be taken to assure administrative and general expenses to assure that as many of these expenses as possible are assigned directly. The indirect expenses which have significant relationship to a particular factor, such as pension expense to payroll, are then segregated and prorated on the basis of an appropriate single factor. The remaining indirect expenses are so general in nature as to require a proration based on a combination of several pertinent factors, as shown in Table 2. It is believed that the application of the arithmetical average of the percentages derived from the use of four factors, namely, (1) Operating Expenses, excluding uncollectibles, general expenses, depreciation and taxes, (2) Gross Plant, (3) Direct Operating Payroll, excluding general office, and (4) Number of Customers, produced results within the range of reasonableness in most instances, in view of the relative complexity and magnitude of the operations usually involved. However, it is also considered desirable that time studies be conducted by the utilities, where practicable, at periodic intervals to test the reasonableness of the continued use of the four factors mentioned.

The use of both operating expenses and gross plant as factors provides for the equitable allocation of indirect expenses where the commodity served may in some instances be purchased for resale and in other instances produced by utility plant. The gross plant factor appears more appropriate than net plant in general office activities are considered more closely related to total plant. The direct operating payroll factor gives effect to, and is used in lieu of employee distribution, and while it is duplicated in the operating expense factor, the additional weighting given this portion of expenses seems proper.

The Separations Manual sets forth the procedures to be used for common utility plant and general expenses of telephone companies. While these methods have since been revised, the basic principles were considered by the Commission in Decision No. 36324 (44 CRC 676) decided May 4, 1943. In the opinion, the Commission stated that a

separation of telephone plant, revenue, and expense may be required for jurisdiction purposes as well as separating state operations between exchange and toll, separations among exchanges, and separations for determining settlements between telephone companies.

CLARENCE UNNEVEHR
Valuation Engineer

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Research Engineer

Attachments (2)

**Companies and Methods of Allocation
Of Common Utility Plant**

| Company | Ratio CUP to Total Plant | Method of Allocation | | |
|--------------------------------------------------------------------------------------------|-----------------------------------|-----------------------------------------|-----------------------------|-------------------|
| | | Currently Used on Company's Books | Used in Last staff study | Proposed |
| <u>Companies where Allocations Between Operating Departments are Involved</u> | | | | |
| California Pacific Util. Co. | 0.86% | Revenue | # | 4 factors & use |
| California Water & Tel. Co. | 0.06 | Plant ≠ CWIP Plant ≠ M&S | # | |
| Citizens Util. Co. of Calif. | 0.30 | Revenues | Plant | -- |
| Pacific Gas and Elec. Co. | 3.29 | Revenues in Ea. Div. | Use | Use |
| San Diego Gas & Elec. Co. | 4.71 | 4 factors incld. Rev. | 4 factors | Use* |
| Sierra Pacific Power Co. | -- | Exp., Demand, Energy | # | -- |
| So. California Water Co. | 2.78 | Gross Add., Cap., Cust. | # | -- |
| <u>Companies Where Allocations Between Districts of One Department are Involved</u> | | | | |
| California-Pacific Util. Co. | 0.86 | Revenue | # | 4 factors & use |
| California Water & Tel. Co. | 0.60 | Plant CWIP Plant M&S | # | Use |
| California Water Service | -- | Gross Plant | # | 4 factors |
| Citizens Util. Co. of Calif. | 0.30 | Revenues | Plant | -- |
| Los Gatos Telephone Co. | 10.12 | None | Plant | -- |
| Pacific Gas and Elec. Co. | 3.29 | Revenues in Ea. Div. | Use | 4 factors |
| San Gabriel Valley Wtr. Co. | 2.90 | 1/3 to Ea. Dist. | Plt., Cust., Exp. | -- |
| So. California Water Co. | 2.78 | Gross Add., Cap., Cust. | # | -- |
| <u>Companies Where Allocations Between Inter- and Intra-state is Involved</u> | | | | |
| California Elec. Power Co. | 0.37 | None | -- | -- |
| California Oregon Power | 10.40 | Plant, Demand, Energy | # | -- |
| California-Pacific Util. Co. | 0.86 | Revenue | # | -- |
| California Interstate Tel. Co. | -- | None | None | -- |
| Citizens Util. Co. (Tel. Dept.) | -- | Separations Manual | # | Separation Manual |
| The Pacific Tel. & Tel. Co. | 1.22 | Separations Manual | # | Separation Manual |
| Sierra Pacific Power Co. | -- | Exp., Demand, Energy | # | -- |

* Agreed to with company 2/9/55.

Indicates staff used company method in last prior proceeding.

** The same allocation method is also used for depreciation expense, depreciation reserve and ad valorem taxes for common utility plant

| Company | Method of Allocation | | |
|------------------------------------------------------------------------------|---------------------------------|--------------------------|-----------|
| | Currently Used on Company Books | Used in Last Staff Study | Proposed |
| Companies Where Allocations Between Operating Department are Involved | | | |
| California-Pacific Utilities Co. | A | # | B,D,E,F,0 |
| California Water & Telephone Co. | A,B,D,E,F | A,B,D,E,F | |
| Citizens Utilities Co. of California | A | A,B,D,E,G | |
| Pacific Gas and Electric Co. | A | A,B,D,E,F | B,D,E,F** |
| San Diego Gas & Electric Co. | A,B,E,G | # | B,D,E,F |
| Sierra Pacific Power Co. | | # | |
| Southern California Water Co. | H | H | H |

| | | | |
|-------------------------------------------------------------------------------------|-----------|-----------|------------|
| Companies Where Allocations Between Districts of One Department are Involved | | | |
| California-Pacific Utilities Co. | A | # | B,D,E,F,0 |
| California Water & Telephone Co. | A,B,D,E,F | A,B,D,E,F | |
| California Water Service Co. | B,E,G | C,D,E,G | B,D,E,F |
| Citizens Utilities Co. of California | A | A,B,D,E,G | |
| Los Gatos Telephone Co. | E | A,B,D,E | |
| Pacific Gas and Electric Co. | A | B,D,E | B,D,E,F,** |
| San Gabriel Valley Water Co. | I | B,D,E | |
| Southern California Water Co. | B,D,E | B,D,E | |

| | | | |
|--------------------------------------------------------------------------------|---|-------|-----------|
| Companies Where Allocations Between Inter- and Intra-state are Involved | | | |
| California Electric Power Co. | A | A,C,D | |
| California Oregon Power Co. | | # | |
| California-Pacific Utilities Co. | A | # | B,D,E,F,0 |
| California Interstate Telephone Co. | | # | |
| Citizens Utilities Co. of California | | | J |
| The Pacific Telephone and Telegraph Co | | J | J |
| Sierra Pacific Power Co. | | # | |

Notes: # - Allocation Factors:

- A Gross Revenue
- B Gross Plant
- C Net Plant (Gross plant less deprec. reserve)
- D Direct Expenses
- E Customers Meters, or Stations
- F Direct Operating Payroll
- G Number of Employees
- H Time Study
- I Use Study or Judgment
- J Separations Manual (Telephone Operations)

No recent staff study.

0 Use of C factor in lieu of B factor agree to with Company 1-17-1955
- Difference minor.

** Proposed to company by staff.