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**Missouri Public
Service Commission**

Exhibit No:

Issues:

AAO, Rate Base
Offsets, Prepayments,
Unbilled Revenues,
Payroll Incentives,
Commission
Assessments, Deposit
Interest, Rate Case
Expenses, TransUCU,
Dues & Contributions,
Advertising, Homeland
Security, Payroll Taxes,
Property Taxes

Witness:

Type of Exhibit:

Sponsoring Party:

Case No:

Date Testimony to be filed:

Richard G. Petersen
Direct Testimony
Aquila
August 1, 2003

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. _____

DIRECT TESTIMONY

OF

RICHARD G. PETERSEN

ON BEHALF OF

**AQUILA, INC.
d/b/a
AQUILA NETWORKS – MPS
and
AQUILA NETWORKS – L&P**

Omaha, Nebraska

August, 2003

Exhibit No. 17

Date 3/31/04 Case No. GR2004-002

Reporter XF

State of Nebraska)
) ss.
County of Douglas)

AFFIDAVIT OF RICHARD G. PETERSEN

Richard G. Petersen, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony and schedules entitled "Direct Testimony of Richard G. Petersen"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Richard G. Petersen

Subscribed and sworn to before me, this 21 day of July, 2003.

(SEAL)

Teresa A. Keefe
Notary Public

My Commission expires:

October 31, 2005

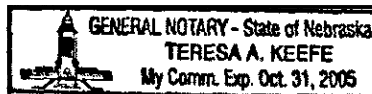


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1 **DIRECT TESTIMONY OF RICHARD G. PETERSEN**

2

3 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

4 A. My name is Richard G. Petersen and my business address is 1815 Capitol
5 Avenue, Omaha, Nebraska.

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by Aquila, Inc. (Aquila) in the Regulatory Services Group.
8 My position is Director of Regulatory Accounting-Gas.

9 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

10 A. I attended Dana College in Blair, Nebraska, from which I received a
11 Bachelor of Science Degree in Business Administration. I began working
12 for Northern Natural Gas Company and held various positions in the
13 accounting and regulatory departments. In 1985, UtiliCorp United Inc. (now
14 known as Aquila) purchased the Peoples Natural Gas Division from
15 Northern Natural Gas Company (known as InterNorth, Inc. at that time). I
16 have held various positions in the accounting areas within Peoples and
17 UtiliCorp United Inc. I assumed my current position in June 1998.

18 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE ANY**
19 **REGULATORY BODIES?**

20 A. Yes. I have filed testimony before the Iowa Utilities Board, the West Virginia
21 Public Service Commission, the Michigan Public Service Commission and
22 the State Corporation Commission of Kansas.

23 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

1 A. The purpose of my testimony is to present certain schedules in support of
2 the proposed tariffs filed by Aquila as required by the Minimum Filing
3 Requirements of the Commission.

4 **Q. PLEASE IDENTIFY THE SCHEDULES YOU ARE SPONSORING.**

5 A. I am sponsoring schedules RGP-1 through RGP-4 which generally consist
6 of financial and other information which supports the MPS and L&P revenue
7 requirements, as well as sponsoring Adjustments RB-40, RB-60, RBO-31,
8 RBO-50, WC-20, R-20, CS-2, CS-6, CS-40, CS-45, CS-50, CS-56, CS-60,
9 CS-65, CS-81, CS-85 and CS-90.

10 **Q. WERE THE SCHEDULES AND ADJUSTMENTS YOU ARE**
11 **SPONSORING PREPARED BY YOU OR UNDER YOUR SUPERVISION?**

12 A. Yes

13 **Q. ARE THE FACTS AND AMOUNTS CONTAINED IN THESE SCHEDULES**
14 **AND ADJUSTMENTS CORRECT TO THE BEST OF YOUR**
15 **KNOWLEDGE, INFORMATION AND BELIEF?**

16 A. Yes.

17 **Q. HOW DOES AQUILA MAINTAIN ITS BOOKS AND RECORDS?**

18 A. Aquila maintains its books and records in accordance with the Federal
19 Energy Regulatory Commission Uniform System of Accounts, as adopted
20 by the commission.

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Test Year

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Q. WHAT TEST YEAR DID AQUILA USE TO DEVELOP THE REVISED TARIFFS THAT ARE THE SUBJECT OF THIS CASE INVOLVING THE GAS PROPERTIES OF AQUILA LOCATED IN MISSOURI?

A. Aquila used the historical test year for the twelve months ending December 31, 2003. Also, Aquila is making certain adjustments to rate base, operating income and cost of capital in order to reflect changes through September 30, 2003 to make this test period more representative of the future periods during which the requested rate would actually be in effect.

Q. WHAT TYPE OF ADJUSTMENTS HAVE YOU MADE TO THE HISTORICAL TEST PERIOD?

A. The historical test period should be adjusted so that it will be representative of the period when the revised rates become effective. This requires the proper matching of rate base, operating expenses, and revenue in a consistent manner.

Q. PLEASE EXPLAIN THE FINANCIAL SCHEDULES THAT YOU ARE SUPPORTING.

A. Schedule RGP-1 contains the Revenue Requirements. Schedule RGP-2 reflects rate base. Schedule RGP-3 reflects the adjusted income statement. Schedule RGP-4 summarizes all adjustments and their respective witness.

Q. PLEASE FURTHER EXPLAIN THE FINANCIAL SCHEDULES.

A. Schedule RGP-1 calculates a revenue deficiency based on an assumed return on equity of 12.25%.

1 **Q. PLEASE CONTINUE.**

2 A. Schedule RGP-2 shows the detailed components of rate base, which is the
3 investment made by Aquila to provide gas service in the MPS and SJPL
4 service territories. Schedule RGP-3 provides the test year income
5 statement along with all known and measurable changes, resulting in the
6 net income available.

7 **Q. WHAT IS THE FINAL SCHEDULE?**

8 A. Schedule RGP-4 provides a brief description of all adjustments made to the
9 income statement, as well as indicating the sponsoring witness for that
10 adjustment. Various witnesses will be providing testimony supporting the
11 adjustments

12

13

Adjustments

14 **Q. PLEASE EXPLAIN THE ADJUSTMENTS YOU ARE SPONSORING.**

15 A. Certainly.

16

Accounting Authority Order-RB-40

17 **Q. WHAT IS ADJUSTMENT RB-40?**

18 A. RB-40 is the adjustment resulting from the Accounting Authority Order
19 (AAO) issued by the Commission in Case No. GO-91-359 on January 7,
20 1992.

21 **Q. WHAT IS THE PURPOSE OF AN AAO?**

22 A. An AAO is an order issued by the Commission, which permits the
23 requesting utility to defer certain costs on its books with the opportunity to

1 subsequently recover these costs through rates, versus being required to
2 expense these costs in the current period.

3 **Q. PLEASE DESCRIBE THE EXPENDITURES COVERED BY THE AAO IN**
4 **THAT ORDER.**

5 A. Aquila's primary request involved the cost of large projects associated with
6 its natural gas distribution properties. These projects were part of a major
7 gas safety program, and included a gas line replacement project.

8 **Q. WHAT IS THE STATUS OF THE REPLACEMENT PROGRAM?**

9 A. The initial phase of the project was completed in 1989 and 1990. The
10 project continued in 1991 and 1992. As a result of these projects a
11 significant increase in capital expenditures was experienced by Aquila.
12 Aquila requested and received permission from the Commission to defer the
13 depreciation expenses and carrying costs incurred with these safety
14 projects. These costs are deferred in account 182.3.

15 **Q. WHEN DID THE AAO BEGIN?**

16 A. In accordance with the Commission Order in Case No. GO-91-359, the
17 deferral began on January 1, 1991.

18 **Q. ARE COSTS CONTINUING TO BE DEFERRED DURING THE TEST**
19 **PERIOD?**

20 A. No. Capital expenditures for these projects had ended before the start of the
21 test period.

22 **Q. ARE THE COSTS ACCUMULATED BEING AMORTIZED?**

1 A. Yes. The costs deferred are being amortized over 20 years, and this
2 amortization is included in the test period.

3 **Q. WHAT ADJUSTMENT IS BEING PROPOSED?**

4 A. MPS' AAO addition to rate base includes the remaining unamortized
5 balance of deferred depreciation and carrying costs associated with the
6 safety expenditures previously deferred to account 182.3.

7 **Q. WHAT HAS BEEN THE TREATMENT OF THE UNAMORTIZED BALANCE**
8 **OF AAO'S AND AMORTIZATION EXPENSE IN THE PAST PROCEEDINGS**
9 **INVOLVING MPS?**

10 A. In Case No. GR-90-198, the Commission, via its October 18, 1990
11 Stipulation and Agreement, approved MPS' inclusion of the gas AAO
12 unamortized balance in rate base and the amortization of the deferral in the
13 cost of service. In Case No. GR-93-172, MPS was also allowed recovery of
14 both the unamortized balance of AAO's and related amortization expense
15 via the Stipulation and Agreement approved by the Commission August 13,
16 1993.

17 **L&P Central Office Building-RB-60**

18 **Q. WHAT IS THE PURPOSE OF ADJUSTMENT RB-60?**

19 A. RB-60 reflects the elimination from Rate Base of the L&P central office
20 building located in St. Joseph, Missouri. This building was sold January 2,
21 2003 as a result of consolidations that had taken place after the purchase of
22 L&P by Aquila. An adjustment to gross plant was made for \$(77,661).

23 **Q. DID YOU ALSO MAKE AN ENTRY TO RESERVES?**

1 A. Yes

2 **Accumulated Deferred Income Taxes-AAO-RBO-31**

3 **Q. DESCRIBE THE ACCUMULATED DEFERRED INCOME TAXES**
4 **ASSOCIATED WITH ACCOUNTING AUTHORITY ORDERS ("AAO").**

5 A. Included as an offset to rate base are deferred taxes related to AAO's that
6 were discussed earlier in this testimony. AAO's include charges that for
7 book purposes have been deferred over a specific period of time, yet for tax
8 purposes the charges have been deducted from income in the year of
9 occurrence. These tax timing differences are recorded as an offset to rate
10 base.

11 **Q. WHAT IS THE GAS ACCUMULATED DEFERRED INCOME TAX-AAO**
12 **RATE BASE OFFSET FOR MPS?**

13 A. The rate base offset totals \$497,998.

14 **Unamortized Investment Tax Credit-RBO-50**

15 **Q. WHAT IS THE PURPOSE OF ADJUSTMENT RBO-50?**

16 A. This adjustment is a reduction to rate base to reflect the offset for the
17 unamortized investment tax credit.

18 **Q. WHAT IS THE INVESTMENT TAX CREDIT?**

19 A. Investment tax credit (ITC) is recorded in FERC account 255. ITC was
20 created by the federal government to encourage plant investment by
21 allowing a company to directly reduce its taxes payable.

22 **Q. HOW WAS THE ADJUSTMENT COMPUTED?**

1 A. The adjustment applies only to MPS. \$5,458 of this credit in Account 255
2 applies to MPS gas operations. Unamortized investment tax credits are
3 treated as offsets to rate base investment under the assumption that these
4 ITC amounts represent a source of cost-free capital.

5 **Prepayments-WC-20**

6 **Q. WHAT IS THE PURPOSE OF WC-20?**

7 A. WC-20 adds to working capital the value of prepayments required for
8 operations. Prepayments have been included in rate base using a thirteen-
9 month average with the exception of prepaid pensions, which will not use
10 thirteen-month averaging due to the nature of its long-term implications and
11 future outlays. As a result of these prepayments, the funds are unavailable
12 for other cash uses, and so the value of the prepayments are treated as part
13 of Working Capital.

14 **Q. ARE PREPAYMENTS FROM ENTERPRISE SUPPORT FUNCTIONS**
15 **(ESF) ALLOCATED TO MPS AND L&P?**

16 A. Yes.

17 **Q. HOW WERE THESE AMOUNTS ALLOCATED?**

18 A. Prepaid insurance, for example, was allocated to MPS and L&P based on
19 percentages determined by the Risk Management group. Other
20 prepayments, such as prepaid pensions and software license agreements,
21 were allocated based on factors determined through the corporate allocation
22 process, which is more fully explained in the testimony of Company witness,
23 Bev Agut.

1 Q. WHAT IS THE AMOUNT OF THE ADJUSTMENT FOR PREPAYMENTS?

2 A. \$3,394,668 was added to rate base for MPS and \$3,066,567 was added to
3 rate base for L&P.

4 Unbilled Revenues-R-20 and Unbilled Purchase Cost CS-2

5 Q. WHAT IS THE PURPOSE OF ADJUSTMENTS R-20 AND CS-2?

6 A. R-20 reflects the elimination of the unbilled revenue adjustment from
7 revenues and CS-2 reflect the elimination of related purchases. This
8 adjustment is booked each month and reflects the estimated margin value
9 of volumes taken during the calendar month, but not yet billed due to cycle
10 billing. For purposes of this rate filing, the estimate of unbilled revenues and
11 related gas costs have been eliminated from the per book data for revenues
12 and purchases.

13 Miscellaneous Purchases CS-4

14 Q. WHAT MISCELLANEOUS PURCHASE ADJUSTMENTS ARE BEING
15 MADE IN ADJUSTMENT CS-4?

16 A. CS-4 adds to the test period gas purchases omitted that mainly relate to
17 Interdepartmental Sales and Lost and Unaccounted for Gas for Small
18 Volume Transportation. The amount of the adjustment for MPS is \$12,907.
19 For L&P, a reduction of \$(134,684) is being made to match gas costs with
20 revenue reported.

21 Payroll Incentive CS-6

22 Q. WHAT IS THE PURPOSE OF ADJUSTMENT CS-6?

1 A. CS-6 adjusts payroll to reflect the addition of the employee variable portion
2 of total payroll costs. The variable payroll component has been included at
3 the target payout level for the plan now in effect. Non-union employee
4 compensation consists of a fixed payroll component and the Variable
5 Compensation Plan.

6 **Q. WOULD YOU DESCRIBE THE VARIABLE COMPENSATION PLAN?**

7 A. Aquila's total employee compensation plan includes a fixed, base salary
8 subject to annual merit reviews, along with a variable or incentive pay
9 compensation plan. The variable compensation plan is tied to company-
10 wide performance on 4 critical objectives. These are customer service,
11 reliability, effective use of capital and safety, which are important
12 components related to serving our customers.

13 **Q. WHAT IS THE PURPOSE OF THE VARIABLE COMPENSATION PLAN?**

14 A. The plan intends to recognize the accomplishments of individual employees
15 who have exceeded goals developed to support the four critical operational
16 areas previously noted. In addition, Aquila intends to have a compensation
17 plan that supports the company in retaining and motivating the employees
18 required to operate and manage the company. Finally, by establishing a
19 lower fixed base pay component and using incentive pay to reward
20 exceptional performance, Aquila has reduced its benefit costs since benefits
21 are not calculated on the variable component of salary.

22 **Q. IS THERE AN OBJECTIVE RELATED TO THE COMPANY'S FINANCIAL**
23 **RESULTS?**

1 A. No.

2 **Q. PLEASE EXPLAIN THE DIFFERENT LEVELS OF PAY INCLUDED IN**
3 **AQUILA'S INCENTIVE PLAN.**

4 A. Aquila's incentive plan has four separate bands into which all eligible
5 employees are assigned. Each band reflects a maximum payout as a
6 percentage of the employee's base pay. Each band is subject to three
7 achievement levels—threshold (achieve 50% of the assigned target
8 accomplishments), target (achieve 100%) and max (achieve 150%)- which
9 are applied to the maximum payout percentage applied to the employee's
10 base pay.

11 **Q. HOW WERE THE INCENTIVE PAY ADJUSTMENTS CALCULATED?**

12 A. The incentive pay adjustments were assigned to the employees included in
13 the payroll annualization adjustment. For each employee eligible for the
14 incentive plan, the employee's base salary and wage as of January 30,
15 2003 was multiplied by the employee's target level of achievement
16 percentage. This represents an annualized level of incentive payments paid
17 to applicable employees directly assigned or allocated to MPS or L&P.
18 These payments were then assigned to FERC accounts based on the same
19 ratio as test year per book payroll amounts. The annualized level of
20 incentive payments was compared to test year per book amounts, and the
21 difference resulted in the incentive annualization adjustment.

22 **Q. WHAT WAS THE NEXT STEP?**

1 A. After assigning the incentive annualization adjustment to FERC accounts,
2 amounts were allocated to electric, steam and gas operations using product
3 allocations based on the FERC account. Adjustment amounts applicable to
4 capital and "below-the-line" FERC accounts were excluded from the
5 adjustment, leaving only gas jurisdictional amounts in the adjustment for
6 MPS and L&P.

7 **Q. WHY WAS THE TARGET LEVEL OF ACHIEVEMENT SELECTED TO**
8 **COMPUTE THE INCENTIVE ANNUALIZATION ADJUSTMENT?**

9 A. The target level represents the average incentive payout in a normal year.
10 By selecting the target level of achievement, average payouts associated
11 with incentive payments were annualized for MPS and L&P.

12 **Q. WHAT IS THE AMOUNT OF THE GAS INCENTIVE ANNUALIZATION**
13 **ADJUSTMENT?**

14 A. \$46,743 for MPS and \$5,613 for L&P, assigned to various FERC accounts.

15 **Commission Assessment-CS-40**

16 **Q. WHAT IS THE PURPOSE OF ADJUSTMENT CS-40?**

17 A. This adjustment updates Missouri Commission assessments in the test year
18 to the level currently experienced. The amount of the adjustment is
19 \$(19,845) for MPS and \$1,600 for L&P.

20 **Customer Deposit Interest-CS-45**

21 **Q. WHAT IS ADJUSTMENT CS-45?**

22 A. CS-45 adjusts Customer Deposit interest to a common level of 6%, as noted
23 in Aquila's tariff sheets on file with the Commission.

1 Q. WHAT IS THE AMOUNT OF THE ADJUSTMENT?

2 A. The adjustment is \$9,000 for MPS and \$2,306 for L&P.

3 Rate Case Expenses-CS-50

4 Q. WHAT IS THE PURPOSE OF ADJUSTMENT CS-50?

5 A. CS-50 determines the level of rate case expenses to be incurred during the
6 preparation and administration of the rate case. The cost of the case is
7 expected to total approximately \$280,000 for MPS and L&P.

8 Q. HOW DOES THE COMPANY PROPOSE TO RECOVER THESE COSTS?

9 A. An amortization of these expenses over a 3-year period is proposed. The
10 annual amortization amount is \$88,339 For MPS and \$5,047 for L&P.

11 TransUCU-CS-56

12 Q. WHAT IS ADJUSTMENT CS-56?

13 A. Adjustment CS-56 eliminates the costs related to the TransUCU travel
14 center and airplane costs that remained in the early portion of the test year.

15 Q. WHAT IS TRANSUCU?

16 A. TransUCU was an Aquila department that managed corporate aircraft and
17 other travel related expenses. The TransUCU travel center and company
18 airplanes were phased out by the middle of the 2002 test year as part of the
19 Company's restructuring process. Therefore, any costs remaining early in
20 the test year for these two costs areas have been eliminated.

21 Q. WHAT IS THE AMOUNT OF THE ELIMINATION?

22 A. \$89,038 was eliminated for MPS and \$13,319 for L&P.

Dues and Contributions-CS-60

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Q. WHAT IS ADJUSTMENT CS-60?

A. This adjustment eliminates most dues and contributions from the test period. Dues that remain in the test period include a company membership in the AGA. This is an industry association that directly benefits gas customers by encouraging the sharing of information between utilities regarding operations, safety and environmental issues.

Q. HAVE LOBBYING EXPENSES ASSOCIATED WITH AGA DUES BEEN ELIMINATED?

A. Yes. Lobbying costs identified as a percentage of total dues for AGA have been eliminated.

Q. WHAT IS THE AMOUNT OF THE ADJUSTMENTS?

A. For MPS the elimination is \$53,452 and for L&P the elimination is \$5,223.

Advertising-CS-65

Q. WHAT IS ADJUSTMENT CS-65?

A. CS-65 eliminates all advertising except informational and safety advertising that benefit gas customers of MPS and L&P.

Q. WHY IS THIS ADJUSTMENT BEING MADE?

A. The Commission and Staff require the separation of advertising into the five categories of general, safety, promotional, institutional and political. Only the reasonable costs for informational (general) and safety advertising remain in test year costs after this adjustment.

Q. WHAT ARE THE AMOUNTS ELIMINATED FOR ADVERTISING?

1 A. \$39,094 has been eliminated for MPS and \$4,581 eliminated for L&P.

2 **Homeland Security Act-CS-81**

3 **Q. WHAT IS THE REASON FOR ADJUSTMENT CS-81?**

4 A. This adjustment adds the costs required to be in compliance with the
5 provisions of the Homeland Security Act as they pertain to utilities. On
6 October 8, 2001 President Bush established the Office of Homeland
7 Security to produce a National Strategy for Homeland Security. Part of this
8 strategy involves protection of energy assets. This protection requires
9 utilities, like Aquila, to make certain investments in security systems, as well
10 as ongoing O&M expense dollars. These costs are required by the Act and
11 were not part of the test period, but are known and measurable
12 expenditures.

13 **Q. HOW WAS THIS COST CALCULATED?**

14 A. The Aquila Security Department performed an audit of the Company's
15 facility and Network security, and then identified and budgeted for, Capital
16 and O&M expenditures necessary to implement security measures
17 consistent with Homeland Security requirements. The Capital and O&M
18 expense dollars are included in rate base and cost of service schedules.
19 Only the cost increases resulting from the Homeland Security requirements
20 are included.

21 **Q. WHAT ARE THE COMPONENTS OF THE INCREASED COSTS?**

1 A. The costs reflect two main areas—Network and IT O&M costs, and
2 increases in contracted security staff or other contracts associated with
3 monitoring Aquila facilities.

4 **Q. WHAT IS THE AMOUNT OF THE O&M ADJUSTMENT FOR HOMELAND
5 SECURITY?**

6 A. \$9,467 for MPS and \$724 for L&P.

7 **Payroll Taxes-CS-85**

8 **Q. WHAT IS CS-85?**

9 A. CS-85 annualizes payroll taxes for the test year, and relates to the level of
10 the payroll annualization adjustment found in Adjustment CS-5.

11 Adjustments for the "Social Security Tax" (FICA and Medicare are included.

12 **Q. HOW WERE THESE ADJUSTMENTS CALCULATED?**

13 A. In 2003, only the first \$87,000 of an employee's compensation is taxed at
14 the FICA rate of 6.2%. A FICA payroll tax ratio and a FICA payroll and
15 incentive tax ratio were calculated to be applied to the total annualized
16 payroll and incentive amounts. Using the January 30, 2003 database, all
17 compensation dollars up to the limit of \$87,000 were totaled and divided by
18 the total compensation dollars to determine a FICA payroll tax ratio.
19 (5.72%). The FICA payroll and incentive tax ratio was computed by adding
20 incentive payments at the target level to payroll, and then proceeding with
21 the calculation in a similar manner to obtain the ratio (5.47%).

1 **Q. WHAT WAS THE NEXT STEP?**

2 A. These ratios were then applied to the adjusted annualized payroll, and
3 adjusted annualized incentive payments to calculate an annualized FICA tax
4 amount. This computed amount was then compared to the per book payroll
5 tax amounts to determine the total amount of the adjustment. The
6 appropriated jurisdictional factors were then applied to the adjustment to
7 obtain from the total MPS or L&P amount, the gas MPS or gas L&P
8 adjustment dollars.

9 **Q. HOW WAS THE MEDICARE ADJUSTMENT DETERMINED?**

10 A. The Medicare rate of 1.45% does not have a payroll dollar ceiling for the
11 employee. So, the 1.45% rate was applied to the adjusted payroll
12 annualization and to the adjusted incentive annualization amounts. The
13 result was compared to actual Medicare dollars for the test period in order to
14 obtain the amount of the adjustment. Appropriate jurisdictional factors were
15 applied to arrive at gas operation amounts.

16 **Q. WERE FURTHER CALCULATIONS REQUIRED?**

17 A. Yes. A capitalization ratio had to be applied to recognize that a portion of
18 payroll dollars and resulting payroll taxes are capitalized, thereby reducing
19 the amount of the payroll tax expense adjustment.

20 **Q. WHAT WAS THE NET PAYROLL TAX ADJUSTMENT?**

21 A. Payroll taxes increased by \$6,083 for MPS and decreased by \$(23,098) for
22 L&P.

Property Taxes-CS-90

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2 **Q. WHAT IS CS-90?**

3 A. Adjustment CS-90 adjusts the test year expense accrual to the level of
4 actual property tax currently experienced.

5 **Q. PLEASE EXPLAIN THE METHOD USED FOR ADJUSTING PROPERTY
6 TAXES.**

7 A. Property taxes actually paid during the test year ending December 31, 2002,
8 as stated by the Aquila Tax Department, were divided by the corresponding
9 level of tax asset base from which this tax was generated. The asset base
10 consists of direct and allocated plant in service, inventory, materials and
11 supplies inventory, undistributed stores expense, and gas storage. This
12 ratio was then multiplied by the asset base described previously. The result
13 was then compared to the per book property tax expense and an adjusted
14 level of expense was determined.

15 **Q. HAS THIS METHOD BEEN USED PREVIOUSLY?**

16 A. Yes. The Missouri Public Service Commission Staff used this method in
17 Case No. ER-01-672.

18 **Q. WHAT IS THE AMOUNT OF THE ADJUSTMENT FOR MPS AND L&P
19 PROPERTY TAXES?**

20 A. For MPS, the increase is \$292,171 and for L&P the increase is \$7,864.

21 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

22 A. Yes.



**Aquila Networks - MPS
Case No. GR-
Twelve Months Ended December 31, 2002**

Revenue Requirement

Line	(a)	Mid 9.739% Return (b)
1	Net Orig Cost of Rate Base (Sch 2)	\$ 59,037,931
2	Rate of Return	9.739%
3	Net Operating Income Requirement	\$ 5,749,409
4	Net Income Available (Sch 7)	\$ 2,286,881
5	Additional NOIBT Needed	3,462,528
6	Additional Current Tax Required	\$ 2,157,432
7	Required Deferred ITC	
8	Test Year Deferred ITC	
9	Additional Deferred ITC Required	\$ -
10	Total Additional Tax Required	2,157,432
11	Gross Revenue Requirement	<u>5,619,960</u>

Aquila Networks - L&P
Case No. GR-
Twelve Months Ended December 31, 2002

Revenue Requirement

Line	(a)	Mid 10.084% Return	(b)
1	Net Orig Cost of Rate Base (Sch 2)		\$ 7,891,459
2	Rate of Return		10.084%
3	Net Operating Income Requirement		\$ 795,735
4	Net Income Available (Sch 7)		\$ 296,436
5	Additional NOI/BT Needed		499,299
6	Additional Current Tax Required		\$ 311,103
7	Required Deferred ITC		
8	Test Year Deferred ITC		
9	Additional Deferred ITC Required		\$ -
10	Total Additional Tax Required		311,103
11	Gross Revenue Requirement		<u>810,403</u>



**Aquila Networks - MPS
Case No. GR-
Twelve Months Ended December 31, 2002**

Rate Base

Line	Line Description	Amount
No.	(a)	(b)
Total Plant :		
1	Total Plant in Service-MPS Only (Sch 3)	\$ 87,906,443
1a	Total Plant in Service-MPS' Share of UCU (Sch 3a)	4,971,344
	Total Plant	<u>92,877,786</u>
Subtract from Total Plant:		
2	Depr Reserve-MPS & UCU Share (Sch 5)	37,718,830
	Total Depreciation Reserve	<u>37,718,830</u>
3	Net Plant in Service	<u>\$ 55,158,957</u>
Add to Net Plant in Service		
4	Cash Working Capital	(572,143)
5	Materials and Supplies	1,607,139
6	Gas Storage	3,563,060
7	Prepayments	3,394,668
8	AAO Gas Pipe replacement	1,297,207
Subtract from Net Plant:		
9	Customer Advances for Construction	\$ 43,040
10	Customer Deposits	150,000
11	Deferred Income Taxes - Depreciation	4,645,543
12	Deferred Income Taxes - AAO	497,998
13	Unamortized Investment Tax Credit	5,458
14	Deferred Income Taxes - Synergies to MPS	68,917
15	Total Rate Base	<u>\$ 59,037,931</u>

Aquila Networks - L&P
Case No. GR-
Twelve Months Ended December 31, 2002

Rate Base

Line No.	Line Description (a)	Amount (b)
Total Plant :		
1	Total Plant in Service-SJLP Only (Sch 3)	\$ 7,883,656
1a	Total Plant in Service-SJLP' Share of UCU (Sch 3a)	<u>278,097</u>
	Total Plant	8,161,753
 Subtract from Total Plant:		
2	Depr Reserve-SJLP & UCU Share (Sch 5)	<u>3,603,477</u>
	Total Depreciation Reserve	3,603,477
3	Net Plant in Service	<u>\$ 4,558,276</u>
 Add to Net Plant in Service		
4	Cash Working Capital	(59,864)
5	Materials and Supplies	23,679
6	Gas Storage	931,475
7	Prepayments	3,066,567
8	\$	-
 Subtract from Net Plant:		
9	Customer Advances for Construction	\$ -
10	Customer Deposits	38,441
11	Deferred Income Taxes - Depreciation	590,233
12	Deferred Income Taxes - AAO	-
13	Unamortized Investment Tax Credit	-
14	Total Rate Base	<u>\$ 7,891,459</u>



Aquila Networks - MPS
Case No. GR-
Twelve Months Ended December 31, 2002

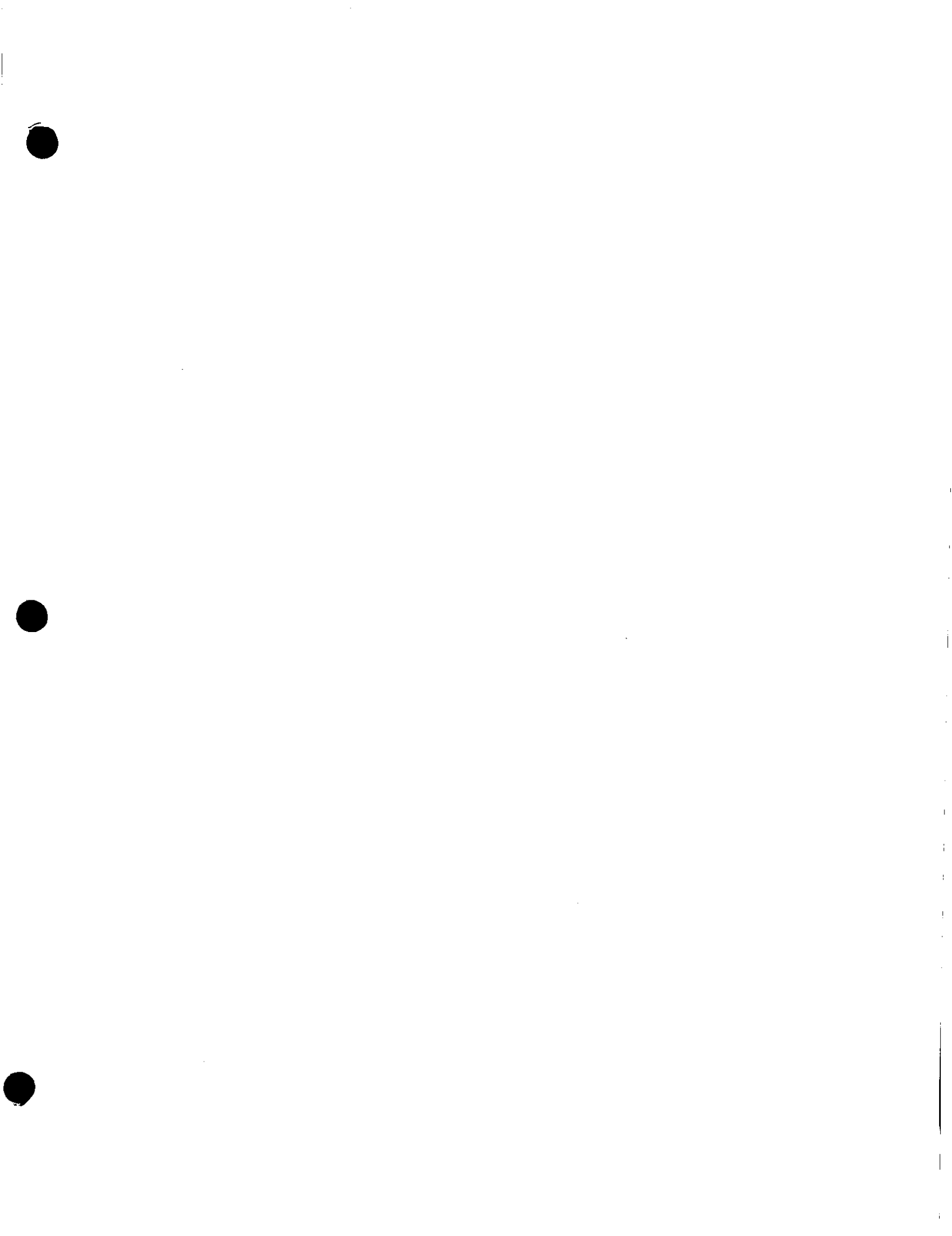
Income Statement

Line No.	Description (A)	Total Gas (B)	Adjustment (E)	Gas As Adjusted (F)
1	Operating Revenue	46,093,613	5,141,774	51,235,387
2	Operating Expenses:			
3	Production	29,520,514	3,068,616	32,589,130
4	Transmission	179,617	2,136	181,753
5	Distribution	3,657,153	(23,684)	3,633,469
6	Customer Accounting	2,220,139	(296,954)	1,923,185
7	Customer Services	116,038	(6,402)	109,636
8	Sales	62,612	(24,931)	37,681
9	A & G Expenses	5,568,067	(328,329)	5,239,738
10	Total O & M Expenses	41,324,140	2,390,452	43,714,592
11	Depreciation Expense	3,167,311	130,603	3,297,914
12	Amortization Expense	50,341	716	51,057
13	Taxes other than Income Tax	846,819	308,151	1,154,970
14	Net Operating Income before Tax:	705,002	2,311,852	3,016,854
15	Income Taxes	(1,172,698)	1,518,370	345,672
16	Income Taxes Deferred	200,581	226,212	426,793
17	Investment Tax Credit	(42,492)	-	(42,492)
18	Total Taxes	(1,014,609)	1,744,582	729,973
19	Total Net Operating Income	1,719,611	567,270	2,286,881

Aquila Networks - L&P
Case No. GR-
Twelve Months Ended December 31, 2002

Income Statement

Line No.	Description (A)	Total Gas (B)	Adjustment (E)	Gas As Adjusted (F)
1	Operating Revenue	5,710,328	352,466	6,062,794
2	Operating Expenses:			
3	Production	4,050,181	32,976	4,083,157
4	Transmission	-	-	-
5	Distribution	515,173	(9,801)	505,372
6	Customer Accounting	195,368	(3,249)	192,119
7	Customer Services	18,770	(965)	17,805
8	Sales	12,129	(4,022)	8,107
9	A & G Expenses	(165,303)	600,606	435,303
10	Total O & M Expenses	4,626,318	615,545	5,241,863
11	Depreciation Expense	278,966	30,442	309,408
12	Amortization Expense	5,882	-	5,882
13	Taxes other than Income Tax	135,984	(14,480)	121,504
14	Net Operating Income before Ta:	663,178	(279,041)	384,137
15	Income Taxes	85,769	(49,848)	35,921
16	Income Taxes Deferred	68,064	(14,041)	54,023
17	Investment Tax Credit	(2,243)	-	(2,243)
18	Total Taxes	151,590	(63,889)	87,701
19	Total Net Operating Income	511,588	(215,152)	296,436



AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
R-10	Customer & Weather Adj This adjusts test period revenues to reflect normal heating degree days and annualizes revenues for 2002 customer level Operating Revenues	Sullivan	\$ 2,172,385
R-15	Eliminate Provision for Rate Refund This adjustment reverses an entry originally booked during 2001 to defer incremental expense incurred and incremental revenues lost pending a decision in case No. GO-2202-175 for recognition of uncollectibles expense under the terms of 4 CSR 240-13.055(10)1. Operating Revenues	R. Petersen	\$ 500,000
R-20	Eliminate Unbilled Revenues This adjusts revenues to a billed basis. Operating Revenues	R. Petersen	\$ 2,169,946
R-25	Fee Revenue This adjustment reflects the addition or increase in service fees for connections, reconnections, special meter reads, collection fees, and charges for bad checks Operating Revenues	B. Amdor	\$ 299,443
CS-1	Customer & Weather Adj This adjusts test period purchases to reflect normal heating degree days and annualizes revenues for 2002 customer level Gas Purchases	T. Sullivan	\$ 1,560,296
CS-2	Eliminate Unbilled Purchases This adjusts test period purchases to match billed revenues. Gas Purchases	R. Petersen	\$ 1,495,408
CS-4	Miscellaneous Purchases This adjusts test period purchases for gas cost omitted from test period expenses related to Interdepartmental Sales, L&U on Small Volume Transportation, and other miscellaneous purchase adjustment. Gas Purchases	R. Petersen	\$ 12,907
CS-5	Payroll This adjustment annualizes payroll expense for the test year. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	A. Stichler	\$ 36,536

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-6	Incentive This adjustment annualizes incentive expenses to be paid at target levels Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	R. Petersen	\$ 46,743
CS-10	Restructuring This adjustment amortizes restructuring related expenses during the test year over three years. Production Transmission Distribution Administrative & General Taxes Other Than Income Taxes Total	J. Thomas	\$ (217,338)
CS-11	Employee Benefits This adjustment annualizes the MPS portion of employee benefits made on behalf of its employees. Administrative and General	H. Mikkelsen	\$ 49,506
CS-16	ESF/IBU Adjustments This adjustment updates the ESF and IBU corporate allocation factors to January 2003 drivers. Administrative and General	B. Agut	\$ (171,769)
CS-17	O&M L&P Merger Synergies This adjustment annualizes the O&M synergies resulting from the L&P Merger. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	V. Siemek/B. Agut	\$ 233,732
CS-35	Bad Debt Expense This adjusts bad debt expense to an annualized level based on a three year average rate times annualized revenue Customer Accounting Expense	H. Mikkelsen	\$ (356,854)

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-40	PSC Assessment This adjustment annualizes the PSC assessment to the most current assessment received. Administrative and General	R. Petersen	\$ (19,845)
CS-45	Customer Deposit Interest This entry annualizes the interest expense related to customer deposits. Customer Accounting Expense	R. Petersen	\$ 9,000
CS-50	Rate Case Expense This adjustment annualizes the expense related to the preparation of the rate case and amortizes it over 3 years. Administrative and General	R. Petersen	\$ 88,339
CS-56	Eliminate TransUCU This adjustment eliminates test year transportation related expenses allocated to MPS from TransUCU. Office Supplies and Expenses	R. Petersen	\$ (89,038)
CS-60	Dues and Donations This adjustment eliminates all dues and donations except AGA dues. Administrative and General	R. Petersen	\$ (53,452)
CS-65	Advertising Expense This adjustment eliminates all advertising except safety and informational . Production Distribution Customer Accounts Customer Service and Informational Expense Sales Expense Administrative & General Total	R. Petersen	\$ (39,094)
CS-81	Homeland Security This adjustment annualizes Homeland Security costs not included in the test year. Office Supplies and Expenses	R. Petersen	\$ 9,467
CS-83	Write-off Pre-2002 Miscellaneous Payroll Expenses This adjustment eliminates miscellaneous payroll costs written off in December 2002 associated with time periods prior to 2002 that are included in test year expenses. Office Supplies and Expenses	J. Thomas	\$ (179,771)

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-85	Payroll Taxes This adjustment annualizes FICA and Medicare tax expense Taxes Other Than Income Tax	R. Petersen	\$ 6,083
CS-90	Ad Valorem Taxes This adjustment annualizes Property taxes based on plant in service adjusted in this case. Taxes Other Than Income Tax	R. Petersen	\$ 292,171
CS-95	Depreciation This adjustment annualizes depreciation expense for plant additions through the known and measurable test period September 30, 2003. Depreciation Expense	B. Tangeman	\$ 427,867
CS-97	Depreciation - Eastern system This adjustment annualizes the impact on depreciation expense for the write-down of the Eastern System. Depreciation Expense	J. Bahr	\$ (310,972)
TAX-10A	Current Income Taxes Expense This adjustment annualizes the current income tax based on adjusted net operating income. Income Taxes, Operating Income	A. Stichler	\$ 1,518,370
TAX-10A	Deferred Taxes & ITC This adjustment annualizes deferred income tax associated with tax straight-line vs. tax timing differences. Deferred Income Taxes	A. Stichler	\$ 226,212

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
R-10	Customer & Weather Adj This adjusts test period revenues to reflect normal heating degree days and annualizes revenues for 2002 customer level Operating Revenues	T. Sullivan	\$ 244,192
R-20	Eliminate Unbilled Revenues This adjusts revenues to a billed basis. Operating Revenues	R. Petersen	\$ 82,135
R-25	Fee Revenue This adjustment reflects the addition or increase in service fees for connections, reconnections, special meter reads, collection fees, and charges for bad checks Operating Revenues	B. Amdor	\$ 26,139
CS-1	Customer & Weather Adj This adjusts test period purchases to reflect normal heating degree days and annualizes revenues for 2002 customer level Gas Purchases	T. Sullivan	\$ 167,660
CS-4	Miscellaneous Purchases This adjusts gas cost per book to gas costs in revenues from revenue reports Gas Purchases	R. Petersen	\$ (134,684)
CS-5	Payroll This adjustment annualizes payroll expense for the test year. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	A. Stichler	\$ (20,939)
CS-6	Incentive This adjustment annualizes incentive expenses to be paid at target levels Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	R. Petersen	\$ 5,613

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-10	<p>Restructuring This adjustment amortizes restructuring related expenses during the test year over three years. Production Transmission Distribution Administrative & General Taxes Other Than Income Taxes Total</p>	J. Thomas	\$ (23,206)
CS-11	<p>Employee Benefits This adjustment annualizes the L&P portion of employee benefits made on behalf of its employees. Administrative and General</p>	H. Mikkelsen	\$ 179,558
CS-16	<p>ESF/IBU Adjustments This adjustment updates the ESF and IBU corporate allocation factors to January 2003 drivers. Administrative and General</p>	V. Siemek/B. Agut	\$ (38,104)
CS-30	<p>Injuries and Damages Expense This adjusts Injuries and Damages to correct a product classification booked in error during the test period. Administrative and General</p>	J Thomas	\$ 527,284
CS-35	<p>Bad Debt Expense This adjusts bad debt expense to an annualized level based on a three year average rate times annualized revenue Customer Accounting Expense</p>	H. Mikkelsen	\$ (5,581)
CS-40	<p>PSC Assessment This adjustment annualizes the PSC assessment to the most current assessment received. Administrative and General</p>	R. Petersen	\$ 1,600
CS-45	<p>Customer Deposit Interest This entry annualizes the interest expense related to customer deposits. Customer Accounting Expense</p>	R. Petersen	\$ 2,306
CS-50	<p>Rate Case Expense This adjustment annualizes the expense related to the preparation of the rate case and amortizes it over 3 years. Administrative and General</p>	R. Petersen	\$ 5,097

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-56	Eliminate TransUCU This adjustment eliminates test year transportation related expenses allocated to L&P from TransUCU. Office Supplies and Expenses	R. Petersen	\$ (13,319)
CS-60	Dues and Donations This adjustment eliminates all dues and donations except AGA and Power Pool dues. Administrative and General	R. Petersen	\$ (5,223)
CS-65	Advertising Expense This adjustment eliminates all advertising except safety and informational . Production Distribution Customer Accounts Customer Service and Informational Expense Sales Expense Administrative & General Total	R. Petersen	\$ (4,581)
CS-81	Homeland Security This adjustment annualizes Homeland Security costs not included in the test year. Office Supplies and Expenses	R. Petersen	\$ 724
CS-83	Write-off Pre-2002 Miscellaneous Payroll Expenses This adjustment eliminates miscellaneous payroll costs written off in December 2002 associated with time periods prior to 2002 that are included in test year expenses. Office Supplies and Expenses	J. Thomas	\$ (27,906)
CS-85	Payroll Taxes This adjustment annualizes FICA and Medicare tax expense Taxes Other Than Income Tax	R. Petersen	\$ (23,098)
CS-90	Ad Valorem Taxes This adjustment annualizes Property taxes based on plant in service adjusted in this case. Taxes Other Than Income Tax	R. Petersen	\$ 7,864
CS-95	Depreciation - L&P Assets This adjustment annualizes depreciation expense for plant additions through the known and measurable test period September 30, 2003 Depreciation Expense	B. Tangeman	\$ 30,442

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
TAX-10A	<p>Current Income Taxes Expense This adjustment annualizes the current income tax based on adjusted net operating income. Income Taxes, Operating Income</p>	A. Stichler	\$ (49,848)
TAX-10A	<p>Deferred Taxes & ITC This adjustment annualizes deferred income tax associated with tax straight-line vs. tax timing differences. Deferred Income Taxes</p>	A. Stichler	\$ (14,041)