

Exhibit No.:

Issues: Payroll, Incentive,
Employee Benefits,
Insurance, Miscellaneous
Test Year Adjustment,
Payroll Tax and
Prepayments

Witness: Amy S. Murray

Sponsoring Party: Aquila Networks-MPS
& L&P

Case No.: ER-

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Before the Public Service Commission of the State of Missouri
Missouri Public Service Commission

Direct Testimony

of

Amy S. Murray

Exhibit No. 8
Case No(s) ER-2005-036
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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
DIRECT TESTIMONY OF AMY S. MURRAY
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-_____**

1 Q. Please state your name and business address.

2 A. My name is Amy S. Murray and my business address is 10700 East 350 Highway, Kansas
3 City, Missouri.

4 Q. By whom are you employed and in what capacity?

5 A. I am employed by Aquila, Inc. ("Aquila" or "Company"), as a Senior Regulatory Analyst.

6 Q. Please briefly describe your duties and responsibilities as a Senior Regulatory Analyst for
7 Aquila.

8 A. I am responsible for the preparation of financial and other statistical data in connection
9 with filings before regulatory bodies having jurisdiction over Aquila's operations.

10 Q. Please describe your educational background and experience.

11 A. In 1991, I received a Bachelor of Science Degree in Accountancy from the University of
12 Missouri-Columbia. In 1991, I joined State Street Bank (formerly "IFTC") holding
13 various positions of increasing responsibilities in the mutual fund accounting area. In
14 1996, I joined Aquila as a Senior Accountant in the General Ledger department. This
15 position involved journal entry preparation for the monthly close process, and account
16 reconciliation's. In 2000, I was promoted to Senior Accountant Experienced where I
17 became involved in the preparation of the annual budget and monthly operating reports
18 for senior management. In January of 2003, I joined Regulatory Accounting Services in
19 my current position.

20 Q. Have you previously testified before any regulatory bodies?

1 A. Yes. I have testified before the Kansas Corporation Commission.

2 Q. What is the purpose of your testimony in this proceeding?

3 A. The purpose of my testimony is to describe certain accounting adjustments made to
4 Aquila Networks – MPS (“MPS”) and Aquila Networks – L&P (“L&P”) rate filing.

5 Q. Please identify the schedules and any adjustments that you are sponsoring.

6 A. I am sponsoring the following adjustments for MPS & L&P:

- 7 • CS-5 Payroll Annualization Adjustment (MPS & L&P)
- 8 • CS-6 Incentive Annualization Adjustment (MPS & L&P)
- 9 • CS-11 Benefits Summary Schedule (MPS & L&P)
- 10 • CS-12 Benefits – Medical, Dental and Vision (MPS & L&P)
- 11 • CS-14 Benefits – OPEB (SFAS 106) Employer Share (MPS & L&P)
- 12 • CS-15 Benefits – 401k Adjustment (MPS & L&P)
- 13 • CS-16 Benefits – ESOP Adjustment (MPS & L&P)
- 14 • CS-17 Benefits – Long Term Incentive Plan Adjustment (MPS & L&P)
- 15 • CS-21 Insurance Adjustment (MPS & L&P)
- 16 • CS-83 Miscellaneous Test Year Adjustments (MPS & L&P)
- 17 • CS-85 Payroll Tax Adjustment (MPS & L&P)
- 18 • WC-20 Prepayments-other (MPS & L&P)

19 **Payroll Annualization Adjustment (CS-5)**

20 Q. Please explain the payroll annualization adjustment.

21 A. The payroll annualization adjustment includes employee headcount and wage levels that
22 are known and measurable as of March 15, 2005.

1 Q. Please explain how the adjustment was calculated.

2 A. Base salaries and wages, as of March 15, 2005, were obtained for all departments directly
3 charging MPS/L&P and departments that are allocated to MPS/L&P. The base salaries
4 and wages represent annual salaries of all applicable full-time and part-time employees.

5 Q. Why was March 15, 2005 employee salary and wage levels selected to annualize payroll
6 costs?

7 A. In order to allow for proper analysis and preparation of the payroll annualization
8 adjustment, data was required to be selected from a period in advance of the actual rate
9 case filing. Employee data from March 15, 2005 was the most current available at the
10 time of my analysis.

11 Q. Please continue with your explanation of the payroll annualization adjustment.

12 A. Base salaries and wages were added to "Other Than Standard" earnings that were actually
13 paid during the test period January 1, 2004 to December 31, 2004 resulting in total
14 payroll before allocations.

15 Q. What are examples of "Other Than Standard" earnings?

16 A. "Other Than Standard" earnings categorize labor costs that are price extras on an
17 employee's standard pay. Examples include shift differential, overtime and call out pay.

18 Q. Please continue with your explanation.

19 A. The next step involved analyzing the total payroll before allocations by department to
20 identify any direct charge-ins or charge-outs to other departments. Labor costs during the
21 test year that were directly charged to MPS/L&P were subtracted. These costs will be
22 added back later in the payroll model, to be explained below. Next, labor costs that were
23 directly charged out of MPS/L&P were subtracted from total payroll before allocations.
24 Then, costs from other departments not included in the payroll model that were directly

1 charged to MPS/L&P were added in. These new subtotals by department were directly
2 assigned to MPS/L&P where possible. When it was not possible to directly assign these
3 costs, cost assignments were made based upon December 2004 corporate cost allocation
4 factors. Please see the direct testimony of Aquila witness Ron Klote for the explanation of
5 corporate cost allocations. At this point, costs that had been subtracted previously for direct
6 charges to MPS/L&P were added back in order to reflect 100% of these labor dollars in the
7 payroll model. The resulting amounts were then multiplied by budgeted 2005 pay increases
8 for union employees only, this will be explained in greater detail below, to arrive at a total
9 payroll annualization amount for MPS/L&P.

10 Q. Please continue with your explanation.

11 A. Per book payroll amounts recorded as of December 31, 2004 were subtracted from this
12 annualization amount to arrive at an annualized payroll total. Then, capitalized payroll
13 and other non-operations and maintenance accounts were subtracted to obtain the overall
14 payroll annualization adjustment. The payroll annualization adjustment was then spread
15 to Federal Energy Regulatory Commission ("FERC") accounts based on the percentage of
16 test year per book payroll dollars by FERC account to total payroll dollars.

17 Q. Explain how the total payroll annualization adjustments for operation and maintenance
18 expenses were determined.

19 A. After the payroll annualization adjustments were calculated by FERC account, amounts
20 were allocated to electric, gas and steam utilities using product allocations based on
21 FERC account. The electric payroll adjustment was multiplied by a jurisdictional factor
22 to differentiate between expenses applicable to retail and wholesale rates for MPS only.

23 Q. What percentage pay increase was used for union and non-union employees?

24 A. For MPS/L&P union and Jeffrey Energy Center union employees (MPS only), a 3.00%
25 budgeted wage increase was used. At the time of the preparation of this testimony,

1 contract negotiations were taking place for these unions. Therefore, a current rate
2 schedule cannot be obtained for 2005. A 3.75% increase effective on March 1, 2005 was
3 used for Iatan union employees (L&P only). For non-union exempt and non-exempt
4 employees, the 2005 annual merit increase is already embedded in the March 15, 2005
5 base salary information.

6 Q. What were the electric payroll annualization adjustments for MPS and L&P?

7 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
8 the adjustment totals.

9 **Incentive Annualization Adjustment (CS – 6)**

10 Q. Describe Aquila's compensation system.

11 A. Aquila maintains a two-factor compensation system, which is comprised of a fixed
12 portion and a variable portion. The fixed portion is comprised of base salaries and wages.
13 The variable portion is comprised of incentive pay. By adding together the fixed and
14 variable components, a salary level that is comparable to market rates is obtained.
15 Aquila's Human Resources department conducts periodic market surveys to compare
16 Aquila's compensation levels to market rates. By linking a portion of an employee's
17 compensation to personal objectives, employees have the incentive to perform at a higher
18 level.

19 Q. Please identify the organizational objectives by which the incentive payments will be
20 determined.

21 A. The incentive pay plan is tied to the following organizational objectives that Aquila
22 believes are critical to all stakeholders. They include:

- 1 • Customer Service
- 2 • Reliability
- 3 • Effective Use of Capital
- 4 • Safety
- 5 • Process Improvement

6 Aquila's performance in each of these areas will be measured to determine what incentive
7 level an employee is eligible for during the reporting period. Then, based on the
8 employee's performance in regard to his or her personal goals, an annual incentive
9 payment is calculated.

10 Q. How were the incentive pay adjustments computed?

11 A. The March 2005 actual incentive payout was obtained by department for applicable
12 employees either directly assigned or allocated to MPS/L&P to represent an annualized
13 level of expense. The total incentive payments either directly assigned or allocated to
14 MPS/L&P were spread to FERC accounts based on the same ratio as test year per book
15 incentive amounts. The annualized level of incentive payments was compared to test year
16 per book amounts to compute the incentive annualization adjustment.

17 Q. Explain how the total incentive annualization adjustment for operation and maintenance
18 expenses was determined.

19 A. After the incentive annualization adjustments were spread to FERC accounts, amounts
20 were allocated to electric, gas and steam utilities using product allocations based on the
21 FERC account. The adjustments assigned or allocated to the electric product were
22 multiplied by the jurisdictional factor based on FERC account for MPS only.

1 Q. What were the electric incentive annualization adjustments for MPS and L&P?

2 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
3 the adjustment totals.

4 **Benefits Summary Schedule (CS-11)**

5 Q. Please explain the Benefits Summary Schedule.

6 A. This schedule includes several benefits adjustments:

- 7 • CS-12 Medical, Dental, and Vision
- 8 • CS-13 Pensions
- 9 • CS-13a Pension Costs – Annual provision and ERISA minimum
- 10 • CS-14 SFAS 106 Other Post Employment Benefits (“OPEB”)
- 11 • CS-15 401(k)
- 12 • CS-16 Employee Stock Option Plan (“ESOP”)
- 13 • CS-17 Long Term Incentive Plan (“LTIP”)

14 Q. Are you sponsoring adjustments CS-13 Pensions and CS-13a Pension Costs – Annual
15 provision and ERISA minimum?

16 A. No. For these adjustments, please see the testimony of Company witness Davis Rooney.

17 **Benefits – Medical, Dental & Vision (CS-12)**

18 Q. Can you please explain the adjustment made to the medical, dental and vision benefits?

19 A. Yes. The amounts recorded at December 31, 2004 were adjusted by the known health,
20 dental and vision plans priced at March 2005 rates.

21 Q. Where were the 2005 rates obtained?

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1 A. The 2005 medical, dental, and vision rates were provided by the Human Resources
2 department at Aquila. Aquila has elected to self-insure for the medical, dental and
3 prescription drug plans in order to minimize the cost of claims and administration. It is
4 more cost effective and therefore, benefits ratepayers to self-fund these plans rather than
5 insure such claims with health care providers. The amount of the increase in medical,
6 dental and prescription drug insurance premiums for 2005 comes from PriceWaterhouse
7 Coopers, and is based on historical claims data and applies medical trend factors to
8 calculate future premium rates. The vision plan and HMO medical plan are both insured
9 plans, and the respective insurance carriers determine the costs for these plans.

10 Q. What was the method used to adjust medical, dental and vision with the 2005 rates?

11 A. The benefit elections data by employee ID number, supplied by the Human Resources
12 department as of March 1, 2005, details the existing coverage election, coverage level,
13 and corresponding dollar amount of benefits coverage for each employee utilizing 2005
14 rates. This data was then summarized by department, and directly assigned to MPS/L&P
15 or allocated based on December 2004 allocation rates. The employer portion of medical,
16 dental and vision coverage cost was then totaled and compared to the December 31, 2004
17 per books as recorded level. Finally, the difference was multiplied by the capitalization
18 rate to arrive at medical, dental and vision amounts appropriately charged to expense.

19 Q. What is the capitalization rate?

20 A. The capitalization rate represents the portion of cost that is not operational or maintenance
21 in nature. Among those items not considered operational are all capital and balance sheet
22 accounts and other income/deduction ("below-the-line") accounts. Since a portion of these

1 benefit dollars are capitalized, the adjustment is decreased by a factor of one minus the
2 capitalization rate to arrive at only the portion of benefits that should be expensed in the test
3 year.

4 Q. Please continue with your explanation.

5 A. The adjustment was allocated to electric, gas and steam utilities using product allocations
6 based on the FERC account. The adjustments assigned or allocated to the electric
7 product were multiplied by the payroll jurisdictional factor for MPS only.

8 Q. What were the electric medical, dental, and vision adjustments for MPS and L&P?

9 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
10 the adjustment totals.

11 **Benefits – OPEB SFAS 106 (CS-14)**

12 Q. Please explain the components of SFAS 106 Other Post-Employment Benefits (“OPEB”)
13 adjustment.

14 A. The annual OPEB expense under SFAS 106 provided by Hewitt includes the employee
15 service costs, which are the estimated costs of benefits paid in the future, discounted to
16 the present year. The interest cost is the increase in the projected benefit obligation due
17 to the passage of time. Differences between the actuarial assumptions and actual
18 experience, the gains/losses, are amortized over five years. The expected return on assets
19 represents the increase in funds from interest, dividends, and realized and unrealized
20 changes in the fair market value of the plan in the year. Another component of the OPEB
21 adjustment is the transition obligation, which is the under funded and unrecognized
22 accumulated post-employment benefit obligation for all plan participants at the date

1 SFAS 106 is adopted. The prior service cost component results from amendments to the
2 pension plan.

3 Q. How were the components used in calculating the OPEB adjustment?

4 A. The following components were added together; service cost, interest cost, amortization
5 of transition amount, amortization of gain/loss, and amortization of prior service cost.
6 The expected return on assets was then subtracted out of this calculation to derive the
7 estimated OPEB expense. The direct and allocated portions of this expense were totaled
8 to arrive at a 2005 annualized OPEB amount for MPS/L&P. The difference between the
9 2005 annualized OPEB amount and the amount recorded on the books as of December
10 31, 2004 is used to calculate the adjustment. The adjustment was then multiplied by a
11 capitalization factor to eliminate OPEB costs that are capitalized. The adjustment was
12 allocated to electric, gas and steam utilities using product allocations based on the FERC
13 account. The adjustments assigned or allocated to the electric product were multiplied by
14 the payroll jurisdictional factor for MPS only.

15 Q. What were the electric OPEB adjustments for MPS and L&P?

16 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
17 the adjustment totals.

18 **Benefits 401K Adjustment (CS-15)**

19 Q. Can you describe Aquila's 401(k) plan?

20 A. Yes. Aquila provides its employees with an optional benefit known as the 401(k) plan.
21 The plan is administered by J.P. Morgan / American Century Retirement Plan Services.

1 The 401(k) plan is a retirement savings program that allows employees to invest a
2 percentage of their salary for retirement.

3 Q. Is there a portion that is matched by Aquila?

4 A. Yes. Aquila matches a portion of the funds invested by employees up to 6% of base
5 salary and wages.

6 Q. Describe the adjustment made to cost of service for 401(k) expense on adjustment CS-15.

7 A. The 6% matched portion, called 401(k) Employer Share, was calculated by taking the
8 401(k) balance, for test year end December 31, 2004, and dividing it by the per books
9 base pay, excluding incentives, for the same period to arrive at the overall percentage of
10 base pay matched by Aquila. This percentage was then multiplied by the annualized net
11 base pay as calculated in adjustment CS-5 to arrive at the annualized 401(k) cost. To
12 calculate the 401(k) adjustment, as recorded 401(k) charges were deducted from the
13 annualized 401(k) cost. This difference was then multiplied by the capitalization rate to
14 eliminate any costs that are capitalized from the adjustment. The adjustment was
15 allocated to electric, gas and steam utilities using product allocations based on the FERC
16 account. The adjustments assigned or allocated to the electric product were multiplied by
17 the payroll jurisdictional factor for MPS only.

18 Q. Why is the percentage not simply 6% of base salaries and wages?

19 A. Certain employees choose not to participate to the full 6% match for various reasons; this
20 has the effect of drawing down the overall percentage.

21 Q. What were the electric 401k adjustments for MPS and L&P?

1 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
2 the adjustment totals.

3 **Benefits - ESOP Contribution (CS-16)**

4 Q. How was adjustment CS-16, the ESOP contribution adjustment calculated?

5 A. The ESOP adjustment was calculated by taking an average 3% Company-wide
6 contribution level and multiplying it by the annualized base salaries and wages. The as
7 recorded at test year-end December 31, 2004 ESOP cost was subtracted from this total.
8 Then the capitalization rate was applied to obtain the ESOP adjustment. The adjustment
9 was allocated to electric, gas and steam utilities using product allocations based on the
10 FERC account. The adjustments assigned or allocated to the electric product were
11 multiplied by the payroll jurisdictional factor for MPS only.

12 Q. What were the electric ESOP adjustments for MPS and L&P?

13 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
14 the adjustment totals.

15 **Long-Term Incentive Plan Adjustment-LTIP (CS-17)**

16 Q. Please describe the purpose of a LTIP.

17 A. The LTIP is the variable compensation portion of executive salaries and wages where
18 awards are based on multi-year Company performance.

19 Q. Please describe how adjustment CS-17, the LTIP adjustment was calculated.

20 A. The as recorded amount for the test year-end, December 31, 2004 was eliminated from
21 the cost of service filing in this rate case proceeding. Therefore, the Company is not
22 requesting recovery of these costs in rates.

1 Q. What were the electric LTIP adjustments for MPS and L&P?

2 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
3 the adjustment totals.

4 **Insurance (CS-21)**

5 Q. Please explain cost of service adjustment CS-21 Insurance.

6 A. This adjustment annualizes insurance costs based on current policy premiums, which are
7 renewed at various times throughout the year. These premiums include the following
8 types of coverage: property, general liability, directors and officers, workers'
9 compensation, aviation, fiduciary liability, crime, employment practices, vehicles, finite
10 risk, and surplus lines tax. The premiums were directly assigned to MPS/L&P based on
11 the company's insurance assignment methodology developed at the beginning of 2005.
12 Additionally, cost assignments were made based upon December 2004 corporate cost
13 allocation factors for some of the premiums, which were assigned to a corporate allocated
14 department. The adjustment was calculated by taking the annualized direct and allocated
15 MPS/L&P premium costs, less the amount as recorded at December 31, 2004.

16 The adjustment was allocated to electric, gas and steam utilities using product allocations
17 based on the FERC account. The adjustments assigned or allocated to the electric
18 product were multiplied by the payroll jurisdictional factor for MPS only.

19 Q. What were the electric Insurance adjustments for MPS and L&P?

20 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
21 the adjustment totals.

Miscellaneous Test Year Adjustments (CS-83)

Q. Please explain adjustment CS-83.

A. CS-83 contains two separate types of adjustments to the as recorded per books at December 31, 2004. The first type includes adjustments to eliminate amounts from the cost of service filing in this rate case. This adjustment eliminates amounts that were recorded to incorrect FERC accounts in the test year during the allocation process (IBU Allocation). Also, a prior-period adjustment recorded on L&P's books during the test year is being eliminated as a part of CS-83.

Q. Please explain the second type of adjustment that is detailed in CS-83.

A. The second type of adjustment included in CS-83 details amounts that need to be added to the as recorded per book amounts at December 31, 2004. An entry was recorded to a corporate retained department during the test year instead of getting allocated to each jurisdiction based on the allocation factors. CS-83 includes MPS/L&P's share of this entry as a part of the cost of service filing in this rate case.

Q. What were the electric Miscellaneous Test Year adjustments for MPS and L&P?

A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for the adjustment totals.

Payroll Taxes Adjustment (CS-85)

Q. What types of payroll taxes are included in the payroll tax adjustment, CS-85 to the statement of operations?

A. The payroll tax adjustment includes Social Security Tax ("FICA") and Medicare taxes.

Q. How was the payroll tax adjustment calculated?

1 A. FICA

2 During 2005, the first \$90,000 of an employee's compensation will be taxed at the FICA
3 tax rate of 6.2%. Therefore, FICA payroll tax ratios had to be computed and applied to
4 the total annualized payroll. The FICA ratios were computed by using the salary and
5 wage database as of March 15, 2005. All salary and wage dollars up to a limit of \$90,000
6 were totaled and divided by the total salary and wage dollars to obtain the FICA payroll
7 tax ratios. The ratios computed were applied to the annualized payroll amounts to
8 compute a pro forma FICA tax amount. The FICA tax adjustments are the differences
9 between the pro forma FICA taxes and the as recorded test year FICA taxes. Finally, the
10 capitalization rate was applied to the adjustment total to eliminate that portion of the
11 FICA tax adjustment that pertains to non-operating expenses.

12 Medicare

13 Unlike the FICA tax rate, the Medicare tax rate of 1.45% does not contain a payroll dollar
14 ceiling. Therefore, the 1.45% was directly applied to total annualized payroll. The result
15 was compared to the Medicare tax recorded for the 12 months ending December 31,
16 2004. The difference between the annualized level of Medicare tax and the as recorded
17 Medicare tax represents the adjustment to Medicare taxes. This adjustment to operations
18 also takes into account the capitalization rate. The adjustment was allocated to electric,
19 gas and steam utilities using product allocations based on the FERC account. The
20 adjustments assigned or allocated to the electric product were multiplied by the payroll
21 jurisdictional factor for MPS only.

22 Q. What were the electric Payroll Taxes adjustments for MPS and L&P?

1 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-4 for
2 the adjustment totals.

3 **Prepayments – other (WC-20)**

4 Q. What was the method used to calculate prepayments – other than pensions, WC-20?

5 A. Prepayments have been included in rate base using a thirteen-month average. Prepayments
6 are a normal working capital rate base allowance as they represent an investment of funds,
7 i.e., cash outlay, made in advance of the future service period to which they apply. For
8 example, prepaid items such as prepaid insurance and prepaid software license have been
9 included in this calculation. The month-end balances were averaged for the months of
10 December 2003 through December 2004. For both MPS and L&P, the calculation includes
11 prepayments for MPS/L&P direct prepayments as well as the MPS/L&P allocated share of
12 common Enterprise Support Function (“ESF”) prepayments.

13 Q. Please explain why a thirteen-month average calculation was used.

14 A. The computation of a thirteen-month average serves as a better measure of investment rather
15 than the use of any one single month. Due to monthly fluctuations in the prepaid balance, no
16 single month is representative.

17 Q. How is MPS/L&P share of prepayments from ESF calculated?

18 A. MPS/L&P share of ESF prepayments consists of both prepaid insurance and prepaid software
19 license. MPS/L&P share of prepaid insurance is directly assigned if possible. Where
20 allocations of policy premiums are necessary, the MPS/L&P portions are calculated using
21 factors maintained by the Risk Management group. Prepaid software license costs relate to
22 software used company wide and cannot be directly identified as expenses related to a
23 specific business unit such as MPS/L&P. Therefore, an Enterprise Support Function

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1 allocation is applied to the ESF balance of prepaid software license to determine MPS/L&P
2 share. Company witness Ron Klote will explain this allocation procedure in detail within his
3 direct testimony filed in this case. The adjustment was allocated to electric, gas and steam
4 utilities using the net plant factor. The adjustments assigned or allocated to the electric
5 product were multiplied by the payroll jurisdictional factor for MPS only.

6 Q. What were the electric Prepayments adjustments for MPS and L&P?

7 A. Please see the testimony of Company witness Susan Braun, and her schedule SKB-2 for
8 the adjustment totals.

9 Q. Does this conclude your direct testimony?

10 A. Yes.

TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008