

Exhibit No. 26
Issue: Depreciation
Witness: Donald S. Roff
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2008-0093
Date Testimony Prepared: April 2008

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

Rebuttal Testimony

of

Donald S. Roff

April 2008

Empire Exhibit No. 26
Case No(s). ER-2008-0093
Date 5-12-08 Rptr KF

REBUTTAL TESTIMONY
OF
DONALD S. ROFF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2008-0093

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND BUSINESS**
2 **AFFILIATION.**

3 A. My name is Donald S. Roff and I am President of Depreciation Specialty
4 Resources. My business address is 2832 Gainesborough Drive, Dallas, Texas
5 75287.

6 **Q. ARE YOU THE SAME DONALD S. ROFF WHO SUBMITTED DIRECT**
7 **TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE EMPIRE**
8 **DISTRICT COMPANY ("EMPIRE")?**

9 A. Yes.

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. The purpose of my rebuttal testimony is to respond to issues concerning
12 depreciation rates and depreciation accounting raised in this case by Office of the
13 Public Counsel ("OPC") witness, Mr. William W. Dunkel, and the Missouri
14 Public Service Commission Staff ("Staff") witness, Mr. Mark Oligschaefer.

15 **Q. HAVE YOU PREPARED ANY SCHEDULES IN CONNECTION WITH**
16 **YOUR TESTIMONY?**

17 A. Yes. Rebuttal Schedule DSR-1 has been prepared to show a comparison of
18 theoretical reserves with the book reserves. Rebuttal Schedule DSR-2 has been

1 prepared to show the correct calculation of the annual depreciation accrual related
2 to reserve differences. Each will be discussed later in my rebuttal testimony.

3 **Q. WERE THESE SCHEDULES PREPARED BY YOU OR UNDER YOUR**
4 **DIRECT AND SUPERVISION?**

5 A. Yes, they were.

6 **Q. WHAT ARE THE ISSUES RAISED BY OPC WITNESS DUNKEL?**

7 A. Mr. Dunkel introduces the remaining life technique in Missouri and presents
8 arguments related to the use of theoretical reserves or actual accumulated
9 provision for depreciation ("book reserve") balances. For certain General Plant
10 accounts, he testified that I have been inconsistent and used the actual book
11 reserve when there is a reserve deficiency, not when there is a reserve surplus.

12 **Q. WHAT ARE "RESERVE DEFICIENCIES" OR "RESERVE**
13 **SURPLUSES"?**

14 A. To answer this question it would first be helpful to define a "theoretical reserve".
15 The "theoretical reserve" may be defined as an estimate of what should be in the
16 accumulated provision for depreciation today, considering the distribution of the
17 aged balances of the existing property, and assuming the correctness of the
18 assumed service life parameters and net salvage percentages. The theoretical
19 reserve is calculated by deducting from the original cost adjusted for net salvage
20 the estimated future accruals at the proposed depreciation rates and the estimated
21 future net salvage credits or charges. If this amount exceeds the book reserve, a
22 reserve deficiency exists. If this amount is less than the book reserve, a reserve
23 surplus exists.

1 **Q. SHOULD THESE TWO AMOUNTS NECESSARILY BE IN**
2 **AGREEMENT?**

3 A. No. The book reserve is a product of history and therefore represents the net sum
4 of all past debit and credit entries made into the accumulated provision for
5 depreciation account. The theoretical reserve is a prospective calculation.
6 However, the fact that these amounts are different may be cause for concern.

7 **Q. WHY?**

8 A. My general rule of thumb is if these amounts are greater than one year's normal
9 accruals, some adjustment may be required. I also would look at this difference
10 on a total company basis. Rebuttal Schedule DSR-1 has been prepared to show a
11 comparison of the theoretical reserve and the book reserve in the case of Empire.
12 In total, Empire has a reserve surplus of less than \$7 million compared to a total
13 book reserve of over \$455 million and a normal annual accrual of over \$37
14 million. No adjustment is therefore required.

15 **Q. EVEN IF THE REMAINING LIFE TECHNIQUE WERE TO BE**
16 **UTILIZED, HAS OPC WITNESS MR. DUNKEL CALCULATED THE**
17 **ADJUSTMENT CORRECTLY?**

18 A. No, he has not. Empire maintains its book reserve by account and/or subaccount
19 and has done so for quite some time. Mr. Dunkel reallocated the book reserve in
20 calculating his depreciation adjustment. This is improper. Therefore his
21 depreciation adjustment is incorrect.

22 **Q. CAN YOU PROVIDE THE CORRECT CALCULATION, ASSUMING**
23 **THAT THE REMAINING LIFE TECHNIQUE WOULD BE APPROVED**

1 **BY THE MISSOURI PUBLIC SERVICE COMMISSION**
2 **("COMMISSION") IN THIS PROCEEDING?**

3 A. Yes. Rebuttal Schedule DSR-2 has been prepared to show the correct calculation.
4 Thus, even if the remaining life technique were authorized, there would still be an
5 increase in annual depreciation expense over that produced by the existing
6 depreciation rates. I make reference to Table 1 in my Direct Testimony on
7 Schedule DSR-3. The remaining life depreciation expense would be \$36,368,864
8 (\$37,214,194 (from Schedule 1 Total Depreciable Electric Plant less \$845,330
9 from Rebuttal Schedule DSR-2), an increase of \$536,116.

10 **Q. MR. DUNKEL ALSO ASSERTS THAT YOU HAVE BEEN**
11 **INCONSISTENT AND ACTUALLY USED THE BOOK RESERVE IN**
12 **CALCULATING AN ADJUSTMENT FOR CERTAIN GENERAL PLANT**
13 **ACCOUNTS. HOW DO YOU RESPOND?**

14 A. Mr. Dunkel is partially correct, but not for the reasons he discusses. Empire is
15 seeking approval to use vintage amortization accounting for certain General Plant
16 accounts. This topic is addressed in my direct testimony.

17 **Q. WHY IS THIS CHANGE BEING PROPOSED FOR THESE ACCOUNTS?**

18 A. This change is being proposed for three reasons. First, these accounts generally
19 represent items of small dollar unit prices, with similar mortality characteristics.
20 Second, the percentage of total plant represented by these accounts is minimal,
21 only about two and one-quarter percent of total depreciable plant balances. Third,
22 the proposed method of accounting will eliminate the individual recording and

1 tracking by Property Accounting of thousands of items. Thus, the goal is to
2 utilize Property Accounting resources more efficiently.

3 **Q. IS EMPIRE REQUIRED TO FOLLOW THE FEDERAL ENERGY**
4 **REGULATORY COMMISSION ("FERC") UNIFORM SYSTEM OF**
5 **ACCOUNTS AS ADOPTED BY THE COMMISSION?**

6 A. Yes.¹

7 **Q. HAS THE FERC APPROVED VINTAGE AMORTIZATION**
8 **ACCOUNTING?**

9 A. Yes. The FERC granted blanket approval in Accounting Release AR-15.

10 **Q. DID YOU CHOOSE THE VINTAGE DEPRECIATION TECHNIQUES**
11 **THAT ARE FAVORABLE TO EMPIRE?**

12 A. No. The purpose of my calculation for the vintage amortization accounts was to
13 "true-up" the accumulated provision for depreciation balance. Vintage
14 amortization accounting results in the amortization of the vintage balance over its
15 useful life. These lives have been over-stated in the past, because retirements are
16 not made in a timely manner. The vintage amortization process results in the
17 proper retirement of each vintage balance at the end of its amortized life. My
18 calculation for the vintage amortization accounts produces the correct level of
19 amortization expense plus the true-up. This difference will be eliminated in four
20 years, and then only the vintage amortization amounts will apply. It should be
21 noted that both reserve deficiencies and reserve surpluses existed for these

¹ 4 CSR 240-20.030, Rules of Department of Economic Development, Page 6

1 accounts.

2 **Q. WHY DID YOU SELECT FOUR YEARS AS THE PERIOD OF THE**
3 **TRUE-UP?**

4 A. The four year period was selected to correspond to the timing of periodic
5 depreciation studies.

6 **Q. HOW WOULD YOU CHARACTERIZE VINTAGE AMORTIZATION**
7 **ACCOUNTING?**

8 A. It is a good process. This process eliminates the need for tracking thousands of
9 small dollar items that are difficult to account for. It provides an orderly process
10 for retiring and amortizing these asset categories, allowing the Property
11 Accounting department to devote more time to other duties.

12 **Q. DO MANY COMPANIES FOLLOW THIS APPROACH?**

13 A. Yes. The majority of the clients that I have dealt with follow this approach. To
14 the best of my knowledge, the following states have approved such an approach:
15 Alabama, Georgia, Florida, Wisconsin, Hawaii, Arizona, Mississippi, Nevada,
16 New Jersey, Oregon, Washington, Idaho, California, Utah, Wyoming, Montana,
17 Oklahoma, Colorado, and Minnesota.

18 **Q. WHAT IS THE DEPRECIATION ISSUE RAISED BY STAFF WITNESS**
19 **MR. OLIGSCHLAEGER?**

20 A. The Staff is proposing no change to the existing depreciation rates.

21 **Q. WHAT IS THE STAFF'S ARGUMENT?**

22 A. The Staff asserts that Empire is already being compensated in the form of the
23 regulatory amortization plan.

1 **Q. DO YOU AGREE?**

2 A. No. The regulatory amortization plan is not related to the appropriate
3 depreciation rates. As I understand the regulatory amortization plan, it results in
4 potential revenue adjustments as a function of helping Empire in maintaining
5 certain financial ratios. The regulatory amortization will then reduce future plant
6 in service when Iatan II and other environmental upgrades are placed in service.
7 The regulatory amortization plan will be addressed by Empire witness Robert
8 Sager. There is no link in the regulatory amortization plan to depreciation rates or
9 on assets already in service. I have conducted a thorough and complete
10 depreciation study, consistent with the basis for the existing depreciation rates.
11 There is no reason to ignore the results of this study, which was accomplished
12 within the periodic timeframe that has been Empire's practice. There is no reason
13 not to accept the results of my depreciation study simply because the regulatory
14 amortization tool exists. Retaining the existing depreciation rates simply because
15 of the regulatory amortization plan is not appropriate and has no basis in
16 depreciation theory, practice or policy. Even OPC witness Mr. Dunkel does not
17 challenge the results of my study, but rather only addresses the methodology
18 associated with the calculation of depreciation rates.

19 **Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

20 A. My rebuttal testimony addresses the issues of remaining life depreciation and
21 vintage amortization accounting discussed by OPC witness Mr. Dunkel. The
22 Commission has long endorsed the use of the whole life depreciation technique.
23 If this Commission approves the use of the remaining life technique, then it

DONALD S. ROFF
REBUTTAL TESTIMONY

1 should be implemented using the appropriate book reserve balances, not a
2 reallocation as proposed by Mr. Dunkel. I have demonstrated that the purpose of
3 the "true-up" for the vintage amortization accounts was not self-serving, but
4 rather tied to periodic depreciation reviews. I endorse the vintage amortization
5 accounting approach, and encourage this Commission to approve its use for
6 Empire. Such approval will result in a systematic and rational process for those
7 General Plant asset categories and will enable a better use of Property Accounting
8 resources. Finally, the Staff has not demonstrated any need for retaining the
9 existing depreciation rates and my recommended depreciation study rates remain
10 appropriate, and I iterate my study recommendations to approve new depreciation
11 rates.

12 **Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?**

13 **A. Yes.**

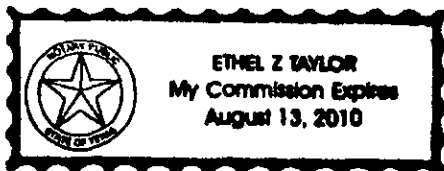
AFFIDAVIT OF DONALD S. ROFF

STATE OF TEXAS)
) ss
COUNTY OF DALLAS)

On the 31st day of March, 2008, before me appeared Donald S. Roff, to me personally known, who, being by me first duly sworn, states that he is the President of Depreciation Specialty Resources and acknowledged that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

Donald S. Roff
Donald S. Roff

Subscribed and sworn to before me this 31st day of March, 2008



Ethel Z. Taylor
Notary Public

My commission expires: August 13, 2010

REBUTTAL SCHEDULE DSR-1

**THE EMPIRE DISTRICT ELECTRIC COMPANY
COMPARISON OF RESERVE AMOUNTS @ DECEMBER 31, 2006**

<u>Function</u>	<u>Theoretical Reserve</u> \$	<u>Book Reserve</u> \$	<u>Difference</u> \$	<u>Normal Accrual</u> \$
Steam Production	72,400,588	103,335,068	(30,934,480)	4,331,421
Hydraulic Production	1,991,877	2,293,955	(302,078)	79,894
Other Production	39,127,278	69,350,008	(30,222,730)	6,747,943
Transmission Plant	81,296,597	57,013,621	24,282,976	5,343,191
Distribution Plant	241,453,584	206,315,660	35,137,924	19,339,746
General Plant	11,815,328	16,758,882	(4,943,554)	1,371,998
Total Electric Plant	<u>448,085,252</u>	<u>455,067,194</u>	<u>(6,981,942)</u>	<u>37,214,193</u>

REBUTTAL SCHEDULE DSR-2

**THE EMPIRE DISTRICT ELECTRIC COMPANY
COMPARISON OF DEPRECIATION RATES AND ANNUAL AMOUNTS**

[1] Account Number	[2] Description	[3] 12/31/2006 Theo. Reserve \$	[4] 12/31/2006 Book Reserve \$	[5] Remaining Life Yrs	[6] Annual Amount \$
<u>STEAM PRODUCTION PLANT</u>					
311.0	Structures & Improvements	6,470,755	8,661,408	58.02	(37,757)
312.0	Boiler Plant Equipment	42,140,208	62,899,279	40.01	(518,847)
312.1	Coal Cars	4,882,759	5,489,556	2.50	(242,719)
314.0	Turbogenerator Units	14,345,765	20,748,143	38.72	(165,351)
315.0	Accessory Electric Equipment	3,609,319	3,555,522	31.86	1,689
316.0	Misc. Power Plant Equipment	951,782	1,981,160	39.25	(26,226)
	Total Steam Production Plant	72,400,588	103,335,068		(989,211)
<u>HYDRAULIC PRODUCTION PLANT</u>					
331.0	Structures & Improvements	148,422	239,275	58.66	(1,549)
332.0	Reservoirs, Dams & Waterways	1,318,272	1,322,680	14.55	(303)
333.0	Waterwheels, Turbines & Generators	248,676	386,529	60.89	(2,264)
334.0	Accessory Electric Equipment	178,514	188,302	48.01	(204)
335.0	Misc. Power Plant Equipment	97,993	157,169	40.30	(1,468)
	Total Hydraulic Production Plant	1,991,877	2,293,955		(5,788)
<u>OTHER PRODUCTION PLANT</u>					
341.0	Structures & Improvements	2,595,737	3,856,677	45.22	(27,885)
342.0	Fuel Holders, Producers & Accessories	4,472,306	3,794,238	23.35	29,039
343.0	Prime Movers	21,899,522	42,382,604	37.95	(539,739)
344.0	Generators	7,439,896	13,297,506	39.98	(146,514)
345.0	Accessory Electric Equipment	1,455,041	2,893,533	53.93	(26,673)
346.0	Misc. Power Plant Equipment	1,264,776	3,125,450	50.15	(37,102)
	Total Other Production Plant	39,127,278	69,350,008		(748,873)
	Total Production Plant	113,519,743	174,979,031		(1,743,872)
<u>TRANSMISSION PLANT</u>					
352.0	Structures & Improvements	781,951	956,612	42.70	(4,090)
353.0	Station Equipment	26,743,014	28,339,591	35.83	(44,560)
354.0	Towers & Fixtures	543,932	728,199	34.18	(5,391)
355.0	Poles & Fixtures	18,491,840	12,215,983	39.93	157,171
356.0	Overhead Conductors & Devices	34,735,860	14,773,236	39.00	511,862
	Total Transmission Plant	81,296,597	57,013,621		614,992
<u>DISTRIBUTION PLANT</u>					
361.0	Structures & Improvements	3,673,342	3,206,981	43.34	10,761
362.0	Station Equipment	26,368,062	24,206,728	32.62	66,258
364.0	Poles, Towers & Fixtures	67,926,880	48,298,664	34.42	570,256
365.0	Overhead Conductors & Devices	61,626,016	40,553,223	44.24	476,329
366.0	Underground Conduit	4,134,815	6,685,692	35.42	(72,018)
367.0	Underground Conductors & Devices	12,602,145	14,080,733	22.08	(66,965)
368.0	Line Transformers	18,545,976	26,073,278	37.90	(198,610)
369.0	Services	33,966,580	25,335,853	32.55	265,153
370.0	Meters	4,379,940	6,061,647	33.08	(50,838)
371.0	Installations on Customers' Premises	4,757,511	7,280,613	19.14	(131,824)
373.0	Street Lighting & Signal Systems	3,472,317	4,532,248	35.51	(29,849)
	Total Distribution Plant	241,453,584	206,315,660		838,654
<u>GENERAL PLANT</u>					
390.0	Structures & Improvements	4,183,993	5,230,549	22.70	(46,104)
392.0	Transportation Equipment	2,467,815	5,708,172	7.77	(417,034)
396.0	Power Operated Equipment	5,163,520	5,820,161	7.14	(91,967)
	Total General Plant	11,815,328	16,758,882		(555,105)
	Total Depreciable Electric Plant	448,085,252	455,067,194		(845,330)