Exhibit No:	
Issues:	**Pensions, OPEBs, tax and ratemaking treatment for ADIT**
Witness:	**Alan D. Felsenthal**
Type of Exhibit:	**Direct Testimony**
Sponsoring Party:	**Spire Missouri Inc.**
Case No.:	**GR-2021-0108**
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SPIRE MISSOURI INC.

CASE NO. GR-2021-0108

DIRECT TESTIMONY

OF

ALAN D. FELSENTHAL

DECEMBER 11, 2020

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INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Alan Felsenthal. My business address is One North Wacker Drive, Chicago, Illinois, 60606.

Q. WHAT IS YOUR EMPLOYMENT?

A. I am a Managing Director at PricewaterhouseCoopers LLP ("PwC").

Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?[1]

A. I am submitting this testimony on behalf of Spire Missouri Inc. ("Spire" or "Company"), including its two operating units, Spire East and Spire West .

Q. PLEASE STATE BRIEFLY YOUR EDUCATIONAL BACKGROUND AND EMPLOYMENT EXPERIENCE.

A. I graduated from the University of Illinois in 1971 and began my career at Arthur Andersen & Co ("Arthur Andersen"), where I was an auditor, and focused on audits of financial statements of regulated entities. In 2002, I joined PwC and became a Managing Director in their Power and Utilities Group and continued performing audits for regulated entities. I was hired by Huron Consulting Group ("Huron") in 2008 and returned to PwC in November of 2010. At both Arthur Andersen and PwC, I supervised audits of financial statements on which the firms issued audit opinions that were filed with the SEC, the Federal Communications Commission, the Federal Energy Regulatory Commission ("FERC") and various state commissions. At Arthur Andersen, PwC and Huron, I

[1] This testimony was prepared in connection with the current Spire Missouri Inc. rate case and for the use and benefit of Spire Missouri Inc. PwC disclaims any contractual or other responsibility to others based on their access to or use of this direct testimony and the information contained herein.

consulted on a significant number of utility rate cases and helped develop testimony for myself and others on a variety of issues, including construction work in progress in rate base, projected test years, lead-lag studies, cost allocation, several accounting issues (e.g., pension accounting, regulatory accounting, income tax accounting, cost of removal) and compliance with the income tax normalization requirements.

Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AT PWC.

A. I am currently a member of the firm's Complex Accounting and Regulatory Solutions ("CARS") practice which focuses on rate-regulated utility accounting, tax and ratemaking issues. Throughout my career, my focus has been on the regulated industry sector, primarily electric, gas, telecommunication and water utilities. I have focused on utility accounting, income tax and regulatory issues, primarily as a result of auditing regulated enterprises. The unique accounting standards applicable to regulated entities embodied in Accounting Standards Codification ("ASC") 980, Regulated Operations (formerly, Statement of Financial Accounting Standards ("SFAS″) 71, SFAS 90, SFAS 92, SFAS 101 and various Emerging Issues Task Force ("EITF") issues, all need to be understood so that auditors can determine whether a company's financial statements are fairly presented in accordance with generally accepted accounting principles ("GAAP"). I have witnessed the issuance of these standards and have consulted with utilities as to how they should be applied. At both Arthur Andersen and PwC, I worked with the technical industry, accounting and auditing leadership to communicate and consult on utility accounting and audit matters. My curriculum vitae is attached as Exhibit A.

Q. HAVE YOU PREVIOUSLY TESTIFIED OR SUBMITTED TESTIMONY BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION") OR ANY OTHER REGULATORY COMMISSION?

A. Yes. While I have not testified in Missouri, I have testified before the Arizona Corporation Commission, the Florida Public Service Commission, the Hawaii Public Utilities Commission, the Illinois Commerce Commission, the Indiana Utility Regulatory Commission, the Maine Public Utilities Commission, the Public Utility Commission of Ohio, the Public Utility Commission of Texas, the Public Service Commission of Utah, the Washington Utilities and Transportation Commission and FERC. My curriculum vitae lists the various issues and testimony I have presented as well as the jurisdiction.

Q. HAVE YOU PROVIDED TRAINING ON THE APPLICATION OF GAAP TO REGULATED ENTERPRISES?

A. Yes. At Arthur Andersen, Huron and PwC, I developed and instructed utility accounting seminars focusing on the unique aspects of the regulatory process and the resulting accounting consequences of the application of GAAP. I have presented seminars as well as delivered training on an in-house basis. Seminar participants have included utility company and regulatory commission staff accountants, utility rate departments and internal auditors, tax accountants and others. I have also conducted these seminars for FERC and several state commissions and presented at various Edison Electric Institute and American Gas Association ratemaking and accounting seminars. The income tax training programs I have presented include topics such as the normalization requirements for public utilities in the Internal Revenue Code ("IRC"), protected and unprotected deferred taxes and the mechanics and application of the Average Rate Assumption Method ("ARAM").

PURPOSE OF TESTIMONY

Q. WHAT ISSUES ARE YOU ADDRESSING IN THIS CASE?

A. My testimony will:

- Provide a summary of the accounting and ratemaking for pension and postemployment benefit ("OPEB") costs;
- Describe the Company's request for recovery of pension and OPEB costs including both the test year pension and OPEB contributions as well as the rate base treatment and amortization of the pension and OPEB regulatory asset/liability;
- Explain why it is appropriate to allow recovery of contributions to the pension trust at an amount above the minimum funding required under The Employee Retirement Income Security Act of 1974 ("ERISA**"**);
- Provide a background on the accounting and ratemaking for income taxes, including Accumulated Deferred Income Taxes ("ADIT");
- Describe the changes to the IRC resulting from the Tax Cuts and Jobs Act of 2017 ("TCJA") and the general impact of the changes on regulated utilities;
- Explain the ratemaking treatment proposed by the Companies for "protected" excess ADIT and how such treatment complies with the TCJA requirement for such excess including the ratemaking treatment of the difference between amounts returned to customers since the last rate case based on estimates and the amounts that should have been returned in this period if the actual protected excess ADIT amounts were known at the time; and
- Explain the ratemaking treatment proposed by the Companies for "unprotected" excess ADIT including the ratemaking treatment of the difference between amounts returned to customers since the last rate case based on estimates and the amounts that should have been

returned in this period if the actual unprotected excess ADIT amounts were known at the time.

Q. ARE THERE EXHIBITS OR SCHEDULES ATTACHED TO YOURTESTIMONY?

A. Yes. The schedules I am supporting are attached in the following Exhibits attached to my testimony:

Exhibit A –Curriculum Vitae of Alan Felsenthal

Exhibit B – Average Rate Assumption Method Example

These schedules and the calculations reflected therein were prepared by me or under my supervision and direction. I will refer to and explain each of the schedules in my testimony.

PENSIONS AND OPEB ACCOUNTING AND FUNDING REQUIREMENTS

Q. PLEASE BRIEFLY SUMMARIZE THE ACCOUNTING FOR PENSIONS UNDER GAAP.

A. For accounting purposes under GAAP, an employee's pension is "accrued" (recognized as an expense) over the employee's service life. In that manner, a portion of the pension that is "earned" each year by the employee providing service for that year is an expense of that year. Estimates of the amount that the employee will eventually receive as a pension payment are developed by actuaries considering how long the employee will live after retirement, the promised benefits, etc. The expense is recognized each year of the employee's service life with a corresponding increase to the pension liability. Once the employee retires, his/her service cost expense accrual is stopped. At this point, pension payments begin. Adjustments for non-service cost, for true-ups from estimated to actual experience, will continue until the liability promised to the retiree is fully met and paid.

The journal entry to record pension expense is:

Dr. Pension Expense XXX

Cr. Accrued Pension Liability XXX

Q. HOW IS THE PENSION COST FUNDED? IS THE FUNDING BASED ON GAAP?

A. No. Apart from the determination of pension expense for GAAP, companies must be able to fund the future retiree payments. It is a prudent business decision to put away amounts prior to the time such retiree payments are to occur and most companies have established a pension trust to accomplish this. This is the "funding" part of the equation. Pension funding is based on requirements established by the Federal Government known as the ERISA laws. ERISA laws govern pension trust funding. The IRS sets minimum and maximum funding requirements and imposes penalties and other limitations for less well-funded pension plans. The Pension Protection Act of 2006 (PPA) expanded on the protections provided by ERISA and increased the cost to companies that underfund pension plans through insurances premiums paid to the Pension Benefit Guarantee Corporation ("PBGC").

The journal entry to record a contribution to the pension trust is:

Dr. Accrued Pension Liability XXX

Cr. Cash XXX

While the ERISA funding rules are complex, it is most important to understand the ERISA objectives. The reason Congress passed ERISA was because of outside pressures resulting from companies being unable to pay the promised pensions to rank-and-file workers. One of the highest profile examples was the Studebaker Corporation, which closed its South Bend, Indiana, facility in 1963. Because its pension plan was woefully underfunded, thousands of vested Studebaker employees received just a small portion of benefits earned

and many others received nothing. While the ERISA funding requirements apply to corporate pension plans, they do not apply to public or governmental plans and that is why a number of states and municipalities have to deal with the well-publicized, negative consequences of significant unfunded pension benefits due their employees.

Q. HOW DO THESE CONTRIBUTIONS IMPACT RATEMAKING?

A. Assets in the pension trust cannot be removed for any purpose other than retiree pension payments. Amounts in the fund can be invested in securities and other vehicles to earn a return—thus reducing the amount that eventually needs to be contributed to the fund in order to have enough cash accumulated to pay the retiree benefits once they begin. If, for example, $50,000 was needed to fund pension benefits for an employee that will retire in 10 years (the payments beginning in year 11), it is possible to contribute less than $50,000 to the pension trust as long as the earnings on the amounts invested produce the required $50,000 when payment to the retiree becomes due. Further, the sooner that contribution is made, the longer that contribution is available to earn within the plan; thus, allowing a lower overall contribution. The sooner and greater the contribution, the less the company will be required to contribute over time to be able to make the pension payments. As a result, and importantly from a ratemaking standpoint, pension trust earnings reduce ongoing annual pension expense. As pension expense is included as a recoverable cost in the ratemaking process, these trust earnings accrue to the benefit of customers. Similarly, in Spire's case where contribution amounts have historically been included in the determination of cost of service, larger contributions earlier in an employee's service period will reduce the total amount of contributions required and, therefore, lower the amount required to be collected from customers over time.

For example, assume an employee is expected to receive a benefit payout when they retire in 20 years of $50,000 and that the annual return on plan assets is 10%.

Scenario One: Contribute $7,000 at the beginning of year one.

$7,000 X (1 + 10%)^20 = $47,092.50

In this scenario, after 20 years there will be $47,092.50 in the trust to use to pay the benefit such that only $2,907.50 will need to be contributed in year 20 to pay the benefit.

Scenario Two: Contribute $3,500 at the beginning of year one.

$3,500 X (1 + 10%)^20 = $23,546.25

In this scenario, after 20 years there will be only $23,546.25 in the trust to use to pay the benefit such that an additional $26,453.75 must be contributed in year 20 to pay the benefit.

In summary, as a result of only contributing $3,500 more to the trust in year one, the total contributions required to pay the benefit are $20,046.25.25 less (after considering the additional $3,500 starting contribution). As a result, regardless of whether pension expense or contributions are included in determining the revenue requirement, the total revenue requirement will be less if higher contributions are made earlier.

Q. PLEASE SUMMARIZE THE DIFFERENCE BETWEEN PENSION ACCOUNTING AND PENSION CONTRIBUTIONS.

A. Pension accounting is based on GAAP and follows an accrual concept, while pension funding/contributions are based, in part, on the requirements of ERISA. It is important to understand that there is no correlation between pension accounting and pension funding under ERISA. In a paper on the subject of pensions prepared by the Pension Committee of

the American Academy of Actuaries, it states clearly that "amounts calculated under pension funding rules are completely different than those calculated for pension accounting, and one must be careful not to mix the two topics." [2]

In addition, in the Basis for Conclusions in Statement of Financial Accounting for Pensions No. 87, Employer's Accounting for Pensions the Financial Accounting Standards Board (FASB), as codified in ASC 715, stated:

> "This Statement reaffirms the APB's conclusion that funding decisions should not necessarily be used as the basis for accounting recognition of cost. The amount funded (however determined) is, of course, given accounting recognition as a use of cash, but the Board believes this is one of many areas in which information about cash flows alone is not sufficient, and information on an accrual basis is also needed. **The question of when to fund the obligation is not an accounting issue**. It is a financing question that is properly influenced by many factors (such as tax considerations and the availability of attractive alternative investments) that are unrelated to how the pension obligation is incurred." (Emphasis added).

When a company makes contributions in excess of GAAP pension expense, a prepaid pension asset results. The amount of that prepaid pension asset is the cumulative amount of contributions in excess of cumulative GAAP pension expense.

Q. PLEASE PROVIDE A SIMPLIFIED EXAMPLE TO ILLUSTRATE THE ACCOUNTING AND FUNDING REQUIREMENTS?

[2] See Fundamentals of Current Pension Funding and Accounting For Private Sector Pension Plans, an analysis by the Pension Committee of the American Academy of Actuaries, July 2004.

A. Assume that cumulative GAAP pension expense is $100 and cumulative pension contributions (pursuant to ERISA) are $150. The journal entry to record the pension expense and pension contribution is:

Dr. Pension Expense $100

Cr. Accrued Pension Liability $100

Dr. Accrued Pension Liability $150

Cr. Cash $150

The net position on the GAAP balance sheet is a $50 prepaid pension asset. The above example does not include the ultimate payments made to the pensioners after they retire – which will come from the pension trust – such payments to retirees from the trust are not a factor in this cause.

Q. ARE OPEB'S TREATED IN THE SAME MANNER?

A. From a GAAP perspective, yes. From a contribution/funding perspective, no. In addition to pensions, many employers provide other retiree benefits such as for medical costs and life insurance and the accounting rules for OPEB's are similar to those of pensions. However, the contributions for OPEB's are quite different than for pensions in that there are no specific requirements to pre-fund these obligations (i.e., no ERISA minimums). But both Spire East and Spire West are contributing the majority of their OPEB obligations using a tax deductible Voluntary Employees' Beneficiary Trust ("VEBA") and to a lesser extent through a Rabbi Trust.

PENSION AND OPEB RATEMAKING TREATMENT

Q. TRANSITIONING TO THE RATEMAKING TREATMENT FOR PENSION AND OPEB COSTS FOLLOWED BY SPIRE, IS THE RATEMAKING TREATMENT BASED ON GAAP OR SOME OTHER AMOUNT?

A. The ratemaking treatment for pensions is based on contributions/funding not GAAP. While, for a period of time, the GAAP accounting for pensions was used to determine the pension expense to be included in determining revenue requirements, since the early 2000's both Spire East and Spire West have been permitted to recover the test year amounts contributed to the pension trust or OPEB funding vehicles. In addition, any difference, positive or negative, in amounts actually contributed to these trusts compared to the pension and OPEB amounts included in the test year determination of revenue requirements is deferred as a regulatory asset or regulatory liability and recovered/refunded, through amortization, in the succeeding rate case. In this manner, actual pension and OPEB contributions are recovered in the ratemaking process.

Q. WHAT IS THE AMORTIZATION PERIOD FOR THE PENSION AND OPEB REGULATORY ASSET/LIABILITIES BEING PROPOSED IN THIS PROCEEDING?

A. The amortization period for the pension/OPEB regulatory asset or pension/OPEB regulatory liability proposed in this proceeding is 8 years. This was the period approved in Spire's last rate cases of (GR-2017-0215 and GR-2017-0216).

Q. WHAT CONTRIBUTION FUNDING LEVELS IS THE COMPANY PROPOSING IN THIS RATE CASE?

A. Spire is proposing to include pension contributions at a level that is projected to achieve 100% pension benefit obligation (PBO) funding status over a 5-year period. No

contributions to OPEB obligations are proposed as those plans combined are adequately funded.

Q. WHAT ARE THE BENEFITS OF CONTRIBUTING TO THE PENSION TRUST ABOVE THE MINIMUM LEVEL WITH A PLAN TO ACHIEVE 100% FUNDED STATUS?

A. There are a number of benefits of contributing at this level. First, eventually, assets in the pension trust will be used to pay pension benefits which are benefits already earned by Spire employees. In the meantime, the pension trust will earn returns for the pension plan, reducing every year the net annual pension cost charged to Spire and, ultimately, the amount needing to be contributed and, therefore, reflected in the ratemaking process. In addition to the reduction of the ultimate retiree pension payments, which accrues to customers, customers also benefit from the company's ability to attract and retain qualified employees knowing their pension is adequately funded. Further, companies with a well-funded pension plan are viewed as having less risk to the investment community which, all else being equal, should reduce the required return which also benefits customers. Said another way, less well-funded pension plans likely affect investment ratings, increasing risk and potentially increasing the cost of capital to the detriment of customers. A well-funded pension plan offers a variety of advantages in addition to stable, predictable contribution levels. For example, funding policy contributions help position the plan to be able to absorb adverse experience (e.g., the 2008 stock market crash and volatility in the stock market seen in the Spring of 2020 due to coronavirus) without necessitating a significant change in annual funding and expense.

Finally, by contributing above the minimum ERISA funding level, the Companies avoid certain payments that are charged when funding is based on the minimum.

Q. CAN YOU EXPLAIN WHAT YOU MEAN BY ADDITIONAL PAYMENTS REQUIRED WHEN CONTRIBUTION LEVELS RESULT IN A FUNDED STATUS BELOW 100%?

A. Yes. While funding pension trust contributions over the minimum level in any particular year, such contributions would have eventually been required to fund the plan. The Companies also are charged PBGC premiums based on several factors including a flat rate amount per covered employee as well as a variable rate calculated as a percentage of the unfunded vested liability. Thus, to the extent that contributions are made above the minimum and improve funding levels, the variable premium payment is reduced/eliminated. In Spire's case , such underfunding on a market value exists, such that the PBGC variable premium is currently capped at $561 per participant, per the Company's actuary Willis Towers Watson, which could be reduced to zero if the plan was fully funded on a market basis. This is another benefit that would accrue to customers. In 2006, the Pension Protection Act ("PPA") changed the ERISA funding rules so that required contributions would drive the plans towards a 100% funding level on a market basis. In the years since, funding relief legislation caused an artificial decrease in the liability, as the ERISA rules disconnected from market interest rates. Spire's approach in this rate case is to return to the original intent of PAA and fund towards a 100% level based on a market liability (PBO).

Q. CAN YOU EXPLAIN USING THE SIMPLE EXAMPLE YOU PROVIDED, HOW PENSION COSTS WOULD BE TREATED IF THE PENSION CONTRIBUTIONS

ARE PERMITTED TO BE RECOVERED IN THE RATEMAKING PROCESS AS YOU HAVE DESCRIBED?

A. Yes. For ratemaking purposes, the $150 would be treated as a recoverable cost in determining revenue requirements. If in the years subsequent to the rate case, contributions to the pension trust were:

Amount included in test year and recoverable:	$150 (a)
Amount contributed in first following year	$160 (b)
Amount contributed in second following year	$162 (c)
Amount contributed in third following year	$152 (d)

Then a pension regulatory asset would be recorded as follows:

Pension regulatory asset after first following year:	$10 (e)
Actual contribution vs. Test Year ($160(b)-$150(a))	
Pension regulatory asset after second following year:	$22 (f)
Actual contribution vs Test Year plus prior year regulatory asset ($162(c)-$150(a)) plus $10(e)	
Pension regulatory asset after third following year:	$24 (g)
Actual contribution vs. Test Year plus prior year regulatory asset ($152(d)-$150(a)) plus $22(f)	

In the *next* rate case, the company would include a $24(g) regulatory asset in rate base and, assuming an eight-year amortization period, an amortized pension cost of $3 ($24 divided by 8=$3). This amortized cost would be in addition to the estimated test year pension contribution.

Q. IN THIS EXAMPLE, WOULD AMOUNTS RECORDED FOR PENSION COSTS UNDER GAAP BE RELEVANT IN DETERMINING THE RATEMAKING TREATMENT OF PENSION COSTS?

A. No. The prepaid pension asset that would be recorded for GAAP is $50 (the difference between the amount contributed to the pension trust $150 in excess of the pension expense recorded under GAAP ($100)). However, in this example, the GAAP prepaid pension asset has no relevance in the ratemaking process as, for ratemaking purposes, recovery is based entirely on pension trust contributions. Similarly, the pension expense recorded under GAAP is not relevant in the ratemaking process as pension cost recovery is based on contributions.

Q. WHAT LEVEL OF RETURN IS BEING APPLIED TO THE PENSION/OPEB REGULATORY ASSET OR REGULATORY LIABILITY?

A. The Companies are including the estimated balance of the unamortized pension/OPEB regulatory asset or regulatory liability in rate base so that the overall weighted cost of capital is applied.

Q. WHY WOULD APPLYING THE OVERALL RATE OF RETURN TO THE UNAMORTIZED PENSION/OPEB REGULATORY ASSET OR REGULATORY LIABILITY BE APPROPRIATE?

A. The difference between the pension and OPEB amounts included in the ratemaking process in a rate case (included in the revenue requirement and charged to customers) compared to actual pension and OPEB amounts contributed in the intervening years between rate cases is, by definition, attributable to investor funding. Thus, such amounts should receive a return on this funding similar to the return provided for all other investor sourced funding.

TEST YEAR PENSION AND OPEB COSTS

Q. WHAT AMOUNTS OF PENSION AND OPEB COSTS IS THE COMPANY INCLUDING IN THIS RATE CASE FILING?

A. Spire East is including $52.1 million as a recoverable pension cost in this rate proceeding, consisting of estimated test year contributions of $41.5 million and amortization of the pension regulatory asset, $84.8 million, over 8 years, of $10.6 million ($84.8 million divided by 8=$10.6 million). In addition, the pension regulatory asset of $84.8 million is included in rate base.

Spire East is including $1.0 million as a recoverable OPEB cost in this rate proceeding, consisting of zero estimated test year contributions and amortization of the regulatory asset, over 8 years, of $ 1.0 million ($7.8 million divided by 8=$1 million). In addition, the regulatory asset of $7.8 million is included in rate base.

Spire West is including $4.4 million as a recoverable pension cost in this rate proceeding, consisting of estimated test year contributions of $6.9 million and amortization of the pension regulatory liability, over 8 years, of $$2.5 million ($19.8 million divided by 8 = $2.5 million). In addition, the pension regulatory liability of $19.8 million is included as a rate base reduction.

Spire West is including $0.2 million as a recoverable OPEB cost in this rate proceeding, consisting of zero estimated test year contributions amortization of the regulatory asset, over 8 years, of 0.2 million ($1.5 million divided by 8=$0.2 million) In addition, the pension regulatory asset of $1.5 million is included in rate base.

VI. INCOME TAX ACCOUNTING BASICS

Q. TURNING TO INCOME TAXES, PARTICULARLY THE TREATMENT OF ADIT AND EXCESS ADIT, CAN YOU PLEASE DESCRIBE THE FUNDAMENTALS OF INCOME TAX ACCOUNTING UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES?

A. Yes. One of the complicating factors when it comes to accounting for income taxes is that there are basically two sets of rules that entities must follow. One is GAAP which governs accounting and financial reporting. Under GAAP, the accrual method of accounting is followed and guidance exists for determining the amount of revenue, income, expenses, assets, and liabilities to report. The other is the Internal Revenue Code ("IRC") which provides guidance on when revenue and income are taxable and when expenditures are deductible. Most items that enter into pre-tax accounting income (financial statement or "book" income) also enter into taxable income (tax return income) in the same year. Some events, however, are recognized for book purposes and for tax purposes in different years. Over time, most of these differences reverse (meaning that in early years, the book amount will be higher/lower than the tax return amount, but in later years, the tax return amount will be lower/higher than the book amount) and will eventually offset each other on a cumulative basis (known as temporary or timing differences). The income tax effects of these temporary differences are recorded as accumulated deferred income taxes ("ADIT") in the intervening periods. The ADIT balance represents the asset (debit) or liability (credit) amount, at the balance sheet date, for future income taxes caused by differences between the financial statement basis and tax return basis of assets and liabilities.

Q. CAN YOU PLEASE EXPLAIN WHAT YOU MEAN BY TIMING/TEMPORARY DIFFERENCES AND PROVIDE AN EXAMPLE?

A. In order to appreciate the accounting for income taxes concept, it is important to have an understanding of what a timing/temporary difference is and how such a difference originates and reverses. It might be helpful to first illustrate the concept using the very simple example of an individual who participates in his/her company's 401K plan. An individual is not taxed on his/her pre-tax contributions to a 401K in the year of the contribution. However, when an individual takes withdrawals from the 401K plan, that withdrawal is taxable. In the year of the contribution to the 401K plan, that portion of the individual's wages are not taxable; thereby, reducing the amount of his/her *current income taxes payable.* However, by contributing to the plan, the individual has incurred a *deferred income tax liability*, an obligation for future income taxes that will be incurred in a future year when the cash in the 401K investment is withdrawn. The individual has deferred the income tax obligation by contributing to the plan and a deferred tax liability measures that future tax obligation. The 401K contribution is an example of a timing/temporary difference.

Q. CAN YOU PROVIDE AN EXAMPLE OF A TIMING/TEMPORARY DIFFERENCE THAT IS APPLICABLE TO CORPORATIONS?

A. To illustrate another book/tax difference that is more relevant to corporate entities, consider the accounting for the depreciation of property/fixed assets. For GAAP purposes, a fixed asset is capitalized (recorded on the balance sheet) when constructed or acquired and depreciated (expensed on the income statement) over its estimated useful life in a systematic and rational manner. This depreciation is typically "straight line," meaning

that the same amount of depreciation expense is recorded each year of the asset's life. Through book depreciation, the cost of a fixed asset is allocated to the income statement as depreciation expense in the various periods in which the asset is being used (providing service). Thus, if the cost of a fixed asset constructed or acquired in Year 1 is $1,200, that amount is capitalized on the balance sheet in Year 1 and charged to the income statement (depreciation expense) over its estimated useful life. If that life was estimated to be, say, three years, each of Year 1, Year 2, and Year 3 would contain depreciation expense of $400. In this manner, each income statement has an expense (depreciation expense) representing the cost of using that asset in that year.

For income tax purposes, the IRC permits an acceleration of depreciation for property/fixed assets. The intent of permitting accelerated depreciation for income tax purposes is to encourage capital investment. By accelerating the write-off of an asset's tax basis, the entity reduces its current income tax payments and can deploy the resulting income tax benefit for additional capital investment or other corporate purposes. Over the years, there have been a variety of tax depreciation methods that have been used to depreciate property for income tax return purposes. In some years, a shorter life, an accelerated method, or both, could be claimed for income tax purposes accelerating the depreciation deduction. The current tax depreciation accelerated depreciation method is known as the Modified Accelerated Cost Recovery System ("MACRS") which permits generally shorter lives than used for determining book/regulatory depreciation expense as well as an accelerated method.

The important point is the amount of tax depreciation that can be claimed, over time, is also limited to the cost (basis) of the property. Thus, for income tax return purposes, that

same $1,200 fixed asset may result in greater tax depreciation deductions (compared to book depreciation) in the early years, but because the total depreciation claimed, over time, cannot exceed the cost of the fixed asset, there will be a reversal or turnaround period where book depreciation expense will exceed tax depreciation. Assume that for tax purposes, the allowed depreciation income tax deduction would be $600 to be claimed on the Year 1 income tax return, $400 to be claimed on the Year 2 income tax return and $200 to be claimed on the Year 3 income tax return. Over the three-year period, $1,200 of tax depreciation has been deducted, fully depreciating the fixed asset/property for income tax return purposes. (It should be noted that prior to the 2017 Tax Cuts and Jobs Act, the IRC had permitted as much as 100% "bonus depreciation" for income tax purposes, meaning the cost of the constructed or acquired asset can all be written off in the year of construction/acquisition).

Q. CAN YOU FURTHER DESCRIBE THIS SIMPLE DEPRECIATION BOOK-TAX DIFFERENCE EXAMPLE?

A. In the example of the $1,200 fixed asset described above, where book depreciation is $400 in each of Years 1, 2 and 3 and tax depreciation would be $600 in Year 1, $400 in Year 2 and $200 in Year 3, the result of comparing book depreciation to tax depreciation would be as follows:

	Year 1	Year 2	Year 3	Cumulative Total
Book Depreciation	$400	$400	$400	$1,200
Tax Depreciation	$600	$400	$200	$1,200
Difference (Tax over Book Depreciation)	$200	($ 0)	($200)	$ 0

As can be seen, the $200 tax depreciation over book depreciation difference originating in Year 1 turns around, or reverses, in Year 3 when book depreciation exceeds tax depreciation. Income tax accounting is based on an understanding of the concept of originating and reversing book/tax differences.

Q. WHAT ARE SOME EXAMPLES OF OTHER TIMING/TEMPORARY DIFFERENCES SEEN AT REGULATED UTILITIES?

A. Some of the other timing/temporary differences commonly seen at regulated entities include:

- Pension and Other Post-Employment Benefits ("OPEB") (deductible for income tax purposes based on cash contributions but expensed based an accrual basis);
- Repairs (certain expenditures are capitalized/depreciated for books but under tax rules, can be deducted currently for income tax purposes);
- Various regulatory assets (capitalized/deferred for books, but deducted currently on the tax return, e.g., rate case expense, storm costs); and
- Various accrued expenses (accrued under GAAP for books, only deductible for tax

when paid, (e.g., bonus pay and vacation accruals)).

Q. WHERE IS INCOME TAX ACCOUNTING GUIDANCE LOCATED IN GAAP?

A. The authoritative guidance on accounting for income taxes under GAAP is contained in Accounting Standards Codification 740, Income Taxes ("ASC 740"). The basic objectives are explained in ASC 740- 10-10-1 as follows:

"There are two primary objectives relating to accounting for income taxes:

1) To recognize the amount of taxes payable or refundable for the current year; and
2) To recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns."

Thus, under ASC 740, financial statements should reflect the current and deferred income tax consequences of **all events that have been recognized in the financial statements or income tax returns.** To accomplish this goal, the following basic principles were established:

- A current tax liability or asset is recognized for the estimated taxes payable or refundable on income tax returns for the current year and
- A deferred tax liability or asset is recognized for the estimated future effects attributable to temporary differences and carryforwards.

Q. HAS THE ACCOUNTING FOR INCOME TAXES UNDER GAAP BEEN ADOPTED BY THE FEDERAL ENERGY REGULATORY COMMISSION'S ("FERC") UNIFORM SYSTEM OF ACCOUNTS ("USOA")?

A. Yes. Most rate-regulated entities maintain their books and records in accordance with the FERC USoA. The FERC has embraced deferred income tax accounting and the USoA contains the following income tax accounts for current and deferred income taxes:

Income Statement Accounts – Current

409.1 Income Taxes, Utility Operating Income

409.2 Income Taxes, Other Income and Deductions

409.3 Income Taxes, Extraordinary Items

Income Statement Accounts – Deferred

410.1 Provision for Deferred Income Taxes, Utility Operating Income

410.2 Provision for Deferred Income Taxes, Other Income and Deductions

411.1 Provision for Deferred Income Taxes-Credit, Utility Operating Income

411.2 Provision for Deferred Income Taxes-Credit, Other Income and Deductions

Balance Sheet Accounts – Current

236 Taxes Accrued

Balance Sheet Accounts – Deferred

190 Accumulated Deferred Income Taxes

281 Accumulated Deferred Income Taxes-Accelerated Amortization Property

282 Accumulated Deferred Income Taxes-Other Property

283 Accumulated Deferred Income Taxes-Other

Note that the FERC USoA contains multiple balance sheet accounts for ADIT. To determine a company's net deferred tax liability or deferred tax asset all ADIT balance sheet accounts must be aggregated.

Q. CAN YOU ILLUSTRATE THE CALCULATION AND ACCOUNTING FOR CURRENT AND DEFERRED INCOME TAXES USING THE DEPRECIATION EXAMPLE YOU PROVIDED PREVIOUSLY?

A. Yes. It is important to understand the interaction between current and deferred income taxes on the income statement and balance sheet in order to determine the appropriate accounting for income taxes for GAAP, USoA, and regulatory purposes. Assume the following facts:

	Year 1	Year 2	Year 3
Utility Revenue:	$2,500	$2,500	$2,500
Various Operating Expenses:	1,100	1,100	1,100
Book/Regulatory Depreciation Expense (Fixed Asset Cost: $1,200. Three-year life, straight-line method)	400	400	400
Tax Depreciation (Fixed Asset Cost: $1,200, Three-year life, accelerated method)	600	400	200
Tax Rate	25%	25%	25%

The first step is to compute taxes payable in the current year. In Year 1, the estimated amounts to be included on the income tax return are:

	Year 1 Tax Return
Revenue	$2,500
Various Expenses (also deductible for tax)	(1,100)
Tax Depreciation	(600)
Taxable Income	800
Tax Rate	25%
Current Taxes Payable	$200

The entry to record current income taxes would be:

409.1	Income Taxes-Utility Operating Income	$200	
236	Taxes Accrued		$200

Next, deferred income taxes need to be recorded. Comparing Year 1 tax depreciation to book depreciation ($600 minus $400) produces a $200 timing/temporary difference. As a result, ADIT of $50 ($200 book/tax difference x 25% tax rate) is required.

The entry to record deferred tax expense and ADIT would be:

410.1	Provision for Deferred Income Taxes, Utility Operating Income	$50	
282	Accumulated Deferred Income Taxes-Other Property		$50

Total income tax expense in Year 1 totals $250 ($200 currently payable, $50 deferred). Pre-tax book income (book income before income taxes) in Year 1 is $1,000 (revenue of $2,500 minus $1,500 of operating expenses ($1,100 and book depreciation of $400)). The $250 of income tax expense relates to the $1,000 of book income before income taxes and applying the 25% income tax rate. By claiming accelerated tax depreciation, the company is able to reduce its *current* income tax obligation by $50 – while recording a future

obligation (ADIT) of $50 for the taxes that will be payable in Year 3 when there is book depreciation that will be recorded in excess of tax depreciation on this one asset.

While I have used a fixed asset with a three-year life to illustrate the issue, most utility property have significantly longer lives, but the concept is the same.

Q. WHAT DOES THE ADIT REPRESENT?

A. In addition to representing the amount of income taxes that will be payable in the future when the book-tax difference reverses, the ADIT is often characterized as an "interest free loan" from the Federal Government – by accelerating deductions in the current year (Year 1), the company reduces its payment to the U.S. Treasury, receiving a "loan" that is subsequently repaid in Year 3. In a rate case, rate base is generally reduced by the ADIT as a portion of the rate base has been financed at zero cost. Thinking about ADIT as an interest free loan from the Federal Government is quite helpful in understanding and applying the concept from an accounting and ratemaking perspective.

It is important to note that for every dollar of ADIT, there is an equal and offsetting reduction in currently payable income taxes. In each year of the example, total tax expense (current plus deferred) is equal to the book income before taxes multiplied by the income tax rate ($1,000 of pre-tax book income x 25%). Because the ultimate expense on the books (in this case, book depreciation of $400 per year for 3 years or $1,200) will be the same as the ultimate deduction on the income tax return (in this case, $600 of tax depreciation claimed on the tax return in Year 1, $400 of tax depreciation claimed on the tax return in Year 2 and $200 of tax depreciation claimed on the tax return in Year 3), the book/tax difference in Year 1 will "turn around" or "reverse" in the future, requiring a

higher taxes payable that will be offset by negative deferred tax expense. ADIT are just a deferral, not forgiveness of taxes.

Q. CAN YOU SHOW THIS REVERSAL AND THE RELATED ACCOUNTING?

A. Yes, in Year 2, book and tax depreciation is the same, so there is no additional, nor any reversal that requires ADIT accounting. The calculations for Year 3 demonstrate the reversal of the depreciation timing difference and the required accounting:

Year 2

	Books	Tax Return	Difference
Revenue	$2,500	$2,500	
Operating Expenses	1,100	1,100	
Depreciation	400	400	(0)
Pre-Tax Income/Taxable Income	1,000	1,000	(0)
Tax Rate		25%	25%
Current Tax Expense (a)	250	250	
Deferred Tax Expense (b)	(0)		(0)
Total Income Tax Expense (a + b)	250		
Net Income	$750		

Year 3

	Books	Tax Return	Difference
Revenue	$2,500	$2,500	
Operating Expenses	1,100	1,100	
Depreciation	400	200	(200)
Pre-Tax Income/Taxable Income	1,000	1,200	(0)
Tax Rate		25%	25%
Current Tax Expense (a)	300	300	
Deferred Tax Expense (b)	(50)		(50)
Total Income Tax Expense (a + b)	250		
Net Income	$750		

The above format shows the calculations of current and deferred income taxes. Current income taxes are based on the treatment for revenue, income and expenses to be claimed on the income tax return. Deferred income taxes are based on originating or reversing (in this case reversing) differences between book and tax treatment of revenue and expense. By lining up the books and tax return amounts, the differences can be tracked. This format also clearly shows that deferred income taxes originate and reverse based on differences between book and tax treatment. In the above example, the $50 reversing difference occurs in Year 3 when book depreciation ($400) continues to be recorded on a straight-line basis and exceeds tax depreciation in that year.

The journal entries would be:

Year 2:

409.1	Income Taxes-Utility Operating Income	$250	
	236 Taxes Accrued		$250
282	Accumulated Deferred Income Taxes – Other Property	$0	
	410.1 Provision for Deferred Income Taxes, Utility Operating Income		$0

(as book depreciation is the same as tax depreciation in Year 2, there are no timing differences to account for)

Year 3

409.1	Income Taxes-Utility Operating Income	$300	
	236 Taxes Accrued		$300
282	Accumulated Deferred Income Taxes – Other Property	$50	
	410.1 Provision for Deferred Income Taxes, Utility Operating Income		$50

Over the three-year period, the sum of current and deferred income tax expense each year would be $250, based on $1,000 of pre-tax book income and an assumed 25% income tax rate. This is the total income tax expense recorded on an accrual basis that relates to the other elements of revenue and expense reviewed and eventually permitted by the regulator in the ratemaking process. ADIT would be $50 at the end of Year 1 and Year 2, reduced by $50 in Year 3 when the timing difference reverses. In Year 3, the interest free loan is "repaid" to the Federal Government through a "higher" current income tax payment.

The ADIT balance at each year end is:

	Year 1	Year 2	Year 3

ADIT (USoA account 282)	$50	$50	$0

Q. YOUR EXAMPLE ILLUSTRATED INCOME TAX ACCOUNTING FOR THE BOOK-TAX DEPRECIATION DIFFERENCE. WOULD SIMILAR ACCOUNTING OCCUR FOR OTHER BOOK-TAX DIFFERENCES?

A. Yes. In this example, only one book/tax difference (accelerated depreciation) was assumed. As I previously described, regulated entities have many book/tax differences that are not related to depreciation. These other book/tax differences (not accelerated depreciation) are recorded in USoA accounts 283 and 190 depending on whether the resulting ADIT is a future income tax obligation (like it would be for repairs) or a future tax benefit (as it would be for OPEBs where the current period book expense is often greater than the current period tax deduction). The ADIT amounts included in USoA 283 are also "interest free loans" from the Federal Government. The ADIT amounts included in USoA 190 represent "prepaid income taxes" where the income tax benefit of future income tax deductions can be realized.

Q. THUS FAR YOU HAVE DESCRIBED THE ACCOUNTING FOR A DEFERRED INCOME TAX LIABILITY, WHERE TAX DEDUCTIONS EXCEED BOOK EXPENSES YET BOOK INCOME AND TAXABLE INCOME RESULT. WHAT IS THE ACCOUNTING FOR THE SITUATION WHERE NET OPERATING LOSSES OCCUR?

A. As explained above, current income taxes are generally recorded by the following entry:

409.1	Income Taxes, Utility Operating Income	$ XXX	
	236 Taxes Accrued		$ XXX

This would be the case when the entity has an obligation for income taxes. There are situations in which an entity would have negative taxable income producing an operating loss for income tax purposes, resulting in no obligation to pay income taxes. This is referred to as a "net operating loss" or NOL. This could result from many things including claiming significant amounts of tax deductions for depreciation.

The entry to record a "negative" current income tax provision would be:

236	Taxes Accrued	$ XXX	
	409.1 Income Taxes, Utility Operating Income		$ XXX

The taxes accrued debit is akin to a receivable from the IRS. It may be possible for an entity to realize this receivable by way of carrying back the tax loss to obtain a refund of previous tax amounts paid. An entity can also carry forward an NOL to offset future taxes that would otherwise be payable. There are specific provisions in the IRC that govern the use and extent of both carrybacks and carryforwards, and depending on a company's facts and circumstances, either option may be chosen.

For GAAP purposes under ASC 740, if it is probable that an NOL can be realized in the future, the 236 taxes accrued will be reclassified to ADIT account 190 representing a Deferred Income Tax Asset for the future benefit of the unrealized deductions.

Thus, to the extent bonus depreciation (or other tax deductions in advance of book expense) results in an entity reporting an NOL, there would be separate ADIT Liabilities recorded in USoA 282 or USoA 283 for the temporary difference caused by accelerated tax deductions which have not been realized together with NOL ADIT Assets in USoA

190, recognizing the future benefit of the unrealized deductions. (the amount of the interest free loan from the US Treasury that has not yet been realized)

RATEMAKING TREATMENT OF INCOME TAXES, INCLUDING INTERNAL REVENUE CODE NORMALIZATION REQUIREMENTS

Q. HOW IS ADIT TYPICALLY INCORPORATED IN THE RATEMAKING PROCESS?

A. To the extent that there is an "interest free loan" from the government in the form of an accumulated deferred tax liability, the benefit of this amount is typically shared with customers by using such balance to reduce rate base. That is to say that customers pay for total tax expense (current plus deferred) as a component of operating expense, but receive a rate reduction (benefit) through the reduction of rate base from accumulated deferred tax liabilities. Similarly, to the extent that there are accumulated deferred tax assets where the utility has "prepaid" its tax obligation and the customer is paying for total tax expense such accumulated deferred tax assets are added to rate base. Additionally, in situations where a NOL ADIT asset exists, for rate case purposes, if the NOL ADIT Asset TA in USoA 190 is caused by ADIT Liabilities in USoA 282 or 283, such NOL ADIT Asset in USoA 190 should be added to rate base to offset any rate base reduction for ADIT in USoA 282 or USoA 283 to reflect the fact that no interest free loan has been realized. It should be noted that accumulated deferred taxes should only impact ratemaking to the extent that the associated cost or revenue is also included in ratemaking. For example, if there is an accumulated deferred tax liability associated with a book asset that has been disallowed for ratemaking purposes, the related ADIT liability should not reduce rate base.

Q. WHAT WOULD BE THE APPROPRIATE RATEMAKING RESULT IN THE PREVIOUS EXAMPLE?

A. In the previous example, $250 of total income tax expense would be recorded in each of Years 1, 2 and 3 and included as an operating expense in a test period. The $250 of total income tax expense relates to the $1,000 of pre-tax operating income and includes both current and deferred income tax components. The pre-tax operating income includes allowable revenue, income and expenses (pre-tax) determined as allowable/recoverable costs in the rate case and, in this manner, the total income tax expense is matched to the pre-tax operating income.

In addition, the rate base would be reduced by the resulting ADIT ($50 in Years 1 and 2) representing the interest-free loan from the U.S. Treasury, providing customers the time value of such loan.

Q. ARE ALL BOOK-TAX DIFFERENCES TIMING/TEMPORARY?

A. No. While most book-tax differences are timing/temporary, certain items of revenue, income and expense are treated differently for financial reporting purposes than for income tax purposes and are included in only one of either taxable income or financial reporting income. These are referred to as permanent differences.

An example of a permanent difference is the cost of meals and entertainment. These costs are reported as expenses in the financial statements for a given period, but, based on the IRC, are not entirely deductible in determining taxable income on the income tax return. Thus, over time, the financial statement reporting of meals and entertainment expenses will differ from the related amounts on the income tax return.

Deferred income taxes are not required on permanent differences because the difference will never reverse, it is "permanent." In the case of meals and entertainment costs, in the period reported, current income taxes will be adjusted to reflect the non-deductibility of a portion of these costs and there will be no deferred income taxes since these amounts, under the current IRC, will never be deducted on the tax return.

Q. IS THE DISTINCTION BETWEEN PERMANENT AND TEMPORARY DIFFERENCES IMPORTANT IN THE INCOME TAX CALCULATION?

A. Yes. Because permanent differences do not require deferred income tax accounting, the income tax effects of such items increase or decrease total income tax expense. With timing/temporary differences, each and every item that impacts current income tax expense has an equal and offsetting impact to deferred income tax expense. Because total income tax expense affects net income under GAAP and total income tax expense is typically recoverable in a rate case, permanent differences need to be separately identified and included in the income tax calculation.

Q. HOW DO YOU BELIEVE THIS COMMISSION SHOULD DETERMINE INCOME TAX EXPENSE FOR RATE-MAKING PURPOSES?

A. Income taxes should be determined in accordance with GAAP which require deferred income tax accounting, sometimes referred to as inter-period income tax allocation or normalization. Normalization, which I consider to be theoretically correct, distributes income tax expense to time periods and, therefore, to customers' revenue requirements consistently with the costs (depreciation) that are affecting income tax expense. As the rate-making process necessarily involves the deferral of costs such as plant investment

and the distribution of these costs over time, normalization is used to produce a consistent determination of income tax expense.

Q. IS THERE ANOTHER METHOD SOMETIMES USED TO ACCOUNT FOR INCOME TAXES IN RATE REGULATED ENTITY?

A. Yes. In some jurisdictions, there is a concept called “flow-through” used to account for book-tax timing differences. Flow through is an accounting/rate-making method of determining income tax expense by exclusive reference to amounts currently payable, with no accounting for the inter-temporal effects on income tax expense of the costs, such as property investment, that are "deferred" and distributed over time.

Under a flow-through method, deferred income taxes are not recorded on book-tax timing differences. Instead, the tax reducing effect of claiming accelerated deductions on the income tax return are “flowed-through” to ratepayers in the form of lower income tax expense and lower revenue requirements. However, under a flow-through approach, when the book-tax timing difference reverses (as it will, because it is a timing difference), income tax expense and revenue requirements are higher than they would be under a deferred tax (or normalized) approach because there are no ADIT to reverse to offset the higher current income taxes that will occur when the tax deduction is less than the book expense.

Q. CAN YOU ILLUSTRATE THE FLOW THROUGH CONCEPT USING THE PREVIOUS EXAMPLE?

A. Yes. In the previous example, in Year 1, tax depreciation exceeded book depreciation. The additional tax depreciation ($200) lowered current income tax expense by $50 ($200 x 25% income tax rate). At the same time, deferred income tax expense was increased by

$50 ($200 x 25% income tax rate). The resulting *total* income tax expense is the same as it would have been if there were no accelerated depreciation. The ratepayers receive a benefit under deferred income tax accounting in that the $50 ADIT reduces rate base.

Under a flow through approach to accounting/rate-making, income tax expense is calculated by exclusive reference to amounts currently payable, with no accounting for the inter-temporal effects on income tax expense of the costs, such as property investment, that are "deferred" and distributed over time.

Because increases/decreases in test year operating expenses result in corresponding increases/decreases in revenue requirements, under the flow-through method, the $50 reduction in taxes currently payable for Year 1 FIRST produces a reduction of $50 in revenue requirements. However, because income taxes are not deductible when computing income tax expense, a $50 reduction in current income taxes results in a $66.67 reduction in customer revenue requirements by applying an “income tax gross-up” formula (1 + tax rate/(1-tax rate)) or $50 x (1+(.25/75)) or $50 x 1.33=$66.67). So instead of a $2,000 Year 1 revenue requirement, as shown in the deferred tax example, the revenue requirement under flow-through would be $1,933.33 ($2,000 minus $66.67). The flow-through method stops here as it is based only on taxes currently payable. There is no reduction/adjustment to rate base in this scenario as there are no deferred taxes being recognized.

While the use of flow-through for book-tax timing differences may reduce income tax expense and revenue requirements in the years that tax deductions are greater than book expenses, at the point in time that the book-tax timing difference reverses, the opposite is true. When, in the future, the tax deduction is less than book depreciation, current tax expense will be increased without any ADIT to offset the increase. In the depreciation

example, this means that in Year 3, the revenue requirement would be $2,066.67, or $66.67 higher than under a deferred tax concept.

Importantly, under the flow-through method, there are no ADIT, so the rate base would not be reduced by $50 in each of Year's 1 and 2, a detriment to customers.

Q. CAN YOU SUMMARIZE THE FLOW THROUGH RATEMAKING APPROACH?

A. Yes, using the example I just described, the customer in Year 1 has the revenue requirement reduced by $66.67 in Year 1 because the tax expense in that year is based on the amounts included in that year's tax return which reflected an accelerated depreciation tax deduction, reducing that year's income tax payment to the Federal Treasury. However, the Year 3 customer's revenue requirement is increased by $66.67 because the Year 3 tax return has less tax depreciation available as a result of the tax basis being used up in Year 1.

Over the life of this asset, revenue requirements will include and recover $750 of income tax expense, but the pattern of recovery will be subject to the depreciation claimed on the income tax return in each year—greater tax depreciation (compared to books) in the early years (Year 1 in the example) and less tax depreciation (compared to books) in the later years (Year 3 in the example).

Q. IS FLOW-THROUGH AN APPROPRIATE METHOD WHEN INTERGENERATIONAL EQUITY IS CONSIDERED?

A. No. In the above example, the customer in Year 1 is using property, plant and equipment and the revenue requirements include book/ratemaking depreciation expense determined on a straight-line basis. But because the IRC permits accelerated depreciation which reduces the Year 1 tax payment based on that accelerated method, under flow-through, the

customer receives a $66.67 reduction in revenue requirements compared to what he/she would have received if there was no accelerated depreciation.

In Year 3, while that same asset continues in service and the revenue requirements again include book/ratemaking expense determined on a straight-line basis, because there is much less tax depreciation available to reduce the tax payment, current income taxes are increased compared to what he/she would have paid if there was no accelerated depreciation. As a result, the revenue requirement for the customer in Year 3 is increased by $66.67.

This generational inequity is caused by determining expenses (other than income taxes) on an accrual basis (such as straight-line depreciation), but using the cash basis to determine income tax expense which is lower in the early years and greater in the later years due to using accelerated depreciation for income tax return purposes.

Under the normalization approach, there is a matching of income tax expense to the revenues, income and expenses used to determine allowable operating costs, each determined on a consistent (accrual) basis.

Said another way, the customer in Year 1 receives a benefit (in the form of reduced income tax expense and revenue requirements) that the customer in Year 3, who may not have been a customer in Year 1, is asked to pay for (increased income tax expense and increased revenue requirements) even though it relates to the same asset with both customers getting the same service from said asset.

Q. HOW DOES THE INCOME TAX GROSS-UP APPLY TO THE NORMALIZATION METHOD FOR DETERMINING INCOME TAX EXPENSE?

A. In contrast to the flow-through method, in order to recognize the tax deferral for the $200 timing difference, a provision of $50 for deferred income taxes is made. This provision has effect of increasing revenue requirements by $66.67 ($50 x 1.33), the increase in revenue requirements being equal to (offsetting) the current reduction. Therefore, as the customer has experienced a $66.67 benefit and a $66.67 detriment, the net effect on him or her is zero before considering the substantial benefit of deducting the reserve from rate base. While my example, for sake of simplicity, relates to a single unit of property, the effect for multiple units with various in-service dates, service lives, etc., such as is the case for Spire, is merely a summation of these effects for all property units.

Q. IT IS SOMETIMES ASSERTED THAT, IN A GROWTH SITUATION, THE DEFERRED TAX AMOUNTS WILL CONTINUE TO GROW SO THERE WILL BE NO NET PAYMENT OF DEFERRED TAXES AND, THEREFORE, "ACTUAL TAXES PAYABLE" SHOULD BE THE SOLE MEASURE OF INCOME TAX EXPENSE. IN YOUR OPINION, IS THIS VIEW CORRECT?

A. No, it is not. "Actual taxes paid" is a cash-flow concept not an accrual accounting concept. I believe the so-called "actual taxes paid principle" is not a principle at all, but an overly simplistic view which omits important economic realities of income taxation. Because these omissions are so significant, the "principle" is not sound for accounting or rate setting where correct determinations of costs are required for time periods which are shorter than the lives of property investments. Stated another way, the "actual taxes paid principle" produces an incorrect tax allowance because it is based exclusively on the timing of cash flows associated with income taxation.

The normalization concept is also supported by authoritative accounting literature. In the Basis of Conclusions section of Financial Accounting Standards Board Statement No. 109, Accounting for Income Taxes (which is codified in ASC 740), the FASB rejected the concept of computing income tax expense based solely on the income tax return as follows:

> "201. The Board believes that the tax consequences of an individual event are separable from aggregate taxable income. For example, if the gain on an installment sale is taxable, both the sale and the tax consequences of the gain on the sale should be recognized in financial income for the same year. The tax law may permit an election to include some or all of the gain in the determination of taxable income in future years. That election, however, only affects when and not whether the gain will be included in determining taxable income. The tax consequences arose at the time of the sale and result from the gain on the sale.
>
> 202. As the installment sale receivable is collected, pro rata amounts of the gain are included in determining taxable income. Reporting the uncollected balance of the receivable at its net realizable value in the statement of financial position reflects an assumption that the receivable will be recovered and, therefore, that the gain will become taxable. Recognition of the sale and the gain on the sale on an accrual basis requires concurrent recognition of the tax consequences of the gain on the sale. For example, commission expense attributable to the installment sale is recognized on an accrual basis even if the commissions are paid as the receivable is collected and, likewise, income tax expense should also be recognized on an accrual basis. To do otherwise would result in accounting for the sale and the gain on an accrual basis

and the related tax consequences on a cash basis—a result that the Board believes is inconsistent and inappropriate."

Q. CAN YOU FURTHER EXPLAIN WHY YOU BELIEVE THAT THE NORMALIZATION APPROACH IS SOUND FROM THE VIEWPOINT OF DETERMINING COSTS FOR RATE MAKING?

A. Yes. Unlike other expenses, income tax expense has no independent existence. A correct allowance cannot be determined merely by reference to amounts paid, as is done under flow-through. This is true because income taxes are a direct function of revenues, income and expenses which are determined for the most part on an accrual accounting basis which corresponds to the accrual basis used for regulatory and financial statement purposes. Income tax expense is a simple arithmetic function of the components of revenue requirements, including return, which are appropriate for setting rates. Once this Commission determines the other components of revenue requirements, allowable income tax expense can be computed simply and accurately. Normalization merely allocates the result of this computation between current and deferred classifications.

The very essence of determining costs for rate-making purposes is resolving the question of the amount of costs which are to be recognized as current-period costs and those which are to be "deferred." For instance, the amount to be deferred is the question to be resolved in determining amounts to be capitalized and the amounts to be expensed. It is also the question in determining the portion of plant investment costs which are to be recognized currently as depreciation expense as distinguished from the portion to be "deferred."

Having determined which costs are to be recognized currently and which are to be deferred, it makes no sense whatsoever to handle their income tax effects inconsistently. The income

tax effects must be handled consistently ("matched") or the initial cost determination is effectively countermanded to that extent.

Q. HAS THE FERC TAKEN A POSITION ON THE APPROPRIATENESS OF DEFERRED INCOME TAX ACCOUNTING?

A. Yes. The FERC requires comprehensive inter-period income tax allocation for all book-tax timing/temporary differences. The FERC's landmark orders, Orders 144 and 144A provide guidance in this area. This has been the FERC methodology since the early 1980's. The FERC Uniform System of Accounts ("FERC USOA") and many FERC rate orders require normalization.

In a study attached to the Notice of Proposed Rulemaking that eventually was adopted in FERC Order 144 and 144a (Docket No. RM-80-42, dated March 31, 1980), the Staff of the FERC confirmed the propriety of the normalization method for rate making:

> "The staff analysis concludes that normalization produces rates that are more equitable to customers over time than flow-through. Under normalization, rates reflected ('match') the tax effects of transactions (tax reductions, or benefits, and tax additions) in the same periods that the transactions are themselves recognized in rates ... In general, flow-through allocates the tax effects of timing difference transactions to customers in different periods than the transactions themselves are allocated"

It also noted that:

> "While the primary rationale used to support flow-through is the 'actual taxes paid' (in each period) doctrine, the staff study notes that this doctrine is inconsistent with the treatment accorded other costs."

Q. WHAT HAPPENS IF A REGULATED ENTITY IS A MEMBER OF A CONSOLIDATED GROUP, WHERE THERE ARE OTHER REGULATED AND NON-REGULATED ENTITIES INCLUDED IN THE AMOUNTS REFLECTED ON THE CONSOLIDATED INCOME TAX RETURN?

A. In situations where a regulated entity is part of a consolidated group that combines the various entities into a single, consolidated income tax return, the regulated company should compute its income tax expense using the "stand-alone method".

Q. WHAT IS THE STAND-ALONE METHOD?

A. Most state commissions and FERC use the traditional "stand-alone" method for calculating the amount of income taxes to be incorporated into a regulated utility company's rates. This method calculates ratemaking income taxes based on the regulated revenues and operating costs of the utility itself without regard to the utility's unregulated activities or the operations of its parent and other affiliated companies. The stand-alone calculation is used so that taxes in utility rates are based on the costs of providing the regulated utility service.

This method is consistent with fundamental principles of basing utility rates on the utility's costs and revenues and prohibiting cross-subsidization between utility and non-utility operations or between jurisdictions. The primary principle here is that consumers should bear only the costs for which they are responsible. Under this principle, there is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if customers are held responsible for operating costs and a return (cost of service), they are entitled to the tax benefits associated with such costs. If ratepayers do not bear the pre-tax costs, they are not entitled to the tax benefits associated with the costs.

Non-regulated operations involve financial risks that are different from a utility's regulated operations. It would be inappropriate for the regulated ratepayers to share the income tax burden of profits generated by the nonregulated entity, just as it would be inappropriate for the regulated entity to reduce its income tax burden by losses generated by the nonregulated entity. Thus, a "stand-alone" method (as opposed to considering entities or transactions outside of the regulated entity but members of the consolidated group) for computing the income tax expense component of cost of service is the proper and equitable method to be followed for ratemaking purposes.

Q. IS THE STAND-ALONE METHOD CONSISTENT WITH GAAP?

A. Yes. Under ASC 740, there are several alternatives provided for allocating income taxes among the entities included in the consolidated group. ASC 740 (ASC 740-10-30-27): states:

> "The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return shall be allocated among the members of the group when those members issue separate financial statements. This Subtopic does not require a single allocation method.
>
> The method adopted, however, shall be systematic, rational, and consistent with the broad principles established by this Subtopic. A method that allocates current and deferred taxes to members of the group by applying this Topic to each member as if it were a separate taxpayer meets those criteria. In that situation, the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. That may also be the result when there are intra entity transactions between member of the group. The criteria are satisfied, nevertheless,

after giving effect to the type of adjustments (including eliminations) normally present in preparing consolidated financial statements."

This is known as the "separate return" method in which each affiliate computes its income tax provision as if it were filing their own income tax return.

Another method, called the "Benefits-for-Loss" approach is also acceptable. Under this method, the consolidated revenues, income and deductions are allocated to the affiliate generating such revenue, income or deduction. The benefits-for-loss method is consistent with the stand-alone method I previously described.

Q. IS THE STAND-ALONE METHOD USED TO DETERMINE REVENUE REQUIREMENTS IN MOST JURISDICTIONS?

A. Yes, virtually every regulatory jurisdiction, including FERC, has adopted the stand-alone method when determining revenue requirements for a regulated utility. The FERC decided this issue in a landmark opinion, FERC Opinion No. 173 and reiterated this position in Interpretation AI93-5-000, Accounting for Income Taxes.

In AI93-5-000 the FERC provided this question and answer:

"Will the FERC permit an entity to use a separate return method for FERC financial accounting and reporting?

Response: No. The FERC has issued several decisions rejecting the use of the separate return method for determining income tax expense when an entity files as part of a consolidated group. Instead, the FERC relies on the standalone method of allocating income taxes between members of a consolidated group."

Under the stand-alone method the consolidated tax expense is allocated to individual members through recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return. Under the standalone method, the sum of amounts allocated to individual members equal the consolidated amount.

Q. RETURNING TO THE CONCEPT OF FLOW-THROUGH, IN THE FLOW-THROUGH EXAMPLE YOU PROVIDED, YOU USED AN ACCELERATED DEPRECIATION BOOK-TAX DIFFERENCE TO ILLUSTRATE THE CONCEPT. CAN BOOK-TAX DEPRECIATION DIFFERENCES ACTUALLY BE SUBJECT TO FLOW THROUGH?

A. No. The IRC contains provisions/rules that prohibit the flow-through of book-tax method and life depreciation differences and certain contributions in aid of construction. However, other book-tax timing/temporary differences can be flowed-through. I used the example of a depreciation timing/temporary difference because I used a similar example to explain deferred tax accounting and it clearly shows the intergenerational equity issue.

Q. CAN YOU DESCRIBE THESE IRC PROVISIONS GOVERNING THE USE OF DEFERRED INCOME TAX ACCOUNTING FOR RATE-REGULATED UTILITIES?

A. Yes. Under the present normalization provisions, with respect to method and life depreciation differences created by tax accelerated depreciation, a regulated utility is required to provide deferred taxes on these differences and reduce rate base (or treat as zero cost capital) for such ADIT. Flow-through of these differences would result in a violation of the normalization rules and severe penalties will result. The basics of the deferred tax

accounting under the normalization provisions work as described in the fundamental examples discussed previously with ADIT being recorded in the USoA 282 accounts from a ratemaking perspective.

The IRS normalization provisions (based on a number of private letter rulings) also require that Deferred Income Tax assets relating to NOL's (recorded in USoA Account 190) resulting from claiming accelerated depreciation for income tax purposes be added to rate base offsetting the rate base reducing impact of ADIT Liabilities recorded in USoA Account 282.

Q. WHY ARE SUCH PROVISIONS INCLUDED IN THE IRC?

A. In the late 1960's, as accelerated tax depreciation became more prevalent, Congress became concerned about the negative revenue impacts to the government from the trend of flowing through the effects of accelerated depreciation in taxes. Under flow through, the tax reducing effects of accelerating depreciation deductions for income tax purposes, lowering current income tax expense, are not offset by increasing deferred income tax expense. In the ratemaking process, there is less tax expense and a lower revenue requirement in the early years of an asset's life when accelerated tax depreciation exceeds book depreciation. When the turnaround of this book/tax depreciation difference occurs, the current expense increases and, because there are no deferred taxes to reverse against the higher current income tax expense, revenue requirements increase. Flow through is more of a taxes payable or cash concept rather than an accrual concept that exists for ADIT under GAAP and FERC rules.

Congress was concerned because if the various regulatory authorities could mandate flow through accounting for accelerated depreciation, tax recoveries through rates would be

less (only permitting the recovery of current income taxes without a component for deferred tax expense), lowering the revenue requirement for utilities, thus reducing taxes paid to the government. As a result, starting with the Tax Reform Act of 1969, Congress enacted normalization provisions in the IRC to prevent the flow through of income taxes for the benefits of accelerated depreciation on public utility property. The current normalization provisions are located in IRC Section 168(i)(9).

Q. WHAT IS THE PENALTY FOR VIOLATING THE IRC NORMALIZATION RULES?

A. The penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation for income tax purposes on all assets as of the violation date and on subsequent additions. It is a severe penalty to both the utility and its customers.

TAX CUTS AND JOBS ACT OF 2017 ("TCJA") AND EXCESS ADIT

Q. PLEASE GENERALLY DESCRIBE THE TCJA.

A. The TCJA was enacted by the United States Congress on December 20, 2017 and was signed into law by the President on December 22, 2017. *See Tax Cuts and Jobs Act of 2017*, Pub. Law 115-97, 131 Stat. 2054 (2017). The TCJA amends the IRC and contains the most significant set of changes to the federal income tax laws since the Tax Reform Act of 1986. The TCJA makes major changes in many areas of our nation's tax laws, some of which directly affect regulated utilities like the Company.

Q. PLEASE DESCRIBE THE PROVISIONS OF THE TCJA THAT HAVE THE GREATEST IMPACT ON REGULATED UTILITIES LIKE SPIRE AND THEIR CUSTOMERS.

A. The TCJA has significant, though varying, impacts on most utilities in terms of reported tax expenses charged against the company's operations, cash flows and the calculation of revenue requirements and cost of service.

The most significant provision of the TCJA for regulated utilities, including Spire, is the reduction of the Federal Income Tax Rate from 35 percent to 21 percent, which reduced current income tax expense and originating deferred tax expense. Further, as a result of the lower 21 percent income tax rate becoming effective under the TCJA, all companies, including utilities, were required under ASC 740 to "remeasure," as of December 31, 2017, the amounts of ADIT in their financial statements.

Q. WHAT ARE "EXCESS" ADIT AND HOW ARE THEY CALCULATED?

A. Excess ADIT is the portion of the ADIT balance existing immediately prior to the reduction in the corporate tax rate (the ADIT balance at December 31, 2017) less the amount that would have been in the ADIT balance had that balance been determined using the revised lower corporate income tax rate. In effect, a portion of the ADIT "interest free loan from the U.S. Treasury" has been forgiven. In other words, if there was an existing book-tax difference of $10 million with $3.5 million of ADIT (at a 35% tax rate) at December 31, 2017, remeasuring the ADIT using the lower 21% income tax rate provided in the TCJA, would result in a remeasured ADIT of $2.1 million (the $10 million book-tax difference times 21%) producing a $1.4 million excess ADIT ($3.5 million minus $2.1 million = $1.4 million). This is the calculated benefit from the forgiveness of the Treasury's interest free loan.

Q. WHAT IS THE ACCOUNTING FOR EXCESS ADIT?

A. Under GAAP, for enterprises in general, the remeasurement of ADIT reduces the ADIT balance with a corresponding reduction in income tax expense. In my simple example above, the $1.4 million reduction of ADIT upon remeasurement would result in a $1.4 million reduction (benefit) in income tax expense in the period of remeasurement, year-end 2017.

However, for rate-regulated entities subject to ASC 980 (e.g., Spire , the reduction in ADIT is subject to rate regulation. As a result, instead of immediately reducing income tax expense upon remeasurement of ADIT, regulated utilities reclassify the reduction in ADIT to a regulatory liability representing the excess ADIT that will be used to reduce future revenue requirements. Thus, in the example above, a regulatory liability of $1.4 million would initially be recorded upon remeasurement.

Because reductions in income tax expense will reduce revenue requirements and those reduced revenue requirements will affect income taxes, the excess ADIT regulatory liability is "grossed-up" for income taxes at the previously described gross-up rate, with an ADIT offset. At the previous 35 percent federal income tax rate, revenue of $1.5385 was required to provide $1.00 of after-tax income. A corporate tax rate of 21 percent requires $1.2685 of revenue to generate $1.00 of after-tax income.

A separate Missouri state income tax rate of 6.25 percent exists prior to October 1, 2020 for the Company. Effective October 1, 2020, the Missouri state income tax rate is reduced to 4%. The Missouri state income tax rate is deductible for federal income tax purposes so the "combined federal and state income tax rate" used for determining regulatory ADIT and excess ADIT has gone from 38.3886 percent to 25.4483 percent (pre-Missouri law change). The combined income tax gross-up factor before and after the TCJA has been

reduced from 1.623 to 1.341, respectively. The additional "gross-up" entry would increase the regulatory liability with an offset to ADIT.

Q. CAN YOU EXPLAIN HOW THE REDUCTION IN THE FEDERAL CORPORATE INCOME TAX RATE AFFECTED THE COMPANY'S ADIT INCLUDING EXCESS ADIT?

A. Yes. The Companies calculated the excess ADIT amounts at September 30, 2017 (as a proxy for the balances before the passage of the TCJA) by comparing the ADIT existing at that date to the ADIT that would have been recorded had the lower 21 percent income tax rate always been in effect. The difference is the excess ADIT, which was estimated as $309.1 million for Spire East and $23.1 million for Spire West as of the previous rate cases. The excess ADIT were then separated into two "buckets": excess ADIT relating to property-related book-tax differences (comprised mostly of protected excess ADIT) and excess ADIT relating to non-property related differences (comprised entirely of unprotected book-tax differences). The reason for separating the excess ADIT is because of different ratemaking treatment, in some cases required to comply with the IRS normalization rules, for the reversal. In Spires's prior rate cases, an estimate of the protected and unprotected excess ADIT "split" was made (50% to protected, 50% to unprotected), with the protected estimate amortized over 20-years and the unprotected excess ADIT estimate amortized over 10-years. I will address both the true-up of these estimated amounts as well as the excess ADIT amortization to be included in this rate case in subsequent questions and answers in this direct testimony.

Q. DID THE TCJA DISCUSS HOW REGULATED PUBLIC UTILITIES WERE TO TREAT PROTECTED EXCESS ADIT?

A. Yes. The TCJA addressed how ADIT on protected book-tax differences (primarily depreciation-related method and life differences, including NOL's associated with method and life differences) are to be treated in the ratemaking process. The TCJA requires that excess ADIT on such protected book-tax differences reduce customer rates over the book lives of the related property no more rapidly than under the Average Rate Assumption Method ("ARAM") which I will describe subsequently. If the necessary books and records are not available to compute the reversal under ARAM, an alternative approach, referred to as the Reverse South Georgia Method ("RSGM"), can be used. The RSGM is straightforward: Determine the excess ADIT balance and spread that balance over the estimated remaining useful lives of the assets giving rise to the excess ADIT. The choice of ARAM vs. RSGM is not optional, ARAM must be used unless the records needed to compute ARAM are not available.

Q. HOW IS THE ARAM COMPUTED?

A. The ARAM requires the development of an average rate which is determined by dividing the aggregate normalized protected timing/temporary differences into the ADIT that have been provided on such timing/temporary differences. The average rate so calculated is applied to reversing temporary differences to derive the deferred taxes that are debited (in the case of excess ADIT on deferred tax assets) or credited (in the case of excess ADIT on deferred tax liabilities) to income tax expense. Under this approach, protected ADIT are increased/reduced over the remaining lives of the property which gave rise to the ADIT as the timing/temporary differences reverse. Public utilities must take care to properly apply the ARAM to protected ADIT because a normalization violation could occur if the amount of protected excess ADIT is reduced more rapidly or to a greater extent than under the

ARAM. If the normalization rules were so violated with respect to reversing protected excess ADIT, two negative results would occur: 1) current income taxes would become payable for the more rapid reduction plus, more importantly, 2) accelerated depreciation methods would not be permitted for income tax purposes going forward. Rather, book depreciation would have to be used for income tax purposes.

Q. HAVE YOU PREPARED AN EXHIBIT THAT DEMONSTRATES HOW THE ARAM IS TO BE CALCULATED?

A. Yes, Exhibit B provides an example describing the originating and reversing book-tax differences and the required ADIT each year when there is a change (in this case, a reduction) in the federal income tax rate. This example is based on the assumptions used in my previous example describing depreciation book-tax differences and how such differences originate and reverse. I begin with an income tax rate of 35 percent in the early years that is reduced to 21 percent before the asset is fully depreciated. The example again assumes a $1 million asset placed in service in 2016 with a 10-year book life and a five-year tax life using MACRS depreciation, with no bonus tax depreciation. The MACRS rate is shown in Column B and each year's tax depreciation is shown in Column C. Book depreciation is $100,000 each year and Column E contains the difference between tax and book depreciation each year. Column F contains the cumulative difference between book and tax at the end of each year. Column G contains the income tax rates, beginning with 35 percent in 2016 and 2017, reducing that rate to 21 percent at the beginning of 2018. Columns H and I show each year's deferred tax expense, with Column H showing the deferred tax expense on originating book-tax differences and Column I showing the deferred tax expense on reversing book-tax differences. Column J shows the ADIT

balance, increasing and decreasing the previous year's balance by the deferred tax expense. Column M shows the excess ADIT balance, decreasing as it reverses according to the ARAM methodology.

Q. CAN YOU WALK THROUGH THE DETERMINATION OF EXCESS ADIT AND HOW THE ARAM IS USED TO REVERSE THE EXCESS ADIT FOR THE TAX RATE CHANGE?

A. Yes. When the tax rate changed at the end of 2017, the balance of ADIT was $112,000 (Column J). This balance was derived by applying the 35 percent tax rate to the cumulative book-tax differences at that time in Column F ($320,000). The remeasurement necessitated by the change in tax rates is shown on Line 2a where the ADIT balance at December 31, 2017 is allocated into two components: The "normal" ADIT amount and the excess ADIT amount. The normal ADIT balance is calculated by applying the new 21 percent tax rate to those cumulative book-tax differences at the time of the rate change ($320,000 x 21 percent = $67,200) and comparing that amount to the then existing ADIT balance with the difference representing the excess ADIT ($112,000-$67,200 = $44,800).

Under the ARAM, this excess ADIT balance does not begin reversing until 2021 when the book-tax difference begins to reverse. In 2018 through 2020, book-tax differences continue to originate, now at the lower 21 percent income tax rate with no reversal permitted for excess ADIT. This is a key distinction between ARAM and RSGM. Under RSGM, the excess ADIT begins to reverse immediately, while under ARAM, reversal does not begin until the book-tax difference begins to reverse. In this example, if RSGM was applied, the excess ADIT at December 31, 2017 would begin reversing in 2018 and continuing through the end of 2025.

At the end of 2020, the combined ADIT and excess ADIT balance is $137,704 (Column H: $35,000+$77,000+$19,320+$3,192+$3,192) and the cumulative book-tax difference is $442,400 (the 2016 through 2020 differences in Column F). The average rate at which the $137,704 combined ADIT and excess ADIT balance was accumulated is thus 31.1266 percent ($137,704 / $442,400). This is the average rate that must be applied to the book-tax differences reversing in each year beginning in 2021 (Column E) broken into two components: 1) the statutory rate (21 percent) applied to the reversing book-tax differences beginning in 2021 to reduce the normal ADIT balance (Column I) and 2) the excess ADIT rate (31.1266 percent minus 21 percent = 10.1266 percent, shown in Column K) also applied to the reversing book-tax differences beginning in 2021.

At the end of its useful life, the originating and reversing deferred tax expense (consisting of both the normal ADIT reversal plus the excess ADIT reversal) equal one another and the ADIT balance is 0.

Q. HOW IS THIS TYPICALLY REFLECTED IN A RATE CASE?

A. As discussed previously, reversal of ADIT is included in the normal calculation of total income tax expense (i.e., the current statutory rate multiplied by pre-tax income). However, to reflect the reversal of the excess ADIT occurring at a different tax rate (i.e., the tax rate calculated under ARAM), once the normal calculation of income tax expense is determined, the reversal of the calculated excess ADIT must be added/subtracted to obtain the amount that is included in the calculation of revenue requirement.

Q. IN YOUR ARAM EXAMPLE, IF A RATE HIGHER THAN THE COMBINED AVERAGE RATE OF 31.1266 PERCENT WERE USED TO REDUCE THE REVERSING ADIT OR IF ANY OF THE EXCESS ADIT WERE REVERSED

PRIOR TO 2020 WHAT WOULD HAPPEN?

A. Flowing back protected ADIT more rapidly than permitted under the ARAM will result in a violation of the normalization rules. I have already discussed the two-fold penalty for violating the normalization rules for excess ADIT: (1) currently payable income tax is increased by the amount by which the utility reduced its excess tax reserve more rapidly than permitted under the ARAM or the RSGM, and (2) the utility will be unable to claim accelerated depreciation for income tax purposes.

Q. DOES THE TCJA PRESCRIBE A METHOD FOR REVERSING EXCESS ADIT ON "UNPROTECTED" EXCESS ADIT?

A. No. Prior to the TCJA, the ADIT provided on all book-tax differences typically reversed at the tax rate used to record the deferred tax expense when the book-tax difference originated; however, the TCJA does not contain such a requirement on the excess ADIT on unprotected book-tax differences. Reversal of the balance of unprotected ADIT is thus up to a decision by the utility and its regulator.

SPIRE TEST YEAR TREATMENT OF PROTECTED AND UNPROTECTED ADIT

Q. HAS SPIRE REVERSED ANY OF THE EXCESS ADIT AMOUNTS AT THIS POINT?

A. Yes. This issue was addressed in Spire's previous rate cases, GR-2017-2015 and GR-2017-2016. In the Amended Report and Order, the Commission concluded:

> "One additional consequence of the TCJA is its effect on ADIT. The parties presented evidence regarding the estimated effects, but because of the complex nature of deferred income taxes and the potential effect on cash flows to the company if the flow back of excess ADIT is not done correctly, this calculation as presented to the Commission still remains an estimate. The estimates of the

percentage of "protected" versus "unprotected" ADIT and the lack of evidence surrounding the appropriate amortization periods for each category, convinces the Commission that effects of the TCJA on ADIT are not sufficiently known and measurable to include in the current rate case with any certainty beyond an estimate. However, Spire Missouri and Staff indicated that they will be able to determine, based on the former composite tax rate of 38.3886 percent and the new effective composite tax rate of 25.4483 percent, an appropriate estimated amount to set as a reduction to ADIT. That amount calculated by Staff's witness Lisa Ferguson is $11.5 million per annual period (a $10.7 million reduction for Spire East and an $815,000 reduction for Spire West). As part of its calculation, Staff applied a 50/50 split between the "protected" and "unprotected" ADIT applying a 20-year amortization to protected ADIT and a 10-year amortization to unprotected ADIT. However, the calculations and the determination of the actual split between protected and unprotected excess ADIT and the appropriate amortization period for the protected and unprotected excess ADIT have not been completed as of the date of this order. The protected component to be flowed back to the ratepayers shall be computed by Spire Missouri in accordance with the normalization requirements of the TCJA. The Commission orders that the ADIT amount for purposes of rates in this case shall be reduced by $11.5 million. Additionally, the Commission orders that a tracker be established to defer any amounts in excess ADIT over or under the $11.5 million amount refunded in rates, from the effective date of rates resulting from this case, forward, for possible inclusion in a later rate case. Further, the determination of the actual split between protected and unprotected ADIT and the

appropriate amortization periods will be determined in Spire Missouri's next rate case."

In short, in their last rate case, Spire East's excess ADIT was $10.7 million per year and Spire West's excess ADIT was $0.8 million per year. However, these amounts were clearly estimates based on an assumed 50-50 protected/unprotected split and using a 20-year straight-line amortization period for protected ADIT and a 10-year amortization period for unprotected ADIT. In this rate case, Spire is proposing to true-up such estimates and provide the actual protected balance and unprotected balance, as well as the amortization period to be applied to each. . For the protected reversal period, the actual ARAM reversal period, which is dependent on the timing of tax versus book depreciation on individual assets and vintages was used for determining the ARAM reversal instead of the 20-year straight line amortization period used in the last rate case.

Q. HAS SPIRE DETERMINED THE ACTUAL EXCESS ADIT AND THE APPROPRIATE SPLIT BETWEEN PROTECTED AND UNPROTECTED EXCESS ADIT?

A. Yes. Spire has calculated the actual excess ADIT at September 30, 2017 and determined how much of the excess ADIT is protected versus unprotected. Instead of a 50%-50% split between protected and unprotected ADIT, the split should have been 46.33% of protected ADIT, 53.67% unprotected ADIT for Spire East and 27.81% protected, 72.19% unprotected for Spire West.

Q. HAS SPIRE RECALCULATED THE ARAM REVERSAL THAT WOULD HAVE OCCURRED IN THE LAST RATE CASE IF THE ACTUAL BALANCES OF AND

SPLITS BETWEEN PROTECTED AND UNPROTECTED ADIT WERE KNOWN AT THE TIME?

A. Yes. Using the actual ARAM reversal versus the 20-year straight line reversal used in the last rate case, Spire has been able to compute the difference between amounts that have been used to reduce customer rates since that last case to amounts that should have been used to reduce customer rates if the actual amounts and reversal periods were known at that time. Applying the actual ARAM calculation for 2018 through September 30, 2020 to the actual protected excess ADIT amounts results in an actual cumulative ARAM reversal of protected excess ADIT for Spire East of $4,688,387 compared to $6,295,231 that has reduced customer billings based on the estimates established in the last rate case. For Spire West, the actual ARAM reversal calculation for the protected excess ADIT from 2018 to September 30, 2020 is a reduction of $73,087 compared to a reduction of $471,464 based on the estimate determined in the last rate case, for a difference (customer billings were reduced too quickly) of $1,606,844 for Spire East and $398,377 for Spire West.

Q. WHAT DOES SPIRE PROPOSE WITH RESPECT TO THE PROTECTED EXCESS ADIT DIFFERENCE BETWEEN THE ESTIMATED AND ACTUAL ARAM REVERSALS?

A. As previously discussed, the TCJA rules prohibit the reversal of protected excess ADIT too quickly. Because of the high-level estimates of protected amounts and the reversal period for these protected amounts, the companies have reduced rates too quickly since the last rate case. If customer rates are reduced too quickly for this item, a normalization violation occurs. However, the IRS has provided guidance for such situations where the

impacts of the TCJA were considered by regulators with a subsequent revision to estimates. In Revenue Procedure 2020-39, the following guidance is provided:

> "(6) Transition Rules. Many utilities have already been required to adjust rates due to the TCJA. Utilities may correct any method of reversing ETR that is not in accord with this revenue procedure at the next available opportunity. The methods adopted prior to the publication of this revenue procedure that are not in accord with this revenue procedure are not considered to be a violation of the normalization rules if so corrected. This corrective action will require the utility to consult with its regulator and obtain its regulator's consent. Utilities are not in conflict with section 13001(d) of the TCJA if the utilities follow such a path to correct potential normalization violations prospectively. These rules extend to companies that may not have started the amortization of ETRs or may be re-deferring the amortization as they evaluate their records." (Revenue Procedure 2020-39, Effective August 14, 2020).

In short, the IRS stated that a normalization violation would not occur if, in the next rate case, amounts that were returned too rapidly were cured. That is the case here. The companies are proposing to recover the over-returned amounts over a three-year period, the estimated time period between rate cases. The amount of the required adjustment is thus $535,615 ($1,606,844 divided by 3= $535,615) for Spire East and $132,792 ($398,377 divided by 3 = $132,792) for Spire West.

Q. IS THE THREE-YEAR PERIOD SELECTED BY THE COMPANY TO ADDRESS THE RECOVERY OF THE PREVIOUSLY OVER-REFUNDED PROTECTED

EXCESS ADIT AN ACCEPTABLE APPROACH TO AVOID A NORMALIZATION VIOLATION?

A. While the IRS would make the ultimate decision as to whether a three-year recovery period is acceptable, based on the guidance in the Revenue Procedure a three-year period is not unreasonable. However, I would suggest that any period longer than three-years to recover the over-refunded protected excess ADIT would increase the risk of a potential normalization issue. As previously stated, the penalties for a normalization violation are severe.

Q. THE ADJUSTMENT YOU JUST DESCRIBED ADDRESSES THE ISSUE OF RETURNING PROTECTED EXCESS ADIT TOO QUICKLY. WHAT IS THE AMOUNT OF THE ARAM REVERSAL IN THE TEST YEAR EXCLUDING THIS ADJUSTMENT TO ADDRESS THE PRIOR OVER-RETURNING AMOUNT?

A. Based on the updated September 30 actual balances, Spire East has reduced income tax expense in this case by $2,066,229, the amount of the ARAM reversal of the protected excess ADIT in the test year (FY2020). Spire West has reduced income tax expense in this case by $15,955, the amount of the ARAM reversal of the protected excess ADIT in the test year.

Q. WHAT DO THE COMPANIES PROPOSE WITH RESPECT TO THE UNPROTECTED EXCESS ADIT.

A. Based on the actual, corrected balances, the unprotected excess ADIT balances at September 30, 2020, are $43,118,253 for Spire East and $6,624,504 for Spire West. These are the adjusted balances, correcting for the estimated balances established in the prior rate case, and will reverse over the remaining portion of the 10-year period established in the

previous rate proceeding, 7.58 years. This results in test year amortization of $5,685,923 for Spire East and $873,561 for Spire West.

In addition, when the amount of unprotected excess ADIT refunded to customers from the last rate case through September 30, 2020 (based on estimates) are compared to what the reversals in this period should have been if the actual unprotected balances would have been available at that time results in a difference of $1,150,520 for Spire East and $1,168,178 for Spire West, calculated as follows:

	Spire East	Spire West
Estimated amounts reducing customer rates		
from the last rate case through September 30, 2020	$12,590,461	$ 942,928
Less: actual amounts that should have reversed in the period		
from the last rate case through September 30, 2020	(13,740,982)	2,111,106)
Difference	$ 1,150,520	$1,168,178

. In order to true-up the estimates updated unprotected reversals for this period, $383,507 for Spire East ($1,150,520 divided by 3 = $383,507) and $389,393 for Spire West ($1,168,178 divided by 3 = $389,393) have been included in this rate case, representing the true-up amounts amortized over three years, similar to the catch-up period for the protected excess ADIT.

Q. WHAT IS NET IMPACT IN THIS RATE CASE OF TRUING-UP THE REVERSALS OF PROTECTED AND UNPROTECTED EXCESS ADIT ESTABLISHED IN THE LAST RATE CASE BASED ON ESTIMATES TO ACTUAL AMOUNTS OVER A THREE-YEAR AMORTIZATION PERIOD?

A. The net impact of truing-up estimated excess ADIT reversals to actual excess ADIT reversals is as follows:

	Spire East	Spire West
True-up of protected excess ADIT over three years (over refunded),	$535,615	$132,792
True-up of unprotected excess ADIT over three years (under refunded)	(383,507)	(389,393)
Net impact	($152,108)	$256,601

Q. WHY IS IT IMPORTANT TO TRACK THE OVER RETURN OF PROTECTED EXCESS ADIT SEPARATE FROM THE SHORTFALL IN RETURNING UNPROTECTED EXCESS ADIT?

A. The IRC & TCJA have stringent requirements for protected ADIT. The IRC & TCJA contain the previously described normalization rules, establishing guidance as to the appropriate ratemaking treatment of protected ADIT. The IRC & TCJA do not address ADIT relating to other book-tax differences (unprotected differences). As mentioned, the IRS has provided guidance on how to remedy potential normalization violations due to implementing the TCJA based on estimates. This guidance does not address unprotected differences which can be adjusted in a rate proceeding based on the decisions of the regulator. Said another way, the normalization rules cover only the protected ADIT and do not allow for mixing of protected and unprotected ADIT. That is why the adjustment to cure the actual versus estimated differences from the last rate case MUST be made for the protected differences.

Q. WHAT IS THE RATE BASE IMPACT OF EXCESS ADIT?

A. The companies have reduced rate base for the excess ADIT relating to the book-tax differences included as a rate base reduction. For Spire East, the amount of the rate base reduction for excess ADIT is $87,522,035. For Spire West, the amount of the rate base reduction for excess ADIT is $9,916,026. These balances represent the result of what total excess ADIT should have been on September 30, 2017 (in lieu of the estimated balances established at that time) less amounts actually refunded to customers based on the 2018 rate case settlement through September 30, 2020.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Spire Missouri Inc.'s Verified Request for Authority to Implement a General Rate Increase for Natural Gas Service Provided in the Company's Missouri Service Areas.	))))))	Case No. GR-2021-0108

AFFIDAVIT

STATE OF ILLINOIS	)	
	)	SS.
COUNTY OF COOK	)	

Alan D. Felsenthal, of lawful age, being first duly sworn, deposes and states:

1. My name is Alan D. Felsenthal. I am a Managing Director at PricewaterhouseCoopers LLP. My business address is 1 North Wacker Drive, Chicago, Illinois, 60606.

2. Attached hereto and made a part hereof for all purposes is my direct testimony on behalf of Spire Missouri, Inc.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief

Alan D. Felsenthal

December 11, 2020

Exhibit A

CURRICULUM VITAE

ALAN D. FELSENTHAL

EDUCATIONAL BACKGROUND

June, 1971	B.S. in Accounting University of Illinois Champaign, Illinois
May, 1972	Certified Public Accountant

EMPLOYMENT

2010-	Managing Director, Power and Utilities PricewaterhouseCoopers LLP
2008-2010	Managing Director-Utilities Industry Huron Consulting Group
2002-2007	Managing Director—Utilities Industry PricewaterhouseCoopers LLP
1985-2002	Principal in Utilities and Telecommunications Practice, Arthur Andersen LLP, Chicago
1976-1985	Manager in Utilities and Telecommunications Practice, Arthur Andersen LLP, Chicago
1971-1976	Staff and Senior Accountant, Arthur Andersen LLP, Utilities and Telecommunications Division, Chicago

TESTIMONY EXPERIENCE

Testified before the Illinois Commerce Commission on behalf of Town Gas Company of Illinois, 1985. Accounting witness covering cost of service issues.

Testified before the Illinois Commerce Commission on behalf of Town Gas Company of Illinois, 1986. Generic hearing regarding high gas costs.

Testified before the Florida Public Service Commission on behalf of Central Telephone Company of Florida (1991). Testimony addressed projected test year,

a computer model we developed to simplify forecast procedures and propriety of including pension asset in rate base.

Submitted an expert report and testified in an appeal by Yellow Cab Company versus the City of Chicago, (2000). Topic dealt with the adequacy of taxicab lease rates. Yellow Cab was appealing the lease rates they were permitted to charge lessees. The model developed by the City of Chicago to set lease rates was based on traditional utility ratemaking principles. Was hired by the City of Chicago to review Yellow Cab's appeal compared to traditional ratemaking principles and submit a report. Yellow Cab appealed the decision and a hearing before a judge resulted.

Testified before the Arizona Corporation Commission on behalf of Tucson Electric Power Company, 2008. Rebuttal testimony addressed application of FAS 71 when a portion of the business was opened to competition and appropriate treatment of the FAS 143 cost of removal regulatory liability.

Testified before the Florida Public Service Commission on behalf of Tampa Electric Company and Peoples Gas, (2008). Direct testimony on income taxes, including the appropriate accumulated deferred income tax calculation when a projected test period is used.

Testified before the Washington Utilities and Transportation Commission on behalf of Avista Corporation, (2008).

Testified before the Illinois Commerce Commission on behalf of The Peoples Gas, Light and Coke Company/North Shore Gas Company (2009). Rebuttal and Surrebuttal testimony on the appropriate treatment of prepaid pension asset in rate base.

Testified before the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2009). Rebuttal testimony on the appropriate treatment of cost of removal vis a vis FAS 143.

Submitted an expert report and a reply expert report to a Seattle-based arbitration panel in a dispute involving Grays Harbor Energy LLC vs. Energy Northwest, 2009. Subject involved the appropriate determination of fixed costs and cost of capital pursuant to a purchase and sale agreement.

Testified before the Public Utility Commission of Texas on behalf of Centerpoint Energy (2010). Direct and Rebuttal testimony on a number of income tax issues including consolidated income tax adjustments and FIN 48.

Testified before the Indiana Utility Regulatory Commission on behalf of Indianapolis Power & Light Company (2015). Rebuttal testimony on including prepaid pension asset in rate base.

Testified before the Public Utility Commission of Ohio on behalf of Dayton Power & Light Company (2015). Direct testimony on the results of a lead-lag study.

Submitted rebuttal testimony to the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2016) on the appropriateness of including the prepaid pension asset in rate base.

Submitted an expert report to the Virginia State Corporation Commission regarding the allocation of Dominion Resources Inc. shared service costs to Virginia Electric Power Company (2016).

Submitted an expert report to the Oregon Public Service Commission regarding the capitalization of administrative and general overhead costs. (2017).

Testified before the Florida Public Service Commission on behalf of Tampa Electric Company and Peoples Gas on the subject of the appropriate treatment of excess Accumulated Deferred Income Taxes resulting from the Tax Cuts and Jobs Act (2018).

Testified before the Indiana Utility Regulatory Commission on behalf of Indianapolis Power & Light Company (2018). Rebuttal testimony supporting a return on the Company's prepaid pension asset.

Testified before the FERC on behalf of GridLiance West (2018). Direct testimony supporting the derivation and reasonableness of the Company's Start-Up Regulatory Asset.

Submitted rebuttal testimony to the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2019) on reasons why including a return on the Company's prepaid pension asset is appropriate.

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of Elizabethtown Gas Company (2019) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers after the acquisition of the Company from Southern Company by South Jersey Industries.

Submitted direct testimony to the Hawaii Public Utilities Commission on behalf of Young Brothers (2019) on a number of income tax topics (Excess Accumulated Deferred Income Taxes, including the NOL Deferred Tax Asset in Rate Base, treatment of the Hawaii Capital Goods Excise Tax Credit) and including the prepaid pension asset in rate base.

Participated on accounting panels before the Maine Public Utilities Commission supporting 1) a market study of Central Maine Power Company's shared service costs and 2) the treatment of Excess Accumulated Deferred Income Taxes (2019).

Submitted rebuttal testimony before the Utah Public Service Commission on pension accounting symmetry in connection with the rate case of Dominion Energy Utah (2019).

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of South Jersey Gas Company (2020) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers using the Average Rate Assumption method for protected book-tax differences to comply with the Tax Cuts and Jobs Act.

Participated on a panel before the Connecticut Public Regulatory Authority supporting GenConn Energy LLC's Accumulated Deferred Income Taxes in their Revenue Requirement proceeding (2020).

Submitted direct testimony before the Public Service Commission of West Virginia for Dominion Energy West Virginia (Hope Gas) supporting 1) the treatment of excess Accumulated Deferred Income Taxes and 2) why it is inappropriate to include Accumulated Deferred Income Tax and Excess Accumulated Deferred Income Tax balances as a rate base offset when the book-tax difference relates to costs not being recovered in revenue requirements. (2020)

REGULATORY CONSULTING EXPERIENCE

Synopsis—Throughout the late 1970's, the 1980's, 1990's, 2000's and 2010's assisted Andersen and PwC partners in the preparation of regulatory testimony covering a variety of accounting issues. Much of this testimony involved income tax accounting issues related to flow-through versus normalization or investment tax credit and the appropriate accounting and ratemaking treatment of excess

accumulated deferred income taxes when statutory tax rates change. Also developed testimony on CWIP in rate base and working capital (lead-lag technique), appropriateness of allocation of service company costs to regulated entities, recovery of pre-operating cost regulatory assets and capital structure issues.

In 2015, assisted with the preparation of an Expert Report for EverSource Energy subsidiary Connecticut Light & Power which was submitted to the Connecticut regulator. The issue concerned reopening a rate order to address the treatment of accumulated deferred income taxes which was incorrectly decided in the rate order.

In 2018, assisted with the preparation of a private letter ruling by American Transmission Company as to whether an internal transfer between a regulated and non-regulated partner would trigger the elimination of accumulated deferred income taxes that would need to be reflected on the books and records of the partnership.

In 2018 and 2019, assisted with the preparation of Expert testimony and a private letter ruling discussing the appropriate income tax treatment of a like-kind exchange between Oncor and Sharyland. The issue concerned whether the accumulated deferred income taxes relating to the exchanged assets could carry over or would need to be eliminated.

Provided assistance on rate case testimony for the following companies:

- Ameritech Corporation
- Central Illinois Light Company
- Central Illinois Public Service Company
- Central Telephone Company of Florida
- Central Telephone Company of Nevada
- Central Telephone Company of Texas
- Connecticut Light and Power Company
- Dayton Power & Light Company
- Dominion Energy Utah

- Elizabethtown Gas Company
- El Paso Electric Company
- GridLiance Corporation
- Hawaiian Electric Companies
- Indiana Bell Telephone Company
- Indianapolis Power & Light Company
- Integrys Energy Group, Inc.
- Iowa-Illinois Gas and Electric Company
- Iowa Power Company
- New Mexico Gas Company
- Northern Indiana Public Service Company
- Pacific Gas & Electric Company
- Peoples Gas Systems (Tampa)
- PPL Montana (contract dispute)
- The Peoples Gas Light and Coke Company
- Public Service Company of New Mexico
- San Gabriel Valley Water Company
- Southern Bell Telephone Company
- South Jersey Gas Company
- Tampa Electric Company/Peoples Gas Company
- Transco Pipeline
- Young Brothers, Limited

Provided regulatory consulting for the Panama Canal Company. Tariffs charged to transit the Panama Canal were based on a cost of service approach. Assisted the Panama Canal Company in determining test year costs. Tariffs were established based on these costs.

2012-2020. Led several projects to evaluate a rate case filing prior to filing validating the completeness, accuracy, consistency and support of the filing. As a result, adjustments and edits were made to the filing to increase the credibility of the utility's filing. Provided a similar role with respect to date request responses and rebuttal testimony.

FINANCIAL CONSULTING EXPERIENCE

Assisted two Chinese utility companies in registration filings to have their shares traded on the New York Stock Exchange. Huaneng Power International and Shandong Huaneng Power Company were the first two Chinese utilities to list on

the NYSE. Process involved working with attorneys, company personnel and the Securities and Exchange Commission to file the equivalent of a Form S-1.

Assisted a number of companies in the preparation, review and filing of Registration Statements with the SEC to raise debt and equity capital. Consulted with an electric transmission company on whether costs charged to generation companies based on specific costs are in accordance with the costs permitted by the Federal Energy Regulatory Commission.

Consulted with Ameritech Corporation on a number of projects involving cost allocations and compliance with the Federal Communications Commission separations rules.

Consulted with several entities in the preparation of a private letter ruling request to determine whether certain regulatory/ratemaking approaches would violate the Internal Revenue Service ("IRS") normalization rules. Provided the ratemaking aspect of the request when, combined with income tax consulting assistance formed the basis for a complete request, accepted by the IRS.

FINANCIAL AUDIT EXPERIENCE

- Allegheny Energy
- Ameritech Cellular
- Ameritech Corporation
- Ameritech New Media
- Centel Corporation
- Chicago Skyway
- Constellation Energy
- Focal Communications
- Iowa-Illinois Gas and Electric Company
- Louisville Gas and Electric Company
- Nicor, Inc.
- Nisource
- Peoples Energy
- United Airlines
- Utilities, Inc.

Exhibit A

LECTURES AND SEMINARS

Speaker at Edison Electric Institute/American Gas Association Introductory, Intermediate and Advanced Accounting Seminar 1996-2019.

Speaker at SNL (Regulatory Research Associates) Utility Foundations Seminar 2013-2017

Speaker at Power Plan Associates annual conference (2012, 2010, 2008, 2006, 2004, 2002) on recent accounting, regulatory and SEC matters affecting utilities.

Developed and conducted Utilities Industry Basic Accounting and Ratemaking Seminar. This two-day seminar is conducted each year for Andersen, Huron and PwC personnel assigned to utility audits or projects. In addition, the seminar is periodically offered on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Developed and conducted Utility Income Taxes-Accounting and Ratemaking Issues. This two-day or two-and-a-half day seminar has been conducted each year for Andersen, PwC and Huron personnel assigned to utility audits or income tax projects. The seminar focus is the accounting, tax return/compliance and financial statement aspects of utility income taxes taking into consideration the consequences of ratemaking/revenue requirements. In addition, the seminar is conducted annually on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Developed and conducted Rate Case Experience Seminar, a week-long seminar taking participants through the process of filing a rate case, including preparing direct testimony based on a mock case study and sitting for cross-examination. At the conclusion of the seminar, an Order is presented. The course is conducted each year on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Exhibit A

Specific examples of special training conducts for utility companies/regulators are as follows:

- Alaska Regulatory Commission
- American Electric Power
- American Water Works
- Ameritech Corporation
- Arizona Public Service Company
- Arkansas Public Service Commission
- Centerpoint Energy
- Cleco Corporation
- Consolidated Edison
- Consumers Power Company
- Dominion Resources
- Duke Energy
- Entergy Corporation
- Exelon Corporation
- Federal Energy Regulatory Commission
- Georgia Power Company
- Illinois Commerce Commission
- Louisville Gas and Electric Company
- National Grid
- Natural Gas Pipeline Company of America
- Nicor, Inc.
- Nisource, Inc.
- Northwest Pipeline
- Oklahoma Corporation Commission
- One Gas Corporation
- Peoples Energy
- Pepco Holdings, Inc.
- PG&E Corporation
- Portland General Electric Company
- PPL Corporation
- Qwest Corporation
- Sempra Energy
- Southern California Edison Company
- Sprint Corporation
- Tampa Electric Company
- The Southern Company
- Transco Pipeline
- Tucson Electric Power
- Williams Pipeline
- Xcel Energy

Exhibit A

PROFESSIONAL ASSOCIATIONS

American Institute of Certified Public Accountants

Illinois CPA Society

Exhibit B

ARAM ILLUSTRATION

Line No.	Year	Asset Cost	(A)	(B) 5-year MACRS Tax Rate	(A x B = C) Tax Depreciation	(A / 10 = D) Book Depreciation 10 yrs. S/L	(C - D = E) Tax over Book Difference	(F) Cumulative Tax Over Book Difference	(G) Tax Rate	(E x G = H) Originating Deferred	(E x G = I) ADIT Reversing Deferred	(F x G = J) ADIT Cumulative Balance	(K) Average Excess ADIT Rate	(E x K = L) Excess ADIT Reversing under ARAM	(M) Excess ADIT Cumulative Balance
1	2016		1,000,000	20.000%	200,000.00	100,000.00	100,000.00	100,000.00	35%	35,000.00		35,000			
2	2017			32.000%	320,000.00	100,000.00	220,000.00	320,000.00	35%	77,000.00		112,000			
2a	**Remeasurement at December 31, 2017**			-	-	-	-	**320,000.00**	**21%**	-		**67,200**			**44,800**
3	2018			19.200%	192,000.00	100,000.00	92,000.00	412,000.00	21%	19,320.00		86,520			44,800
4	2019			11.520%	115,200.00	100,000.00	15,200.00	427,200.00	21%	3,192.00		89,712			44,800
5	2020			11.520%	115,200.00	100,000.00	15,200.00	442,400.00	21%	3,192.00		92,904			44,800
6	2021			5.760%	57,600.00	100,000.00	(42,400.00)	400,000.00	21%	-	(8,904)	84,000	10.1266%	(4,294)	40,506
7	2022			0.000%	-	100,000.00	(100,000.00)	300,000.00	21%	-	(21,000)	63,000	10.1266%	(10,127)	30,380
8	2023			0.000%	-	100,000.00	(100,000.00)	200,000.00	21%	-	(21,000)	42,000	10.1266%	(10,127)	20,253
9	2024			0.000%	-	100,000.00	(100,000.00)	100,000.00	21%	-	(21,000)	21,000	10.1266%	(10,127)	10,127
10	2025			0.000%	-	100,000.00	(100,000.00)	-	21%	-	(21,000)	0	10.1266%	(10,127)	0
	Total				1,000,000.00	1,000,000.00	-			137,704.00	(92,904)			(44,800)	

(137,704)

$1,000,000 fixed asset placed in service on January 1, 2016
Book Depreciation using straight-line method, 10-year life, no half-year convention
Tax Depreciation using MACRS, five-year life

At the end of 2017, when the tax rate changes, the ADIT is remeasured at 21%. The remeasurement reclassifies a portion of the ADIT as Excess ADIT. (line 2a)
The remeasured ADIT reverses normally (i.e. the book tax difference times the current statutory rate) while the Excess ADIT reverses following ARAM

Average Rate (Column K) computed when the book-tax difference reverses (Column E-Year 2021). Computation is based on dividing the Excess ADIT balance at the time of reversal (44,800 in Column M) by the cumulative book-tax differences at the beginning of the year ($442,400 - the total originating differences in Column F). The average rate is 31.166 per cent, broken into 1) the statutory tax rate to apply to reversing book-tax differences (21 perecent) to clear the ADIT balance (Column I) and 2) the rate to apply to reversing book-tax differences to clear the Excess ADIT balance (Column L).

Ratemaking tax expense includes both the deferred tax expense (i.e originatind deferred or reversing defered) and rate base is reduced for both the Cumulative ADIT and Excess ADIT balances.