

Exhibit No.:
Issue: Regulatory Plan Amortization
Witness: Robert W. Hriszko
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2006-0314
Date Testimony Prepared: September 8, 2006

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2006-0314

REBUTTAL TESTIMONY

OF

ROBERT W. HRISZKO

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
September 8, 2006**

REBUTTAL TESTIMONY

OF

ROBERT W. HRISZKO

Case No. ER-2006-0314

1 **Q: Would you please state your name, occupation and business address?**

2 A: My name is Robert W. Hriszko. I am a managing director in the firm of
3 PricewaterhouseCoopers LLP. My business address is One North Wacker Drive,
4 Chicago, IL 60606.

5 **Q: Would you please describe the firm of PricewaterhouseCoopers (“PwC”)?**

6 A: PwC is an international firm of independent public accountants with offices throughout
7 the United States and in many countries. We have as clients a large number of both
8 publicly and privately owned companies. The firm performs audits of financial
9 statements, prepares and reviews income tax returns for all types of businesses, and
10 consults with businesses regarding financial, accounting and tax matters. PwC audits a
11 significant number of the electric, gas and telecommunications companies in the United
12 States.
13 PwC also performs financial and accounting consultation services for utility clients and
14 consults with utility clients on a variety of tax matters, including income tax issues raised
15 in utility rate cases.

16 **Q: Would you please describe your professional background and qualifications to**
17 **testify as an expert in this proceeding?**

1 I am a graduate of St. Mary's College in Winona, Minnesota, from which I obtained a
2 Bachelor of Arts degree in Accounting and Economics in 1964. I am also a graduate of
3 Northwestern University School of Law from which I obtained a Juris Doctor degree in
4 1967. I am a member of the American Institute of Certified Public Accountants, the
5 Illinois CPA Society, and the Tax Committee of the American Bar Association.

6 **Q: What experience have you personally had in the utility field?**

7 A: I have spent my entire career working with utility companies on industry issues. After a
8 35-year career at Arthur Andersen LLP, I presently assist in directing the PwC tax
9 practice for the utility industry in the U.S. and head the central region utility tax practice.
10 I have been with PwC for four years. I am also responsible for technical matters
11 involving federal income tax and related ratemaking issues. My responsibilities also
12 include consulting with our offices throughout the world on tax matters relating to utility
13 clients. In addition, I am responsible for the tax training programs the firm offers in the
14 utility industry.

15 **Q: Have you previously testified before regulatory agencies?**

16 A: Yes. I have testified before the Public Utility Commission of Texas, the Illinois
17 Commerce Commission, the Ohio Public Utility Commission, the Wisconsin Public
18 Utility Commission and the U.S. Treasury Department. My testimony has addressed the
19 normalization requirements of the Internal Revenue Code as applied to various factual
20 settings and various other tax issues in ratemaking proceedings.
21 In addition to my personal testimony, I have reviewed testimony prepared by my present
22 and predecessor firms and/or their clients on numerous occasions.

23 **Q: Have you previously testified in this proceeding?**

1 A: No, I have not.

2 **Q: What is the purpose of your rebuttal testimony?**

3 A: The purpose of my testimony is twofold: first, to rebut the contention of

4 Mr. Steve Traxler of the Missouri Public Service Commission ("MPSC") Staff that

5 Kansas City Power & Light Company ("KCPL") is not entitled to a tax gross-up on

6 Regulatory Plan amortization. Second, I would like to discuss the impact of a gross-up

7 on the amount that would be recorded for amortization expense and the associated

8 accumulated reserve for amortization and for deferred income tax expense and the

9 associated reserve for deferred income taxes.

10 **Q: What is your understanding of Regulatory Plan amortization?**

11 A: My understanding is that Regulatory Plan amortization is a mechanism previously agreed

12 to that provides additional cash to KCPL to insure that the Company maintains its debt at

13 investment grade. The additional cash requirement is triggered under a formula reflected

14 in the Regulatory Plan Stipulation and Agreement.

15 **Q: So Regulatory Plan amortization is a cash-flow concept?**

16 A: Yes.

17 **Q: If the formula of Regulatory Plan amortization results in a required amortization of**

18 **\$1,000, how much would KCPL have to collect from its ratepayers in order to**

19 **increase cash flow by \$1,000?**

20 A: KCPL would have to collect \$1,538 from its ratepayers.

21 **Q: Please explain.**

22 A: Regulatory Plan amortization results in additional book amortization which is treated

23 similarly to additional book depreciation. Thus, the additional revenue generated under

1 the amortization formula is offset dollar-for-dollar by additional book
2 depreciation/amortization in cost of service.

3 But there is no additional tax deduction available to KCPL on its income tax return as a
4 result of the additional book depreciation/amortization. Thus, KCPL will have an
5 increased tax liability to pay on the revenues generated by Regulatory Plan amortization.
6 Referring back to your example, in order for KCPL to increase cash flow by \$1,000, it
7 would have to collect \$1,538 because income taxes would be due on the additional
8 revenue. For illustration purposes, I have disregarded state income taxes and used the
9 federal income tax rate of 35%.

10	Additional Revenue	\$1,538
11	Tax at 35%	<u><538></u>
12	Cash Available to KCPL	\$1,000

13 **Q: Why is there no additional tax deduction for depreciation on KCPL's tax return**
14 **associated with Regulatory Plan amortization?**

15 A: There is no additional tax deduction for depreciation on KCPL's tax return because there
16 is no change in the tax basis of KCPL's assets. Tax depreciation on the tax return will be
17 exactly the same whether there is Regulatory Plan amortization or not.

18 **Q: How is tax depreciation computed on the tax return?**

19 A: Tax depreciation is computed by multiplying tax basis times a tax depreciation rate
20 determined under one of the methods allowed by the Internal Revenue Code; e.g.,
21 MACRS, ACRS, ADR, etc., depending on when the asset was placed in service.

22 **Q: So it is your conclusion that Regulatory Plan amortization must be grossed-up for**
23 **taxes?**

1 A: Yes. A tax gross-up is required to provide the needed cash flows to KCPL under the
2 formula.

3 **Q: Why does Mr. Traxler contend that the amortization should not be grossed-up for**
4 **income taxes?**

5 A: It is difficult to discern Mr. Traxler's reasoning. He appears to be assuming that any time
6 there is book depreciation/amortization there is automatically an associated amount of tax
7 straight-line depreciation. This is a faulty assumption. As I have stated previously,
8 KCPL will not be entitled to any additional tax depreciation on its tax return as a result of
9 Regulatory Plan amortization.

10 Mr. Traxler appears to be confusing the computation of deferred taxes on accelerated tax
11 depreciation with the computation of increased cash flows resulting from amortization.
12 They have nothing to do with each other. To contend otherwise would be mixing apples
13 and oranges. Regulatory Plan amortization is a cash-flow concept. Thus, it is taxes
14 currently payable on a tax return that must be considered in determining the cash taxes to
15 be paid and, thus, the net cash available to KCPL.

16 **Q: But isn't there a tax deduction associated with other types of amortization on**
17 **KCPL's books, such as for computer software and leasehold improvements?**

18 A: Yes. The key distinction between Regulatory Plan amortization and amortization of
19 computer software and leasehold improvements is that the latter items have tax basis and
20 thus result in an amortization/depreciation deduction for tax purposes. Regulatory Plan
21 amortization does not have tax basis associated with it.

22 **Q: Does Mr. Traxler recognize that a gross-up for income taxes may be required?**

23 A: Yes. On page 22, lines 6-10, Mr. Traxler quotes the original Stipulation and Agreement:

1 ... Additional taxes will be added to the
2 amortization to the extent that the Commission
3 finds such taxes to be appropriate ...

4 He goes on to state that the Commission may be required to decide the issue.

5 **Q: You indicated that the purpose of your testimony was twofold and that you would**
6 **like to discuss the impact of a gross-up on the amount that would be recorded for**
7 **amortization expense and the associated accumulated reserve for amortization and**
8 **for deferred income tax expense and the associated reserve for deferred income**
9 **taxes. Assuming that the MPSC Staff concurs that the amortization expense should**
10 **be grossed-up for income taxes, do you have any additional concerns?**

11 **A:** Yes. It is important that the amortization expense and the associated accumulated reserve
12 for amortization be recorded at an amount inclusive of the gross-up and that deferred tax
13 expense and the associated reserve for deferred income taxes be computed on the
14 grossed-up amortization expense amount.

15 **Q: Why is this necessary?**

16 **A:** KCPL needs to reflect the transactions related to additional amortization appropriately in
17 its financial statements. On Exhibit RWH-1, I have portrayed the effects of the additional
18 amortization using both a method whereby the amortization expense is not grossed-up
19 and under the method advanced by KCPL whereby the amortization expense is grossed-
20 up.

21 Under the first method, there is an effective tax rate on amortization expense of 100%.

22 This is a result of not reflecting the gross-up for taxes as additional amortization expense
23 and of not reflecting the deferred tax effects of the amortization expense. In order to

1 force the numbers to work under the first method, the tax effect of the original
2 amortization expense would be flowed through and treated as a permanent item. The
3 results of this methodology would skew the income tax expense amounts in the financial
4 statements and be misleading.

5 The KCPL methodology more accurately reflects the amortization expense and deferred
6 income tax expense and will not distort taxes in the financial statements.

7 **Q: Should the MPSC Staff object to the KCPL method of reflecting the additional**
8 **amortization expense and related deferred income taxes?**

9 A: I do not believe so. The KCPL accounting will not result in a different revenue
10 requirement now or in the future. Revenues, operating expenses and rate base, I believe,
11 would be the same under either methodology. KCPL is merely trying to avoid showing a
12 higher effective tax rate than should be shown.

13 **Q: Does this conclude your testimony?**

14 A: Yes, it does.

Kansas City Power & Light Company
Case No. ER-2006-0314

Income Statement Example

	<u>Amort Exp</u> <u>Reflected Excl</u> <u>Gross-up</u>	<u>Amort Exp</u> <u>Reflected Incl</u> <u>Gross-up</u>
Revenue	1,538	1,538
Amortization Expense	<u>(1,000)</u>	<u>(1,538)</u>
Book Income Before Tax	<u>538</u>	<u>0</u>
Current Tax Expense	538	538
Deferred Tax Expense	0	(538)
Total Tax Expense	<u>538</u>	<u>0</u>
Book Income After Tax	<u>0</u>	<u>0</u>
Effective Tax Rate	100%	0%

Rate Reconciliation

Book Income Before Tax	538	0
Statutory Rate	35%	35%
Taxes @ Statutory Rate	188	0
Flow through of Amortization Expense (1,000 x 35%)	350	0
Total Tax Expense as Reported	<u>538</u>	<u>0</u>

Rate Base Impact

Reserve for Amortization	(1,000)	(1,538)
Deferred Tax (Liability)/Asset	0	538
Net Future Effect on Rate Base	<u>(1,000)</u>	<u>(1,000)</u>

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

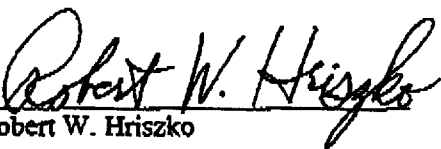
In the Matter of the Application of Kansas City)
Power & Light Company to Modify Its Tariff to) Case No. ER-2006-0314
Begin the Implementation of Its Regulatory Plan)

AFFIDAVIT OF ROBERT W. HRISZKO

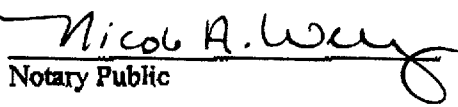
STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Robert W. Hriszko, being first duly sworn on his oath, states:

1. My name is Robert W. Hriszko. I work in Chicago, Illinois, and I am employed by PricewaterhouseCoopers LLP as a managing director.
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Kansas City Power & Light Company consisting of seven (7) pages and Schedule RWH- 1, having been prepared in written form for introduction into evidence in the above-captioned docket.
3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.


Robert W. Hriszko

Subscribed and sworn before me this 8th day of September 2006.


Notary Public

My commission expires: Feb. 4, 2007

NICOLE A. WEHRY
Notary Public - Notary Seal
STATE OF MISSOURI
Jackson County
My Commission Expires: Feb. 4, 2007