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Sponsoring Party: Public Counsel
Case No.: WO-2002-273

REBUTTAL TESTIMONY

FILED³

APR 09 2002

OF

Missouri Public
Service Commission

KIMBERLY K. BOLIN

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

Case No. WO-2002-273

April 9, 2002

NP

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

In the Matter of the Joint Application of Missouri-)
American Water Company, St. Louis County Water)
Company, d/b/a Missouri-American Water Company,)
and Jefferson City Water Works, d/b/a Missouri-) Case No. WO-2002-273
American Water Company, for an Accounting)
Authority Order Relating To Security Costs.)

AFFIDAVIT OF KIMBERLY K. BOLIN

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

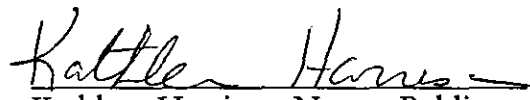
Kimberly K. Bolin, of lawful age and being first duly sworn, deposes and states:

1. My name is Kimberly K. Bolin. I am a Public Utility Accountant for the Office of the Public Counsel.
2. Attached, hereto and made a part hereof for all purposes, is my rebuttal testimony consisting of pages 1 through 21 and Schedule KKB-1.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


Kimberly K. Bolin

Subscribed and sworn to me this 9th day of April, 2002.

KATHLEEN HARRISON
Notary Public - State of Missouri
County of Cole
My Commission Expires Jan. 31, 2006


Kathleen Harrison, Notary Public

My Commission expires January 31, 2006.

REBUTTAL TESTIMONY

OF

KIMBERLY K. BOLIN

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WO-2002-273

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. Kimberly K. Bolin, P.O. Box 7800, Jefferson City, Missouri 65102.

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

4 A. I am employed by the Office of the Public Counsel of the State of Missouri (OPC or Public
5 Counsel) as a Public Utility Accountant I.

6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

7 A. I graduated from Central Missouri State University in Warrensburg, Missouri, with a Bachelor of
8 Science in Business Administration, major in Accounting, in May 1993.

9 **Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WITH THE OFFICE OF**
10 **THE PUBLIC COUNSEL?**

11 A. Under the direction of the Chief Public Utility Accountant, I am responsible for performing audits
12 and examinations of the books and records of public utilities operating within the state of Missouri.

13 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC**
14 **SERVICE COMMISSION (COMMISSION)?**

15 A. Yes. Please refer to Schedule KKB-1, attached to this direct testimony, for a listing of cases in
16 which I have previously submitted testimony.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to express the Public Counsel's evaluation, concerns and recommendations regarding Missouri-American Water Company's (Company) request that the Missouri Public Service Commission issue an Accounting Authority Order (AAO) to permit the deferral of security costs. I will address the Company's request for an Accounting Authority Order, filed on December 10, 2001, which initiated this case. The Company requested that the Commission order "that the Commission intends that rates established in the Company's next general rate case will include, among other things, treatment of the Company's prudently incurred costs pertaining to security of water plant, as described above, and, if amortized, an amortization of the Company's prudently incurred costs deferred pursuant to this AAO, over a period of time ending no later than three years after rates become effective in the Company's next rate case." I will also respond to comments and recommendations made in the direct testimony of Company witnesses, Edward Grubb and Frank Kartmann.

Q. WHAT IS THE ISSUE?

A. The Company is asking this Commission to authorize the deferral of certain expenses the Company alleges are the incremental costs resulting from the September 11, 2001 terrorist attack. The Company is further requesting that it be allowed to maintain these amounts on its balance sheet until the effective date of the Report and Order in the Company's next general rate proceeding. The Company has also requested a commitment from the Commission stating that the rates established in the Company's next general rate case will include the treatment of the Company's prudently incurred costs pertaining to security of water plant, and if amortized, an amortization of the Company's prudently incurred costs deferred pursuant to an AAO, over a period of time ending no

1 longer than three years after rates, incorporating the amortization, become effective in the
2 Company's next rate case.

3 **Q. WHAT IS AN ACCOUNTING AUTHORITY ORDER?**

4 A. An accounting authority order is an accounting mechanism that permits deferral of costs from one
5 period to another. The items deferred are booked as an asset rather than as an expense, thus
6 improving the financial picture of the utility in question during the deferral period. During a
7 subsequent rate case, the Commission determines what portion, if any, of the deferred amounts will
8 recovered in rates. AAOs should be used sparingly because they permit ratemaking consideration
9 of items from outside the test year.

10 **Q. DOES PUBLIC COUNSEL SUPPORT COMPANY'S REQUEST FOR AN**
11 **ACCOUNTING AUTHORITY ORDER?**

12 A. No. The Company's AAO request is an attempt to insulate its shareholders not only from
13 regulatory lag associated with the amortization of a deferral and also include an attempt to insulate
14 shareholders from Company's failure to establish security measures that should have been in place
15 prior to the September 11th terrorist attacks. The Company's request is based upon estimates of
16 future plant costs and future **on-going and recurring monthly expenses.**

17 **Q. IF THE MPSC GRANTS AN AAO, DOES PUBLIC COUNSEL SUPPORT**
18 **COMPANY'S REQUEST TO AMORTIZE THE PROPOSED AAO, OVER A TIME**
19 **PERIOD ENDING NO LONGER THEN THREE YEARS AFTER RATES BECOME**
20 **EFFECTIVE IN THE NEXT RATE CASE?**

1 A. No. A three-year amortization does not represent a reasonable amortization time period. It is unfair
2 and arbitrary. A more reasonable and realistic time period is one that allows the Company to
3 recover the deferred amounts parallel with the recovery of the investment upon which the deferral
4 was calculated. Under normal regulatory accounting, carrying costs (AFUDC) and property taxes
5 are added to an investment's balance during the period that the investment is categorized as
6 construction work in progress. These additional costs appropriately follow the investment to plant-
7 in-service upon its completion. The Company then recovers the total cost of the investment,
8 including the AFUDC and taxes, over the used and useful life of the investment. In many instances
9 these costs are associated with plant that is normally recovered over periods that far exceed a
10 twenty-year used and useful life. Public Counsel believes that, if the Commission decides to grant
11 the requested AAO, the time period for recovery of the deferred balances should be at least twenty
12 years.

13 **Q. IF THE AAO IS GRANTED SHOULD THE AMORTIZATION OF THE AAO**
14 **BEGIN IMMEDIATELY OR BEGIN WHEN NEW TARIFF RATES BECOME**
15 **EFFECTIVE?**

16 A. If the AAO is granted the amortization of the AAO should be begin as soon as the Report and Order
17 in this case takes effect. If the amortization begins when new tariff rates become effective, the
18 Commission will have effectively determined that it is appropriate to include the amortization
19 expense in the overall cost-of-service (i.e., revenue requirement) used to set rates for some
20 undefined future period in a potential future rate proceeding. This would be improper. Public
21 Counsel does not believe it is appropriate or consistent with past Commission precedent to make
22 such ratemaking determinations in an AAO proceeding.

1 Q. IS BEGINNING THE AMORTIZATION EFFECTIVE WITH THE REPORT AND
2 ORDER'S EFFECTIVE DATE IN THIS CASE CONSISTENT WITH THE
3 COMMISSION'S PAST TREATMENT OF AMOUNTS DEFERRED UNDER AN
4 ACCOUNTING AUTHORITY ORDER?

5 A. Yes. In Case No. EO-94-35, the Company was required to begin the amortization of amounts
6 deferred under an AAO immediately. Specifically in Case No. EO-94-35, (July/August 1993 flood)
7 the Company was allowed to accumulate costs related to flood costs through March 31, 1994, but
8 was required to begin the amortization on November 1, 1993.

9 Q. IS THE COMPANY ASKING THE COMMISSION TO DETERMINE FUTURE
10 RATEMAKING ISSUES IN THIS AAO REQUEST?

11 A. Yes. In the Company's Application for Accounting Authority Order, pages 6 and 7, the Company
12 has requested the Commission to issue its AAO with the following language:

13 b) That the Commission intends that rates established in the Companies' next general
14 rate case will include, among other things, treatment of the Companies' prudently
15 incurred costs pertaining to security of water plant, as described above, and, if
16 amortized, an amortization of the Companies' prudently incurred costs deferred
17 pursuant to this AAO, over a period of time ending no later than three years after
18 rates become effective in the Companies' next rate case.

19 Q. DOES THE COMMISSION GENERALLY ISSUE ORDERS IN AAO CASES WHICH
20 BIND THE COMMISSION TO A PARTICULAR RATEMAKING TREATMENT OF
21 THE AAO DEFERRALS IN FUTURE CASES?

1 A. No. The Commission stated in St. Louis County Water Company, Case No. WR-2000-844, page
2 24:

3 "Nothing binds the Commission to a particular ratemaking treatment of deferrals
4 made pursuant to an AAO:

5 In the Public Counsel case [State ex rel. Office of Public Counsel v. Public
6 Service Com'n of Missouri, 858 S.W. 2d 806, Mo.App. W.D. 1993]], the court
7 made it clear that AAOs are not the same as ratemaking decisions, and that AAOs
8 create no expectation that deferral terms within them will be incorporated or
9 followed in rate application proceedings."

10 **Q. WHAT IS THE AMOUNT OF THE TOTAL ESTIMATED SECURITY COSTS?**

11 A. The total estimated amount of incremental security costs that the Company will incur is estimated
12 anywhere between **_____. ** The Company claims the amount to be
13 incurred will vary depending the alert status under which the Company is operating.

14 **Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED ALERT STATUSES.**

15 A. The Company has defined **_____
16 _____, ** No specific
17 threat to the Company has been made. **_____
18 _____.

19 **Q. HAS THE COMPANY EVER INVOKED THE **_____** PROPOSED ALERT**
20 **STATUS?**

21 A. No. The Company has not received a specific terrorist threat. The Company has been at a **
22 _____

** to review and update security and emergency reponse plans.

**Q. WHAT AMOUNT OF SECURITY COSTS DEFERRALS DID THE COMPANY
INCUR IN 2001?**

A. The Company incurred ** _____ ** of capital costs and ** _____ ** of expense deferrals.
The Company has deferred both these amounts pending the outcome of this case.

**Q. WHAT AMOUNTS HAVE THE COMPANY ESTIMATED FOR SECURITY COSTS
DURING THE YEAR 2002?**

A. The Company has **estimated** spending ** _____ ** in capital costs and spending anywhere
between ** _____ ** in expenditures during the year 2002.

**Q. HOW DOES THIS DIFFER FROM ON-GOING SECURITY COSTS THE COMPANY
INCURRED PRIOR TO SEPTEMBER 11TH?**

A. Company's on-going prudent security costs are already built into rates.

Q. WILL ANY OF THE ESTIMATED EXPENSES BE ON-GOING MONTHLY COSTS?

A. Yes. The Company has estimated that anywhere from ** _____ ** will be on-
going monthly costs. The rest of Company's estimated expenses are one time expenditures in the
amount of ** _____ **.

1 Q. WHAT TYPES OF SERVICES SHOULD BE CONSIDERED ON-GOING MONTHLY
2 COSTS?

3 A. On-going monthly costs include ** _____

4 _____ **

5 Q. WILL THE COMPANY CONTINUE TO INCUR THESE TYPES OF EXPENSES
6 EVEN AFTER THE COMPANY'S NEXT RATE INCREASE CASE?

7 A. In all likelihood, yes. As recurring costs, these costs, if prudent, will then be included in the
8 Company's cost of service along with other expenses that the Company will incur in order to
9 provide service to its Missouri customers.

10 Q. HAS THE COMMISSION IN THE PAST REJECTED APPLICATIONS FOR AAOS
11 FOR ON-GOING EXPENSES?

12 A. Yes. For example, in Missouri Public Service Company, Cases No. EO-91-348 and EO-91-360, the
13 Commission stated:

14 Purchasing power or capacity to meet a company's demand for service is a
15 fundamental undertaking of a regulated utility. A utility must plan for future
16 demand and make a decision of how best to meet that demand. Purchase power
17 capacity contracts which ensure a source of supply of energy for a period are a
18 proper function of management. The fact that these contracts contain rate increases
19 or additional charges as they mature does not render them extraordinary or unique.
20 Costs of other service go up, while others may go down. If the commission
21 allowed deferral of these costs, then any expense with rising costs could arguably
22 be deferred. As the Commission has discussed earlier, only costs associated with
23 extraordinary, nonrecurring events should be deferred since they are not part of the
24 normal operating expenses of a company. Power purchases of this nature are not
25 extraordinary events.

The costs associated with the purchase power capacity contracts are recurring expenses. The Commission has established rates based upon both capacity costs and kW's purchased during the test year. The fact that these costs increase based upon the contract does not make them extraordinary. The fact that the contracts were entered into instead of building new peaking capacity does not make them extraordinary. The management of MPS is expected to make prudent and reasonable decisions to meet MPS's need for energy. This is a part of the normal operations of a utility and costs associated with these decisions are normal operating expenses which are recoverable through existing rates.

**Q. ARE COSTS RELATING TO SECURITY MEASURES OF A WATER PLANT
NORMAL RECURRING EXPENSES?**

A. Yes.

**Q. WHAT IS THE COST DIFFERENCE BETWEEN THE COMPANY'S ESTIMATE
FOR ** _____ ? ****

A. ** _____ . **

**Q. HOW MANY DAYS HAS THE COMPANY ESTIMATED THE COMPANY WILL BE
UNDER THE ** _____ ? ****

**A. The Company has figured ** _____

_____ . ****

1 Q. WHAT ARE SOME OF THE IMPROVEMENTS THE COMPANY HAS MADE OR
2 WILL MAKE?

3 A. The Company has **
4 _____ **

5 Q. SHOULD THE COMPANY HAVE MADE THESE TYPES IMPROVEMENTS BEFORE
6 SEPTEMBER 11, 2001?

7 A. Yes. Threats to water companies and actual property damage as a result of vandalism have
8 occurred prior to the September 11th terrorist attacks. In fact, the **
9 _____ ** has been subject to vandalism and trash dumping in the past. This has been a problem
10 the Company has needed to address and should have addressed prior to September 11, 2001.

11 Q. WOULD GRANTING THIS AAO INSULATE THE COMPANY FROM THE EFFECTS
12 OF REGULATORY LAG?

13 A. Yes. The AAO insulates the Company's shareholders from a significant majority of the risks
14 associated with regulatory lag by allowing the Company to defer these costs prior to the time it may
15 seek to recover the costs in rates by filing a request for a rate increase.

16 Q. PLEASE EXPLAIN THE CONCEPT OF REGULATORY LAG.

17 A. This concept is based on the difference in timing of a decision by management and the
18 Commission's recognition of that decision and its effect on the rate base/rate of return relationship
19 in the determination of a company's revenue requirement. Regulatory lag sometimes operates to the
20 benefit of the shareholders and sometimes operates to the benefit of the customers. Prudent

1 management decisions, which reduce the cost of service without changing revenues, result in a
2 change in the rate base/rate of return relationship. This change increases the profitability of the firm
3 in the short-run, and until such time as the Commission reestablishes rates which properly match the
4 new level of service cost, companies are allowed to retain cost savings, i.e., excess profits during the
5 lag period between rate cases. When faced with escalating costs that will change the rate base/rate
6 of return relationship adversely with respect to profits, regulatory lag places pressure on
7 management to minimize the change in the relationship, by filing an application for a rate increase
8 to minimize the negative effect on shareholder returns.

9 **Q. HAS THIS COMMISSION RULED WHETHER IT IS REASONABLE TO PROTECT**
10 **SHAREHOLDERS FROM ALL REGULATORY LAG?**

11 A. Yes. In Missouri Public Service Company, Cases Nos. EO-91-348 and EO-91-360, the
12 Commission stated:

13 Lessening the effect of regulatory lag by deferring costs is beneficial to a company
14 but not particularly to ratepayers. Companies do not propose to defer profits to
15 subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit
16 to defer costs. Regulatory lag is a part of the regulatory process and can be a
17 benefit as well as a detriment. Lessening regulatory lag by deferring costs is not a
18 reasonable goal unless the costs are associated with an extraordinary event

19 Maintaining the financial integrity of a utility is also a reasonable goal. The
20 deferral of costs to maintain current financial integrity though is of questionable
21 benefit. If a utility's financial integrity is threatened by high costs so that its ability
22 to provide service is threatened, then it should seek interim rate relief. If
23 maintaining financial integrity means sustaining a specific return on equity, this is
24 not the purpose of regulation. It is not reasonable to defer costs to insulate
25 shareholders from any risks. If costs are such that a utility considers its return on
26 equity unreasonably low, the proper approach is to file a rate case so that a new
27 revenue requirement can be developed which allows the company the opportunity
28 to earn its authorized rate of return. Deferral of costs just to support the current
29 financial picture distorts the balancing process used by the Commission to establish

1 just and reasonable rates. Rates are set to recover ongoing operating expenses plus
2 a reasonable return on investment. Only when an extraordinary event occurs
3 should this balance be adjusted and costs deferred for consideration in a later
4 period (Emphasis added).

5 **Q. SHOULD CUSTOMERS BE REQUIRED TO PROVIDE THE COMPANY WITH AN**
6 **EFFECTIVE GUARANTEED RETURN ON THE SECURITY EXPENDITURES JUST**
7 **BECAUSE THE COMPANY'S MANAGEMENT CHOOSES NOT TO EXERCISE ITS**
8 **PLANNING AND OPERATING RESPONSIBILITIES?**

9 **A.** No, customers should not be required to fund such a guaranteed return. Planning and operations of
10 the Company's security costs are a fundamental responsibility of Missouri-American's
11 management. Only management has complete access to the data and resources necessary to fulfill
12 these responsibilities. As such, management can take steps to minimize the effects of regulatory lag
13 on the Company's finances. To the extent regulatory lag moves against the company, the
14 Commission has already decided, as mentioned earlier, that lessening regulatory lag by deferring
15 costs is not a reasonable goal.

16 The purpose of the accounting variance sought in this case is to protect the Company from any
17 adverse financial impact caused by the regulatory delay period, and to afford it the opportunity to
18 recover these charges from customers. The accounting variance should not be used to place the
19 Company in a better position than it would have been in if plant investment and rate synchronization
20 had been achieved.

1 **Q. HAS THE COMPANY STATED WHEN IT PLANS TO FILE ITS NEXT GENERAL**
2 **RATE CASE?**

3 A. Yes, Company witness Edward Grubb stated in his direct testimony on page 5, "The Company has
4 tentatively set June 2003, as its date to file its next rate case."

5 **Q. PLEASE EXPLAIN THE TERMS " RETURN OF" AND " RETURN ON."**

6 A. If an expenditure is recorded on the income statement as an expense it is compared dollar for dollar
7 to revenues. This comparison is referred to as a "return of" because a dollar of expense is matched
8 by a dollar of revenue.

9 "Return on" occurs when an expenditure is capitalized within the balance sheet because it increased
10 the value of a balance sheet asset or investment. This capitalization is then included in the rate base
11 calculation, which is a preliminary step in determining the earnings the company achieves on its
12 total regulatory investment.

13 **Q. WHAT IS THE PRACTICAL EFFECT OF AN AAO WITH RESPECT TO HOW A**
14 **COMPANY REPORTS ITS EARNINGS?**

15 A. An AAO allows the Company to "manage" its reported earnings by ignoring costs incurred (to
16 produce revenue) in a specific period that would have an impact on earnings (always negative).
17 These costs are then included in the determination of earnings for several periods in the future and
18 thus minimize the negative impact on reported earnings in any one-year.

1 Q. IS THIS "MANAGEMENT OF EARNINGS" A GOAL OF, OR BASED ON,
2 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES?

3 A. Most definitely not. The Commission should use extreme caution when deciding whether to issue
4 AAOs and also recognize that GAAP allow the recording of an asset (or deferral of costs) on the
5 balance sheet only if that asset reasonably represents the flow of future cash revenues. It is
6 analogous to the recording of a debit to Allowance for Funds Used During Construction (which
7 increases Plant-in Service) and the corresponding credit entry increasing revenue (but not cash
8 receipts) for the period. The cash will be received in future periods when the plant-in-service is
9 depreciated.

10 Public Counsel recognizes that MPSC decisions addressing AAOs normally contain language
11 expressly excluding ratemaking findings. Public Counsel believes the Commission should continue
12 to recognize this divergence from GAAP and only use AAOs when it can be shown that the costs
13 deferred were incurred in response to events that are non-recurring and beyond the control of
14 management.

15 Q. DO EVENTS WHICH RESULT IN EXPENSE CHANGES RELATED TO
16 AMORTIZATION OF AN AAO OCCUR IN A VACUUM WITH RESPECT TO
17 OTHER POSSIBLE CHANGES IN THE OPERATION OF THE UTILITY?

18 A. No. The overall cost of service is made up of a many factors. Isolating or focusing on only one
19 component, such as AAO amortization, fails to look at all relevant factors in determining the overall
20 cost of service. Other factors may have changed that have a corresponding decrease or increase on

1 the overall cost of service. Unless all factors are analyzed, it is not appropriate to single out one
2 specific event.

3 **Q. WHAT MUST THE COMPANY ESTABLISH BEFORE THE COMMISSION WILL**
4 **GRANT AN AAO?**

5 A. The Company must provide evidence that establishes that the expenses, which the Company seeks
6 to defer, are unique, extraordinary and non-recurring.

7 **Q. WAS THE COMMISSION'S "EXTRAORDINARY AND NONRECURRING"**
8 **STANDARD AS OULINED IN RE: M.P.S AFFIRMED BY THE WESTERN**
9 **DISTRICT COURT OF APPEALS?**

10 A. Yes, the Western District Court of Appeals states:

11 "[An AAO deferral] . . . distorts the balancing process utilized by the Commission
12 to establish just and reasonable rates. Because rates are set to recover continuing
13 operating expenses plus a reasonable return on investment, only an extraordinary
14 event should be permitted to adjust the balance . . ." State ex. Rel. Missouri Office
15 of the Public Counsel v. Public Service Commission, 858 S.W. 2d 806, 810 (Mo.
16 App. 1993).

17 The Court of Appeals also noted that the Uniform System of Accounts (USOA) defines
18 "extraordinary items" as:

19 [t]hose items related to the effects of events and transactions which have occurred
20 during the current period and which are not typical or customary business activities
21 of the company . . . Accordingly, they will be events and transactions of significant
22 effect which would not be expected to recur frequently and which would not be
23 considered as recurring factors on any evaluation of the ordinary operating
24 processes of business. . . Id at 810.

1 **Q. WHAT DOES THE COMPANY MEAN WHEN IT USES THE TERM " DEFER" ?**

2 A. When a cost that normally would be expensed and therefore reflected on the income statement in
3 the current accounting period is deferred, the expenditure is entered on the balance sheet in a special
4 section called deferred debits. In this case, the specific account Missouri-American proposes to
5 utilize is Account 182.3, Other Regulatory Assets. The Company's request to defer costs pertaining
6 to security of water plant falls into this category.

7 **Q. PLEASE DEFINE EXPENDITURE?**

8 A. An expenditure is any outflow of money paying for a good or service. An expenditure is either
9 capitalized (recorded on the balance sheet) or it is considered an expense (recorded on the income
10 statement).

11 **Q. WHAT IS AN EXPENSE?**

12 A. Expense is the use of assets and services in the creation of revenue during a specific period.
13 Expenses are recorded on the income statement and are subtracted from revenues in order to
14 determine net income for the period.

15 **Q. PLEASE DEFINE THE TERM " COST" .**

16 A. I use the term "costs" to refer to each component of the total revenue requirement of the utility.
17 Cost includes all expenses along with the earnings and interest expense associated with the rate
18 base. The total revenue requirement is also called the cost of service.

1 Q. HAVE YOU REVIEWED THE NATIONAL ASSOCIATION OF REGULATORY
2 UTILITY COMMISSIONERS (NARUC), UNIFORM SYSTEM OF ACCOUNTS FOR
3 CLASS A AND B WATER UTILITIES (USOA)?

4 A. Yes.

5 Q. ARE THE DEFINITIONS YOU PREVIOUSLY PROVIDED CONSISTENT WITH
6 HOW THE USOA APPLIES THESE TERMS?

7 A. Yes.

8 Q. FROM A REGULATORY ACCOUNTING PERSPECTIVE, WHAT OCCURS WHEN AN
9 EXPENSE IS DEFERRED PURSUANT TO AN ACCOUNTING AUTHORITY
10 ORDER?

11 A. From a regulatory accounting perspective, when a cost has been deferred it is not recognized on the
12 income statement as an expense in the current period. The expenditures are recorded on the balance
13 sheet in a section called Deferred Debits, pending the final disposition of the costs at some future
14 point, usually in a rate case. These deferred debit accounts act simply as a temporary holding
15 accounts until the appropriate accounting ratemaking treatment can be determined.

16 Q. IS THE DEFERRAL OF A COST FROM ONE ACCOUNTING PERIOD TO
17 ANOTHER ACCOUNTING PERIOD FOR THE DEVELOPMENT OF A REVENUE
18 REQUIREMENT CONSISTENT WITH TRADITIONAL RATEMAKING PRACTICES?

19 A. No. Generally, the deferral of costs from one accounting period to another accounting period for
20 the development of a revenue requirement violates the traditional method of setting utility rates.

1 Rates in Missouri are usually established based upon a historical test period which focuses on four
2 factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a
3 return may be earned; (3) the depreciation expense related to plant and equipment; and (4) the
4 allowable operating expenses including income and other taxes.

5 The relationship of the four factors is such that the expenses and rate base necessary to produce the
6 revenues are synchronized. For example, the level of expense is developed based on the expected
7 amount of sales that is used in the determination of revenue for the test period. Similarly, the plant-
8 in-service necessary to produce or deliver water to customers is also based on the customers'
9 demands for the same period. This process is often referred to as the "Matching Principle".

10 Deferral of expenses from one period to another (and the amortization in subsequent periods) results
11 in costs associated with the production of revenue in one period being charged against the revenue
12 in different unrelated periods. This violates the "Matching Principle" and if unfettered would allow
13 a utility to manage its earnings in order to avoid regulatory oversight or adverse reactions from the
14 financial community. In my professional opinion, avoiding this possibility is one of the
15 fundamental purposes of generally accepted accounting principles and the USOA.

16 **Q. HAS THE COMMISSION ALLOWED REGULATED UTILITIES SUCH AS**
17 **MISSOURI-AMERICAN WATER COMPANY TO DEVIATE FROM TRADITIONAL**
18 **RATEMAKING PRACTICES TO DEFER COSTS FROM ONE ACCOUNTING**
19 **PERIOD TO ANOTHER ACCOUNTING PERIOD VIA AN ACCOUNTING**
20 **AUTHORITY ORDER?**

1 A. Yes. The Commission has determined that utilities, when warranted, can be allowed to defer costs
2 from prior accounting periods on a limited basis when events occur during a period which are
3 extraordinary, unusual and unique, and nonrecurring.

4 Q. IN PREVIOUS REPORT AND ORDERS HAS THE COMMISSION EMPHASIZED
5 THAT AAOS MOST PROPERLY ADDRESS ONLY " EXTRAORDINARY AND NON-
6 RECURRING" EVENTS?

7 A. Yes. The Commission stated in St. Louis County Water Company, Case No. WR-96-263, page 13:

8 As both the OPC and the Staff point out, the Commission has, to date, granted
9 AAO accounting treatment exclusively for one-time outlays of capital caused by
10 unpredictable events, acts of government, and other matters outside the control of
11 the utility or the Commission. It is also pointed out that the terms "infrequent,
12 unusual and extraordinary" connote occurrences which are unpredictable in
13 nature."

14 The Commission reiterated this position in United Water Missouri, Inc., Case No. WA-98-187, page
15 6-7.

16 In order to justify the issuance of an Accounting Authority Order to permit the
17 deferral of such costs, the costs incurred by the utility must result from an event or
18 circumstance that is extraordinary, unusual and unique, and not recurring.

19 Q. DOES THE COMMISSION MERELY CONSIDER THE FINANCIAL IMPACT TO A
20 COMPANY WHEN DECIDING WHETHER TO GRANT AN AAO?

21 A. No.

1 **Q. IF FINANCIAL IMPACT WAS THE ONLY CONSIDERATION, WOULD THAT**
2 **OPEN A FLOODGATE OF OPPORTUNITY FOR UTILITIES TO ATTEMPT TO**
3 **MANAGE THEIR EARNINGS THROUGH THE USE OF AN AAO?**

4 **A.** Yes. An event such as an abnormally cool summer or warm winter would have a significant impact
5 on earnings. Other significant impacts could occur from any event in the normal course of utility
6 operations that had a material impact on earnings. Other cyclical costs that are normalized for
7 ratemaking treatment but expensed on the utilities financial records include tree-trimming expenses
8 for electric utilities, tank painting for water utilities, and over-time hours. However, these are not
9 appropriate subjects for an AAO.

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

11 **A.** Public Counsel is opposed to the Company's request for Accounting Authority Order to defer costs
12 pertaining to the security of its water plant facilities. Public Counsel believes the Company should
13 have had security measures in place before September 11, 2001. Also, some of these costs the
14 Company will incur are monthly on-going costs, that may be considered in the Company's cost of
15 service, along with other normal, on-going expenses in the Company's next rate case. On-going
16 costs are recurring and so they are not appropriate subject matter for an AAO. The Company has
17 stated it plans to file their next rate case June 2003. If the costs are too significant for the Company
18 to incur, the Company could file a general rate case. Another reason Public Counsel is opposed to
19 this AAO is most of the costs the Company says they will incur are based upon estimates, that vary
20 by over a **, _____, ** depending on what alert status the Company is operating under.

Rebuttal Testimony of
Kimberly K. Bolin
Case No. WO-2002-273

1 Whether or not the Commission grants the Company's request for an AAO, the Commission should
2 reserve all ratemaking decisions related to the proposed AAO until the next rate case.

3 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

4 **A. Yes.**

CASE PARTICIPATION
OF
KIMBERLY K. BOLIN

<u>Company Name</u>	<u>Case Number</u>
St. Louis County Water Company	WR-95-145
Missouri-American Water Company	WR-95-205
Steelville Telephone Company	TR-96-123
St. Louis Water Company	WR-96-263
Imperial Utility Corporation	SR-96-427
Missouri-American Water Company	WA-97-45
Associated Natural Gas Company	GR-97-272
St. Louis County Water Company	WR-97-382
Union Electric Company	GR-97-393
Gascony Water Company, Inc.	WA-97-510
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GR-98-374
St. Joseph Light & Power	ER-99-247
	GR-99-246
	HR-99-245
Laclede Gas Company	GR-99-315
Missouri-American Water Company	WR-2000-281
St. Louis County Water Company	WR-2000-844
Osage Water Company	SR-2000-556
	WR-2000-557
Empire District Electric Company	ER-2001-299
Gateway Pipeline Company	GM-2001-585
Warren County Water & Sewer	WC-2002-155
	SC-2002-160
Laclede Gas Company	GR-2001-629
Environmental Utilities	WA-2002-65