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Income Taxes
Witness: JAMES M. RUSSO
Sponsoring Party: MoPSC Staff
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Case No.: SR-2000-556

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MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

DIRECT TESTIMONY
OF

JAMES M. RUSSO

OSAGE WATER COMPANY

CASE NO. SR-2000-556

Jefferson City, Missouri
February 2001

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DIRECT TESTIMONY

OF

JAMES M. RUSSO

OSAGE WATER COMPANY

CASE NO. SR-2000-556

Q. Please state your name and business address.

A. James M. Russo, P. O. Box 360, Jefferson City, Missouri 65102.

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

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Please describe your educational background and other qualifications.

A. I graduated from California State University-Fresno, Fresno, California and received a Bachelor of Science degree in Accounting. Prior to my employment with the Commission, I was employed in various capacities by local elected officials in county government. I was the assistant treasurer-tax collector for San Joaquin and El Dorado Counties in California. My responsibilities included all financial dealings of the county and all accounting activities of the agency. In addition, I was the supervising accountant auditor in El Dorado County for two years. My division was responsible for internal audits of all county agencies, special districts and franchise/lease agreements.

Q. Have you previously testified before this Commission?

A. Yes, I have. Please refer to Schedule 1, which is attached to this direct testimony, for a list of cases in which I have previously filed testimony.

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1 Q. With reference to Case No. SR-2000-556, have you made an examination of
2 the books and records of Osage Water Company (OWC)?

3 A. Yes, in conjunction with other members of the Commission Staff (Staff).

4 Q. Please describe your principal areas of responsibility in this case.

5 A. My principal areas of responsibility are revenues, Staff's recommendation
6 for the test year that should be utilized, and the recommended update period.

7 Q. What is the purpose of a test year?

8 A. The purpose of a test year is to develop appropriate relationships between
9 the various components of the ratemaking process. In developing a revenue requirement, it
10 is important to maintain a representative and consistent relationship between rate base
11 investment, revenues, expenses and rate of return, in order for a public utility to have an
12 opportunity to earn a fair and reasonable rate of return. The attempt is made in the
13 regulatory process to set rates that properly reflect the levels of investment and expenses
14 necessary to provide safe and reliable service.

15 Q. Has the Commission established the test year that is to be utilized in this
16 case?

17 A. No.

18 Q. What test year did the Staff utilize for this case?

19 A. The Staff utilized the 12 months ending December 31, 1999 as its test year,
20 to be updated through March 31, 2000. This test year represents the most recent
21 12-month period ending on a annual basis for which information was readily available at
22 the time the Staff performed its audit. The Staff chose to update the test year information
23 to March 31, 2000, because that was the latest quarter-ending date for which information

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1 was available prior to the time that the Staff needed to complete its investigation under the
2 Commission's Small Company Rate Increase Procedure.

3 Q. What Accounting Schedules are you sponsoring?

4 A. I am sponsoring the following schedules:

5 Accounting Schedule 1- Revenue Requirement

6 Accounting Schedule 2- Rate Base

7 Accounting Schedule 9- Income Statement

8 Accounting Schedule 10- Adjustments to Income Statement

9 Accounting Schedule 11- Income Tax

10 Q. Please explain Accounting Schedule 1.

11 A. Accounting Schedule 1, Revenue Requirement, represents the gross revenue
12 requirement recommendation as determined by the Staff. Line 1 is the net original cost
13 rate base obtained from Accounting Schedule 2, Rate Base. Line 2 reflects the rate of
14 return range supplied by Staff witness Ronald L. Bible of the Financial Analysis
15 Department. The product of lines 1 and 2 is the net operating income requirement before
16 income taxes (NOIBT), shown on line 3. Line 4 is the net income available per the Income
17 Statement, Accounting Schedule 9. Line 3 less line 4 is the additional NOIBT shown on
18 line 5. Line 7 is the required current income tax from Accounting Schedule 11, Income
19 Tax, using the net operating income requirement on line 3 and the rate of return
20 recommended by the Staff. This is the additional tax associated with the additional net
21 operating income needed before income taxes shown on line 5. The total additional tax
22 required is shown on line 13. Line 13 plus the additional NOIBT from line 5 is the gross

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1 revenue requirement shown on line 14. This amount represents the Staff's gross revenue
2 requirement recommendation based on the Staff's audit in this case.

3 Q. Please explain Accounting Schedule 2.

4 A. Accounting Schedule 2, Rate Base, represents the total rate base that is
5 transferred to line 1 of Accounting Schedule 1. Line 1 is the total plant in service as shown
6 on Accounting Schedule 3. Line 2 is the total depreciation reserve shown on Accounting
7 Schedule 6. Line 1 less line 2 is the net plant in service shown on line 3. Line 12 is the
8 Contribution in aid of Construction. Line 3 is reduced by line 12 to determine the total rate
9 base shown on line 14.

10 Q. Please explain Accounting Schedule 9.

11 A. Accounting Schedule 9, Income Statement, lists in column "B", OWC's
12 book amounts of revenues and expenses for the test year ended December 31, 1999,
13 updated to March 31, 2000. Staff's adjustments to revenue and expense (detailed in
14 Accounting Schedule 10, Adjustments to Income Statement) are listed in column "C".
15 Column "D" contains the Staff's allocated percentages for revenues and expenses for the
16 test year ended December 31, 1999, updated through March 31, 2000.

17 Q. Please explain Accounting Schedule 10.

18 A. Accounting Schedule 10, Adjustments to Income Statement, contains a
19 listing of the specific adjustments that the Staff has made to the unadjusted test year
20 income statement to derive the Staff's adjusted net income. A brief explanation for each
21 adjustment, the adjustment amount and the name of the Staff witness sponsoring the
22 adjustment are listed on Accounting Schedule 10.

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1 Q. Please explain Accounting Schedule 11.

2 A. Accounting Schedule 11, Income Tax, reflects the Staff's calculation of
3 current and deferred income taxes using the recommended rate of return range based on the
4 adjusted NOIBT amount from column "D", Accounting Schedule 9, Income Statement.
5 I will discuss the various details concerning the income tax calculation later in this
6 testimony.

7 Q. What adjustments are you sponsoring?

8 A. I am sponsoring adjustment S-5.1, which is an adjustment to the Income
9 Statement listed on Accounting Schedule 10.

10 **Revenues**

11 Q. How did Staff determine OWC's operating revenue as shown on
12 Accounting Schedule 9, Income Statement?

13 A. The Staff reviewed the billing records of OWC and annualized the revenues
14 based on customer counts as of March 31, 2000.

15 **Income Taxes**

16 Q. How did Staff determine OWC's current income tax component as shown
17 in Accounting Schedule 11?

18 A. The current income tax component is calculated on Accounting Schedule 11
19 by taking the NOIBT amount from Accounting Schedule 9, Income Statement. The result
20 is then multiplied by the appropriate Federal and State income tax rates. This calculation
21 is based upon the fact that Federal income taxes are 50% deductible for State income tax
22 purposes, and State income taxes are fully deductible for Federal income tax purposes.

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1 The calculation in this case is based on the use of a 15% Federal income tax rate, and a
2 6.25% State income tax rate, which results in an effective tax rate of 19.936%.

3 Q. Please explain adjustment S-5.1.

4 A. Adjustment S-5.1 is necessary to adjust the current income taxes to a level
5 that is consistent with Staff's adjusted operating income.

6 Q. Does this conclude your direct testimony?

7 A. Yes, it does.

RATE CASE PROCEEDING PARTICIPATION

JAMES M. RUSSO

<u>COMPANY</u>	<u>CASE NO.</u>
Union Electric Company	GR-97-393
Gascony Water Company	WA-97-510
St. Joseph Light and Power Company	EC-98-573
St. Joseph Light and Power Company	HR-99-245
St. Joseph Light and Power Company	GR-99-246
St. Joseph Light and Power Company	ER-99-247
UtiliCorp United Inc./St. Joseph Light and Power Company	EM-2000-292
UtiliCorp United Inc./Empire District Electric Company	EM-2000-369