

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

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

**Rebuttal Testimony**

**of**

**Donald S. Roff**

**April 2008**

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

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

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

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

9   A.   Yes.

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

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

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

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

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

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

5 A. Yes, they were.

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

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

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

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

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

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

7   **Q.   WHY?**

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

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

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

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

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

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

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

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

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

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

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

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

6 A. Yes.<sup>1</sup>

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

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

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

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

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<sup>1</sup> 4 CSR 240-20.030, Rules of Department of Economic Development, Page 6

1 accounts.

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

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

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

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

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

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

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

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

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

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

1   **Q.   DO YOU AGREE?**

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

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

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



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

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

13 **A.** Yes.