

Exhibit No.: Depreciation
Issues: Depreciation
Witness: Arthur W. Rice
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: WR-2011-0337
Date Testimony Prepared: January 19, 2012

MISSOURI PUBLIC SERVICE COMMISSION
REGULATORY REVIEW DIVISION
UTILITY SERVICES

REBUTTAL TESTIMONY
OF
ARTHUR W. RICE, PE

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2011-0337

Jefferson City, Missouri
January 19, 2012

Staff Exhibit No. 10
Date 2-21-12 Reporter JL
File No WR-2011-0337

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1 2. Staff's recommendation that the Commission reject MAWC's request that the
2 Commission authorize a **12 year amortization period** for future accounting
3 of the cost of American Water's Business Transformation System.

4 3. MAWC's failure to maintain books and records so as to be able to furnish full
5 information in a **continuing property record** as required by Commission rule
6 4 CSR 240-50.030.

7 **St. Joseph Understated Depreciation Reserves**

8 Q. Do MAWC book reserves properly reflect the retirement of the old St Joseph
9 plant?

10 A. No. In the Appendices of the Staff Cost Of Service Report, schedule AR 3-4,
11 Staff refers to apparent excessive over or under depreciation accruals in MAWC's accounting
12 schedules. Staff indicated that it was continuing to inquire into the reasons for these apparent
13 deficiencies. An apparent understatement of depreciation reserves, with resultant over statement
14 of rate base, exists in the St Joseph plant accounts related to the year 2000 retirement of a water
15 treatment facility.

16 Q. How was this deficiency created?

17 A. MAWC has failed to record, to its depreciation reserve, the creation of a separate
18 regulatory asset that is being amortized independent of MAWC's normal depreciation expense.
19 Staff found that no book entry to depreciation reserves occurred to offset the creation of this
20 regulatory asset, and further that no book entries are occurring to reserves to reflect the monthly
21 amortization.

22 Q. Why was this regulatory asset created?

1 A. When the old St. Joseph water treatment plant was removed from service in 2000,
2 the original cost of the retired equipment was booked to (removed from) both plant and reserves.
3 The amounts retired for some accounts exceeded the accumulated depreciation reserves, creating
4 an under recovery of plant, leaving the equivalent of stranded negative reserve balances. The
5 Commission authorized creation of a regulatory asset of \$3,177,861 to compensate MAWC for
6 under recovered plant, including cost of removal, resulting from this retirement. Amortization of
7 the regulatory asset was commenced in May 2004.

8 Q. According to MAWC, how was this regulatory asset created?

9 A. Company witness Edward J. Grub stated the following in his Direct
10 Testimony in Case No. WR-2003-0500, pages 17 through 20:

11 Grub Q. What was the origin of these amounts?

12
13 Grub A. When the new St. Joseph plant came on line, the old plant was
14 retired and taken out of service. However, the old plant was not fully
15 depreciated. On the day the old St. Joseph treatment plant was retired, its
16 book value (investment minus depreciation) was \$2,832,906.

17
18 Grub Q. What did the Commission decide to do with the remaining book
19 value in Case No. WR-2000-281?

20
21 Grub A. Among other things, the Commission Order denied MAWC
22 recovery of those under depreciated amounts associated with the
23 retirement of its old St. Joseph treatment plant and directed that the
24 remaining plant balance of \$2,832,906 and the related cost of removal be
25 written off. MAWC complied with this Order and wrote the subject
26 amounts off its books. The associated cost related to the removal was in
27 the amount of \$344,955.

28
29 Grub Q. Why does MAWC believe the remaining book value and the cost
30 of removal associated with the old St. Joseph treatment plant should be
31 treated differently in this case?

32
33 Grub A. MAWC appealed the Commission's decision regarding the Old
34 St Joseph plant amounts to the Cole County Circuit Court. (Sic)

35
36 Grub Q. What did the Circuit Court find?

1
2 Grub A. The Cole County Circuit Court found in its Order and Judgment
3 issued May 25, 2001, that the Commission erred when it denied MAWC's
4 recovery of depreciated amounts associated with the retirement of the old
5 St. Joseph treatment plant . (Sic) This issue was, therefore, reversed and
6 remanded to the Public Service Commission for further proceedings
7 consistent with the court's opinion.
8

9 Grub Q. Does MAWC seek to earn a "RETURN ON" the unamortized
10 balance?
11

12 Grub A. No. MAWC proposes to receive only a "RETURN OF" the
13 amounts. Therefore, including cost of removal, the annual amortization is
14 \$158,893. (for 20 years, totaling \$3,177,861).

15 Q. Mr. Grub's testimony states that MAWC complied with the Case No.
16 WR-2000-281 Commission Order and wrote the subject amounts off its books. Does Staff have
17 evidence this did not occur?

18 A. Yes. One of the plant accounts associated with the old St Joseph treatment plant
19 retirement is account 313, (Lake, River and Other Intakes). The retirement of the old plant
20 resulted in this account 313 becoming basically inactive, there are no other Lake or River intakes
21 for the St. Joseph water supply system. For account 313, Staff accounting records for rate cases
22 WR-2003-0500, WR-2007-0216, WR-2008-0311, WR-2010-0131 and WR-2011-0337 continue
23 to show a stable negative reserve of approximately \$680,000. The amount of the retirement
24 associated with account 313 is \$1,247,531.

25 The Company's response to Data Request No. 0243 for this Case No. WR-2011-0337
26 reads as follows:

27 In the year 2000 the St. Joseph Treatment Plant was retired. The
28 retirement of assets recorded to USOA Account 313 in the amount
29 of \$1,247,531 resulted in the Accumulated reserve becoming
30 negative. The Accumulated Reserve as of 12/31/1999 was
31 \$547,344 less the retirement of St. Joseph treatment Plant of
32 \$1,247,531 causing the reserve to go negative to (\$680,591).

1 The () parenthesis in this quotation represent a negative accounting balance. In summary, if the
2 Company wrote off this investment as Mr. Grub states, then the reserve balance should have
3 been adjusted to show that these amounts were not still uncollected from rate payers. However,
4 the reserves were not adjusted to reflect the write off per Commission order.

5 Q. Has MAWC continued to collect "RETURN ON" investment for this \$3,177,861
6 through all rates cases since WR-2000-281?

7 A. It appears the answer is, Yes. Staff's records show no evidence of adjustment to
8 reserves to reflect a write off of these under recovered amounts. Therefore these under recovered
9 amounts continue to contribute to rate base.

10 Q. Did Staff ask MAWC to explain why the \$158,893 annual amortization for the
11 under recovered \$3,177,861 plant is not being reflected in plant reserves?

12 A. Yes. Staff submitted Data Request No. 0279 to the Company asking why
13 adjustments were not being made to reserves to reflect a reduction in net plant by the amount that
14 has been amortized. The Company response to Data Request No. 0279 states, in part, "*The net*
15 *book balance of the St. Joseph retired plant is being amortized as a regulatory asset and not a*
16 *plant asset*".

17 Q. What is Staff's response to the treatment as a regulatory asset versus plant asset?

18 A. When the Company created this \$3,177,861 regulatory asset in 2004, the
19 Company should have adjusted the depreciation reserves to reflect this transfer from a plant asset
20 to a regulatory asset. Again, Staff's records show no adjustment occurred to reserves for the
21 period of 1999 through 2010.

22 Q. Do current customer rates include collection of funds to pay the original cost of a
23 water treatment plant retired from the St. Joseph water system in the year 2000?

1 A. Yes. The St. Joseph water system cost of service currently includes a 20 year
2 amortization (\$3,177,861 total, ending 4/30/2024) for unrecovered plant which occurred when a
3 water treatment plant was retired in the St. Joseph area in 2000. Current cost of service also
4 includes a return on investment for the total amount of the amortization, \$3,177,861 which is still
5 recorded in reserves.

6 Q. What is Staff's current plan to address this issue?

7 A. If MAWC cannot show documentation where this \$3,177,861 is reflected in
8 reserves to reduce rate base, either when it was reportedly written off, when it became a
9 regulatory asset, or now as it is being expensed as an amortization, then Staff will adjust the
10 reserves accordingly in the true up accounting runs.

11 **Business Transformation System 12 year Amortization**

12 Q. What has MAWC requested with respect to capital recovery for the new Business
13 Transformation System?

14 A. Company witness Dennis Williams states as follows in page 37 of his Direct
15 Testimony: "The Company requests the Commission authorize in this preceding a twelve year
16 depreciable life for the Business Transformation investment cost ultimately incurred."

17 Q. What is Staff's response to this request?

18 A. Staff witness Kimberly K. Bolin will address Staff's position recommending the
19 Commission reject MAWC's request generally. I will address Staff's recommendation that the
20 Commission reject the specific amortization treatment requested.

21 Q. Is there a difference between the terms depreciation and amortization, and please
22 explain the difference?

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1 A. Yes, there is a vast difference in the regulatory sense. Depreciation, or a
2 depreciable account, is a continuous living account where additions, retirements, monthly
3 depreciation expense, salvage and cost of removal are booked as they occur. A depreciable
4 account has no end of life as long as equipment is still in service and booked in that account. An
5 average service life is defined for a depreciable account, which is an estimate of the expected life
6 of dollars. The dollars referred to are the original cost of plant in service booked to that account,
7 plus expected future cost of removal, minus expected future salvage. An amortization is defined
8 as a fixed accrual for a fixed period of time to accumulate a fixed amount, after which the
9 accruals stop.

10 Q. Company witness Dennis Williams' states in his Direct Testimony at page 37,
11 "Twelve years corresponds closely to the period of time that two of the Company's major
12 information systems, JD Edwards and ORCOM, will have been in place at the time they are
13 replaced by SAP." Does Staff agree that a 12 year amortization or average service life is
14 reasonable for the new Business Transformation System?

15 A. No. The JD Edwards and ORCOM systems referred to by Mr. Williams are
16 mainly software, not hardware. The JD Edwards and ORCOM systems were installed on AS400
17 computers. New hardware is also part of the new Business Transformation system installation.
18 Company responses to Staff's Data Request Nos. 0158 and 0257 show extensive additions and
19 modifications to the software and the hardware throughout this 12 year life. These additional
20 dollar investments far exceed the original investment. It is unknown at this time what portions
21 and at what actual service life the current software and hardware will be retired as a result of the
22 new Business Transformation System installation. Further analysis and discussion should be
23 conducted to determine what portions of the new system should be considered intangible

1 software versus tangible plant in service, and whether return of investment should be broken up
2 into part fixed amortization and part depreciable in service equipment.

3 Q. Will Staff have sufficient information to recommend or agree to any specific
4 amortization period, or average service life for the new Business Transformation System in this
5 rate case?

6 A. No. Staff will not have sufficient information to recommend a specific
7 amortization in this case because Staff will not be able to identify what current software and
8 hardware that will be retired until the Business Transformation System is installed and operating.

9 **Continuing Property Record**

10 Q. What is the authority that requires water companies to maintain continuing
11 property records?

12 A. All water companies under the jurisdiction of the Missouri Public Service
13 Commission are required, pursuant to Commission Rule 4 CSR 240-50.030, to use the Uniform
14 Systems of Accounts (USOA) for Class A and B and for Class C and D water companies, issued
15 by the National Association of Regulatory Utility Commissioners (NARUC) in 1973, as revised
16 July 1976.

17 Q. What is a Continuing Property Record (CPR) and where in the NARUC USOA is
18 there reference to or a definition of a CPR?

19 A. A CPR is a history of plant and equipment additions, modifications, sales,
20 transfers, and retirements, including any associated cost of removal and/or salvage. These
21 records are referred to in NARUC USOA under GENERAL INSTRUCTION number 2,
22 Records parts A, B and C. This instruction requires the utility to maintain books and records
23 so as to be able to furnish full information which may be useful in developing the history of or

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1 facts regarding any transaction, and no utility shall destroy any such books or records unless the
2 destruction thereof is permitted by rules and regulations of the Commission.¹

3 Additional record keeping requirements are defined for work orders and property records
4 in NARUC USOA under UTILITY PLANT INSTRUCTION number 11, Work Order and
5 Property Record System Required, part A, B and C.² These instructions define separate record
6 keeping practice for construction, retirement and maintenance work orders, that the utility shall
7 keep so as to show the nature and cost of each addition and retirement. The treatment of
8 additions, retirements, salvage and cost of removal are described in NARUC USOA Utility Plant
9 Instruction 10.

10 Q. Has MAWC maintained books and records so as to be able to furnish full
11 information which may be useful in developing the history of or facts regarding any transaction?

12 A. No.

13 Q. What is the basis for Staff's position that MAWC failed to maintain adequate
14 historical continuous property records as defined by record keeping rules?

¹ NARUC USOA GENERAL INSTRUCTION 2, parts A, B and C.

A. Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit a ready identification, analysis, and verification of all facts relevant thereto.

B. The books and records referred to herein include not only accounting records in a limited technical sense, but all other records, such as minute books, stock books, reports, correspondence, memoranda, etc., which may be useful in developing the history of or facts regarding any transaction.

C. No utility shall destroy any such books or records unless the destruction thereof is permitted by rules and regulations of the Commission.

² NARUC USOA UTILITY PLANT INSTRUCTIONS 11, parts A, B, and C

A. Each utility shall record all construction and retirements of utility plant by means of work orders or job orders. Separate work orders may be opened for additions to and retirements of utility plant or the retirements may be included with the construction work order provided however that all items relating to the retirements shall be kept separate from those relating to construction and provided further that any maintenance costs involved in the work shall likewise be segregated.

B. Each utility shall keep its work order system so as to show the nature of each addition to or retirement of utility plant the total cost thereof, the source or sources of costs, and the utility plant account or accounts to which charged or credited. Work orders covering jobs of short duration may be cleared monthly.

C. Each utility shall maintain records in which for each plant account, the amounts of the annual additions and retirements are classified so as to show the number and the cost of the various retirement units or other appropriate record units included therein.

1 A. In addition to testimony presented by Staff in the Cost of Service report, and the
2 Cost of Service Report Appendix, a partial list of failures by MAWC to adequately respond to
3 Staff's data requests (DR) are listed as follows:

4 DR 0092, related to the St. Joseph water treatment plant retirement in the year 2000.
5 The Company could not answer the requested original cost of the equipment retired, and the cost
6 of removal and salvage for this retirement. The answer provided was the amount of an
7 amortization allowed to account for under recovered plant due to the retirement. At a meeting
8 with the Company, Staff informed the Company that the response was not an answer to the
9 Staff's questions, and the Company's response was that the information was contained in
10 "legacy" files which were not accessible.

11 DR 0243, was a second attempt by Staff to obtain information related to the St. Joseph
12 water treatment plant retirement in the year 2000. The Company's response to this request
13 contradicted responses given to DR 0092. The Company's response to DR 0243 stated the
14 original cost, reserves, and unrecovered amounts for one of the plant accounts associated with
15 the treatment plant retirement, (information previously reported as not accessible). But, under
16 recovered amounts stated in DR 0090 were listed as the original cost amount in the DR 0243
17 response, with a different amount shown as the unrecovered portion.

18 DR 0258: The Company's response to Staff's Data Request 0158 describes numerous
19 customizations that have been applied to the information system infrastructure originally
20 installed in the 1990s. Staff's Data Request 0258 was submitted as a follow-up request to obtain
21 the cost and in service dates for the majority of those customizations. At the time of filing this
22 Rebuttal Testimony, the Company's response to DR 0258 is more than five weeks over due and
23 Staff is attempting to resolve the discovery dispute with the Company. The fact that a Company

1 response to DR 0258 has never materialized, indicates to Staff that the Company does not have
2 readily accessible records for this infrastructure.

3 DR 0278, is another attempt by Staff to investigate the retirement records of the
4 St. Joseph facilities. The Company response states, "Due to multiple system conversions and
5 office relocations, detailed property records are not available to support the plant balances that
6 are specifically related to the retirement of the St. Joseph water treatment plant."

7 In summary, the Company's conflicting responses to Staff's data requests and inability to
8 provide information that should be readily accessible causes Staff to conclude that MAWC has
9 not maintained adequate historical records, as required to do under the NARUC USOA
10 Guidelines.

11 Q. What corrective action does Staff recommend be taken to address the apparent
12 poor quality of historical retirement records maintained by MAWC?

13 A. If MAWC has any of the requested historical retirement records, Staff requests
14 the Company produce them to assist Staff in addressing this issue further. Additionally, Staff is
15 willing to continue working with MAWC to define an allocation of resources and timing to
16 identify and search Company historical plant records, and gather all reliable plant records into
17 one system. Staff further recommends that one system shall be incorporated as a part of the
18 existing in service plant records system such that as plant and equipment is modified, transferred
19 or removed from service, the records are maintained by MAWC as truly a *continuing* property
20 record (CPR).

21 Q. What is the value of MAWC having accessible historical retirement records?

22 A. In addition to the rule requirement and the necessity of adequate CPRs to
23 company operations and performance of depreciation studies, Staff views accurate historical

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1 | plant records at MAWC to be a valuable asset to the general public of the whole State of
2 | Missouri. Surrogate depreciation rates are used across all small water companies as well as
3 | sewer companies. Staff would appreciate the opportunity to work with MAWC to quantify and
4 | qualify water and sewer historical plant records at MAWC. Such information would be
5 | reasonable to use to periodically update not just MAWC's depreciation rates, but also the
6 | surrogate depreciation rates used for all Missouri regulated small water and sewer utilities.

7 | Q. Does this end your Rebuttal Testimony?

8 | A. Yes.

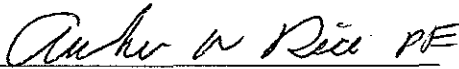
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water)
Company's Request for Authority to) Case No. WR-2011-0337
Implement A General Rate Increase for Water)
and Sewer Service Provided in Missouri)
Service Areas)

AFFIDAVIT OF ARTHUR W. RICE, PE

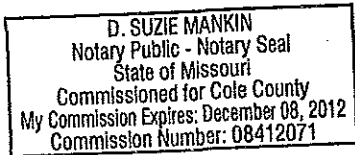
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

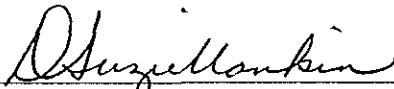
Arthur W. Rice, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Arthur W. Rice, PE

Subscribed and sworn to before me this 19th day of January, 2012.





Notary Public