

Exhibit No:	
Issues:	Allocations O&M Synergies
Witness:	Beverlee R. Agut
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Aquila, Inc.
Case No:	GR-
Date Testimony to be Filed:	August 1, 2003

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-_____

DIRECT TESTIMONY

OF

BEVERLEE R. AGUT

ON BEHALF OF

**AQUILA, INC.
d/b/a
AQUILA NETWORKS – MPS
and
AQUILA NETWORKS – L&P**

**Omaha, Nebraska
August, 2003**

State of Missouri)
) ss
County of Jackson)

AFFIDAVIT OF BEVERLEE R. AGUT

Beverlee R. Agut, being first duly sworn, deposes and says that she is the witness who sponsors the accompanying testimony and schedules entitled "Direct Testimony of Beverlee R. Agut"; that said testimony was prepared by her and/or under her direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, she would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of her knowledge, information, and belief.

Beverlee R Agut

Subscribed and sworn to before me this 16th day of June, 2003.

Terry D. Lutes

Notary Public
Terry D. Lutes

My Commission expires:

8-20-2004

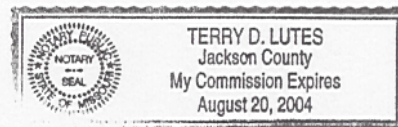


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DIRECT TESTIMONY OF BEVERLEE R. AGUT

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

2 A. My name is Beverlee R. Agut and my business address is 10700 East 350
3 Highway, Kansas City, Missouri.

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

5 A. I am employed by Aquila, Inc. ("Aquila" or "Company") in the Networks Financial
6 Management group as Sr. Manager-Regulatory Accounting acting as a liaison
7 between the Financial Management and Regulatory Services groups and an
8 advisor to the financial systems groups.

9 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

10 A. In 1986, I received a Bachelor of Science Degree in Business Administration with a
11 major in Accounting from Rockhurst University in Kansas City. I am a Certified
12 Management Accountant and a member of the Institute of Management
13 Accountants. In 1976, I began working for Missouri Public Service, now Aquila
14 Networks-MPS ("MPS"), a division of Aquila, and held various positions in the
15 accounting and regulatory departments. In 1988, I joined Kansas Public Service,
16 previously a division of Aquila, as Manager of Accounting and Regulatory Affairs.
17 Since 1995, I have held various positions in Aquila's Accounting, Regulatory
18 Services, and Financial Management groups. I transferred to my current position in
19 June 2002.

1 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE ANY REGULATORY**
2 **BODIES?**

3 A. Yes. I have previously filed testimony before the Missouri Public Service
4 Commission (“Commission”), Kansas Corporation Commission, West Virginia
5 Public Service Commission, and Federal Energy Regulatory Commission.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

7 A. The purpose of my testimony is to: 1) describe the process for allocating costs
8 associated with various centralized support functions along with the impact of these
9 allocations on the operations of MPS and Aquila Networks-L&P (“L&P”) and to
10 sponsor the associated centralized support function allocations relating to base test
11 year Operations Adjustment CS-16 (MPS and L&P); 2) describe the utility allocation
12 factors developed for MPS and L&P and the purpose and use of these allocation
13 factors; and 3) describe the calculations of the Merger Synergy adjustment for
14 operating costs included in adjustment CS-17 and as more fully described by Aquila
15 witness Vern Siemek.

16 **CORPORATE COST ALLOCATIONS**

17 **Q. PLEASE EXPLAIN THE OBJECTIVE FOR ALLOCATING CORPORATE**
18 **COSTS TO THE AQUILA OPERATING DIVISIONS AND SUBSIDIARIES.**

19 A. The Aquila cost allocation objective provides management with useful information to
20 control costs and provides a reasonable and consistent method for assigning costs
21 to the operating divisions and subsidiaries.

22 **Q. WHAT IS THE THEORY BEHIND THE AQUILA ALLOCATION METHOD?**

1 A. The method was developed to assign the cost of a service to the specific Business
2 Unit(s) that drives that specific cost. A Business Unit is a strategic business unit,
3 operational group, or legal entity that requires its own (balanced) set of books
4 because of regulatory or legal requirements. Costs are either “directly assigned” to
5 Business Units, allocated to Business Units based upon a specific “cost driver” or
6 allocated to Business Units based upon the “Massachusetts Formula.” Aquila’s
7 preference is to directly assign costs wherever possible to facilitate the proper
8 matching of costs to the appropriate Business Units that utilize the service.

9 **Q. PLEASE DESCRIBE IN MORE DETAIL THE “DIRECTLY ASSIGNED”**
10 **METHOD OF CHARGING COSTS TO BUSINESS UNITS.**

11 A. From time to time, a department will provide a specific service to a specific
12 Business Unit. For example, the Aquila department entitled HR-UED (“Human
13 Resources”) may place a newspaper ad in order to recruit prospective applicants
14 for an open position. The cost of this newspaper ad is then directly assigned to the
15 Business Unit requesting this service.

16 **Q. PLEASE EXPLAIN IN MORE DETAIL A SPECIFIC “COST DRIVER” AND**
17 **PROVIDE AN EXAMPLE OF ASSIGNING COSTS TO BUSINESS UNITS**
18 **BASED UPON A “COST DRIVER.”**

19 A. A cost driver has a direct cause and effect relationship to the costs incurred to
20 provide a specific service. The allocation of the corporate headquarters
21 department entitled “Payroll” is a good example of this concept. All payroll costs are
22 allocated to the Business Units receiving the service based upon the number of

1 paychecks issued to employees of each Business Unit. Allocating payroll costs to
2 the Business Units based upon employee paychecks issued, the "cost driver,"
3 results in each Business Unit incurring an appropriate level of cost. Furthermore, by
4 understanding what drives the costs, Aquila will be in a better position to control
5 those costs.

6 **Q. PLEASE DESCRIBE THE MASSACHUSETTS FORMULA AND ITS USE IN**
7 **THE ALLOCATION OF CENTRALIZED SUPPORT FUNCTION COSTS.**

8 A. If common costs cannot be charged directly to a Business Unit and a specific cost
9 driver is not determinable, then the Massachusetts Formula is used as a general
10 allocator to allocate common costs. The Massachusetts Formula consists of the
11 arithmetic average of payroll charged to expense, gross margin and net plant.
12 These statistics are gathered for each division and averaged together on a
13 weighted basis.

14 **Q. WHAT PERCENTAGE OF COMMON COSTS WAS ALLOCATED TO THE**
15 **BUSINESS UNITS USING THE MASSACHUSETTS FORMULA?**

16 A. For the year ended December 31, 2002, approximately 73% of the total allocation
17 pool dollars are allocated via a specific cost driver while the remaining 27% are
18 allocated using the Massachusetts Formula.

19 **Q. HOW DOES AQUILA ASSIGN COSTS TO ITS INTERNATIONAL**
20 **OPERATIONS?**

21 A. Costs to the international operations are assigned directly. Each employee, on his
22 or her timesheet or business expense report, directly charges any work performed

1 for a foreign or international unit, such as Canada. The costs assigned through
2 timesheet reporting include labor, fringe loadings, and an overhead loading factor
3 designed to fully distribute overhead costs associated with the individual's
4 employment. The overhead loading factor includes such costs as corporate
5 headquarter building costs (e.g., depreciation), information technology support
6 costs, telecom costs, and human resource costs. There are specific Business Unit
7 chart field designations in the financial accounting system structure that identify the
8 foreign unit. These direct foreign unit costs are then accumulated and billed to the
9 foreign partners by the corporate international reporting department.

10 **Q. HOW OFTEN DOES AQUILA MAKE CHANGES TO ITS ALLOCATION**
11 **DRIVERS?**

12 A. Aquila continually reviews the allocation process in order to ensure that costs are
13 properly assigned to the various Business Units so that their financial performance
14 can be properly measured. The statistics associated with the allocations drivers,
15 e.g., the number of paychecks issued, are updated annually based upon the actual
16 historical experience of the prior year. This ensures that the most accurate cost
17 causative driver is in place with the most recent statistical data. For most
18 centralized corporate departments, there exists a specific cost driver that results in
19 the most accurate causative relationship to the Business Unit being serviced.
20 Operations Adjustment CS-16 reflects the most current cost drivers and statistics
21 available at the time this case was prepared.

22 **Q. PLEASE DESCRIBE HOW THE ALLOCATION PROCESS WORKS.**

1 A. System allocations are performed and maintained in two groups: IBU (“Intra-
2 Business Unit”) allocations and ESF (“corporate headquarters”) allocations. Each
3 month, the costs incurred in designated centralized allocable departments that have
4 not been directly charged out are systematically processed in the PeopleSoft
5 Financial Accounting System based on the allocation drivers and statistics
6 associated with the drivers as more fully explained in the Aquila Corporate Cost
7 Allocation Manual (“CAM”). The 2002 CAM was included with Aquila’s March 2003
8 Fully Distributed Costing Filing to the Commission.

9 **Q. PLEASE DESCRIBE OPERATIONS ADJUSTMENT CS-16.**

10 A. Operations Adjustment CS-16 represents the “residual” ESF and IBU allocation pool
11 dollars allocated to MPS and L&P based on current allocation factors effective
12 January 1, 2003 for ESF and February 1, 2003 for IBU. The term residual refers to
13 the net remaining pool dollars that have not been adjusted by other Aquila witnesses
14 in this filing application. The following is a list of items that are being addressed by
15 other Aquila witnesses and which are not included in Operations Adjustment CS-16.
16 [Each Aquila witness performed adjustments on allocated dollars following the
17 same methodology as outlined in my testimony and as utilized in Operations
18 Adjustment CS-16.]

- 19 1) Payroll (CS-5), Interest Charges and Income Taxes – Aquila witness Ann
20 Stichler;
- 21 2) Employee Pensions and Benefits (CS-11) – Aquila witness Harold Mikkelsen;
- 22 3) Incentives (CS-6), TransUCU residual elimination (CS-56), Dues and Donations
23 (CS-60), Advertising (CS-65), Payroll Taxes (CS-85), Property Taxes (CS-90) –

1 Aquila witness Rich Petersen;

2 4) Restructuring (CS-10), Miscellaneous Payroll Costs (CS-83) – Aquila witness

3 Jeff Thomas; and

4 5) Depreciation Expense (CS-95) – Aquila witness Becky Tangeman.

5 **Q. BESIDES ADJUSTING THE ESF AND IBU ALLOCATED DOLLARS TO THE**
6 **CURRENT ALLOCATION FACTORS, HAVE YOU MADE OTHER**
7 **ADJUSTMENTS TO THE POOL DOLLARS THAT WERE ALLOCATED TO**
8 **MPS OR L&P DURING THE TEST YEAR?**

9 A. Yes. Contained in the test year ESF and IBU centralized support function groups
10 are costs pertaining to events surrounding Aquila's negative financial results from
11 our non-regulated businesses. It is Aquila's intention and desire to insulate the
12 ratepayer from these events and not pass any of these costs through in the cost of
13 service to Aquila's regulated utility customers.

14 **Q. HOW WERE THESE COSTS IDENTIFIED FOR ELIMINATION?**

15 A. The majority of these costs were retained in departments that did not allocate to any
16 of Aquila's regulated business units. However, I also performed a review of several
17 ESF and IBU departments that did allocate costs to MPS and L&P during the test
18 year and removed either entire departments' allocated residual amounts or other
19 identified transactions which should not be passed along to the ratepayer.

20 **Q. WHICH TEST YEAR ALLOCATED DEPARTMENTS WERE REMOVED FROM**
21 **THE ALLOCATIONS ADJUSTMENT?**

1 A. The departments entitled "Strategic Initiatives," "Capital Structure and Analysis-
2 Domestic," "Strategic Planning & Analysis," "Chief Executive Officer," "Chief
3 Financial Officer," and "UED Headquarters President" were removed from the
4 allocations adjustment. The first three departments were removed because their
5 function during the test period mainly focused on selling off business units. It is
6 anticipated this type of work will continue. With the resignation of Mr. Robert Green,
7 Mr. Richard Green assumed dual roles of Chairman and Chief Executive Officer.
8 Therefore, it was proper to eliminate the residual expenses in the separate Chief
9 Executive Officer department. In 2002, the Chief Financial Officers, Messrs. Dan
10 Streek and Rick Dobson, extensively focused on maintaining the solvency of Aquila.
11 It is anticipated this focus will continue for at least a couple of years. With the
12 restructuring of Aquila's domestic utility operations to a state based organization,
13 the department entitled "UED (UtiliCorp Energy Delivery) Headquarters President"
14 was eliminated and it was therefore proper to eliminate the residual expenses in
15 this department. With the elimination of allocations from these six departments and
16 miscellaneous adjustments to other allocated departments, approximately \$17.4
17 million was removed from the allocation pool and incorporated in Operations
18 Adjustment CS-16 of which \$4.3 million was allocated to MPS during the test year
19 and \$1.3 million was allocated to L&P during the test year.

20 **Q. WHAT IS THE FINAL CS-16 ADJUSTMENT?**

21 A. After the adjustment was distributed by account and the appropriate utility allocation
22 was applied, the final CS-16 adjustment for the MPS gas operations is \$(.17)
23 million and for the L&P gas operations is \$(.04) million.

1 **Q. HAS MPS AGREED TO MAINTIN ANY ADDITIONAL INFORMATION**
2 **CONCERNIONG ALLOCATIONS?**

3 A. Yes. As part of the settlement in MPS's last electric rate case, Case No. ER-2001-
4 672, Aquila agreed to create additional reports in support of direct and allocated
5 costs. On August 16, 2002, and again on May 15, 2003, I met with members of the
6 Commission Staff and Office of the Public Counsel to review reports we created for
7 MPS and L&P as part of this agreement. As part of this filing, I have included
8 schedules in support of the allocated costs to MPS and L&P for the test year ended
9 December 31, 2002. The following schedules are incorporated as part of my
10 testimony:

11 Schedule BRA-1 (MPS) and Schedule BRA-2 (L&P) - Statement of Allocated
12 Charges for Balance Sheet Accounts;

13 Schedule BRA-3 (MPS) and Schedule BRA-4 (L&P) - Statement of Allocated
14 Charges for Income Statement Accounts;

15 Schedule BRA-5 (MPS) and Schedule BRA-6 (L&P) - Statement of ESF Allocated
16 Charges by Department by Resource; and

17 Schedule BRA-7 (MPS) and Schedule BRA-8 (L&P) - Statement of IBU Allocated
18 Charges by Department by Resource.

19 In addition, I have included the following schedules summarizing the basis of the
20 "ESF/IBU Allocations Adjustment," Operations Adjustment CS-16:

21 Schedule BRA-9 - ESF Cost Allocations – Actuals Effective January 1, 2003. This
22 schedule lists the source departments ("pool"), the target business units, the
23 allocation driver, and the allocation percentages effective January 1, 2003; and

1 Schedule BRA-10 - IBU Cost Allocations – Actuals Effective February 1, 2003. This
2 schedule lists the source IBU departments (“pool”), the target business units, the
3 allocation driver, and the allocation percentages effective February 1, 2003.

4 **UTILITY ALLOCATIONS**

5 **Q. HAVE ADDITIONAL ALLOCATION FACTORS BEEN DEVELOPED?**

6 A. Yes. Since MPS and L&P are combination electric and gas utilities, it is proper to
7 develop allocation factors to segregate the common electric and gas retail
8 operations for this case. A discussion of the development of these gas allocation
9 factors for MPS and L&P is included in Schedule BRA-11 attached to my testimony.

10 **MERGER SAVING ADJUSTMENT FOR OPERATING COSTS**

11 **Q. PLEASE EXPLAIN THE CALCULATION OF THE MERGER SYNERGY**

12 **ADJUSTMENT NO. CS-17.**

13 A. As more fully described by Aquila witness Vern Siemek, this adjustment reflects the
14 MPS’s share of the MPS/L&P merger related operating cost synergies arising from
15 centralized support functions (“ESF” and “IBU” allocations). The steps to calculate
16 this adjustment as illustrated in Schedule BRA-12 are as follows:

17 1) Determine the per book centralized support function allocated costs to
18 MPS for the twelve months ended December 31, 2002. (Line 1, \$47.5 million);

19 2) Reduce the MPS per book allocated costs for incremental costs to
20 support L&P to determine pre-merger support costs had the merger not occurred.
21 (Line 6, \$.3 million);

22 3) Annualize the MPS pre-merger support costs for current allocation

1 factors, payroll levels, benefit levels, and elimination of other residual expenses
2 previously discussed. (Line 14 plus Line 22, \$(2.6) million); and

3 4) Eliminate L&P from the allocation targets and compare the result to the
4 annualized amount. (Line 32 less Line 25, or \$4.1 million).

5 This \$4.1 million difference is the operating cost savings that MPS received from
6 the merger.

7 **Q. WERE THERE ANY ADDITIONAL ALLOCATIONS PERFORMED TO ARRIVE**
8 **AT THE FINAL CS-17 ADJUSTMENT?**

9 A. Yes. First the \$4.1 million difference was reduced by 50% to \$2.1 million to reflect
10 the proposal by witness Siemek to share the costs savings on a 50/50 basis with
11 MPS customers. The \$2.1 million was then distributed by account resulting in a total
12 pro forma MPS gas operations adjustment of \$.23 million.

13 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

14 A. Yes.