

Exhibit No.:
Issues: Corporate Allocations; Six
Sigma; Payroll Expense;
Incentive Compensation; Payroll
Taxes; Employee Benefits;
Pension Expense; Prepaid
Pension Assets; ERISA Minimum
Tracker and Amortization
Witness: Lesley R. Preston, CPA
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: ER-2005-0436
Date Testimony Prepared: October 14, 2005

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

LESLEY R. PRESTON, CPA

AQUILA, INC.

d/b/a AQUILA NETWORKS-MPS - ELECTRIC

AND AQUILA NETWORKS - L&P - ELECTRIC

CASE NO. ER-2005-0436

Jefferson City, Missouri
October 2005

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Case No(s). ER-2005-0436
Date 1-09-06 Rptr 24


BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Tariff Filing of Aquila, Inc.,)	
to Implement a General Rate Increase for)	Case No. ER-2005-0436
Retail Electric Service Provided to Customers)	Tariff No. YE-2005-1045
in Its MPS and L&P Missouri Service Areas.)	

AFFIDAVIT OF LESLEY R. PRESTON

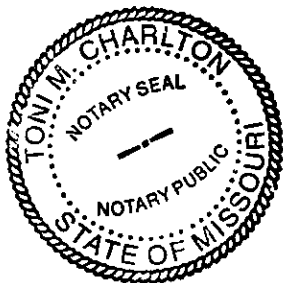
STATE OF MISSOURI)	
)	ss.
COUNTY OF COLE)	

Lesley R. Preston, being of lawful age, on her oath states: that she has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 20 pages to be presented in the above case; that the answers in the following Direct Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.



Lesley R. Preston

Subscribed and sworn to before me this 12th day of October 2005.





Notary

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

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LESLEY R. PRESTON, CPA

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS – ELECTRIC

AND AQUILA NETWORKS – L&P – ELECTRIC

CASE NO. ER-2005-0436

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1 **DIRECT TESTIMONY**

2 **OF**

3 **LESLEY R. PRESTON, CPA**

4 **AQUILA, INC. d/b/a AQUILA NETWORKS-MPS – ELECTRIC**

5 **AND AQUILA NETWORKS – L&P – ELECTRIC**

6 **CASE NO. ER-2005-0436**

7 Q. Please state your name and business address.

8 A. My name is Lesley R. Preston, Fletcher Daniels Office Building, 615 E. 13th
9 St., Suite G-8, Kansas City, Missouri, 64106.

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

11 A. I am a Regulatory Auditor for the Missouri Public Service Commission
12 (Commission or MoPSC).

13 Q. Please describe your education and other qualifications.

14 A. In May of 2005, I graduated with a Masters of Science in Accounting from the
15 University of Missouri-Kansas City. My undergraduate degrees of Bachelor of Science in
16 Accounting and Business Administration, emphasis in Finance, were earned from Truman
17 State University in Kirksville, Missouri, in May of 2002. I am a licensed Certified Public
18 Accountant in the state of Missouri. I commenced employment with the Commission in
19 September 2002.

20 Q. Have you previously filed testimony before this Commission?

21 A. Yes, I have. Please see the attached Schedule 1.

22 Q. Have you worked on any other cases since your employment with the
23 Commission?

1 A. Yes. I have participated in other types of cases, such as small water cases.
2 The information is also included on Schedule 1 attached to this direct testimony.

3 **PURPOSE OF TESTIMONY**

4 Q. With reference to Case No. ER-2005-0436 have you made an examination of
5 the books and records of Aquila Networks-MPS (MPS) and Aquila Networks-L&P (L&P),
6 divisions of Aquila, Inc (Aquila or Company)?

7 A. Yes, I have, with the assistance of other members of the Commission Staff
8 (Staff).

9 Q. What are your areas of responsibility in regard to Case No. ER-2005-0436?

10 A. I will be sponsoring the areas of payroll expense, payroll taxes, incentive
11 compensation, employee benefits and corporate allocations.

12 Q. What knowledge, skill, experience, training or education do you have in
13 regulatory matters?

14 A. In addition to my education background and professional license, since
15 beginning employment with the Commission, I have attended various in-house training
16 seminars and have reviewed in-house training materials. I worked on three small water and
17 sewer cases, which has provided a strong basis in the ratemaking process and an in-depth
18 understanding on certain issues. I have also worked closely with senior auditors and
19 supervisors, with extensive regulatory knowledge and experience. I have been assigned to
20 and filed testimony as described in Schedule 1. I have also extensively reviewed other utility
21 rate cases related to the issues I am sponsoring to ensure the consistency of the Staff's method
22 and procedures. My prior academic education helped prepare me to successfully sponsor the
23 ratemaking areas I've been assigned in this case. I have received a certificate of training from

1 the National Association of Regulatory Utility Commissioners in a seminar it has sponsored
2 concerning utility cost of service and regulation.

3 Q. Which adjustments are you sponsoring in this case?

4 A. I have numerous payroll adjustments for both MPS and L&P, which I have
5 listed on Schedule 2 attached to this direct testimony. In addition to these adjustments, I am
6 sponsoring the rate base components found on Accounting Schedule 2, Rate Base, for Prepaid
7 Pension Asset, and ERISA Minimum Tracker.

8 I am sponsoring the following additional adjustments for MPS:

9 Payroll Taxes: S-93.1, S-93.2, S-93.3, S-93.4;

10 Long-Term Incentive Plan: S-85.10;

11 Variable Compensation: S-9.8, S-11.8, S-13.8, S-16.8, S-18.8, S-19.8, S-21.8, S-24.8,
12 S-26.8, S-33.8, S-34.8, S-35.8, S-36.8, S-37.8, S-38.8, S-40.8, S-42.8, S-44.8, S-45.8,
13 S-47.8, S-48.8, S-49.8, S-50.8, S-54.8, S-55.8, S-56.8, S-58.8, S-60.8, S-61.8, S-65.8,
14 S-66.8, S-67.8, S-68.8, S-69.8, S-71.8, S-72.8, S-73.8, S-74.8, S-75.8, S-76.8, S-79.8,
15 S-80.8, S-82.8, S-85.8, S-88.8, S-90.8;

16 401(k): S-85.15;

17 Profit Sharing: S-85.14;

18 Medical, Dental & Vision: S-85.16, S-85.17;

19 Pension Expense: S-85.11;

20 ERISA Minimum Amortization: S-85.9;

21 Corporate Allocations:

22 *Aquila's Updated Factors:* S-34.11, S-69.11, S-80.10, S-82.10, S-89.10,
23 S-93.6;

24 *Staff's Modified Massachusetts Formula:* S-34.12, S-69.12, S-80.11, S-82.11,
25 S-89.11, S-93.7;

26 *Impact of South Harper on Massachusetts Formula:* S-34.13, S-69.13, S-80.12,
27 S-82.12, S-89.12, S-93.8;

1 *Six Sigma* S-34.19, S-69.19, S-80.18, S-82.18, S-82.19, S-89.18, and S-93.14.

2 I am sponsoring the following additional adjustments for L&P:

3 Payroll Taxes: S-94.1, S-94.2, S-94.3, S-94.4;

4 Long-Term Incentive Plan: S-84.9;

5 Variable Compensation: S-9.8, S-11.8, S-13.8, S-14.8, S-17.8, S-18.8, S-19.8, S-20.8,
6 S-21.8, S-24.8, S-27.8, S-33.8, S-34.8, S-35.8, S-36.8, S-37.8, S-40.8, S-42.8, S-43.8,
7 S-44.8, S-45.8, S-46.8, S-47.8, S-51.8, S-52.8, S-54.8, S-58.8, S-59.8, S-63.8, S-65.8,
8 S-66.8, S-67.8, S-69.8, S-70.8, S-71.8, S-72.8, S-73.8, S-74.8, S-75.8, S-78.8, S-79.8,
9 S-81.8, S-84.8, S-88.8, S-90.8;

10 401(k): S-84.14;

11 Profit Sharing: S-84.16;

12 Medical, Dental & Vision: S-84.16, S-84.17;

13 Pension Expense: S-84.13;

14 ERISA Minimum Amortization: S-84.8;

15 Corporate Allocations:

16 *Aquila's Updated Factors*: S-34.11, S-67.11, S-79.11, S-81.11, S-89.10,
17 S-94.5;

18 *Staff's Modified Massachusetts Formula*: S-34.12, S-67.12, S-79.12, S-81.12,
19 S-89.11, S-94.6;

20 *Impact of South Harper on Massachusetts Formula*: S-34.13, S-67.13,
21 S-79.13, S-81.13, S-89.12, S-94.7;

22 *Six Sigma*: S-34.19, S-67.19, S-79.19, S-81.19, S-81.20, S-89.18, and S-94.13.

23 **EXECUTIVE SUMMARY**

24 Q. Please provide a summary of each of the issues you have identified.

25 A. Aquila corporate departments incur expenses that are allocated to its operating
26 business units by various allocations. A general allocator, the Massachusetts Formula, is used
27 to distribute costs to departments that do not have a specific cost driver. The Staff has

1 modified the Massachusetts Formula to allocate a more accurate level of cost to the non-
2 regulated business unit. The Massachusetts Formula has also been modified to include the
3 impact of the South Harper generating facility on net plant. Aquila has implemented a new
4 management process, Six Sigma, to improve efficiency and reduce costs. Six Sigma costs are
5 also included in the corporate cost pool. The Staff is proposing to normalize outside
6 consulting costs, related to the Six Sigma project, over a five-year period and include any
7 identified Six Sigma savings on an annualized basis.

8 The Company's payroll is comprised of both direct and allocated employee costs. The
9 Staff is proposing to include the employee and salary levels at June 30, 2005. The allocated
10 portion of the payroll costs are impacted by the changes in the corporate allocation factors that
11 were updated as of July 1, 2005, the modifications to the Massachusetts Formula, and specific
12 adjustments proposed by Staff witness Charles R. Hyneman. Payroll taxes were also
13 annualized based upon the current tax rates and annualized level of payroll expense.

14 Incentive Compensation was updated to reflect the appropriate corporate allocations.
15 Medical, dental and vision insurance was annualized to reflect an appropriate level of expense
16 for the self-insured and premium based insurance. 401(k) and Profit Sharing were annualized
17 based upon an appropriate ratio of the expense to the annualized level of payroll expense.
18 Pension expense and related components which include the ERISA Minimum contribution,
19 prepaid pension asset and the ERISA Minimum Tracker are reflected based upon the same
20 methodology presented in the Stipulation and Agreement for Case No. ER-2004-0034.

21 **CORPORATE ALLOCATIONS-MASSACUSETT'S FORMULA**

22 Q. Please describe the corporate structure of Aquila.

1 A. Aquila's corporate allocations consist of two groups, both organized in
2 specialized departments. Enterprise Support Functions (ESF) provide general corporate
3 services such as executive, legal, payroll and tax to the business units. Aquila currently has
4 approximately 55 corporate ESF departments with 213 employees. Intra Business Units
5 (IBU) provide services such as customer service, regulatory, and operations to the Network's
6 business units. Aquila currently has approximately 145 corporate IBU departments with 787
7 employees.

8 Q. How many people does Aquila employ as of June 30, 2005?

9 A. In total, Aquila has 3,233 employees. In addition to the ESF and IBU
10 employees, 2,037 employees are assigned to the various utility business units, 178 employees
11 are under Aquila's non-regulated Everest Communications, and 18 employees are assigned to
12 other non-regulated business units.

13 Q. Please describe the process Aquila uses to allocate costs to its business units.

14 A. Aquila has developed a comprehensive corporate overhead allocation
15 procedure to allocate costs to its domestic business units. Aquila's primary method of
16 allocating ESF and IBU costs is a three-factor formula referred to as the "Massachusetts
17 Formula." Aquila uses the factors of gross profit (margin), net plant in service, and payroll to
18 calculate the relative allocation percentage for each business unit.

19 The Massachusetts Formula is used to allocate costs to the business units when a
20 specific cost driver cannot be identified. Such departments that are allocated in this manner
21 include the executive officer departments, financial reporting, tax, board of directors, and
22 audit services.

1 In addition to the Massachusetts Formula, Aquila uses other allocation factors to
2 allocate ESF and IBU department costs to its business units. For example, the costs charged
3 to ESF department of 4179 (Payroll) are allocated based on the number of paychecks issued in
4 that business unit to the total number of all business unit checks issued.

5 Q. Does Aquila allocate all corporate costs incurred to its operating companies
6 like MPS and L&P?

7 A. No. Aquila has created departments where certain costs are accumulated but
8 not allocated to the regulated business units. These are referred to as corporate retained
9 departments. A significant portion of costs charged to the retained departments is associated
10 with Aquila's continued exit from non-regulated activities and restructuring and do not get
11 recovered in rates. Please refer to Staff witness Charles Hyneman as he further addresses
12 these issues in his testimony.

13 Q. Is the Staff proposing adjustments to MPS and L&P test year corporate
14 allocated costs in this case?

15 A. Yes. The Staff's adjustments can be classified into several categories of
16 adjustments to MPS and L&P per book corporate allocated costs. These adjustments are
17 included in Accounting Schedule 10, Adjustments to Income Statement:

- 18 1. Adjust test year costs to reflect Aquila's July 1, 2005 corporate allocations;
- 19 2. Adjust corporate expenses to reflect the Staff's adjustment to the
20 Massachusetts Formula;
- 21 3. Adjust the Massachusetts Formula to reflect the Staff's level of net plant
22 associated with the South Harper generating facility;
- 23 4. Adjust certain corporate expenses related to restructuring;

1 5. Adjust lobbying expenses;

2 6. Adjust Community Relations Department expenses;

3 7. Adjust corporate expenses to reflect 20 W. 9th lease revenue;

4 8. Adjust corporate expenses to reflect Staff's SERP adjustment;

5 9. Reflect the Staff's adjustment associated with Six Sigma.

6 Q. Please explain adjustments S-34.11, S-69.11, S-80.10, S-82.10, S-89.10, and
7 S-93.6 for MPS and adjustments S-34.11, S-67.11, S-79.11, S-81.11, S-89.10 and S-94.5 for
8 L&P.

9 A. These adjustments update MPS and L&P corporate allocated costs in 2004
10 using the updated July 1, 2005 allocation factors provided by Aquila. These adjustments are
11 simply the difference between the level of MPS and L&P per books net residual allocated
12 corporate costs and the annualized level of net residual allocated corporate costs proposed by
13 Aquila.

14 Q. Please explain what you mean by "net residual" corporate costs.

15 A. Net residual corporate costs simply mean total corporate costs less the
16 corporate costs that are being annualized and adjusted by other witnesses. For example, both
17 Aquila and the Staff have witnesses that are sponsoring corporate payroll and benefits,
18 pensions, insurance, dues and donations, advertising, depreciation and injuries and damages.
19 These witnesses are sponsoring adjustments to MPS and L&P direct costs as well as the
20 related corporate costs. Thus, the corporate costs have been removed from the total corporate
21 pool of expense dollars subject to allocation to the business units. The remaining costs left in
22 the corporate pool after removal of these costs are referred to as net-residual corporate costs.

1 Q. Please explain adjustments S-34.12, S-69.12, S-80.11, S-82.11, S-89.11 and
2 S-93.7 for MPS and adjustments S-34.12, S-67.12, S-79.12, S-81.12, S-89.11 and S-94.6 for
3 L&P.

4 A. These adjustments reflect the impact of the Staff's adjustment to the
5 Massachusetts Formula. As discussed above, the Massachusetts Formula is comprised of
6 three factors including margin, net plant and payroll. I have attached Schedule 3 to show the
7 calculation of the Massachusetts Formula that would be applied to a department such as 4030,
8 Chief Operating Officer. The first calculation demonstrates the result as included in the
9 Company's direct filing. The margin (gross profit), in the first line for MEP, is a negative
10 \$57,760,000. A negative number in the calculation will cause less cost to be allocated to the
11 business unit with the negative number and more to the other business units included in the
12 calculation.

13 Q. What is department 1150 MEP General?

14 A. Department 1150 is the department that corporate costs are allocated to for the
15 non-regulated Aquila Merchant Services.

16 Q. Has the Company's allocation factors changed since their direct filing?

17 A. Yes. The Company, in response to Data Request No. 121, indicated that the
18 "use of the negative figure for the Merchant gross margin was an oversight...our intent [is] to
19 treat any negative gross margin amount as null (zero)." The Company provided the Staff with
20 updated workpapers that reflected this change and the July 1, 2005 allocation factors. This
21 calculation is shown by the second calculation on Schedule 3.

22 Q. How is the Staff proposing to treat the margin associated with MEP?

A. The Staff proposes to use the actual margin for MEP, but included it as a positive number. The actual margin for MEP had decreased further to negative \$72,962,000. The calculation that Staff performed is shown by the third example on Schedule 3.

Q. Will you please provide an example to illustrate the application of the Massachusetts Formula?

A. Yes. Assume that there is Company X with Divisions A and B, which has \$100,000 in corporate shared costs to be allocated in 2003. Below is the allocation for 2003.

<u>Company X</u>	<u>Margin</u>	<u>Payroll</u>	<u>Net Plant</u>	<u>Average=</u> <u>Mass. Formula</u>
Division A	\$100 63%	\$75 60%	\$200 57%	60%
Division B	\$60 37%	\$50 40%	\$150 43%	40%
Total	\$160	\$125	\$350	

Division A is allocated \$60,000 ($\$100,000 \times 60\%$) of the corporate costs, and Division B is allocated \$40,000 ($\$100,000 \times 40\%$) of the corporate costs based on the respective weighting of each of the three allocation factors.

Assume again for 2004, \$100,000 was incurred for corporate costs. The only change from the above example is that Division B lost \$35 instead of earning \$60. Due to this single change, Division A is allocated \$90,000 ($\$100,000 \times 90\%$) and Division B is allocated \$10,000 ($\$100,000 \times 10\%$). The calculation of the allocation is illustrated below.

<u>Company X</u>	<u>Margin</u>	<u>Payroll</u>	<u>Net Plant</u>	<u>Average=</u> <u>Mass. Formula</u>
Division A	\$100 154%	\$75 60%	\$200 57%	90%
Division B	\$(35) -54%	\$50 40%	\$150 43%	10%
Total	\$65	\$125	\$350	

This example illustrates the counterintuitive effect of including a negative number in a component of the Massachusetts Formula. This would lead to a smaller allocation of management time to a division that is losing money. This is counterintuitive as it is expected

1 that management will focus more of its energy on a division that is losing money over a
2 division with stable earnings.

3 Q. Please explain adjustments S-34.13, S-69.13, S-80.12, S-82.12, S-89.12 and
4 S-93.8 for MPS and adjustments S-34.13, S-67.13, S-79.13, S-81.13, S-89.12 and S-94.7 for
5 L&P.

6 A. These adjustments represent an additional change to the Massachusetts
7 Formula, and are included as the fourth calculation listed on Schedule 3. This simply adjusts
8 the net plant for MPS to reflect the Staff's level of plant for the South Harper generating
9 facility. This is consistent with the amount recommended by Staff Auditing witness
10 Phillip K. Williams. The total plant value for the facility of \$124,993,519 can be found on
11 Schedule 3, Total Plant in Service. The Company's direct filing reflected estimated costs for
12 the South Harper generating facility at \$140,000,000, and the updated workpapers reflecting
13 the July 1, 2005 allocation factors included \$155,000,000 as the total estimated cost.

14 Q. Will you be addressing the remaining proposed adjustments?

15 A. I will address issue 9, Six Sigma in the next section of my testimony. Staff
16 witness Hyneman will address the remaining corporate issues listed above.

17 **SIX SIGMA**

18 Q. Please explain what is meant by Six Sigma?

19 A. Six Sigma is a methodology Aquila has implemented to improve its processes
20 and efficiency. Aquila began training and implementation of Six Sigma in 2004.

21 Q. Are there costs associated with the introduction of Six Sigma?

1 A. Yes. Aquila has established corporate IBU department 6134, to capture costs
2 associated with Six Sigma. This department is then allocated to the business units through the
3 allocation process.

4 Q. How have the costs for this function been treated in this case?

5 A. The Staff has not adjusted any departmental costs except for the outside
6 consulting fees. The Staff proposes to normalize those costs over a five-year period. This
7 period is typically used by the Staff on costs that are non-investment related.

8 Q. Has Six Sigma resulted in improved efficiency?

9 A. Yes. In implementing Six Sigma, the Company identified specific projects
10 where improvements can be made. Data Request No. 209 response identified several
11 successfully completed projects since 2004, which resulted in improved efficiency and cost
12 savings.

13 Q. What other adjustments has the Staff made in regards to Six Sigma?

14 A. Also in the response to Data Request No. 209, Aquila identified potential cost
15 savings that can be recognized for each project that is proposed. These savings may affect the
16 income statement or balance sheet and may be a recurring savings (cost reduction), or a one-
17 time benefit. In 2004, Aquila identified savings that were recurring and impacted the income
18 statement. These cost reductions are embedded in the per book amounts in the income
19 statement. The Staff has made an additional adjustment to realize additional savings Aquila
20 identified that have occurred through June 30, 2005.

21 Q. Which adjustments are you sponsoring associated with Six Sigma?

1 A. For MPS, I am sponsoring adjustments S-34.19, S-69.19, S-80.18, S-82.18,
2 S-82.19, S-89.18 and S-93.14, and for L&P, adjustments S-34.19, S-67.19, S-79.19, S-81.19,
3 S-81.20, S-89.18 and S-94.13.

4 **PAYROLL EXPENSE**

5 Q. Please explain the payroll adjustments you are sponsoring.

6 A. A listing of the payroll adjustments can be found on Schedule 2.1 for MPS and
7 Schedule 2.2 for L&P.

8 Q. Please explain the process taken to annualize payroll.

9 A. As Staff witness Williams explains in his direct testimony, the Staff is filing a
10 calendar year 2004 test year updated for known and measurable events through June 30, 2005.
11 Therefore, I have developed the payroll expense by annualizing payroll costs at June 30,
12 2005, for MPS, L&P and the corporate ESF and IBU departments. The annualized payroll
13 expense is based upon actual employees and the authorized wage levels paid as of June 30,
14 2005.

15 Q. How did Staff develop payroll costs in this case?

16 A. The Staff requested payroll information for each department and individual
17 employed by Aquila and its operating divisions. This information was analyzed to track
18 changes in the work force and to identify any areas that needed to be reviewed in further
19 detail. Salary and wage rates were reviewed to determine the pay levels of the Aquila
20 employees.

21 I determined the salary and wage rates as of June 30, 2005, and applied those rates to
22 employees that were included in the payroll costs as of that date. The annualized amount was
23 compared to the test-year per-book amount at December 31, 2004, to identify the related

1 adjustment to the annualized level as of June 30, 2005. The annualized amount was
2 distributed to the Federal Energy Regulatory Commission (FERC) Uniform System of
3 Accounts by a payroll distribution percentage based on the payroll distribution percentage
4 used for the test year. I also developed the payroll annualization by applying a capitalization
5 ratio to assign part of the payroll to construction activities. This essentially assigns a portion
6 of payroll costs for employees who work on construction projects.

7 I have also included an allowance for overtime and "other than standard" labor costs
8 by including them at the test year level. These costs were reviewed over a three-year
9 historical time frame to determine the reasonableness of the test year levels.

10 Finally, I was provided changes to the costs, subject to allocation, for specific
11 corporate departments by Staff witness Hyneman to incorporate into the payroll and payroll
12 related costs. For a discussion on the specific corporate adjustments, please refer to
13 Mr. Hyneman's direct testimony.

14 Q. How did Staff account for the payroll costs of Aquila's corporate departments
15 and other business units that provide service to MPS and L&P?

16 A. These costs have been allocated to MPS and L&P using an appropriate
17 allocation factor using the updated factors as of July 1, 2005, the modified Massachusetts
18 Formula and the impact of South Harper.

19 Q. Has Aquila paid any executive bonuses in 2004?

20 A. No. However, Aquila announced the sale of four of its utility properties on
21 September 21, 2005. The Compensation and Benefits Committee of the Board of Directors
22 determined that the chief executive officer and eight other top executives will receive a cash

1 bonus of 25% of their current salary. Upon the consummation of the sales transactions, the
2 executives are eligible for an additional 75% cash bonus of *their current salary*.

3 Q. Has the Staff reflected the announced executive bonuses in its direct filing?

4 A. No.

5 Q. Will the executive bonuses be reflected in the true-up?

6 A. No.

7 Q. Why will these bonuses not be reflected?

8 A. These bonuses are associated with the corporate restructuring activities and
9 should not be recovered in rates. Staff witness Hyneman discusses this further in his direct
10 testimony.

11 **INCENTIVE COMPENSATION**

12 Q. Please explain what is meant by incentive compensation.

13 A. Incentive compensation is additional compensation, above base wages/salary,
14 that employees receive if certain pre-set goals are met.

15 Q. What is the nature of Staff's review in auditing this area?

16 A. Among other things, the Staff's audit scope includes a review of the goals of
17 the plan and a determination as to who benefits by achieving the goals and, therefore, who
18 should pay for achieving the goals. Historically, the Staff has recommended that ratepayers
19 pay for progress made towards accomplishing goals of improving safety, reliability and
20 customer service, and that goals intended to improve the Company's earnings/rate of return be
21 assigned to shareholders.

22 Q. What types of incentive compensation plans does the Company have?

1 A. The Company has a Variable Compensation Plan (VCP), and a Long-Term
2 Incentive Plan (LTIP).

3 ***Variable Compensation Plan***

4 Q. What is the purpose of the Variable Compensation Plan?

5 A. Aquila's response to Data Request No. 53 identifies the purpose to "reward
6 the accomplishment of operation business objectives and to motivate participants to
7 accomplish significant business group and individual goals. Achievement of these goals will
8 further enhance Aquila's mission to enhance business stability and service reliability."

9 Q. How are incentive payments determined under the VCP?

10 A. Incentive payments for the 2004 VCP are made based upon the achievement of
11 established goals for each of the components of reliability, safety, customer service and
12 effective use of capital.

13 Q. Is the Staff recommending any disallowance of payments made under the
14 VCP?

15 A. No. No disallowance to the VCP program is being proposed in this case
16 because the goals are not directly related to the Company achieving a specific rate of return or
17 financial earnings benchmark. Future recommendations made to support inclusion in rates for
18 the VCP in future rate cases will be made on a case-by-case basis based on the information at
19 the time.

20 Q. Please explain adjustments S-9.8, S-11.8, S-13.8, S-16.8, S-18.8, S-19.8,
21 S-21.8, S-24.8, S-26.8, S-33.8, S-34.8, S-35.8, S-36.8, S-37.8, S-38.8, S-40.8, S-42.8, S-44.8,
22 S-45.8, S-47.8, S-48.8, S-49.8, S-50.8, S-54.8, S-55.8, S-56.8, S-58.8, S-60.8, S-61.8, S-65.8,
23 S-66.8, S-67.8, S-68.8, S-69.8, S-71.8, S-72.8, S-73.8, S-74.8, S-75.8, S-76.8, S-79.8, S-80.8,

1 S-82.8, S-85.8, S-88.8 and S-90.8 for MPS and adjustments S-9.8, S-11.8, S-13.8, S-14.8,
2 S-17.8, S-18.8, S-19.8, S-20.8, S-21.8, S-24.8, S-27.8, S-33.8, S-34.8, S-35.8, S-36.8, S-37.8,
3 S-40.8, S-42.8, S-43.8, S-44.8, S-45.8, S-46.8, S-47.8, S-51.8, S-52.8, S-54.8, S-58.8, S-59.8,
4 S-63.8, S-65.8, S-66.8, S-67.8, S-69.8, S-70.8, S-71.8, S-72.8, S-73.8, S-74.8, S-75.8, S-78.8,
5 S-79.8, S-81.8, S-84.8, S-88.8 and S-90.8 for L&P.

6 A. These adjustments reflect the test-year levels of incentive compensation
7 adjusted to reflect the July 2005 corporate allocation factors.

8 ***Long-Term Incentive Plan***

9 Q. Please explain the adjustments S-85.10 for MPS and S-84.10 for L&P for the
10 long-term incentive plan (LTIP).

11 A. These adjustments remove LTIP expenses from the cost of service. The
12 Company is not seeking recovery of this plan in rates at this time.

13 **PAYROLL TAXES**

14 Q. Please explain adjustments for S-93.1, S-93.2, S-93.3 and S-93.4 MPS and
15 adjustments S-94.1, S-94.2, S-94.3 and S-94.4 for L&P related to payroll taxes.

16 A. These adjustments serve to ensure the appropriate level of Social Security
17 (FICA), Medicare, state unemployment (SUTA) and federal unemployment (FUTA) taxes
18 associated with the level of Staff's annualized payroll are included in rates.

19 Q. Please briefly explain how you computed the correct level of payroll taxes.

20 A. The current 2005 tax rates for the individual tax components were used for this
21 calculation. Applying these rates to the current annualized level of payroll expense produces
22 an appropriate level of payroll taxes on a going forward basis.

1 **EMPLOYEE BENEFITS**

2 ***Medical, Dental & Vision Expense***

3 Q. Please describe adjustments S-85.16 and S-85.17 for MPS and adjustments
4 S-84.16 and S-84.17 for L&P associated with the health, vision and dental benefits.

5 A. The Staff's adjustment regarding health, vision and dental benefits is two-fold.
6 An adjustment was made to eliminate the historical over-accrual on the Company's books for
7 the self-insured portion of health, dental and vision benefits. The second adjustment reflects
8 the change in premium-based insurance based on Aquila's Election Report dated for June
9 2005.

10 ***401(k) Expense***

11 Q. Please describe adjustment S-85.15 for MPS and adjustment S-84.14 for L&P
12 associated with 401(k) expense.

13 A. The 401(k) benefits matching expense incurred by MPS and L&P in the test
14 year represent a certain percentage of payroll. I have maintained this same relationship, but
15 multiplied it by the Staff's annualized level of payroll to produce the Staff's 401(k) benefit
16 level. The difference between this and the test-year level generates the adjustment.

17 ***Profit Sharing Plan***

18 Q. Please describe adjustment S-85.14 for MPS and adjustment S-84.16 for L&P
19 associated with the profit sharing plan.

20 A. The profit sharing plan was formerly known as the employee stock
21 contribution plan. The change occurred in 2004 and is a cash contribution to the employees
22 investment account.

23 Q. Please explain how your adjustment was determined.

1 A. The profit sharing contribution expense incurred by Aquila in the test year
2 represents a certain percentage of payroll. I have maintained the same relationship, but
3 multiplied it by the Staff's annualized level of payroll to produce the Staff's profit sharing
4 contribution expense level. The difference between this and the test year level gives rise to
5 my adjustment.

6 **PENSION EXPENSE**

7 Q. How has the Staff reflected pension expense in the instant case, adjustment
8 S-85.11 for MPS and adjustment S-84.13 for L&P?

9 A. The Staff has taken the same approach in calculating pension expense as
10 outlined in the Stipulation and Agreement (Stipulation) for Aquila's last case, Case
11 No. ER-2004-0034. The annual pension cost is based upon a five-year average of the
12 Company's ERISA contributions to the pension fund and is intended to reflect the Company's
13 funding requirement under ERISA minimum.

14 **PREPAID PENSION ASSET**

15 Q. Please explain the prepaid pension asset.

16 A. The prepaid pension asset represents the level of negative Financial
17 Accounting Standard (FAS) 87 expense flowed back in rates in prior years. The amount was
18 determined as part of the settlement of the pension issue in Case No. ER-2004-0034. The
19 unamortized balance has been included as an addition to Rate Base, Schedule 2.

20 Q. Please explain the adjustments to amortize the prepaid pension asset.

21 A. The adjustments to amortize the prepaid pension assets are based upon a
22 5.5 year amortization period for MPS and 9.25 year amortization period for L&P. The
23 amortization periods correspond with the time frame since the adoption of FAS 87 for

1 ratemaking purposes for MPS and L&P and are in accordance with the Stipulation in Case
2 No. ER-2004-0034.

3 **ERISA MINIMUM TRACKER AND AMORTIZATION**

4 Q. What is the ERISA minimum tracker and associated amortization expense?

5 A. The Stipulation in Case. No. ER-2004-0034 provided that the difference
6 between annual ERISA minimum and the ERISA minimum included in rates in Case
7 No. ER-2004-0034 be recorded as a regulatory asset or liability. The Company has not made
8 any ERISA minimum contributions since the effective date of rates for Case
9 No. ER-2004-0034. Thus, as of June 30, 2005, the Company had recovered funds for
10 14.3 months, which results in a regulatory liability that is being included as an offset to rate
11 base.

12 The terms of the Stipulation provided for a five year amortization of the regulatory
13 asset or liability. This has been reflected as adjustment S-85.9 for MPS and S-84.9 for L&P.

14 Q. Does this conclude your direct testimony?

15 A. Yes, it does.

**CASE PARTICIPATION
LESLEY PRESTON**

Participation			Testimony
Company	Case No.	Exhibit	Issues
Missouri Gas Energy	GR-2004-0209	Direct	Advertising, Dues & Donations, Plant in Service, Depreciation Reserve, Depreciation Expense, Rate Case Expense, PSC Assessment, Injuries & Damages
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	GR-2004-0072	Direct	Cash Working Capital, Account Receivable Sales, Materials & Supplies, Prepayments, Customer Deposits and Interest, Customer Advances, Postage, Maintenance Expense
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	GR-2004-0072	Rebuttal	Cash Working Capital
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	ER-2004-0034 & HR-2004-0024 (Consolidated)	Direct	Cash Working Capital, Account Receivable Sales, Materials & Supplies, Prepayments, Customer Deposits and Interest, Customer Advances, Maintenance Expense, Postage
Aquila, Inc. d/b/a Aquila Networks-L&P and Aquila Networks-MPS	ER-2004-0034 & HR-2004-0024 (Consolidated)	Surrebuttal	Cash Working Capital

SMALL COMPANY CASE PARTICIPATION

Company	Case No.	Tracking No.
Middlefork Water Company		QW-2005-0005
Central Rivers Wastwater	SA-2005-0302	
Hickory Hills Water & Sewer Compay, Inc.	WR-2005-0126	QW-2004-0008
Hickory Hills Water & Sewer Compay, Inc.	SR-2005-0125	QS-2004-0009
Raytown Water Company	WR-2005-0052	QW-2003-0023
Taney County Utilities	WR-2004-0450	QW-2003-0016
Taney County Utilities	SR-2004-0451	QS-2003-0015

Income Statement Adjustments-MPS

Payroll Adjustments

CS-5	June 30, 2005	Adjusted Massachusetts	South Harper Impact	Restructuring (Per C. Hyneman)	Lobbying (Per C. Hyneman)	Community Relations (Per C. Hyneman)
S-9.1	S-9.2	S-9.3	S-9.4	S-9.5	S-9.6	S-9.7
S-11.1	S-11.2	S-11.3	S-11.4	S-11.5	S-11.6	S-11.7
S-12.1	S-12.2	S-12.3	S-12.4	S-12.5	S-12.6	S-12.7
S-13.1	S-13.2	S-13.3	S-13.4	S-13.5	S-13.6	S-13.7
S-16.1	S-16.2	S-16.3	S-16.4	S-16.5	S-16.6	S-16.7
S-17.1	S-17.2	S-17.3	S-17.4	S-17.5	S-17.6	S-17.7
S-18.1	S-18.2	S-18.3	S-18.4	S-18.5	S-18.6	S-18.7
S-19.1	S-19.2	S-19.3	S-19.4	S-19.5	S-19.6	S-19.7
S-20.1	S-20.2	S-20.3	S-20.4	S-20.5	S-20.6	S-20.7
S-21.1	S-21.2	S-21.3	S-21.4	S-21.5	S-21.6	S-21.7
S-23.1	S-23.2	S-23.3	S-23.4	S-23.5	S-23.6	S-23.7
S-24.1	S-24.2	S-24.3	S-24.4	S-24.5	S-24.6	S-24.7
S-26.1	S-26.2	S-26.3	S-26.4	S-26.5	S-26.6	S-26.7
S-27.1	S-27.2	S-27.3	S-27.4	S-27.5	S-27.6	S-27.7
S-28.1	S-28.2	S-28.3	S-28.4	S-28.5	S-28.6	S-28.7
S-33.1	S-33.2	S-33.3	S-33.4	S-33.5	S-33.6	S-33.7
S-34.1	S-34.2	S-34.3	S-34.4	S-34.5	S-34.6	S-34.7
S-35.1	S-35.2	S-35.3	S-35.4	S-35.5	S-35.6	S-35.7
S-36.1	S-36.2	S-36.3	S-36.4	S-36.5	S-36.6	S-36.7
S-37.1	S-37.2	S-37.3	S-37.4	S-37.5	S-37.6	S-37.7
S-38.1	S-38.2	S-38.3	S-38.4	S-38.5	S-38.6	S-38.7
S-40.1	S-40.2	S-40.3	S-40.4	S-40.5	S-40.6	S-40.7
S-41.1	S-41.2	S-41.3	S-41.4	S-41.5	S-41.6	S-41.7
S-42.1	S-42.2	S-42.3	S-42.4	S-42.5	S-42.6	S-42.7
S-44.1	S-44.2	S-44.3	S-44.4	S-44.5	S-44.6	S-44.7
S-45.1	S-45.2	S-45.3	S-45.4	S-45.5	S-45.6	S-45.7
S-47.1	S-47.2	S-47.3	S-47.4	S-47.5	S-47.6	S-47.7
S-48.1	S-48.2	S-48.3	S-48.4	S-48.5	S-48.6	S-48.7
S-49.1	S-49.2	S-49.3	S-49.4	S-49.5	S-49.6	S-49.7
S-50.1	S-50.2	S-50.3	S-50.4	S-50.5	S-50.6	S-50.7
S-51.1	S-51.2	S-51.3	S-51.4	S-51.5	S-51.6	S-51.7
S-52.1	S-52.2	S-52.3	S-52.4	S-52.5	S-52.6	S-52.7
S-53.1	S-53.2	S-53.3	S-53.4	S-53.5	S-53.6	S-53.7
S-54.1	S-54.2	S-54.3	S-54.4	S-54.5	S-54.6	S-54.7
S-55.1	S-55.2	S-55.3	S-55.4	S-55.5	S-55.6	S-55.7
S-56.1	S-56.2	S-56.3	S-56.4	S-56.5	S-56.6	S-56.7
S-58.1	S-58.2	S-58.3	S-58.4	S-58.5	S-58.6	S-58.7
S-60.1	S-60.2	S-60.3	S-60.4	S-60.5	S-60.6	S-60.7
S-61.1	S-61.2	S-61.3	S-61.4	S-61.5	S-61.6	S-61.7
S-62.1	S-62.2	S-62.3	S-62.4	S-62.5	S-62.6	S-62.7
S-63.1	S-63.2	S-63.3	S-63.4	S-63.5	S-63.6	S-63.7
S-64.1	S-64.2	S-64.3	S-64.4	S-64.5	S-64.6	S-64.7
S-65.1	S-65.2	S-65.3	S-65.4	S-65.5	S-65.6	S-65.7
S-66.1	S-66.2	S-66.3	S-66.4	S-66.5	S-66.6	S-66.7
S-67.1	S-67.2	S-67.3	S-67.4	S-67.5	S-67.6	S-67.7
S-68.1	S-68.2	S-68.3	S-68.4	S-68.5	S-68.6	S-68.7
S-69.1	S-69.2	S-69.3	S-69.4	S-69.5	S-69.6	S-69.7
S-71.1	S-71.2	S-71.3	S-71.4	S-71.5	S-71.6	S-71.7
S-72.1	S-72.2	S-72.3	S-72.4	S-72.5	S-72.6	S-72.7
S-73.1	S-73.2	S-73.3	S-73.4	S-73.5	S-73.6	S-73.7
S-74.1	S-74.2	S-74.3	S-74.4	S-74.5	S-74.6	S-74.7
S-75.1	S-75.2	S-75.3	S-75.4	S-75.5	S-75.6	S-75.7
S-76.1	S-76.2	S-76.3	S-76.4	S-76.5	S-76.6	S-76.7
S-79.1	S-79.2	S-79.3	S-79.4	S-79.5	S-79.6	S-79.7
S-80.1	S-80.2	S-80.3	S-80.4	S-80.5	S-80.6	S-80.7
S-81.1	S-81.2	S-81.3	S-81.4	S-81.5	S-81.6	S-81.7
S-82.1	S-82.2	S-82.3	S-82.4	S-82.5	S-82.6	S-82.7
S-85.1	S-85.2	S-85.3	S-85.4	S-85.5	S-85.6	S-85.7
S-88.1	S-88.2	S-88.3	S-88.4	S-88.5	S-88.6	S-88.7
S-89.1	S-89.2	S-89.3	S-89.4	S-89.5	S-89.6	S-89.7
S-90.1	S-90.2	S-90.3	S-90.4	S-90.5	S-90.6	S-90.7

Income Statement Adjustments-L&P

Payroll Adjustments

	June 30, 2005	Adjusted	South	Restructuring	Lobbying (Per	Community
CS-5	Payroll	Massachusetts	Harper	(Per C.	C. Hyneman)	Relations
			Impact	Hyneman)		(Per C.
						Hyneman)
S-9.1	S-9.2	S-9.3	S-9.4	S-9.5	S-9.6	S-9.7
S-11.1	S-11.2	S-11.3	S-11.4	S-11.5	S-11.6	S-11.7
S-13.1	S-13.2	S-13.3	S-13.4	S-13.5	S-13.6	S-13.7
S-14.1	S-14.2	S-14.3	S-14.4	S-14.5	S-14.6	S-14.7
S-17.1	S-17.2	S-17.3	S-17.4	S-17.5	S-17.6	S-17.7
S-18.1	S-18.2	S-18.3	S-18.4	S-18.5	S-18.6	S-18.7
S-19.1	S-19.2	S-19.3	S-19.4	S-19.5	S-19.6	S-19.7
S-20.1	S-20.2	S-20.3	S-20.4	S-20.5	S-20.6	S-20.7
S-21.1	S-21.2	S-21.3	S-21.4	S-21.5	S-21.6	S-21.7
S-22.1	S-22.2	S-22.3	S-22.4	S-22.5	S-22.6	S-22.7
S-24.1	S-24.2	S-24.3	S-24.4	S-24.5	S-24.6	S-24.7
S-25.1	S-25.2	S-25.3	S-25.4	S-25.5	S-25.6	S-25.7
S-26.1	S-26.2	S-26.3	S-26.4	S-26.5	S-26.6	S-26.7
S-27.1	S-27.2	S-27.3	S-27.4	S-27.5	S-27.6	S-27.7
S-28.1	S-28.2	S-28.3	S-28.4	S-28.5	S-28.6	S-28.7
S-33.1	S-33.2	S-33.3	S-33.4	S-33.5	S-33.6	S-33.7
S-34.1	S-34.2	S-34.3	S-34.4	S-34.5	S-34.6	S-34.7
S-35.1	S-35.2	S-35.3	S-35.4	S-35.5	S-35.6	S-35.7
S-36.1	S-36.2	S-36.3	S-36.4	S-36.5	S-36.6	S-36.7
S-37.1	S-37.2	S-37.3	S-37.4	S-37.5	S-37.6	S-37.7
S-38.1	S-38.2	S-38.3	S-38.4	S-38.5	S-38.6	S-38.7
S-40.1	S-40.2	S-40.3	S-40.4	S-40.5	S-40.6	S-40.7
S-42.1	S-42.2	S-42.3	S-42.4	S-42.5	S-42.6	S-42.7
S-43.1	S-43.2	S-43.3	S-43.4	S-43.5	S-43.6	S-43.7
S-44.1	S-44.2	S-44.3	S-44.4	S-44.5	S-44.6	S-44.7
S-45.1	S-45.2	S-45.3	S-45.4	S-45.5	S-45.6	S-45.7
S-46.1	S-46.2	S-46.3	S-46.4	S-46.5	S-46.6	S-46.7
S-47.1	S-47.2	S-47.3	S-47.4	S-47.5	S-47.6	S-47.7
S-48.1	S-48.2	S-48.3	S-48.4	S-48.5	S-48.6	S-48.7
S-49.1	S-49.2	S-49.3	S-49.4	S-49.5	S-49.6	S-49.7
S-50.1	S-50.2	S-50.3	S-50.4	S-50.5	S-50.6	S-50.7
S-51.1	S-51.2	S-51.3	S-51.4	S-51.5	S-51.6	S-51.7
S-52.1	S-52.2	S-52.3	S-52.4	S-52.5	S-52.6	S-52.7
S-53.1	S-53.2	S-53.3	S-53.4	S-53.5	S-53.6	S-53.7
S-54.1	S-54.2	S-54.3	S-54.4	S-54.5	S-54.6	S-54.7
S-58.1	S-58.2	S-58.3	S-58.4	S-58.5	S-58.6	S-58.7
S-59.1	S-59.2	S-59.3	S-59.4	S-59.5	S-59.6	S-59.7
S-60.1	S-60.2	S-60.3	S-60.4	S-60.5	S-60.6	S-60.7
S-61.1	S-61.2	S-61.3	S-61.4	S-61.5	S-61.6	S-61.7
S-62.1	S-62.2	S-62.3	S-62.4	S-62.5	S-62.6	S-62.7
S-63.1	S-63.2	S-63.3	S-63.4	S-63.5	S-63.6	S-63.7
S-64.1	S-64.2	S-64.3	S-64.4	S-64.5	S-64.6	S-64.7
S-65.1	S-65.2	S-65.3	S-65.4	S-65.5	S-65.6	S-65.7
S-66.1	S-66.2	S-66.3	S-66.4	S-66.5	S-66.6	S-66.7
S-67.1	S-67.2	S-67.3	S-67.4	S-67.5	S-67.6	S-67.7
S-69.1	S-69.2	S-69.3	S-69.4	S-69.5	S-69.6	S-69.7
S-70.1	S-70.2	S-70.3	S-70.4	S-70.5	S-70.6	S-70.7
S-71.1	S-71.2	S-71.3	S-71.4	S-71.5	S-71.6	S-71.7
S-72.1	S-72.2	S-72.3	S-72.4	S-72.5	S-72.6	S-72.7
S-73.1	S-73.2	S-73.3	S-73.4	S-73.5	S-73.6	S-73.7
S-74.1	S-74.2	S-74.3	S-74.4	S-74.5	S-74.6	S-74.7
S-75.1	S-75.2	S-75.3	S-75.4	S-75.5	S-75.6	S-75.7
S-78.1	S-78.2	S-78.3	S-78.4	S-78.5	S-78.6	S-78.7
S-79.1	S-79.2	S-79.3	S-79.4	S-79.5	S-79.6	S-79.7
S-80.1	S-80.2	S-80.3	S-80.4	S-80.5	S-80.6	S-80.7
S-81.1	S-81.2	S-81.3	S-81.4	S-81.5	S-81.6	S-81.7
S-84.1	S-84.2	S-84.3	S-84.4	S-84.5	S-84.6	S-84.7
S-88.1	S-88.2	S-88.3	S-88.4	S-88.5	S-88.6	S-88.7
S-89.1	S-89.2	S-89.3	S-89.4	S-89.5	S-89.6	S-89.7
S-90.1	S-90.2	S-90.3	S-90.4	S-90.5	S-90.6	S-90.7

Company Direct Filing

	Margin	Payroll	Net Plant	
MEP	-57,760	14,336	183,038	3.65%
MPS	206,954	22,062	927,360	29.68%
L&P	84,906	10,043	190,459	9.76%
Other Units	426,859	73,921	1,053,604	56.92%
	660,959	120,362	2,354,461	

Company Updated Filing

	Margin	Payroll	Net Plant	
MEP	-	2,560	164,018	3.21%
MPS	196,418	16,836	1,065,126	30.68%
L&P	66,172	7,167	191,577	8.57%
Other Units	409,538	63,834	989,631	57.53%
	672,128	90,397	2,410,352	

Staff's Proposed Massachusetts Formula

	Margin	Payroll	Net Plant	
MEP	72,962	2,560	164,018	6.48%
MPS	196,418	16,836	1,065,126	29.72%
L&P	66,172	7,167	191,577	8.25%
Other Units	409,768	63,834	989,631	55.55%
	745,320	90,397	2,410,352	

Staff's Proposed Massachusetts Formula-South Harper Net Plant

	Margin	Payroll	Net Plant	
MEP	72,962	2,560	164,018	6.50%
MPS	196,418	16,836	1,035,120	29.49%
L&P	66,172	7,167	191,577	8.28%
Other Units	409,768	63,834	989,631	55.72%
	745,320	90,397	2,380,346	