Exhibit No.:	
Issues:	FAS 106, FAS 87 Deferred Income Taxes
Witness:	Laurie Delano
Sponsoring Party:	Empire Dist. Electric Company
Type of Exhibit:	Direct Testimony
Case No.:	
Date Testimony Prepared:	February 2006

Before the Public Service Commission
of the State of Missouri

Direct Testimony

Of

Laurie Delano

February 2006

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LAURIE DELANO
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY
OF
LAURIE DELANO
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
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CASE NO.

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Laurie Delano. My business address is 602 Joplin Street, Joplin, Missouri 64802.

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

A. I am a Controller and Assistant Secretary/Treasurer of The Empire District Electric Company (the "Company" or "Empire").

Q. PLEASE DESCRIBE YOUR EDUCATION AND BACKGROUND.

A. I received a Bachelor of Science in Business Administration from Missouri Southern State University and a Master of Business Administration from Missouri State University. I joined the Company in 1979 and served as Director of Internal Auditing from 1983 to 1991. I left the Company in 1991 and was employed as an Accounting Lecturer at Pittsburg State University, and in management positions with TAMKO Roofing Products, Inc. and Lozier Corporation before rejoining the Company in December 2002.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to recommend a tracker mechanism to recover Empire's other post-employment benefits ("OPEB"), commonly referred to as FAS (Financial Accounting Standard) 106 Costs. I am also requesting approval of future recovery of regulated assets as a result of the accounting treatment for the recognition of minimum pension liability as described by Federal Energy Regulatory Commission (FERC). Finally, I am supporting the FAS 87 Regulatory Asset Amortization adjustment and Deferred Tax adjustment.

TRACKER MECHANISM

Q. DOES EMPIRE CURRENTLY USE AN APPROVED TRACKER MECHANISM TO RECOVER ITS FAS 87 COSTS?

A. Yes, in our last rate case, a tracker mechanism was approved for the recovery of FAS 87 costs. In this rate case, we are requesting to implement a similar mechanism for the recovery of our FAS 106 costs.

Q. PLEASE EXPLAIN HOW THE TRACKER MECHANISM YOU ARE PROPOSING FOR FAS 106 WILL WORK.

A. The mechanism we are proposing will enable Empire to accumulate the difference between the actual FAS 106 costs incurred in the future and the current test year costs as either a regulatory asset or liability. The regulatory asset or liability that is recorded in the future will then be included in rate base and amortized over five years in the next rate case.

Q. PLEASE EXPLAIN WHY EMPIRE DESIRES TO ESTABLISH SUCH AN ACCOUNTING PROCEDURE.

A. Currently, Empire collects FAS 106 costs in rates based on the test year level. As a result, increases or decreases in costs between rate cases are either over or under-recovered. The tracker mechanism we are proposing eliminates this problem by ensuring the level of expense recognized for financial purposes is consistent with the level of expense included in rates.

Q. HOW WOULD YOU CHARACTERIZE THIS PROPOSAL?

A. It is reasonable and appropriate. In this regard, Section 386.315, RSMo.2000 allows the Company to recover FAS 106 costs. The statute says " ... the commission shall not disallow or refuse to recognize the actual level of expenses the utility is required by Financial Accounting Standard 106 to record the postretirement [sic] employee benefits for all the utility's employees, including retirees, if the assumptions and estimates used by a public utility in determining the Financial Accounting Standard 106 expenses have been reviewed and approved by the commission . ."

In order to recover FAS 106 costs in their entirety, Empire requests the Commission authorize the implementation of our proposed FAS 106 tracker mechanism. (See Exhibit LD-1 for a description of this mechanism).

<u>MINIMUM PENSION LIABILITY ADJUSTMENT</u>

Q. WHAT IS A MINIMUM PENSION LIABILITY ADJUSTMENT?

A. According to Financial Accounting Standard number 87 ("FAS 87"), a minimum pension liability must be recorded on the Company's books if the accumulated benefit obligation exceeds the fair value of the assets set aside to meet the obligation. According to Generally Accepted Accounting Principles ("GAAP:), the offset to the pension liability is a charge (debit) to Other Comprehensive Income ("OCI"). FERC Instruction No. 23 (paragraph 3), states that if it is probable that an item of OCI will be included in rates in subsequent periods, a reclassification adjustment to a regulatory asset is appropriate.

Q. DOES FERC PROVIDE ANY OTHER GUIDANCE REGARDING MINIMUM PENSION LIABILITY ADJUSTMENTS?

A. Yes. On March 29, 2004, FERC issued a reply to a question regarding this issue in OED-DRAP Docket No. AI04-2-000. A copy of this is attached as Schedule LD-2.

Q. DOES THE ORDER ISSUED BY THE COMMISSION IN EMPIRE'S MOST RECENT RATE CASE ALLOW FOR ADDITIONAL FUNDING TO THE PENSION ASSET ACCOUNT TO PREVENT AN UNDER FUNDED POSITION?

A. Yes, our current rate order allows us to recover the cost of additional funding if it is made to avoid the write off of an existing prepaid pension asset (i.e. charge to OCI). However, the Company could possibly find itself in a position, through market conditions or future accounting or other legislation, where this funding would be impractical.

Q. IS THE COMPANY SEEKING COMMISSION APPROVAL TO RECORD A MINIMUM PENSION LIABILITY AS A REGULATORY ASSET?

A. Yes. We request that the Commission authorize Empire to follow the accounting treatment prescribed by the FERC regarding minimum pension liabilities, and authorize the transfer of any existing and future pension OCI amounts to a regulatory asset on the Empire general ledger.

Q. HOW DO YOU PROPOSE THAT THE COMMISSION ACCOMPLISH YOUR REQUEST?

A. The final order issued in this case should clearly state that Empire is authorized to follow the accounting treatment prescribed by the FERC regarding minimum pension liabilities, and that Empire is authorized to transfer any existing and future pension OCI amounts to a regulatory asset on the Empire general ledger and amortized in future rate proceeding.

FAS 87 REGULATORY ASSET AMORTIZATION ADJUSTMENT

Q. DID EMPIRE MAKE AN ADJUSTMENT TO THE TEST YEAR EXPENSES TO REFLECT THE AMORTIZATION OF THE FAS 87 REGULATORY ASSET?

A. Yes. In the last rate case, Case No. ER-2004-0570, the Commission approved an accounting mechanism to track FAS 87 Pension Expense. Since that rate case, Empire has accumulated $970,387 of FAS 87 costs as a regulatory asset. In accordance with the accounting process authorized by the Commission in the last rate case, the FAS 87 regulatory asset has been recognized in the rate base of this case. Furthermore, per the order, Empire is to begin the amortization of this asset in its next rate case. Our proposed adjustment of $158,214 reflects the amortization of the non-capital FAS 87 regulatory asset accumulated since the last rate order over a five-year period. Empire requests that the Commission accept this amount for ratemaking purposes.

DEFERRED TAX ADJUSTMENT

Q. PLEASE DESCRIBE THE ADJUSTMENT TO DEFERRED TAXES PROPOSED FOR THIS RATE CASE.

A. An additional annual income tax expense of $130,431 has been added to the deferred tax calculation related to state income taxes previously flowed through to the benefit of rate payers.

Q. PLEASE DESCRIBE THE CHANGE IN DEFERRED TAXES DUE TO THE STATE INCOME TAX RATES.

A. Prior to Case No. ER-94-174 which authorized new rates effective August 15, 1994, Empire had been provided revenues which recovered only federal income tax expense related to timing differences created by accelerated tax depreciation.
The Company booked this deferred income tax at the federal income tax rate as provided in previous rate cases. The effect of providing rates for only the federal income tax rate was to flow through a tax benefit of Missouri state income tax to ratepayers, thus lowering cost of service.

Q. PLEASE CONTINUE.

A. Beginning with Case No. ER-94-174, deferred state income taxes were provided to the Company in rates. However, no mechanism was provided to allow for the recovery of the previously flowed through state income tax benefits to rate payers. Subsequent rate cases have also not addressed the issue.

Q. HOW DOES EMPIRE PROPOSE TO REMEDY THIS DISCREPANCY?

A. The Company has made detailed computations of the amount of the state income tax benefits that ratepayers received prior to Case No. ER-94-174. Empire proposes to use the South Georgia method to recover this amount over an eighteen year period beginning with the effective date of this case. As previously mentioned, an additional annual income tax expense of $130,431 was recorded in the deferred tax calculation.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes. At this time, it does.

EXHIBIT DL-1

EMPIRE DISTRICT ELECTRIC COMPANY

PROPOSED PROCEDURE

Case No.

January 2006

The intent of this procedure is to ensure that the amount collected in rates is based on the FAS 106 cost recognized by the Company for financial reporting purposes. To accomplish these goals, the following items are part of this procedure:

1. FAS 106 costs will be calculated based on the methodology used by the Company for financial reporting purposes.
2. FAS 106 cost recognized for financial reporting purposes will also be recognized in rates.
3. A regulatory asset or liability will be established on the Company's books to track the difference between the level of FAS 106 expense during the rate period and the level of expense built into rates for that period. If the FAS 106 expense during the period is more than the expense built into rates for the period, the Company will establish a regulatory asset, but only to the extent that such expense is not used to reduce a regulatory liability maintained pursuant to item 4. If the FAS 106 expense during the period, adjusted for any amount of such expense used to reduce a regulatory liability maintained pursuant to item 4, is less than the expense built into rates for the period, the Company will establish a regulatory liability. If the FAS 106 expense becomes negative, the regulatory liability will increase by the difference between the level of expense built into rates for that period and \$0. Since this is a cash item, the regulatory asset or liability will be included in rate base and amortized over 5 years at the time of the next rate case.

4. If the FAS 106 expense becomes negative, the Company is ordered to set up a regulatory liability to offset the negative expense. The regulatory liability will increase by the amount of negative expense, or decrease by the amount of positive expense, in each subsequent year. Positive expense in such subsequent year will be used to reduce this regulatory liability before being used to establish a regulatory asset pursuant to item 3. If the cost is negative at the time of the next rate case, the amount included in rates will be zero. If the cost is positive at the time of the next rate case, the positive expense will not be included in rates until the regulatory liability has been reduced to $0. This regulatory liability is a non-cash item and should be excluded from rate base in future years.
5. Any future FAS 106 prepaid asset will not be included in Rate Base in any future rate case. The regulatory assets/liabilities identified in this settlement will address all Rate Base amounts.

EXHIBIT DL-2

106 FERC ¶ 62,230

In Reply Refer To:
OED-DRAP
Docket No. AI04-2-000

March 29, 2004

Recognition of a Regulatory Asset for Minimum Pension Liability

TO ALL JURISDICTIONAL PUBLIC UTILITIES AND LICENSEES, NATURAL GAS COMPANIES, AND OIL PIPELINE COMPANIES

The generally lower interest rate environment of recent years and decline in value of assets set aside to meet pension obligations has resulted in many FERC jurisdictional entities recognizing a minimum liability for employee pension obligations. The Commission has received a number of requests for guidance on whether a regulatory asset should be recognized for some or all of the charge to other comprehensive income that is made at the time the minimum pension obligation is recognized. The following discussion responds to these requests.

Facts: An entity provides pension benefits to its employees under a defined pension benefit plan and recognizes pension expense (i.e. net periodic pension cost) for financial accounting and reporting purposes in accordance with Statement of Financial Accounting Standards No 87. (SFAS No. 87).[1] The rates the entity charges for services provided by a segment of its business are regulated by a third party regulator and are determined on the basis of the entity's costs. Development of the rates to be charged for services provided by this business segment include an allowance for employee pension benefits and the amount of that allowance is based on net periodic pension cost determined in accordance with SFAS No. 87. As a result of a decline in the value of its pension fund assets and an increase in the accumulated pension benefit obligation due to lower interest rates used to estimate that obligation on a present value basis, the entity determines that its accumulated pension benefit obligation exceeds the fair value of the assets set aside to meet that obligation. Consistent with the requirements of SFAS No. 87, the entity records a minimum pension liability for the amount of such excess.

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[1] Financial Accounting Standards Board Statement of Financial Accounting Standards No 87, Employer's Accounting for Pensions

Question: At the time the entity recognizes its minimum pension liability in accordance with SFAS No. 87, should it recognize a regulatory asset for the amount of the liability otherwise chargeable to accumulated other comprehensive income that relates to its cost based rate-regulated business segment?

Response: The cost of pension benefits provided to employees under a defined pension benefit plan are recognized as an expense at the time the employee provides related employment services. SFAS No. 87 contains a delayed recognition feature. This means that changes in the pension obligation and the value of assets set aside to meet these obligations are not recognized when they occur but are recognized systematically and gradually over subsequent periods. [2] An entity that determines its pension allowance included in its costs based regulated rates on the basis of SFAS No. 87 adopts that same delayed recognition feature for ratemaking purposes. That is, changes in the pension obligation and assets set aside to meet those obligations are not included in rates when they occur but rather are included in rates systematically and gradually in subsequent periods. The recognition of a minimum pension liability which would otherwise be charged to accumulate other comprehensive income therefore constitutes a measurement of the changes in pension obligations and the value of plan assets that are to be included in the determination of rates in subsequent periods in so far as they relate to the cost based rate regulated segment of the entity.

Under the Commission's accounting requirements regulatory assets are to be established for those charges that would have been included in net income or accumulated other comprehensive income determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.

Therefore, in the circumstances described above and provided that it is probable that the pension allowance to be included in rates in future periods will continue to be calculated on the basis of SFAS No. 87, entities shall recognize a regulatory asset for the minimum pension liability otherwise chargeable to accumulated other comprehensive income related to its cost based rate regulated business segments.

[2] Ibid. (See: Summary - Fundamentals of Pension Accounting)

EXHIBIT DL-2

Further, the minimum pension liability, as well as, any related regulatory asset is not amortized over future periods. At each measurement date, the entry recorded for the previous measurement date is reversed and the computation redone. A new minimum liability and related regulatory asset would be recognized, if required, at the new measurement date.

This guidance is for accounting purposes only and does not limit the Commission from reviewing the reasonableness of the elements of pension expense included in future rate proceedings before the Commission.

John M. Delaware
Deputy Executive Director
And Chief Accountant