

Exhibit No.:
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Payroll, Payroll Taxes, Bonuses
Witness: Graham Vesely
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: GR-2001-292
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MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

DIRECT TESTIMONY
OF
GRAHAM VESELY

FILED²
APR 19 2001
Missouri Public
Service Commission

MISSOURI GAS ENERGY,
A DIVISION OF SOUTHERN UNION COMPANY

CASE NO. GR-2001-292

Jefferson City, Missouri
April 2001

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1 Missouri, as a Civil Engineer. On February 26, 1999, I began my current employment
2 with the Commission.

3 Q. What is the nature of your duties while in the employ of this Commission?

4 A. I am responsible for assisting in the audits and examinations of the books
5 and records of utility companies operating within the state of Missouri.

6 Q. With reference to Case No. GR-2001-292, have you made an investigation
7 of the books and records of Missouri Gas Energy, a division of Southern Union
8 Company (MGE or Company) relating to the proposed rate application?

9 A. Yes, with the assistance of other members of the Commission Staff
10 (Staff).

11 Q. Please describe your principal areas of responsibility in this case.

12 A. I am responsible for the rate base component of cash working capital, and
13 payroll, payroll taxes, and employee bonus components of the income statement.

14 Q. What Accounting Schedules are you sponsoring in this case?

15 A. I am sponsoring Accounting Schedule 8, Cash Working Capital, which
16 details the Staff's calculation of the Company's cash working capital requirement.

17 **CASH WORKING CAPITAL (CWC)**

18 Q. What is Cash Working Capital (CWC)?

19 A. CWC is the amount of cash necessary for a utility to pay the day-to-day
20 expenses incurred in providing service to the ratepayers.

21 Q. What methodology did the Staff apply in determining the Company's
22 CWC requirement?

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1 A. I calculated the CWC requirement by performing a partial lead/lag study
2 in this case, and through reliance on certain components of the lead/lag study used in
3 Case No. GR-98-140, the prior MGE rate proceeding.

4 Q. Is the method the Staff used to calculate the CWC requirement consistent
5 with that used in previous rate cases?

6 A. Yes. The Commission has adopted use of a lead/lag study to calculate a
7 Company's CWC requirement in numerous rate cases.

8 Q. How does a lead/lag study calculate CWC?

9 A. In a lead/lag study, the Staff performs an analysis of the cash flows the
10 Company received from payments by its customers for utility service, and the
11 disbursements the Company made to suppliers, vendors, employees, and others in order
12 to be able to provide that service. A lead/lag analysis compares the number of days the
13 Company takes (or is allowed) to make payments after receiving goods or services from
14 vendors with the number of days it takes the Company to receive payments for the
15 service provided to its customers. The lead/lag study also determines who provides
16 CWC.

17 Q. What are the sources of CWC?

18 A. The sources of CWC are the ratepayers and the shareholders.

19 Q. In what instances do ratepayers supply CWC?

20 A. Ratepayers supply CWC when they pay for utility service before the
21 Company pays for the expenses incurred to provide that service. When this happens, the
22 Company benefits by having the use of money received from ratepayers but not

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1 immediately needed to pay expenses. Ratepayers are given consideration for this time
2 value of money, through a reduction to the Company' rate base.

3 Q. In what instances do shareholders supply CWC?

4 A. Shareholders supply CWC when the Company must pay for an expense
5 incurred to provide utility service before the ratepayer has paid for the related usage.
6 This outlay of Company funds is an investment by the shareholders, for which they are
7 compensated through an increase in rate base.

8 Q. How are the results from a lead/lag study interpreted?

9 A. A negative CWC requirement indicates that the ratepayer provided the
10 overall net CWC during the test year. This means that the ratepayers paid their bills, on
11 average, before the Company paid for expenses incurred to provide utility services.

12 A positive CWC requirement indicates that shareholders provided the net
13 overall working capital during the test year. This means that the Company, on average,
14 pays for the expenses incurred in providing utility services before ratepayers pay their
15 utility bills to the Company.

16 Q. Please explain the components of the Staff's calculation of CWC shown
17 on Accounting Schedule 8.

18 A. Column A, Account Description, lists various categories of transactions
19 requiring the Company to make cash outlays in conducting its utility operations.
20 Column B, Test Year Expenses, lists the amount of normalized and annualized test year
21 expenses included in the cost of service. Column C, Revenue Lag, is the number of days
22 between the midpoint of the service period and the date ratepayers pay for that service.
23 Column D, Expense Lag, is the number of days between receiving and paying for

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1 products and services used by the Company to provide utility service to ratepayers.
2 Column E, Cash Working Capital Net Lag, results from the subtraction of the Expense
3 Lag from the Revenue Lag. Column F, Cash Working Capital Factor, expresses the
4 CWC lag in days as a fraction of the total days in the year. This is calculated by dividing
5 the net lags in Column E by 365 days. Column G, Cash Working Capital Requirement, is
6 the average amount of cash necessary to provide service to the ratepayer. This is
7 calculated by multiplying the test year expenses (Column B) by the Cash Working
8 Capital factors (Column F).

9 Q. Please describe the revenue lag used by Staff in this case.

10 A. The revenue lag is actually made up of three individual lags. They are
11 defined as follows:

12 **Usage Lag:** The midpoint of the time from the beginning of the first day of the
13 service period through the last day of the service period.

14 **Billing Lag:** The period of time between the end of the last day of a service
15 period and the day the bill is placed in the mail by the Company.

16 **Collection Lag:** The period of time between the day the bill is placed in the mail by
17 the Company and the day the Company receives payment from the
18 ratepayer for utility services provided.

19 Q. Please define the term "service period" used previously.

20 A. In reference to the revenue lag, a service period is the number of days
21 during which a customer receives gas for billing purposes (i.e., the meter read period). In
22 reference to the expense lag, a service period is the period in which the Company
23 receives materials or services from its suppliers.

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1 Q. Please explain how the usage lag was calculated.

2 A. The Staff computed the usage lag by dividing the number of days in a year
3 (365) by the number of billing periods in a year (12) and dividing the result by two. The
4 average usage lag computed using this formula is 15.21 days.

5 Q. Have Company personnel and Staff reached an agreement on the overall
6 revenue lag in this case?

7 A. Yes. We have agreed to use a 43-day revenue lag in this case.

8 Q. How were the expense lags on Accounting Schedule 8 determined?

9 A. In general, Staff calculated the expense lags by measuring the time from
10 the midpoint of the period during which the goods and services were provided to the
11 Company, to the date the Company paid for those services.

12 Q. Please explain the bad debt expense lag on Accounting Schedule 8.

13 A. Bad debt expense does not involve an outflow of cash and therefore
14 should not properly have an effect on CWC. It is necessary to assign bad debt expense an
15 individual line item so that it is not included in cash vouchers. The Staff assigns bad debt
16 a zero net lag, thereby ensuring it has no effect on CWC.

17 Q. Please explain the net payroll expense lag on Accounting Schedule 8.

18 A. The expense lag for net payroll reflects the time lapse between the average
19 date the Company's employees earn compensation and the date payment is made by the
20 Company.

21 Q. How did Staff compute the lag days assigned to payroll withholding for
22 FICA (Social Security) tax, federal income tax, state income tax, city tax and resident
23 state tax on Accounting Schedule 8?

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1 A. All withholdings expense lags are based on the time lapse between the
2 midpoint of the pay period and the tax due dates.

3 Q. Please explain the computation of the expense lag for vacation expense on
4 Accounting Schedule 8.

5 A. The expense lag computation accounts for the time between the average
6 date the vacation is earned (i.e., the midpoint of the year) and the date when employees
7 are actually paid for vacation.

8 Q. Please explain the calculation of the expense lag for pensions on
9 Accounting Schedule 8.

10 A. The expense lag calculation for pensions measures the time lapse between
11 the average point when service is provided by the employee (i.e., the midpoint of the
12 year) and the date payment is made to the pension fund.

13 Q. Please explain the calculation of the expense lag for group medical
14 insurance on Accounting Schedule 8.

15 A. The Company makes payments into the medical bank on an as needed
16 basis. As an employee draws on the account, the Company makes payments into the
17 account. Given that illnesses may occur anytime during the year, Staff considered the
18 medical payments will be made evenly throughout the year and assigned it a zero expense
19 lag.

20 Q. Please explain the expense lag calculation for purchased gas on
21 Accounting Schedule 8.

22 A. Staff examined all vouchers over \$500,000 for gas purchased in the
23 twelve months ended December 31, 2000. The Staff calculated time lapse between the

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1 Company's average receipt date of natural gas and the payment date for each invoice.
2 Then, the lag days associated with each invoice were weighted based on the dollar
3 amount of the invoice to produce an average expense lag for all the gas purchases.

4 Q. Please explain the expense lag calculation for building rents and leases on
5 Accounting Schedule 8.

6 A. The expense lag days for building rents and leases is calculated by taking
7 the time lapse between the average service period and the date each invoice is paid. The
8 lag days associated with each invoice were then weighted based on the amount of the
9 invoice.

10 Q. Please explain the outside legal expense lag included on Accounting
11 Schedule 8.

12 A. Staff performed an analysis of payments made for legal services incurred
13 by the Company during the test year to determine the average length of time between the
14 rendering of service and the date of payment for legal services.

15 Q. Please explain the inclusion of taxes and interest in the Staff's analysis of
16 CWC on Accounting Schedule 8.

17 A. Taxes and interest are not operating and maintenance expenses, unlike the
18 other cash expenses listed on Accounting Schedule 8. However, they are known and
19 certain obligations of the Company with payment periods and payment dates established
20 by statute or by the terms of the debt instrument. Since the amounts collected for taxes
21 and interest represent a source of cash to the Company until passed on to the appropriate
22 taxing authority or bondholder, they should be included in a lead/lag analysis.

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1 Q. Please explain the expense lag for property taxes as shown on Accounting
2 Schedule 8.

3 A. The property tax lag days were calculated using the midpoint of the
4 service period and the payment due date for property taxes paid in Missouri. These lags
5 were multiplied by the amount of taxes paid to arrive at the weighted lag days.

6 Q. Please explain the expense lag for state franchise tax as shown on
7 Accounting Schedule 8.

8 A. In its response to Staff Data Request No. 225, MGE indicated that the due
9 date for its yearly franchise tax payment was October 15, 2000. Since the tax reporting
10 period was the 12-month period ended June 30, 2000, this results in a 289-day expense
11 lag.

12 Q. Please explain the employer's portion of the FICA tax expense lag on
13 Accounting Schedule 8.

14 A. The employer's portion of FICA tax is the amount of taxes paid by the
15 employer on payroll paid to the employees. The expense lag is calculated using the same
16 method as the lag used for the employee's portion of FICA tax.

17 Q. Please explain the federal and state unemployment tax expense lag on
18 Accounting Schedule 8.

19 A. The federal and state unemployment tax lag is calculated using federal and
20 state unemployment tax payments. The lag represents the length of time between the
21 average day service is rendered by the employee and the day the Company makes
22 payment for that service.

23 Q. Please explain the use tax expense lag on Accounting Schedule 8.

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1 A. Use taxes are paid monthly and are due on the last day of the following
2 month. The lag between the midpoint of the taxable month and the due dates was
3 calculated and multiplied by the associated amounts to compute a weighted amount.

4 Q. Please explain the sales tax expense lag on Accounting Schedule 8.

5 A. The sales tax lag is computed in a manner similar to that previously
6 addressed with regard to franchise taxes. The lag between the midpoint of the taxable
7 month and the due dates was calculated and multiplied by the associated amounts to
8 compute a weighted amount.

9 Q. Please explain the expense lag for gross receipt taxes as shown on
10 Accounting Schedule 8.

11 A. Gross receipt taxes are paid monthly, quarterly, or semi-annually based on
12 the requirements of the applicable taxing authority. The expense lag for this item
13 includes the appropriate number of days between the average service period and the tax
14 payment date.

15 Q. Are there any components of CWC that do not appear in the Staff's
16 Accounting Schedule 8?

17 A. Yes. The income tax offsets and interest offsets are components of CWC
18 but are included as separate items in Accounting Schedule 2, Rate Base.

19 Q. Why are the income tax offset and interest expense offset included in
20 Rate Base (Accounting Schedule 2) rather than Cash Working Capital
21 (Accounting Schedule 8)?

22 A. The normalized Missouri jurisdictional expense for these components are
23 directly tied to the mechanical computation of the revenue requirement. The Staff's

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1 computer program has the capability to extract these amounts from the Staff's Income
2 Tax Accounting Schedule, apply the CWC factor to each component, and place the CWC
3 requirement directly in Accounting Schedule 2.

4 Q. Please explain the expense lags for interest and income tax.

5 A. The interest expense lag was developed by weighting the long term debt
6 expense lags by their respective interest that was paid semi-annually or quarterly.

7 The expense lag for income taxes represents the period of time between
8 the midpoint of the tax/calendar year and the dates the income taxes must be paid to the
9 federal and state taxing authority.

10 Q. Please explain why a rate base offset is appropriate for interest expense.

11 A. Interest expense is a cost of doing business and is recoverable from the
12 ratepayers through rates. Ratepayers prepay this interest and the Company has the use of
13 the funds until payment is made to the bondholders.

14 Q. What was the result of the Staff's lead/lag calculation?

15 A. The individual calculations, when totaled, result in total net ratepayer
16 supplied funds and illustrate the excess of CWC supplied by the ratepayer over the
17 amount supplied by the shareholder. The CWC requirement component is deducted from
18 rate base to compensate the ratepayer for the use of their funds.

19 **PAYROLL**

20 Q. Please explain adjustments S-12.1, S-13.1, S-14.1, S-15.1, S-16.1, S-17.1,
21 S-18.1, S-19.1, S-20.1, S-21.2, S-23.1, S-24.1, S-25.1, S-26.2, S-27.1, S-28.1, S-29.1,
22 S-30.2, S-31.1, S-32.2, S-33.1, S-34.2, S-36.2, S-37.1, S-40.1, S-41.4, S-44.3, S-45.9, and
23 S-49.2?

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1 A. These adjustments were made to include the Staff's annualization of
2 payroll that included an estimate for increases effective prior to June 30, 2001.

3 Q. How did the Staff decide what employee level to include in its
4 annualization?

5 A. The Staff used the number of employees on the payroll at the end of test
6 year.

7 Q. Why has the Staff included an estimate for payroll increases through
8 June 30, 2001 in cost of service?

9 A. The Company requested a true-up audit in order to capture significant
10 plant additions through June 30, 2001. The Staff considers the true-up audit request to be
11 valid. MGE's annual payroll increases for union and non-union employees are expected
12 to become effective prior to June 30, 2001. The estimated wage increases included in
13 Staff's direct filing will be updated to reflect MGE's actual wage increases during the
14 true-up audit.

15 **PAYROLL TAXES**

16 Q. Would you please explain adjustment S-58.1?

17 A. Yes. Adjustment S-58.1 was made to annualize the FICA taxes associated
18 with the Staff's payroll annualization at the current FICA tax rates.

19 **BONUSES**

20 Q. Please explain Adjustments S-12.2, S-13.2, S-14.2, S-15.2, S16.2, S-18.2,
21 S-19.2, S-20.2, S-21.3, S23.2, S-24.2, S-25.2, S-26.3, S-27.2, S-28.2, S-29.2, S-30.3,
22 S-30.3, S-31.2, S32.3, S-33.2, S-34.3, S-37.2, S-40.2, S-41.5, S-44.4, and S-45.12.

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1 A. These adjustments spread the effect of Staff's elimination of bonuses paid
2 by the Company during the test year in accordance with the percentages the Company
3 used to distribute bonus expense throughout its accounts.

4 Q. Why did the Staff eliminate Christmas bonuses paid during the test year?

5 A. The Staff believes that Christmas bonuses are in the nature of gifts made
6 to employees purely at the discretion of the Company, rather than a contractual
7 obligation.

8 Q. Why did the Staff eliminate Heroism bonuses paid during the test year?

9 A. Because heroism bonuses reward activities other than work performance.

10 Q. Why did Staff eliminate test year merit bonuses paid to employees in
11 connection with Y2K preparation efforts?

12 A. These costs are properly deferred and capitalized by a previous
13 Commission order into an Accounting Authority Order. As confirmed with Company,
14 these costs should not have been directly included in test year expenses. Staff
15 Accounting witness Mark L. Oligschlaeger addresses the Staff's recommendations
16 concerning rate treatment of deferred Y2K costs in his direct testimony

17 Q. Why did Staff eliminate \$36,000 charged to test year bonuses for
18 employee raises taken as a lump-sum payment?

19 A. As explained by the Company, some employees opted to receive their pay
20 raises in the form of a lump-sum payment rather than spread out over the year. The
21 Company booked these payments to the bonuses account.

22 Q. Did the Company omit these lump-sum payments from computation of its
23 test year payroll expense?

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1 A. Yes, the Company explained that this is what took place. This
2 understatement of test year payroll expense causes Staff's adjustment to annualize payroll
3 to be overstated. Staff decided to correct this overstatement by adjusting test year
4 bonuses.

5 Q. Does this conclude your testimony?

6 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

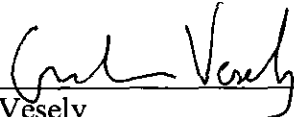
In The Matter of Missouri Gas Energy's Tariff)
Filing For General Rate Increase)

Case No. GR-2001-292

AFFIDAVIT OF GRAHAM VESELY

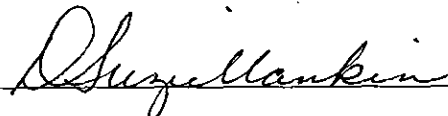
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Graham Vesely, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that the answers in the foregoing Direct 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.



Graham Vesely

Subscribed and sworn to before me this 18th day of April 2001.



D SUZIE MANKIN
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21, 2004

