Exhibit No.:	
Issues:	*Cash Working Capital; Maintenance; Turbine Overhaul Maintenance; Advertising Expense; Dues and Donations; Injuries and Damages; Insurance; and Miscellaneous Test Year Adjustments*
Witness:	*Scott D. Clark*
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

SCOTT D. CLARK

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

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 Retail Electric Service Provided to Customers in Its MPS and L&P Missouri Service Areas.	))))	Case No. ER-2005-0436 Tariff No. YE-2005-1045

AFFIDAVIT OF SCOTT CLARK

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Scott Clark, being of lawful age, on his oath states: that he has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 29 pages to be presented in the above case; that the answers in the following 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.

Scott Clark

Scott Clark

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

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

D Suzie Mankin

Notary

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CASE NO. ER-2005-0436

Q. Please state your name and business address.

A. My name is Scott D. Clark, 615 East 13th Street, Kansas City, MO, 64106.

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

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

BACKGROUND OF WITNESS

Q. Please describe your education and other qualifications.

A. I graduated from Northwest Missouri State University in Maryville, Missouri, in May of 2004, with Bachelor of Science degrees in Accounting and Corporate Finance. I commenced employment with the Commission in September 2004.

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

A. Yes. I have worked on a variety of different cases since my employment began with the Commission. Below is a list of cases that I have worked on:

- Case No. EO-2005-0270 In the Matter of the Application of Kansas City Power & Light Company for Authority to Sell to Aquila, Inc. Certain Electric Transmission Facilities

- Case No. GM-2005-0136 In the matter of the Application for authority of Sendero SMGC LP Acquisition Company, and Sendero SMGC GP Acquisition Company to purchase the partnership interests of DTE Enterprises, Inc. and DET Ozark, Inc
- Case No. WO-2005-0206 In the Matter of the Joint Application of Silverleaf Resort, Inc. and Algonquin Water Resources of Missouri, LLC for Authority for Silverleaf Resorts, Inc. to Sell Certain Assets to Algonquin Water Resources of Missouri, LLC
- Case No. WR-2006-0091 In the matter of Stockton Hills Water Company small company rate increase.
- Case No. QS-2006-0001 In the matter of Hickory Hills Water & Sewer Company small company rate increase.

EXECUTIVE SUMMARY

Q. Please provide a summary of each of the items you will be sponsoring.

A. An analysis of Cash Working Capital was done by performing a lead/lag study. Each of the major expenses was evaluated to determine a reasonable expense lag. The revenue lead was used from the previous case. The net of the expense lag and revenue lead resulted in a negative cash working capital requirement. This means that the ratepayers supplied the cash working capital during the year. A reduction to rate base was made to account for this.

Maintenance expense was normalized by performing a 3-year average for Aquila Networks-MPS (MPS) and a 5-year average for Aquila Networks-L&P (L&P). In an effort to remove the volatility of fluctuating levels of yearly maintenance expense, MPS and L&P were evaluated separately. It was determined that using a 3-year average for MPS and a

5-year average for L&P most accurately reflected the level of maintenance expense that will occur on an ongoing basis.

Turbine overhaul maintenance was normalized by comparing the accrual for each turbine to its actual overhaul maintenance costs. An appropriate level of overhaul maintenance costs were determined by dividing the last major outage costs by the number of years expected between overhauls. An adjustment was made to account for the difference between the actual annual turbine overhaul maintenance expense and the annual accrual.

Advertising expenses were adjusted to restate test year levels to reflect only the allowable portion of advertising expense. Only advertising that is considered useful in the provision of adequate service (General) and advertising that conveys the ways to use the Company's service safely and to avoid accidents (Safety) was included for advertising expenses.

Dues and donations were excluded from the cost of service.

Injuries and damages were normalized by reflecting a 36-month average of actual claim payouts. A period of 36-months was used to best smooth the effect of annual fluctuations in actual payouts.

Insurance was annualized based on the most current insurance premiums available through the end of the test year update period.

Miscellaneous test year adjustments were made to reflect the removals/reclassifications of various test year accounts that the Company made and Staff agreed with.

PURPOSE OF TESTIMONY

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

A. Yes, I have, in conjunction with other members of the Commission Staff (Staff).

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

A. I will be sponsoring the areas of cash working capital, maintenance expense, turbine overhaul expense, advertising expense, dues and donations expense, insurance expense, injuries and damages expense, and miscellaneous test year adjustments.

Q. Will your testimony be addressing MPS electric and L&P electric?

A. Yes, my testimony will address the areas I previously identified and relate specifically to the electric operations of MPS and electric operations of L&P (the former St. Joseph Light & Power Company). L&P was acquired and merged with Aquila December 31, 2000.

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

A. Since commencing employment with the Commission, I have attended various in-house training seminars and have reviewed in-house training materials. I worked on two small water and sewer cases, which have provided a strong basis in the ratemaking process and an in-depth understanding on certain issues. I have also worked closely with senior auditors and supervisors, whom possess extensive regulatory knowledge.

Q. Are you sponsoring any accounting schedules in this case?

A. Yes. I am sponsoring Accounting Schedule 8, Cash Working Capital.

Q. Please identify which adjustments you are sponsoring in this case.

A. I am sponsoring the following Income Statement adjustments for MPS electric:

Maintenance Expense: S-16.9, S-17.9, S-18.9, S-19.9, S-20.9, S-26.9, S-27.9, S-28.9, S-29.1, S-42.9, S-43.1, S-44.9, S-45.9, S-47.9, S-59.1, S-60.9, S-62.9, S-63.9, S-64.9, S-65.9, S-66.9;

Turbine Overhaul: S-19.10, S-28.10;

Advertising Expense: S-34.10, S-36.9, S-54.10, S-65.10, S-72.10, S-73.10, S-75.9, S-76.10, S-77.1, S-78.2, S-79.10, S-81.9, S-87.1, S-88.10, S-90.10;

Dues & Donations: S-13.9, S-33.9, S-34.9, S-35.9, S-40.9, S-48.9, S-50.9, S-54.9, S-56.9, S-61.9, S-67.9, S-69.9, S-71.9, S-72.9, S-73.9, S-76.9, S-78.9, S-79.9, S-80.9, S-82.9, S-88.9, S-89.9, S-90.9;

Insurance Expense: S-83.1, S-84.1;

Injuries & Damages: S-84.2, S-84.3; and

Misc. Test Year Adjustments: S-7.1, S-8.1, S-93.5.

I am sponsoring the following Income Statement adjustments for L&P electric:

Maintenance Expense: S-17.9, S-18.9, S-19.9, S-20.9, S-21.9, S-26.9, S-27.9, S-28.9, S-42.9, S-43.9, S-44.9, S-45.9, S-57.1, S-58.9, S-59.9, S-60.9, S-61.9, S-62.9, S-63.9, S-64.9;

Turbine Overhaul: S-20.10, S-27.10;

Advertising Expense: S-34.10, S-36.9, S-65.10, S-72.9, S-76.1, S-77.1, S-78.10, S-79.10, S-81.10, S-87.2, S-88.10, S-90.9;

Dues & Donations: S-11.9, S-33.9, S-34.9, S-35.9, S-40.9, S-46.9, S-52.9, S-54.9, S-59.10, S-65.9, S-67.9, S-69.9, S-73.9, S-75.9, S-78.9, S-79.9, S-81.9, S-87.1, S-88.9, S-89.9;

Insurance Expense: S-82.1, S-83.1;

Injuries & Damages: S-83.2, S-83.3; and

Misc. Test Year Adjustments: S-7.1, S-8.2, S-88.12, S-94.14.

In addition to those adjustments, I am sponsoring the rate base components regarding Cash Working Capital found on Accounting Schedule 2, which include the federal and state income tax offset and the interest offset. The calculation of Cash Working Capital is found on Schedule 8.

CASH WORKING CAPITAL

Q. What is Cash Working Capital (CWC)?

A. Within the confines of a rate case heard before this Commission, CWC is the amount of cash necessary for a utility to pay the day-to-day expenses incurred to provide utility services to its respective customers.

Q. How has Aquila's financial condition impacted Staff's analysis of CWC?

A. Aquila's financial condition was examined very closely to ensure that any adverse effects of the Company's financial condition were not reflected in the calculation of CWC.

Q. What types of adverse effects due to the Company's financial condition could be reflected in the calculation of CWC?

A. As a result of the Company's poor credit ratings, some vendors now require certain expenses, such as purchased power and fuel purchases, to be paid differently than when Aquila was considered to be an investment grade company.

Q. How have these expenses been paid differently?

A. Because of Aquila's poor financial condition, methods such as prepayments, early pays, letters of credit, and collateral have been required by concerned vendors. The need to use different methods of payment have associated costs which impact the Company's CWC needs.

Q. Can you please describe these different methods of payments?

A. Yes. When a vendor requires prepayments, the customer must pay, in advance, for goods or services. Early pays are a type of accelerated payments. Early payments are usually required to be paid after the goods or services are provided, but prior to the normal due date shown on the invoice/bill. Letters of credit are usually issued by banks, to the Company, which the company can present to third parties as proof of ability to pay. There are usually fees involved with letters of credit. The use of collateral is a means by which vendors hold cash, which is usually obtained by wired funds from the Company, as a type of "insurance" to cover defaulted payments. These methods of payments are required by some vendors when a customer is considered to be a poor credit risk. Staff's approach to calculating CWC for this case is to mitigate, as much as possible, any adverse effects relating to Aquila's financial condition.

Q. How long has Aquila's financial condition come into question?

A. Aquila first experienced financial difficulties in early 2002. Its financial condition deteriorated after the collapse of Aquila's non-regulated operations. Much of the information examined relating to the cash management of the company is impacted by its financial condition. Because the adverse financial conditions were not related to the regulated utility operations of Aquila, Staff spent a considerable amount of time determining the appropriate CWC by removing the negative impact of the financial condition caused by the non-regulated operations so that Aquila's utility customers would not be harmed.

Q. Where are the results of the Staff's CWC analysis?

A. The results of CWC is reflected on the Rate Base Accounting Schedule 2, line 4 - Cash Working Capital. In addition to calculation of CWC on Schedule 8, there are other off sets to rate base that are considered part of CWC. These additional CWC components are show on line 8-Federal Tax Offset, line 9-State Tax Offset, line 10-City Tax Offset and line 11-Interest Expense Offset on Schedule 2, Rate Base.

Q. Was a lead/lag study performed in this case?

A. Yes. The Staff performed a lead/lag study.

Q. Is the method you used to calculate MPS and L&P's CWC requirements the same method the Staff has used in previous rate cases?

A. Yes. The lead/lag method has been used by the Staff and adopted by the Commission in numerous rate proceedings dating back to the 1970s, including MPS's and L&P's most recent rate cases (Case Nos. ER-2004-0034, GR-2004-0072 and ER-2001-0672).

Q. What is the purpose of a lead/lag study?

A. The lead/lag study determines the amount of cash that is necessary on a day-to-day basis for MPS and L&P to provide electric services to its customers. A lead/lag study analyzes the cash flows related to the payments received from its customers for the provision of electric services and the disbursements made by MPS and L&P to its suppliers and vendors of goods and services necessary to provide this electric service. A lead/lag study determines the number of days MPS and L&P has to make payments after receiving goods or services from a vendor and is compared with the number of days it takes MPS and L&P to receive payment for the electric service it provides to its customers. A lead/lag study also determines who provides CWC.

Q. What are the sources of CWC?

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

Q. How do shareholders supply CWC?

A. When MPS and/or L&P expend funds to pay for an expense before the ratepayers provide the cash, the shareholders are the source of the funds. This cash represents a portion of the shareholders' total investment in the MPS and/or L&P. The shareholders are compensated for the CWC funds they provided by the inclusion of these funds in rate base. By including these funds in rate base, the shareholders earn a return on the funds they have invested.

Q. How do ratepayers provide CWC?

A. Ratepayers supply CWC when they pay for electric services received before MPS and L&P pay expenses incurred to provide that service. Ratepayers are compensated for the CWC they provide by reducing rate base by the amount of CWC the ratepayers provide.

Q. How does the Staff interpret lead/lag study results?

A. A positive CWC requirement indicates that, in the aggregate, the shareholders provided the CWC for the test year. This means that, on average, the utility paid the expenses incurred to provide the electric service to its customers before those customers had to pay the Company for the provision of utility service.

A negative CWC requirement indicates that, in the aggregate, the ratepayers provided funds to the Company in advance of payments. This means that, on average, the ratepayers paid for their electric services before the utility paid the expense incurred to provide those services.

Q. Please explain the components of the Staff's calculation of CWC that appear on Accounting Schedule 8.

A. The components of the Staff's calculation are as follows:

1) Column A (Account Description): lists the types of cash expenses, which MPS and L&P pay on a day-to-day basis;

2) Column B (Test Year Expenses): provides the amount of annualized expense included in the cost of service. It shows the dollars associated with the items listed in Column A on an adjusted Missouri jurisdictional basis;

3) Column C (Revenue Lag): indicates the number of days between the midpoint of the provision of service by MPS and L&P and the payment for the service by the ratepayer. The revenue lag addressed in this case is discussed later in this direct testimony;

4) Column D (Expense Lag): indicates the number of days between the receipt of and payment for the goods and services (i.e., cash expenditures) used to provide service to the ratepayer. The expense lags addressed in this case are discussed later in this direct testimony;

5) Column E (Net Lag): results from the subtraction of the Expense Lag (Column D) from the Revenue Lag (Column C);

6) Column F (Factor): expresses the CWC lag in days as a fraction of the total days in the test year. This is accomplished by dividing the Net Lags in Column E by 365;

7) Column G (CWC Requirement): shows the average amount of cash necessary to provide service to the ratepayer. This is computed by

multiplying the Test Year Expenses (Column B) by the CWC Factor (Column F).

Q. Please describe the revenue lag.

A. The revenue lag is the amount of time between the days the MPS and L&P divisions provide the service to customers, and when it receives payment from those customers for that service. The overall revenue lag in this case is the sum of three subcomponent lags. They are as follows:

1) Usage Lag: The midpoint of average time elapsed from the beginning of the first day of a service period through the last day of that service period;

2) Billing Lag: The period of time between the last day of the service period, the day the meter is read, and the day the bill is placed in the mail by the company;

3) Collection Lag: The period of time between the day the bill is placed in the mail by the company and the day the company receives payment from the ratepayer for services performed.

Q. Did MPS and L&P use the same three subcomponent lags discussed above in developing its total revenue lag?

A. Yes. Staff's revenue lag subcomponents are identified below:

	Staff
Usage Lag	15.21 days
Billing Lag	2.00 days
Collection Lag	4.38 days
Total	21.59 days

Q. Please explain how the usage lag was determined.

A. The usage lag was determined by dividing the number of days in a typical year (365) by the number of months in a year (12) to yield the average number of days in a month (30.42). The 30.42 was then divided by two to yield an average usage lag of 15.21 days. This further calculation using two as the divisor is necessary since MPS and L&P bill monthly, and it is assumed that service is delivered to the customer evenly throughout the month.

Q. Please explain the Staff's approach to determining the billing lag.

A. The billing lag is the time it takes between when MPS and L&P read the meters and when the bills are subsequently mailed to the customer. Staff used the billing lag from the previous Aquila rate case of two days.

Q. Please explain the Staff's approach to determining the collection lag.

A. The collection lag is the average number of days that elapse between the day that the bills were mailed and the day when MPS and L&P receive payments for those bills. The Staff used the collection lag from the two previous cases (Case Nos. ER-2004-0034 and ER-2001-672) of 4.38 days. Staff's calculation of the collection lag will be addressed by Staff witness Phillip K. Williams. The calculated total revenue lag was 21.59 days.

Q. What was the scope of the Staff's work in the calculation of expense lags in this case?

A. The Staff calculated expense lags in areas where significant expenses were involved, or in areas where significant changes in payment pattern occurred since previous rate cases.

Q. What expense lags did the Staff calculate?

A. The Staff calculated the following expense lags in this audit: (1) payroll expense; (2) federal, state and FICA taxes withheld; (3) federal and state unemployment taxes; (4) Sibley coal and freight; (5) Jeffrey operations and fuel; (6) Iatan operations and fuel; (7) Lake Road coal and freight; (8) city franchise taxes; (9) purchased power; (10) gas and oil purchased; (11) property tax; (12) sales and use tax; and (13) corporate franchise tax.

Q. What expense lags, calculated by the Company, did the Staff accept?

A. Staff accepted expense lags for accrued vacation.

Q. What other expense lags did the Staff accept from the prior case?

A. The Staff did not recalculate the expense lag for cash vouchers. The Staff believes that there were not sufficient changes to the accounts payable functions for payments of these miscellaneous expenses to warrant the time and resources required to perform a full cash voucher expense lag analysis. Staff also did not recalculate pension fund payment and lease payment lags.

Q. Please describe the expense lag for cash vouchers as found on line 1 of Accounting Schedule 8 for both MPS and L&P.

A. Cash vouchers are miscellaneous expenditures that do not coincide with other operations and maintenance (O&M) expense items and that were not specifically examined elsewhere in the CWC analysis study (e.g., payroll, fuel, etc.). The Staff used the lag that was accepted in previous cases of 44.14 days.

Q. Please explain the expense lag for federal income withholding taxes and Social Security payroll taxes collected under authority of the Federal Insurance Contributions Act (FICA) found on lines 2, 4 and 18 of Accounting Schedule 8 for both MPS and L&P.

A. The expense lag for FICA and federal income withholding taxes relating to payroll taxes is the period of time between the midpoint of the pay period for which the taxes are withheld and the date the tax withholdings must be paid to the taxing authorities. Payments for the employee's portion of FICA taxes and employer's portion of FICA taxes are made at the same time. An employer must typically deposit the income tax withheld and the FICA taxes with an authorized commercial bank depository or Federal Reserve Bank on the Monday following the previous Friday payday. The resulting tax lags are 16.5 days.

Q. Please describe the expense lag for state withholding taxes as found on line 3 of Accounting Schedule 8 for both MPS and L&P.

A. The expense lag for the state withholding taxes is the period of time between the midpoint of the pay period for which the taxes were withheld and the date that the tax withholdings must be turned over to the taxing authorities. The lag for state withholding taxes is 18.50 days.

Q. Please explain the payroll expense lag found on line 5 of Accounting Schedule 8 for both MPS and L&P.

A. The payroll expense lag is the time lapse between the midpoint of the period in which the employees earned wages and the date the Company paid the wages. Employees are paid on the Friday following the two-week pay period, which ended on the previous

Friday. The payroll expense lag is 13.42 days. This is seven days, to the midpoint of the 14-day period, plus 6.42 days between the end of the pay period and the Friday pay date.

Q. Please explain the vacation expense lag found on line 6 of Accounting Schedule 8 for both MPS and L&P.

A. The expense lag computation accounts for the time between the average date the vacation is earned (i.e., the midpoint of the year) and the date when employees are actually paid for vacation. The Company's employees are entitled to two weeks vacation at the beginning of each calendar year, which is earned from the prior year. The Staff is therefore using a vacation expense lag of 365 days.

Q. Please explain the expense lag for natural gas and oil on line 7 of Accounting Schedule 8 for both MPS and L&P.

A. The natural gas and oil expense lag is the difference in days between the midpoint of the period when the Company received natural gas or oil from its suppliers and the date when the natural gas/oil deliveries are paid. The natural gas and oil expense lag is 40.79.

Q. Please explain the injuries and damages lag as found on line 9 of Accounting Schedule 8 for both MPS and L&P.

A. A significant portion of injuries & damages claims were paid in multiple installments. As a result, a weighted average lag was calculated between the reported date and the mid point of each month which a specific payment was made. The injuries and damages expense lag is 311.18 for MPS and 338.05 for L&P.

Q. Please explain the purchased power expense lag as found on line 10 of Accounting Schedule 8 for MPS and L&P.

A. Purchased power expense lag is the difference in days between the midpoint of the period when the Company received the purchased power and the date the Company paid for the power. The purchased power expense lag is 36.42.

Q. Please explain the expense lag for Sibley coal and freight on line 11 of Accounting Schedule 8 for MPS.

A. The Sibley coal and freight expense lag is the time lapse between the date the coal and/or freight services were received and the date the Company paid for these goods and/or services. The Sibley coal and freight expense lag is 20.03 days.

Q. Please explain the expense lag for Lake Road coal and freight on line 11 of Accounting Schedule 8 for L&P electric.

A. The Lake Road coal and freight expense lag is the time lapse between the date the coal and/or freight services were received and the date the Company paid for these goods and/or services. The coal and freight expense lag for Lake Road is 20.02 days.

Q. Please explain the expense lag for Jeffrey fuel and operations found on lines 12 and 13 of Accounting Schedule 8 for MPS electric.

A. The managing partner of the Jeffrey Energy Center (Jeffrey), a coal-fired generating facility jointly owned by Aquila and Westar Energy, bills MPS bi-monthly resulting in a time lapse between the midpoint of when services are provided and when MPS pays for these services. The resulting lag is 30.62 days. The fuel and operations for Jeffrey have been split into separate lines on Accounting Schedule 8 to clarify the types of expenses incurred for Jeffrey. The lags are the same for both lines because of the manner in which the managing partner bills.

Q. Please explain the expense lag for Iatan fuel and operations found on lines 12 and 13 of Accounting Schedule 8 for L&P electric.

A. The managing partner of the Iatan plant, Kansas City Power & Light Company, bills L&P as expenditures are incurred for fuel and freight. L&P is also billed monthly for operational fees. This results in two different lags based on the variation in billings from the managing partner and the date payment was made for the services by L&P. The lags are 30.16 days for fuel and 52.74 days operations.

Q. Please explain the expense lag associated with pension fund payment found on line 14 of Accounting Schedule 8 for both MPS and L&P.

A. The pension fund payment lag is the number of days between the midpoint of the calendar year and the date payment was made to the pension fund. Staff used the lag from the previous case (Case No. ER-2004-0034) of 90 days.

Q. Please explain the expense lag associated with lease payments found on line 15 of Accounting Schedule 8 for both MPS and L&P.

A. The lease payment lag is the difference between the midpoint of the service and the date payment was made for that service. The Staff has used the lag from the previous cases (Case Nos. ER-2004-0034 and ER-2001-0672) of 67.32 days.

Q. Please explain the expense lag associated with property taxes as found on line 17 of Accounting Schedule 8 for both MPS and L&P.

A. The property tax payment lag is the weighted average number of days between the midpoint of the calendar year and the statutory due date for each state that MPS and L&P own property in. The property tax payment lag is 188.36 days for MPS and 182.52 days for L&P.

Q. Please explain the federal and state unemployment tax lags as found on line 19 of Accounting Schedule 8 for both MPS and L&P.

A. Federal and state unemployment taxes (FUTA and SUTA, respectively) are paid quarterly and are due at the end of the month following each quarter. The Staff's calculation for FUTA and SUTA resulted in an expense lag of 86.82 days for MPS and 86.51 days for L&P.

Q. Please explain the corporate franchise tax lag found on line 20 of Accounting Schedule 8 for both MPS and L&P.

A. Corporation franchise taxes are paid annually. The lag is the number of days between the midpoint of the taxable period (calendar year) and the date the taxes are due to be paid (April of the current year). The Staff determined a lag of negative 77.5 days for corporate franchise tax.

Q. Please explain the city franchise tax lag found on line 21 of Accounting Schedule 8 for both MPS and L&P.

A. City franchise taxes are remitted to each respective city either monthly, semimonthly, quarterly, or semi-annually depending on the agreement between the city and the Company. The lag is the weighted number of days between the taxable period and the date that the taxes are due. The Staff calculated a lag of 98.20 days for MPS and 47.82 days for L&P.

Q. Please explain the expense lags associated with sales and use taxes as found on line 22 of Accounting Schedule 8 for both MPS and L&P.

A. The sales and use tax expense lag is the weighted number of days between the taxable period and the date the taxes are due. The sales and use taxes lag was calculated at 35.68 days for MPS and 37.84 days for L&P.

Q. Why does the revenue lags for sales and use taxes differ from the revenue lags discussed earlier?

A. The Company acts solely as an agent of the taxing authority in collecting sales and use taxes from the ratepayer, and paying the proper institution on a timely basis. The Company has not provided any service to the ratepayer associated with sales and use taxes. Therefore, in order to match the same time frames for these components, the Staff adopted the collection lag and used it as the revenue lag. As explained earlier, the Staff calculated a 4.38-day collection lag and used this number as the revenue lag for the sales and use tax lag.

Q. What components of CWC are not on Staff's Accounting Schedule 8?

A. The Federal Income Tax Offset, State Income Tax Offset and Interest Expense Offset do not appear in the Accounting Schedule 8, CWC. These items appear as separate line items in the Staff's Rate Base Schedule, Accounting Schedule 2.

Q. Why are the Federal Income Tax Offset, State Income Tax Offset, and Interest Expense Offset included in the Rate Base Accounting Schedule, rather than the CWC Accounting Schedule 8?

A. The normalized Missouri jurisdictional expense component used for these offsets is tied directly to the computation of the revenue requirement. The revenue requirement computer program (EMS run) has the capability to extract these amounts from Accounting Schedule 11, Income Tax. The computer program applies the CWC factor to each component and places the CWC requirement directly in Accounting Schedule 2, Rate Base.

Q. Please explain and describe the inclusion of taxes in the Staff's analysis of CWC.

A. Unlike other line items reflected within the CWC Accounting Schedule, taxes are not considered as O&M expenses, but they are known and certain obligations of the Company with payment periods and payment dates established by statutes. Rates paid by customers to cover taxes payable represents a source of cash to the Company until passed on to the appropriate taxing authority.

Q. Please explain the federal and state income tax offsets.

A. The federal and state income tax expense lags represent the period of time between the midpoint of the tax or calendar year and the dates the income taxes must be paid to the federal and state taxing authority. Currently, 100% of the estimated federal tax must be paid during the year in four installments, which are due by the 15th day of April, June, September and December. The state of Missouri requires that at least 90% of the Company's estimated tax liability be paid during the year in four equal installments, which must be paid by the 15th day of April, June, September, and December. Unlike the estimated federal tax requirements, the remaining 10% tax liability is due by April 15th following the close of the tax year. Because there have been no known changes to these payment dates, the Staff accepted the lags used by the Company of 36.5 and 61.55 days for the federal and state income tax lags, respectively. The CWC factor is placed in the Rate Base Accounting Schedule, and the Staff's computer program calculated the CWC requirement for income taxes.

Q. Please explain the Interest Expense offset.

A. Although not an O&M expense, interest expense is included in the Staff's lead/lag analysis because interest is a source of cash provided by the ratepayer and, therefore, properly considered in CWC. The Company has a known and certain obligation to pay cash, in the form of interest on its debt. The interest is pre-collected through rates from the ratepayer for the purpose of passing it on to the bondholder. The funds are a source of cash to the Company for use toward any purpose that it desires until they are passed on to the bondholder.

The expense lag for interest was computed by dividing the number of days in the year by four. All Aquila's long-term debt bears semi-annual interest. The lag represents the period of time between the midpoint of the semi-annual period, and the date interest paid. The expense lag computed for interest is 91.25 days (365 / 4). The CWC factor was placed in the Rate Base Accounting Schedule and the Staff's computer program calculated the CWC requirement for interest.

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

A. The lead/lag study performed by the Staff resulted in a negative CWC requirement. This means that in the aggregate the ratepayer has provided the CWC to the Company during the test year. Therefore, the ratepayer is compensated for the CWC that the ratepayer provides, through a reduction to rate base. This rate base offset is shown on Accounting Schedule 2.

<u>MAINTENANCE</u>

Q. Please explain adjustments S-16.9, S-17.9, S-18.9, S-19.9, S-20.9, S-26.9, S-27.9, S-28.9, S-29.1, S-42.9, S-43.1, S-44.9, S-45.9, S-47.9, S-59.1, S-60.9, S-62.9, S-63.9, S-64.9, S-65.9, and S-66.9 for MPS and S-17.9, S-18.9, S-19.9, S-20.9, S-21.9, S-26.9, S-27.9, S-28.9, S-42.9, S-43.9, S-44.9, S-45.9, S-57.1, S-58.9, S-59.9, S-60.9, S-61.9, S-62.9, S-63.9, S-64.9 for L&P.

A. The adjustments normalize non-payroll and maintenance expense for production (FERC Uniform System of Accounts (USOA) 510-514 and 551-554), transmission (Accounts 568-573) and distribution (Accounts 590-598) plant, respectively, during the test year.

Q. What are normalization adjustments?

A. Normalization adjustments reflect the removal of events or items within the test year that are non-recurring, or exhibit a fluctuation from the level, which would normally be expected to occur. Normalization adjustments need to be made to the test year to achieve the appropriate forward-looking focus of the investment/revenue/expense relationship.

Q. What is the investment/revenue/expense relationship?

A. This relationship is critical to the determination of the overall revenue requirement. It is essential to keep the investment to serve customers on the same basis as the revenues and expenses. As an example, the amounts of expense for maintenance are normalized to ensure that an appropriate amount of costs is included in the rate structure so the Company does not over-collect or under-collect expenses. The expenses are annualized and normalized along with revenues so that the levels of sales in a given period have the proper level of costs associated with those revenues. The Company must have the proper level of plant investment to serve the customers that are providing the revenues for the electric service. All the cost elements of utility operations are examined in a rate case and amounts are determined keeping the timing consistent with test year and known and measurable concepts.

Q. How did the Staff determine normalized maintenance expense for the test year ended December 31, 2004?

A. After removing turbine overhaul accrual costs for production maintenance, and Company payroll costs for production, transmission, and distribution maintenance, a 60-month average, calendar years 2000 through 2004 was calculated for non-payroll production, transmission, and distribution accounts for L&P. After removing turbine accrual costs for MPS's production maintenance, a 36-month average, calendar years 2002 through 2004 was calculated for non-payroll production, transmission, and distribution maintenance accounts for MPS's electric operations. The adjustments restate the test year 2004 results to reflect the average costs described above.

Q. Why was a three-year average used for MPS while a five-year average was used for L&P.?

A. I observed the trends in the fluctuations of balances for each applicable maintenance account. To best smooth the volatility in the yearly balances, a five-year average was used for MPS and a three-year average was used for L&P.

Q. Why was payroll removed prior to calculating the average of maintenance expense?

A. Payroll is annualized separately in the ratemaking process. Therefore, any payroll costs recorded in the maintenance accounts must be removed to avoid double counting of such payroll costs. Staff witness Lesley Preston will be sponsoring the Staff's payroll adjustments in this case

Q. Why was the turbine overhaul accruals removed from the non-payroll production maintenance analysis prior to calculating the normalized level of production maintenance?

A. The normalized level of turbine overhaul maintenance has been calculated separately because major overhauls on the large coal units, for example, only occur every six or seven years.

TURBINE OVERHAUL MAINTENANCE

Q. Please explain adjustments S-20.10, S-27.10 for L&P and S-19.10, S-28.10 for MPS.

A. These adjustments are made to normalize the turbine overhaul accrual.

Q. What is the purpose of the accrual for major turbine overhaul maintenance?

A. Major turbine overhauls occur every six or seven years for the large coal units. The accrual spreads the cost on the income statement over the six or seven year time frame.

Q. How was the turbine overhaul maintenance adjustment calculated?

A. The actual costs for major turbine overhauls were provided for each of the MPS and L&P generating units. The frequency for a major turbine overhaul for the base-load coal units is six to seven years. The historical costs for the turbine overhauls were divided by six or seven years to determine the annual cost to be recovered in rates.

The MPS peaking units incur three types of major maintenance, each of which has a different time interval. Due to the lack of actual historical maintenance costs, for all three types of major maintenance, the annual level of maintenance expense was determined differently than the method used for base load coal units. The historical costs for major maintenance on each of these units were provided for the period from May, 1999 through June 30, 2005. An average cost per year was developed based upon this data. The 2004 test year was adjusted to reflect the average annual cost for these units.

ADVERTISING EXPENSE

Q. Please explain adjustments MPS S-34.10, S-36.9, S-54.10, S-65.10, S-72.10, S-73.10, S-75.9, S-76.10, S-77.1, S-78.2, S-79.10, S-81.9, S-87.1, S-88.10, S-90.10 and L&P—Electric- S-34.10, S-36.9, S-65.10, S-72.9, S-76.1, S-77.1, S-78.10, S-79.10, S-81.10, S-87.2, S-88.10 and S-90.9;

A. These adjustments restate the test year advertising levels to reflect allowable expense.

Q. Please explain the history of such adjustments before the Commission.

A. As part of Re: Kansas City Power and Light Company, 28 MO P.S.C. (N.S.) 228 (1986) (KCPL), the Commission adopted an approach that classifies advertisements into five categories and provides separate rate treatment for each category. The five categories of advertisements recognized by the Commission for purposes of this approach are:

1. General: advertising that is useful in the provision of adequate service;

2. Safety: advertising that conveys the ways to use the Company's service safely and to avoid accidents;

3. Promotional: advertising that encourages or promotes the use of the particular commodity the utility is selling;

4. <u>Institutional</u>: advertising that seeks to improve or retain the Company's public image;

5. <u>Political</u>: advertising which is associated with political issues.

The Commission adopted these categories of advertisements because it believed that a utility's revenue requirement should: 1) always include the reasonable and necessary cost of general and safety advertisements; 2) never include the cost of institutional or political advertisements; and 3) include the cost of promotional advertisements only to the extent that the utility can provide cost-justification for the advertisement (<u>KCPL</u>, pp. 269-271).

Q. What standard did the Staff use to evaluate the Company's advertising expense in this case and to develop the adjustments?

A. The Staff used the standards as initially established in the <u>KCPL</u> case identified above, and utilized in subsequent cases, to determine the test year level of advertising expense for the general, safety, institutional, promotional and political categories of advertising. The Staff proposes to disallow advertisements that are institutional, promotional, unrelated to the electric industry or ask for charitable donations. The Staff allowed all general and safety-related advertisements to the extent that they were related to the electric industry and beneficial to Missouri electric ratepayers.

Q. Has the Company provided the Staff with copies of all test year advertisements that were charged/allocated to MPS and L&P ratepayers in this proceeding?

A. Yes, the Company has provided all advertisements charged/allocated to MPS and L&P ratepayers per Staff Data Request No. 164.

Q. How did the Staff treat these advertisements for rate purposes?

A. The Staff allowed all general and safety-related advertisements to the extent that they were related to the electric industry and beneficial to Missouri electric ratepayers. The Staff disallowed all advertisements identified by the Company as safety or general, but which the Staff believes are institutional, promotional, or unrelated to the electric industry, as well as advertisements that could not be identified by the Staff.

Q. How did Staff determine which advertisements should be allowed in rates?

A. Staff reviewed the advertisements provided by the Company and made a determination based on the criteria identified by the Commission in the KCPL case as to the type and nature of the advertising. Any advertising considered to be institutional, promotional or of a political natural was disallowed from the test year amounts.

Q. Did the Company provide the Staff with any advertisements of a political nature?

A. No. The Company did not submit to the Staff any advertisements of a political nature.

DUES AND DONATIONS

Q. Please explain adjustments MPS— S-13.9, S-33.9, S-34.9, S-35.9, S-40.9, S-48.9, S-50.9, S-54.9, S-56.9, S-61.9, S-67.9, S-69.9, S-71.9, S-72.9, S-73.9, S-76.9, S-78.9, S-79.9, S-80.9, S-82.9, S-88.9, S-89.9, S-90.9 and L&P—Electric-S-11.9, S-33.9, S-34.9, S-35.9, S-40.9, S-46.9, S-52.9, S-54.9, S-59.10, S-65.9, S-67.9, S-69.9, S-73.9, S-75.9, S-78.9, S-79.9, S-81.9, S-87.1, S-88.9 and S-89.9.

A. These adjustments decrease test year expenses relating to various dues the Company has included in its cost of service. The Staff has excluded such dues and donations because they are not necessary for the provision of safe and adequate service, and thus do not provide any direct benefit to ratepayers.

Q. Did the Company book any charitable donations above-the-line?

A. No. The Company did not book any charitable donation expenses above-the-line in this case so no amounts are included in the cost of service levels relating to the revenue requirement Staff is recommending in this case.

INJURIES AND DAMAGES

Q. Please describe adjustments MPS— S-84.2, S-84.3 and L&P--Electric S-83.2, S-83.3.

A. These adjustments normalize injuries and damages expense by reflecting a 36-month average of actual claims payments. The adjustment amount is the difference between the actual average of payments and the test year accrued provision for injuries and damages.

Q. Why has the Staff used a 36-month average of actual payments?

A. Actual payments for injuries and damages normally fluctuate from year to year. The Staff believes that a 36-month average will smooth the effect of these annual fluctuations.

Q. Please define the 36-month period used by the Staff.

A. The 36-month period is the time period from January 1, 2002, to December 31, 2004.

INSURANCE

Q. Explain adjustments MPS— S-83.1, S-84.1 and L&P—Electric- S-82.1, S-83.1.

A. These adjustments annualize insurance expense based on the most current insurance premiums available through the end of the test year update period.

MISCELLANEOUS TEST YEAR ADJUSTMENTS

Q. Explain adjustments MPS- S-7.1, S-8.1, S-93.5 and L&P-Electric S-7.1, S-8.2, S-88.12, S-94.14.

A. These adjustments remove/reclassify miscellaneous test year revenue accounts to reflect various adjustments made in company workpapers MPS-CS-83.3, 83.5 and L&P-CS-83.3, 83.5, 83.6.

Q. Does this conclude your direct testimony?

A. Yes, it does.