

**FILED**<sup>4</sup>

MAY 03 2004

Missouri Public  
Service Commission

Exhibit No.:

Issues: Working Capital,  
Unbilled Revenue &  
Rate Case Expense

Witness: Richard O. Clayburn

Sponsoring Party: Aquila Networks-MPS

Case No.: ER- [REDACTED]

Before the Public Service Commission  
of the State of Missouri

Direct Testimony

of

Richard O. Clayburn

Exhibit No. 1031  
Case No(s). ER-2004-0034  
Date 3-1-04 Rptr III

**TABLE OF CONTENTS**

**MATERIALS AND SUPPLIES.....2**

**PREPAYMENTS.....3**

**CASH WORKING CAPITAL.....4**

**UNBILLED REVENUE.....13**

**RATE CASE EXPENSE.....13**

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI  
DIRECT TESTIMONY OF RICHARD O. CLAYBURN, JR.  
ON BEHALF OF AQUILA, INC.  
D/B/A AQUILA NETWORKS-MPS  
CASE NO. ER-\_\_\_\_\_**

1 Q. Please state your name and business address

2 A. My name is Richard O. Clayburn, Jr. and my business address is 10700  
3 East 350 Highway, Kansas City, Missouri.

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

5 A. I am employed by Aquila, Inc. ("Aquila").  
6 as a Senior Regulatory Analyst.

7 Q. Please describe your educational background and professional experience.

8 A. I am currently working on a Masters of Business Administration from Baker University,  
9 with an estimated completion date of June 2004. I received a Bachelor in Business  
10 Administration with an emphasis in Accounting from Howard University in August 1991.  
11 After graduation, I joined a regional CPA firm in the Washington, DC area as an  
12 Auditor.  
13 I have worked as a Staff Accountant, Senior Accountant, and Supervisor from 1993 to  
14 2002. I began to work for Aquila in February 2002.

15 Q. What is the purpose of your testimony in this proceeding involving Aquila Networks –  
16 MPS ("MPS") ?

17 A. The purpose of my testimony is to explain and support various working capital, revenue  
18 and cost of service (operations) adjustments.

19 Q. Please identify the adjustments that you are sponsoring.

1 A. I am sponsoring the following working capital items:

- 2 • Materials & Supplies (MPS )
- 3 • Prepayments (MPS )
- 4 • Cash Working Capital (MPS )

5 In addition to the above-mentioned items, I am sponsoring the following revenue and cost  
6 of service (operations) adjustment.

- 7 • Unbilled Revenue (MPS )
- 8 • Rate Case Expenses (MPS )

9 **MATERIALS & SUPPLIES**

10 Q. Why are materials and supplies (“M&S”) inventories included in rate base?

11 A. M&S is considered working capital which is defined as the economic input of funds, in  
12 excess of the amount used to provide for utility plant, which is necessary to operate the  
13 business.

14 Q. Please explain the computation of the M&S rate base adjustment.

15 A. A thirteen-month average is used for most working capital items. For M&S, the month-  
16 end balances of Federal Energy Regulatory Commission accounts 154 (Materials and  
17 Supplies) and 163 (Stores Expense) were averaged for the months of December 2001  
18 through December 2002. By their general ledger product code, they were designated by  
19 utility (electric, gas, common or non-regulated) and function (generation, transmission or  
20 distribution).

21 Q. Please explain why a thirteen-month average calculation was selected.

22 A. The use of a thirteen-month average is a better measure than the investment at any one  
23 single month since monthly amounts fluctuate, and no one single month is representative.

1 The application of thirteen-month averaging has been utilized in previous cases by  
2 MPS and the Missouri Public Service Commission Staff ("Staff").

3 Q. Please continue with your explanation of the M&S adjustment.

4 A. Next, jurisdictional utility allocation factors were applied based on functional class. For  
5 common M&S inventories, the net plant-in-service electric allocation factor Number 18  
6 was used. A blended jurisdictional allocation factor based on the average of transmission  
7 and distribution jurisdictional allocation factors was used to jurisdictionalize the electric  
8 portion of common M&S.

9 Q. Was this blended jurisdictional factor accepted by the Staff in MPS Case No. ER-01-672  
10 ?

11 A. Yes, It was previously used by the Staff in its computation of the common portion of  
12 M&S.

13 **PREPAYMENTS**

14 Q. What was the method used to calculate prepayments, Adjustment No. WC-20?

15 A. Prepayments have been included in rate base using a thirteen-month average.  
16 Prepayments are a normal working capital rate base allowance as they represent an  
17 investment of funds, i.e., cash outlay, made in advance of the future service period to  
18 which they apply. For example, prepaid items such as prepaid insurance and prepaid rent  
19 have been included in this calculation. The month-end balances were averaged for the  
20 months of December 2001 through December 2002. In addition, the calculation includes  
21 prepayments for MPS as well as the 'MPS share of common Enterprise  
22 Support Function ("ESF") prepayments. A separate thirteen-month average calculation  
23 was performed for both MPS and 'MPS share of ESF.

1 Q. Please explain why a thirteen-month average calculation was used.

2 A. The computation of a thirteen-month average serves as a better measure of investment  
3 rather than the use of any one single month. Due to monthly fluctuations in the prepaid  
4 balance, no single month is representative in this situation. However, prepaid pensions  
5 are the only category that will not use the thirteen-month averaging due to minimum  
6 monthly fluctuations.

7 Q. How is 'MPS share of prepayments from ESF calculated?

8 A. 'MPS share of ESF prepayments consists of both prepaid insurance and prepaid  
9 rent. 'MPS share of prepaid insurance is directly assigned if possible. Where  
10 allocations of policy premiums are necessary, the MPS portions are calculated  
11 using factors maintained by the Risk Management group. Prepaid rent relates to corporate  
12 facilities and equipment that cannot be directly identified as expenses related to a specific  
13 business unit such as MPS . Therefore, an Enterprise Support Function allocation is  
14 applied to the ESF balance of prepaid rent to determine 'MPS share. Company  
15 witness Beverlee R. Agut will explain this allocation procedure in detail within her direct  
16 testimony filed in this case.

17 **CASH WORKING CAPITAL**

18 Q. What is Cash Working Capital?

19 A. Cash Working Capital ("CWC") is the amount of cash necessary for the MPS  
20 Division to pay the day-to-day expenses incurred to provide electric service to MPS  
21 customers.

22 Q. Has this CWC requirement method been used in previous MPS rate cases?

23 A. Yes, the method has been used by the Staff and adopted by the Commission in numerous

1 rate proceedings and used in the most recent cases (Case Nos. ER-01-672 & ER-99-247).

2 Q. What are the sources of CWC?

3 A. Ultimately, shareholders or customers provide all sources of cash working capital.

4 Q. How do shareholders supply CWC?

5 A. When the MPS Division spends cash to pay for an expense before the ratepayers  
6 provide the cash, the shareholders must provide the cash. This cash represents a portion  
7 of the shareholders total investment in the MPS Division. The shareholders are  
8 compensated for the CWC funds they provided by the inclusion of these funds in rate  
9 base. By including these funds in rate base the shareholders earn a return on the funds  
10 they have invested.

11 Q. How do ratepayers provide CWC?

12 A. Ratepayers supply CWC when they pay for electric service that they received before the  
13 MPS Division pays the expenses it incurred to provide that service. Ratepayers are  
14 compensated for the CWC they provide by reducing rate base by the amount of CWC the  
15 ratepayers provide.

16 Q. How is the amount of CWC provided by both the ratepayers and shareholders generally  
17 determined?

18 A. A lead/lag study is usually performed.

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

20 A. A positive CWC requirement indicates that, in the aggregate, the shareholders provided  
21 the CWC for the test year. This means that, on average, the MPS Division paid the  
22 expenses incurred to provide the electric service to the customers before the customers  
23 paid cash for the service. A negative requirement indicates that, in the aggregate, the

1 customers provided the CWC during the test year. This means that, on average, the  
2 customers paid for their electric service before the MPS Division paid the expense  
3 incurred to provide that service.

4 Q. Please explain the components of the calculation of CWC that appear on Accounting  
5 Schedule 6.

6 A. The components of the calculation are as follows:

- 7 1) Column A (Account Description): lists the types of cash expenses, which the  
8 MPS Division pays on a day-to-day basis.
- 9 2) Column B (Test Year Expenses): provides the amount of annualized expense  
10 included in the cost of service. It shows the dollars associated with the items  
11 listed in Column A on an adjusted Missouri jurisdictional basis.
- 12 3) Column C (Revenue Lag): indicates the number of days between the provision of  
13 service by the MPS Division, and the payment for the service by the  
14 ratepayer.
- 15 4) Column D (Expense Lag): indicates the number of days between the receipt of  
16 and payment for goods and services (i.e., cash expenditures) used to provide  
17 service to the ratepayer.
- 18 5) Column E (Net Lag): results from the subtraction of the Expense Lag (Column D)  
19 from the Revenue Lag (Column C).
- 20 6) Column F (Factor): expresses the CWC lag in days as a fraction of the total days  
21 in the test year. This is accomplished by dividing the Net Lags in Column E by  
22 365.

23 Q. Please describe the revenue lag.



1 A. The revenue lag is the amount of time between the day the MPS  
2 the services, and when it receives payment from the ratepayers for that service. The  
3 overall revenue lag in this case is the sum of three subcomponent lags. They are as  
4 follows:

5 1) Collection Lag: The period of time between the day the company places the bill  
6 in the mail and the day the company receives payment from the ratepayer for  
7 service performed.

8 2) Service Lag: The midpoint of average time elapsed from the beginning of the first  
9 day of a service period through the last day of that service period.

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

12 Q. Did the MPS Division use the same three subcomponent lags discussed above in  
13 developing it's total revenue lag?

14 A. Yes. The MPS Division's revenue lag subcomponents are identified  
15 below:

16	Collection Lag	24.18
17	Service Lag	15.21
18	Billing Lag	2.00

19 Q. Please explain the approach to determining the collection lag.

20 A. The collection lag is the average number of days that elapse between the day that the bill  
21 was mailed and the day when the MPS Division receives payment for that bill. The  
22 MPS Division determined revenue lag days by averaging the account receivables  
23 turnover days during the year ended December 31, 2002.

1 Q. Please explain how the Service lag was determined.

2 A. The service lag was determined by dividing the number of days in a typical year (365) by  
3 the number of months in a year (12) to yield the average number of days in a month  
4 (30.42). The 30.42 was then divided by two to yield an average usage lag of 15.21 days.  
5 This further calculation using two as the divisor is necessary since the MPS  
6 Division bills monthly, and it is assumed that service is delivered to the customer evenly  
7 throughout the month.

8 Q. Please explain the approach to determining the billing lag.

9 A. The billing lag is the time it takes between when the MPS Division reads the meter  
10 and when the bills are subsequently mailed to the customer.

11 Q. Please describe the expense lead.

12 A. The expense lead is the amount of time it takes the MPS Division to make payments  
13 for services rendered.

14 Q. Please describe the expense lead for cash vouchers as found on Accounting Schedule 6.

15 A. Cash vouchers are miscellaneous expenditures that do not coincide with other operations  
16 and maintenance ("O&M") expense items, and were not specifically examined elsewhere  
17 in the CWC analysis study (e.g., payroll, fuel, etc.) The 45-day rule (365 days divided by  
18 1/8) was used to explain the expense lead for cash voucher's in this case. This rule has  
19 been accepted by FERC (Case No. ER-91-124).

20 Q. Please explain the Payroll expense lead found on Accounting schedule 6.

21 A. The payroll expense lag is the time lapse between the midpoint of the period in which the  
22 employees earned wages, and the date the MPS Division paid the wages. The  
23 MPS Division pays all employees on the Friday following the two-week pay period,

1 which ended on the previous Friday. The payroll expense lag is 14 days. The pay period  
2 lead-time is calculated as follows: 365 divided by 26 pay periods, which equals 14 days.  
3 Within the 14-day pay period the midpoint is 7.0 days. Employees are paid on the  
4 following Friday, or 7 days later.

5 Q. Please explain the purchase gas, power, and coal expense lags.

6 A. In order to calculate the lead-time between the date of receipt to the date of payment, the  
7 receipt date must be determined. Gas is received from the supplier during the entire  
8 month; consequently, it is appropriate to use an average number for the receipt date. The  
9 midpoint of 15.2 days (Delivery Time) is used to represent the number of days between  
10 gas receipt date and month end. The payment is calculated by taking the number of days  
11 from the last day of the delivery period to the date paid for each month in the test period.  
12 The resulting payment time is then multiplied by the amount paid. The calculated  
13 weighted average payment amount is totaled along with the total amount paid. Dividing  
14 the total weighted average payment by the total amount paid provided the lead-time due  
15 to the payment of gas. The resulting lead-time was 24.204 days.

16 Total lead-time for gas purchase expense is as follows:

17	Delivery Time	15.2
18	Payment Time	24.2
19	Total Lead Time	39.4

20 The Purchase Power lead used payments over \$100,000, which comprised over 90% of  
21 the total purchase power invoices. The lead was calculated by taking the difference  
22 between the payment day, and the above-mentioned reference midpoint of the previous  
23 month.

1 Total lead-time for purchase power expense is as follows:

2	Delivery Time	15.2
3	Payment Time	22.25
4	Total Lead Time	37.45

5 Taking the invoice date and adding the number of days required to process the payments  
6 calculated the lead for Sibley and Lake Road coal.

7 Total lead-time for purchase of Sibley and Lake Road coal is as follows:

8	Delivery Time	15.2
9	Payment Time	7.58
10	Total Lead Time	22.78

11 Payments are wired every 7 days for Jeffrey Coal & Freight.

12 Q. Please explain the Interest Expense offset.

13 A. Although not an O&M expense, interest expense is included in the lead/lag analysis  
14 because interest is a source of cash provided by the customer and therefore, properly  
15 considered in CWC. The MPS Division has a obligation to pay cash, in the form of  
16 interest on its debt. The interest is pre-collected through rates from the ratepayer for the  
17 purpose of passing it on to the bondholder. The funds are a source of cash to the  
18 MPS Division for use toward any purpose that it desires until they are passed on to  
19 the bondholder. The expense lag for interest was computed by dividing the number of  
20 days in the year by four. All UCU's long-term debt bears semi-annual interest. The lag  
21 represents the period of time between the midpoint of the semi-annual period, and the  
22 date interest paid. The expense lag computed for interest is 91.25 days (365/4).

1 Q. Please explain the expense lag associated with property taxes as found on Accounting  
2 Schedule 6.

3 A. Property taxes for the MPS Division are paid once a year. The net result is a  
4 property tax lag of 193 days.

5 Q. Please explain the expense lag for FICA and federal income withholding taxes as found  
6 on Accounting Schedule 6.

7 A. The expense lag for FICA and federal withholding taxes relating to payroll taxes is the  
8 period of time between the midpoint of the pay period for which the taxes are withheld,  
9 and the date the tax withholdings must be paid to the taxing authorities. Payments for the  
10 employee's portion of FICA taxes and employer's portion of FICA taxes are made at the  
11 same time. An employer must typically deposit the income tax withheld and the FICA  
12 taxes with an authorized commercial bank depository or Federal Reserve Bank on the  
13 Monday following the previous Friday payday. The FICA, federal withholding and  
14 employer FICA were weighted by the total amounts paid and then averaged together. The  
15 tax lags are 16.93 days.

16 Q. Please explain the Federal and State unemployment tax lags as found on Accounting  
17 Schedule 6.

18 A. Federal and State unemployment taxes (FUTA and SUTA, respectively) are paid  
19 quarterly and are due at the end of the month following each quarter. The MPS  
20 Division's calculation of FUTA and SUTA expense lag of 75.19.

21 Q. Please explain the expense lags associated with gross receipts taxes and sales and use  
22 taxes as found on Accounting Schedule 6.

1 A. There has been no known statutory or payment date changes associated with gross  
2 receipts taxes or sales and use taxes since a company wide lead/lag study conducted  
3 during a West Plains Kansas rate case (01-WPEE-473-RTS). The expense lag of 37.05 is  
4 accepted for the MPS Division's.

5 Q. Please explain the expense lag associated with Other Taxes found on Accounting  
6 Schedule 6.

7 A. The 45-day rule (365 days divided by 1/8) was used to explain the expense lead for cash  
8 voucher in this case.

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

10 A. The federal and state income tax expense lags represent the period of time between the  
11 midpoint of the tax or calendar year and the dates the income taxes must be paid to the  
12 federal and state taxing authority. Currently, 100% of the estimated federal tax must be  
13 paid during the year in four installments, which are due by the 15<sup>th</sup> day of April, June,  
14 September and December. The state of Missouri requires that at least 90% of the  
15 MPS Division's estimated tax liability be paid during the year in four equal  
16 installments, which must be paid by the 15<sup>th</sup> day of April, June, September, and  
17 December. Unlike the estimated federal tax requirements, the remaining 10 % tax  
18 liability is due by April 15<sup>th</sup> following the close of the tax year. Because there have been  
19 no known changes to these payment dates, the federal and state income tax lags of 58.95  
20 and 62.05 days were used for MPS , respectively.

21 Q. What is the overall result of the lead/lag calculation?

22 A. The lead/lag calculations results in a negative CWC requirement. This means that in the  
23 aggregate the ratepayer has provided the CWC to the MPS Division during the test

1 year. Therefore, the ratepayer is compensated for the CWC that the ratepayer provides  
2 through a reduction in the rate base.

3 **UNBILLED REVENUE**

4 Q. Please explain Adjustment No. R-20.

5 A. Adjustment No. R-20 reduces test year revenues to reflect the elimination of unbilled  
6 revenue.

7 Q. Why was an adjustment made to reverse unbilled revenue?

8 A. Unbilled revenue represents an estimate of revenues that have not yet been recognized but  
9 for which services have been rendered and costs incurred. Although this is a commonly  
10 used accounting procedure to better match revenues and expenses, customers have not  
11 been billed and therefore no sale has occurred.

12 **RATE CASE EXPENSE**

13 Q. Please explain Adjustment No. CS-50.

14 A. This adjustment is an estimate of rate case expense that MPS expects to incur during  
15 this electric rate proceeding. The estimate is based on the level of actual expenses  
16 incurred in 'MPS prior case, Case No. ER-01-672 and ER-99-247. The estimated  
17 amount of \$750,000 is amortized over a three-year period, thereby reducing the annual  
18 rate case expense to \$250,000.

19 Q. Why was a three-year amortization period chosen?

20 A. Based on 'MPS rate case history over the past ten years, a three-year average seems  
21 most indicative of future rate case proceedings.

22 Q. Does this conclude your prefiled direct testimony?

23 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

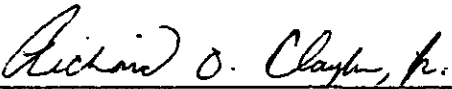
In the matter of Aquila, Inc. d/b/a Aquila )  
Networks-MPS [REDACTED] )  
for authority to file tariffs increasing electric )  
rates for the service provided to customers in )  
the Aquila Networks-MPS [REDACTED] )  
[REDACTED] area )

Case No. ER-\_\_\_\_\_

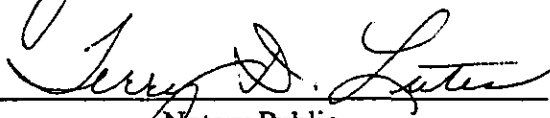
County of Jackson )  
) ) ss  
State of Missouri )

AFFIDAVIT OF RICHARD O. CLAYBURN, JR.

Richard O. Clayburn, Jr., being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Direct Testimony of Richard O. Clayburn, Jr.;" that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

  
\_\_\_\_\_  
Richard O. Clayburn, Jr.

Subscribed and sworn to before me this 26th day of June, 2003.

  
\_\_\_\_\_  
Notary Public  
Terry D. Lutes

My Commission expires:

8-20-2004

