

Exhibit No.:
Issue: Accounting Authority Orders (AAOs)
Witness: Phillip K. Williams, CPA, CIA
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: ER-2005-0436
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

PHILLIP K. WILLIAMS, CPA, CIA

AQUILA, INC.

**D/B/A AQUILA NETWORKS MPS – ELECTRIC
AND AQUILA NETWORKS – L & P**

CASE NO. ER-2005-0436

*Jefferson City, Missouri
November 2005*

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1 A. AAOs are Commission authorizations for a utility to keep approved costs on
2 the utility's books for potential recovery in a rate case.

3 Q. What AAOs are involved in this case?

4 A. There are three AAOs in this case. The first two AAOs were granted to
5 authorize the company to defer depreciation expenses, property taxes and carrying costs
6 associated with the Capacity Life Extension (Sibley Rebuild Project) and Western Coal
7 Conversion projects at its Sibley generating station. The approvals to defer and recover those
8 costs were made pursuant to the Commission's AAOs in Case Nos. EO-90-114 and
9 EO-91-358, and the Commission subsequently reauthorized them in Case Nos. ER-90-101
10 and ER-93-37. The Commission also granted Aquila authority to defer and amortize costs
11 incurred due to an ice storm in its Missouri Public Service (MPS) service area in January
12 2002. The Commission granted that authority in Case No. EU-2002-1053. It is my
13 understanding that the AAO associated with the Ice Storm is not an issue in this case.

14 Q. What is the current issue concerning the AAOs?

15 A. The current issue in this case is whether the unamortized balance of the AAOs
16 associated with the Sibley Rebuild Program and the Western Coal Conversion Program
17 should be included in rate base.

18 Q. Is there any issue concerning the expense amortization of the AAOs?

19 A. No.

20 Q. Who has raised the AAO issue in this case regarding the unamortized balance
21 of the AAOs for the Sibley Rebuild Program and the Western Coal Conversion?

22 A. The Office of the Public Counsel. Public Counsel witness Robertson states:
23 "...it is the Public Counsel's recommendation that the remaining unamortized deferred

1 balances not be included as an addition in the determination of the MPS rate base.”
2 (Robertson Direct, p. 14, line 8).

3 Q. Does the Staff agree with this stated position of the Office of the Public
4 Counsel?

5 A. No. Staff believes that the unamortized deferred balances of the AAOs for the
6 Sibley Rebuild Program and the Western Coal Conversion Program authorized in Case Nos.
7 ER-90-101 and ER-93-37 should be included as an addition in the determination of rate base.
8 Staff has consistently applied this methodology for each Aquila, Inc. rate case and the rate
9 cases of its predecessor company since Case No. ER-90-101. The Sibley Rebuild Program
10 AAO and the Sibley Western Coal Conversion AAO were ordered by the Commission to be
11 amortized over a 20-year period consistent with the life extension of the generating units. The
12 20-year amortization period was developed based on the expected remaining life of the Sibley
13 plant at the time of the life extension program. The capital expenditures and the related AAO
14 authorized by the Commission for the life extension of Sibley can be thought of in the same
15 way as any other capital expenditure in that they are given rate base treatment (return on the
16 investment) as well as a recovery of the related costs through depreciation/amortization
17 expense recovery. The Commission allowed the Company to include the unamortized
18 balances in rate base in the Commission's Report and Order in Case No. ER-90-101. The
19 Report and Order in Case No. ER-90-101 provided:

20 The Commission determines that these costs should be amortized over
21 20 years which is the approximate extended life of the plant. The
22 Commission finds that this approach matches the payments of the costs
23 by the ratepayer for the rebuilding with their enjoyment of its benefits.
24 The Commission further determines that the unamortized costs should
25 be reflected in rate base. This is the usual practice when capital costs
26 are amortized.

1 Q. What is Staff's understanding of why Public Counsel believes that the
2 unamortized balances associated with the AAOs should not be allowed in rate base?

3 A. Mr. Robertson states "The Public Counsel's position on this issue is based on
4 our belief that MPS is being given what essentially amounts to a guaranteed 'return of' the
5 deferrals associated with the SCLE/WC projects; therefore it should not be also provided with
6 a 'return on' those same amounts." (Robertson Direct, p. 16, line 9).

7 Q. Why does Staff disagree with Public Counsels rationale?

8 A. The Commission already determined this issue. To now accept the Public
9 Counsel's arguments would negate the Commission orders from Case Nos. ER-90-101 and
10 ER-93-37. The AAOs granted in those cases were the result of life extension projects and, as
11 such, should be treated in the same way as normal capital expenditures (which are classified
12 as plant in service and not as routine maintenance costs). Companies are routinely allowed to
13 earn a return on amounts that are capitalized. These amounts were included in the AAOs to
14 provide the Company an opportunity to recover the depreciation, property taxes and carrying
15 costs associated with the rebuilds that occurred between the completion of the projects and the
16 Company's next rate case. Absent AAO treatment, these amounts would have been lost as a
17 result of booking these costs directly to expense following completion of the projects.

18 Q. Would you define what you mean by "return of" and "return on?"

19 A. "Return of" provides the Company the opportunity to recover its investment
20 through depreciation/amortization expense. "Return on" occurs when an asset is placed in
21 service, and subsequently receives rate base treatment in a rate case. Through this approach,
22 shareholders are given an opportunity to earn a return on their investment.

1 Q. Is the Staff's recommended deferred cost treatment, under an AAO, and
2 resulting rate base treatment limited to major construction additions?

3 A. Yes. With the exception of major capital additions Aquila, as well as other
4 electric utilities, are expected to follow the Federal Energy Regulatory Commission (FERC)
5 accounting procedures which require a discontinuation of construction accounting
6 (capitalizing property taxes and carrying costs) when the construction project has been
7 completed.

8 Because of the significant cost of major construction projects, like the Sibley Rebuild
9 and Western Coal Conversion, the resulting expensing of depreciation, property taxes and
10 carrying cost (interest expense), related to these projects, have a significant impact on the
11 Company's earnings until these additional expenses can be reflected in the next rate case.
12 Without AAO treatment, the additional expenses, which occur prior to the effective date of
13 rates in the Company's next rate case, result in a reduction in earnings that will never be
14 reflected in rates.

15 Q. Please summarize the Staff's position on this issue.

16 A. The Sibley Rebuild Program and the Sibley Western Coal Conversion Project
17 were extraordinary construction projects undertaken by the Company to provide a
18 continuation of adequate service. These projects represent major capital additions to plant in
19 service as opposed to extraordinary maintenance expenditures resulting from an extraordinary
20 occurrence like the ice storm. The deferred costs included in the AAO authorized by the
21 Commission for the life extension of Sibley should be treated the same way as the other
22 capital costs for these projects and afforded rate base treatment. Allowing a continuation of
23 construction accounting under an AAO, for major capital projects, and including the AAO

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1 costs in rate base provides an incentive for the utility to commit significant capital investment
2 on a timely basis.

3 Q. Does this conclude your rebuttal testimony?

4 A. Yes, it does.