Exhibit No.:
Issues: Cash Working Capital; Accounts Receivable Sales; Materials and Supplies/Prepayments; Customer Deposits; Customer Deposit Interest Expense; Customer Advances; Maintenance; and Postage Expense
Witness: Lesley R. Preston
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: GR-2004-0072
Date Testimony Prepared: January 6, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

LESLEY R. PRESTON

AQUILA, INC.
d/b/a AQUILA NETWORKS-MPS AND
AQUILA NETWORKS-L&P

CASE NO. GR-2004-0072

Jefferson City, Missouri
January 2004

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Aquila, Inc. d/b/a Aquila Networks-MPS and Aquila Networks-L&P, Natural Gas General Rate Increase	)))	Case No. GR-2004-0072

AFFIDAVIT OF LESLEY R. PRESTON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Lesley R. Preston, being of lawful age, on her oath states: that she has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 23 pages to be presented in the above case; that the answers in the following Direct Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Lesley R Preston
Lesley R. Preston

Subscribed and sworn to before me this 4th day of January 2004.

Toni M Charlton
Notary

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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LESLEY R. PRESTON

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS

AND AQUILA NETWORKS – L&P NATURAL GAS OPERATIONS

CASE NO. GR-2004-0072

DIRECT TESTIMONY

OF

LESLEY R. PRESTON

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS

AND AQUILA NETWORKS – L&P NATURAL GAS OPERATIONS

CASE NO. GR-2004-0072

Q. Please state your name and business address.

A. My name is Lesley R. Preston, 3675 Noland Road Suite 110, Independence, Missouri 64055.

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).

<u>BACKGROUND OF WITNESS</u>

Q. Please describe your education and other qualifications.

A. I am currently pursuing a Masters of Science in Accounting from the University of Missouri-Kansas City. I graduated from Truman State University in Kirksville, Missouri, in May of 2002, with Bachelor of Science degrees in Accounting and Business Administration, with an emphasis in Finance. I commenced employment with the Commission in September 2002.

Q. Have you previously filed testimony before this Commission?

A. Yes, I submitted testimony in Case Nos. ER-2004-0034 and HR-2004-0024 (consolidated), Aquila, Inc. (Aquila or Company) d/b/a Aquila Networks-MPS (MPS) and Aquila Networks-L&P (L&P) for the electric and steam divisions.

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

A. Yes. I was assigned to a small informal water and sewer case for Taney County Utilities (Tracking Nos. QW-2003-0016, QS-2003-0015). I also worked on Raytown Water Company (Tracking No. QW-2003-0023), filed under the Commission's informal small water procedures.

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 three small water and sewer cases, which has 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. I have reviewed the Company's testimony, workpapers and responses to data requests in this case, as well as the testimony and workpapers of the Company's most previous MPS and L&P cases to gain an understanding of the issues I am addressing.

PURPOSE OF TESTIMONY

Q. With reference to Case No. GR-2004-0072, have you made an examination of the books and records of Aquila Networks-MPS and Aquila Networks-L&P, divisions of Aquila, Inc?

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

Q. What are your areas of responsibility in regard to Case No. GR-2004-0072?

A. I will be sponsoring the areas of cash working capital, accounts receivable sales, materials and supplies, prepayments, customer advances, customer deposits and maintenance expense.

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. Staff is filing three separate revenue requirements relating to Aquila's natural gas operations, MPS Northern/Southern, MPS Eastern, and L&P. Auditing department Staff witness Phillip K. Williams will address this issue in his direct testimony. The adjustment numbers for MPS Northern/Southern and MPS Eastern natural gas systems are the same for both revenue requirements.

I am sponsoring the following Income Statement adjustments for the MPS natural gas systems:

Accounts Receivable Sales: S-47.6;

Postage: S-47.5, S-59.4;

Customer Deposits Interest: S-47.4; and

Maintenance Expense: S-21.3, S-22.2, S-24.3, S-35.1, S-36.4, S-38.4, S-39.4, S-40.4, S-41.3, S-42.4, and S-43.4.

I am sponsoring the following Income Statement adjustments for L&P natural gas system:

Accounts Receivable Sales: S-45.7;

Postage: S-45.4, S-57.2;

Customer Deposits Interest: S-45.4; and

Maintenance Expense: S-34.4, S-36.4, S-37.4, S-38.4, S-39.3, S-40.4 and S-41.4.

In addition to those adjustments, I am sponsoring the rate base components found on Accounting Schedule 2, Rate Base, for materials and supplies, prepayments, customer deposits offset and customer advances offset for each of the three revenue requirement calculations made for Aquila's natural gas operations.

CASH WORKING CAPITAL

Q. What is Cash Working Capital?

A. Cash Working Capital (CWC) is the amount of cash necessary for the MPS and L&P Divisions to pay the day-to-day expenses incurred to provide natural gas service to their respective customers.

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, then reduced by line 8 - Federal Tax Offset, line 9 - State Tax Offset, line 10 - City Tax Offset and line 11 - Interest Expense Offset.

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 most recent natural gas rate case (Case No. GR-93-172) and L&P's most recent natural gas rate case (Case No. GR-99-246).

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 natural gas service to its customers. A lead/lag study analyzes the cash flows related to the payments received from its customers for the provision of natural gas service and the disbursements made by MPS and L&P to its suppliers and vendors of goods and services necessary to provide natural gas 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 natural gas 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 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 natural gas service 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 natural gas service to the ratepayers before the ratepayers paid the Company for the provision of utility service.

A negative requirement indicates that, in the aggregate, the ratepayers provided the CWC during the test year. This means that, on average, the ratepayers paid for their natural gas service 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; and

7) Column G (CWC Requirement): 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 day 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; and

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 result 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 meter and when the bills are subsequently mailed to the customer. Staff accepted the Company's proposed billing lag 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 bill was mailed and the day when MPS and L&P receive payment for that bill. The Staff used the collection lag from the current electric and steam case, Case No. ER-2004-0034, of 4.38 days. The collection lag is considerably shorter than most typical collection lags because of sale of the Company's accounts receivable, which will be discussed later in this direct testimony. 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; and (4) city franchise taxes.

The Staff has also included the natural gas purchased lag calculated by Staff Auditing witness Williams. These lags were calculated for Case No. EF-2003-0465, a current Aquila financing case, using information collected from the test year and update period.

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

A. The Staff accepted the following Company expense lags because there have been no known statutory or payment date changes since the previous rate case: (1) property taxes; and (2) sales and use taxes. The Staff reviewed these calculations and determined, based on knowledge of where approximately these lags should be, that they could be used without further audit work.

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. The Staff also did not recalculate accrued vacation, injuries and damages, and lease payment lags.

Q. Please describe the expense lag for cash vouchers as found on line 1 of Accounting Schedule 8.

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, etc.). The Staff used the lag from the current electric and steam case, Case No. ER-2004-0034, of 44.14 days.

Q. Please explain the expense lag for federal income withholding and FICA taxes found on lines 2, 4 and 14 of Accounting Schedule 8.

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 16.27 days.

Q. Please describe the expense lag for state withholding taxes as found on line 3 of Accounting Schedule 8.

A. The expense lag for the state withholding taxes (Missouri and Kansas) 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 18.49 days.

Q. Please explain the payroll expense lag found on line 5 of Accounting Schedule 8.

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 13.38 days. This is seven days, to the midpoint of the 14-day period, plus 6.38 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.

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 on line 7 of Accounting Schedule 8.

A. The natural gas expense lag is the difference in days between the midpoint of the period when the Company received natural gas from its suppliers and the date when the natural gas deliveries are paid. The natural gas expense lag, as calculated for Case No. EF-2003-0465 by Staff witness Williams, was 39.07 days for the MPS Northern/Southern natural gas systems, 40.27 days for MPS Eastern natural gas system, and 40.22 days for L&P natural gas.

Q. Why are the natural gas expense lags different for each of the three systems?

A. Each of the three natural gas systems operated by Aquila have separate natural gas suppliers. The systems are not interconnected. Because of this separation, Aquila has different payment patterns for the natural gas expense lags.

Q. Please explain the injuries and damages lag as found on line 9 of Accounting Schedule 8.

A. The injuries and damages lag is the difference in days between the midpoint of the period between occurrence and the date the payment was made. The Staff has used the lag from current electric and steam case, Case No. ER-2004-0034, of 388 days.

Q. Please explain the expense lag associated with pension fund payment found on line 10 of Accounting Schedule 8.

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. The Staff determined a lag of 90 days.

Q. Please explain the expense lag associated with lease payments found on line 11 of Accounting Schedule 8.

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 that was included in the current electric and steam case, Case No. ER-2004-0034, of 67.32 days.

Q. Please explain the expense lag associated with property taxes as found on line 13 of Accounting Schedule 8.

A. Since there have been no known or statutory or payment date changes for property taxes, the Staff accepted the Company's calculation of 193 days.

Q. Please explain the federal and state unemployment tax lags as found on line 15 of Accounting Schedule 8.

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 109.32 days.

Q. Please explain the corporate franchise tax lag found on line 16 of Accounting Schedule 8.

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 78 days for corporate franchise tax.

Q. Please explain the city franchise tax lag found on line 17 of Accounting Schedule 8.

A. City franchise taxes are remitted to each respective city either monthly, semimonthly, quarterly, semiannually depending on the agreement between the city and the Company. Typically, for L&P, taxes are remitted monthly, while taxes are paid bimonthly for MPS. The lag is the number of days between the taxable period and the date that the taxes are paid. The Staff calculated a lag of 46.9 days for L&P, and determined a lag of 73.3 days for MPS.

Q. Please explain the expense lags associated with sales and use taxes as found on line 18.

A. Because there have been no known or statutory or payment date changes associated with sales and use taxes since the last rate case, the Staff accepted the Company's expense lag of 37.05 days.

Q. Why do 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 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. Normally, 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. 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. Did the Company pay income taxes during the test year?

A. No. In response to Staff Data Request Nos. 58 and 59 for federal and state income taxes the Company stated that, MPS and L&P did not make any income tax payments because of income losses. Staff Auditing witness Steve M. Traxler will address the current income tax payment situation in his direct testimony.

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 of 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 is 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 revenue requirement 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 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.

ACCOUNTS RECEIVABLE SALES

Q. What is an accounts receivable sales program?

A. An accounts receivable sales program (Program) is a way to enhance cash flow and reduces Aquila's, and its MPS and L&P divisions', needs for short-term loans from investors, banks and other financial institutions. Depending on the amount of accounts receivables sold, the Program produces an immediate influx of cash.

Q. Does Aquila Networks-MPS and Aquila Networks-L&P currently participate in an accounts receivable sales program?

A. No, Aquila does not currently participate in such a Program.

Q. Please explain the history associated with the accounts receivable sales program?

A. In the late 1980's, Aquila implemented the accounts receivable sales program to increase immediate cash flow. Depending upon Aquila's cash needs, Aquila sold its MPS and L&P Divisions' accounts receivables, less uncollectibles to Ciesco, an affiliate of Citibank. Also included in the Program was payment of interest and administrative fees. Basically, the Program is a loan from a third party backed by MPS and L&P divisions' accounts receivables. MPS was initially the only Missouri division whose accounts receivable were sold until after the 2000 merger with St. Joseph Light and Power Company. As a result of the merger, both MPS and L&P receivables were subsequently sold. The Program was phased out through September and October of 2002 and was terminated on November 1, 2002.

Q. Why was the Program terminated?

A. Aquila experienced a significant decline in its credit rating from investment grade to non-investment grade. Ciesco no longer issued commercial paper to fund the Program because Aquila's credit rating fell outside the established criteria of the Program.

Q. How has the Staff treated the accounts receivable program?

A. The Staff has included the Program and treated it as though the Program was still available to Aquila. The termination of the accounts receivable program is ultimately a negative result derived from problems that Aquila has faced in its non-regulated ventures. The Staff has made the best effort to eliminate all costs associated with the corporate financial restructuring that Aquila is facing due to its poor financial condition, as those costs are not directly related to regulated activities. To achieve the elimination of corporate restructuring costs, the Staff has treated the program as if it was still in place, which results in a shorter collection lag and the inclusion of an annualized level of fees associated with the Program.

Q. How does the ratepayer benefit from the accounts receivable program?

A. The ratepayer benefits from the reduction in the cash working capital. The accounts receivable program significantly reduces the revenue lag in the cash working capital calculation thereby decreasing the amount of funds that the ratepayer must contribute to cash working capital. Since the cash working capital amount is an offset to rate base, overall revenue requirement is less, thus customers benefit.

Q. How does Aquila benefit from the accounts receivable program?

A. The benefit to the Aquila is that the accounts receivable program provides short-term funds to Aquila at a cost less than a financial institution might charge.

Q. What expenses has Aquila incurred in selling its accounts receivable?

A. Under the agreement with the buyer of the accounts receivable, Aquila is required to pay fees to various parties. These fees include interest on the outstanding balance plus an administrative fee, a program fee and an investment fee. Also, Aquila is required to pay for any defaults on the receivables sold.

Q. Were these accounts receivable program expenses booked above or below the line in the MPS and L&P divisions' test year expenses?

A. According to Aquila's response to Staff Data Request No. 421 in Case No. ER-2004-0034, all accounts receivable sales program expenses were booked below the line to Federal Energy Regulatory Commission (FERC) account 426.500 and resource code 2502.

Q. Please explain adjustments S-47.6 for the MPS natural gas systems and S-45.7 for L&P natural gas.

A. The Staff has made these adjustments to include in the cost of service interest for the accounts receivable program. These adjustments were necessary because the costs of the Program were charged below-the-line. In order to reflect these costs consistent with the use of the Program, the above adjustments were necessary.

MATERIALS AND SUPPLIES/PREPAYMENTS

Q. Please describe the Staff's treatment of materials and supplies, and prepayments.

A. Materials and supplies, and prepayments are represented in the Staff's rate base by thirteen (13)-month averages. Due to the cyclical nature of these two items, 13-month averages are developed to smooth out seasonal variations.

Q. What are materials and supplies?

A. Materials and supplies are miscellaneous items that are stored by the Company in inventory for use in day-to-day routine maintenance and operational projects. These items are also stored in inventory for the Company's construction projects.

Q. What are prepayments?

A. Prepayments relate to items that the Company "prepaid" so that the services will be on-hand during the normal course of the utility's operations. These types of items include the prepayment of insurance, software licenses, etc. that are paid in advance of coverage. Staff witness Traxler will address prepayments relating to pensions.

Q. Were any of the prepayments not calculated on a 13-month average?

A. Yes. The corporate prepaid software costs that are allocated between MPS and L&P demonstrated a downward trend. The ending account balances at September 30, 2003 were used instead of a 13-month average.

CUSTOMER DEPOSITS

Q. Please describe the customer deposits amount that is deducted from rate base.

A. Customer deposits generally represent funds received from customers as security against potential loss arising from failure to pay for service. The deposit represents a liability to repay the funds received after a specified period or upon satisfaction of certain requirements. Since customer deposits are, in effect, an interest-free loan to the Company, a representative level is included as an offset to the rate base investment. This treatment allows customers to receive a "return" on the customer deposit amounts maintained by the Company. The customer deposits computation is represented by a 13-month average. As with materials and supplies/prepayments, a 13-month average is used to smooth out cyclical variations in the account.

CUSTOMER DEPOSIT INTEREST EXPENSE

Q. Please explain income statement adjustment S-47.4 for the MPS natural gas systems and S-45.4 for L&P natural gas.

A. The Staff's adjustment annualizes interest expense related to customer deposits. Customer deposits are interest bearing so the liability is deducted from rate base with the associated interest included as a cost of service. To calculate this adjustment, a 5% interest rate (prime + 1%) (recommended by Staff witness James M. Russo of the Energy Department) was multiplied by the balance in customer deposits discussed earlier in my direct testimony.

CUSTOMER ADVANCES

Q. Please describe this item that is deducted from rate base.

A. The customer advances computations are represented by a 13-month average. Customer advances are funds provided by customers of the Company to assist in the costs of the provision of natural gas service. These funds, like customer deposits, represent interest-free money to the Company. Therefore, it is appropriate to include these funds as an offset to rate base. However, unlike customer deposits, no interest is paid to these customers for the use of the money.

MAINTENANCE

Q. Please explain adjustments S-21.3, S-22.2, S-24.3, S-35.1, S-36.4, S-38.4, S-39.4, S-40.4, S-41.3, S-42.4 and S-43.4 for the MPS natural gas systems, and S-34.4, S-36.4, S-37.4, S-38.4, S-39.3, S-40.4 and S-41.4 for L&P natural gas.

A. The adjustments normalize non-payroll maintenance expense for transmission (FERC Uniform System of Accounts (USOA) 861-867) and distribution (Accounts 885-894) plant, respectively, during the test year.

Q. Which FERC USOA accounts are included in the maintenance adjustments?

A. Transmission maintenance accounts include:

861 Maintenance Supervision & Engineering
862 Maintenance of Structures & Improvements
863 Maintenance of Mains
864 Maintenance of Compressor Station Equipment
865 Maintenance of Measuring and Regulating Station Equipment
866 Maintenance of Communication Equipment
867 Maintenance of Other Equipment

Distribution maintenance accounts include:

885 Maintenance Supervision & Engineering
886 Maintenance of Structures & Improvements
887 Maintenance of Mains
888 Maintenance of Compressor Station Equipment
889 Maintenance of Measuring and Regulating Station Equipment - General
890 Maintenance of Measuring and Regulating Station Equipment - Industrial
891 Maintenance of Measuring and Regulating Station Equipment - City Gate
892 Maintenance of Services
893 Maintenance of Meters and House Regulators
894 Maintenance of Other Equipment

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 be normally 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. How did the Staff determine normalized maintenance expense for the test year ended December 31, 2002?

A. After removing Company payroll costs for transmission and distribution maintenance, a 69-month average, calendar years 1998 through 2002 and the nine months ending September 30, 2003, was calculated for non-payroll transmission and distribution accounts for L&P natural gas and the non-payroll transmission and distribution maintenance accounts for MPS natural gas. The adjustments restate the test year 2002 results to reflect the average costs described above.

Q. Why was payroll removed prior to calculating the 69-month 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 Auditing witness Dana E. Eaves will be sponsoring the Staff's payroll adjustments in this case.

POSTAGE EXPENSE

Q. Please explain adjustments S-47.5 and S-59.4 for the MPS natural gas systems and S-45.4 and S-57.2 for L&P natural gas.

A. These adjustments were made to annualize postage expense to reflect the increase in postage rates, which took effect July 1, 2002.

Q. Does this conclude your direct testimony?

A. Yes, it does.