



**Exhibit No.:**  
**Issue:** Depreciation  
**Witness:** R. Lawrence Sherwin  
**Type of Exhibit:** Direct Testimony  
**Sponsoring Party:** Laclede Gas Company  
**Case No.:** GR-2002-356

**LACLEDE GAS COMPANY**

**GR-2002-356**

**DIRECT TESTIMONY**

**OF**

**R. LAWRENCE SHERWIN**

January 2002

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**Direct Testimony of R. Lawrence Sherwin**

Q. Please state your name and business address.

A. My name is R. Lawrence Sherwin, and my business address is 720 Olive Street, St. Louis, Missouri, 63101.

Q. What is your present position?

A. I am Assistant Vice President - Regulatory Administration of Laclede Gas Company ("Laclede" or "Company").

Q. Please tell us how long you have held this position and describe your responsibilities.

A. I was appointed to my present position in February, 1999. In this position I am responsible for managing the administration of Laclede's tariff and certain other federal and state regulatory matters, and am also responsible for conducting various projects, studies, analyses and other tasks from time to time.

Q. What is your educational background?

A. I graduated from St. Louis University in 1975 with the degree of Bachelor of Science in Business Administration, majoring in Accounting.

Q. Are you a member of any professional organizations?

A. I am a member of the Institute of Management Accountants.

Q. Will you briefly describe your experience with the Company prior to assuming your current position?

A. I joined Laclede in 1975 as an Accountant. I was transferred the following year to the Budget department, where I served in senior staff and assistant managerial capacities. I later served successively as Supervisor of Corporate Accounting and Manager of Financial Planning. In 1982 I was appointed Manager of Accounting, with responsibility for managing Corporate Accounting, General Accounting and Property

1 Records departments. In 1988 I was named Director of Customer Accounting, with  
2 responsibility for Collection and Credit, Customer Accounting, Meter Reading and  
3 Methods and Procedures. Cashiers was added to my area of responsibility in 1991. In  
4 August 1992 I was elected Assistant Vice President of Customer Accounting.  
5 Effective January 1997 I was named Assistant Vice President of Human Resources.  
6 Although several of my assignments detailed above have been in other areas, I have  
7 assisted in various facets of Laclede's rate matters over much of my employment,  
8 including work at times in cases filed by Mississippi River Transmission Corporation,  
9 an interstate pipeline that serves Laclede.

10 Q. Have you previously filed testimony before this Commission?

11 A. Yes. I have also testified before the Federal Energy Regulatory Commission.

12 Q. What is the purpose of your testimony?

13 A. I will sponsor and explain the depreciation rates Laclede is proposing in this case,  
14 which are unchanged from the settlement of Laclede's last rate case. I will also  
15 propose an amortization of the anticipated cost of removing Laclede's four above-  
16 ground gas holders. I will also propose a change in Laclede's capitalization policy  
17 with respect to personal computers and related equipment.

18 Q. Are you presenting a depreciation study?

19 A. No. In the context of Laclede's last rate case, I presented an updated depreciation  
20 study and provided pertinent data updates to the Staff.

21 Q. Are you sponsoring any schedules?

22 A. Yes, I am sponsoring Schedule RLS-1.

23 **Depreciation Rates**

24 Q. What do you believe is the function of depreciation accounting?

1 A. The American Institute of Certified Public Accountants ("AICPA") defines  
2 depreciation accounting in its Accounting Terminology Bulletin, Paragraph 56  
3 (August 1953): "Depreciation accounting is a system of accounting which aims to  
4 distribute the cost or other basic value of tangible capital assets, less salvage (if any),  
5 over the estimated useful life of the unit (which may be a group of assets) in a  
6 systematic and rational manner. It is a process of allocation, not of valuation."

7 In Accounting for Public Utilities, by Robert L. Hahne and Gregory Aliff, the  
8 critical attributes of this definition are analyzed. At page 6-6, the authors note in  
9 regard to depreciation accounting that

10 "... several aspects are important:

- 11 (1) Salvage (net salvage) is to be recognized.
- 12 (2) The allocation is to be over the life of the asset.
- 13 (3) The assets being depreciated may be a group of assets.
- 14 (4) Depreciation accounting is a process of allocation, not valuation.
- 15 (5) Most importantly, the allocation must be systematic and rational."

16 The National Association of Regulatory Utility Commissioners (NARUC) has  
17 defined depreciation accounting as "the mechanism through which the capital invested  
18 in depreciable plant is recovered. It is the process used to allocate that capital  
19 investment to the accounting periods during which the depreciable plant is in service.  
20 A system of accounting which allocates the cost adjusted for salvage over the  
21 estimated useful life of a property unit or group of assets in a systematic and rational  
22 manner."

23 The NARUC Uniform System of Accounts includes a number of definitions that  
24 were arranged in the book by Hahne and Aliff in a manner that is helpful:

- 1           “(1) *Depreciation*, as applied to depreciable utility plant, means the loss in service  
2           value not restored by current maintenance, incurred in connection with the  
3           consumption or prospective retirement of utility plant in the course of service  
4           from causes which are known to be in current operation and against which the  
5           utility is not protected by insurance. Among the causes to be given  
6           consideration are wear and tear, decay, action of the elements, inadequacy,  
7           obsolescence, changes in the art, changes in demand and requirements of public  
8           authorities, and, in the case of natural gas companies, the exhaustion of natural  
9           resources.
- 10          (2) *Service value* means the difference between original cost and net salvage value  
11          of utility plant.
- 12          (3) *Original cost*, as applied to utility plant, means the cost of such property to the  
13          person first devoting it to public service.
- 14          (4) *Net salvage value* means the salvage value of property retired, less the cost of  
15          removal.
- 16          (5) *Salvage value* means the amount received from property retired, less any  
17          expenses incurred in connection with the sale or in preparing the property for  
18          sale, or if retained, the amount at which the material recoverable is chargeable  
19          to materials and supplies, or other appropriate accounts.
- 20          (6) *Cost of removal* means the cost of demolishing, dismantling, tearing down or  
21          otherwise removing utility plant, including the cost of transportation and  
22          handling incidental thereto.
- 23          (7) *Service life* means the time between the date utility plant is includible in utility  
24          plant in service, or utility plant leased to others, and the date of its retirement. If  
25          depreciation is accounted for on a production basis rather than on a time basis,

1 then service life should be measured in terms of the appropriate unit of  
2 production.”

3 Laclede's depreciation accounting is typical of that of most industries whereby  
4 an annual rate determined for the various accounts and classes of property is applied to  
5 the original cost of such property.

6 Q. Are proper depreciation accrual rates especially important to a regulated local gas  
7 distribution company?

8 A. Yes. Depreciation rates involve the recovery or return of capital. Return allowances  
9 on investment within the regulated utility industry do not provide for the substantial  
10 risk that would be involved if the original investment in utility plant were not  
11 recovered.

12 Q. Please describe the depreciation system employed historically by Laclede Gas  
13 Company.

14 A. Since its incorporation by an act of the Missouri legislature in 1857, Laclede has used  
15 a number of methods of accounting for its fixed asset recovery, some of which would  
16 hardly be recognized today as depreciation. At times, the method was based upon the  
17 Company's sales level, rather than an annual rate applied to a property balance. A  
18 retirement reserve method was used for some years, where the level of accrual was far  
19 below that which would fit the AICPA's definition set forth above. From September,  
20 1953 through the effective date of the rates ordered in Laclede's last rate case, Laclede  
21 had used the straight line - average life - amortization method of depreciation (SL-AL-  
22 AM). Under this method, the accrual rate is normally calculated by this formula:

$$\text{Depreciation Rate} = \frac{100\% - \% \text{ Net Salvage}}{\text{Average Service Life (years)}}$$

1 where net salvage equals gross salvage minus cost of removal. The "% Net Salvage"  
2 (net salvage percentage) in the formula equals net salvage for a period, divided by the  
3 retirement value for that same period, in order to derive a percentage. This percentage  
4 is combined with unity (100%) before dividing by the average service life.

5 Q. You mentioned that a depreciation change was made beginning with the effective date  
6 of the rates established in Laclede's last rate case. Please explain.

7 A. In resolution of our last rate case proceeding, Case No. GR-2001-629, the Commission  
8 approved a stipulation and agreement which was recommended by all the parties.  
9 Pending final judicial review of a prior Commission decision relating to net salvage  
10 costs, the agreement adopted the depreciation rates proposed by Staff, which treat net  
11 salvage as an expense item, rather than as an item which is subject to recovery through  
12 depreciation as I have previously described. The agreement specifically provides,  
13 however, that such treatment of net salvage is to have no effect on Laclede's appeal of  
14 this issue or otherwise prejudice the right of the Company. Pursuant to the agreement,  
15 Laclede began expensing net salvage as of the effective date of rates in conclusion of  
16 Case No. GR-2001-629. I should note, however, that in addition to any judicial  
17 resolution of this issue, the potential impact of Statement of Financial Accounting  
18 Standards No. 143 on accounting for removal costs may also provide a new  
19 framework for resolving some or all of the issues that have arisen in this area over the  
20 past several years.

### 21 Gas Holders

22 Q. Could you please discuss your proposal related to gas holders?

23 A. Certainly. As company witness Hoeflerlin testifies, Laclede will be removing its four  
24 gas holders in the near future, at considerable cost. Staff's position on such matters  
25 has been that removal cost of major facilities such as these should be recovered

1 through an amortization process at the end of the life of the facility, rather than  
2 through inclusion in depreciation over the life of the property. Mr. Hoeflerlin has  
3 estimated a total removal cost of \$5,130,400.

4 Q. Are you proposing to collect this full amount immediately in rates?

5 A. No. As shown on Schedule RLS-1, I propose to amortize the \$5,130,400 estimated  
6 removal cost of the four gas holders over a five year period commencing with the  
7 effectiveness of gas rates resulting from this rate case. This results in an initial annual  
8 amortization amount of \$1,026,080.

9 **Personal Computer Capitalization Policy**

10 Q. Would you now describe your proposed change in Laclede's capitalization policy with  
11 respect to personal computers and related equipment?

12 A. I propose that an adjustment be made in this case to recognize a proposed modification  
13 of the Company's capitalization threshold for personal computers and related  
14 equipment to \$3,000 per item. Upon further analysis, an expense allowance would be  
15 made as an adjustment to cost of service in this case to cover an annual equipment  
16 replacement cost of such items, so as to provide for this proposed change.

17 Q. Please explain.

18 A. Laclede's personal computers and related equipment are capitalized in account 391,  
19 Office Furniture and Equipment - Data Processing Equipment, with a ten-year life.  
20 This life is primarily derived from property records data concerning large mainframe  
21 computers and related appurtenances, for the last twenty years or so. I do not believe  
22 that using such a lengthy timeframe is entirely reasonable for our current mainframe  
23 equipment, since our recent mainframe replacements have been well in advance of a  
24 ten-year life. For personal computers, however, an average life anywhere near ten  
25 years is far greater than the most optimistic life-span one can expect. Personal

1 computer technology advances so rapidly today that a far shorter average life would  
2 make sense. Further, the personal computer at Laclede (as elsewhere) has become  
3 standard equipment for nearly all of our office workers. With such a short expected  
4 life-span and such universal placement, the record-keeping and approval overhead of  
5 capitalizing this type of equipment is inefficient and unnecessary. Some record-  
6 keeping would, of course, remain, and the security over this property would be  
7 unchanged, but the items would no longer be accounted for in Laclede's property  
8 records system. Laclede intends to provide a quantification of this proposed  
9 accounting change as part of the update in this case.

10 **Summary**

11 Q. Could you please summarize your testimony?

12 A. In summary, Laclede's anticipated gas holder removal cost should be amortized as  
13 shown on Schedule RLS-1, and cost of service should be adjusted to reflect a revised  
14 capitalization threshold on personal computer equipment.

15 Q. Does this complete your direct testimony?

16 A. Yes, it does.

**LACLEDE GAS COMPANY**  
**Case No. GR-2002-356**

**PROPOSED AMORTIZATION**  
**Gas Holder Removal Cost**

<b>Demolition Cost Estimate</b>	
<b>per Company Witness Craig R. Hoeferlin</b>	<b><u>\$5,130,400</u></b>
<b>Proposed Amortization Period</b>	<b>5 Years</b>
<b>Proposed Annual Amortization</b>	<b><u>\$1,026,080</u></b>

LACLEDE GAS COMPANY  
ACCOUNTING AND OTHER SUPPORTING SCHEDULES  
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SUBMITTED TO: MISSOURI PUBLIC SERVICE COMMISSION  
ON JANUARY 25, 2002  
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