Exhibit No.:
Issues: Working Capital,
Unbilled Revenue &
Rate Case Expense
Witness: Richard O. Clayburn
Sponsoring Party: Aquila Networks-MPS
[redacted]
Case No.: ER-

Before the Public Service Commission
of the State of Missouri

# Direct Testimony

of

Richard O. Clayburn

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**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-_____**

Q. Please state your name and business address

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

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

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

Q. Please describe your educational background and professional experience.

A. I am currently working on a Masters of Business Administration from Baker University, with an estimated completion date of June 2004. I received a Bachelor in Business Administration with an emphasis in Accounting from Howard University in August 1991. After graduation, I joined a regional CPA firm in the Washington, DC area as an Auditor.

I have worked as a Staff Accountant, Senior Accountant, and Supervisor from 1993 to 2002. I began to work for Aquila in February 2002.

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

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

Q. Please identify the adjustments that you are sponsoring.

A. I am sponsoring the following working capital items:

- Materials & Supplies **(MPS )**
- Prepayments **(MPS )**
- Cash Working Capital **(MPS )**

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

- Unbilled Revenue **(MPS )**
- Rate Case Expenses **(MPS )**

## MATERIALS & SUPPLIES

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

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

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

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

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

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

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

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

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

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

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

**PREPAYMENTS**

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

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

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

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

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

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

## CASH WORKING CAPITAL

Q. What is Cash Working Capital?

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

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

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

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

Q. What are the sources of CWC?

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

Q. How do shareholders supply CWC?

A. When the MPS Division spends cash to pay for an expense before the ratepayers provide the cash, the shareholders must provide the cash. This cash represents a portion of the shareholders total investment in the MPS Division. 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 service that they received before the MPS Division pays the expenses it 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 is the amount of CWC provided by both the ratepayers and shareholders generally determined?

A. A lead/lag study is usually performed.

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

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 MPS Division paid the expenses incurred to provide the electric service to the customers before the customers paid cash for the service. A negative requirement indicates that, in the aggregate, the

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

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

A. The components of the calculation are as follows:

1) Column A (Account Description): lists the types of cash expenses, which the MPS Division pays 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 provision of service by the MPS Division, and the payment for the service by the ratepayer.

4) Column D (Expense Lag): indicates the number of days between the receipt of and payment for goods and services (i.e., cash expenditures) used to provide service to the ratepayer.

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.

Q. Please describe the revenue lag.

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

1) Collection Lag: The period of time between the day the company places the bill in the mail and the day the company receives payment from the ratepayer for service performed.
2) Service 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.
3) 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.

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

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

| | |
|---|---|
| Collection Lag | 24.18 |
| Service Lag | 15.21 |
| Billing Lag | 2.00 |

Q. Please explain the 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 the MPS Division receives payment for that bill. The MPS Division determined revenue lag days by averaging the account receivables turnover days during the year ended December 31, 2002.

Q. Please explain how the Service lag was determined.

A. The service 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 the MPS Division bills monthly, and it is assumed that service is delivered to the customer evenly throughout the month.

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

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

Q. Please describe the expense lead.

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

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

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

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

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 MPS Division paid the wages. The MPS Division pays all employees on the Friday following the two-week pay period.

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

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

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

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

| | |
|---|---|
| Delivery Time | 15.2 |
| Payment Time | 24.2 |
| Total Lead Time | 39.4 |

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

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

| | |
|---|---|
| Delivery Time | 15.2 |
| Payment Time | 22.25 |
| Total Lead Time | 37.45 |

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

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

| | |
|---|---|
| Delivery Time | 15.2 |
| Payment Time | 7.58 |
| Total Lead Time | 22.78 |

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

Q. Please explain the Interest Expense offset.

A. Although not an O&M expense, interest expense is included in the lead/lag analysis because interest is a source of cash provided by the customer and therefore, properly considered in CWC. The MPS Division has a 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 MPS Division 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 UCU'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).

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

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

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

A. The expense lag for FICA and federal 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 FICA, federal withholding and employer FICA were weighted by the total amounts paid and then averaged together. The tax lags are 16.93 days.

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

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 MPS Division's calculation of FUTA and SUTA expense lag of 75.19.

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

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

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

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

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 MPS Division'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 federal and state income tax lags of 58.95 and 62.05 days were used for MPS , respectively.

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

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

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

## UNBILLED REVENUE

Q. Please explain Adjustment No. R-20.

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

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

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

## RATE CASE EXPENSE

Q. Please explain Adjustment No. CS-50.

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

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

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

Q. Does this conclude your prefiled direct testimony?

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] 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.

Richard O. Clayburn, Jr.

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

Terry D. Lutes

Notary Public
Terry D. Lutes

My Commission expires:

8-20-2004

TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2004