

REBUTTAL TESTIMONY  
OF  
ACCOUNTING PANEL  
CASES 09-E-0588 & 09-E-0589

1 Q. Are you the Nancy L. Komar and Lora J. Gescheidle who submitted pre-filed  
2 direct testimony in this proceeding?

3 A. Yes, we are.  
4

5 Q. What is the purpose of your rebuttal testimony?

6 A. We will address the testimony and positions of the Staff Gas Rates Panel  
7 concerning the accounting and ratemaking for the negative net salvage  
8 (which occurs when gross salvage is less than the cost of removal) for gas  
9 distribution mains and services. We will also address the timeline for  
10 implementing International Financial Reporting Standards (IFRS).  
11

12 Q. Are you presenting any exhibits in support of your rebuttal testimony?

13 A. Yes. We will identify them during the course of this rebuttal testimony.  
14

15 Q. Please describe the Staff Gas Rates Panel proposal with respect to cost of  
16 removal for gas distribution mains and services?

17 A. Under the Staff Gas Rates Panel's proposal, for Account 376 (Gas  
18 Distribution Mains) and Account 380 (Gas Services) a "cap" or limitation of  
19 60% of the book cost of the plant retired, which is also referred to as 60%  
20 negative net salvage, would be employed to constrain the growth in the  
21 depreciation reserve. Actual costs of removal incurred in excess of negative

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1           60% net salvage for Account 376 (Gas Distribution Mains) and Account 380  
2           (Gas Services) would be charged to operating and maintenance expense  
3           ("O&M Expense") but, under the Staff Gas Rates Panel's position, there  
4           would be another "cap" on the amount that could be recognized as an  
5           expense for ratemaking purposes. The Staff Gas Rates Panel proposes a  
6           dollar level "cap" of \$439,000 for the rate year O&M Expense rate allowance.  
7           The Panel's expense "cap" would be limited to (1) the average negative net  
8           salvage as a % of book cost of plant retired for the years 2004 – 2008 less  
9           60% times (2) the average book cost of plant retired. This produced  
10          proposed rate allowances to cover the portion of negative net salvage to be  
11          charged to O&M Expense of \$131,000 for mains (based on five-year average  
12          negative net salvage of 134% minus 60% and average retirements of  
13          \$178,000) and \$308,000 for services (based on five-year negative net  
14          salvage of 287% minus 60% and average retirements of \$136,000).

15

16    Q.    Does Staff's proposed accounting and ratemaking treatment align with the  
17          Company's recent actual experience regarding negative net salvage for gas  
18          distribution mains and services?

19    A.    No.

20

21    Q.    Can you please describe the costs of removal the company has incurred in

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1 the period 2007 through 2009?

2 A. As was recognized in the Staff Gas Safety Panel testimony page 13, for the  
3 three year period 2007- 2009 the Company was required to spend a total of  
4 \$15.75 million replacing leak-prone pipe excluding the cost of removing the  
5 leak-prone pipe. This equates to an average of \$5.25 million per year of new  
6 capital. The actual net salvage for the three-year period are shown in our  
7 Exhibit \_\_\_\_ (AP-1R), along with calculations applying the 60% net cost of  
8 removal limitation to illustrate the remaining costs that would need to be  
9 recovered through expense. It should be noted that the three-year (2007-  
10 2009) average for the costs charged to expense under the three-year rate  
11 plan is significantly above the expense allowance being proposed by Staff in  
12 the present case (\$821,000 vs. \$439,000).

13 During 2009 through November, which is the latest available data at the  
14 time of preparation of this testimony, we have experienced the actual costs  
15 shown below. We have also shown below what the impact on the Company  
16 would be assuming that the expense allowance supported by the Staff Gas  
17 Rates Panel were to be applied to those results. As shown below \$721,100  
18 would not be covered in rates and shareholders would be harmed by this  
19 amount.

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2009	Book Retirements	Net Salvage	Net salvage %
Account 376 Gas Distrib. Mains	\$370,931	\$1,102,710	-297.3
60% Limitation	\$222,559	\$222,559	
Actual Expense Above 60% to Reserve		\$880,151	
Account 380 Gas Distrib. Services	\$259,492	\$435,644	-167.9
60% Limitation	\$155,695	\$155,695	
Actual Expense Above 60% to Reserve		\$279,949	
Total Actual Expense <b>Above</b> Allowed Charge to Reserve		\$1,160,100	
Expense Allowance per Staff Gas Rates Panel		\$439,000	
<b>Total Unrecovered</b>		<b>\$721,100</b>	

1

2

3 Q. What does the Accounting Panel recommend with respect to negative net  
4 salvage for gas distribution mains and services?

5 A. The Accounting Panel continues to believe that the Uniform System of  
6 Accounts should be followed for the treatment of net costs associated with  
7 the removal of gas distribution mains and services. Exceptions to these rules  
8 for gas mains and services result in distorted activity in the depreciation

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1 reserve which could influence depreciation study results and theoretical  
2 reserve requirements. The Accounting Panel believes that to be an  
3 undesirable consequence. If the Commission wishes to achieve other  
4 regulatory goals, such as limiting the growth in the depreciation reserve  
5 being caused by higher current actual costs, those goals should not be  
6 achieved through methods, such as expense "caps," that shift legitimate  
7 costs of operations costs from ratepayers to shareholders.

8 If expense "caps" must be used than the \$951,000 expense allowance as  
9 originally filed should be used. As noted in the Gas Safety Panel testimony  
10 the required spending level for replacing leak-prone pipe will increase from  
11 the \$5.25 million annual amount in the most recent three year historic period  
12 to \$6.1 million in 2010 and an even higher level of \$6.7 million in 2011. This  
13 27.6% increase in replacement activity will therefore result in a  
14 corresponding increase in net salvage costs related to these replacements.

15 Therefore the amount of \$951,000 as shown on Exhibit \_\_\_\_ (AP-8) of the  
16 original filing should be used to set the expense allowance for the Rate Year  
17 ending 6/30/2011 since it better reflects the net salvage amount expected to  
18 be incurred and is based on Construction Budget forecasts used and  
19 accepted throughout this case.

20 It should also be recognized that the three year average of \$821,000 net  
21 salvage calculated for 2007-2009 on Exhibit \_\_\_\_ (AP-1R) is much more

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1           reflective of current levels of expense than the five year average proposed by  
2           the Staff Gas Rates Panel.

3    Q.    Does this conclude your testimony concerning treatment of negative net  
4           salvage for Gas Distribution Mains and Services?

5    A.    Yes.

6    Q.    Turning now to the Staff Accounting Panel removal of funding related to the  
7           implementation of IFRS do you agree with their conclusions?

8    A.    No.

9    Q.    Is the Company currently required to maintain its books and records in  
10           accordance with International Financial Reporting Standards (IFRS)?

11   A.    No. The SEC has instituted a proposal to require public companies to  
12           provide their financial reporting using IFRS as of January 1, 2014. That  
13           proposal would also have the effect of requiring the development of financial  
14           statements using IFRS for the 2012 calendar year, even though the formal  
15           reporting using IFRS would not be required until 2014. As of the date of  
16           preparation of this testimony, the SEC had not set a date-certain for  
17           conversion to IFRS.

18   Q.    Why has the Company requested rate recovery for costs to comply with  
19           standards that it is not required to follow?

20   A.    We believe that it is prudent for us to plan to implement the new standards  
21           and that we will incur incremental non-labor costs. The Company has created

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1 a timeline for implementing IFRS as currently proposed by the SEC. The  
2 timeline is attached as Exhibit \_\_\_\_ (AP-2R) As the Company stated in its  
3 response to Staff IR-352, attached as Exhibit \_\_\_\_ (AP-3R), the SEC has  
4 stated its support of a transition to IFRS. The SEC has also proposed a  
5 timeline for conversion to IFRS that would make those standards applicable  
6 to the Company beginning January 1, 2014, for filing the Company's first  
7 quarter 10-Q in 2014. Under the SEC's proposed regulations, in its filings  
8 after January 1, 2014, the Company would be required to file two years of  
9 comparative financial data. As a result, the Company's 2014 SEC filings  
10 would need to include its financial results under IFRS beginning with January  
11 1, 2012. Accordingly, the Company expects to incur incremental non-labor  
12 costs during the rate year in the present case. If the Company were to wait  
13 until its next rate filing (which would be for the rate year ended June 30,  
14 2012) to begin to implement IFRS, the Company would only have six months  
15 to learn all of the IFRS, identify necessary changes to its policies, procedures  
16 and controls and have these changes approved internally and by its external  
17 auditors. Companies that have converted to IFRS have stated that the  
18 longer they waited to begin the conversion process, the more outside support  
19 was needed resulting in higher costs. In an article written by Deloitte &  
20 Touche, titled "IFRS Roadmap Planning a Safe, Economical Tip" , attached  
21 as Exhibit\_\_ (AP-4R), they stated that "for many companies, IFRS conversion

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1           resulted in a major capital outlay and significant budget overruns” and that  
2           “companies that have delayed their conversion until the deadline resorted to  
3           a “fire-drill” approach, which often lead to inefficiency, complexity, distraction  
4           and redundancy.” They also pointed to the American Institute of Certified  
5           Public Accountants recommendation that companies use a three to five year  
6           timeline for the transition.

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8    Q.    Does this conclude the Accounting Panel's rebuttal testimony?

9    A.    Yes, it does.

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