DIRECT TESTIMONY

OF

DIANNA HATHHORN

Accountant
Accounting Department
Financial Analysis Division
Illinois Commerce Commission

Central Illinois Public Service Company

Docket No. 03-0696

September 15, 2004

Witness Identification

Q. Please state your name and business address.

A. My name is Dianna Hathhorn. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

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

A. I am currently employed as an Accountant in the Accounting Department of the Financial Analysis Division of the Illinois Commerce Commission ("ICC" or "Commission").

Q. Please describe your professional background and affiliations.

A. I am a licensed Certified Public Accountant. I earned a B.S. in Accounting from Illinois State University in 1993. Prior to joining the Staff of the Illinois Commission ("Staff") in 1998, I worked as an internal auditor for another Illinois state agency for approximately 3.5 years. I also have 1.5 years experience in public accounting for a national firm.

Q. Have you previously testified before any regulatory bodies?

A. Yes. I have testified on several occasions before the Commission.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to report the results of my review of Central Illinois Public Service Company's ("CIPS" or "Company")

Purchased Gas Adjustment ("PGA") Reconciliation, as calculated by its witness Leonard A. Mans, on his Schedule LAM-CIP-1, and the underlying documents that support his calculations.

Q. Are you sponsoring any schedules as part of ICC Staff Exhibit 1.00?

A. Yes. I prepared the following schedules, which are applicable to the reconciliation year ended December 31, 2003:

Schedule 1.01- Reconciliation of Purchased Gas Adjustment Clause
Schedule 1.02- Summary of Adjustments
Schedule 1.03- Adjustment for Lost Gas
Schedule 1.04- Adjustment for Rotherwood Storage Discrepancy
Schedule 1.05- Adjustment for Interest Expense Charges

<u>Results of the Review</u>

Q. Please describe ICC Staff Exhibit 1.00, Schedule 1.01- Reconciliation of Purchased Gas Adjustment Clause.

A. Schedule 1.01 sets forth Staff's proposed 2003 PGA reconciliation. Line 14 reflects the net effect of Company and Staff adjustments, and the resulting Factor O.

Q. Do you recommend any adjustments to CIPS' PGA reconciliation as a result of your review?

A. Yes, I have three adjustments, which are summarized on ICC Staff Exhibit 1.00, Schedule 1.02. The Staff calculated commodity gas cost from Schedule 1.02, in turn, carries forward to Schedule 1.01, line 5.

Adjustment for Lost Gas

Q. Please describe ICC Staff Exhibit 1.00, Schedule 1.03, Adjustment for Lost Gas.

A. Schedule 1.03 is a three-page schedule that reflects my calculations of the dollar impact on the 2003 PGA cost of gas that resulted from the Company's volume and cost reductions for lost gas at its Sciota and Johnson City storage fields. Page 1 of 3 is a total of the calculations set forth on the subsequent pages. Pages 2 and 3 quantify the impacts of the Company’s adjustments for lost gas to its Sciota and Johnson City storage fields, respectively.

Q. Please identify the origin of the costs that you are disallowing.

A. The costs originate from the Company owned and operated underground gas storage fields at Sciota and Johnson City. The Company periodically adjusts the balance of working gas in these fields to recognize gas lost due to migration and other factors. My disallowance relates to the cost of the lost gas that was passed through the PGA in the 2003 reconciliation year.

Q. What does this lost gas represent?

A. Lost gas represents gas that has been injected into storage and becomes unavailable for withdrawal because it has been lost due to migration or used in the operation of the storage field.

Q. Has this lost gas been physically withdrawn from storage for use by the Company's PGA customers?

A. No. It remains in the storage field as cushion gas or is used in the operation of the field.

Q. Is the cost of gas injected into storage but not available for withdrawal in the normal operation of the gas reservoir a PGA recoverable gas cost in accordance with 83 Ill. Adm. Code 525 (the Commission's PGA rules)?

A. No. The cost of storage gas is not chargeable to customers through the PGA until it is withdrawn and made available for consumption. According to 83 Ill. Adm. Code 525, the Commission's PGA rules:

> The cost of gas estimated to be withdrawn from storage during the base period shall be included in the gas charge. (83 Ill. Adm. Code 525.40(c)).

The cost of gas that I am disallowing was not withdrawn from storage for consumption during the reconciliation year.

Q. Please describe how gas cost is properly accounted for when the gas utility has underground storage facilities in order to be in compliance with 83 Ill. Adm. Code 505 (the USOA for gas utilities).

A. Initially, the cost of gas bought by a utility is charged to the purchased gas expense account. However, if portions of these purchases are transferred (injected) into the storage field, there will be an accounting adjustment to reduce the purchased gas expense account to recognize this transfer. The accounting sequence is to credit (or decrease) the purchased gas expense account and charge (debit or increase) the gas stored underground account (commonly referred to as working gas) for the cost of gas injected into storage. After this adjustment to reflect the transfer of gas into the storage field is made, only the cost of gas actually delivered to the customer remains in the purchased gas expense account. The cost of gas in the purchased gas expense account is the amount charged to the customer through the PGA. When the gas is ultimately withdrawn from the underground storage for customer use, the accounting sequence is reversed. The cost of the gas withdrawn will be credited (decreased) from the gas stored underground account and charged back (increased) to the purchase gas expense account. Thus, the customer is not charged until the gas is actually withdrawn and consumed.

Q. Explain briefly the appropriate accounting for gas withdrawn from underground storage.

A. Accounting should be an accurate representation of the events that have actually happened. In the case of storage gas, four separate and distinct events have taken place:

1. Gas has been purchased;
2. Gas has been injected into the storage field;
3. Gas has been withdrawn for customer consumption; and
4. A portion of the gas injected into the storage field remains in storage as cushion gas or was used in the operation of the field. This is the lost gas at issue here.

Q. Describe how CIPS accounted for the cost of gas lost in the Sciota storage field.

A. The Company decreased the volumes of working gas in inventory by the amount of the gas that is lost. The cost associated with the lost gas is then spread over the volumes of working gas inventory that remain. Since the Company uses a weighted average method of costing withdrawals, this has the effect of increasing the cost of each unit of gas withdrawn. As these units are withdrawn, the cost of the lost gas that has been attached to these units, is credited to the working gas inventory and charged to the cost of gas withdrawn from storage. This cost is subsequently recovered through the PGA.

Q. Describe how CIPS accounted for the cost of gas lost in the Johnson City storage field.

A. The Company decreased both the volumes and cost of working gas in inventory for the gas that is lost. This method provides an immediate recovery of the cost of gas withdrawn from storage through the PGA.

Q. Is there any uncertainty in how CIPS accounted for its cost of gas?

A. Yes. According to the Company's response to Staff Data Request GS-12, only volumes were reduced in both fields. However, the monthly inventory analysis worksheets, provided in response to Staff Data Request DLH-2.02, reflect that both volumes and cost were reduced in the Johnson City field. No additional supporting documentation was provided in response to my further follow up data request DLH-5.02. As discussed further below, neither of the Company's methods is appropriate.

Q. Do you agree with CIPS' accounting treatment of the gas lost in the Company's storage fields?

A. No. In both instances, CIPS' methods have the effect of accounting for the cost of this lost gas as if it had been withdrawn from the storage field and delivered to its PGA customers. As explained further below, such practice violates the Commission's PGA rules (83 Ill. Adm. Code 525) and system of accounts (83 Ill. Adm. Code 505).

Q. Explain how CIPS' accounting for gas withdrawn from underground storage deviates from the appropriate accounting previously described.

A. As discussed previously, the accounting should be an accurate representation of the four separate and distinct events have taken place:

1) gas being purchased;
2) gas being injected into the storage field;
3) gas being withdrawn for customer consumption; and
4) the lost gas which remains in storage field.

CIPS fails to properly account for the fourth event by including the cost of the lost gas with the cost of the actual withdrawals. Thus, CIPS has removed the cost of the lost gas from storage and charged it to gas cost that will be recovered through the PGA. This accounting treatment is not an accurate representation of what actually happened. Instead, it gives the erroneous impression that the lost gas was actually withdrawn from storage for customer consumption. More importantly, this accounting treatment is inconsistent with PGA rules, because it includes costs for gas that was not withdrawn.

Q. How should CIPS account for the cost of the lost gas?

A. When gas is initially injected into storage it is classified as working gas (or top gas). If a portion of this injected gas becomes unavailable for withdrawal, it should be reclassified to non-recoverable cushion gas, or charged to underground storage expense. The costs associated with either of these accounting treatments are base rate recoverable costs, not PGA recoverable costs.

Q. When did CIPS begin using the present method?

A. According to the Company's response to Staff Data Request DLH-5.02, CIPS began using this method in November 2003.

Q. How did CIPS account for this lost gas prior to 2003?

A. Prior to 2003, the Company made periodic adjustments to reclassify the gas from working gas to cushion gas. As discussed previously, the change in accounting methods was due to CILCO's treatment of lost gas.

Q. Would you summarize your position on the accounting for the gas lost in storage?

A. The PGA does not allow the cost of gas to be charged to customers until it is available for consumption. This is precisely why the cost of purchased gas that is injected into storage is deducted from gas costs and charged to storage inventory. The cost of the gas is held in an inventory account until it is withdrawn and delivered to the customer. In fact, the lost gas in question here has never left the storage field in the form of withdrawals. Any loss of this gas while in storage is the result of, and a cost associated with, the operation of a company-owned storage field. It does not become part of the cost of the remaining working gas inventory and as such, is not a recoverable gas cost as defined by Section 525.40 of the Commission's PGA rules. Only the costs associated with leased storage are allowed to be recovered through the PGA. Costs associated with the development, operation, and maintenance of company-owned storage fields can only be recovered through a company's base rates.

Q. Has the Commission previously addressed the issue the recoverability of CILCO's lost gas through the PGA?

A. Yes. In Docket No. 02-0717 ("the CILCO case"), the Commission gave the clear directive that:

> ...at the earliest time possible, CILCO is to change the manner in which it treats these costs and recover them through base rates rather than through the PGA. (Commission Conclusion, p. 5)

In that Docket, based on facts and circumstances clearly distinguishable from those in the instant case, the Commission allowed CILCO to recover the cost of lost gas through the PGA.

Q. How are the facts and circumstances that led to the Commission's limited grant of recovery to CILCO in Docket No. 02-0717 distinct from the instant proceeding?

A. In the Order in Docket No 02-0717, the Commission noted that a rate case, Docket No. 02-0837, was pending simultaneously with the PGA reconciliation, but that although Staff conceded that these costs were recoverable in base rates, no adjustment was made in the rate case to allow for the cost of lost gas from storage. CILCO had agreed to a rate freeze until October 2005. Thus disallowance of the costs would deny recovery of these costs from 2002 through most of 2005. Under those circumstances, the Commission found that disallowance of the costs would violate the principles of fairness concerning the recovery of costs. (Order, p. 5)

Another difference between the CILCO case and the instant proceeding is that CILCO used its method of accounting for lost gas for many years. In contrast, 2003 is the first time CIPS utilized this method.

Other Adjustments

Q. Please describe ICC Staff Exhibit 1.00, Schedule 1.04, Adjustment for Rotherwood Storage Discrepancy.

A. Schedule 1.04 reflects my adjustment to correct for a $69,773 discrepancy between the Company's inventory analysis worksheet balance of storage in its Rotherwood field, and its general ledger balance of that same field. My adjustment is related to an adjustment the Company made to correct for an error in 1998, when the Rotherwood storage field was taken out of service, but the gas expense not flowed through the PGA. (Company response to Staff Data Request GS-12)

After review of numerous Company documents and data request responses, the Company is unable to support why its general ledger balance is more accurate than its inventory analysis worksheets.

(Company responses to Staff Data Requests DLH-2.02, 2.06, and 4.04) In the absence of supporting documentation, the Company should not be allowed to recover the higher, unsupported amount from its general ledger, when the inventory analysis worksheets do not verify that amount. Therefore, my adjustment is necessary and appropriate.

Q. Please describe ICC Staff Exhibit 1.00, Schedule 1.05, Adjustment for Interest Expense Charges.

A. Schedule 1.05 reflects my adjustment to remove delayed payment interest charges of $384 from commodity gas recoverable costs for 2003. The charges were incurred when various pipeline invoices were not paid in a timely manner. (Company Response to Staff Data Request GS-5) Ratepayers should not have to pay for avoidable costs; shareholders should bear responsibility for late payment charges.

<u>Summary</u>

Q. Please summarize your recommendations.

A. I recommend that the Commission accept the reconciliation of revenues collected under the purchased gas adjustment clause with actual costs as reflected on ICC Staff Exhibit 1.00, Schedule 1.01. I also recommend that the Company implement the Factor O refund of $319,724 in the first monthly PGA filing after the date of the Order in this proceeding.

Q. Does this conclude your prepared direct testimony?

A. Yes, it does.

Docket No. 03-06
ICC Staff Exhibit
Schedule 1.01

Central Illinois Public Service Company
Reconciliation of Purchased Gas Adjustment Clause
For the Twelve Months Ended December 31, 2003
(In Dollars)

Line No.		Commodity (A)	Demand (B)	TPC (C)	Total (D)
1	Unamortized Balance as of 12/31/2002 per 2002 Reconciliation	$ 709,943	$ -	$ -	$ 709,943
2	Factor A Adjustments Amortized to Schedule 1 at 12/31/2002	385,282	4,544,387	(912)	4,928,757
3	Factor O Collected/(Refunded) During 2003	-	-	-	-
4	Balance to be Collected/(Refunded) During 2003 from prior periods (sum of lines 1-3)	$ 1,095,225	$ 4,544,387	$ (912)	$ 5,638,700
5	2003 Gas Costs	$ 95,691,070	$ 23,356,102	$ -	$ 119,047,172
6	2003 PGA Revenues	(96,412,796)	(23,298,285)	-	$ (119,711,081)
7	Pipeline Surcharges/(Refunds)	-	-	-	$ -
8	Other Adjustments (Rounding)	-	(2)	-	$ (2)
9	Interest	(781)	-	-	$ (781)
10	2003 Under/(Over) Recovery (sum of lines 5-9)	$ (722,507)	$ 57,815	$ -	$ (664,692)
11	Under/(Over) Recovery Balance at 12/31/2003 (line 4 + line 10)	$ 372,718	$ 4,602,202	$ (912)	$ 4,974,008
12	Factor A Adjustments Amortized to Schedule 1 at 12/31/2003	$ 692,442	$ 4,602,202	$ (912)	$ 5,293,732
13	Unamortized Balance as of 12/31/2003	$ -	$ -	$ -	$ -
14	Requested Factor O (line 11 - line 12 - line 13)	$ (319,724)	$ -	$ -	$ (319,724)

Central Illinois Public Service Company
Summary of Adjustments
For the Twelve Months Ended December 31, 2003
(In Dollars)

Line No.	Description (A)	Amount (B)	Source (C)
1	2003 Commodity Gas Costs per Company	$ 96,010,794	Company Schedule LAM-CIP-1, line 5
2	Adjustment for Lost Gas	(249,567)	Schedule 1.03,page 1, line 3
3	Adjustment for Rotherwood Storage Discrepancy	(69,773)	Schedule 1.04, line 3
4	Adjustment for Interest Expense Charges	(384)	Schedule 1.05, line 3
5	2003 Commodity Gas Costs per Staff	$ 95,691,070	Sum of lines 1 through 4 To Staff Schedule 1.01 line 5

Central Illinois Public Service Company
Adjustment for Lost Gas
For the Twelve Months Ended December 31, 2003
(In Dollars)

Line No.	Description (A)	Amount (B)	Source (C)
1	Sciota Adjustment per Staff	$ (148,200)	Schedule 1.03, page 2, line 8
2	Johnson City Adjustment per Staff	(101,367)	Schedule 1.03, page 3, line 3
3	Total Staff Proposed Adjustment for Storage Working Gas	$ (249,567)	Line 1 + line 2

Central Illinois Public Service Company
Adjustment for Lost Gas
For the Twelve Months Ended December 31, 2003

Sciota Field

Line No.	Description (A)	Cost per MCF (B)	Volumes (C)	Source (D)
1	Bal. prior to Nov. adjustment		981,726	Response to DLH-2.02 p. 43 line 8
2	December injections		6,816	Response to DLH-2.02 p. 47 line 6
3	December withdrawals		(12,552)	Response to DLH-2.02 p. 47 line 9
4	Adjusted Ending Dec. Balance		975,990	Sum of lines 1 through 3
5	Cost/MCF prior to Nov. adjmt	3.877127		Response to DLH-2.02 p. 43 line 8
6	Cost/MCF after Nov. adjmt	4.028973		Response to DLH-2.02 p. 43 line11
7	Price difference due to adjmt	-0.151846		Line 6 - line 5
8	Staff Proposed Adjustment	$ (148,200.18)		Line 7 multiplied by line 4

Central Illinois Public Service Company
Adjustment for Lost Gas
For the Twelve Months Ended December 31, 2003
(In Dollars)

Johnson City Field

Line No.	Description (A)	Amount (B)	Source (C)
1	Storage Adjustment per Staff	$ -	Staff Testimony
2	Storage Adjustment per Company	101,367	Response to DLH-2.02 p. 44 line 9
3	Staff Proposed Adjustment to Commodity Gas Costs	$ (101,367)	Line 1 - line 2

Central Illinois Public Service Company
Adjustment for Rotherwood Storage Discrepancy
For the Twelve Months Ended December 31, 2003
(In Dollars)

Line No.	Description (A)	Amount (B)	Source (C)
1	Rotherwood Storage Balance per Inventory Worksheets	$ 328,669	Company Responses to Staff Data Requests DLH-2.04, 2.06, and 4.04
2	Rotherwood Storage Balance per General Ledger	398,442	Same as above
3	Staff Proposed Adjustment to Commodity Gas Costs	$ (69,773)	Line 1 - line 2

Central Illinois Public Service Company
Adjustment for Interest Expense Charges
For the Twelve Months Ended December 31, 2003
(In Dollars)

Line No.	Description (A)	Amount (B)	Source (C)
1	Interest Expense per Staff	$ -	Staff Testimony
2	Interest Expense per Company	384	Company Response to Staff Data Request GS-5
3	Staff Proposed Adjustment to Commodity Gas Costs	$ (384)	Line 1 - line 2