

DIRECT TESTIMONY

OF

DIANNA HATHHORN

Accountant

Accounting Department

Financial Analysis Division

Illinois Commerce Commission

Aqua Illinois, Inc. and
Elwood Greens Utility Corporation

Petition for Approval of Proposed Reorganization and Approval of Asset Purchase Agreement; Petition for Issuance of Certificate of Public Convenience and Necessity to Operate Wastewater System; and Approval of Rates and Accounting Entries

Docket No. 09-0335

November 6, 2009

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SCHEDULES

Schedule 2.01	Recommended Change to Company Proposed Journal Entry #2 to Record Purchase at Closing
Schedule 2.02	Recommended Change to Company Proposed Journal Entry #3 to Record Acquisition Adjustment

ATTACHMENT

Attachment A	Company Responses to Staff Data Requests DLH-1.02 and JF-1.05
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1 **Witness Identification**

2 Q. Please state your name and business address.

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

5

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

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

10

11 Q. Please describe your professional background and affiliations.

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

17

18 Q. Have you previously testified before a regulatory body?

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

20

21 **Purpose of Testimony**

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

23 A. The purpose of my testimony is to review Aqua Illinois, Inc.'s ("Aqua" or "the
24 Company") and Ellwood Greens Utility's ("Ellwood") filing and make
25 recommendations. Specifically, my testimony addresses Section 7-204(b)(2),
26 (3) and 7-204(c) of the Public Utilities Act ("Act") with respect to the
27 reorganization application. It also addresses the accounting treatment of the
28 reorganization transaction.

29

30 **Schedule Identification**

31 Q. Are you sponsoring any schedules with your testimony?

32 A. Yes. I prepared the following schedules:

33 Schedule 2.01 Recommended Change to Company Proposed Journal
34 Entry #2 to Record Purchase at Closing

35
36 Schedule 2.02 Recommended Change to Company Proposed Journal
37 Entry #3 to Record Acquisition Adjustment
38

39 Q. Are you including any attachments as part of ICC Staff Exhibit 2.0?

40 A. I have included the following attachment that presents information provided
41 by the Company in response to ICC Staff Data Requests:

42 Attachment A Company responses to Staff Data Requests DLH-1.02
43 and JF-1.05
44

45 **Section 7-204(b)(2) and (3)**

46 Q. Has the Company offered testimony concerning Section 7-204?

47 A. Yes. Specifically, I reviewed the testimony concerning the claims that the
48 proposed reorganization:

- 49 • will not result in the unjustified subsidization of non-utility activities by
50 the regulated utility or by Illinois customers, [7-204(b)(2)]; and
- 51 • will provide for the fair and reasonable allocation of cost between the
52 utility and non-utility activities in such a manner that the Commission
53 may identify those costs and facilities which are properly included by
54 the utility for ratemaking purposes, [7-204(b)(3)].

55

56 Q. Does the Company's testimony adequately address the Sections listed
57 above?

58 A. Yes. Aqua witness Hanley addresses the issue of no unjustified
59 subsidization of non-utility activities by Aqua or its customers. (Aqua Ex. 2.0,
60 p. 5). Mr. Hanley explained that, at present, neither Aqua nor Ellwood
61 engage in a significant level of such activity. He further stated to the extent
62 Aqua engages in such activities in the future, it will continue to maintain its
63 books and records in such a manner as to fairly and reasonably allocate
64 utility and non-utility activities and allow the Commission to identify costs and
65 facilities that are properly included for ratemaking purposes. *Id.*

66

67 **Section 7-204(c)**

68 Q. Has the Company offered testimony concerning Section 7-204(c), which

69 states that the Commission shall not approve a reorganization without ruling
70 on (i) the allocation of any savings resulting from the proposed organization
71 and (ii) whether the companies should be allowed to recover any costs
72 incurred in accomplishing the proposed reorganization and, if so, the amount
73 of costs eligible for recovery and how the costs will be eligible?

74 A. The Company did not address any allocation of savings resulting from the
75 proposed reorganization but stated in its amended response to Staff Data
76 Request DLH-3.01 that there are no savings anticipated, as the projected
77 capital expenditures and operating costs will exceed the current revenue
78 generated by the system. Concerning costs, the Company proposes to
79 recover an estimated \$25,000 in transaction costs as an increase to rate
80 base. However, as I discuss below, I do not agree with this accounting
81 treatment. There are no other costs of the proposed reorganization
82 (Company Response to Staff Data Request DLH-3.02).

83

84 **Transaction Analysis**

85 Q. Has Aqua offered testimony concerning the accounting treatment of the
86 proposed reorganization?

87 A. Yes. Aqua witness Hanley addresses the accounting treatment of the
88 proposed reorganization.

89

90 Q. Do you have any objections to the proposed accounting treatment by the

91 Aqua?

92 A. Yes. I recommend that certain costs discussed by Aqua Witness Hanley as
93 transaction costs and identified at Journal Entry #2 be accounted for as costs
94 of the acquisition rather than capitalized as organizational costs, as proposed
95 by the Company. My proposal would increase the purchase price of the
96 acquisition and increase the positive acquisition adjustment.

97

98 Q. Please discuss the Uniform System of Accounts for Sewer Utilities, 83 Ill.
99 Adm. Code 650 ("USOA") instructions regarding the transaction and Aqua's
100 proposed journal entries (Aqua Exhibit 2.1).

101 A. The USOA's Instruction 21, Item A, states the cost of the acquisition
102 including incidental expenses thereto shall be charged to Account 104-Utility
103 Plant Purchased or Sold. Further, the USOA's Instructions to Account 104
104 state, among other things, that this account should be charged with the cost
105 of utility plant acquired by purchase. The Company's Journal Entry #1
106 accurately reflects this guidance.

107

108 However, in Journal Entry #2, the Company itemized its estimated costs of
109 acquisition to include settlement costs including recording fees, title transfer
110 costs, insurance, and legal fees, and proposed to record them in Account
111 351, Organization. (Attachment A-Company Responses to Staff Data
112 Request DLH-1.02 and JF-1.05) In testimony, Mr. Hanley also states that

113 Aqua will incur costs for inspection and engineering. (Aqua Exhibit 2.0, page
114 3, line 56)

115

116 Q. Has the Company correctly classified the \$25,000 in transaction costs to be
117 incurred from the asset purchase?

118 A. No. The Company's transaction costs should be accounted for as costs of
119 the acquisition, since they are not consistent with the types of costs intended
120 for organizational costs, as provided for in the following instruction to
121 Account 351:

122 This account shall include all fees paid to federal or state
123 governments for the privilege of incorporation and expenditures
124 incident to organizing the corporation, partnership or other
125 enterprise and putting it into readiness to do business.
126

127 The costs the Company has or expects to incur, as described in Journal
128 Entry #2, are more accurately defined as costs incurred to purchase the
129 system, not to reorganize the corporation of Aqua, and thus should be
130 treated as an added cost to purchase the Ellwood system.

131

132 Q. How does change to the accounting of the settlement costs affect the
133 Company's proposed Journal Entry #2?

134 A. The USOA Instruction 21 B (6) requires the amount remaining in Account
135 104 Utility Plant Purchased or Sold to be closed to Account 114 Utility
136 Acquisition Adjustments. My recommendations increase the Company's

137 acquisition adjustment in Account 114 as follows:

138

Line No.	Description (a)	Per Company (b)	Per Staff (c)
1	Purchase Price	\$ 115,000	\$115,000
2	Transaction Costs		25,000
3	Total Purchase Price	<u>\$ 115,000</u>	<u>\$140,000</u>
4	Original Cost:		
5	Net Plant	\$ 91,966	\$ 91,966
6	Acquisition Adjustment (line 3 - line 5)	<u>\$ 23,034</u>	<u>\$ 48,034</u>

139

140 Therefore, in order to be consistent with the USOA Instruction 21 and
 141 definitions of Account 114, Utility Acquisition Adjustments and Account 351,
 142 Organization, I recommend a change to the Company's proposed entry to
 143 record \$25,000 as costs of the acquisition rather than organizational costs.
 144 This change is reflected in my Schedule 2.01. It increases the debit or
 145 positive acquisition adjustment from \$23,034 to \$48,034.

146

147 A positive acquisition adjustment means the Company paid in excess of the
 148 original cost of the assets, in this case, by \$48,034. Thus, Aqua will earn a
 149 rate of return on the original cost of the assets (\$91,966) rather than the
 150 amount Aqua paid for the assets (\$140,000).

151

152 Q. Does your adjustment in Journal Entry #2 affect Journal Entry #3, recording
153 of the positive acquisition adjustment upon final approval and closing? (Aqua
154 Exhibit 2.1)?

155 A. Yes. Since Journal Entry #2 changed the amount of the acquisition
156 adjustment, in my Schedule 2.02 I present a revised Journal Entry #3
157 reflecting that amount to be recorded upon final approval and closing. I have
158 no objection to the Company's proposal to record the acquisition adjustment
159 in Account 421 Non Utility Income-Other, which is a below the line account.

160

161 Q. Has the Commission previously adopted the accounting treatment for costs
162 to acquire the assets of another utility as you recommend here?

163 A. Yes. In a previous proceeding before the Commission, Consumers Illinois
164 Water Company, which is the former name of Aqua Illinois, Inc, ("CIWC")
165 accepted, and the Commission adopted, Staff's same recommendation to
166 treat original cost study expense, legal fees, outside contractor costs, and
167 company overheads as incidental costs of the acquisition of the water
168 treatment and distribution system of the Village of Aroma Park, in Docket
169 Nos. 00-0784/00-0785 Consolidated. (Order, May 23, 2001, p. 8)

170

171 Additionally, in CIWC's acquisition of the water supply and distribution
172 system in Vermillion County, CIWC again accepted, and the Commission
173 adopted, Staff's same recommendation to record estimated costs of

174 acquisition for original cost study expenses and legal fees as incidental costs
175 of the acquisition rather than organizational costs as originally proposed.
176 (Docket No. 03-0069, October 22, 2003, p. 5)

177

178 **Recommendation Concerning Final Accounting Entries**

179 Q. Do you have any recommendations concerning the journal entries?

180 A. Yes. I recommend Aqua file with the Commission the final accounting
181 entries for the transaction, showing the actual dollar values of all involved
182 accounts, as a filing on the Commission's e-Docket system with a copy of to
183 the Commission's Accounting Department Manager and to the Office of the
184 Chief Clerk of the Commission within sixty (60) days after the transaction
185 date. If the transaction has not occurred within six months after the Final
186 Order in this proceeding, the Company shall submit a status report in the
187 same manner described above. Aqua has agreed to this recommendation in
188 response to Staff Data Request DLH-2.01.

189

190 **Summary of Conclusions and Recommendations**

191 Q. Please summarize your recommendation.

192 A. I recommend that the Commission find that

- 193 • the proposed reorganization will not result in the unjustified subsidization of
194 non-utility activities by the utility or its customers [Section 7-204(b)(2)];

- 195 • costs and facilities are fairly and reasonably allocated between utility and
196 non-utility activities in such a manner that the Commission may identify those
197 costs and facilities which are properly included by the utility for ratemaking
198 purposes [Section 7-204(b)(3)];
- 199 • there are no anticipated savings from the proposed reorganization [Section
200 7-204(c)];
- 201 • the Company's proposal to include its anticipated \$25,000 in transaction
202 costs as proposed Journal Entry #2 in Aqua Exhibit 2.1 should be denied
203 [Section 7-204(c)];
- 204 • Rather, the Commission should order the Company to record the transaction
205 costs of the acquisition as costs of the acquisition as reflected in Schedule
206 2.01;
- 207 • the Company's proposed Journal Entry #1 in Aqua Exhibit 2.1 should be
208 approved;
- 209 • the Company should record its positive acquisition adjustment of \$48,034 as
210 reflected in Schedule 2.02; and
- 211 • the Company shall file the final accounting entries for the transaction,
212 showing the actual dollar values of all involved accounts, as a filing on the
213 Commission's e-Docket system with a copy of to the Commission's
214 Accounting Department Manager and to the Office of the Chief Clerk of the
215 Commission within sixty (60) days of the transaction date. If the transaction

216 has not occurred within six months of the Final Order in this proceeding, the

217 Company shall submit a status report in the same manner described above.

218 **Conclusion**

219 Q. Does this question end your prepared direct testimony?

220 A. Yes.

ILLINOIS COMMERCE COMMISSION

AQUA ILLINOIS, INC'S RESPONSE TO STAFF DATA REQUEST DLH 1.02

Utility Company: AQUA ILLINOIS, INC.

Docket No. 09-0335

Date Submitted: 09/17/09

Submitted By: Paul J. Hanley, Controller of Aqua Illinois, Inc.
(815) 935-6535 ext. 533

DLH-1.02 Referring to page 2 of Aqua Exhibit 2.0, the direct testimony of Paul J. Hanley, lines 55-63 stating in part, "the transaction costs, totaling \$25,000...and debited to account 351 – Organization Costs." please explain why the Company believes it is appropriate to record the transaction related expenses in Account 351, Organization.

RESPONSE: I want to segregate the costs to acquire the System from the physical assets of the System. Recording these costs to account 351 - Organization costs offers Aqua the ability to separately account for these costs as part of Rate Base.

ILLINOIS COMMERCE COMMISSION

AQUA ILLINOIS, INC.'S RESPONSE TO STAFF DATA REQUEST JF 1.05

Utility Company: AQUA ILLINOIS, INC.

Docket No. 09-0335

Date Submitted: 09/17/09

Submitted By: Paul J. Hanley, Controller of Aqua Illinois, Inc.
(815) 935-6535 ext. 533

JF 1.05 Please describe each and every internal administrative cost (e.g. inspection, engineering, legal and other transaction related expenses) that Aqua expects to incur in connection with the transaction. Additionally, provide an itemized list of those expenses, including the dollar amounts related to each item individually. Include supporting documentation in the response.

RESPONSE: The \$25,000 is an estimate. If these costs come in less than anticipated, then I will adjust the recording of the acquisition accordingly. Here is an estimated list of expenses.

Settlement Costs (recording fees, title transfer costs, insurance, etc.)	\$2,000
Legal	<u>\$23,000</u>
Total internal administrative costs	\$25,000

Aqua Illinois, Inc
Recommended Change to Company Proposed
Journal Entry # 2 to Record Purchase at Closing

Line No.	Account Number	Account Description	Entries Per Company (1)		Staff Proposed Adjustment (2)		Final Entry Per Staff	
			Debit (c)	Credit (d)	Debit (e)	Credit (f)	Debit (g)	Credit (h)
1	Various	Utility Plant in Service	\$437,762				\$437,762	
2	271	Contributions in Aid of Construction ("CIAC")		\$ 332,591				\$ 332,591
3	272	Accumulated Amortization of CIAC	\$332,591				\$332,591	
4	186	Misc. Deferred Debits-Pond Clean-Up	\$ 28,120				\$ 28,120	
5	108	Accumulated Depreciation		\$ 373,916				\$ 373,916
6	104	Utility Plant Purchased or Sold		\$ 140,000				140,000
7	351	Organizational Costs	\$ 25,000			\$ 25,000		0
8	114	Acquisition Adjustment	\$ 23,034		\$ 25,000		\$ 48,034	
9		Total	\$846,507	\$ 846,507	\$ 25,000	\$ 25,000	\$846,507	\$ 846,507

(1) Aqua Exhibit 2.1, Summary of Journal Entry #2

(2) To record the transactional costs of the acquisition in Account 104 rather than Account 301, consistent with Accounting Instruction 21 of the Uniform System of Accounts.

Aqua Illinois, Inc.
Recommended Change to Company Proposed
Journal Entry #3 to Record Acquisition Adjustment

Line No.	Account Number	Account Description	Entries Per Company (1)		Staff Proposed Adjustment (2)		Final Entry Per Staff	
			Debit	Credit	Debit	Credit	Debit	Credit
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
1	421	Non Utility Income- Other	\$ 23,034		\$ 25,000		\$ 48,034	
2	115	Accum. Amort. Of Utility Plant Acquisition Adjustment		\$ 23,034		25,000		\$ 48,034

(1) Aqua Exhibit 2.1, Journal Entry #3
 (2) ICC Staff Exhibit 2.0, Schedule 2.01