

ILLINOIS COMMERCE COMMISSION

DOCKET 09-0400

IAWC EXHIBIT 3.00

SUPPLEMENTAL REBUTTAL TESTIMONY OF

EDWARD J. GRUBB

ILLINOIS-AMERICAN WATER COMPANY

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1 **SUPPLEMENTAL REBUTTAL TESTIMONY**
2 **OF**
3 **EDWARD J. GRUBB**

4
5 **I. WITNESS INTRODUCTION**

6 **Q1. Please state your name.**

7 A. My name is Edward J. Grubb.

8 **Q2. Are you the same Edward Grubb who previously provided testimony in this**
9 **proceeding?**

10 A. Yes.

11 **II. PURPOSE OF TESTIMONY**

12 **Q3. What is the purpose of your Direct Testimony?**

13 A. The purpose of my Supplemental Rebuttal Testimony is to provide additional
14 information regarding the accounting policies related to IAWC's petition for
15 authority to change the accounting methodology used to record pension and
16 other post-employment benefits ("OPEB") costs.

17 **III. ACCOUNTING POLICIES**

18 **Q4. Please describe the Company's present approach to accounting for**
19 **pension and OPEB costs.**

20 A. As discussed in my direct testimony, in keeping with the accounting and rate-
21 making treatment of pension and OPEB costs approved by the Commission in
22 past proceedings (such as in IAWC's prior rate case, Docket 07-0507), IAWC
23 presently records the accrued amount of each respective cost, as determined
24 under the applicable accounting standard, in USOA Account 604 (for both
25 pension and OPEB cost). The applicable accounting rules are Financial

26 Accounting Standards Board Statement No. 87 ("FAS 87") in the case of pension
27 expense and Financial Accounting Standards Board Statement No. 106 ("FAS
28 106") in the case of OPEB. The accrued amounts of each respective cost are
29 determined on the basis of an actuarial study. Under the Company's proposed
30 accounting change, actuarial studies will continue to be prepared to determine
31 the costs for pension and OPEB. The Commission has indicated in prior orders
32 that the amounts of pension and OPEB costs accrued for a given year under
33 FAS 87 and FAS 106, respectively, should be recorded (and for a rate case test
34 year recovered in rates) because the FAS 87 and FAS 106 amounts
35 appropriately reflect the amounts of pension and OPEB expense that are
36 associated with utility service provided during the year.

37 **Q8. What accounting approach does the Company now propose?**

38 A. As discussed in detail in my direct and rebuttal testimony, due to the fluctuating
39 pattern of pension and OPEB costs, IAWC concluded that reconsideration of the
40 approach used to record pension and OPEB costs for accounting purposes was
41 warranted. Specifically, IAWC proposes to account for pension and OPEB costs
42 in a manner similar to that used for other costs that fluctuate in amount from year
43 to year, namely, recording these costs in USOA Account 186.

44 **Q5. Why is use of Account 186 appropriate?**

45 A. USOA Account 186, Miscellaneous Deferred Debits, is defined as follows:

46 This account shall include all debits not elsewhere provided
47 for, such as miscellaneous work in progress, losses on
48 disposition of property net of income taxes, deferred by
49 authorization of the Commission, unusual or extraordinary
50 expenses and regulatory assets resulting from ratemaking
51 actions, not included in other accounts, which are in process

52 of amortization, and items the proper final disposition of
53 which is uncertain.

54 The language of Account 186 does not expressly require Commission approval
55 to defer expenses, other than “losses on disposition of property net of income
56 taxes.” For certain costs recorded in Account 186, such as tank painting
57 expense discussed below, no prior Commission approval is sought or required to
58 record the deferred amount. However, the Commission has in prior orders
59 addressed the methodology to be used for the recording of pension and OPEB
60 costs. Accordingly, the Company is submitting its proposal to utilize an
61 alternative accounting approach for the recording of pension and OPEB costs in
62 accordance with Accounting Instruction 5 of the USOA (adopted by the
63 Commission pursuant to 83 Ill. Adm. Code Section 605.10). That Instruction
64 states that a utility may submit questions of accounting interpretation to the
65 Commission for a decision.

66 **Q6. Please explain the proposed change in methodology for accounting of**
67 **pension and OPEB costs.**

68 A. Commencing with the year 2009, IAWC proposes that the respective annual
69 amount of pension and OPEB currently reflected in rates as approved by the
70 Commission in Docket 07-0507 (the “Docket 07-0507 Amount”) would continue
71 to be recorded in Account 604 (pension and employee benefits). For each
72 respective cost, the amount determined for the year under the applicable
73 accounting standard that is above the Docket 07-0507 cost amount (the
74 “Amortization Amount”) would be amortized over a five year period, and deferred
75 in USOA Account 186. This approach would continue in succeeding years until

76 the Commission approves a return to the prior or other accounting methodology
77 for use in recording these expenses.

78 **Q9. Have you prepared an example of the accounting entries which would be**
79 **used under this approach?**

80 **A.** Yes. They are attached as IAWC Exhibits 3.01 and 3.02.

81 **Q10. Are there general accounting policies which govern IAWC's ability to**
82 **record the proposed deferral of pension and OPEB costs on its books?**

83 **A.** Yes. The deferral of costs by IAWC is covered by the Financial Accounting
84 Standards Board Statement 71 ("FAS 71") (see IAWC Exhibit 3.03). Under FAS
85 71, what IAWC refers to as "deferral" of a cost is termed "capitalize," indicating
86 that the cost would be recorded as the cost of an asset. To "capitalize" (i.e.
87 defer) an "incurred cost" and create a "regulatory asset," FAS 71 requires that
88 IAWC be a regulated enterprise under the three criteria of paragraph 5 of FAS
89 71. Under paragraph 9 of FAS 71, a regulated entity shall capitalize all or part of
90 an incurred cost that would otherwise be charged to expense if both of the
91 following criteria are met: (a) it is probable that future revenue in an amount at
92 least equal to the capitalized cost will result from inclusion of that cost in
93 allowable costs for ratemaking purposes; and (b) based on available evidence,
94 the future revenue will be provided to permit recovery of the previously incurred
95 cost rather than to provide for expected levels of similar future cost. Thus, it
96 must be probable that cost recovery of the capitalized (deferred) cost will be
97 allowed by the regulator. Paragraph 77 of FAS 71 also provides a discussion of
98 unusual or unpredictable costs. Paragraph 77 of FAS 71 concludes that costs

99 should be capitalized only if the future revenue is expected to be provided to
100 permit recovery of the previously incurred cost rather than merely to provide for
101 recovery of higher levels of similar future costs.

102 **Q11. How does IAWC determine if deferral is allowed under FAS 71?**

103 **A.** IAWC's management has the responsibility to determine the probability of rate
104 recovery of any deferral under FAS 71. Management will review all available
105 information, such as applicable Commission Orders, to determine the probability
106 of recovery for the amounts deferred under FAS 71.

107 **Q7. Does this conclude your Supplemental Testimony?**

108 **A.** Yes.

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