

**DIRECT TESTIMONY**

of

**Thomas Q. Smith**

**Accounting Department  
Financial Analysis Division  
Illinois Commerce Commission**

**Petition for a Certificate of Public Convenience and Necessity to provide  
water service to areas in and near the Village of Bolingbrook, Will and  
DuPage Counties, pursuant to Section 8-406 of the Public Utilities Act.**

**Illinois-American Water Company  
Docket No. 01-0001**

**February 2002**

1 Witness Identification

2 Q. Please state your name and business address.

3 A. My name is Thomas Q. Smith. 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 an Accountant in the Accounting Department of the Financial  
8 Analysis Division of the Illinois Commerce Commission.

9  
10 Q. Please describe your background and professional affiliation.

11 A. In 1974 I received a Bachelor of Arts Degree in Accounting from Michigan  
12 State University. I am a Certified Public Accountant licensed to practice in  
13 Illinois, Michigan, and Wisconsin. My prior accounting experience  
14 includes seven years as an auditor with the Michigan Public Service  
15 Commission. Subsequently, I was employed for three years by Wisconsin  
16 Southern Gas Company in the initial capacity of Senior Accountant - Rate  
17 Specialist and later as Controller. I am a member of the American  
18 Institute of Certified Public Accountants.

19  
20 Q. Have you previously testified before regulatory bodies?

21 A. Yes, I have testified on several occasions before the Illinois Commerce  
22 Commission, the Michigan Public Service Commission, and the Public  
23 Service Commission of Wisconsin.

24 Q. What is the function of the Accounting Department of the Illinois  
25 Commerce Commission?

26 A. The Department's function is to monitor the financial condition of public  
27 utilities as part of the Commission's responsibilities under Article IV of the  
28 Public Utilities Act and to provide accounting expertise on matters before  
29 the Commission.

30

31 Q. What are your responsibilities in this case?

32 A. I have been assigned to this case by the Manager of the Accounting  
33 Department of the Illinois Commerce Commission. I am to review Illinois-  
34 American Water Company's ("Illinois-American" or "Company") filing,  
35 analyze the underlying data and make recommendations as appropriate.

36

37 Purpose of Testimony

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

39 A. My testimony addresses the accounting for the original cost of the plant  
40 net of contributions in aid of construction ("CIAC") being acquired from the  
41 Village of Bolingbrook, the cost of acquiring the property, and the need for  
42 the Company to provide the final journal entries once the property has  
43 been acquired.

44

45 Q. Are you sponsoring any schedules as part of ICC Staff Exhibit 2?

46 A. Yes. I prepared, and am sponsoring, the following schedules for the  
47 Company:

48	Schedule 1	Adjustment of Journal Entries
49	Schedule 2	Consolidation of Plant and Depreciation
50		Journal Entries
51	Schedule 3	Adjustment to Accumulated Amortization of
52		CIAC.
53		

54 Q. What portions of the Company's filing have you reviewed?

55 A. I reviewed the direct testimonies of Bob Kahn, Reed T. Scheppmann, and  
56 John F. Guastella. I have also reviewed the Petition and the  
57 Commission's Interim Order of March 7, 2001.

58

59 Q. What is your understanding of the Company's request in this Docket?

60 A. Illinois-American is requesting approval to acquire certain water assets  
61 currently owned by the Village of Bolingbrook in exchange for assets  
62 currently owned by Illinois-American's.

63

64 Contributions in Aid of Construction

65 Q. Have you reviewed Illinois-American's filing as it relates to the cost of the  
66 plant which is being acquired?

67 A. Yes, I have reviewed cost data as contained primarily in the Direct  
68 Testimony of John F. Guastella along with his supporting exhibits. It is my  
69 understanding that the Village of Bolingbrook, as is customary for most  
70 governmental water/sewer systems, did not maintain its records in such a  
71 way that the original cost of the utility assets can be identified. As a result  
72 it was necessary for the Company to estimate original cost and  
73 contributions in aid of construction.

74

75 Q. Why is it necessary to determine the original cost of the assets at issue in  
76 this Docket?

77 A. It is important to know the original cost of utility assets, because the  
78 Uniform System of Accounts (“USOA”) requires that when utility plant is  
79 acquired it must be recorded in the utility’s sub-accounts of account 101,  
80 utility plant in service, at the cost of that plant, when it was first devoted to  
81 providing utility service to the public. The USOA further requires that any  
82 difference between the net original cost of the plant, and the cost of  
83 acquiring the plant, be recorded by the acquiring company in account 114,  
84 plant acquisition adjustment.

85

86 In this case the Company’s witness Guastella prepared an estimate of the  
87 original cost of plant and contributions in aid of construction. Staff witness  
88 Roy King has proposed changes to the Company’s estimate of CIAC.

89

90 Q. Did the Company prepare an exhibit which identifies its proposed  
91 accounting entries to record this transaction?

92 A. Company Exhibit JFG – 2 contains the Company’s proposed accounting  
93 entries to record this transaction.

94

95 Q. Do any of the Company’s proposed accounting entries need to be  
96 changed as a result of Mr. Kings proposed changes to the Company’s  
97 estimate of CIAC?

98 A. Yes. I have prepared ICC Staff Exhibit 2, Schedule 1, Adjustment of  
99 Journal Entries. Schedule 1 summarizes the changes to accounting  
100 entries which result from Staff's estimate of contributions in aid of  
101 construction, Staff's estimate of accumulated amortized CIAC, and the  
102 removal from account 301 of the cost of acquiring the property.

103

104 Q. Which accounting entries must be changed as a result of Mr. King's  
105 estimate of CIAC?

106 A. Staff witness King is increasing the amount of contributions in aid of  
107 construction by \$1,256,116 as shown on page 5, line 110 of ICC Staff  
108 Exhibit 1. The Company's proposed credit to account 271, as shown on  
109 ICC Staff Exhibit 2, Schedule 1, must be increased to \$6,381,372 as  
110 shown in Column H.

111

112 Q. What is the purpose of ICC Staff Exhibit 2?

113 A. Schedule 2, Consolidation of Plant and Depreciation Journal Entries,  
114 combines all of the various plant and accumulated depreciation categories  
115 shown on Company Exhibit JFG – 2 into two line items for presentation on  
116 my Schedule 1.

117

118 Accumulated Amortization of Contributions in Aid of Construction

119 Q. Are any other estimated amounts appearing on Illinois-American's Exhibit  
120 JFG-2 impacted by Mr. King's estimate of CIAC?

121 A. Yes, the amount of accumulated amortization of CIAC is directly

122 dependent on the level of CIAC, and it is thus impacted by Mr. King's  
123 adjustment to CIAC. I have recalculated the proper amount of  
124 accumulated amortization of CIAC to reflect Mr. King's level of CIAC. This  
125 recalculation is shown on ICC Staff Exhibit 2, Schedule 3, Adjustment to  
126 Accumulated Amortization of CIAC.

127

128 Q. Will the recalculation of the estimated amount of accumulated amortization  
129 of CIAC as shown on Schedule 3 affect the accounting entries to record  
130 this purchase?

131 A. Yes, the accounting entries will change as a result of the change in this  
132 item. Schedule 1 shows that the entry to account 272 must be increased  
133 by \$254,758 to arrive at the final debit entry of \$1,294,230 shown in  
134 Column G.

135

136 Cost of Acquisition

137 Q. Illinois-American's Exhibit JFG – 2, includes a debit entry of \$767,819 in  
138 account 301. What does this entry represent?

139 A. The Company's exhibit indicates that this item represents the cost of  
140 processing the transaction. This item includes such things as attorney's  
141 fees, appraisals, and cost studies.

142

143 Q. What items are properly recorded in account 301?

144 A. The title of account 301 as shown in the USOA is Organization. The  
145 instructions to account 301 indicate that:

146 This Account shall include all fees paid to federal or  
147 state governments for the privilege of incorporation  
148 and expenditures incident to organizing the  
149 corporation, partnership or other enterprise and  
150 putting it into readiness to do business.  
151

152 Items which are properly recorded in account 301 include costs necessary  
153 for the process to organize, or reorganize, a utility.

154

155 Q. What is the purpose of this proceeding?

156 A. The purpose of this proceeding is to identify the proper value and proper  
157 accounting entries to recognize the acquisition by Illinois-American of  
158 utility property. Illinois-American is not being created, incorporated, or  
159 otherwise organized or reorganized. Because the costs the Company is  
160 recommending be recorded in account 301 were not incurred for purposes  
161 instructed by the USOA, that is, the costs were not incurred for  
162 organizational purposes, these costs should not be recorded in Account  
163 301.

164

165 Q. Please identify how these costs are properly eliminated from  
166 account 301.

167 A. Staff Schedule 1, column F shows that a credit in the amount of \$767,819  
168 will eliminate these costs from account 301.

169

170

171

172 Acquisition Adjustment

173 Q. Staff Schedule 1, column E, includes a \$1,769,177 debit to account 114,  
174 plant acquisition adjustment. What is the purpose of this entry?

175 A. The USOA provides that when utility plant is acquired, the difference  
176 between debit entries and credit entries is recorded in account 114. The  
177 difference between the adjusting debit accounting entries and the  
178 adjusting credit accounting entries which I am proposing is equal to  
179 \$1,769,177, and this amount must be debited to account 114 to result in a  
180 balanced accounting entry. The result of making my proposed  
181 adjustments as discussed previously is a net \$7,207,852 credit to account  
182 114 as shown in column H of Schedule 1. In essence the entries to  
183 account 114 are fallout entries which are required to keep the accounting  
184 records in balance.

185

186 Q. What is the ultimate outcome of the credit to account 114?

187 A. The USOA provides that amounts recorded in account 114 be amortized  
188 as non-operating expense, or in this case, non-operating income. The  
189 result is that the amortization and the un-amortized balance in account  
190 114 are excluded from the rate setting process and have no rate impact.  
191 While the Commission can authorize that account 114 be amortized to  
192 operating income or operating revenue, the Company has not requested  
193 such authorization and I am proposing that no such authorization be  
194 granted.

195

196 Reporting Requirements

197 Q Do you have additional proposals relative to this docket?

198 A. Yes I do. By technical application of the USOA, Illinois-American should  
199 initially record this acquisition in Account 104, Utility Plant Purchased or  
200 Sold. Because account 104 is a temporary account, its use, or lack of  
201 use, does not impact the final result. However, account 104 requires that  
202 the Company provide the Commission with the journal entries to clear  
203 from this account the amounts recorded therein. Because of this  
204 requirement, I propose that the Company be directed to record this  
205 acquisition according to the requirements of Account 104, including the  
206 requirement that it file the final journal entries with the Commission within  
207 6 months of the transaction. Even though not specifically required, I  
208 further recommend that the Company be directed to provide a copy of the  
209 final journal entries to the Manager of the Commission's Accounting  
210 Department.

211

212 Conclusion

213 Q. Please, summarize your recommendations.

214 A. I recommend that:

- 215 1) The Company's proposed credit entry to Account 271 be  
216 increased by \$1,256,116 to \$6,381,372,  
217 2) The Company's proposed debit entry to Account 272 be  
218 increased by \$254,758 to \$1,294,230,

219 3) The Company's proposed debit entry of \$767,819 to Account  
220 301 be eliminated,

221 4) The Company's proposed credit entry to Account 114 be  
222 decreased by \$1,769,177 to \$7,207,852, and

223 5) The Company be directed to file copies of the final journal  
224 entries with the Commission and the Accounting Department  
225 within 6 months of the acquisition of the Plant.

226

227 Q. Does this conclude your prepared direct testimony?

228 A. Yes, it does.

Illinois-American Water Company  
 Adjustment of Journal Entries

Acct No	Title	Journal Entries Per Company		Adjusting Entries		Journal Entries Per Staff	
		Debit	Credit	Debit	Credit	Debit	Credit
A	B	C	D	E	F	G	H
310	Acquisition Cost	\$ 767,819	\$ -	\$ -	\$ 767,819	\$ -	\$ -
101	Plant in Service - Water	30,042,530				30,042,530	
108	Accumulated Depreciation - Water		5,092,310				5,092,310
271	CIAC		5,125,256		1,256,116		6,381,372
272	Accumulated Amortization of CIAC	1,039,472		254,758		1,294,230	
101	Wastewater Assets		12,436,266				12,436,266
108	Accumulated Depreciation on Wastewater	7,951,158				7,951,158	
224	Fixed Payments		9,075,260				9,075,260
	PV Discount	2,589,618				2,589,618	
224	Variable Payments		4,400,000				4,400,000
	PV Discount	2,715,524				2,715,524	
114	Plant Acquisition Adjustment		8,977,029	1,769,177			7,207,852
		<u>\$45,106,121</u>	<u>\$ 45,106,121</u>	<u>\$ 2,023,935</u>	<u>\$ 2,023,935</u>	<u>\$ 44,593,060</u>	<u>\$ 44,593,060</u>

Sources: Accts 101 and 108 (Water) -- ICC Staff Exhibit 2, Schedule 2  
 Other Accounts -- Company Exhibit JFG-2

Illinois-American Water Company  
 Consolidation of  
 Plant and Depreciation Journal Entries

Sub Account <u>A</u>	Title <u>B</u>	Plant <u>C</u>	Accumulated Depreciation <u>D</u>
303	Land & Land Rights	\$ 94,750	\$ -
304	Structures	869,000	244,060
305	Collecting Reservoirs	333,430	112,560
307	Wells & Springs	197,850	74,600
311	Pumping Equipment	160,140	110,680
320	Treatment Equipment	76,840	46,380
330	Distribution Reservoirs	598,130	324,880
331	T & D Mains	20,393,720	2,113,350
333	Services	4,029,510	1,040,950
334	Meters	1,223,860	642,530
335	Hydrants	2,065,300	382,320
		<u>\$30,042,530</u>	<u>\$ 5,092,310</u>
Total			

Source: Citizens Exhibit JFG-2

Illinois-American Water Company  
Adjustment to  
Accumulated Amortization of CIAC

1	Increase in Contributions in Aid of Construction	\$ 1,256,116
2	Contributions in Aid of Construction Per Company	<u>5,125,256</u>
3	Percent Increase in CIAC	24.51%
4	Accumulated Amortization of CIAC Per Company	<u>1,039,472</u>
5	Increase in Accumulated Amortization of CIAC Per Staff	<u>\$ 254,758</u>

Sources:

- Line 1 -- ICC Staff Exhibit 1, page 5, Line 110
- Line 2 -- Citizens Exhibit JFG-2, Account 271
- Line 3 -- Line 1 divided by Line 2
- Line 4 -- Citizens Exhibit JFG-2, Account 272
- Line 5 -- Line 3 times Line 4