BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF OKLAHOMA GAS AND ELECTRIC COMPANY FOR APPROVAL OF A GENERAL CHANGE IN RATES AND TARIFFS	))))	DOCKET NO. 08-103-U

DIRECT TESTIMONY

OF

L.A. RICHMOND
PUBLIC UTILITY AUDIT SUPERVISOR
AUDIT SECTION

ON BEHALF OF THE GENERAL STAFF OF THE
ARKANSAS PUBLIC SERVICE COMMISSION

JANUARY 13, 2009

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INTRODUCTION

Q. Please state your name and business address.

A. My name is L.A. Richmond. My business address is Arkansas Public Service Commission (APSC or Commission), 1000 Center Street, P.O. Box 400, Little Rock, Arkansas 72203-0400.

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

A. I am employed by the General Staff of the Commission (Staff) as an Audit Supervisor in the Audit Section. In addition to providing supervisory support to the Manager of the Audit Section, I assist in analyzing utility company filings, developing related accounting and tax issues, presenting those issues when necessary in written and oral testimony before the Commission, and performing other duties as assigned.

Q. Please describe your educational background and experience

A. I graduated from Harding University with a Bachelor of Arts degree in accounting and business. I am a Certified Public Accountant licensed to practice in Arkansas and I am a member of the American Institute of Certified Public Accountants. Prior to joining Staff in 1998, I practiced in public accounting where I provided audit and income tax services for a variety of clients. I worked as an internal auditor and cost separations supervisor for a large telephone utility. I served as controller and chief financial officer of two closely-held diversified firms. I also worked in banking for several years. Since joining the Staff, I have attended conferences and seminars pertaining to utility issues, including the National Association of Regulatory Utility Commissioners' Annual Regulatory

Studies Program at Michigan State University. I have filed testimony and exhibits before this Commission in several proceedings.

PURPOSE OF TESTIMONY

Q. What is the purpose of your Direct Testimony in this docket?

A. I present the results of Staff's examination of the August 29, 2008 Application of Oklahoma Gas and Electric Company (OG&E or Company) for an increase in rates. Specifically, I sponsor Exhibits LAR-1 through LAR-6, which summarize the development of Staff's recommended revenue requirement, and Exhibit LAR-7, which compares Staff's revenue and expense adjustments with the Company's. I discuss my recommended adjustments to OG&E's working capital assets (WCA) shown on Exhibit LAR-3 and summarized on Exhibit LAR-2 and the calculation of income tax shown on Exhibit LAR-6 and the related adjustments shown on Exhibit LAR-5 and summarized on Exhibit LAR-4. I also discuss my examination of current, accrued and other liabilities (CAOL) and accumulated deferred income taxes (ADIT).

Specifically, I sponsor the adjustments listed in Table 1, as well as CAOL and ADIT adjustments addressed later in my testimony.

Table 1
Summary of Adjustments Addressed

Staff Adj. No.	OG&E Adj. No.	Description	Staff Adj. Amount	OG&E Adj. Amount	Difference
RB-6	RB-4	Adjusts WCA to 13 month average	$48,122,707	($55,438,190)	$103,560,897
RB-7	RB-4	Reduces WCA	($386,384,295)	($81,101,877)	($305,282,418)

Staff Adj. No.	OG&E Adj. No.	Description	Staff Adj. Amount	OG&E Adj. Amount	Difference
IS-41	C-2.2-39	Adjusts Federal Income Tax (less Investment Tax Credit)	($40,351,374)	($39,330,131)	($1,021,243)
IS-42	C-2.2-40	Adjusts State Income Tax	$14,622,837	$323,952	$14,298,885
IS-43	C-2.2-41	Adjusts Investment Tax Credit	$4,812,540	$172,236	$4,640,304

TEST YEAR AND PRO FORMA YEAR

Q. What test year and pro forma year was used?

A. OG&E's Application used a historical test year ending December 31, 2007. The pro forma year is the 12-month period ending December 31, 2008.

REVENUE REQUIREMENT

Q. Please discuss the revenue requirement as determined by Staff and OG&E.

A. Staff's determination of Arkansas jurisdictional retail non-fuel revenue requirement is shown on Exhibits LAR-1 through LAR-6. As shown on Exhibit LAR-1, Summary of Operations, Staff's recommendations result in a retail non-fuel rate schedule revenue requirement of $79,914,175 and a revenue deficiency of $12,019,586. In contrast, OG&E proposes a non-fuel rate schedule revenue requirement of $94,267,950, and a revenue deficiency of $26,391,288, a difference of $14,353,775 in the non-fuel rate schedule revenue requirement. In deriving the Arkansas jurisdictional revenue requirement, the adjustments were made at the total company level and the adjusted test year amounts were allocated to Arkansas in the cost of service study. Therefore, Staff's exhibits reflect adjustments on a total company basis, but include the resulting Arkansas jurisdictional adjusted test year information.

Staff's adjustments and all of the principal components in determining OG&E's rate base are shown in Exhibits LAR-2 and LAR-3. Staff's proposed rate base differs from OG&E's by $304,004,419 on a total company basis and by $26,160,698 for the Arkansas jurisdiction. $201,721,521 of the total company difference is attributable to additional eliminations of working capital assets, which I will discuss later in my testimony, with the remaining differences attributable to utility plant of $102,282,898 discussed in the Direct Testimony of Staff witness William L. Matthews.

Staff's adjustments to the Company's test year and the determination of the proposed operating revenues and expenses are shown in Exhibits LAR-4 and LAR-5. In addition, Exhibit LAR-7 provides a comparison of Staff's and the Company's adjustments. Staff's operating revenues differ by $3,439 on a total company basis and $38,316 for Arkansas. Staff witness Robert H. Swaim discusses the billing determinants used to develop operating revenues. Operating expenses before income taxes differ by $55,534,532 on a total company basis and $5,028,886 for Arkansas. Staff witness Matthews discusses the total company difference due to depreciation and amortization expense of $7,340,434 and *ad valorem* taxes of $3,146,423 in his Direct Testimony, while Staff witnesses Rick Dunn and Trent Fulmer address the remaining $45,047,675, including differences due to payroll and benefits of $32,776,670, insurance of $486,728, vegetation management of $4,989,492, Southwest Power Pool of $2,302,103, and disallowances of advertising, marketing, dues, and lobbying of $3,569,144.

Staff's income tax calculation is shown in Exhibit LAR-6 and is based on the Arkansas jurisdictional operating revenues and expenses. OG&E's weighted cost of debt of 2.73%, as provided by Staff Financial Analyst Angela Sidler, was applied to Staff's rate base to determine the amount of fixed charges (interest expense) to include in the income tax calculation. In addition, similar to the tax calculation in OG&E's last rate case, Docket No. 06-070-U, a manufacturing deduction and a production credit were included. The resulting federal and state income tax reduced the total operating expense difference between Staff and OG&E by $17,917,946 on a total company basis and $1,486,045 for Arkansas, resulting in a net difference of $37,616,586 on a total company basis and $3,542,841 for the Arkansas jurisdiction.

MODIFIED BALANCE SHEET APPROACH

Q. Please explain the methodology used to determine WCA and CAOL amounts.

A. In developing its recommended WCA and CAOL, the Company used the Modified Balance Sheet Approach (MBSA). In Order No. 7 of Docket No. 84-199-U, this Commission directed Staff to use the MBSA, either in the absence of a lead-lag study or as a check on a lead-lag study filed by the utility. Since that time, Staff has used the MBSA to determine working capital in evaluating rate case filings with continued acceptance by the Commission. Consistent with the Commission's directive, I used the MBSA and its embodied principles to determine revenue requirement. OG&E also used the MBSA in deriving its WCA and CAOL for inclusion in its filing.

Q. Please describe the MBSA.

A. The MBSA requires that assets, other than plant, that are not interest-bearing, which are necessary in providing utility service, and which are not considered elsewhere in the cost of service be included in a utility's rate base as WCA. Additionally, all CAOL, which are a source of funds to the utility, should be included in the Company's capital structure at their appropriate cost. The MBSA recognizes two basic facts: (1) a utility has investments in assets other than plant which are necessary to provide utility service and on which a return should be allowed; and, (2) a utility has sources of funds, other than equity and long-term debt, which should be included in the capital structure.

WORKING CAPITAL ASSETS

Q. You have recommended an amount of WCA that is $201,721,521 less than the Company. Would you please explain the difference in your WCA as opposed to the Company's WCA?

A. I agree with the Company's use of 13-month averages for all the accounts included and with the amounts excluded from rate base. However, I used the most recently available 13-month averages for the period ended September 30, 2008. In addition, I have further adjusted WCA for amounts that are considered either interest-bearing or should not be included in revenue requirement based on my review of the Company's books and records. My Adjustment RB-6 is necessary to bring the year-end amounts of WCA to the updated thirteen-month averages, and Adjustment RB-7 adjusts those averages to a more representative balance where appropriate and eliminates those that should not be included in rate base.

Q. Please describe the specific adjustments included in Adjustment RB-7 that you made to WCA in addition to those made by the Company.

A. The first adjustment I made was to remove the entire amount in account 912400, Other Investments. The balance of this account was the Company's equity in life insurance policies on certain employees. I eliminated the amount of equity accumulated in the life insurance as it earns interest.

Next, I adjusted account 915100, fuel stock. In its Application, OG&E used forecasted fuel costs and requested approval for a 75-day level of coal inventory. For my adjustment, I used actual fuel costs for the most recently available 13-month average balances at September 30, 2008. For this period, the average days of coal inventory was 60 days, the level of coal inventory previously reflected in Docket No. 06-070-U.

Next, I adjusted account 916500, prepayments. The only portion of this account I eliminated was the 13-month average of prepaid Edison Electric Institute (EEI) dues and the 13-month average for prepayments-interest on commercial paper. The EEI dues have been eliminated from expenses elsewhere in calculating the revenue requirement and the interest on commercial paper is dealt with in the cost of capital calculation.

I also removed the amount in account 918230, other regulatory assets – FAS 158. In September 2006 the Financial Accounting Standards Board (FASB) implemented Statement of Financial Accounting Standards No. 158 (FAS 158), Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. This statement required, for financial reporting purposes, an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize through comprehensive income the changes in funded status in the year in which the changes occur. Under the Federal Energy Regulatory Commission's (FERC) accounting requirements, regulatory assets or liabilities are to be established for amounts that would have been included in net income or accumulated in other comprehensive income determinations in the current period under the general requirements of the Uniform Systems of Accounts (USOA), but for it being probable that such items will be included in a different period(s) for developing rates the utility is authorized to charge for its utility services. Therefore, OG&E has included a regulatory asset in its Application. The change due to FAS 158 does not affect the determination of pension or other postretirement benefits expense or the proposed ratemaking treatment of this expense; therefore I agree that a regulatory asset is appropriate. However, I do not agree with including the regulatory asset in rate base for earning a return because OG&E was not required to make any additional contributions to the pension or other postretirement benefits plan, nor did FAS 158 result in changes in OG&E's working capital requirements.

FAS 158 did not affect the Company's required level of working capital or the timing of its cash flows; therefore I have not included assets and liabilities previously only included in the notes to the financial statements. My adjustment removes the effects of FAS 158 and includes the resulting prepaid pension benefit obligation as a reduction to pension and other postretirement related liabilities in CAOL. My adjustment also comprehends pro forma year activity by using the Company's actual pension plan contributions and annualizing pensions and other postretirement costs for the nine months ended September 30, 2008.

The total effect of these adjustments was a $201,721,521 reduction in WCA from the amount included in the Company's rate base calculation.

CURRENT, ACCRUED AND OTHER LIABILITIES

Q. You recommend CAOL of $211,232,237 compared to the Company's amount of $338,577,290 to be included in Staff's capital structure. Please discuss this difference of $127,345,053.

A. The $127,345,053 difference between the Company's and my recommended CAOL is comprised of the following adjustments. First, I used the most recently available 13-month averages for the period ended September 30, 2008, which increased the total by $21,036,448. As discussed previously, I reduced account 922830, accumulated provision for pensions and benefits for the overfunded status of its defined benefit pension plan by $186,153,107.

Next I included $28,105,853 in accrued interest payable calculated using the average daily balance and the average lag days between interest payment dates. The Company has use of the interest accrual at zero cost for the period of time between its daily receipt of revenues and its payment of interest, either semi-annually for long-term or monthly for short-term. Therefore, it is appropriate to include an amount in CAOL which is also consistent with the Staff's long-term and short-term debt amounts included in the capital structure in arriving at the overall rate of return.

The last adjustment to CAOL was to include dividends payable of $9,665,753 based on the declaration date and the date paid along with the total amount of dividends paid during the test year. Dividends payable is clearly a current liability and should therefore be included. It is appropriate to include dividends payable in CAOL recognizing the time between when the dividend is declared (recorded as a liability) and when it is paid. Staff witness Angela Sidler further supports the inclusion of interest payable and dividends payable. .

ACCUMULATED DEFERRED INCOME TAXES

Q. Please discuss your adjustment to ADIT.

A. I recommend ADIT in the amount of $714,946,985. The difference between the Company's and Staff's ADIT is $32,721,675. The difference is a result of my updating ADIT to a later date than the Company used in calculating its ADIT. OG&E used December 31, 2007 numbers and I updated this amount to September 30, 2008. I will update ADIT in surrebuttal testimony to capture the most current numbers available to be consistent with plant additions proposed by Staff.

Q. Does this conclude your testimony?

A. Yes, it does.

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing has been delivered to all parties of record by hand-delivery, facsimile, electronic transmission, or first-class mail, postage prepaid, this January 13, 2009.

Paul J Ward

Paul J. Ward