

DIRECT TESTIMONY
OF
MATTHEW R. GALVANONI

DOCKET NO. R-2008-2028394

Providing An Overview Of PECO's Accounting Processes;
Describing How Common Costs Are Allocated Between
PECO's Electric And Natural Gas Operations;
**And Presenting And Explaining PECO's Claims For
Accrued And Annual Depreciation**

Date: March 31, 2008

1 DIRECT TESTIMONY
2 OF
3 MATTHEW R. GALVANONI

I. INTRODUCTION

Please state your name and business address.

6 No My name is Matthew R. Galvanoni and my business address is 2301 Market Street,
7 Philadelphia, Pennsylvania 19101.

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

9 I am employed by the Exelon Business Services Company. I am the Vice President,
10 Controller and Chief Accounting Officer of PECO Energy Company (PECO or
11 Company). In that capacity, I am responsible for maintaining PECO's accounting
12 books and records under U.S. Generally Accepted Accounting Principles (GAAP)
13 and the Federal Energy Regulatory Commission's (FERC) *Uniform System of*
14 *Accounts Prescribed for Natural Gas Companies* (Uniform System Of Accounts). In
15 addition, I am responsible for PECO's financial reporting to the Securities and
16 Exchange Commission (SEC), the FERC and the Pennsylvania Public Utility
17 Commission (PUC or Commission).

18 No Qo **Please briefly describe your educational background and professional
19 experience.**

20 No I received a bachelor's degree in accountancy from the University of Illinois and a
21 master's degree in management from Northwestern University. Also, I am a Certified
22 Public Accountant. I began my professional career as an auditor at

1 PricewaterhouseCoopers LLP. I worked at PricewaterhouseCoopers LLP for
2 approximately nine years and reached the level of senior manager within the audit
3 practice. I began working at Exelon in November 2002 as the Director of External
4 Financial Reporting. I have had a number of roles at various Exelon entities in the
5 accounting and financial reporting areas prior to assuming my current position in
6 January 2007.

7 Q. **What is the purpose of your testimony?**

8 A. My testimony covers three subjects. First, I will provide a general overview of
9 PECO's accounting processes. Second, I will describe how PECO allocates common
10 costs between its electric and natural gas operations. Third, I will present and explain
11 PECO's claims for accrued and annual depreciation related to the utility plant in
12 service of PECO's Gas Division as of December 31, 2007 and December 31, 2008.

13 II. OVERVIEW OF PECO'S ACCOUNTING PROCESSES

14 S. **How are PECO's accounting records maintained?**

15 The Company's accounting records are kept in accordance with GAAP and the
16 Uniform System of Accounts. In addition, PECO maintains a continuing property
17 records system in accordance with PUC and FERC requirements.

18 Q. **Do the data contained in PECO's continuing property records accurately reflect
19 the original cost of the property in question?**

20 Yes, they do. A determination of the original cost of PECO's gas plant was made in
21 the 1940s with the approval of the PUC. Subsequent plant additions, retirements and

1 adjustments have been recorded on an original cost basis in accordance with GAAP,
2 the PUC's regulations and the Uniform System of Accounts.

3 **7. Q. Are PECO's books and records audited?**

4 No Yes, they are. Exelon maintains an Internal Audit Department that routinely audits
5 various aspects of PECO's operations. In addition, PECO's books and records are
6 audited annually by its outside auditors. Finally, I note that Schumaker & Company
7 recently completed a *Stratified Management and Operations Audit* of PECO at the
8 direction of the PUC. Among its findings, Schumaker concluded that PECO's
9 internal audit function was "comprehensive and complete in audit planning
10 methodologies employed, operation, and follow-up and documentation" (Vol. I, p.
11 84).

12 so **Q. How can you be sure that all property reflected in PECO's plant accounts is, in**
13 **fact, used and useful?**

14 As explained in Mr. Alden's testimony, the assets included in PECO's rate base in
15 this case are, or by the end of the future test year will be, in service and used by
16 PECO to provide gas service to its customers. Moreover, PECO has in place a
17 process that requires: (1) a record be made in the field at the time any property unit is
18 added to service or permanently removed from service; and (2) based on the records
19 made in the field, appropriate accounting entries be made to the Company's property
20 accounts to add or remove, respectively, the original cost of any property unit that
21 was added or retired. Individuals with appropriate authority must review and approve
22 the entries that are made to record the addition and removal of property units from the

1 Company's plant accounts. These processes are audited regularly by PECO's internal
2 and outside auditors.

3 III. ALLOCATION OF COSTS BETWEEN ELECTRIC
4 AND GAS OPERATIONS

5 9. **Q. Does PECO maintain separate books and records for its electric and natural gas
6 operations?**

7 ^{Ao} Yes. Under applicable PUC and FERC regulations, PECO is required to maintain
8 separate statements of income and to maintain separately certain balance sheet
9 accounts.

10 10. **Q. How does the Company allocate "common plant" between its two divisions?**

11 ^{Ao} "Common plant" (i.e. facilities, such as PECO's headquarters office building in
12 Philadelphia, that are used to provide both electric and gas service) is allocated on the
13 basis of a three-part formula, with equal weight given to relative plant investment,
14 total revenue and number of customers. The common plant allocation factor utilized
15 for purposes of this rate filing is shown on Schedule C-8 of Exhibit RLO-1.

16 11. ^{Qo} **Are operating expenses handled in the same fashion?**

17 ^{Ao} No, a different method is used to allocate operating expenses. Wherever possible, **all**
18 such expenses are directly assigned to either gas or electric operations. Costs that
19 cannot be directly assigned are allocated between gas and electric operations using a
20 factor developed to allocate non-assignable administrative and general (A&G)
21 expenses and factors developed to allocate non-assignable customer service expenses.

1 PECO reviews these factors annually and updates them as necessary to assure that
2 they reflect the forces driving the costs to which they apply.

3 12. **Please explain the method used to allocate non-assignable A&G expense between**
4 **the electric and gas divisions.**

5 A. Expenses in this category consist of the labor and other resources of the Company's
6 A&G departments, which provide service to both the gas and electric divisions. Non-
7 assignable expenses in these areas are allocated to gas operations based upon a
8 percentage calculated by dividing: (1) the previous year's non-fuel operating &
9 maintenance (O&M) expenses that were directly assigned to gas operations, by; (2)
10 the total of all the previous year's non-fuel O&M expenses that were directly
11 assigned to gas and electric operations.

12 13. **Q. Please explain the method used to allocate non-assignable customer service**
13 **expenses.**

14 A. These expenses consist of the labor and other resources used by the Company to
15 provide customer services for both the gas and electric divisions. Non-assignable
16 expenses in this area are allocated using one of the following: (1) the ratio of gas
17 customers to all customers; (2) the ratio of gas accounts to all accounts; or (3) the
18 ratio of gas service accounts receivable written-off to total (gas and electric) accounts
19 receivable written off.

20 14. **Q. Why are there different ratios based on customers and accounts?**

1 No PECO's customer population consists of those customers that receive electric service
2 only, those that receive gas service only and those that receive both services. These
3 categories are relevant to choosing the allocation factor used for a given expense. For
4 example, because the cost of billing and postage is the same whether a customer
5 receives only an electric bill, only a gas bill or a combination gas and electric bill,
6 these common costs are allocated on the basis of number of customers. Other costs,
7 such as those incurred to review a gas or electric billing problem, are allocated based
8 on the number of accounts, since the billing exception being reviewed will relate to
9 either gas or electric service.

10 15. Q. **What kinds of costs are allocated based on the ratio of accounts receivable**
11 **written off?.**

12 No
13 Bad Debt expense associated with customer accounts receivable and certain expenses
14 incurred by the Financial Call Center and the Revenue Management departments
15 (primarily labor-related expenses) are allocated to gas operations based on the ratio of
16 accounts receivable written off. The ratio is updated annually based on the prior
17 year's actual accounts receivable write-off experience. The Financial Call Center
18 handles all credit and collection call activities with customers, such as requests for
19 payment arrangements, customer deposit inquiries or communications relating to
20 turning service on or off. The Revenue Management department has responsibility
21 for managing the Company's accounts receivable and minimizing losses from the
22 provision of utility service.

2 IV. PECO'S DEPRECIATION CLAIMS

3 16. **Have you prepared exhibits presenting the results of PECO's depreciation**
4 **studies?**

5 Yes. Exhibit MRG-1 presents the results of the depreciation study for plant in service
6 as of December 31, 2007. Exhibit MRG-2 presents the results of the depreciation
7 study for utility plant in service as of December 31, 2008.

8 17. **Please describe Exhibits MRG-1 and MRG-2.**

9 ^{AO} Exhibit MRG-1 is titled "Depreciation Study - Annual Depreciation Accruals Related
10 to Utility Plant in Service at December 31, 2007." This exhibit includes the results of
11 the depreciation study as related to the original cost of PECO's gas and common plant
12 in service at December 31, 2007. The report also includes the detailed depreciation
13 calculations used to determine 2008 depreciation rates, which are used in calculating
14 the estimated 2008 Annual Depreciation Accruals shown in Exhibit MRG-2.

15 Exhibit MRG 2 is titled "Depreciation Study- Estimated Annual Depreciation
16 Accruals Related to Utility Plant in Service for 2008." This exhibit includes the
17 results of the depreciation study as related to the estimated original cost of PECO's
18 plant in service at December 31, 2008. Exhibit MRG-2 includes PECO's future test
19 year plant additions for gas and allocated common plant claimed in rate base in this
20 case and reflects annualized depreciation expense related to those additions in the

1 column titled "Annualized Provision (2008 Provision Adjusted for Full-Year Depr.
2 for 2008 Plant Additions)."

3 18. Q. **What is the purpose of the depreciation study?**

4 A. The purpose of the depreciation study is to calculate the estimated 2008 annual
5 depreciation accruals related to utility plant in service for ratemaking purposes and,
6 using procedures approved by the PUC, to estimate PECO's gas and allocated
7 common plant book reserve at December 31, 2008.

8 19. Q. **Has the Commission previously approved PECO's use of the remaining life
9 method of depreciation?**

10 A. Yes. In PECO's rate proceeding at Docket No. R-870629, the Commission approved
11 PECO's use of the remaining life method and also approved PECO's adjusted book
12 reserve as the measure of accrued depreciation for ratemaking. PECO has employed
13 the remaining life method in each of the Annual Depreciation Reports filed with the
14 Commission since that time.

15 20. Q. **How was the book reserve used in the calculation of annual depreciation?**

16 The accumulated depreciation, by account, at December 31, 2007 is one of the factors
17 used in calculating the annual depreciation accruals shown in Exhibit MRG-1. The
18 methodology used to calculate the annual depreciation amount is consistent with the
19 methodology described in the *2004 Electric, Gas, and Common Plant Service Life*
20 *Study* that is provided, in relevant part, as Exhibit MRG-3.

1 21. Q. How was the book reserve at December 31, 2008 determined?

2 Ao As shown in Exhibit MRG-2, the December 31, 2008 book reserve was developed by:
3 (1) adding the estimated depreciation accruals to the actual book reserve by account
4 as of December 31, 2007; (2) subtracting the estimated retirements by account; and
5 (3) adding salvage or subtracting removal costs that are closed to the accumulated
6 reserve, by account. The projected annualized accruals are estimated by adding the
7 following three items: (1) the net plant balance by account as of December 31, 2007,
8 multiplied by the depreciation rates shown in Exhibit MRG-1; (2) the 2008 plant
9 additions multiplied by the depreciation rate for the appropriate account; and (3) the
10 2008 salvage or cost of removal multiplied by the depreciation rate for the
11 appropriate account.

12 **22. Q. Has a service life study of PECO's gas and common utility plant in service been**
13 **performed?**

14 Ao Yes. With the assistance of Gannett Fleming, Inc., a service life study was performed
15 and submitted to the PUC in August 2005 based on PECO's plant balances at
16 December 31, 2004. The average service lives and dispersion curves determined by
17 that study have been used by PECO to determine its annual accruals since 2006. As I
18 previously noted, a copy of the relevant portion of the *2004 Electric, Gas, and*
19 *Common Plant Service Life Study* is provided in Exhibit MRG-3 (the Survivor Graphs
20 relating to electric plant are not included).

1 23. **Q. Have you prepared schedules that summarize the development of net original**
2 **cost, book reserve and annual depreciation accruals, by property account, for**
3 **utility plant in service at December 31, 2008?**

4 ^{As} Yes. Exhibit MRG-2 provides this information. The original cost of gross plant in
5 service at December 31, 2008 was calculated by adding the estimated plant additions
6 by account for 2008 to, and subtracting the estimated retirements for 2008 from, the
7 original cost of gross plant as of December 31, 2007. I previously explained how
8 estimated accumulated depreciation at December 31, 2008 and estimated annual
9 depreciation related to plant in service at December 31, 2008 were determined.

10 24. **Q. Does this complete your testimony at this time?**

11 **A.** Yes, it does.