

**PECO ENERGY COMPANY
STATEMENT NO. 4**

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PECO ENERGY COMPANY – ELECTRIC DIVISION

DOCKET NO. R-2010-2161575

DIRECT TESTIMONY

WITNESS: JORGE ACEVEDO

SUBJECT: OVERVIEW OF PECO ENERGY COMPANY'S
ACCOUNTING PROCESSES; ALLOCATION OF
COSTS BETWEEN ELECTRIC AND GAS
OPERATIONS; ELECTRIC DIVISION
DEPRECIATION CLAIMS

DATED: MARCH 31, 2010

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1 A. Upon receiving my Masters Degree, I was hired as a staff accountant for an
2 accounting firm in Florida. Two years later, in 1996, I accepted a position at
3 Pricewaterhouse Coopers LLP as an Audit Manager. After six years in that role, I
4 began employment with Exelon Corporation. I first served as Manager of Technical
5 Accounting, where I ensured timely identification and resolution of accounting issues,
6 implementation of new accounting standards, and consultative guidance on complex
7 accounting transactions. A year later, I became the Director of Accounting for
8 Exelon Power Team, where I oversaw the accounting operations of Exelon's
9 wholesale power marketing division, with revenues of approximately \$11 billion. In
10 2006, I was promoted to Director of Accounting for Exelon Generation, where I
11 oversaw the accounting operations of Exelon Generation, including Exelon Power
12 Team, Exelon Nuclear, Exelon Power, and Exelon Generation Corporate. In 2007, I
13 became Assistant Controller for Exelon Generation. I assumed my current
14 responsibilities as Vice President and Controller of PECO in July 2009.

15 5. Q. **What is the purpose of your testimony?**

16 A. My testimony covers three subjects. First, I will provide a general overview of
17 PECO's accounting processes. Second, I will describe how PECO allocates common
18 costs between its electric and natural gas operations. Third, I will present and explain
19 PECO's claims for accrued and annual depreciation related to the utility plant in
20 service of PECO's Electric Division as of December 31, 2009 and December 31,
21 2010.

22 6. Q. **Please identify the exhibits you are sponsoring.**

1 A. I am sponsoring PECO Exhibits JA-1 and JA-2, which include, respectively, the
2 results of the depreciation studies related to the original cost of PECO's electric and
3 common plant in service at December 31, 2009 and estimated to be in service at
4 December 31, 2010, and PECO Exhibit JA-3, which is the relevant portion of
5 PECO's 2008 Electric, Gas, and Common Plant Service Life Study.

6 II. OVERVIEW OF PECO'S ACCOUNTING PROCESSES

7 7. Q. **How are PECO's accounting records maintained?**

8 A. The Company's accounting records are kept in accordance with GAAP and the
9 Uniform System of Accounts Prescribed for Public Utilities and Licensees (Class A
10 and B) of the FERC, as required by the PUC's regulations at 52 Pa. Code § 57.42(a).
11 In addition, PECO maintains a continuing property records system in accordance with
12 PUC and FERC requirements.

13 8. Q. **Does the data contained in PECO's continuing property records accurately
14 reflect the original cost of the property in question?**

15 A. Yes, it does. A determination of the original cost of PECO's electric plant was made
16 in the 1940s with the approval of the PUC. Subsequent plant additions, retirements
17 and adjustments have been recorded on an original cost basis in accordance with
18 GAAP, the PUC's regulations and the Uniform System of Accounts.

19 9. Q. **Are PECO's books and records audited?**

20 A. Yes, they are. Exelon Corporation, PECO's parent, maintains an Internal Audit
21 Department that routinely audits various aspects of PECO's operations. In addition,

1 PECO's books and records are audited annually by its outside auditors. Finally, in
2 2007, Schumaker & Company completed a Stratified Management and Operations
3 Audit of PECO at the direction of the PUC. Among its findings, Schumaker
4 concluded that PECO's internal audit function was "comprehensive and complete in
5 audit planning methodologies employed, operation, and follow-up and
6 documentation" (Vol. I, p. 84).

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

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

19 **III. ALLOCATION OF COSTS BETWEEN ELECTRIC AND GAS OPERATIONS**

20 **11. Q. Does PECO maintain separate books and records for its electric and natural gas**
21 **operations?**

1 A. Yes. Under applicable PUC and FERC regulations, PECO is required to maintain
2 separate statements of income and to maintain, separately, certain balance-sheet
3 accounts.

4 **12. Q. How does the Company allocate “common plant” between its two divisions?**

5 A. “Common plant” (*i.e.*, facilities, such as PECO’s headquarters office building in
6 Philadelphia, that are used to provide both electric and gas service) is allocated on the
7 basis of a three-part formula, with equal weight given to relative plant investment,
8 total revenue and number of customers. The allocation factors utilized for purposes
9 of this rate filing are shown on Schedule C-8 of both Exhibit RLO-1 and RLO-2.

10 **13. Q. Are operating expenses handled in the same fashion?**

11 A. No, a different method is used to allocate operating expenses. Costs that cannot be
12 directly assigned are allocated between gas and electric operations using a factor
13 developed to allocate non-assignable Administrative and General (“A&G”) expenses
14 and factors developed to allocate non-assignable customer-service expenses. PECO
15 reviews these factors annually and updates them as necessary to assure that they
16 reflect the forces driving the costs to which they apply.

17 **14. Q. Please explain the method used to allocate non-assignable A&G expense.**

18 A. Expenses in this category consist of the labor and other resources of the Company’s
19 A&G departments, such as Finance, Marketing, and Accounting, which provide
20 service to both the gas and electric divisions. Non-assignable expenses in these areas
21 are allocated to electric operations based upon a percentage calculated by dividing:

1 (1) the previous year's non-fuel Operating & Maintenance ("O&M") expenses that
2 were directly assigned to electric operations, by; (2) the total of all the previous year's
3 non-fuel O&M expenses that were directly assigned to gas and electric operations.

4 **15. Q. Please explain the method used to allocate non-assignable customer service**
5 **expenses.**

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

12 **16. Q. Why are there different ratios based on customers and accounts?**

13 A. PECO's customer population consists of those customers that receive electric service
14 only, those that receive gas service only and those that receive both services. These
15 categories are relevant to choosing the allocation factor used for a given expense. For
16 example, because the cost of billing and postage is the same whether a customer
17 receives only an electric bill, only a gas bill or a combination gas and electric bill,
18 these common costs are allocated on the basis of number of customers. Other costs,
19 such as those incurred to review a gas or electric billing inquiry, are allocated based
20 on the number of accounts, since the billing inquiry being reviewed will relate to
21 either gas or electric service.

1 17. Q. What kinds of costs are allocated based on the ratio of accounts receivable
2 written off?

3 A. Bad debt expense associated with customer accounts receivable and certain expenses
4 incurred by the Financial Call Center and the Revenue Management departments
5 (primarily labor-related expenses) are allocated to electric operations based on the
6 ratio of accounts receivable written off. The ratio is updated annually based on the
7 prior year's actual accounts receivable write-off experience. Bad debt expense is
8 allocated for accounting purposes, however, the Revenue Requirements Model
9 utilizes actual charge offs instead of PECO's bad debt expense. The Financial Call
10 Center handles all credit-and-collection call activities with customers, such as
11 requests for payment arrangements, customer deposit inquiries or communications
12 relating to turning service on or off. The Revenue Management department has
13 responsibility for managing the Company's accounts receivable and minimizing
14 losses from the provision of utility service.

15 IV. PECO ELECTRIC DIVISION DEPRECIATION CLAIMS

16 18. Q. Have you prepared exhibits presenting the results of PECO's depreciation
17 studies?

18 A. Yes. Exhibit JA-1 presents the results of the depreciation study for utility plant in
19 service as of December 31, 2009. Exhibit JA-2 presents the results of the
20 depreciation study for utility plant in service as of December 31, 2010.

21 19. Q. Please describe Exhibits JA-1 and JA-2.

1 A. Exhibit JA-1 is titled “Depreciation Study – Annual Depreciation Accruals Related to
2 Utility Plant in Service at December 31, 2009.” This exhibit includes the results of
3 the depreciation study as related to the original cost of PECO’s electric and common
4 plant in service at December 31, 2009. The report also includes the detailed
5 depreciation calculations used to determine 2010 depreciation rates, which are used in
6 calculating the estimated 2010 Annual Depreciation Accruals shown in Exhibit JA-2.
7 Exhibit JA-2 is titled “Depreciation Study – Estimated Annual Depreciation Accruals
8 Related to Utility Plant in Service for 2010.” This exhibit includes the results of the
9 depreciation study as related to the estimated original cost of PECO’s plant in service
10 at December 31, 2010. Exhibit JA-2 includes PECO’s future test year plant additions
11 for electric and allocated common plant claimed in rate base in this case and reflects
12 the annualized depreciation accrual related to those additions in the column titled
13 “2010 Estimated Annualized Depreciation Accrual.”

14 **20. Q. What is the purpose of the depreciation study?**

15 A. The purpose of the depreciation study is to calculate the estimated 2010 annual
16 depreciation accruals related to utility plant in service for ratemaking purposes and,
17 using procedures approved by the PUC, to estimate PECO’s electric and allocated
18 common plant book reserve at December 31, 2010.

19 **21. Q. Has the Commission previously approved PECO’s use of the remaining-life
20 method of depreciation?**

21 A. Yes. In 1984, PECO’s rate proceeding at Docket No. R-842590, the Commission
22 approved PECO’s use of the remaining life method and also approved PECO’s

1 adjusted book reserve as the measure of accrued depreciation for ratemaking. PECO
2 has employed the remaining-life method in each of the Annual Depreciation Reports
3 filed with the Commission since that time. The remaining life method spreads the
4 undepreciated cost of plant over the estimated remaining life of the depreciable
5 group.

6 **22. Q. How was the accumulated book reserve used in the calculation of annual**
7 **depreciation?**

8 A. The accumulated book reserve, by account, at December 31, 2009, is one of the
9 factors used in calculating the annual depreciation accruals shown in Exhibit JA-1.
10 The methodology used to calculate the annual depreciation accrual is consistent with
11 the methodology described in the 2008 Electric, Gas, and Common Plant Service Life
12 Study that is provided, in relevant part, as Exhibit JA-3.

13 **23. Q. How was the estimated accumulated book reserve at December 31, 2010**
14 **determined?**

15 A. As shown in Exhibit JA-2, the December 31, 2010 estimated accumulated book
16 reserve was developed by: (1) adding the 2010 estimated annual depreciation accrual
17 to the actual accumulated book reserve by account as of January 1, 2010; (2)
18 subtracting the 2010 estimated plant retirements by account; and (3) adding 2010
19 estimated salvage or subtracting estimated removal costs that are closed to the
20 accumulated book reserve, by account. The 2010 estimated annual depreciation
21 accruals are estimated by adding the following three items: (1) the estimated
22 depreciable plant net book value balance by account as of December 31, 2009,

1 multiplied by the depreciation rates shown in Exhibit JA-1; (2) the 2010 estimated
2 plant additions multiplied by the depreciation rate (using a half-year convention) for
3 the appropriate account; and (3) the 2010 estimated salvage or cost of removal
4 multiplied by the depreciation rate (using a half-year convention) for the appropriate
5 account.

6 **24. Q. Has a service-life study of PECO's electric and common utility plant in service**
7 **been performed?**

8 A. Yes. With the assistance of Gannett Fleming, Inc., a service-life study was performed
9 based on PECO's plant balances at December 31, 2008. As I previously noted, a
10 copy of the relevant portion of the 2008 Electric, Gas, and Common Plant Service
11 Life Study is provided as Exhibit JA-3 (the Survivor Graphs relating to gas plant are
12 not included).

13 **25. Q. Have you prepared schedules that summarize the development of the original**
14 **cost of gross plant, estimated accumulated book reserve, estimated depreciable**
15 **plant net book value, estimated annual depreciation accrual, and estimated**
16 **annualized depreciation accruals, by property account, for utility plant in**
17 **service at December 31, 2010?**

18 A. Yes. Exhibit JA-2 provides this information. The original cost of gross plant in
19 service at December 31, 2010 was calculated by adding the estimated plant additions
20 by account for 2010 to, and subtracting the estimated plant retirements for 2010 from,
21 the original cost of gross plant as of December 31, 2009. I previously explained how
22 the estimated accumulated book reserve at December 31, 2010 and estimated annual

1 depreciation accrual related to plant in service at December 31, 2010 were
2 determined. The estimated depreciable plant net book value at December 31, 2010
3 was calculated by subtracting the estimated accumulated book reserve at December
4 31, 2010 from the estimated original cost of gross plant at December 31, 2010. The
5 2010 estimated annualized depreciation accruals are estimated by adding the
6 following three items adjusted for the results of the 2008 Electric, Gas and Common
7 Plant Service Life Study: (1) the estimated depreciable plant net book value balance
8 by account as of December 31, 2009, multiplied by the depreciation rates shown in
9 Exhibit JA-1; (2) the 2010 estimated plant additions multiplied by the depreciation
10 rate for the appropriate account; and (3) the 2010 estimated salvage or cost of
11 removal multiplied by the depreciation rate for the appropriate account.

12 V. CONCLUSION

13 26. Q. Does this conclude your direct testimony?

14 A. Yes, it does.