

1 **Q. Please state your name, business address and occupation.**

2 A. My name is Stephen P. Feltz. My business address is 220 N.W. Second,
3 Portland, OR 97209. I am a certified public accountant. My current position with
4 NW Natural (company) is Treasurer and Controller. I have served previously as
5 an auditor in the company's Internal Auditing department and as Manager of the
6 Customer Account Services and Accounting departments.

7 **Q. What are your responsibilities with NW Natural?**

8 A. As Treasurer and Controller, I am responsible for the receipt and disbursement
9 of company funds, for borrowing and investing to meet cash requirements, and
10 for maintaining accounting records in accordance with Generally Accepted
11 Accounting Principles and other regulatory accounting requirements. Prior to
12 March 1, 1999, I was Manager of Accounting and my responsibilities included
13 establishing accounting policies and procedures, maintaining company's
14 accounting records, and preparing company financial statements and statistical
15 reports.

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

17 A. The purpose of my testimony is to provide cost information relating to the
18 company's investment in a Customer Information System and to respond to
19 questions regarding accounting policies.

20 **Q. What is the company's total investment in CIS?**

21 A. The company's current investment in CIS includes the original development of a
22 Residential and Commercial (R&C) system, which went into service on

1 November 1, 1997, and an Industrial and Commercial (I&C) billing system
2 addition to CIS, which went into service on December 1, 1999.

3 The amount invested in R&C was \$40.3 million, which includes total
4 expenditures of \$43.4 million minus a cash reimbursement of \$3.1 million from
5 the sale of hardware and software used during development but sold prior to
6 November 1, 1997 (see Exhibit 20 (SPF-Exhibit/1)).

7 The amount invested in I&C is estimated at \$3.8 million (see Exhibit 20
8 (SPF-Exhibit/2)).

9 **Q. What costs are included in the company's CIS investment?**

10 A. CIS investment includes R&C and I&C project costs which were incurred in
11 connection with design, development and implementation of the CIS System.
12 These costs include all hardware, software, labor, and facilities, plus materials
13 and supplies related to these technology development projects. Also included
14 were the cost of a new mainframe test environment, a major infrastructure
15 investment in a company-wide enterprise network, network servers, wiring,
16 switching equipment, desktop workstations, and printers, plus training materials,
17 independent project monitoring, and an allowance for funds used during
18 construction (AFUDC). Some of these costs could have been capitalized as part
19 of general Information Systems (IS) expenditures, but the reason NW Natural
20 decided to include these costs in CIS accounts because the scope and design of
21 CIS was to enable it to be fully integrated. The company's cost of CIS may not
22 be comparable to what other utilities have spent recently on CIS systems
23 because of differing system requirements and because other companies may

1 have included only the cost to develop the software components of CIS while
2 capitalizing other costs separately as technology infrastructure investments.

3 **Q. What is the split between CIS hardware and software?**

4 A. R&C gross plant balance at December 31, 1999 is \$37.1 million, with \$3.8 million
5 for hardware and \$33.3 million for software (see Exhibit 20 (SPF-Exhibit/3)).
6 Originally, R&C included \$3.8 million for hardware and \$36.0 million for software,
7 or a total of \$39.8 million. The difference between original R&C gross plant
8 (\$39.8 million) and the amount invested (\$40.3 million) is \$0.5 million, which
9 represents the amount of depreciation taken on CIS assets sold and removed
10 from utility plant during 1996. Additionally, the company has taken a write-down
11 of \$2.7 million as software plant disallowance.

12 I&C gross plant at December 31, 1999 is estimated to be \$3.8 million (see
13 Exhibit 20 (SPF-Exhibit/4)). The entire plant balance of I&C is classified as CIS
14 software.

15 **Q. What is the amount of AFUDC charged to CIS?**

16 A. The amount of AFUDC charged to the R&C was \$3.8 million (see Exhibit 20
17 (SPF-Exhibit/5)). The amount of AFUDC charged to I&C is estimated to be
18 \$120,000 (see Exhibit 20 (SPF-Exhibit/6)).

19 **Q. What methodology was used in the calculation of AFUDC?**

20 A. AFUDC amounts were calculated using a formula prescribed by FERC Order
21 561. The calculation is shown in Exhibit 20 (SPF-Exhibit/7). AFUDC was
22 calculated monthly on the cumulative balance in Construction Work In Progress
23 (CWIP) times a cost of capital rate as determined by the company's balance in

1 short-term debt, long-term debt and equity. The company's short-term debt
2 balances and interest rates were applied first in calculating AFUDC. When
3 CWIP balances exceeded the average amount of short-term debt outstanding,
4 then a combined long-term debt and equity rate was applied to the excess in
5 determining AFUDC. The total amount of AFUDC calculated each month was
6 added to the CWIP balance.

7 **Q. How was the cost of company overhead allocated to the development of**
8 **CIS?**

9 A. Similar to other capital projects, CIS included both direct costs and indirect costs,
10 including overhead and AFUDC. Most of the major cost items in developing CIS
11 were easily identifiable as direct costs of the project, and therefore these costs
12 were charged to the CIS accounts. These direct costs included the software
13 developer's base fee, hardware and software purchases, office rents, leasehold
14 improvements, furniture, utilities, contract labor, consulting services, and
15 miscellaneous materials and supplies. The costs of company's own Information
16 Services (IS) personnel were also charged to the CIS projects. We developed a
17 policy on how personnel costs would be charged, including a cost allocation
18 methodology which used direct payroll as the basis for allocating indirect payroll
19 for a few management personnel in the IS area. The following explains how we
20 accounted for company personnel costs and payroll overheads.

21 Labor costs associated with Information Systems (IS) department
22 employees were generally allocated to CIS based on actual or estimated hours
23 worked. For non-managerial IS positions, employees were required to record

1 actual hours, by project, in the company's IS labor tracking system. These hours
2 were then used to calculate payroll and the amount to be charged to CIS. As for
3 managerial IS positions, these employees were charged to CIS based on an
4 estimated percentage of their own time spent on CIS activities and direct time
5 spent by their staff. If an IS manager was assigned full-time to a project, then
6 their payroll was charged one hundred percent to that specific project account
7 regardless of where their staff time was spent.

8 Labor costs for employees from user departments were not generally
9 charged to CIS because their expense was not considered to be incremental. In
10 the case of supervisors, a CIS assignment was most often an extension of
11 his/her normal job duties. For example, if a supervisor with responsibility for
12 department procedures, policies, training, and/or system improvements was
13 assigned to work on CIS business rules or testing, then the supervisor was
14 performing duties assigned as a normal part of the job. However, labor expense
15 associated with bargaining unit (union) personnel from the user departments
16 were charged to the CIS *if* the Project assignment prevented that employee from
17 performing his/her regular assigned work and therefore required overtime or
18 temporary employees to fill in. In these cases, the employee's payroll was
19 transferred to CIS accounts based on hours worked.

20 In all cases, if company labor costs were charged to CIS, then payroll
21 overhead costs were transferred too. Payroll overhead rates used were the
22 same rates in effect for all company personnel at the time when labor costs were

1 incurred. The payroll overhead rate applied to CIS Project ranged from a low of
2 21.4% to a high of 24.2% (see Exhibit 20 (SPF-Exhibit/8)).

3 Other miscellaneous overhead costs such as purchasing, accounts
4 payable, human resources, and office services were not charged to CIS.

5 **Q. What is the annual depreciation charge for the hardware and software?**

6 A. For system plant balances applicable to Washington, the 1999 depreciation
7 charge for R&C was \$2.8 million. R&C's annual depreciation expense will
8 decrease to \$2.5 million in 2000, \$2.4 million in 2001, \$2.2 million annually from
9 2002-2011, \$1.9 million in 2012 and a negligible amount in 2013 when the CIS
10 system is fully depreciated (see Exhibit 20 (SPF-Exhibit/3)). The reason
11 depreciation begins declining after 1999 is because certain individual assets are
12 fully amortized.

13 Annual depreciation for I&C is estimated to be \$288,000 for the years
14 2000 through 2012 (see Exhibit 20 (SPF-Exhibit/4)).

15 **Q. What are the useful lives used for the calculation of depreciation?**

16 A. The useful life for CIS hardware is five years, and the useful life for CIS software
17 is 15 years. These plant costs are being amortized over the expected useful life
18 period for CIS. The actual life of most computer systems is normally much
19 shorter than 15 years, but we applied the results of a recent depreciation study
20 conducted by Donald S. Rott of Deloitte & Touche, which study was approved by
21 the WUTC in its August 28, 1996, Order in Docket No. UG-960283, and looked
22 at the expected life of NW Natural's CIS system along with the expected cost
23 recovery period, and we determined that 15 years for software was reasonable.

1 Due to the I&C's integration with R&C, the depreciation life for I&C software will
2 be equal to the remaining life of R&C software.

3 **Q. How has the company allocated CIS plant in Washington?**

4 A. NW Natural allocated CIS to Washington on the basis of number of customers.
5 This allocation is included in the testimony and exhibits of Mr. McVay, Exhibits 3
6 (KSM-Testimony) and 4 (KSM-Exhibit/24 and 25), and Exhibits 5 (KSM-
7 Testimony) and 6 (KSM-Exhibit/6 and 7).

8 **Q. Does this conclude your testimony?**

9 A. Yes.