

Exhibit T ___ (DPK-1T)
Docket No. TO-011472
Witness: Danny P. Kermode

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION)	
)	
Complainant,)	
)	DOCKET NO. TO-011472
v.)	
)	
OLYMPIC PIPE LINE COMPANY, INC.)	
)	
Respondent)	
_____)	

TESTIMONY OF
DANNY P. KERMODE, CPA

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

MAY 24, 2002

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS**

2 A. My name is Danny P. Kermode. My business address is 1300 South Evergreen Park
3 Drive S.W., PO Box 47250, Olympia, Washington 98504-7250. My e-mail address is
4 dkermode@wutc.wa.gov.

5
6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by the Washington Utilities and Transportation Commission as a
8 Regulatory Analyst.

9
10 **Q. WHAT ARE YOUR EDUCATION AND EXPERIENCE QUALIFICATIONS?**

11 A. In 1982, I graduated from Arizona State University in Tempe, Arizona with a Bachelor of
12 Science in Accounting. Later that same year, I attended San Carlos University in the
13 Philippines for postgraduate studies in Economic Analysis and Quantitative Business
14 Analysis. I am a Certified Public Accountant (CPA) and also a Certified Financial
15 Planner (CFP).

16 In 1992 and 1993, I was invited to become a member of the faculty at the
17 National Association of Regulatory Commissioners (NARUC) Annual Regulatory
18 Studies Program held at Michigan State University in East Lansing, Michigan. I taught
19 classes in Financial and Regulatory Accounting Standards and in Deferred Tax
20 Accounting.

21 My Exhibit No.____ (DPK-2) is a resume of my professional and regulatory
22 experience.

23

24

1 **I. PURPOSE OF TESTIMONY AND SUMMARY**

2
3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

4 A. I performed an examination of certain accounting data provided by Olympic Pipe Line
5 Company (Olympic or Company). I focused on the issue whether Olympic’s accounting
6 conformed with Generally Accepted Accounting Principles (GAAP). I present my
7 findings in this testimony.

8
9 **Q. PLEASE SUMMARIZE THE RESULTS OF YOUR REVIEW.**

10 A. In my professional opinion, the accounting system, and the accounting policies, practices
11 and procedures of Olympic Pipe Line cannot be reasonably expected to produce financial
12 data that conforms to GAAP on a consistent and comprehensive basis.

13
14 **II. BACKGROUND**

15
16 **Q. WHEN YOU USE THE TERM “ACCOUNTING SYSTEM,” ARE YOU**
17 **REFERRING TO THE COMPUTERIZED ACCOUNTING SYSTEM USED BY**
18 **THE COMPANY?**

19 A. No. The term “accounting system,” as I use it in my testimony, refers to the accounting
20 policies, practices, and procedures used by the Company to recognize and record
21 financial transactions on the Company’s books and records.

22
23 **Q PLEASE DEFINE “GENERALLY ACCEPTED ACCOUNTING PRINCIPLES”**
24 **(GAAP)?**

25 A. The Washington Administrative Code (WAC) correctly defines Generally Accepted
26 Accounting Principles (GAAP) as “an accounting term that encompasses the
27 conventions, rules, and procedures necessary to define accepted accounting practice at a
28 particular time. It includes not only broad guidelines of general application, but also
29 detailed practices and procedures. Those conventions, rules, and procedures provide a
30 standard by which to measure financial presentations.” WAC 4-25-410 (17). Such
31 standards include Statements issued by the Accounting Principles Board (APB) and the
32 Financial Accounting Standards Board (FASB). GAAP includes not just the final

1 presentation of the financial statements, but also the “detailed practices and procedures”
2 related to preparing and maintaining accounting information.

3
4 **Q. PLEASE DESCRIBE THE ACCOUNTING PRINCIPLES BOARD (APB) AND**
5 **THE FINANCIAL ACCOUNTING STANDARDS BOARD (FASB).**

6 A. The APB was created in 1959 to establish accounting standards. The APB issued 31
7 Opinions stating specific accounting standards. In 1973, the FASB replaced the APB as
8 the designated organization in the private sector for establishing standards of financial
9 accounting and reporting.

10
11 **Q. ARE THERE ACCOUNTING STANDARDS SPECIFIC TO REGULATED**
12 **COMPANIES?**

13 A. Yes. Regulated companies are required to follow the provisions of Financial Accounting
14 Standards Board Statement 71 (FASB 71). FASB 71, entitled *Accounting for the Effects*
15 *of Certain Types of Regulation*, is the authoritative standard that one looks to regarding
16 proper accounting for AFUDC under GAAP. There are also FASB 90 *Accounting for*
17 *Abandonments* and FASB 92, *Accounting for Phase-In Plans*, which apply to regulated
18 companies.

19
20 **Q. DO THE REQUIREMENTS OF FASB 71 APPLY TO OLYMPIC PIPE LINE?**

21 A. Yes. Paragraph 5 of FASB 71 sets out the criteria that establishes whether the application
22 of the accounting standards cited in the Statement applies to a specific entity. According
23 to Paragraph 5, the Statement will be applied to entities that (1) have its rates “for
24 services or products provided to its customers... established by or are subject to approval
25 by an independent, third-party regulator...,” (2) “...Rates are designed to recover the
26 specific enterprise’s costs of providing the regulated services or products,” and (3) “...it
27 is reasonable to assume that rates set at levels that will recover the enterprise’s costs can
28 be charged to and collected from customers....” In the case of Olympic Pipe Line, all
29 three criteria are met. Therefore, FASB 71 applies to Olympic Pipe Line.

1 **Q. PLEASE DIFFERENTIATE BETWEEN AN ACCOUNTING SYSTEM THAT**
2 **CONFORMS TO GAAP AND FINANCIAL STATEMENTS THAT CONFORM**
3 **TO GAAP.**

4 A. An accounting system that conforms to GAAP is designed to produce financial
5 statements that conform to GAAP with little, if any adjustment. On the other hand, an
6 accounting system that has not been designed to conform to GAAP cannot directly
7 produce financial statements that conform to GAAP. Any financial data produced from
8 such a system must be adjusted and/or modified to produce financial statements based on
9 GAAP.

10

11 **Q. WHAT PROBLEMS MAY RESULT FROM AN ACCOUNTING SYSTEM THAT**
12 **IS NOT DESIGNED TO CONFORM TO GAAP ACCOUNTING?**

13 A. There are a number of problems that are created by the lack of a properly designed
14 accounting system. First and foremost is that the degree of confidence in the accuracy of
15 the company's financial data is seriously degraded. This problem is compounded when a
16 user is unaware of the extent to which the accounting system does not follow GAAP. For
17 example, a user who is a company employee may be aware of the various aspects of the
18 company's accounting that are not consistent with GAAP and would therefore be able to
19 qualify his or her understanding of the company's financial data. However, persons
20 outside the company would not have the benefit of such an understanding.

21

22 **Q. IS OLYMPIC REQUIRED BY THE FEDERAL ENERGY REGULATORY**
23 **COMMISSION (FERC) TO MAINTAIN ITS BOOKS AND RECORDS IN**
24 **ACCORDANCE WITH THE FERC'S UNIFORM SYSTEM OF ACCOUNTS**
25 **(USOA)?**

26 A. Yes. In Title 18, Code of Federal Regulations, Part 352, Chapter I, paragraph 1-2, FERC
27 requires all carriers to keep their accounts and records in accordance with the FERC
28 USOA.

29

30 **Q. ARE THE ACCOUNTING PRINCIPLES REQUIRED UNDER THE FERC USOA**
31 **CONSISTENT WITH GAAP?**

1 A. Yes. Other than a few specific transactions such as equity method of accounting, the
2 FERC accounting requirements are consistent with GAAP. In fact, FERC's USOA often
3 refers the user to GAAP for additional clarification.
4

5 **Q. PLEASE DESCRIBE YOUR APPROACH IN THE PLANNING AND**
6 **PREPARATION OF YOUR EXAMINATION.**

7 A. I focused my review on two areas: 1) An examination of the Company's ability to
8 promptly record expenditures, and 2) a review of the Company's treatment of Allowance
9 for Funds Used During Construction (AFUDC).

10 To examine how Olympic records expenditures, I acquired a copy of the
11 Company's September ledger detail for Other Specialized Services (Account 712025). I
12 also acquired a copy of the Company's monthly trial balances, showing balances related
13 to monthly revenue and expenses, and the amounts reflected in Olympic's monthly
14 financial statements. In addition, I obtained a copy of the Company's December 31,
15 2001, accounts payable accrual. I also reviewed the direct testimony and deposition
16 testimony of Ms. Hammer, the Company's Assistant Treasurer, and Mr. Collins,
17 Olympic's consultant.

18 To examine the Company's accounting for AFUDC, I obtained the Company's
19 year-end financial statements provided to Staff by the Company.
20

21 **Q. DID YOU PERFORM A COMPLETE AUDIT OF OLYMPIC'S BOOKS?**

22 A. No. I reviewed a selected number of test year transactions and reviewed the regulatory
23 assets that were recognized by the Company in its filing. I did not perform an audit.
24

25 **III. OLYMPIC'S ACCOUNTING OF TRANSACTIONS**

26
27 **Q. IN YOUR OPINION, DOES THE COMPANY'S RECORDING OF**
28 **TRANSACTIONS IN THE SPECIALIZED OUTSIDE SERVICES ACCOUNT**
29 **CONFORM TO GAAP?**

1 A. No. In my opinion, the accounting practices and procedures the Company uses to record
2 expenditures for outside services do not conform to GAAP.

3

4 **Q. PLEASE EXPLAIN THE BASIS FOR YOUR CONCLUSION.**

5 A. GAAP requires that invoices be processed promptly for transactions to be recognized in
6 the appropriate period:

7 If information is not available when it is needed or becomes
8 available only so long after the reported events that it has no
9 value for future action, it lacks relevance and is of little or no
10 use... Timeliness alone cannot make information relevant,
11 but a lack of timeliness can rob information of relevance it
12 might otherwise have had.

13 (FASB Statement of Concepts 2 paragraph 56)

14 The goal of accrual accounting is to account in the periods in
15 which they occur for the effects on an entity of transactions
16 and other events and circumstances, to the extent that those
17 financial effects are recognizable and measurable.

18 (FASB Statement of Concepts 6, paragraph 145). I include copies of both
19 paragraphs in my Exhibit No. ____ (DPK- 3).

20 The FERC USOA requires that all transactions be entered not later than 60 days
21 after the last day of the period ended. (Title 18, Code of Federal Regulations, Part 352,
22 Chapter I, Paragraph 103).

23 In examining Olympic's records, I found that Olympic recorded 148 transactions
24 in its September ledger account for "Other Specialized Services." Of those 148
25 transactions, only 23 had September document dates. Of the remainder, seventy-three
26 were from August, thirty-one were from July, fifteen from June, three from May, two
27 from March and even one from February. Staff witness Mr. Colbo makes the same type
28 of observation when he discusses in his testimony that for most of the accounts in the
29 general ledger, invoices were received from up to four and five months prior to when
30 they were actually recorded in its accounting system.

1 The Company's delayed recording of transactions is inconsistent with GAAP's
2 accrual accounting principle:

3 Accrual accounting attempts to record the financial effects on
4 an entity of transactions and other events and circumstances
5 that have cash consequences for the entity in the periods in
6 which those transactions, events, and circumstances occur
7 rather than only in the periods in which cash is received or
8 paid by the entity.

9 FASB Statement of Financial Accounting Concepts No. 6, paragraph 139.
10 A copy of this paragraph is contained on page number 4 of my Exhibit No.
11 ___ (DPK-3).

12
13 **Q. DO YOU HAVE ANOTHER EXAMPLE OF THE COMPANY FAILING TO**
14 **PROMPTLY RECORD TRANSACTIONS IN THE PERIOD THE COST WAS**
15 **INCURRED?**

16 A. Yes. In Ms. Hammer's deposition, Olympic was asked about the difference in the
17 Company's August power costs, which was reported in the FERC proceedings to be
18 \$741,126, and the power costs for the same period supplied to Tosco in this proceeding:
19 \$582,518. Olympic explained that one of the reasons for the difference is that power
20 invoices are not necessarily recorded in the same month as the invoice is received.

21 Olympic explained that power costs are recorded when the invoices are paid:

22 Ms Hammer: The month of August was – just happened to be all
23 of the invoices that happened to be recorded in that month. They
24 aren't tracked individually, whereas the 582,000 is tracked
25 individually by station and doesn't necessarily reflect the month
26 that it was paid in.

27 (Exhibit No. ___ (DPK-4), Deposition of Ms. Hammer at Tr. 118, lines
28 14-19).

29 The same situation applies to Olympic's recording of invoices for
30 services rendered by outside service providers:

1 By Mr. Trotter: With respect to outside service providers, are those expenses
2 recorded by Olympic for the month the work actually performed... or when
3 Olympic actually paid the invoice?

4 Ms. Hammer: They're recorded when the invoice is paid. (Exhibit
5 No. ___ (DPK-4), Deposition of Ms. Hammer at Tr. 103, lines 4-8).

6 In addition, Olympic testified that in "most cases" there was a time lag between when an
7 invoice for outside services is received and when it is paid. (Exhibit No. ___ (DPK-4),
8 Deposition of Ms. Hammer at Tr. 103 lines 9-13).

9
10 **Q. WHAT IS THE EFFECT ON THE COMPANY'S FINANCIAL DATA WHEN**
11 **THE RECORDING OF AN INVOICE IS DELAYED BEYOND THE PERIOD IN**
12 **WHICH THE RELATED COST WAS INCURRED?**

13 A. The effect of the Company's failure to record an invoice in the month it is received can
14 result in an extraordinarily large expense to be recorded in one month, and an
15 extraordinarily small expense recorded in another month. That is what happened with
16 Olympic's power costs in the example I found. With most transactions being recorded in
17 this matter, the accuracy and reliability of a company's accounting and financial data
18 diminishes.

19
20 **Q. IF THE COMPANY IS NOT MAINTAINING ITS BOOKS AND RECORDS**
21 **USING ACCRUAL ACCOUNTING, WHAT METHOD IS OLYMPIC USING?**

22 A. The type of accounting the Company is using is referred to as a "modified cash basis" of
23 accounting. The modified cash basis is a hybrid accounting model that uses accounting
24 techniques from both a cash basis and accrual accounting methods. Revenue,
25 depreciation, and long-term assets are recognized using accrual accounting. However,
26 expenses are recognized on a cash basis.

27
28 **Q. DOES SUCH A MODIFIED CASH BASIS OF ACCOUNTING CONFORM TO**
29 **GAAP?**

30 A. No, the modified cash basis of accounting does not conform to GAAP. When a company
31 uses methods or principles, other than those prescribed by GAAP, i.e. using the modified

1 cash basis, the accounting basis is referred to as an “Other Comprehensive Basis Of
2 Accounting” or OCBOA. (AICPA, Statement of Auditing Standards No. 62, *Special*
3 *Reports*).

4
5 **Q. IS THE FERC USOA CONSIDERED AN OCBOA?**

6 A. Yes, it is. However, the differences between FERC and GAAP are few and specific. The
7 issues I address, such as the use of the modified cash basis and recording of AFUDC, are
8 the same between the two systems.

9
10 **Q. WHAT ACCOUNTING METHOD DOES THE FERC USOA REQUIRE**
11 **CARRIERS TO MAINTAIN ITS BOOKS?**

12 A. The USOA requires the accrual basis of accounting. In its general instructions, under
13 accounting method, the FERC directs its carriers that “[The] system of accounts shall be
14 kept by the accrual method of accounting.” (Title 18, Code of Federal Regulations, Part
15 352, Chapter I, Paragrah1-4 (a)).

16
17 **Q. PLEASE EXPLAIN THE TERM “ACCOUNTING PERIOD.”**

18 A. An “accounting period” is the period of time that is used to measure financial activity. At
19 the end of an accounting period, all transactions that are known, or can be accurately
20 determined, should be recorded. In an accrual basis accounting system, all revenues
21 should be recorded for the month and related expenses accrued that month, if they are not
22 already paid. To allow time to record costs, it is not unusual to have a two or three week
23 closing cycle at the end of a period.

24
25 **Q. WHAT ACCOUNTING PERIOD DOES OLYMPIC USE?**

26 A. Olympic uses an annual accounting period. Olympic’s witness Ms. Hammer testified in
27 her deposition that the Company, for accrual purposes, maintains its records on an annual
28 basis. Exhibit No. ____ (DPK-4), Deposition of Ms. Hammer at Tr. 102, lines 22-25).
29 Therefore, Olympic maintains its monthly statements on the modified cash basis. The
30 use of the modified cash basis is consistent with Olympic’s delayed recording and cash

1 basis recognition of expenses.

2
3 **Q. IS THE USE OF AN ANNUAL ACCOUNTING PERIOD CONSISTENT WITH**
4 **THE FERC USOA?**

5 A. No. An annual accounting period is not consistent with the FERC USOA. The USOA
6 requires the company to keep its books on a monthly basis using the accrual method of
7 accounting. (Title 18 Code of Federal Regulations, Chapter I, Paragraph 103 (a): Each
8 carrier shall keep its books on a monthly basis so that all transactions, as nearly as may be
9 ascertained, shall be entered in the accounts not later than 60 days after the last day of the
10 period for which the accounts are stated...)

11
12 **Q. IN ITS DIRECT CASE, DID THE COMPANY RELY ON THE MONTHLY**
13 **FINANCIAL DATA YOU REVIEWED?**

14 A. Yes. According to Olympic, “the revised base period operating expenses were taken
15 from Olympic’s monthly income statements.” (Exhibit No. ____ (CAH-1T) at page 12,
16 line 3).

17
18 **Q. DID YOUR REVIEW DISCLOSE ANY OTHER EXAMPLES WHERE, IN YOUR**
19 **OPINION, OLYMPIC’S ACCOUNTING HAS NOT CONFORMED TO GAAP?**

20 A. Yes. In my review of Company records, I discovered an example of a project in
21 which the Company lowered a length of its 16-inch transmission line, at a cost of
22 \$455,000. The line was lowered deeper below East Creek, for safety reasons.
23 The cost of this project was expensed. In Ms. Hammer’s deposition, she testified
24 that the reason this project was expensed was that the line itself was not changed:
25 “you just lower it.” (Exhibit No. ____ (DPK-4), Deposition of Ms. Hammer at Tr.
26 71, line 4). This does not conform to GAAP. Under GAAP accounting, a cost is
27 capitalized when that cost provides a benefit beyond one operating cycle,
28 normally one year. Lowering the pipeline improves the safety over the remaining
29 life of the asset. Under GAAP, the associated cost would be capitalized, not
30 expensed.

31 ...many assets yield their benefits to an entity over several periods,...Expenses

1 resulting from their use are normally allocated to the periods of their estimated
2 useful lives (the periods over which they are expected to provide benefits) by a
3 “systematic and rational” allocation procedure...

4 FASB Statement of Financial Accounting Concepts No. 6, paragraph 149. A
5 copy of this paragraph is contained on page 6 of my Exhibit No. ____ (DPK-3).
6

7 **Q. WHAT IS THE EFFECT OF THE COMPANY’S FAILURE TO CONFORM TO**
8 **GAAP IN ITS ACCOUNTING PRACTICES AND PROCEDURES?**

9 A. First and foremost, the integrity of the Company's financial records becomes suspect.
10 The results of the Company’s accounting practices and procedures reveal internal control
11 weaknesses. For example, invoices that have been dated months earlier not getting
12 recorded on the books until months after they are received.

13 Because the Company’s accounting practice and procedures do not conform to
14 GAAP, the degree to which the Commission and its Staff can rely on the financial
15 information Olympic provided is seriously weakened. All auditors must rely to some
16 extent on the internal processes of the Company’s accounting system, since it is
17 unrealistic that each and every transaction can be traced and confirmed. Auditors will
18 review a mixture of test year transactions. If the transactions are recorded in a method
19 not consistent with Generally Accepted Accounting Principles, the auditor has little
20 confidence that the remaining transactions are recorded correctly. As more transactions
21 are found that either cannot be supported, or are improperly recorded, the auditor’s
22 confidence in the Company’s financial data continues to be undermined, and the
23 Company’s financial data becomes unreliable.
24

25 **IV. OLYMPIC’S ACCOUNTING OF ALLOWANCE FOR FUNDS USED DURING**
26 **CONSTRUCTION (AFUDC)**
27

28 **Q. PLEASE DESCRIBE “ALLOWANCE FOR FUNDS USED DURING**
29 **CONSTRUCTION” (AFUDC).**

30 A. During construction of carrier plant, a company incurs capital costs, but these costs are
31 not allowed to be recovered in rates until the plant is used and useful. AFUDC is a

1 method that allows the company to capitalize the related cost of funds, and defer the
2 recognition of those costs until the plant is actually placed in service. At the point the
3 plant actually begins to provide service, the related capitalized financing costs are added
4 to the associated plant accounts, and the company begins recovering the deferred costs
5 over the life of the associated plant.
6

7 **Q. HAS OLYMPIC INCLUDED AFUDC IN ITS DIRECT CASE?**

8 A. Yes. Company Exhibit No. ___ (CAH-4), Schedule 5, lines 3 and 6 show that the
9 Company included \$7.5 million of unamortized AFUDC in the Depreciated Original Cost
10 rate base for the base period, and \$10 million for the test period. The Company also
11 included \$152,000 of AFUDC amortization expense for the base period, and \$204,000
12 for the test period. See Exhibit No. ___ (CAH-4), Schedule 1, line 5.
13

14 **Q. DO OLYMPIC'S BOOKS AND RECORDS REFLECT THE SAME AFUDC**
15 **AMOUNTS THAT OLYMPIC INCLUDES IN ITS RATE FILING?**

16 A. No. In fact, my examination of Olympic's 2001 Balance Sheet (provided by Olympic in
17 response to WUTC Staff Data Request No. 27) shows that Olympic maintains no balance
18 of AFUDC at all its books. Nor does the Company recognize AFUDC income on its
19 income statements.
20

21 **Q. DID ANY OLYMPIC WITNESS DISCUSS THE RECORDING OF AFUDC ON**
22 **THE COMPANY'S BOOKS?**

23 A. Yes. Ms. Hammer deferred the question of AFUDC to Mr. Collins. See Exhibit No. ___
24 (DPK-4), Deposition of Ms. Hammer at Tr. 21, lines 11-19. Mr. Collins testified:

25 By Mr. Trotter: . . .am I correct that Olympic does not record
26 AFUDC on its books?

27 Mr. Collins: I am not aware of recording AFUDC on its books.

28 It's a regulatory calculation that is done when computing cost of
29 [service].

30 Exhibit No. ___ (DPK-5), Deposition of Mr. Collins at Tr. 68, lines 14-19).
31

1 **Q. IS AFUDC A REGULATORY CALCULATION THAT IS ONLY DONE WHEN A**
2 **COMPANY COMPUTES ITS COST OF SERVICE?**

3 A. No. While AFUDC is a component of the cost of service, AFUDC is a regulatory asset
4 that should be recorded on a company's books if it is probable that the cost will be
5 allowed in rates.

6
7 **Q. IN YOUR OPINION, DOES THE COMPANY'S FAILURE TO MAINTAIN AN**
8 **ACCOUNTING OF AFUDC ON ITS BOOKS AND RECORDS CONFORM TO**
9 **GAAP?**

10 A. No. Paragraph 15 of FASB 71 is the authoritative standard regarding the accounting of
11 AFUDC, and requires a company to capitalize the cost of financing related to AFUDC.
12 That paragraph states, in pertinent part:

13 "In some cases, a regulator requires an enterprise subject to its authority to
14 capitalize, as part of the cost of plant and equipment, the cost of financing
15 construction as financed by borrowings and partially by equity. ...In such
16 cases, the amount capitalized for rate-making purposes...shall be
17 capitalized for financial reporting purposes..."

18 I have included the full text of FASB 71, Paragraph 15, in my Exhibit No. ____ (DPK-6).

19

20 **Q. COULD A REGULATED COMPANY NOT HAVE AFUDC AND STILL**
21 **COMPLY WITH GAAP?**

22 A. Yes, but only if the recovery of the AFUDC in regulated rates was not probable. In that
23 case, the company would not record AFUDC as a regulatory asset. AFUDC would be
24 expensed in the period the cost was incurred, regardless of when the related asset was
25 placed in service.

26 **V. CONCLUSION**

27

28 **Q. IN YOUR OPINION, CAN THE ACCOUNTING SYSTEM, ACCOUNTING**
29 **POLICIES, PRACTICES, AND PROCEDURES OF OLYMPIC PIPE LINE BE**
30 **REASONABLY EXPECTED TO PRODUCE FINANCIAL DATA THAT**
31 **CONFORMS TO GAAP ON A CONSISTENT AND COMPREHENSIVE BASIS?**

1 A. No. Olympic's present accounting methods cannot produce financial data that complies
2 with GAAP on a comprehensive and consistent basis. While Olympic's revenue is being
3 recorded in the month that the revenue is earned, Olympic's accounting system will not
4 be in conformity with GAAP until all transactions are accounted for using the accrual
5 basis of accounting and not on a modified cash basis. Olympic's accounting system must
6 be redesigned to begin the prompt processing and recording of transactions. Olympic
7 must put into place internal controls, so it does not expense costs that should be
8 capitalized. The Company's lack of an accounting system that produces financial data in
9 conformity with GAAP does not preclude the production of financial statements that
10 conform with GAAP. However, such financial statements would be the result of detailed
11 and specific adjustments and restatements. Reliance on the financial data for the test year
12 that Olympic has produced based on its accounting system is limited due to the
13 weaknesses in that accounting system that I have discovered.

14

15 **Q. DID OLYMPIC PROVIDE FINANCIAL DATA BASED ON GAAP IN THIS**
16 **CASE?**

17 A. No.

18

19 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

20 A. Yes.

21