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-2018-3000164

DIRECT TESTIMONY

WITNESS: SCOTT A. BAILEY

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

DATED: MARCH 29, 2018

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DIRECT TESTIMONY
OF
SCOTT A. BAILEY

I. INTRODUCTION AND PURPOSE OF TESTIMONY

1. Q. Please state your name and business address.

A. My name is Scott A. Bailey. My business address is PECO Energy Company, 2301 Market Street, Philadelphia, Pennsylvania 19103.

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

A. I am employed by PECO Energy Company ("PECO" or the "Company") as Vice President and Controller. In that capacity, I am responsible for maintaining PECO's accounting books and records under United States Generally Accepted Accounting Principles ("GAAP") and the Federal Energy Regulatory Commission's ("FERC") *Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act* ("Uniform System of Accounts"). In addition, I am responsible for PECO's financial reporting to the U.S. Securities and Exchange Commission ("SEC"), the FERC and the Pennsylvania Public Utility Commission ("PUC" or "Commission").

3. Q. Please describe your educational background.

A. I received a Bachelor's Degree in Accountancy from West Chester University.

4. Q. Please describe your professional experience.

A. Upon graduation, I was hired as a staff accountant for Deloitte & Touche LLP in Philadelphia. After 6 years at Deloitte & Touche, I began employment with Exelon Corporation in 2004. I held various roles at Exelon, including Manager of Corporate Accounting and Manager of Power Team Accounting prior to being promoted to Director of Accounting for Power Team in 2007. In 2011, I became Assistant Controller for Exelon Generation overseeing the accounting operations of Exelon's power marketing and fossil generation division. I assumed my current responsibilities as Vice President and Controller of PECO in April 2012.

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

A. My testimony covers three subjects. First, I will provide a general overview of PECO's accounting processes. Second, I will describe how PECO allocates common costs between its electric and natural gas operations. Third, I will present and explain PECO's claims for accrued and annual depreciation related to the utility plant in service of PECO's Electric Division as of the end of the historic test year (December 31, 2017), the future test year (December 31, 2018) ("FTY") and the fully projected future test year (December 31, 2019) ("FPFTY").

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

A. I am sponsoring PECO Exhibits SAB-1, SAB-2 and SAB-3, which are based on the results of the *2013 Depreciation Study – Calculated Annual Depreciation Accruals Related to Electric and Common Plant as of December 31, 2013* which was filed with the Commission in 2015 (the "2013 Depreciation Study") and updated, respectively, to reflect the original cost of PECO's electric and common plant in service at December 31, 2017 and estimated to be in service at December 31, 2018 and December 31, 2019. I am also sponsoring PECO Exhibit SAB-4, which is PECO's 2013 Depreciation Study that was also used in the Company's 2015 base rate proceeding (Docket No. R-2015-2468981).

II. OVERVIEW OF PECO'S ACCOUNTING PROCESSES

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

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

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

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

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

A. Yes, they are. Exelon Corporation, PECO's parent, maintains an Audit and Controls Department (often referred to as "Internal Audit", or "IA") that routinely audits various aspects of PECO's operations. In addition, PECO's books and records are audited annually by its outside auditors.

In 2014, the PUC completed a Focused Management and Operations Audit of PECO Energy Company, which included a review of the Company's internal audit process.[1] The PUC's report made note that "the IA department is responsible for evaluating the design and effectiveness of internal control systems and governance processes throughout the Exelon organization by performing risk based audits on activities affecting the financial, legal, reputational and operational aspects of the Company. The PUC's review of the internal audit process resulted in no findings or recommendations.

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

A. As explained in Mr. Innocenzo's testimony (PECO Statement No. 1), the assets included in PECO's rate base in this case are, or by the end of the FTY and the FPFTY will be, in service and used by PECO to provide electric service to its customers. Moreover, PECO has in place a process which requires that: (1) a record be made in the field at the time any property unit is added to service or permanently

[1] *See* Focused Management and Operations Audit of PECO Energy Company, Docket No. D-2013-2370921 (Issued September 2014).

removed from service; and (2) based on the records made in the field, appropriate accounting entries be made to the Company's property accounts to add or remove, respectively, the original cost of any property unit that was added or retired. Individuals with appropriate authority must review and approve the entries that are made to record the addition and removal of property units from the Company's plant accounts. Additionally, IA performed an audit of the controls surrounding PECO's fixed asset process in 2015, which included review of fixed asset accounting records. IA concluded that the processes and general control environment, which includes those activities necessary to provide reasonable assurance that risks are being managed and objectives met, are effective.

III. ALLOCATION OF COSTS BETWEEN ELECTRIC AND GAS OPERATIONS

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

A. Yes. Under applicable PUC and FERC regulations, PECO is required to maintain separate statements of income and to maintain, separately, certain balance sheet accounts for its electric and natural gas operations.

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

A. "Common plant" (i.e., facilities, such as PECO's headquarters office building in Philadelphia, that are used to provide both electric and gas service) is allocated on the basis of a three-part formula, with equal weight given to relative plant investment, total revenue and number of customers. The allocation factors utilized for purposes of this rate filing are shown on Schedule C-8 of PECO Exhibits BSY-1, BSY-2 and BSY-3.

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

A. No, a different method is used to allocate operating expenses. The Company developed factors to allocate operating expenses that cannot be directly assigned between electric and gas operations. PECO reviews these factors annually and updates them as necessary to ensure that they reflect the forces driving the costs to which they apply.

14. Q. Please explain the method used to allocate non-assignable Administrative and General expenses and bad debt expense.

A. Non-assignable Administrative and General ("A&G") expenses consist of the labor and other resources of the Company's A&G departments, such as Finance, Marketing, and Accounting, which provide service to both the gas and electric divisions. Non-assignable expenses in these areas are allocated to electric operations based upon a percentage calculated by dividing: (1) the previous year's non-fuel Operating & Maintenance ("O&M") expenses that were directly assigned to electric operations, by (2) the total of all the previous year's non-fuel O&M expenses that were directly assigned to gas and electric operations.

Bad debt expense associated with customer accounts receivable is allocated to electric operations based on the ratio of accounts receivable written off. The ratio is updated annually based on the prior year's actual accounts receivable charge-off experience.

Bad debt expense is allocated for accounting purposes. However, for ratemaking purposes, uncollectible accounts expense is calculated based on net uncollectible accounts charged off (excluding Customer Assistance Plan in-program arrearage write-offs) as a percentage of total tariff revenue, for the period 2015-2017.

IV. PECO ELECTRIC DIVISION DEPRECIATION CLAIMS

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

A. Yes. With the assistance of Gannett Fleming, Inc., PECO prepared its 2013 Depreciation Study which is provided as PECO Exhibit SAB-4. The service lives developed in the study were used in the Company's 2015 base rate proceeding (Docket No. R-2015-2468981) and were not opposed by any party in that proceeding. The service lives from that study continue to be used in support of this proceeding as a service-life study is required to be filed once every five years under the Pennsylvania Public Utility Code. Because PECO filed its most recent study in 2015, a new study is not due to be filed until 2020.

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

A. Yes. PECO Exhibits SAB-1, SAB-2 and SAB-3 are based on the results of the 2013 Depreciation Study and updated to reflect PECO's electric and common plant in service as of December 31, 2017, 2018 and 2019 respectively.

17. Q. What is the purpose of the depreciation study?

A. PECO is relying principally on data for a FPFTY ending December 31, 2019 to support its proposed increase in revenue requirement in this case. Accordingly, the purpose of the depreciation study is to provide the basis to calculate the estimated 2019 annual depreciation accruals related to electric and common plant in service for ratemaking purposes and, using procedures approved by the PUC, to estimate PECO's electric and allocated common plant book reserve at December 31, 2019.

18. Q. Please describe PECO Exhibits SAB-1, SAB-2 and SAB-3.

PECO Exhibit SAB-1 is titled "Annual Depreciation Accruals Related to Utility Plant in Service at December 31, 2017." This exhibit is based on the results of the 2013 Depreciation Study and updated to reflect the original cost of PECO's electric and common plant in service at December 31, 2017. The report also includes the detailed depreciation calculations used to determine 2018 depreciation rates, which are used in calculating the estimated 2018 Annual Depreciation Accruals shown in PECO Exhibit SAB-2.

PECO Exhibit SAB-2 is titled "Estimated Annual Depreciation Accruals Related to Utility Plant in Service for 2018." This exhibit is based on the results of the 2013 Depreciation Study and updated to reflect the estimated original cost of PECO's plant in service at December 31, 2018. PECO Exhibit SAB-2 includes PECO's FTY plant additions for electric and allocated common plant claimed in rate base in this case and reflects the depreciation accruals related to those additions in the column titled "2018 Estimated Annual Depreciation Accrual."

PECO Exhibit SAB-3 is titled "Estimated Annual Depreciation Accruals Related to Utility Plant in Service for 2019." This exhibit is based on the results of the 2013 Depreciation Study and updated to reflect the estimated original cost of PECO's plant in service at December 31, 2019. PECO Exhibit SAB-3 includes PECO's FPFTY plant additions for electric and allocated common plant claimed in rate base in this case and reflects the depreciation accruals related to those additions in the column titled "2019 Estimated Depreciation Accrual."

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

A. Yes. In 1984, in PECO's rate proceeding at Docket No. R-842590, the Commission approved PECO's use of the remaining life method and also approved PECO's adjusted book reserve as the measure of accrued depreciation for ratemaking.[2] PECO has employed the remaining-life method in each of the Annual Depreciation Reports filed with the Commission since that time. The remaining life method spreads the undepreciated cost of plant over the estimated remaining life of the depreciable group.

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

A. The accumulated book reserve, by account, at December 31, 2017, is one of the factors used in calculating the annual depreciation accruals shown in PECO Exhibit

[2] *Pa. P.U.C. v. Philadelphia Elec. Co.*, Docket No. R-842590 *et al.*, 58 Pa PUC 743, 751-755 (Order entered Jan. 24, 1985).

SAB-1. The methodology used to calculate the annual depreciation accrual is consistent with the methodology described in the 2013 Depreciation Study that is provided as PECO Exhibit SAB-4.

21. Q. How was the estimated accumulated book reserve at December 31, 2018 determined?

A. As shown in Exhibit SAB-2, the December 31, 2018 estimated accumulated book reserve was developed by: (1) adding the 2018 estimated annual depreciation accrual to the actual accumulated book reserve by account as of January 1, 2018; (2) subtracting the 2018 estimated plant retirements by account; and (3) adding 2018 estimated salvage or subtracting estimated removal costs that are closed to the accumulated book reserve, by account. The 2018 estimated annual depreciation accruals are estimated by adding the following three items: (1) the estimated depreciable plant net book value balance by account as of December 31, 2017, multiplied by the depreciation rates shown in PECO Exhibit SAB-1; (2) the 2018 estimated plant additions multiplied by the depreciation rate (using a half-year convention) for the appropriate account; and (3) the 2018 estimated salvage or cost of removal multiplied by the depreciation rate (using a half-year convention) for the appropriate account.

22. Q. How was the estimated accumulated book reserve at December 31, 2019 determined?

A. As shown in PECO Exhibit SAB-3, the December 31, 2019 estimated accumulated book reserve was developed by: (1) adding the 2019 estimated annual depreciation accrual to the estimated accumulated book reserve by account as of January 1, 2019; (2) subtracting the 2019 estimated plant retirements by account; and (3) adding 2019 estimated salvage or subtracting estimated removal costs that are closed to the accumulated book reserve, by account. The 2019 estimated annual depreciation accruals are estimated by adding the following three items: (1) the estimated depreciable plant net book value balance by account as of December 31, 2018, multiplied by the depreciation rates shown in PECO Exhibit SAB-3; (2) the 2019 estimated plant additions multiplied by the depreciation rate (using a half-year convention) for the appropriate account; and (3) the 2019 estimated salvage or cost of removal multiplied by the depreciation rate (using a half-year convention) for the appropriate account.

23. Q. Have you prepared schedules that summarize the development of the original cost of gross plant, estimated accumulated book reserve, estimated depreciable plant net book value, estimated annual depreciation accrual, and estimated annual depreciation accruals, by property account, for utility plant in service at December 31, 2019?

A. Yes. PECO Exhibit SAB-3 provides this information. The original cost of gross plant in service at December 31, 2019 was calculated by adding the estimated plant additions by account for 2019 to, and subtracting the estimated plant retirements for 2019 from, the estimated original cost of gross plant as of December 31, 2018. I previously explained how the estimated accumulated book reserve at December 31, 2018 and estimated annual depreciation accrual related to plant in service at December 31, 2018 were determined.

The estimated net book value of depreciable plant at December 31, 2019 was calculated by subtracting the estimated accumulated book reserve at December 31, 2019 from the estimated original cost of gross plant at December 31, 2019.

The 2019 annual depreciation accruals were estimated by adding the following three items: (1) the estimated net book value balance of depreciable plant by account as of December 31, 2018, multiplied by the depreciation rates shown in PECO Exhibit SAB-3; (2) the 2019 estimated plant additions multiplied by the depreciation rate (using a half-year convention) for the appropriate account; and (3) the 2019 estimated salvage or cost of removal multiplied by the depreciation rate (using a half-year convention) for the appropriate account.

V. CONCLUSION

24. Q. Does this complete your direct testimony at this time?

A. Yes, it does.