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Statement H

HOPE NATURAL GAS COMPANY

Determination Of Trends Used To Ascertain Original Cost Trended To 1938 Prices

1. Basic Trends

To trend the original cost of the Company's properties to reflect 1938 material and labor prices certain basic trends hereinafter described were determined from the Company's records, supplemented where necessary from other labor and material price data. In applying these basic trends to the Company's various property accounts they were appropriately combined, when necessary, into composite trends to reflect the proportionate cost of labor and kinds of material in each account. All such composite trends were determined and applied on the basis of a careful study of the properties in each account and the full details appear in subsidiary trended original cost sheets.

The determination of the basic trends used is here briefly described, the details of this determination likewise appearing in subsidiary trended original cost sheets.

2. Labor Trends

Labor trends for pipe line and gas well construction from 1906 to 1938 were based on average Company rates paid to various classifications of labor. Prior to 1906, Company rates were available only for common labor and these rates were used as the basis for determining rates and trends for other classifications as explained below.

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Average Company rates were determined from an analysis of payroll vouchers for the months of April, July and October and of payroll department records for each year from 1906 to 1938. From these data, an adopted average daily rate was obtained which in turn was converted to an average hourly rate based on the schedule of working hours in effect in each year.

Individual trends were thus ascertained for the years 1906 to 1938 inclusive, for the following principal classifications of labor used for pipe line and gas well construction:

Driller
Tool Dresser
Roustabout
Laborer

(a) These individual trends for driller and for tool dresser were combined in the ratio of one to one to determine the composite trend for gas well construction. This ratio was based on the Company's experience in drilling operations.

(b) These individual trends for roustabout and for laborers were combined in the ratio of one to four to determine the composite trend for pipe line construction, the proportion being estimated from the typical Company gang setup in laying lines.

While comparable data was not available prior to 1906, payroll vouchers for certain transmission and field lines constructed by the Company and predecessor companies provided rates paid to common labor. From the prevailing rate in each year, a trend was determined for common labor from 1891 (when some purchased property now owned by the Company was built) to 1906 and this trend was used as the basis for determining rates and trends for other classifications of labor prior to 1906.

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(c) In order to ascertain trends for building construction and equipment installation, field payroll vouchers for compressor station construction were examined for each year from 1901 to 1938 to obtain average rates paid by the

Company to the classes of labor in this type of work. Average hourly rates were thus determined for the following classifications of labor:

Carpenter
Electrician
Machinist
Laborer

Since more complete data was available on the rates paid to carpenters, the trend for this classification, after comparison with other skilled labor trends (electrician and machinist), was used as typical of skilled labor. This trend was then combined with the trend for unskilled labor (laborer) in the ratio of 2 to 3, respectively, to determine the composite trend used for all structures and equipment installations except measuring and regulator station equipment and telephone equipment, the proportion of skilled and unskilled labor being determined from an analysis of MacFarlan Compressor Station construction costs.

(d) The trends for the installation of field measuring and regulator station equipment were determined from unit cost developments, based on field estimates of the time required for various classifications of labor (foreman, utility man and roustabout) and team or truck, priced at average Company rates from payroll vouchers and payroll department records as noted above. The trends so determined for field stations were also used for the corresponding type of transmission stations.

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(e) Separate labor trends were not determined for the installation of telephone equipment, composite trends including both material and labor being used, the details of which appear in subsidiary trended original cost sheets.

(f) The trend for contract labor, used for the Clarksburg Office and Garage-Shop Building, was based on the index of union hourly wage rates for all building trades, determined by the Industrial Relations Division, U. S. Department of Labor, Bureau of Labor Statistics, as published in the Engineering News Record of April 27, 1939.

3. Pipe Trends

The trend for steel line pipe from 1902 to 1938 was based on the weighted average trend for two, three, four, six and eight inch steel screw line pipe as determined primarily from the average delivered prices paid by the Company. In some instances, it was necessary to supplement these prices with the corresponding prices paid by affiliated companies served by the Purchasing Department of The Peoples Natural Gas Company. In a few cases, estimated prices were used, based on the available average Company prices, adjusted by the use of the steel line pipe trend developed from the average delivered prices paid by The Peoples Natural Gas Company.

Prior to 1902, the Company's price data was insufficient in detail to establish a trend. Pipe price data for wrought iron pipe up to 1899 and for steel pipe from 1900 to 1902, taken from Ford, Bacon & Davis, Inc. cost files, was used to establish a trend which was equalized to the

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Company trend in 1904 and used as the basis for extending the Company price trend to earlier years.

The manufacture of steel pipe on a commercial basis began in 1900 and for this reason this year was adopted as the dividing point between steel and wrought iron pipe. The line pipe trend for the whole period to 1938 was expressed in terms of the price of steel pipe in 1938 so that the cost of all wrought iron pipe included in the original cost is thus converted to the equivalent cost of steel pipe in 1938, rather than the higher priced wrought iron.

4. Casing and Tubing Trends

The trend for casing and tubing from 1902 to 1938 was based on the weighted average trend for two and three inch tubing and $6\frac{5}{8}$, $8\frac{1}{4}$ and 10 inch casing as determined primarily from the average delivered prices paid by the Company. Where prices were not available from Company records, supplementary prices were obtained as described above for line pipe.

The casing and tubing trend was extended back from 1902 on the basis of the line pipe trend explained above. As with line pipe, the trend for the entire period to 1938 was expressed in terms of the price of steel casing and tubing in 1938 and applied to the cost of all casing and tubing included in the original cost.

5. Fitting Trends

Separate trends were determined, based primarily on prices paid by the Company, for the following types of fittings:

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Bull Plugs
Casing Heads
Dresser Couplings
Check Valves, brass (same as globe valves)
Globe Valves, brass
Nipples (same as line pipe)
Orifice Flanges
Orifice Plates
Regulators
Saddles
Stop Cocks, brass
Swedge Nipples

The Company's records of prices paid for other types of fittings do not sufficiently identify the particular kind and character of fitting or provide enough data in consecutive years with which to ascertain a trend. Consequently, price data obtained from Ford, Bacon & Davis, Inc. cost files based on manufacturers' quotations were used to determine trends for the following:

Check Valves, iron
Fittings, screwed
Fittings, flanged
Gate Valves, screwed
Gate Valves, flanged
Gauges
Globe Valves, iron
Stop Cocks, iron

Company price records were available in most instances back to 1901 or some later year. To extend the price trends to prior years trends for corresponding types of fittings based on Ford, Bacon & Davis, Inc. cost data similar to that noted above were used.

6. Equipment Trends

Separate trends were determined for more than 25 different items of equipment such as gas compressors, gas engines, pumps, motors, generators, etc. More details than were obtainable from the Company's records were required to establish trends for these various items of equipment

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and accordingly specific data available from Ford, Bacon & Davis, Inc. cost files was used as the primary basis for developing these trends from 1914 to 1938. In some cases specific data was available for as early as 1900. Where specific data could not be obtained to extend these trends prior to 1914 various appropriate bases were used depending on the type of equipment. For example, trends for gas compressors, gas engines, pumps, etc. were extended to earlier years on the basis of the trend for foundry iron, determined from the yearly average net cost per ton; the trends for electric motors, generators, etc. were extended back to 1900 on the basis of the trend for electric motors obtained from General Electric Company data as published in the Building Committee Report of the New York-Pittsburgh Association of Valuation Engineers.

The bases described above were used for determining trends for all equipment except that included in the telephone account, the trends for which were based on the prices paid by the Company for the wire, poles, insulators, telephones, etc. included in the telephone installation. The methods of determining these trends are explained in the subsidiary trended original cost sheets.

7. Building Material Trends

Trends from 1901 to 1938 for the principal items of building material were based on average prices paid by the Company obtained from analysis of construction work performed by the Company. Trends were developed on this basis for the following materials:

Cement
Sand
Gravel
Corrugated Iron
Flat Sheet Iron

The Company records of prices paid for other building materials do not sufficiently identify the particular kind of material or provide enough data in consecutive years with which to determine a trend. The Building Committee Report of the New York-Pittsburgh Association of Valuation Engineers was used as the main source of price data for these materials for the period from 1901 to 1930, the trends so developed for approximately 50 different items being extended to 1938 by referring to prices published in the Engineering News Record and in bulletins of the United States Bureau of Labor Statistics, supplemented by data from the Ford, Bacon & Davis, Inc. cost files.

* * * * *

Statement J

HOPE NATURAL GAS COMPANY

Original Cost Trended to 1938 Prices of Natural Gas Production Plant, Transmission Plant and General Plant (Jointly Used) Existing at December 31, 1938

Total By Years First Placed in Public Service

Year First Placed in Public Service	Original Cost	Original Cost Trended to 1938 Prices			Approximate Weighted Average Trend (1938=100)
		Not Trended	Trended (A)	Total	
(1)	(2)	(3)	(4)	(5)	(6) = (2) ÷ (5)
1891	$ 9,732	$ —	$ 30,400	$ 30,400	32.0
1892	203,822	1,214	486,643	487,857	41.8
1893	52,126	2,144	133,422	135,566	38.5
1894	74,419	681	191,866	192,547	38.6
1895	68,264	1,072	193,111	194,183	35.2
1896	26,292	101	81,672	81,773	32.2
1897	41,064	569	128,504	129,073	31.8
1898	40,043	1,133	99,732	100,865	39.7
1899	239,067	29,721	447,577	477,298	50.1
1900	177,521	7,619	417,297	424,916	41.8
1901	118,241	520	273,806	274,326	43.1
1902	1,229,574	388,718	1,839,403	2,228,121	55.2
1903	1,823,260	79,086	3,284,355	3,363,441	54.2
1904	2,088,446	46,900	4,205,102	4,252,002	49.1
1905	1,008,070	59,661	2,509,825	2,569,486	39.2
1906	440,829	19,921	957,492	977,413	45.1
1907	1,588,829	246,039	2,744,223	2,990,262	53.1
1908	796,342	124,406	1,454,305	1,578,711	50.4
1909	1,146,626	32,497	2,490,244	2,522,741	45.5
1910	2,150,919	185,497	4,346,665	4,532,162	47.5
1911	2,632,698	375,954	4,915,310	5,291,264	49.8
1912	1,429,618	62,359	3,151,430	3,213,789	44.5
1913	2,640,408	69,506	5,660,456	5,729,962	46.1
1914	1,691,034	58,832	3,728,864	3,787,696	44.6
1915	1,285,027	64,038	2,774,815	2,838,853	45.3
1916	2,247,279	164,430	3,882,538	4,046,968	55.5
1917	3,090,157	76,473	4,558,364	4,634,837	66.7
1918	2,732,017	71,354	3,483,126	3,554,480	76.9
1919	3,103,006	47,397	3,803,875	3,851,272	80.6
1920	2,507,985	28,483	2,731,058	2,759,541	90.9
1921	3,195,259	58,468	3,829,491	3,887,959	82.2
1922	1,031,019	29,995	1,428,939	1,458,934	70.7
1923	2,334,062	55,496	2,911,756	2,967,252	78.7
1924	3,065,508	101,052	3,458,500	3,559,552	86.1
1925	7,231,827	149,363	8,157,403	8,306,766	87.1
1926	2,484,197	187,011	2,565,014	2,752,025	90.3
1927	2,040,911	123,354	2,150,738	2,274,092	89.7
1928	1,155,524	23,254	1,302,199	1,325,453	87.2
1929	1,734,331	174,526	1,723,355	1,897,881	91.4
1930	1,395,355	25,931	1,615,465	1,641,396	85.0
1931	471,244	37,393	516,000	553,393	85.2
1932	226,955	12,283	262,132	274,415	82.7
1933	186,770	7,470	217,644	225,114	83.0
1934	2,390,535	312,361	2,317,183	2,629,544	90.9
1935	338,156	24,660	338,905	363,565	93.0
1936	2,591,508	109,784	2,737,333	2,847,117	91.0
1937	1,136,838	99,062	1,064,176	1,163,238	97.7
1938	860,725	44,056	816,669	860,725	100.0
	$70,553,439	$3,821,844	$102,418,382	$106,240,226	66.4

NOTE: (A) Includes accounts only partially trended.

8. COMMISSION WITNESSES PACE'S AND DUNN'S EXHIBIT NO. 57 ENTITLED: "Original Cost of Gas Plant as at December 31, 1938, Volume I"

Docket G-113

HOPE NATURAL GAS COMPANY

ORIGINAL COST OF GAS PLANT
AS AT DECEMBER 31, 1938

VOLUME I

TABLE OF CONTENTS

—1—

WRITTEN STATEMENT

The Federal Power Commission, under date of October 14, 1938, issued an order of investigation into and concerning all rates, charges, classifications, rules, regulations, practices or contracts of Hope Natural Gas Company. In accordance therewith, an examination of the accounts and records of Hope Natural Gas Company has been made, and, as a result, this report on the original cost of the Gas Plant of the Company is submitted.

This report is in two parts. Volume I sets forth the investment of Hope Natural Gas Company in Gas Plant per Company books and as adjusted, as of December 31, 1938. The adjusted figures show the original cost as defined in the Federal Power Commission's Uniform System of Accounts for Natural Gas Companies of the gas plant. Volume II contains a detailed explanation of the staff adjustments.

On January 1, 1939, there became effective and applicable to the Company a new Uniform System of Accounts for Gas Utilities prescribed by the Public Service Commission of West Virginia. In July, 1938, the Company began an investigation and study of its records for the purpose of stating in its Gas Plant Accounts the cost of its properties and to reflect the amount of such cost in each primary account as prescribed by said Commission.

The results of this investigation and study made by

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the Company, were made available to the accountants of the Federal Power Commission during May, 1940. An inventory of the existing property at December 31, 1938, was made by the Company and priced at what the Company claims was original cost. The results of this inventory, among other things, necessitated numerous reclassifications of costs, adjustment of prior distribution of certain costs and correction of certain accounting errors, all of which have been examined by the Commission's staff of accountants.

There is presented immediately hereinafter a condensed balance sheet of the Company as reflected by the books of account at December 31, 1938, before any adjustments, in order to set forth the capitalized cost of Gas Plant per books on that date:

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Assets	*Amount*
Gas Plant:	
Gas Plant in Service	$56,101,875.49
Construction Work in Progress	81,392.75
Gas Plant Adjustment	94,814.75
Coal Property	341,529.68
Franchises, Patent Rights and Other Intangibles	30,185.91
Total Gas Plant	$56,649,798.58
Investment and Fund Accounts	3,796,362.25
Current and Accrued Assets	15,460,687.85
Deferred Debits	5,002.28
Total Assets and Other Debits	$75,911,850.96
Liabilities	
Capital Stock	$27,969,300.00
Current and Accrued Liabilities	1,971,351.32
Deferred Credits	3,167.89
Contributions in Aid of Construction	540.87
Reserves:	
Depreciation and Depletion — Utility Plant	40,759,450.48
Other	13,932.63
Surplus—Earned	5,194,107.77
Total Liabilities and Other Credits	$75,911,850.96

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As shown on the preceding balance sheet, the Capitalized Cost of Gas Plant as of December 31, 1938, was \$56,649,798.58, of which \$56,101,875.49 represented Gas Plant in Service, summarized by functions as follows:

Production Plant	\$26,460,050.10
Transmission Plant	25,253,484.00
Distribution Plant	2,795,083.04
General Plant	1,593,258.35
Total	\$56,101,875.49

This report deals with the cost of the production plant, transmission plant, and general plant, although a cursory examination was made of the distribution plant. The following summary sets forth the cost per Company books, reclassified by the Company as shown by Schedule I, Page .... of this report, and as adjusted by the examiners:

Particulars	*Cost Per Book*	*Examiners' Adjustments*	*As Adjusted*
Production Plant	\$26,718,065.06	(\$ 384,673.83)	\$26,333,391.23
Transmission Plant	25,279,965.69	(1,414,567.34)	23,865,398.35
General Plant	1,308,761.70	(299,930.64)	1,008,831.06
Total	\$53,306,792.45	(\$2,099,171.81)	\$51,207,620.64

Schedule I of this report sets forth the total cost of Gas Plant in Service per Company books, Company's reclassification adjustments, Examiners' (F.P.C. staff) adjustments and the resulting adjusted balances, representing original cost as defined in the Commission's System of Accounts.

This schedule has been constructed to show separately the total cost of the production plant, transmission plant and general plant, representing the cost dealt with in this

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report. The total cost per books, in this respect, of \$53,306,792.45, corresponds with that shown by Exhibit 20, page 32, column 4.

Attention is called to the total examiners' adjustments of $2,099,171.81, representing a credit to the total capitalized cost of Gas Plant in Service, exclusive of distribution plant. This amount represents the net adjustment made by the examiners and is arrived at by the difference between credit adjustments, amounting to $5,883,085.12 and debit adjustments of $3,783,913.31, and is summarized by classes as follows:

Description	*Amount*
Company adjustments per Exhibit 20	$(1,804,383.48)
Company adjustments—Prior Utility Acquisitions	(232,930.69)
Correction of accounting errors	1,480,227.70
Transfers to accounts other than Gas Plant in Service	(1,542,085.34)
Examiners' adjustment—Net Credit	$(2,099,171.81)

Schedule 1-A sets forth all adjustments by sources, showing contra accounts involved. It also identifies the adjusting journal entries which are given in Volume II.

The total original cost of Gas Plant in Service, exclusive of distribution plant, at December 31, 1938, is summarized in the following tabulation which shows separately acquisitions of properties classed as operating units or systems.

Company constructed and purchases from non-utilities:		
Cost per Books	$50,088,393.17	
Adjustments	(1,866,241.12)	
As adjusted		$48,222,152.05

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Acquisitions of Prior Utilities:		
Cost per books	$3,218,399.28	
Adjustments	(232,930.69)	
As adjusted		$ 2,985,468.59
Total as adjusted—Dec. 31, 1938		$51,207,620.64

The above tabulation has been made, to focus attention on properties acquired from prior utilities. As shown above and also by Exhibit 20, page 32, column 12, the cost capitalized per Company books for this class of acquisitions is $3,218,399.28. By repricing these same properties, the Company arrives at a cost of $4,639,010.78, as shown by Exhibit 20, page 32, column 13. This repricing would result in an increase in cost recorded in plant accounts of $1,-420,611.50. The Company adjustments or repricing are not concurred in. The only adjustments to this class of property approved by the examiners are shown in the above tabulation ($232,930.69). They represent Company adjustments to reclassify capitalized cost and correct accounting errors.

An analysis of approximately ninety percent of such acquisitions and a careful examination of all vouchers, books and data available, together with consideration of each individual acquisition, leads to the conclusion there is no justification for any adjustments whereby the amounts now recorded in plant accounts would be increased. It is the opinion of the examiners that the amounts recorded at the time of acquisition represent the original cost as near as can be determined.

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The total proposed adjustment to this class of property, developed by the original cost study made by the Company, included a credit of $967,151.87, classified as follows:

Credit plant accounts—Accrued Depreciation	$(746,851.51)
Estimated costs of obtaining	10,917.50
Estimated costs of construction............	1,712.83
Correction of accounting errors	(232,930.69)
Total	$(967,151.87)

Of the above proposed adjustments, the examiners have approved only the correction of accounting errors representing a credit to Capitalized Cost of $232,930.69.

Schedules 2 to 33, inclusive, set forth the investment in gas plant, exclusive of distribution plant, by accounts, showing the cost per books, staff adjustments, and the adjusted or original cost balances. These schedules are the result of a detailed examination made by the Commission's staff of accountants of the books, records, and documents of the Company, including the Company's Original Cost study. The adjustments include the reclassification of items shown in Schedule 1.

Schedule No. 34 is a summary of amounts transferred to Account 100.4, Gas Plant Held for Future Use, of the Commission's Uniform System of Accounts.

Schedule No. 35 is a statement of Account 107, Gas Plant Adjustments, showing the source of data and manner of determining amounts by the Company.

Schedule No. 36 is a statement of Investment in Coal Property. This investment was included in Gas Plant as of December 31, 1938 by the Company, although not in-

cluded as a part of the original cost claimed per Exhibit 20. No adjusting entry has been proposed by the Company to transfer this cost to other accounts. This item has been eliminated from Gas Plant by the examiners and transferred to Account 110, Other Physical Property, by Balance Sheet Journal Entry No. 100.

Schedule No. 37 is a summary of an account designated by the Company as "Franchises, Patent Rights and Other Intangibles" and was included in Gas Plant as of December 31, 1938. An analysis of this account discloses that it consists of three items as follows:

Patent Rights:

Thermo-syphon system for gasoline absorption plant	$ 458.66
Contracts and Franchises:	
Acquired in acquisition of Clarksburg Light and Heat Co.	5,811.64
Contract for Gas:	
Hamilton Gas Corporation	23,915.61
Total	$30,185.91

The first two items shown above have been eliminated from Gas Plant by the Examiners and charged to Surplus by Balance Sheet Journal Entry No. 101.

The third item has also been eliminated from Gas Plant and transferred to Account 146, Other Deferred Debits, by Balance Sheet Journal Entry No. 101.

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Volume II of this report, as stated hereinbefore, deals with adjustments made by the examiners and includes a summary of all adjustments, together with adjusting journal entries and a detailed explanation of each.

John W. Pace,
Senior Examiner of Accounts.

Edward L. Dunn,
Examiner in Charge of Field Assignment.

Clarksburg, West Virginia
February 20, 1941

Approved:

W. E. Baker,
Chief Accountant.

Chas. W. Smith,
Chief, Bureau of Accounts, Finance and Rates.

Docket G-113

Schedule No. 1
Sheet 1 of 2

HOPE NATURAL GAS COMPANY

Investment in Gas Plant Per Books and As Adjusted As At December 31, 1938

Schedule No.	Account Number	Description	Cost Per Books	Reclassification by Company Dr.	Reclassification by Company Cr.	Cost per Books Reclassified	Examiners' Adjustments Dr.	Examiners' Adjustments Cr.	As Adjusted
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
		Natural Gas Production Plant							
2	330.1	Natural Gas Producing Lands	$ —	$ 3,319.84	$ —	$ 3,319.84	$ —	$ —	$ 3,319.84
	330.2	Natural Gas Producing Leaseholds—							
3		Operated	1,331,100.55	—	—	1,331,100.55	267,904.31	—	1,599,004.86
4		Unoperated	479,570.75	—	—	479,570.75	104,811.48	584,382.23	—
5	330.4	Rights of Way	530,476.17	9,412.94	8,978.33	530,910.78	181,930.98	67,450.29	645,391.47
6	330.5	Other Land and Land Rights	23,729.28	8,866.78	7,993.90	24,602.16	—	3,593.64	21,008.52
7	331.2	Field Measuring and Regulating Station Structures	30,244.11	3,894.08	5,520.62	28,617.57	651.94	8,130.59	21,138.92
8	331.3	Other Production System Structures	177,682.39	65,418.75	29,937.20	213,163.94	5,691.31	27,666.44	191,188.81
9	332.1	Producing Gas Wells—Well Construction	4,370,612.79	—	3,679.04	4,366,933.75	391,689.83	669,145.87	4,089,477.71
10	332.2	Producing Gas Wells—Well Equipment	7,893,605.30	—	8,023.71	7,885,581.59	8,078.12	283,149.96	7,610,509.75
11	333.11	Field Lines: Construction	3,040,755.47	35,999.16	38,233.64	3,038,520.99	921,753.13	337,784.54	3,622,489.58
12	333.12	Equipment	7,950,541.90	29,637.87	13,137.24	7,967,042.53	317,703.03	610,493.74	7,674,251.82
13	333.2	Field Measuring and Regulating Station Equipment	244,176.06	15,753.87	—	259,929.93	6,734.51	82,279.41	184,385.03
14	334	Drilling and Cleaning Equipment	387,555.33	156,184.60	—	543,739.93	52,752.85	800.07	595,692.71
15	337	Other Production Equipment	—	45,030.75	—	45,030.75	31,758.09	1,256.63	75,532.21
		Total Gas Production Plant	26,460,050.10	373,518.64	115,503.68	26,718,065.06	2,291,459.58	2,676,133.41	26,333,391.23
		Transmission Plant							
16	351.12	Land	152,660.05	13,624.99	5,163.97	161,121.07	7,116.64	5,325.50	162,912.21
20	351.23	Rights of Way	551,354.41	697.91	56,331.85	495,720.47	52,298.61	156,776.39	391,242.69
17	352.2	Compressor Station Structures	1,760,317.25	489,844.60	539,885.67	1,710,276.18	102,623.88	371,017.68	1,441,882.38
18	352.3	Measuring and Regulating Station Structures	6,305.15	5,873.14	779.79	11,398.50	151.55	3,342.84	8,207.21
19	352.4	Other Transmission System Structures	6,709.29	997.85	359.03	7,348.11	—	572.42	6,775.69
20	353	Mains	14,614,229.98	296,750.65	292,513.14	14,618,467.49	556,162.13	1,042,554.90	14,132,074.72
21	354.2	Compressor Station Equipment	8,135,673.87	273,378.24	178,069.38	8,230,982.73	684,614.14	1,231,924.88	7,683,671.99
22	354.3	Measuring and Regulating Station Equipment	26,234.00	5,190.65	1,961.90	29,462.75	3,044.23	14,891.07	17,615.91
23	354.4	Other Transmission System Equipment	—	15,188.39	—	15,188.39	5,827.16	—	21,015.55
		Total Transmission Plant	25,253,484.00	1,101,546.42	1,075,064.73	25,279,965.69	1,411,838.34	2,826,405.68	23,865,398.35
		General Plant							
24	370	Land and Land Rights	154,590.82	43.13	27,956.22	126,677.73	7,202.00	36,898.52	96,981.21
25	371	Structures and Improvements	262,605.30	26,385.90	51,667.86	237,323.34	2,176.81	13,612.37	225,887.78
26	372	Office Furniture and Equipment	239,989.32	—	—	239,989.32	13,516.77	74,822.75	178,683.34
27	373	Transportation Equipment	211,115.41	3,951.90	53,636.30	161,431.01	2,779.07	21,895.59	142,314.49
28	374	Stores Equipment	—	3,321.00	—	3,321.00	1,989.50	203.74	5,106.76
29	375	Shop Equipment	—	63,168.92	—	63,168.92	43,106.82	2,090.57	104,185.17
30	376	Laboratory Equipment	—	1,003.40	—	1,003.40	—	—	1,003.40
31	377	Tools and Work Equipment	449,871.11	—	249,110.52	200,760.59	9,319.42	205,534.68	4,545.33
32	378	Communication Equipment	254,602.17	—	—	254,602.17	—	5,626.43	248,975.74
33	379	Miscellaneous Equipment	20,484.22	—	—	20,484.22	525.00	19,861.38	1,147.84
		Total General Plant	1,593,258.35	97,874.25	382,370.90	1,308,761.70	80,615.39	380,546.03	1,008,831.06
		Total Gas Plant (Exclusive of Distribution)	$53,306,792.45	$1,572,939.31	$1,572,939.31	$53,306,792.45	$3,783,913.31	$5,883,085.12	$51,207,620.64

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Docket G-113

Schedule No. 1
Sheet 2 of 2

HOPE NATURAL GAS COMPANY

Investment in Gas Plant Per Books and as Adjusted
As at December 31, 1938

Schedule No.	Account Number	Description	Cost Per Books	Reclassification by Company		Cost Per Books Reclassified	Examiners' Adjustments		As Adjusted
				Dr.	Cr.		Dr.	Cr.	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
		Total Gas Plant (Exclusive of Distribution Plant)	$53,306,792.45	$1,572,939.31	$1,572,939.31	$53,306,792.45	$3,783,913.31	$5,883,085.12	$51,207,620.64
		Distribution Plant							
	357.1	Land	19,151.18						
	357.22	Rights of Way	17,818.40						
	358.1	Measuring and District Regulating Station Structures	34,352.87						
	358.2	Other Distribution System Structures	84,840.06						
	359.1	Mains—Construction	625,556.29						
	359.21	Mains—Pipe	1,155,526.53						
	359.22	Mains—Fittings	152,376.28						
	360	Pumping and Regulating Equipment	51,388.06						
	361	Services	184,496.15						
	362	Meters	469,198.31						
	363	Meter Installations	378.91						
		Total Distribution Plant	2,795,083.04			2,795,083.04	19,995.41		2,815,078.45
	100.1	**Total Utility Plant in Service**	56,101,875.49			56,101,875.49	3,803,908.72	5,883,085.12	54,022,699.09
	100.3	Construction Work in Progress	81,392.75			81,392.75	16.65		81,409.40
34	100.4	Gas Plant Held for Future Use	—			—	789,118.73		789,118.73
35	107	Gas Plant Adjustments	94,814.75			94,814.75			94,814.75
36		Other Physical Property—Coal Property (100)	341,529.68			341,529.68		341,529.68	—
37		Franchises, Patent Rights and Other Intangibles (101)	30,185.91			30,185.91		30,185.91	—
		Total Gas Plant	$56,649,798.58			$56,649,798.58	$4,593,027.45	$6,254,800.71	$54,988,041.97

Note: Distribution Plant Accounts have not been examined in detail.

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Docket G-113

HOPE NATURAL GAS COMPANY

Summary of Examiners' Journal Entries Adjusting Plant Accounts Showing Types of Adjustments and Contra Accounts Affected

Schedule No. 1-A

A. J. E. No.	Description	Total Examiners' Adjustments: Company's Adjustments Per Original Cost Study (Exhibit 20)	Company's Adjustments To Prior Utility Purchases: A. J. E. No.	Company's Adjustments To Prior Utility Purchases: Amount	Examiners' Other Adjustments	Total Examiners' Adjustments	100-4 Utility Plant Held For Future Use	110 Other Physical Property	100-3 Construction Work In Progress	144 Retirement Work In Progress	250-1 Reserve For Depreciation Of Utility Plant	250-2 Res. For Amort. And Depl. of Prod. Nat. Gas Lands And Land Rights	250-3 Reserve For Abandoned Leases	271 Earned Surplus	Distribution Plant
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)	(o)	(p)
	Company Adjustments Accepted By Examiners:														
300	Transfers to and from utility plant in service accounts. *Debits* — $ 466,187.96 *Credits* — (466,187.96)														
301	Adjustments to agree with adopted inventory	$(179,769.12)	326	$(8,227.19)		$(187,996.31)					$ 187,996.31				
302	Capitalized structures or materials removed	(269,273.27)	327	(5,831.43)		(275,104.70)					275,104.70				
303	Depreciation on purchased property	(412,186.80)				(412,186.80)					412,186.80				
304	Abandoned—Still on books	(78,905.51)	329	(20,336.25)		(99,241.76)				$ 99,241.76					
305	Items on books found in storage	(37,464.60)				(37,464.60)		$ 25.75		37,438.85					
306	Transfers to and from other than utility plant in service accounts	(211,080.04)				(211,080.04)	$ 13,967.21	55,505.81		141,607.02					
307	Adjustments of vouchers M-699 and A-155 estimates	(158,767.75)	331	(67,101.74)		(225,869.49)					225,869.49				
308	Voucher charges to investment not in ledger	69,559.52				69,559.52								$(69,559.52)	
309	Correction of voucher amounts and records	53,805.31	332	(48,145.03)		5,660.28								(5,660.28)	
310	Estimated cost of obtaining	11,814.46				11,814.46								(11,814.46)	
311	Recording costs—From original papers	5,719.50				5,719.50								(5,719.50)	
312	Damages due to maintenance	(8,402.43)				(8,402.43)								8,402.43	
313	Removal of amounts shown on books—No equipment added at corresponding time, repairs, or could not identify charges on vouchers	(11,284.41)				(11,284.41)								11,284.41	
314	Improper charges and credits	51,003.29	333	(1.00)		51,002.29					(51,003.29)			1.00	
315	To restore original cost	38,992.16				38,992.16					(38,992.16)				
316	Repairs and replacements	(79,832.19)				(79,832.19)								79,832.19	
317	Fleet owners and quantity discounts	(2,227.40)				(2,227.40)								2,227.40	
318	Unproductive drilling deeper	(72,473.08)				(72,473.08)								72,473.08	
319	Removal of rig charges	(429,707.12)				(429,707.12)					429,707.12				
319	Arbitrary rig charges added	391,230.00				391,230.00					(391,230.00)				
320	Retirement of well construction—Change of well equipment	(12,576.26)				(12,576.26)					12,576.26				
321	Adjustment for lines taken up	(344,550.43)	334	(24,257.94)		(368,808.37)					368,808.37				
322	Unretired labor	(263,977.16)				(263,977.16)					263,977.16				
323	Transfer to distribution system	(19,678.07)				(19,678.07)									$19,678.07
324	To balance with books	167,236.40	335	(57,953.77)		109,282.63					248,281.03	$(252,752.18)	$(104,811.48)		
325	Miscellaneous small adjustments	(1,588.48)				(1,588.48)					1,588.48				
—	Transfers to and from utility plant in service accounts. *Debits* — $ 8,797.21 *Credits* — (8,797.21)		328	—		—									
—	Abandoned lines not removed		330	(1,076.34)		(1,076.34)				1,076.34					
	Examiners' Adjustments:														
336	To reinstate construction costs expensed				$ 1,480,227.70	1,480,227.70								(1,480,227.70)	
337	To transfer adjusted cost of property used to transport coke oven gas				(762,592.06)	(762,592.06)		762,592.06							
338	To transfer to "Utility Plant Held For Future Use," the adjusted cost of field lines connected to non-producing wells.				(21,126.61)	(21,126.61)	21,126.61								
339	To realize depreciation on retirements of prior utility property				(3,106.27)	(3,106.27)					3,106.27				
340	To transfer to "Other Physical Property," cost of sites formerly used for compressing stations				(901.50)	(901.50)		901.50							
341	To transfer to "Utility Plant Held For Future Use," the adjusted cost of unoperated leaseholds				(584,382.23)	(584,382.23)	584,832.23								
342	To transfer to "Utility Plant Held For Future Use," the cost of wells not connected to utility plant				(169,642.68)	(169,642.68)	169,642.68								
343	Transfer to construction work in progress—Account 100-3				(16.65)	(16.65)			$16.65						
344	Transfer from production plant to transmission plant. (Dr. & Cr. $6,965.64)				—	—									
345	Transfer within general plant. (Dr. & Cr. $7,200.00)				—	—									
346	To transfer additional cost of prior units to distribution system				(317.34)	(317.34)									317.34
	Total Examiners' Adjustments	$(1,804,383.48)		$(232,930.69)	$(61,857.64)	$(2,099,171.81)	$789,118.73	$819,025.12	$16.65	$279,363.97	$ 1,947,976.54	$(252,752.18)	$(104,811.48)	$(1,398,760.95)	$19,995.41

( ) denotes red figures.

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9. TESTIMONY OF COMMISSION WITNESS CHARLES W. SMITH AS TO PRINCIPLES OF ACCOUNTING, TUESDAY, APRIL 22, 1941, RECORD PAGES 2702 TO 2823.

—2702—

Whereupon, CHARLES W. SMITH, a witness called on behalf of the Commission, having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION by Mr. Springer.

Q. Will you state your full name and position, please? A. Charles W. Smith, I am chief of the Bureau of Accounts, Finance and Rates, of the Federal Power Commission.

Q. Will you please state your qualifications? A. I have a B. S. degree in finance and business administration, and, also, an L.L.B. degree. I am a certified public accountant of North Carolina and of Maryland, the first having been obtained about eighteen years ago. I am a past president of the Maryland Association of Certified Public Accountants and a member of the American Institute of Accountants, the American Accounting Association, the American Economic Association, the American Bar Association, and an honorary member of Delta Sigma Pi, an international commerce fraternity, and Beta Alpha Psi, a national accounting fraternity. I am also a member of the Committee on Statistics and Accounts and the Committee on Depreciation of the National Association of Railroad and Utilities Commissioners. I have been admitted to bar of the Court of Appeals of Maryland and the Supreme Court of the United States.

—2703—

For nine years, beginning in 1920, I was an auditor in the Income Tax Unit of the U. S. Treasury Department and, in this capacity, I audited the income tax returns and books and records of practically every type of business corporation, including public utilities. On June 1, 1929, as the result of obtaining the highest mark in a competitive examination, I became the Chief Auditor of the Public Service Commission of Maryland, remaining in that position for seven years. I joined the staff of the Federal Power Commission on July 1, 1936, in substantially my present capacity.

For ten years I taught accounting in evening schools in Baltimore, Maryland, including eight years at Johns Hopkins University where I gave the course in accounting systems and for two years the course in cost accounting. These courses were for both day and evening students.

I have written several articles on accounting and economic subjects, including a text on accounting systems for my classes at Johns Hopkins. I have delivered more than fifty lectures, including two radio addresses, on accounting, financial and economic subjects.

While with the Maryland Commission, I did a good deal of work as consultant in accounting, taxation and finance in my spare time. On one occasion I obtained leave of absence to do some consulting work for the Tennessee Valley Authority and on two other occasions I was granted leave to act as consulting accountant to the Federal Power

—2704—

Commission. On these latter two occasions I supervised the drafting of the Uniform System of Accounts which the Commission has prescribed for public utilities.

While in the employ of the Public Service Commission of Maryland, I had charge of all accounting, auditing and financial matters which were under the jurisdiction of that body. This included the making of the usual accounting investigations for all regulatory purposes, all studies relating to the issuance of securities, financial structures, rate of return, et cetera.

In my present position I have charge of four divisions of the Federal Power Commission, namely, the Division of

Accounts, Division of Finance and Statistics, Division of Rates and Research, and the Division of Original Cost. Altogether, I have testified in more than thirty public utility cases.

Mr. Springer: Mr. Examiner, when Mr. Smith testifies on depreciation principles later, I would like to have him add to his qualifications.

Now, may I have marked for identification as Exhibit No. 57 and Exhibit No. 57-A, volumes I and II, entitled "Original Cost of Gas Plant as at December 31, 1938," referring to the Hope Natural Gas Company?

Trial Examiner: They may be so marked.

(The documents referred to were marked, respectively, as Exhibit No. 57 and Exhibit No. 57-A for identification.)

By Mr. Springer:

—2705—

Q. Mr. Smith, referring to the exhibits marked for identification as 57 and 57-A, are they the result of an accounting investigation undertaken in conformance with the original order of investigation in the Hope Natural Gas rate case? A. That is true.

Q. Was this investigation conducted under your general supervision and direction? A. It was.

Q. Will you explain how this supervision and direction were exercised? A. I exercised supervision directly by discussing with each examiner in charge the principles and the methods on the problem involved in the investigation. These discussions took place in the offices of the company, and in my office in Washington.

Supervision was also exercised indirectly through Mr. Baker, the chief accountant of the Commission, and Mr. Jackson, formerly assistant chief accountant of the Commission.

I discussed with these gentlemen all of the problems and methods involved in the investigation before they visited the offices of the company to review the work, and had conferences with them upon their return.

Q. What were your instructions as to the determination of the original cost of the properties of the Hope Natu-

—2706—

ral Gas Company? A. The staff was instructed to determine original costs in accordance with the system of accounts prescribed by the Commission for public utilities and licensees.

At the time the investigation began, the Commission had not prescribed a system of accounts for natural gas companies.

I anticipated however that when the system of accounts for natural gas companies was issued, the original cost provisions would be the same as in the system for the electric utilities, and I was right in that anticipation.

Q. Is the system of accounts prescribed by the Federal Power Commission for natural gas companies substantially the same as the system of accounts adopted by the National Association of Railroad and Utilities Commissioners? A. Yes, it is almost word for word the same.

Q. And you have stated that some of the provisions are the same for the system of accounts prescribed for public utilities and licensees? A. Many of the provisions are the same, particularly the provisions relating to the determination of original costs.

Q. Are the provisions relating to original costs the same as those in the system adopted by the National Association of Railroad and Utilities Commissioners for electric utilities?

Mr. Cockley: I object to that. What has that got to do with what we are concerned with here?

—2707—

Mr. Springer: It shows the uniformity of accounting systems for all types of utilities. It is very proper, Mr. Examiner.

Trial Examiner: The objection is overruled.

The Witness: They are the same.

By Mr. Springer:

Q. Are such accounting systems in widespread use today? A. They are. The system of accounts for electric utilities is effective for about 95 percent of the industry, the electric industry, measured by revenues or plant.

The system has been adopted by some 29 commissions.

The system of accounts for gas utilities has been adopted by about 18 commissions.

Of course certain commissions have made some changes, primarily to conform to local conditions.

Q. Will you explain how the system of accounts for natural gas companies prescribed by the Federal Power Commission was compiled, showing particularly how uniformity was obtained by the national associations and the Federal Power Commission?

Mr. Cockley: I object to that. He is now going into how the uniform system of accounts was adopted. Are we going to try out the question of whether or not it was properly adopted, or what changes were made in going through its adoption, and so on?

—2708—

Mr. Springer: This is still the original objective of showing the uniformity and consistency in accounting principles in most of the systems of accounting in the United States.

Mr. Cockley: I submit it hasn't a thing to do with this present rate case. I haven't any objection to this witness testifying as to how much of this exhibit he accepts responsibility for, and what principles he instructed his subordinates to follow in carrying it out—I assume that that is his purpose—but to go into the history of the theory of accounting in the United States on these uniform systems of accounts, and how the Federal Power Commission has prescribed for electric utilities or other utilities, or the National Association of Railroad and Utilities Commissioners has prescribed for other utilities, hasn't a thing to do with the simple problem we have got here.

Mr. Springer: It happens to be vital to the problem we have here. These are principles of accounting. Mr. Smith is taking the logical preliminary step of testifying on principles of accounting, and then he will show that they were employed in the preparation of this accounting exhibit.

Mr. Cockley: That isn't what your question asked, as I understand.

Trial Examiner: Read the question, please.

(The pending question was read by the reporter.)

Mr. Cockley: He wants to know how it was compiled.

—2709—

Trial Examiner: Well, it seems to me that it is somewhat remote, but it is perhaps preliminary to questions which will bring it up closer to our subject.

Mr. Springer: Precisely.

Trial Examiner: The objection is overruled.

Mr. Cockley: Note an exception.

The Witness: The Federal Power Commission retained me in 1935 to work with the Committee on Statistics and Accounts of the National Association of Railroad and Utilities Commissioners in drafting a new system of accounts for electric utilities.

As soon as that system was prepared, a system was prepared for gas utilities. I did very little work on the latter system at that time. The two systems were adopted by the National Association and the electric system was adopted by the Federal Power Commission. When the Natural Gas Act was passed, the Federal Power Commission instructed me to look towards the drafting of a system of accounts for natural gas companies.

I worked with the Committee on Statistics and Accounts of the National Association in compiling certain revisions of the system which had been adopted by that organization in 1936; when the revisions were agreed upon, they were adopted by the National Association, and the resulting system was adopted by the Federal Power Commission.

—2710—

It was in this manner that uniformity in the system of accounts, particularly uniformity in regard to provisions relating to original cost, has been obtained.

By Mr. Springer:

Q. Do you know of any other system of accounts promulgated by regulatory bodies which requires the keeping of plant accounts in accordance with what is known as the original cost principles?

Mr. Cockley: I object to that. There is no issue here at all about how a company should keep its plant account. This isn't an accounting case, but a rate case, and it is wholly immaterial.

Mr. Springer: This is in the category of the other preliminary questions, to show uniformity and consistency; and consistent with your former ruling I think you will have to rule in my favor this time.

Mr. Cockley: An earlier error doesn't excuse a later one, if I may suggest. (Laughter.)

Trial Examiner: Well, it seems to me that the Commission is raising some question here which will make this point directly in issue. The objection is overruled.

Mr. Cockley: Note an exception.

The Witness: The Federal Communications Commission in 1935 prescribed a system of accounts for telephone carriers in which the original cost principle is set forth.

—2711—

The system of accounts prescribed by the Interstate Commerce Commission for pipeline companies in 1935 likewise provides for original cost accounting, although the term "original cost" is not used. The language, in other words, is not the same, but the substance is there.

And the system of accounts adopted within the last five years by the National Association of Railroad and Utilities Commissioners for water companies, likewise provides for the keeping of accounts according to the original cost doctrine.

By Mr. Springer:

Q. How is original cost defined by the Federal Power Commission system of accounts? A. Original cost, as applied to gas plants, means the cost of such property to the person first devoting it to public service.

Q. Will you explain the general underlying principles of the original cost provisions of the uniform system of accounts for natural gas companies? A. Specifically, the original cost provisions relate to acquisitions of operating units or systems. As public utility operating units or systems are acquired, some means must be found for distributing the purchase price to the various accounts.

The purchase price usually contemplates the earning power of assets, the fact that customers are attached, the

—2712—

fact that properties acquired represent a profitable business, and other factors.

One of the most difficult problems of accounting involves the accounting for acquisitions of going businesses.

When one public utility acquires the properties of another, it is necessary to distribute the purchase price in some manner to the various accounts, as I have just indicated.

Heretofore, distributions often have not been made, and the purchase price has been continued as a lump sum in one account, without ever afterward changing it.

In a great many cases, the distributions were most unsatisfactory.

Accordingly, the system of accounts attempted to solve this problem by requiring the original cost of the acquired properties to be set up in the various plant accounts, and any differences between the original cost figure and the actual cost to the acquiring company, to be entered in a special account called Account 100.5—Acquisition Adjustments Account.

Mr. Cockley: Mr. Smith, pardon me, I don't like to interrupt you, and I apologize for doing it, but if you will read your answers a little slower, we will be able to understand them better, because you appreciate we have not had a copy of the answers from which you are reading.

The Witness: Mr. Cockley, I have just a few answers which I will read. Most of them will be delivered without

—2713—

reading. The ones where I thought I might become involved, or go off on a tangent, I reduced to writing, but I will try to read those slowly.

Mr. Cockley: My point is that you were reading a little too rapidly to follow you.

The Witness: The original cost doctrine specifically relates to the acquisitions of operating units or systems.

By Mr. Springer:

Q. How are the costs of properties constructed by the accounting utility, accounted for, Mr. Smith? A. They are accounted for at cost to the utility according to an established plan of accounting. When these costs are accounted for by the utility according to a bona fide and acceptable accounting plan, and when the costs of operating units acquired are accounted for in accordance with the original cost principles, then we have the original cost of properties recorded in the various plant accounts.

Q. Well, is the original cost of the properties constructed by the Hope Natural Gas Company, the cost accounted for in the past exclusive of errors in accounting? A. Yes, that is true. In other words, the cost of the company's own construction, as recorded on its books, except for accounting errors, is the proper original cost.

Q. Now referring to the Commission's uniform system of accounts for natural gas companies, is there any

—2714—

authority under that system of accounts for a company like the Hope Company to re-account for its own construction in such a manner as to increase the amounts heretofore entered in the accounts, if the original entries were in accordance with accepted principles of accounting?

Mr. Cockley: I object to that. That exhibit speaks for itself. It is already an exhibit, as I understand it, in this case, and there is no occasion for asking the witness his construction of it; and it is wholly improper to do so unless some question arises about it.

Mr. Springer: Mr. Cockley, you prevailed with your objection to the admission in evidence of this document. It is not an exhibit.

But at the same time, we are talking about accounting principles and I am asking Mr. Smith a proper question in line with his development of the original cost principles.

Mr. Cockley: And the proper way to prove it is through the introduction of that exhibit in the case. If it now becomes relevant, whereas it wasn't before, the Examiner could admit it or not. But to have a witness testify that, taking this system of accounts—this is proper or that is proper, I submit is wholly improper.

—2715—

Mr. Springer: May I have marked for identification as Exhibit No. 58, a copy of the Federal Power Commission's uniform system of accounts prescribed for natural gas companies, effective January 1, 1940?

Trial Examiner: It may be so marked.

(The document referred to was marked as Exhibit No. 58 for identification.)

By Mr. Springer:

Q. Mr. Smith, I show you Exhibit No. 58 for identification. Is that the document you have just described? A. It is.

Q. Is that the system of accounts I referred to in my last question? A. It is.

Mr. Springer: I offer Exhibit No. 58 marked for identification, in evidence.

Mr. Cockley: There is no objection to the identification of this document, we admit what it is. I do object to it as wholly immaterial in this case, and I want to preserve that objection of record.

Mr. Springer: It happens to be the crux of the case, Mr. Trial Examiner.

Mr. Cockley: Well, somebody else than you will decide that, I am happy to say.

Trial Examiner: The objection is overruled. Exhibit

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No. 58 is admitted into evidence.

(Exhibit No. 58 received in evidence.)

Mr. Cockley: Note an exception.

Mr. Springer: Will you please read my original question to Mr. Smith?

(Whereupon, the reporter read the pending question.)

Mr. Cockley: That question I object to. The system of accounts is now in evidence and will speak for itself.

Trial Examiner: Well, it seems to me that the form of question is perhaps somewhat objectionable, but the substance of it is rather important and proper. The objection is overruled.

The Witness: The answer is no, and that has been my consistent interpretation of the system of accounts and the companion system, the one for electric utilities, since they were adopted; and I might add that I am authorized by the Commission to issue interpretations over my own signature, and I have made many such interpretations.

By Mr. Springer:

Q. Will you please define reaccounting as distinguished from reclassification of accounts? A. Reclassification is a distribution of the amounts in the accounts—

Mr. Cockley: (Interposing) I don't like to object all the time, but I want to object to this question. There is no

—2717—

issue here at all about the method of reaccounting or reclassification, as I understand it; and may I have a general objection here to these general accounting questions that are not related specifically to the exhibits in this case, and then I will retire in peace and let him go ahead?

Trial Examiner: Yes, I think that would be proper.

Mr. Springer: I would like to have a statement then that all of the accounting principles are related and embodied in the proposed exhibit on original costs.

Trial Examiner: The general objection is overruled, you may have an exception.

By Mr. Springer:

Q. Will you please start again, Mr. Smith, on the distinction between reaccounting and reclassification? A. Reclassification is a redistribution of the amounts in the books of account. Reclassification deals particularly with what we know as real accounts, that is the balance sheet accounts.

The accounting system provides for a reclassification in that it provides that certain amounts recorded at one place in the balance sheet shall now be transferred to another account. Particularly is this true in respect to plant accounts. We have different plant accounts in which the amounts in the books are redistributed.

Reaccounting on the other hand goes not to the clas-

—2718—

sification so much as to the amounts themselves.

By reaccounting we mean going back to the time of the original transaction and restating that transaction so as to get a different cost, different plant cost, a different cost of some real account than appears in the books in respect to the transaction.

Q. Well, in consequence a reclassification does not change the total dollars in plant accounts, does it? A. That is correct.

Q. But a reaccounting may? A. Yes.

Q. Which is improper? A. It is improper, a reaccounting generally is improper. I want to make the reservation that it is always proper to correct pure accounting errors.

Q. Will you explain any provision in the system of accounts which prohibits the reaccounting which you have described? A. Gas plant instruction 2(b) deals with this matter, and the particular part of that instruction which is pertinent reads as follows:

> "It is likewise not intended that adjustments shall be made to record in gas plant accounts amounts previously charged to operating expenses in accordance with the uniform system of accounts in effect at the
>
> —2719—
>
> time, and in accordance with the discretion of management as exercised under such uniform system of accounts."

Q. Will you please explain that provision? A. In other words, reaccounting does not conform to sound principles of accounting, and this provision was inserted in the system of accounts to make doubly sure that no one would construe the system of accounts as authority for such reaccounting.

Q. Suppose the cost of the company's own construction was entered in its accounts at a time when regulatory commissions had not prescribed systems of accounts, could the company under the system of accounts now in effect reaccount for items accounted for during this period? A. If your items were accounted for properly in the first instance, they could not be reaccounted for, in my opinion.

Q. Do you care to elaborate on that, Mr. Smith?

Mr. Cockley: I object to it. The witness has answered the question.

Trial Examiner: Objection sustained.

By Mr. Springer:

Q. That is, the determination of cost is one of the chief purposes of accounting? A. The determination of cost is one, if not the chief, purpose of accounting, but many kinds

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of cost are involved in accounting.

We have costs of plant and we have costs of operations.

One of the most difficult accounting problems is the assigning of costs to a particular operating period such as a year.

There is no precise answer in regard to the latter problem. Considerable judgment must be used in allocating costs to a particular period of time, and in this field considerable discretion is allowed under the accepted principles of accounting.

Q. Is it as difficult to determine the revenues for a period as it is to determine the costs? A. No, it is not. Ordinarily, there is very little problem in ascertaining the revenues over a particular period, but where a company expands its business and it has betterments and improvements, the difficulty of determining the cost of operations, the cost of keeping up that business, and the cost of the additions and betterments, is sometimes pretty great. It is in this particular field that considerable discretion is allowed in the field of accounting.

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Q. Then it is difficult to draw the line of demarcation between the cost of the additions and maintenance expenses, I take it? A. Yes, it is difficult, and that is recognized by all accountants having any real experience in that particular field.

Q. In that particular field is it necessary to be consistent? A. It is necessary to be consistent; in fact, consistency in this respect is of particular importance. The principles followed by a company should be consistently applied from year to year. Changes, of course, are permitted, but in public utility accounting, at least, they should be adopted for the future and properly explained.

The absence of consistency in the application of principles may lead to most inequitable results. In fact, failure to be consistent in matters of accounting may lead to distortion and manipulation.

It would be an easy matter to manipulate a financial statement by merely being inconsistent in the treatment of important items from year to year.

This view is so widely held that practically all certificates of public accountants to financial statements now contain a positive assertion with reference to the principles of consistency. The certificate, sometimes called the short

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form of report, recently approved by the American Institute of Accountants in connection with statements to the Securities and Exchange Commission, reads in part as follows:

> "In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the XYZ Company at February 28, 1941, and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

The emphasis on consistency is apparent.

To illustrate that point, if well drilling costs were charged to expense during the years large profits were realized, and if they were capitalized during poor years, distorted statements would be reflected and manipulations consciously or unconsciously practiced.

Such statements could not help but be misleading. Hence the importance of the principle of consistence in accounting.

Q. Now referring to the Federal Power Commission System of Accounts for Natural Gas Companies again, Mr. Smith, do variations exist in accounting under that system of accounts? A. They do.

Q. Will you explain some of those variations? A. Some companies capitalize no general and administrative expenditures at all, whereas other companies capitalize as much as possible under accepted accounting principles.

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Some utilities add all the interest possible to plant costs, whereas others contend that if they do not pay interest, no interest should be charged to plant assets.

Some companies try to determine the exact time of each laborer, of each mechanic, spent on each job, and charge the specific labor cost to that job; whereas, others use an average rate, such average being based in some instances upon a crew of workmen, and in some instances for an entire group or a division, and in some instances yearly averages of pay, with proper adjustment allowances for sick leave and vacation, are reported.

Sometimes the labor cost is associated with a machine, such as a steam shovel, and a machine hour rate includes the labor rate.

Many variations likewise exist in regard to accounting for materials.

Except for large identifiable units, many materials must necessarily go into plant, and into operating expenses at average cost of one kind or another.

Thus a stock of pipe of a certain size may have been acquired at various unit costs. When the pipe is used for maintenance purposes, and for the purpose of making additions and betterments, some assumption, such as the "first in—first out," or some average cost, is employed, and very frequently this average cost gives recognition to re-used

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materials on which the original cost, the actual specific original cost, cannot be found.

There is no certainty that the particular piece of pipe that was charged to plant was charged at the actual cost of that particular piece of pipe. There is no reason, in fact, why this should be so.

Many practices regarding the replacement of property have existed in the past, and the practices today are not altogether uniform.

A study of the reports of American Railroads to their stockholders during the last century, will disclose many interesting illustrations of the difficulties of determining the difference between what should be charged to maintenance and what should be charged to plant.

The area of choice in maintenance accounting has been somewhat restricted under our system of accounts by the prescribing of a list of retirement units of property, but even under that list, variations still exist.

Thus, while there are broad principles of accounting, variations exist between these principles. No one can say that one particular variation is absolutely correct, and another absolutely wrong. No one can say, for instance, that only one method of accounting for labor costs is proper. Many methods of accounting for labor costs are in vogue, and the question is not so much what is right or

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wrong, but rather what is the better practice in a particular case.

This statement is likewise true as to material costs and it is even more true as to accounting for overheads.

In accounting for overheads, there is no one best method of distributing the amount. The method must necessarily be somewhat arbitrary. Certified public accountants do not hesitate to certify statements which do not conform to what they deem might be the best method. The same firm of accountants, in fact, frequently certifies to statements of different companies, employing different methods such as I have just outlined, and as far as I can see, they are right in both instances.

Q. Mr. Smith, assuming that a transaction is accounted for under one of the permissible variations, should it later be re-accounted for?

Mr. Cockley: I object to that. There is no evidence of any such thing in this case, nor will there be.

Mr. Springer: This is a question directed to the principles of accounting.

Trial Examiner: The objection is overruled.

Mr. Cockley: Exception.

The Witness: Once a transaction is accounted for by consideration of the entire setting at the time of the transaction, and has been accounted for under one of the alternatives of accounting principles, it should not be changed

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at a later date, particularly when the change is brought about merely because someone thinks a better answer could be obtained. If the accounting in the original instance conformed to sound principles, it should remain accounted for in that fashion, and that is especially true of businesses such as public utilities, in which there is a deep public interest.

Trial Examiner: The hearing is recessed, to reconvene at 2 o'clock.

(Whereupon, at 12:40 o'clock p. m., a recess was taken until 2 o'clock p. m., of the same day.)

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Afternoon Session.

The Trial Examiner: Gentlemen, the hearing will now be resumed.

Mr. Cockley: Before we proceed with the examination of this witness, Mr. Examiner, I would like to direct attention to the situation that is causing us considerable delay in the preparation of this case.

One of the principal exhibits that has been furnished us, and one that will soon be offered in evidence, if not the next, after these original cost exhibits are out of the way, is an exhibit that was prepared by Mr. French, of the Commission's staff, showing estimated lives of various classes of properties, which is a fundamental exhibit on which the depreciation determination is to be made.

We advised Mr. Springer on April 1st, when we received that exhibit, that we would have to see Mr. French's working papers to see what he had done, because the exhibit itself does not disclose that fact. We were told that he would not be available the coming week but would be on April 14th. On that date a couple of our men did interview Mr. French and asked for copies of various working papers that were necessary in order to understand what he had done. He insisted upon having copies of those prepared himself. They were not delivered to us until Saturday night, April 19th, after we got down here.

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Then, it developed this morning on the pipe accounts that we had no working papers on the other accounts, and that the papers on the pipe accounts lacked some key information that was necessary to a complete understanding of them.

We are now told that other work papers absolutely essential to any preparation of any examination of this exhibit will not be ready until Wednesday or Thursday of this week.

It is obvious, of course, that we can not examine them and be prepared to cross examine immediately upon their production. I would like to call that to the attention of the Commission and the attention of counsel to see if we can not have some arrangement by which we will get the work papers within a reasonable time so that we can prepare for cross examination.

Mr. Springer: We endeavor to accommodate counsel in each case. Mr. French was on a field assignment, which prevented our having access to his work papers to be reproduced for the convenience of the company men. But we will continue to cooperate with them to the best of our ability.

Mr. French was sent to New York the first part of this week. That is the reason for the delay in connection with the additional work papers that Mr. Cockley men-

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tioned. Of course, we will furnish them. They are surely entitled to them. It is just a matter of a man working concurrently on more than one case; and he can not be at the Washington office at all times.

The Trial Examiner: Does he have to be here?

Mr. Springer: Yes, sir. They are his working papers. I think it is necessary when experts examine the work papers of other experts that the man who employed them as a foundation for an exhibit should be present. That is a matter of professional courtesy, as I understand it.

The Trial Examiner: I understood the work papers were being reproduced to be delivered to the company.

Mr. Springer: That is correct. The matter of the time required for reproducing the work papers I believe is the explanation of the delay.

We will continue to cooperate as much as we can.

The Trial Examiner: What I am trying to find out is why the work papers were not available at the time the exhibit was served. It seems to me that Mr. French must have known that the work papers would be required and arrangements might have been made to make them available.

Mr. Springer: That is correct. And arrangements were made when he returned from the field on April 14th and working papers were made available to representatives of the company who were present. And they have accom-

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plished a certain amount of the objective undertaken at that time. And when Mr. French returns tomorrow we will do our best to give them rapid service on any other working papers copies of which they desire to have.

The Trial Examiner: You may proceed with the examination of the witness.

Charles W. Smith resumed the witness stand, and having been previously sworn, testified on behalf of the Commission as follows:

Direct Examination by Mr. Springer (resumed).

Q. Mr. Smith, do you have in mind the last question I asked you before the recess? A. I do not have the answer to it, but I do recall answering the last question fully.

Q. Mr. Smith, if a transaction is accounted for under one of the permissible variations, should it later be re-accounted for? A. That was the last question that was answered.

Q. Your answer was that it should not be re-accounted for, as I remember it. Does your answer imply that accounting errors should not be corrected? A. No, sir. Accounting errors should be corrected as soon as they are discovered. However, a distinction must be made between an accounting error and a correction of an accounting error

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and re-accounting.

Accounting errors represent mathematical errors, errors in posting and entries of transactions which were not in accordance with the principles of accounting. Re-accounting is the restatement of the amounts which were entered properly in the first place to conform to some different condition.

To repeat, accounting errors should be corrected as soon as they are discovered.

Q. What is your definition of accounting errors? A. My definition of an accounting error is an entry which is an error in posting, a mechanical error, or an entry which did not conform to sound principles and practices of accounting.

Q. Would unrecorded retirements be an example of an accounting error? A. Yes, it would be. Where an item of property is in fact retired without any replacement having been made and an entry to record the retirement is not made on the books, that is an accounting error, known as an error of omission.

Q. Mr. Smith, it is sometimes said that, for the purposes of a rate case, we must compute the maximum cost of plant now in existence, regardless of how such costs were originally accounted for. This may mean that general,

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administrative expenditures which were never capitalized should now be restated and included in plant and that items previously charged to maintenance should now be capitalized. In fact, statements of cost conforming to this principle have been filed as exhibits in this case. In your opinion, is it necessary or is it proper to re-account for transactions in order to get the maximum costs which I have just described? A. My answer is no.

Q. Then, you do not agree with the statement I have just made, that for the purpose of accounting and for the purpose of a rate case, you must follow the principle of getting the maximum costs of the property regardless of how such property was originally accounted for? A. No, most positively I do not agree.

Q. Will you please give an explanation of the reasons for your answer? A. Accounting does not deal with plant accounts alone. It is most important to recognize this fact. Accounting does not, in fact, emphasize particularly plant accounts. Expense accounting is just as important as plant accounting. It is just as appropriate to get all possible costs in the expense accounts as it is to get all possible costs in the plant accounts. All the phases of a transaction must

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be analyzed at the time of the transaction in order to determine upon the correct entries. Plant phases and operating phases must both be considered. The answer must give proper weight to all factors. If we follow blindly the principle that all possible costs must now be assigned to plant, we fail to visualize the accounting process in all its entirety. We then make a fetish of plant costs. We forget that in determining upon an entry, many more things than the cost of additions and betterments are involved in accounting and in the running of a business. To repeat, all phases of the transaction must be studied and to concentrate on one phase only, that phase being how much can possibly be charged to plant accounts, warps the principles of accounting. Such false emphasis gives no heed to the cost of operating and maintaining the plant. It follows blindly an abstraction in a practical field of endeavor.

Q. Will you show how your reasoning applies in the case of general, administrative expense? A. Our System of Accounts permits a reasonable amount of the salaries of officers, general office clerks, and other general and administrative expenses, to be charged to plant accounts. I might note that the System of Accounts of the Interstate Commerce Commission does not permit such items to be allocated or prorated to plant accounts. Such expenditures, however, may, under our System of Accounts, be

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charged in toto to expense or a reasonable amount may be prorated to plant. The expenditures, of course, cannot be identified with any particular plant item and at best we can merely find a scheme of allocation, or proration, which will be deemed satisfactory. There are many variations in practice in accounting for the general and administrative expenditures which I have just described. It is not unnatural that this would be so because such expenditures are associated with all phases of the business, operations, maintenance, additions, betterments, the payment of dividends, interest, etc. There is no such thing as a one and only rule to follow in accounting for these expenditures. My own personal view is that the better practice is to charge such items to expense, except the specific, incremental costs which are incurred in connection with construction and these should be capitalized.

My reason for this view is that a utility is in business primarily to sell service or a commodity and not for the purpose of constructing additions and betterments, which are only incidental to the former. General and administrative expenses do not, in fact, fluctuate proportionately with construction and they should not be made to do so arbitrarily by some method of accounting.

If, to repeat, a utility determines that these items are expenses, I would recommend that the amounts be treated

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as expenses. If a utility charges a reasonable amount to construction, I would make no change for such accounting is satisfactory. When, however, such items are first charged to expense, as being a part of the cost of operating the business and then they are restated in plant, under the theory that the maximum cost of all plant items now in existence must be included in the plant accounts regardless of past accounting, a serious offense, I believe, is committed. Such a practice, to repeat, would emphasize only one phase of accounting, namely, plant accounting. It would represent clearly a one-way street. It would treat plant costs as the end and purpose of accounting, and of business. The expenses I have mentioned are in reality joint costs and, as to joint costs, we all know that precise cost determinations are not possible of achievement. Where a reasonable and generally satisfactory answer has been obtained, it should not thereafter be vitiated by changing the philosophy of accounting so as to forget the entire setting of a transaction at the time of its occurrence and now aim at the highest plant costs obtainable under any principle.

Q. Will you please explain your answer from the viewpoint of maintenance accounting? A. I have already pointed out that there is no sharp line of demarcation be-

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tween the cost of adding to a plant and the cost of maintaining it. Before our recent system of accounts for natural gas companies was adopted, much more discretion was allowed in the field of maintenance accounting than is now permitted. Many replacement items formerly chargeable to the maintenance accounts must now be charged to plant and the cost of the old items removed. It is still the practice of railroads, for instance, to charge the cost of numerous replacements to expense. We have tried to obtain more uniformity in the field of maintenance accounting. Toward this end, the Commission has prescribed a list of what is termed "retirement units of property" which is required to be adhered to, with some slight exception, by natural gas companies. This list shows the items which, when replaced, must be treated as plant retirements and plant additions. If two lengths of gas mains, for instance, are replaced, the cost of the old mains must be taken out of the plant accounts and the cost of the new added thereto. If a single length is retired, plant accounts are not disturbed, but the cost of the new length is charged to maintenance.

The exception I spoke of a moment ago is that natural gas companies may refine the retirement list—may have more retirement units, in other words—but they cannot consolidate them. Again we have not established a principle of pure accounting science in drafting the list of re-

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tirement units. Rather we have been somewhat arbitrary in order to obtain better results and, in particular, more uniform results. In compiling the list of retirement units, representatives of the industry participated in the discussions. All such representatives were aware of the fact that we were trying to determine upon some good workable rule in the interest of uniformity, rather than to announce a new principle of accounting.

It cannot be said that the old practices of natural gas companies in regard to maintenance accounting are wrong and that the new methods are absolutely right; rather the new methods were designed to obtain better results and not to correct something which was absolutely wrong. To hold otherwise would be to hold railroad accounting of today to be wrong. When we follow the principle of obtaining all possible costs of existing plant regardless of how the costs were accounted for previously, we forget, in fact we close our eyes to, maintenance practices. A new cost is then assigned to each existing item of property. If a railroad tie or a piece of iron pipe represented a replacement which was charged to maintenance expense, its cost is now included in the plant accounts. Under such a one-way scheme, accounting cannot function unless we make every conceivable expenditure associated with plant a unit of property and require it to be charged to plant. This

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would be a new kind of accounting. It would emphasize plant costs to the exclusion, or almost the exclusion, of operating costs. Conceivably under it, every time we would paint a structure we would have a new cost of the structure. Every time we replaced a tire or a tube or a brake lining, we would have a new cost for the automobile. This would be most unfortunate, in my opinion.

Q. Mr. Smith, are deferred debits and deferred charges synonymous in your terminology? A. They are frequently used synonymously. I might add that there may be a difference. I will have to know the connection in which you use the words in order to give you a technical answer.

Q. Sometimes, Mr. Smith, it is said that plant assets are deferred charges. Is that true? A. Yes; that is true. In the broad sense the cost of plant assets represents a deferred charge. You buy a piece of equipment, an automobile today, and it is capitalized and it is charged off during an operating period or over operating periods. In other words, its cost is deferred in part to the revenues of the future. In a sense, all plant assets are deferred charges.

Q. Is it easy to determine how much of such deferred charges is a proper expense of a given period? A. No; it is not. It is rather difficult to determine how much of

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the deferred charge representing large plant assets should be charged to a given operating period. A great deal of judgment must be exercised in making that determination. And that is one reason why business men, who are naturally conservative, are reluctant to add too much to deferred charges and postpone too much to the future. Generally speaking, in case of doubt, business men and accountants generally prefer to charge an item to expense today rather than defer it over the future. That is, naturally, conservatism, and it represents good, sound practice, in my opinion.

Q. In Exhibit No. 20 the company shows the addition to the book cost of plant of about $17,000,000, under the theory that that amount must be added to book figures to obtain full and complete cost of plant in existence as of the end of 1938. Did you discuss these items with the staff and did you agree as to how such items should be treated?

A. We did discuss that. I discussed the items with the staff, and we are agreed as to their treatment. In fact, there was no disagreement on the part of any staff member.

Q. One of the adjustments proposed by the company in the exhibit mentioned related to overheads. Did you instruct the staff to add these overheads to the recorded

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cost of plant? A. I instructed the staff not to add the recorded expense items to the cost of plant.

Q. Why?

Mr. Cockley: I object to the long detailed reasons as to why it was done. He said what he did. Isn't that what we are interested in?

Mr. Springer: We are interested in this principle of accounting.

Mr. Cockley: If he thinks what he did needs some defense, yes. But it seems to me that it is a complete and perfect answer when he says "I instructed the staff to do so and so."

Mr. Springer: I thought it would be enlightening to have his reasons on this principle of accounting. We are on a vital point in this case, and he has already testified that he is responsible for the interpretation of the system of accounts for this Commission; and he is a most eminent authority on it.

Mr. Cockley: The accounting lecture that we have had so far was very interesting; but I can not see that very much of it has anything to do with Exhibit No. 57, except that it is apparent that Mr. Smith instructed the staff what to do with certain items.

Mr. Springer: I think it is important to have his reasons and why he gave such instructions.

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The Trial Examiner: The objection is overruled.

Mr. Cockley: An exception, please.

The Witness: The company did not charge general and administrative overheads to the plant accounts at the time the original entries were made. This was its consistent practice. The practice of the company was not an unusual one at all, but I believe it conformed to the practice of the majority of natural gas companies. It conformed to sound accounting of the time and sound practices of today, in my opinion. I know, for instance, that many public utility companies do not include such overhead expenditures as a part of their plant cost at the present time. The items in the instant case have been properly charged to expense and, in my opinion, they should remain there. It would be wrong, therefore, to include such items in plant now and start depreciating them and perhaps allow a return on them. Such a practice would be bad accounting and, in my opinion, bad regulation as well. The addition of the overheads mentioned to the plant accounts would clearly not represent the correction of an accounting error. It would merely be substituting one alternative method of accounting for another which was used in the regular course of business and which was reflected in the financial statements prepared by the company, in its income tax returns, etc.

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The practice there conformed to sound practices of the time and, I think, sound practices as of today. I think it would be a write-up of accounts to permit those items to be included in plant today, either for accounting purposes or for rate making purposes.

By Mr. Springer:

Q. On Exhibit No. 20, about $11,000,000 were added to the book figures for drilling costs which were originally charged to expense and not capitalized. What was your instruction to the staff regarding those items? A. I instructed the staff not to add that amount to the plant cost.

Q. Why did you give that instruction?

Mr. Cockley: May I have an objection to all of these why's? I take it that I may.

The Trial Examiner: Yes. The objection is overruled.

Mr. Cockley: An exception, please.

The Witness: From the inception of the company to the end of 1922, the company charged such expenditures to operations, that is, to expense. The practice conformed to the practice of natural gas companies at the time. Inasmuch as it conformed to good practice, I believe it would be wrong to permit the restatement of such items, to include them in plant accounts today.

There can be no doubt, in my opinion, but that it was

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the widespread practice and good practice at the time to charge such expenditures to operations. And I say that not only for natural gas companies, but all companies in other extractive industries as well.

By Mr. Springer:

Q. Then, it follows that the practice in not capitalizing the costs at that time was not an accounting error? A. That is correct.

Q. Will you state why you think the charging of such items in that manner conformed to good practice at that time? A. Our study of the subject shows that the practice was widespread. In fact, I understand the practice still continues in the case of certain oil companies. The practice of charging intangible costs to expense was strongly advocated by the natural gas industry. The practice was changed, in my opinion, only because a change was required by regulatory commissions. I happened to be in the Income Tax Unit of the Internal Revenue Bureau when the question as to proper treatment of the so-called drilling costs—

Mr. Cockley: I object to this as wholly aside from anything that we have here now. Now we are going into the personal experiences that he had in the Bureau of Internal Revenue. That is not responsive to the question.

The Trial Examiner: Well, he is testifying as to ac-

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counting principles and practices. I presume he intends to develop something relating to the practices.

The objection is overruled.

Mr. Cockley: An exception, please.

The Witness: I was in the Income Tax Bureau when this same question was presented. I had to make decisions on the subject at that time. The Income Tax Bureau ruled that such costs could either be capitalized or charged to expense at the election of the utility, provided the practice first established was consistently applied. A change after a practice had been established could not be made.

This is still a part of the Income Tax Regulations and will be found in Section 19.23(m)-16 (1) of Regulations 103.

I have made inquiry and find that most natural gas companies today continue the practice of charging well drilling expenditures to expense for income tax purposes. That was not something peculiar to the income tax law, because the income tax law of 1918 provided, among other things, in general language, that the books of accounts should be used where they properly reflected income.

When a system of accounts for natural gas companies was under consideration in 1919 by the Public Service Commission of Pennsylvania, the Natural Gas Association of America strongly urged that the expenditures mentioned be treated as operating expenses. They argued that such

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items constituted expenses. The Commission held, however, that the costs should be capitalized. This is a better practice from the regulatory viewpoint for many reasons. It is the practice required by our present system of accounts. It, too, is more in line with present theories of accounting.

The decision of the Pennsylvania Commission was the first which to my knowledge required the capitalization of intangible production expenses. Other commissions followed the Pennsylvania Commission. I fully believe that regulatory commissions are responsible for the change from treating such items as operating expenses, to the requirement that they be capitalized. Some oil companies, as I have pointed out, still follow the old practice.

In general, intangible production costs were deemed to have been incurred to keep the company in business. Extractive businesses are often looked upon as single ventures. Under this viewpoint it was held the chief purpose of drilling new wells was to keep the company going. It was believed unwise to defer such costs over a future period. This is not an unusual principle as far as the extractive industries are concerned. Quite generally, items are charged to expense in such industries when they would be charged to capital by other business enterprises.

I know from having audited a great many accounts

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of mining companies, that many items normally capitalized in the manufacturing and commercial institutions are charged to expense by the extractive industries.

By Mr. Springer:

Q. Mr. Smith, I understand that the company, the Hope Natural Gas Company, for the years 1918 to 1922 charged off the cost of direct labor incurred in laying mains and similar labor in connection with compressor station construction and equipment installation. Is that true? A. I believe it is.

Q. What were your instructions in regard to those costs? A. I instructed the staff to include them in plant account.

Q. Why? A. First of all, the items were actually capitalized by the company in the first instance. After being capitalized they were arbitrarily written off at the end of the year in which capitalized. The company's practice did not conform to general practices or to accounting theory. Its practice, for this period, was an accounting error. I believe the practice was resorted to primarily to have the items allowed for income tax deductions, although I do not have any positive knowledge that this is true. In any event, I am of the opinion that an accounting principle was

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violated by charging off the capitalized items, therefore the amounts should be added to the plant accounts, as far as the general principles of accounting are concerned. I recognize, of course, that a different conclusion from what I have given may obtain for rate-making. It is possible that once a charge is made against customers in calculating rates, even though the charge were made in error, the same charge should not be exacted again. However, at this particular time, I am addressing myself to accounting principles and, as far as accounting principles are concerned, I believe it is proper to state the direct labor costs I have described as a part of the cost of plant.

Q. I understand, Mr. Smith, that the company in Exhibit No. 20 made certain adjustments to the book cost of plant so as to conform to an inventory of its property which it compiled as of the end of 1938. What were your instructions regarding these adjustments? A. I instructed the staff to accept the company's adjustments. The inventory adjustments represented in the main a correction for unrecorded retirements. In other words, the company's inventory disclosed what we expected to be the fact—that a lot of property items had, in fact, been retired without a concomitant entry having been made in the books of account.

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In addition, however, there was disclosed many items which did not appear in the books. We accepted those items because we believed in large measure that they offset some of the items which were retired.

The problem of identification where an inventory is taken is enormous. Very frequently items are considered to be unrecorded retirements when, in fact, another item taking its place is added. The difficulty of identifying the units of property with the actual dollars is a great one. So we have accepted the inventory adjustments which, as I have indicated, in the main result in a correction for unrecorded retirements.

Q. Are there any other adjustments to the book figures which you wish to discuss? A. There were many adjustments made to the book figures, but most of these do not rest upon the fundamental principle that I am testifying to at this time.

Q. You have testified as to the original cost as contemplated by the Commission's Uniform System of Accounts for Natural Gas Companies. Does that cost, in your opinion, have any validity for any purpose other than matters of accounting? A. In my opinion, such costs should be considered the original costs for rate making and for all other purposes of regulation. In fact, I think they are

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the only valid costs for that purpose.

I make one exception to the latter statement, an exception which I have noted before, and that is where an item has been charged to expense in error, an item which should be charged to plant, there would still be considerable justification for the Commission's treating that item as an expense. And I think as far as costs are concerned, with the exception I have mentioned, costs computed in accordance with the Commission's uniform system of accounts are the only valid costs.

Q. What do you mean by "valid costs"? A. Costs, to have any validity for regulatory purposes particularly, must be cost computed in accordance with a definite scheme of accounting. In other words, as I have previously testified, in determining cost of plant and in determining the cost of operations, all phases of the particular transaction should be considered before the accounting entries are determined upon. If this is done, the resulting plant costs are valid, but if the costs are included both in expense and then restated in plant, the plant costs are, in my opinion, invalid. It would be most unfortunate, most inequitable, to follow abstractions in this matter and not give consideration to actualities. Items which are expenses should re-

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main expenses; items which are plant costs should remain as such. There is no validity, to repeat, to plant costs which are determined by transferring thereto previously recorded operating expenses after the operating expenses have served their purpose. Only costs which square with the treatment of operating expenses have any integrity for rate-making purposes, in my opinion. In this connection, I would like to cite a very pertinent example.

Today we treat delay rentals as expenses. Now, under the principle of determining maximum or abstract costs, delay rentals should be charged to plant. Delay rentals can be identified directly with particular leases. These costs are incurred before production is obtained. They represent a cost of carrying the leases until drilling is completed. If we follow the cost principle blindly, delay rentals should be charged to plant as a cost of the leases. There can be no question concerning this statement, in my opinion. Yet we have knowledge of only one company in the United States which capitalizes delay rentals and I understand that that company is glad to cease the practice.

Delay rentals are treated as expense because it is not deemed wise for a natural gas company to capitalize such items and postpone indefinitely in the future the charging

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of them to expenses. In other words, there is an overwhelming consensus of opinion that delay rentals constitute a current expense which should not be capitalized in spite of all the finely spun theory to the contrary. Even witnesses for the company have not followed this fine theory, although it is no more tenuous than the theory supporting adjustments for well drilling costs, overheads, etc. It seems to me to be axiomatic that if delay rentals are treated as operating expenses today, they should never be re-accounted for in the future as plant costs.

The only valid costs, to repeat, would be those which give recognition to the original treatment of delay rentals. If delay rentals are currently charged as operating expenses and years later they are added to plant costs, I submit that plant costs will have no validity whatsoever. Valid plant costs, to reiterate, are only those which give full recognition to all phases of the accounting process—expense accounting as well as plant accounting.

Q. Mr. Smith, financial statements are made in the ordinary course of business by the management, are they not? A. Yes; they are constantly being used by management.

Q. And on those financial statements information the management make their decisions, do they not? A. Yes, indeed. As a matter of fact, I believe it was Stuart Chase who said that when a business gets so large that one man

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can't take care of all of its details, accounting takes over.

Naturally, financial statements are relied upon by executives in making their decisions.

Q. While re-accounting may be proposed by the utility, can it go back and undo the transactions which the company entered into and the decisions which it made as a result of the facts shown by such statements? A. No. It is easy enough to transfer figures; and it is easy, the easiest thing in the world, to put another figure in the plant account and make the contra entry somewhere else in the books; but the decision of the management on the facts shown by the financial statement in the past can not be changed.

To give an example, natural gas companies generally consider well drilling expenses as expense. Undoubtedly their decisions were based upon that concept, and undoubtedly the practice had a good deal to do with the rates, charges and revenues of the companies. We can not go back and restate those matters of substance; we can not go back and make new rate contracts. It is an easy matter to change the accounting, but the substance remains permanently fixed.

Q. Have you made many accounting investigations for the purpose of determining original cost? A. I have.

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Q. How many? A. I don't know, but I have made a good many.

Q. Have the principles testified to by you in this proceeding been applied in making those investigations? A. They have; and they have been consciously applied. Offhand I do not recall any more than two cases where I have restated the general administrative expenses. And yet I am familiar and was familiar at the time of making the investigation of many practices of accounting with regard to them. After studying such instances, if I deemed that they were accounted for under one of the alternative methods I made no change.

That applies with equal force as to the accounting for maintenance items. That makes me more than amazed when I find companies claiming that such items are now to be charged to plant accounts.

Q. The accounting principles to which you have now testified are applied and embodied in the original cost exhibit marked for identification as Exhibits 57 and 57-A, are they not? A. That is true.

Q. In the exhibits marked for identification as Nos. 57 and 57-A, is the cost on the company's books as adjusted by the Commission's accounting examiners synon-

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ymous with original costs as you have defined it and in accordance with the Commission's system of accounts? A. Yes, to the extent that it relates to property shown in the exhibit. In other words, I make one qualification. We did not go into the distribution property of the company. And except for that one variation, the original cost is correct.

I had better change that. The statement shows the original cost of the company's property, excluding the distribution property.

Q. Mr. Smith, I believe that Mr. Antonelli, who sponsored Exhibit No. 20 showing the claimed original cost of the company, said he based his study upon the West Virginia System of Accounts for Natural Gas Companies. Are you familiar with that portion of the record? A. Yes. I believe that is correct.

Q. Are the provisions of the West Virginia System of Accounts and the Federal Power Commission system of accounts for natural gas companies substantially the same? A. They are substantially the same. They were not word for word the same until November 29, 1940, when the West Virginia Commission amended its system. I happened to know about the amendment before it took place. I agreed therewith. The amendment does not change the principles at all.

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We have constantly interpreted our system of accounts to mean what the West Virginia Commission's system of accounts now reads with the amendment I just described.

Q. Then there is no difference between the West Virginia system and the Federal Power Commission system accounting principles and original cost principle to which you testified? A. Certainly not as to original cost.

Q. Mr. Smith, referring to the exhibit on original cost in two volumes, marked for identification as Exhibits 57 and 57-A, and written statements and supporting schedules in those two volumes, if appropriate questions were directed to you, would that be your direct testimony in this case? A. It would be my direct testimony in this case so far as principles are concerned. It must be remembered that we had as many as thirteen men on the assignment and, naturally, I could not check the details of the work of those thirteen men. As a matter of fact, I did not attempt to do so. The mechanics, the figures, the computations, etc., represent the work of others.

Q. Naturally. But your instructions on principles are embodied in this original cost exhibit? A. That is correct.

Mr. Springer: That is all the direct testimony of Mr.

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Smith at this time.

Mr. Cockley: I am prepared to cross examine Mr. Smith, subject perhaps to some further cross examination if after his testimony is written up and we can see it, we desire to do so. But I understood from Mr. Springer that for the convenience of Mr. Smith he wanted to have him testify at this time on principles of depreciation.

Mr. Springer: That is entirely satisfactory.

Mr. Cockley: I have no objection to that, but I just wanted it understood before we did it that I should probably cross examine Mr. Smith on this so-called original cost exhibit and perhaps Mr. Milde would want to cross examine him on the other exhibit. I do not wanted to be limited by the usual rule of one man cross examining, as long as we do it on different exhibits.

If you want to go ahead as a convenience to Mr. Smith and have him testify on direct, I will be glad to have you do it.

The Trial Examiner: What is the particular advantage to Mr. Smith?

Mr. Cockley is present and we are ready for the cross examination with respect to the original cost. I can not see where it will affect Mr. Smith's convenience. He will have to be here for the cross examination, whether it is now or later.

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* * * * *

Cross Examination by Mr. Cockley.

Q. As I understand, Mr. Smith, so far as Exhibits 57 and 57-A are concerned, you instructed your staff to prepare those in accordance with the Commission's code of accounts as interpreted by you to them. Is that right? A. Yes, sir.

Q. And while you do not assume responsibility for these figures in detail, you believe they have done that? A. That is correct.

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Q. And I suppose any examination about the detailed figures should be addressed to Mr. Pace or Mr. Dunn, or whoever will appear later? A. Yes.

Q. Is the same statement true with respect to the text appearing in the first part of these exhibits? A. That is right. As far as the detailed figures are concerned, the men who prepared them are responsible. But so far as principles are concerned, I am responsible.

Q. You did review Schedule 1 on page 10 of this Exhibit No. 57, did you? A. Yes, sir; I reviewed it generally.

Q. You reviewed it generally? A. Yes.

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Q. I will ask you if it is not a fact, Mr. Smith, that the figure appearing in the lower right-hand corner at the bottom of the page, $51,207,000, is not the figure that you find to be the original cost of this property? A. Yes, sir.

Q. And when I say that, Mr. Smith, we are always excluding the distribution system property? A. Yes, sir.

Q. I will ask you if it is not a fact that as developed on that page you started with a cost per books of the whole company of $53,306,000, shown at the bottom of column "D," accept some reclassifications in that which have been made by the company, with the same total amount appearing in column g, and then made some adjustments up and down in accordance with these principles which you announced and arrived at an adjusted book cost of $51,207,000. Isn't that so? A. Yes, sir.

Q. That figure developed there, as this exhibit shows in the title, is the investment in gas plant per books and as adjusted as of December 31, 1938, is it not? A. Yes, sir.

Q. It is an adjusted book cost? A. Yes.

Q. Isn't that so? A. That is right.

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Q. And I will ask you if the subsequent schedules that appear in Exhibit No. 57 and also in Exhibit No. 57-A are not in their entirety supporting details for this adjusted book cost of $51,207,000? A. Yes; adjusted book cost, meaning that we think that is a proper cost of the property.

Q. It is a cost that you got from the books of the company and adjusted downward to the extent of about two million dollars to arrive at $51,207,000? A. It is the cost that we got from auditing the company's books and records.

Q. But it is just what this exhibit calls it—the investment in gas plant per books? A. Yes, sir.

Q. That is the part of the original investment that was made at the time that was charged on the books of the company to plant account, isn't it? A. That is right.

Q. Now, I want to ask you another question. A. Just a minute, please. I had better explain that. There may be some difference of viewpoint here, and we ought to understand each other.

In all of our work we feel that we are compelled to start with book figures so that the company will know the

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derivation of every figure in the report. We presume the company knows what is in its books. By starting out with that figure and showing the adjustments we arrive at an adjusted figure.

We have done that in this case. We have shown the cost per books primarily for the convenience of the company in order that it may check thoroughly the stages through which we have gone to reach the final figure. I say the final figure represents what I think ought to appear in the books today as the adjusted book figure.

Q. Is there any doubt but that that figure of $51,207,-000 as developed there and as supported by all these schedules, Mr. Smith, is an adjusted book cost? A. If you are attaching any specific weight to that, then I have to make myself clear, that I think the figure is a figure of real substance. It is the only valid original cost figure that I know of.

Q. Will you tell me what it is. As it is developed and supported here it is an adjusted book cost, isn't it? A. I think you are attaching some special meaning to the schedule which I may have to deny. The final figure does not appear on the books, if that is what you mean.

Q. The $53,306,000 appears on the books? A. Yes. That is the first figure, not the final figure.

Q. You adjust that downward by two million dollars

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or thereabouts and arrive at the adjusted book cost? A. We make adjustments to practically every account, and the effect of it happens to be an adjustment downward; and we get a final figure, which I say represents original cost under the Commission's Uniform System of Accounts.

Q. I did not ask you what you finally called this figure. I am only taking one step at a time. As this is developed here it is an adjusted book cost, as the exhibit shows, isn't it? A. I do not like to take—

Q. Can't you answer that yes or no? A. No; I cannot. It does not appear in the books, if that is what you mean. I don't understand what you mean by "adjusted book cost."

Q. I am only taking the expression that appears on this exhibit, which says "investment in plant account per books and as adjusted." You started with the plant account per books? A. Yes. And we say that that figure is wrong.

Q. You say that that figure is wrong by two million dollars? A. Yes.

Q. And you write it down two million dollars? A. We do not write it down. We make adjustments to show what the answer ought to be.

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Q. Is the effect of the adjustments to get a figure or a lower figure? A. A lower figure.

Q. And that is what you call here "as adjusted," and that means book cost as adjusted, doesn't it? A. It means more than that. It means it is the bona fide original cost figure.

Q. Does it mean that? A. In one sense, yes. In one sense we start off with a book figure and we make the necessary adjustments to it and arrive at another figure, and in one sense you could call that the book figures as adjusted. But the final figures have a lot of substance to them.

Q. Whether or not they have substance, the figures as developed by the Examiner's adjustment to the plant accounts as they appeared on the company's books, that is as the cost appeared on the company's books? A. That is merely the mechanics.

Q. Whether or not it is the mechanics, that is how it was arrived at, isn't it?

The Trial Examiner: As I understand it, that is the cost as arrived at by the application to the book costs of certain adjustments.

The Witness: Yes, sir.

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By Mr. Cockley:

Q. I want to refer you to the depreciation exhibit, which has not yet been identified, and ask you to turn to page 23. That is the exhibit that you are going to testify to next as to accounting principles, isn't it? A. I believe it is.

Q. I will ask you if the figure— A. I would just like to correct that slightly. It is more than accounting principles that I am going to testify to next.

Q. All right. I will accept that.

I call your attention to line 55 and note above it which says "net adjusted book cost December 31, 1938."

And opposite that, for the total plant, $51,207,000? A. That is right.

Q. And on page 8 of that exhibit you make a statement to that effect, don't you? A. Yes; I think I do. In the beginning I thought we were together, but you talk about adjusted book cost, which makes me think that we are not.

We use that as a convenient term to show the figures which we have arrived at as a result of auditing the company's books. Actually the final figure is not on the company's books.

Q. Of course, Mr. Smith, we have been over that sev-

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eral times. It is perfectly obvious from this schedule that the figure on the company's books is $53,306,000? A. That is correct.

Q. And you took some retirements which were not shown and made some other adjustments up and down and come out with the figure of $51,207,000? A. That is correct.

Q. Which was an adjustment of the company's book figures, wasn't it? A. That is right.

Q. Now, I call your attention to schedule 2, page 13 of Exhibit No. 57. That says, does it not, "The capitalized cost per books and as adjusted"? A. Yes.

Q. Is that a different basis? A. No; it is not.

Q. That means the same thing, doesn't it? A. Yes.

Q. What it means is that it is part of the cost appearing on the company's books in capital account? A. I can not go along with you on the word "part."

Q. I will accept that. It is the dollars that the company capitalized in its plant account as the cost at the time, isn't it? A. Yes.

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Q. That means precisely the same thing, doesn't it? A. Yes.

Q. Does this expression that I see on schedule No. 1, "Investment in gas plant per books" mean the same thing? A. Yes.

Q. At another place on page 4 it says, "Total cost of gas plant in service per company's books." A. The same thing.

Q. That mean the same thing? A. Yes.

Q. And all of them refer to this $51,207,000 that is developed and supported by all of these succeeding exhibits? A. When you use the language "per books," then you relate it to the books.

Q. We understand each other. If it says "related per books" that means the $53,306,000. If it says "per books adjusted" it means the $51,207,000, doesn't it? A. That is correct.

Q. And it is that figure that you also call on the face of this exhibit the original cost of gas plant? A. Yes, sir.

Q. And isn't it a fact, Mr. Smith, that there is not a table or figure anywhere in here that develops and supports that figure of $51,207,000 except Schedule No. 1 which is the summary and the supporting sheets? A. They all sup-

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port it.

Q. And they support that figure which, in the first instance, is an adjusted book cost which you also say is original cost, in your view? A. Yes. I am sort of sorry we had "adjusted book cost" in view of the apparent interpretation that you place on it. To me it means the original cost.

Q. That is, to you, an original cost of an item of property is whatever the company has recorded at the time on its books? A. No, sir; only in accordance with sound accounting principles.

Q. Omitting accounting errors? A. That is correct.

Q. Omitting accounting errors, it is whatever the company charged on its books at the time cost? Is that right? A. If whatever it charged on the books then was proper, that follows.

Q. In company Exhibit No. 20 it purports to show an original cost of Hope Company's property at December 31, 1938 of close to 70 million dollars, in round figures. A. Yes, sir.

Q. And am I correct, Mr. Smith, that the principal difference between that statement and Exhibit No. 57 relates to only four or five general items? First, and by far the

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most important, is the direct material and labor costs of various kinds which the company in the past had charged at the time to operating expenses and had not capitalized. A. I will have to deny it so far as direct material is concerned. I found no evidence on my visits to the company's offices of direct materials. But certainly the big difference represents labor costs in drilling wells. That is by far the largest item.

Q. Is it your statement that if material costs were charged at the time to operating expenses that would be an accounting error which you now restore? A. No; only if it were in connection with replacements which were generally charged to expense my answer is no.

I might say right now we think that Mr. Antonelli, who prepared the exhibit, did not have support for some of the material cost he shows there. But that will be taken up by another witness who is making a check of the matter.

Q. Then you are not going to say that if there are materials appearing in there that they should be there? A. No. You would have to go back to see whether they represented items which were properly charged to maintenance. In other words, if you set out to get all of the possible costs of plant you could get one figure; if you set out to get all of the possible items which could be charged to expense,

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you would get another figure; but the same items would be in both accounts.

Q. Let's get back to the main differences. You say one of the principal differences is the question of these direct material and labor costs insofar as they involve materials charged to capital account and which your men have not included in capital account? A. Yes.

Q. And the biggest item of that is well drilling cost? A. That is correct.

Q. That is about $12,500,000? A. It is a large item.

Q. And that represents the cost of wells drilled by the Hope Company or by the company from whom the Hope Company purchased them that were at the time not capitalized? A. That is correct.

Q. The second item of any importance was these overheads to which you testified, which at that time were not capitalized? A. Yes, sir.

Q. And those are the two principal items, are they not? A. I believe they are.

The Trial Examiner: At this time, gentlemen, we will

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take a short recess.

(Thereupon, a short recess was taken, after which the following occurred:)

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The Trial Examiner: You may proceed with the examination of the witness.

By Mr. Cockley:

Q. Mr. Smith, I direct your attention to schedule No. 1, appearing on page 10 of exhibit 57. I am correct, am I not, in saying that under account 332.1, producing gas well, well construction, you have in there in the adjusted column "J" a little over four million dollars to represent the drilling cost of all of Hope's wells that were in use on December 31, 1938? Is that right? A. Yes; that is right. That is the proper cost of well construction of the wells which were in existence on December 31, 1938.

Q. And Mr. Antonelli has in exhibit 20 an item of about approximately 12½ million dollars higher than that? A. I believe that is correct.

Q. Will you tell me if it is not a fact that this item of four million dollars which you have in there represents the drilling cost of about 700 out of 3,300 wells, Mr. Smith? A. I don't know.

Q. You can't answer that? A. I cannot.

Q. You do know that prior to 1924 or, rather, be-

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fore 1923, the Hope Company charged those drilling costs to expense and did not capitalize them? A. That is correct. I would estimate that there is a substantial number of wells which do not carry drilling costs in the plant accounts.

Q. And of the total difference between the figures in exhibit 20 and those in exhibit 57 of something over 18 million dollars, 12½ million dollars is in that one item, isn't it? A. That is right.

Q. Now, Mr. Smith, I want to ask you one or two questions to get straight on this. Assuming that in 1920 the Hope Company drilled a producing gas well and the work order of the Hope Company shows that it properly expended $10,000 for materials and $10,000 for well drilling and other construction costs, on these assumptions and omitting any consideration of overheads for the present, are you agreed that the money actually paid by the company in drilling and equipping these wells was $20,000? A. Yes; I think the money paid was $20,000.

Q. There is no doubt about it? A. There is no doubt. But that does not necessarily mean that it is a valid cost at this date of that well.

Q. We will come to that later. There is no question but that the company originally paid $20,000, and prop-

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erly paid $20,000 for drilling and equipping that well? A. That is right.

Q. Can you tell me what was the cost of that well to the company? A. The cost of that well at that time might have been, in the assumed case, $20,000. But still that does not shake my principle that the valid original cost is $10,000.

Let me state it this way.

Q. I am not interested in whether it shakes your principles or not. I want to know if you can answer that question. Before any bookkeeping on that well was done the cost of that well to the Hope Company was $20,000, was it? A. Yes. I think I can go that far.

Q. At that time was the original cost of that well $20,000? A. Knowing nothing further, yes.

Q. And the actual legitimate cost was $20,000? A. So far, yes.

Q. There is no doubt about that, is there? A. There is no real doubt any more than that the cost of paint on a building is an actual legitimate cost under the theory that you mention, until you get to the operating and account-

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ing stage and stage of producing revenues, and then we have a different situation.

Q. Then, what you say is that although the original amount of money paid for this is $20,000 the actual cost and original cost and legitimate cost of that is $20,000, if the company subsequently records only a part of that cost in its plant account, then the $20,000 ceases to be the actual cost or the original cost? Is that correct, Mr. Smith? A. Oh, no. I think that again we are following abstractions and an isolated case. I think when you reach the operating stage and the company treats those things as expenses, they are bona fide expenses. The fact that you put a new inner tube into a tire gives you a new cost of that tire. You deal abstractly with it. The inner tube and tire must be taken. But we are getting away from realities when we do those things and we forget how businessmen run their businesses; you are following an abstraction.

Q. It is not my purpose to argue with you as to why you do this, because this cross examination will be unnecessarily prolonged. If you feel that you must make some explanation of your position and that it requires some defense, of course, you can volunteer those things. But I want a direct answer to my question as to how you treat

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these things. A. I have an obligation here to give a full answer, too, I believe.

Q. I don't want to preclude you from doing that, Mr. Smith.

Mr. Springer: I object to the characterization of the response of the witness by Mr. Cockley. He is certainly entitled to explain any answer.

Mr. Cockley: Mr. Smith is a very intelligent witness and a capable witness.

The Trial Examiner: Let's proceed with the examination of the witness.

By Mr. Cockley:

Q. Now, let's come to the bookkeeping, Mr. Smith. Suppose the company, in the case that we have assumed, capitalized on its books the whole of that $20,000 for labor and materials and now carries that amount on its books; there would be no doubt in your mind that that would be the book cost and still be the original cost? A. That is correct. And we would not change it.

Q. And you would not change it? A. That is right.

Q. Am I correct in saying that if the whole of this substantially 12½ million dollars in the well construction accounts had been originally capitalized by the company

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on its books that there would be no question in your mind now but that it would be part of what you term the original cost? A. If we can go one step further and assume that that was the general practice of the industry, certainly we would have no difficulty.

Q. Assuming that it was an acceptable practice? A. Yes. We would have no difficulty. In other words, where there are alternative methods of accounting—and there are alternative methods—and you follow one system, I will accept that scheme, provided you apply it consistently. That is the only way, Mr. Cockley, that you are ever going to have any consistency in the determination of profits or income and determination of cost of plant.

Q. Am I further correct in saying that substantially the whole difference between exhibit 20 and the total figure at which you arrive here in exhibit 57, if the company had at the time capitalized all of the items which it shows and which you disallowed—if I may use that expression—you would have now included them in original cost? A. No; that is not quite so. We think that Mr. Antonelli in his study has resorted to some arbitrary estimates which we would not allow in any event, because we do not think

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the items would ever have appeared on the books; but to the extent the items would have appeared in the books, if you had followed one of the alternative methods of accounting, we would have accepted them.

Q. That is applicable to the $19,000,000. That is a relatively minor item. A. It may be a substantial item. Someone else is going to testify to some of the amounts.

Q. If they had been actual expenditures at the time capitalized in the accounts, so that the question of estimates was out of it, you would have allowed a substantial figure? A. That is correct—assuming the entries would have conformed to accepted principles and practices.

Q. You don't mean to say that that has to be the universal practice in the industry? A. No.

Q. And you recognize, do you not, that some gas companies did capitalize these well drilling costs in the past and others did not? A. There were very few of them which capitalized them, so far as I know. We made diligent inquiry and found very few companies; and I don't think we found any that capitalized the items regularly before about 1919, when the Pennsylvania Commission required cap-

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italization. Overwhelmingly natural gas companies charged those items to expense, and the Commission acted upon them as expense.

Q. That is your assumption, that they acted upon them? A. They had to.

Q. Suppose they did act upon them; what difference does it make? A. All the difference in the world. If you treat something as expense which is treated as expense by the industry and everybody in the industry recognizes it as an expense, and executive decisions are made on those assumptions, you can not go back and undo it or change the rates or the moneys which you collected from the customers, which were based upon the accounting for well drilling expense.

Q. Suppose you have $10,000,000 of well drilling costs; suppose the condition of the well drilling accounts charge is 50 per cent; that would mean that you would have at least $5,000,000 to set up in your rate base on your asset side, wouldn't it? A. I think so. The net amount—actually you set up twice that amount and have the reserve offset it. The net amount would be as you indicate.

Q. If you would figure it at a net basis you would take the depreciated condition of the dollars, whatever

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dollars you set up for it originally? A. That is correct.

Q. So it would be about $5,000,000? A. That is correct.

Q. And if you allowed 12 per cent to cover both depletion and return on that, you would get in operating expenses about $600,000, roughly, wouldn't you? A. Your return does not get into operating expenses.

Q. Well, it does for the purpose of a rate statement, doesn't it? A. The return is profit. It never gets into the expense. I don't want to have these differences on technical matters.

Q. You are talking as a technical accountant, aren't you? A. Yes.

Q. As a practical man, when you get over into operating expense which you consider for purposes of fixing rates, you get about $600,000 on that, and you would get about $600,000 expense and return. If on the other hand, instead of having anything in capital account for these items you put over into operating expense about $600,000, your rate would be precisely the same, wouldn't it? A. The rate?

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Q. Yes; the rate at which you arrived would be precisely the same? A. I don't see that.

Q. The price at which you sell your gas to cover this cost would be precisely the same? A. No; I don't think so.

Q. You think it makes a difference whether $600,000 is the amount of expense or whether $600,000 is the return; plus depreciation or depletion it would be expense? Is that your statement? A. I think it makes a big difference as to what you consider expense. I am having difficulty in following your questions. The questions are confusing to me.

Q. I do not mean them to be confusing. Of course, I am not an accountant, and I try to state it simply from the point of view of the effect on rates. Actually in either case you are going to get $600,000 in some form or other? A. No; I don't think so. In the latter case you are going to try to get $600,000; but in the first case if you do not have any expense, you are not trying to recover something for expenses which are not incurred.

Q. Then your statement is that there is a difference between those two situations? A. Yes; I think there is all of the difference in the world—

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Q. That is sufficient. A. —as to your action based upon what expenses are shown by your income statement.

Q. Let's come back to the bookkeeping. You have already stated, I think, that if in the case we assume, where a company had properly spent $10,000 for equipment and $10,000 for drilling a well if they had capitalized the whole on their books, you would now allow it as a part of the original cost? A. That is correct.

Q. Now, suppose that instead of doing that they capitalized only the material and charged the labor cost to expense, which Hope did prior to 1923; I understand your position to be that you would now consider the original cost of that well and the book cost to be the same, namely, $10,000. A. There is no doubt about it. And I gave an illustration which I would like to repeat.

Q. You have answered the question. A. I want to give this illustration and drive home that point.

Q. Now, just a minute, Mr. Smith, please. I am going to object to these voluntary statements. I am merely trying to ascertain the position of the witness about these things. I submit it is not a matter subject to debate every time I ask a question.

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If I can not be protected in pursuing the cross examination in my own way to develop facts and not accounting theories, we will never end the cross examination. If Mr. Springer wants to ask further questions when I have finished, of course that is his right.

Mr. Springer: We are dealing with accounting principles. When Mr. Cockley opens the door on an accounting principle by a question, certainly the witness is entitled to explain his answer. That is all he is attempting to do.

The Trial Examiner: I think he is entitled to explain his answer, but it did not seem to me that that last answer required any particular explanation.

Mr. Springer: May we have the last question and answer read, Mr. Examiner?

(The question and answer were then read by the reporter.)

By Mr. Cockley:

Q. That is an illustration.

And Exhibit No. 57 is set up on that basis?

Mr. Springer: Just a minute, please. We have not had a ruling. I think the witness is entitled to explain his answer.

The Trial Examiner: I understood that; but I do not understand that there is any objection pending. There is nothing to be ruled upon.

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Mr. Springer: No, but he is not given an opportunity.

Mr. Cockley: I object to the witness going into and giving other illustrations.

The Trial Examiner: I think an explanation and an illustration are two entirely different things. If the witness wants to explain his answer, he may do so.

The Witness: What I wanted to do was to point out that in this very case we have a problem of that nature involved in the determination of income, that is delay rentals. In the course of time, I think delay rentals will amount to more than the cost of well drilling which has been charged to expense. And whatever ruling may ultimately be made in regard to the well drilling expenses ought to be made with the full realization that delay rentals are in the same category.

By Mr. Cockley:

Q. Have you finished? A. Yes.

Q. Did I correctly state your position in my last question? A. You did.

Q. Now, Mr. Smith, suppose a company, in accordance with the practice followed by other companies at the time, although not the universal practice or a practice of universal application, had charged both the cost of drilling and

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equipment to expense; is it your present position that both the book cost and the original cost of that well is zero? A. No.

Q. On that theory, I suppose that would be an accounting error? A. That is correct.

Q. Let me understand you. Did you understand from my assumption that I assumed that that was the practice that was followed by many companies at the time? A. That would not have conformed to accepted principles of accounting. If you assume that it did conform to accepted principles of accounting, I would go along with you. But it did not conform to accepted principles of accounting.

Q. But if it had conformed to accepted principles of accounting, by which you mean a principle which was applied with some degree of generality— A. And which certified public accountants would certify to unhesitatingly. There is one qualification we must make. We are dealing solely with original costs. You will recall I testified if something were charged to expense in error and it were recovered from the rate payer, as a regulatory measure I doubt that you should recover that cost again, regardless

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of the fact that the error was made. That error would not bind me as far as getting original cost in the accounting sense is concerned.

Q. You did not make any investigation to determine whether any of these costs were recovered from the rate payer, did you? A. I had an idea they were all pretty generally recovered.

Q. That is based on your general assumption? A. No, on the assumption that this company has been very profitable during its existence.

Q. Am I right, Mr. Smith, that it is only true that you could be said to recover the things from a rate payer in the event that your rates would have been fixed at a higher rate if you had expensed these items than if you had capitalized them? Is that right? A. Yes. It goes one step further; by reason of the fact that you have treated this cost as expense and all others treated it as expense, naturally these costs were considered by management as expense in fixing rates.

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Q. Well, you didn't, in your investigation, go any further, did you, than to ascertain the fact that these drilling costs and some other items that you have eliminated, were recorded on the Hope Company's books as expenses? A. Oh, yes, we went farther than that. First of all, you left out one essential element. We determined that they were charged as expenses in accordance with sound principles and practices of accounting. As a matter of fact, we added to your plant accounts about $1,400,000 which we felt had been charged off in error, and when you say that we have reduced the plant accounts some $2,000,000, actually we have increased the plant accounts.

You yourself made an adjustment recording unrecorded retirements. When you make allowance for adjustments, we have increased the plant account by about $1,400,000.

Q. What I meant was, Mr. Smith, you did not investigate the basis on which the company's rates had been fixed at any time in the past, or whether those rates would have been higher or lower if, in the past, it had capitalized well drilling costs instead of expenses, did you? A. We made a study of earnings with that purpose in mind.

Q. Well, general earnings, you mean, of the company? A. That is right.

Q. Well, I am asking you specifically if you made any

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study to determine where the company would have come out if it had capitalized these well drilling costs instead of expensing them, and whether it would have larger or smaller amounts? A. Yes, I made some study of that. I found that your company, for instance, claimed some of those items as expenses, the Clarksburg Company claimed them as expenses, at least, before the West Virginia Commission, and they were allowed as expenses. I found other commissions allowed them as expenses.

Q. Well, now, let's see. Our company claimed them in a case before the West Virginia Public Service Commission decided in 1921, wasn't it? A. I believe it was.

Q. And isn't it a fact that that rate case affected only 4 percent of the company's total volume of business? A. I don't know, that is of no consequence to me, however—

Q. (Interposing) Isn't it a further fact that it affected only the domestic consumers in West Virginia, whose rates here aren't under consideration? A. There is no difference in principle, Mr. Cockley—

Q. (Interposing) And isn't it a fact that in that same case, if the company had presented its evidence on the basis of a capitalization of drilling costs, with appropriate allowances for return and depletion on those costs, it would have had just as high a rate as was allowed it? Did you

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investigate that? A. I don't know what it would have been, if you had done something else. I do know you claimed them as expenses, and they were allowed as expenses, and others did the same thing.

I do know that the items we have mentioned were generally considered as expenses, at that time, and I repeat that I think regulatory commissions are responsible for the change.

Q. Now isn't it a fact that both times that the Ohio Commission, in 1932 and 1937, had the question of the Hope's East Ohio rates before it, that well drilling costs were capitalized and were not in any sense expensed?

Mr. Springer: I object to the testimony of Mr. Cockley. There isn't any evidence in this case of the practice in those other cases that he has presented.

Trial Examiner: Well, I understood this witness to testify that he had certain information on which he was basing his opinion, and that information consisted of these rate cases; is that correct?

The Witness: Yes, sir.

Mr. Springer: Well, in each one of Mr. Cockley's questions, he testifies to information that I doubt this witness would have the details of to determine the accuracy of—

Mr. Cockley: (Interposing) Well, the witness can perfectly well answer. I said, "isn't it a fact"—and if he

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doesn't know whether it is a fact, he can say so.

Mr. Springer: Make them assumptions, and I will go along with you.

Mr. Cockley: I don't make assumptions—

The Witness: (Interposing) What were the years, Mr. Cockley?

By Mr. Cockley:

Q. Well, in the 1932 Akron case, and the 1937 Cleveland case. A. Well, I think that is correct.

Mr. Reeder: Just a minute, Mr. Examiner. I want to move to strike that question and answer unless counsel will say, capitalized by whom. If he wants to say it was capitalized by anybody in particular, I want to ask for strict proof.

Mr. Cockley: Well, I have asked the question and it has been answered.

Mr. Reeder: I am pressing my motion to strike, because it is my recollection that in 1931, in the Cleveland case, the Ohio Commission didn't find a valuation of the Hope property, and I have heard Mr. Cockley say that over and over again—

Mr. Cockley: (Interposing) That is right, and if you had listened to my question, instead of objecting, you would have noted that I said in the 1932 Akron case, and in the 1937 Cleveland case that it was capitalized by the Commission; is that not the fact, Mr. Smith?

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The Witness: Mr. Cockley, I made inquiry from the Chief Accountant of the Public Service Commission of Ohio regarding that matter a year or two ago, and the information he gives me corroborates your statement. That is the extent of my knowledge.

Trial Examiner: The objection is overruled.

Mr. Reeder: I withdraw it, I am sorry, I didn't hear it on account of the noise.

By Mr. Cockley:

Q. Now those cases before the Ohio Commission, to which I have just referred, are the only times within your knowledge, are they not, when the export rates of the Hope Company had been under consideration by any regulatory body until this present case? A. I have no knowledge of any other case.

Q. Mr. Smith, getting back to these well drilling costs and how they are charged on the books, as I understand your testimony, if there were two companies, each of which drilled a well at a cost of $10,000 for construction and $10,000 for equipment, and one company capitalized that all in its books and the other charged the well drilling to expense, and those companies came here before you to set up their accounts in accordance with the Uniform System of Accounts, one of them would have the well in at $20,000, and the other would have it in at $10,000, is that not so? A.

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That is true, but that is not unusual, Mr. Cockley. I have got to make myself clear on that—

Q. (Interposing) Do you think that answer needs some explanation? A. I think it does. There is an implication there that that would be a wrong situation, and it would be a perfectly valid situation. I think I ought to be given the opportunity to explain it.

Q. Well, if you think your position, standing alone, requires explanation, go ahead and explain it. A. Well, it does.

Q. I haven't asked you for an explanation, have I? A. No.

Q. You are volunteering it? A. Yes.

Trial Examiner: Have you completed your answer now, Mr. Smith?

The Witness: It is not the kind of answer that I would like to stand by itself. I think someone reading it may be misled.

Trial Examiner: Go ahead with your explanation.

Mr. Cockley: Go ahead and explain it.

The Witness: Today, when an electric utility replaces a cross-arm, some utilities treat that as a maintenance item, and some treat it as—

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Mr. Cockley: (Interposing) I object to accounting for electric utilities now. We are talking about a plain, simple question of drilling costs of natural gas wells.

Mr. Springer: We have had testimony that the principles of accounting are the same for all utilities.

Mr. Cockley: Well, we shouldn't have had.

Trial Examiner: Well, it seems to me—

Mr. Cockley: (Interposing) If the witness wants to explain this particular question, I have given him the opportunity to do it.

Trial Examiner: Could you use some item used in the gas industry instead of a cross-arm, for instance?

Mr. Cockley: Use this item.

The Witness: I will use a pipe. A company can take each unit of pipe as an item of property, and every time it replaces a length it can put it through its plant accounts; or it can charge it to expense. Over the course of years you are going to get a different answer for those two companies.

The point I make is that you will always have different answers for any two companies.

I know from my experience that any two utilities, any two department stores or businesses of any kind, with plants, will have different results when it comes to their plant costs applying to exactly the same items.

Mr. Cockley: I move we strike out the discussion about

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department stores; I think that is entirely too far afield.

Trial Examiner: We are discussing accounting principles, and I can't see that it makes any particular difference.

By Mr. Cockley:

Q. Well, it is a fact, isn't it, Mr. Smith, regardless of the reasons for it, that your position is, and your interpretation of the Uniform System of Accounts, and your method of determining original cost, is that you would freeze the accounting practices of the company, if they were not due to error, in their statement of plant accounts to be filed with this Commission? A. Absolutely, because I think their accounts have been kept correctly. Otherwise—

Q. (Interposing) And then if one company did it one way, and another company did it another way, and on some other feature the same thing was true, you would preserve in those plant accounts, for those various companies, the elections—if you want to call them that—which they had made between accounting practices, and all the variations in accounting practices that they had followed over the years, would you not? A. Assuming that the practices were in accordance with accepted principles of accounting.

Q. I am talking about nothing else. A. Absolutely, I most assuredly would insist upon it, and, Mr. Cockley, just

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imagine the position this Commission would be in if it didn't insist upon it.

Today your company is not following the same practice as all other natural gas companies. A few years from now this very company could come in and do the same thing over again. You have got to have a finality to this accounting sometime or other.

Q. Isn't it a fact that if the book costs of these companies, or of A Company were set up in accordance with its accounting practices—assuming always that there was no, what you call, accounting error—and B Company were set up in accordance with its accounting practices; and C Company were set up in accordance with its accounting practices—you would have no uniformity whatever in a statement of plant accounts for those three companies? A. Oh, yes, you would have a uniformity, but it wouldn't be absolute or a precise uniformity, and I don't think it is humanly possible to get precise uniformity. That is one of the real reasons why, once you account for something in accordance with a principle, that you ought to abide by it.

Q. Your interpretation of this Code of Accounts is,—this so-called Uniform System of Accounts,—that it was intended to require gas companies to preserve the accounting methods that they had pursued from the beginning of time, so long as there wasn't any accounting error? A.

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That is correct, and that has been my practice for 20 years.

Q. Well, you mean that that has been your interpretation? A. I mean that I have audited oil companies 20 years ago, which charged well drilling to expense, and I found it was a generally accepted practice and made no change in it. I still think I was absolutely right in doing so.

Q. Now, Mr. Smith, I want to ask you one other question. Suppose two companies, such as we have assumed, drilled two wells, or each drilled a well, with a total labor and material cost of $20,000.

One of them put it in its plant account at $10,000, and the other put it in at $30,000. Now in each case $10,000 of that would be the book cost, wouldn't it? A. Will you read that?

Q. Well, it is simply a case of two companies each spending $20,000 to drill and equip a well,—one of them charges it on its books at $10,000, and the other at $30,000. A. I can't see why one would charge it at $30,000?

Q. Well, they might have had a re-appraisal. A. Of course, that would be most unsound accounting.

Q. Well, do you mean to say that there is never inflation that gets into these costs at all? A. Not if I can help it, there won't be any inflation.

Q. Before you came into the picture? A. I think com-

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missions, since they started regulating accounting—and one of the first jobs a commission undertakes when it gets organized is to regulate accounting—generally have tried to keep inflation out of the accounts.

Q. If it will make you feel any better, suppose we say that one company sells their well, which cost it $20,000—it is a utility, and it sells this well to another company for $30,000. It would then be $30,000 on the books of the accounting company, wouldn't it? A. There is no affiliation between the companies?

Q. No affiliation. A. That is correct.

Q. It is a good well, it is honestly worth $30,000. A. O. K.

Q. Now you would set that up in your plant accounts as $20,000, wouldn't you, and show the $10,000 additional in account 107? A. No, sir, we would show it as $30,000. An individual well is not an operating unit or system.

Q. Well, I assumed that it was. I want to take the assumption where it is an operating unit or system. A. Then you have got to get a business with customers attached, and a going business, and when you buy a going business, you can't tell how much you pay for the well. That is exactly why we have this original cost provision in

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the System of Accounts.

Q. All right. Suppose it is a case where one utility sells to another what you would call an operating unit, and the purchasing utility puts it on its books at $10,000 or $100,000, whatever it has paid, above the cost of the selling utility? A. Yes, sir.

Q. Am I not right that you show, in your adjustment account—100.5—the amount that is paid over and above the cost to the selling utility, is that not so? A. That is correct.

Q. As shown by its books? A. That is correct.

Q. And if there were a re-appraisal which appeared on the accounts at any time, of a given item, you would show that in some plant adjustment account, would you not? A. If the appraisal figure on the books of the selling company were less than the cost to the purchaser, all the excess would go into account 100.5, but if the purchaser put on an appraisal figure higher than cost, then the excess would go into the account 107.

Q. And if that were done, the write-up, or the inflation, whatever it is, would not disappear from the company's accounts, would it? A. Oh, yes, it would disappear

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eventually, because both account 100.5 and account 107 provide that the amounts included therein "shall be disposed of as the Commission may approve or direct."

Q. But the information would be shown by the accountants for the benefit of the Commission, and the Commission would decide what ought to be done with it, would they not? A. Yes, the Company still having a right to petition the Commission for disposal in accordance with its wishes.

Q. But you believe that that is a proper method of accounting for the accountants to show the facts as to the amount of the inflation, if there is any, and that the Commission disposes of it as it sees fit? A. I will go one step farther,—I think if it is real inflation, the Commission ought to order it charged off at once.

Q. Regardless of what your views are as to what the Commission ought to do, you think it is an accountant's duty to show any overstatement of costs, isn't that so? A. I will go farther than that. I don't think the accountant has any right to sign his name to a statement containing inflation.

Q. Well, are we agreed as to what inflation means? Do you call it inflation if a company legitimately has paid more than the cost for the acquisition of property? A. No, sir.

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Q. Well, then, call it just an overstatement, and assume it is a mere overstatement? A. Just payment in excess of original cost.

Q. And the Commission will be advised by the accountants of all the facts, the amount of the increase over original cost, will it not, and the Commission could dispose of it as it saw fit? A. It would, indeed. We would go farther, we would try to show to what it relates, if we can possibly do it—

Q. (Interposing) And you believe it is an accountant's duty to bring out all those facts, and that that is one of the purposes of the new System of Accounts? A. That is right.

Q. But it is your interpretation of that System of Accounts that it applies only to overstatements and does not apply to any understatements of original cost, is that right? A. That is absolutely not so. Account 100.5 may contain a credit figure as well as a debit figure.

Q. But Account 107 would never show any difference on your interpretation, between the actual money paid by the company in the construction of property, and the book cost of that, would it? A. Well, it would show other things. Account 107 will show chiefly write-ups. It will also show unrecorded retirements when we find them, until the time comes when the entries are made correcting the

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adjustments. Sometimes we find that a discount on common stock is charged to the plant accounts. That discount does not belong in the plant accounts at all, and we show that in Account 107. Generally speaking, however, Account 107 is designed to include any amounts of inflation in the company's accounts.

Q. But not to show understatement? A. Not 107.

Q. Well, this says, "This account shall include the difference between the original cost, estimated if not known, and the book cost of gas plant, at the effective date of this System of Accounts, to the extent that such difference is not properly includable in Account 100.5, Gas Plant Acquisition Adjustments."

Now am I right that it is your construction of that, and you have so advised your examiners, that if the money actually paid by the company in the acquisition of property, actually paid by the company in the construction of property, is higher than the cost as recorded on its plant accounts, the difference shall not be shown in Account 107? A. Again, we are assuming that the costs were accounted for in accordance with accepted principles?

Q. That is right. A. It does not go in 107.

Q. Well, "accepted principles" as we have discussed

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them before—I mean they followed the practice of other companies which was recognized as not an improper practice at the time? A. Well, if you speak of the well drilling costs in this case, we have a specific example; those well drilling costs should not be restated with the offsetting credit in Account 107.

Q. In other words, in that case you do not show the Commission the difference between the money actually paid for the construction of the property in the first instance, and the book cost? A. Mr. Cockley, we do not, we can never show the Commission pure cost in some abstract fashion, forgetting how those costs have been accounted for. The Commission knows in this case that these items have been charged to expense, and if it had not been brought out already, we would make it clear to the Commission that they had been charged to the expense.

The items have been brought out, but in addition we intend to file a reconciliation statement showing exactly how those items have been accounted for. So in this case, at least, we will give the Commission all the information.

Q. Have you finished? A. Yes, sir.

Q. Mr. Smith, will you tell me what is theoretical and impracticable about going back to the original work orders

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of a company which show in detail the dollars it has spent for equipment and for construction costs of a well, and setting up those dollars as the amount of money actually paid for the construction of that property? A. Can't we eliminate the item of equipment from your question?

Q. Well, work orders show both, don't they? A. Yes, but only the costs of drilling were charged to expense.

Q. That is right. A. I would say that we would be absolutely wrong to take those drilling costs which were charged to expense and put them in a statement and say to the Commission, "This is our understanding of the original cost of this property." We have got to get down to realities and actualities in this thing. Things which are charged to expenses, and are properly expenses, I would never put into plant accounts.

Q. I object to the lecture, it isn't necessary. I am just asking you what is impracticable about determining the cost as shown by the work orders of the company, and the records of the company, and what is theoretical about it. A. Well, it is wrong. As far as being practical, you could do it or you can make a statement of any kind of figures you want, but it would be wrong to do it.

Q. Do you think it would be wrong to tell the Com-

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mission in a rate case how much money the company actually and properly spent in the construction of property now in service, whether it was charged to expense or capital account, or where it was charged, or whether it wasn't charged at all? A. No, Mr. Cockley, it would not be wrong to tell the Commission that. It would be wrong for us to bring an original cost statement in, in which were included those items and overheads previously charged to expense, and to say to the Commission, "We think this is the original cost," when we do not think that.

Q. Will you answer my question?

Mr. Reeder: I object unless the witness has had a chance to finish. I think he ought to have a chance to finish.

Trial Examiner: Go ahead and finish your answer.

The Witness: I think I have finished.

Mr. Cockley: I move to strike the answer as non-responsive.

Trial Examiner: I can't agree with you; it seems to me that the answer was responsive to the question. Read the question, please.

(The question was repeated by the reporter.)

By Mr. Cockley:

Q. Well, you agreed at the beginning, didn't you, Mr. Smith, with me that if a company had properly spent $10,000 for well equipment, and $10,000 for labor for constructing a single well, and if you didn't know anything

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about the bookkeeping, that the original cost of that well was $20,000? A. At that time, yes.

Q. And you think that your interpretation of the uniform code of accounts is that you do not need to show all of these costs shown by the company's records to have been expended for the construction of the property, all of these drilling costs for the construction of some 2600 wells, not a one of which appears in your exhibit? A. I don't think we ought to show them as part of the plant cost.

Q. Well, as I say, you think your code of accounts precludes you from doing that? A. I am sure of it.

Q. You are absolutely positive about it, are you? A. Yes, I am positive about it.

Q. And that has been your consistent interpretation of it, hasn't it? A. Yes, and it has been my practice in determining original cost.

Q. And that is based on paragraph 2(b) which you read this morning, isn't it? A. Yes, and much more than that. The auditors who audited the Standard Oil Company and the Hope Company,—Price, Waterhouse—didn't find any fault with the fact that these things were charged to expense, it was a sound principle.

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Q. Were those auditors determining original cost? A. They were certifying to financial statements which showed cost.

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Q. Were they testifying in any respect to the statement of cost contained in this definition of accounts, which means the amount of money actually paid for property or services, or the cash value at the time of the transaction of any consideration other than money? A. Yes, indeed, that is exactly what "cost" means, and they were required, under the rules of the Securities & Exchange Commission to conform to a general principle of that nature, or to qualify their statement.

Q. And when it applies to original cost it means that cost to the first company devoting the property to public service? A. Now you are talking about something else.

Q. I see; all right.

Now isn't it a fact, Mr. Smith, that except for some general overheads charged after 1923, none of the expenditures made by the company in excess of book costs, and here in question between us, were charged to expense in accordance with any uniform system of accounts in effect at the time? A. As far as I know that is true.

Q. Isn't it a further fact that they were not so charged in accordance with the discretion of the management as exercised under such uniform system of accounts? A. That is true. Mr. Cockley, upon reflection I would like to say that the items were charged to expense under the discretion of management, but not under a uniform system of

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accounts.

Q. Well, I just read you the phrase as it appears in Instruction 2(B) which you read. A. That is right.

Q. Instruction 2(B) says:

> "It is likewise not intended that adjustments shall be made to record in gas plant accounts amounts previously charged to operating expenses in accordance with the uniform system of accounts in effect at the time or in accordance with the discretion of management as exercised under such uniform system of accounts."

A. I want to make it clear too, that, as I testified this morning, that was put in to show that nothing in the system of accounts changed the general rule. We were afraid someone would construe the system of accounts as authority for doing that thing, and we wanted to show that that was not so.

Q. Isn't it true that there are other accountants and auditors, who had something to do with the determination of that final form of the system of accounts, who take a slightly different view of the purpose of this than you do? A. I don't know about individual auditors, I know that the Committee on Statistics and Accounts of the National Association takes the same view that I have. Officially, its view is the same.

Q. Well, the Pennsylvania Commission hasn't inter-

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preted it that way, have they? A. As far as I know they have. In my last conversation with a representative of the Pennsylvania Commission he stated that he did not think that items previously charged to expense in accordance with the established principles of accounting at the time, should be restated.

Q. Well, that Committee interpretation that you just referred to is one that you had a pretty large hand in writing, isn't it? A. It was written originally by the chairman of the committee. I toned it down somewhat; it went farther than I wanted to go. I edited it and revised it, but it was written originally by the chairman of the committee.

Q. But it wasn't adopted at any time by the Association, was it? A. No, by the committee; the Association authorized the committee to send it out under its own name, the Executive Committee of the Association did that.

Q. They all do that, don't they? A. No, this was special. The Executive Committee of the Association at a formal meeting authorized the committee to send out that document.

Q. Well, they didn't approve it? A. The National Association doesn't approve any committee reports as such, as I understand it.

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Q. Well, they accepted it as the Committee filed it, and authorized them to send it out; isn't that what happened? A. That is correct.

Q. And was there any effort made to have them adopt it? A. No, sir.

Q. None to your knowledge? A. None to my knowledge. I think it would be unusual to have them adopt a report of that kind.

Q. All right. I want to ask you just one or two more questions.

It is a fact, is it not, that in the company's income statements for the test years as set up here, it has not included any well drilling costs in those annual expenses? A. That is correct.

Q. It has not included any construction overheads in those annual expenses? A. Well, it has included overheads in expenses; it has, for some of the years, prorated some of the overheads to construction.

Q. Well, it has eliminated, has it not, the amount of overheads prorated to construction, from its annual statements? A. That is right.

Q. The expense statements? A. That is correct.

Q. And so far as the annual statement of the com-

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pany's income is concerned, under its rates, its operating statement, let us say, and the rate base it offers, it has been entirely consistent as between the two, has it not, so far as you now know? A. Yes, in a way it is consistent. Ours is consistent too, but the consistency is in different respects. Ours is consistent with past practice.

What you have done is restated the plant cost and restated your income of recent years to be on a consistent basis under the capitalization theory.

Along that line I intended to make a statement—I intended to make it later but I might make it now. I don't know whether you folks intend to continue your present method of capitalizing overheads or not, I don't think your method is a particularly good one, I don't like it at all—

Q. (Interposing): I am interested in this, but I submit that it has no part in this rate case. A. Yes, it does, a very vital part.

Q. All right, go ahead. A. If you intend to change that method of allocating overheads for the future—and I think you may want to change it—I think, before this case is over, you ought to say so, so that proper recognition can be given to the change. If you are not going to capitalize these overheads in the future, the items now included in overheads should be considered as expenses in prognosti-

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cating the expenses of the future. It is only in simple justice to you that I make that statement. I think you will want to change it some time, to be frank with you.

Q. I appreciate your comments, but you understand that we are not yet applying to the Commission for permission to set up our accounts in connection with the Code of Accounts, that we are just trying a rate case now. A. Well, I think your rate case and the way you keep your books, have got to be tied together. I think this business of keeping books in one way, and having extraneous figures or different figures in a rate case, is a horrible thing, and I can't condemn it too strongly.

Q. In other words, so far as you are concerned a rate case is just a question of accounting? A. No, I think you have an obligation to keep books right, and that those figures ought to have a real substantial meaning for rate case purposes.

Mr. Cockley: I move that that be stricken out; that certainly is not responsive to any question put to the witness.

Trial Examiner: Read the question, please.

(Whereupon the reporter read the pending question.)

Mr. Cockley: Now, I move to strike that answer as not responsive, and ask the witness to be directed to answer the question.

Trial Examiner: The motion is overruled. It seems to

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me that he has answered the question.

By Mr. Cockley:

Q. Well now, to get back to another question that I think is not controversial.

As a matter of fact, Mr. Smith, am I correct that there isn't very much difference between you, in your Exhibit 57, and the Company's Exhibit 20, as to the ultimate facts, namely, how much money was originally spent by the Company on these various accounts, how it was treated on the books as a matter of fact, and the whole question is whether or not it is proper to include it in a statement of original cost in a rate case; isn't that really it? A. That is substantially correct.

Q. And am I further correct—would you admit this—that if the company's plant accounts were now to be stated on the assumption that its books had always been kept in accordance with the present Uniform System of Accounts, from the beginning, that Mr. Antonelli's statement of original cost would be substantially correct? A. There would be several million dollars of adjustments, but most of the $17,000,000 adjustment we are talking about would be added to the plant accounts. As an offset to that we would naturally show a much higher depreciation reserve than we do show in one of our exhibits.

Q. Of course if we are talking about the original cost

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of the property, the depreciation would not have to be reflected in it. A. That is right.

Q. But aside from a couple of million dollars, you think perhaps his statement would be a correct statement of that original cost if the books had been kept in accordance with the present uniform system of accounts? A. That is correct. I still, for instance, have a good deal of qualification on overheads. I think the overheads were computed in a pretty ready manner, and getting over-all relationships, which I don't have any faith in myself.

Q. Well, the net result of it might be that you might adjust that two or three million dollars downward—perhaps a million or less? A. It would be several million dollars, but the bulk of the $17,000,000 would be put into plant accounts.

Q. You wouldn't throw all the overheads out, you would recognize the propriety of whatever overheads had been charged? A. I don't know how in the world you could go back and establish it; I would rather Mr. Antonelli have that burden, than that I have it.

Q. I think you have already stated that the company has been consistent in its operating statements and in its rate base statements? A. That is true. I made an explanation at the time and I want my explanation to cover

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my present answer.

Q. Mr. Smith, the only other question I want to ask you is this—do you claim that the figure of $51,200,000 which you have arrived at, or which your staff has arrived at in Exhibit 57, is any evidence of the value of the Hope Company's plant devoted to public service at the present time? A. To the extent that valid cost to the company is an element of value, that is an element.

Q. Now is it evidence, on your theory, as to the value of all of the property devoted to public service on December 31, 1938, or only that part of the property that is shown in your exhibit? A. It is evidence, it is the real evidence of value of all the property except the distribution property.

Q. Of all the property? A. Yes, sir.

Q. Including the 2600 wells, the drilling costs of which are omitted? A. Absolutely.

Q. And including any physical property or other construction costs that have been omitted? A. As to physical property I don't think we have excluded anything except that which is normally charged to maintenance, and I certainly would exclude that.

Q. As a matter of fact you said you weren't familiar

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with the details of it and that I should ask someone else about it, but you have excluded some 9500 telephone poles with cross-arms, brackets and pins; and you have excluded