

**Minnesota Public Utilities Commission**  
**Staff Briefing Papers**

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Meeting Date: April 1, 2014..... \* Agenda Item # 3

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Company: Otter Tail Power Company

Docket No. E017/D-13-795

In the Matter of Otter Tail Power Company's Request for Approval of its  
Five Year Depreciation Study.

Issue(s): Should the Commission approve the proposed depreciation parameters  
and the resulting depreciation rates for Otter Tail Power Company's  
five-year depreciation study?

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***Relevant Documents***

OTP-Initial Filing..... September 3, 2013  
Department-Comments (Non-Public) ..... January 17, 2014  
OTP- Reply Comments ..... February 18, 2014<sup>1</sup>  
Department-Response Comments ..... March 3, 2014  
OTP-Letter ..... March 4, 2014

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The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless otherwise noted.

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<sup>1</sup> Letter dated February 17, 2014. Filed in e-dockets on February 18, 2014.

## ***Statement of the Issue***

Should the Commission approve the proposed depreciation parameters and the resulting depreciation rates for Otter Tail Power Company's five-year depreciation study?

## ***Introduction***

Public utilities in Minnesota are required to get Commission approval for their depreciation practices, pursuant to Minn. Stat. § 216B.11 and Minn. Rules, parts 7825.0500-7825.0900. Utilities must also file depreciation studies at least once every five years and must use straight-line depreciation unless the utility can justify a different method. The Commission approved OTP's last five-year depreciation study in its June 2009 Order, in Docket No. E-017/D-08-1042.

Because Otter Tail uses the remaining life method for depreciating group property accounts, the underlying life and salvage factors may not change, but depreciation rates are adjusted annually to reflect the passage of time on remaining lives, as well as the impact of plant additions and retirements. Annual depreciation study updates are required when the remaining-life method is used to allow the Commission the opportunity to approve changes in depreciation rates. With the exception of certain plant accounts, Otter Tail uses a remaining-life accounting method and, as a result, must file annual depreciation study updates. The Commission approved OTP's last (2012) annual depreciation study in its May 31, 2013 Order, in Docket No. E-017/D-12-933.

In this docket, Otter Tail is asking for Commission approval of its 2013 five-year depreciation study.

## ***Background***

September 3, 2013: Otter Tail Power Company (OTP or the Company) filed its 2013 Five-Year Review of Depreciation Certification Petition (2013 Depreciation Petition or petition). OTP requested approval of changes to the lives and salvage rates of a number of property accounts. The net effect of the proposed changes would be a reduction in annual depreciation expense of \$3.0 million, or 7.46 percent. The Company has requested an effective date of January 1, 2014 for its proposed depreciation parameters.

January 17, 2014: The Minnesota Department of Commerce (Department) submitted reply comments and recommended that the Commission require the Company to retain the current retirement date for its Big Stone plant until the Air Quality Control System (AQCS) that is currently being installed is closer to completion and its in-service date. The Department stated that the Company is currently allowed to recover some of the costs associated with the AQCS upgrade through its Environmental Cost Recovery (ECR) rider.

The Department also requested more information from the Company to explain why the large change in depreciation expense for its General Office Buildings, Fleet Service Center Building and Central Stores Building accounts are reasonable.

February 18, 2014: The Company submitted reply comments and agreed with the Department's recommendation to delay extending the retirement date of the Big Stone plant until the AQCS is closer to its in-service date.

The Company stated that its previous depreciation studies did not consider terminal salvage values in the calculations for General Office Buildings, Fleet Service Center Building and its Central Stores Building. Including terminal values accounted for the large change in depreciation expense.

March 3, 2014: The Department responded to the Company's comments and concluded that while the change in assumptions of terminal values for its General Office Buildings, Fleet Services Center Building and Central Stores Building negatively impact ratepayers, the assumptions are reasonable and represent the Company's best predictions regarding the future of these facilities at this time.

March 4, 2014: The Company submitted a letter to confirm its acceptance of the Department's recommendations as identified in the March 3, 2014 Response Comments.

### ***Party Positions***

After several rounds of comments, the parties have agreed on the parameters and resulting depreciation rates of the study. Staff is in agreement with OTP and the Department's resolution of the issues. Staff will not repeat the entire discussion, but will briefly outline the major items of interest in this briefing paper.

### **Big Stone Production Plant**

In this petition, OTP proposed extending the life of the Big Stone plant from 14.2 years to 32.0 years. This would result in an additional life extension of 17.2 years and extend the retirement date to 2046. Annual depreciation expense would be reduced by \$2.2 million.

The 475 megawatt plant is located in Big Stone City, South Dakota. The plant is jointly owned by OTP (53.9%), NorthWestern Energy (23.4%) and Montana-Dakota Utilities (22.7%). OTP is currently constructing a \$405 million Air Quality Control System (AQCS) consisting of Selective Catalytic Reduction (SCR), Dry Scrubber and a Baghouse to comply with the U.S. Environmental Protection Agency's Regional Haze Rule. The AQCS is expected to be placed into service in 2015.

The Company provided additional information about the project in response to the Department's information request. Construction on the project began in April 2013. As of September 30, 2013, the owners have invested \$109.2 of the budgeted \$405.2 million project. This represents a 27% project completion on a project cost basis. The commissioning and performance testing phase is expected to begin in June 2015 with a projected in-service date of October 1, 2015.

The Company stated that it received an Advanced Determination of Prudence (ADP) from the

Commission, in Docket No. E-017/M-10-1082, and construction of the project is well underway. These two occurrences affect the existing plant in-service and are now being managed by the Company under the expectation of the additional operating timeline. The Company stated that the new remaining life timeline commenced at the time the Owner's committed to construction of the AQCS project (upon issuing the Full Notice to Proceed) and not at the time the AQCS is commissioned into service. The balance of plant remaining life reflects what the Company believes should be recognized as the plant's remaining life to be at the time of this filing.

The Department agreed with the Company that the AQCS project will result in a life extension for Big Stone. The Department disagreed with the Company as to when the life extension should be recognized. The Department stated that if the life extension is recognized in the Company's 2013 Depreciation petition, in this docket, the extended life would be recognized as of January 1, 2014, or nearly two years before the AQCS expected in-service date. The effect of Commission approval of a life extension in this filing would be that the Company would enjoy the benefits of lower depreciation expense while the Customers would not receive any benefits of the life extension through a corresponding decrease in rates.

The Department addressed the fact that the Company has begun to recover some of the costs of the AQCS project through its Environmental Cost Recovery (ECR) rider. If the Commission were to approve the life extension in this filing, the Company would accrue all of the benefits of the lower depreciation expense while at the same time recovering some of the costs of the project. The Department acknowledged that simultaneous allocation of benefits to the Company and costs to the Ratepayers is somewhat unavoidable, but noted that the negative impact to Ratepayers can be minimized by timing Big Stone's life extension appropriately.

The Department concluded that the life extension for Big Stone should be delayed until the AQCS is in service, or closer to the time to the project being placed into service. The Department recommended that the Company propose a life extension for Big Stone in its next depreciation filing. The Department and the Commission can reevaluate the progress of the AQCS and its expected in-service date in the Company's 2014 filing.

OTP submitted reply comments on February 17, 2014 and stated that the Company agrees with the Department's recommendation to delay the life extension of Big Stone until closer to its in-service date. The Company plans to propose the life extension in its next annual depreciation filing.

### **Coyote Station**

Coyote Station is a single 427 megawatt lignite-fired unit located two miles south of Beulah, North Dakota. The station is operated by OTP (35%) and jointly owned with Montana-Dakota Utilities (25%), Northern Municipal Power Agency (30%) and NorthWestern Energy (10%). The original coal contract for the plant, which is a mine-to-mouth operation, expires in May 2016. In October 2012, the Coyote owners entered into a lignite sales agreement with Coyote Creek Mining Company, LLC, a subsidiary of The North American Coal Corporation,

to deliver the annual coal supply needs of Coyote Station for 25 years beginning in May 2016 through 2040.

In its petition, OTP proposed to extend the remaining life of Coyote Station by 8.4 years, from 19.0 years to 27.4 years. This results in a retirement year of 2041. The proposed extension would lower OTP's depreciation expense by approximately \$0.7 million per year. OTP stated that the proposed remaining life extension was prompted by the execution of a new, 25-year coal contract, signed in 2012, which commences in 2016 and expires in 2041. OTP stated that the decision to pursue a 25-year coal contract was based on several factors, including expected life durations of plants similar to Coyote, the condition of the major components of Coyote, and the operational performance of the facility.

OTP described its maintenance and capital investment program for Coyote and considers the program to be "normal operations," including routine items that occur frequently and at regular intervals during a plant's life and non-routine items that are expected but occur infrequently, perhaps only once during a plant's life. OTP explained that, beyond normal levels of maintenance and replacement it anticipates two capital investments will be necessary for Coyote to achieve the proposed remaining life, both related to new environmental regulations. First, OTP is planning a capital project in 2014 to bring Coyote Station into compliance with the Mercury and Air Toxics Standards (MATS). Second, OTP is planning a capital project to be completed by mid-2018 pursuant to North Dakota's State Implementation Plan for the EPA's Regional Haze Rule.

The Department agreed that it is reasonable to expect Coyote to operate beyond its currently assumed retirement year of 2032, but questioned the timing of the proposed life extension. As noted in the Department's discussion of Big Stone's remaining life, the Department generally prefers to wait until life-extending capital projects are placed into service to extend plant lives, and Coyote has two planned future projects, the larger of which will not be completed for at least four years. Based on this logic, the Department would prefer to wait until the second project is placed in service, or is close to being placed in service, before extending Coyote's life.

The Department noted that there is a significant difference between the cost of Big Stone's AQCS project and the cost of Coyote's two planned projects. The cost of the AQCS project is greater than the original cost of Big Stone. The two planned projects at Coyote represent only a small percentage of the original cost of the plant. Projects the size of the AQCS project are rarer and more significant than projects the size of Coyote's planned projects and require a higher level of scrutiny with respect to the plant's remaining life. Capital projects the size of Coyote's planned projects are more frequent and much closer to a normal level of investment and maintenance expense, and arguably, the in-service dates for the Coyote projects deserve a lesser role in determining this plant's remaining life than OTP's engineering assessment.

The Department concluded that because of the small size of the two planned capital projects and the fact that the Company's engineering assessment of the Coyote Station indicates a longer life for the plant, it is reasonable to extend Coyote's life in this Docket.

## **Hoot Lake**

The Hoot Lake plant is located near Fergus Falls, Minnesota. This two unit, 138 megawatt coal fired plant is owned and operated by OTP. In its petition, OTP proposed to shorten the remaining life of the Hoot Lake Plant, Units 2 and 3 from 10.4 years to 7.4 years, with an AYFR (anticipated year of final retirement) of 2020.

The Department concluded shortening the life of Hoot Lake is reasonable because it is consistent with the Company's most recent Integrated Resource Plan (Docket No. E015/RP-10-623). The Company conducted a Baseload Diversification Study with a specific focus on evaluating retirement and repowering options for the Hoot Lake Plant. The Company proposed a plan to retrofit Hoot Lake units 2 and 3 in 2015 to comply with MATS, and then retire both units in 2020. The Commission's March 25, 2013 Order in the 2010 IRP Docket approved OTP's proposed plan. The Company's proposed AFYR (and the corresponding remaining life) for Hoot Lake units 2 and 3 is consistent with the Commission's Order.

## **Changes to Salvage Rates**

OTP proposed significant changes to the salvage rates of three of its General Plant Accounts: 390.10 General Office Buildings, 390.20 Fleet Service Center Building & 390.30 Central Stores Building. Otter Tail stated that, in past depreciation filings, the salvage rates for these accounts had reflected interim retirements only. In this petition, the Company reassessed the final retirement scenarios for these facilities and determined the most likely scenario for these general plant buildings is that they would be sold, rather than retired and demolished. The Company used each properties estimated market value as assessed for property tax purposes and inflated these estimated market values over time to the estimated year of retirement for the property.

The Department noted that the proposed change negatively impacts ratepayers, with the currently approved annual depreciation expense being approximately \$331,000, the proposed annual expense being approximately (\$57,300). The net result is a decrease in the annual depreciation expense of approximately (\$388,300). The Department concluded that the five-year study is the appropriate time for the Company to reassess its assumptions and these assumptions about estimated future market value reasonably reflect the Company's best predictions regarding the future of these facilities.

## ***Decision Alternatives***

1. Big Stone life extension
  - a. Approve the Company's proposed life extension of the Big Stone plant from 14.2 years to 32.0 years.
  - b. Require the Company to keep the current retirement date of the Big Stone plant at 14.2 years. [DOC, OTP accepts DOC recommendation]

2. Coyote Station life extension

- a. Approve the Company's proposed life extension of Coyote Station from 19.0 years to 27.4 years. [OTP, DOC]
- b. Require the Company to keep the current retirement date of 19.0 years for Coyote Station.

3. Hoot Lake remaining life

- a. Allow the Company to decrease the remaining life of Hoot Lake from 10.4 years to 7.4 years. [OTP, DOC]
- b. Require the Company to keep the current retirement date of 10.4 years for Hoot Lake.

4. Building terminal salvage values

- a. Approve the Company's proposed changes to include the terminal salvage value in the calculation of salvage rates for the following General Plant Accounts: 390.10 General Office Building, 390.20 Fleet Service Center Building & 390.30 Central Stores Building. [OTP, DOC]
- b. Require the Company to maintain the \$0 salvage value when calculating the salvage rates for the following General Plant Accounts: 390.10 General Office Building, 390.20 Fleet Service Center Building & 390.30 Central Stores Building.

5. Effective date of OTP's revised service lives, salvage values and depreciation rates as indicated in the schedules attached to the briefing papers

- a. Approve the effective date of January 1, 2014. [OTP, DOC]
- b. Approve an effective date other than January 1, 2014

6. OTP's next annual depreciation study

- a. Require the Company to file its next annual depreciation study on or before September 1, 2014. [DOC, OTP does not object]
- b. Require the Company to file its next annual depreciation study on a different date.

7. OTP's next five year depreciation study
  - a. Require the Company to file its next five year depreciation study on or before September 1, 2018. [DOC, OTP does not object]
  - b. Require the Company to file its next five year depreciation study on a different date.
8. Comparison of peaking plant capacity costs
  - a. Require the Company to provide in its first depreciation filing that includes new peaking generators, a comparison of the last rate case's short term peaking capacity costs to the peaking plant capacity costs of the new generators. [DOC, OTP does not object]
  - b. Do not require the Company to provide in its first depreciation filing that includes new peaking generators, a comparison of the last rate case's short term peaking capacity costs to the peaking plant capacity costs of the new generators.
9. Comparison of estimated asset lives used in resource planning and estimated remaining lives used in depreciation studies
  - a. Require the Company to include in future depreciation filings a table comparing asset lives used for the purposes of the Company's resource planning with the remaining lives proposed in the depreciation filings and explain any differences. [DOC, OTP does not object]
  - b. Do not require the Company to include in future depreciation filings a table comparing asset lives used for the purposes of the Company's resource planning with the remaining lives proposed in the depreciation filings and explain any differences.

***Recommendation***

1b, 2a, 3a, 4a, 5a, 6a, 7a, 8a, 9a

**OTTER TAIL POWER COMPANY  
 2013 FIVE-YEAR REVIEW OF DEPRECIATION CERTIFICATION  
 PROPOSED REMAINING LIVES & SALVAGE FOR USE IN 2014**

<u>Account Number</u>	<u>Class of Utility Plant</u>	<u>Remaining Life (Yrs)</u>	<u>Net Salvage (%)</u>	<u>Amortization Period (Yrs)</u>
<b>STEAM PRODUCTION</b>				
<u>Big Stone Plant</u>				
311-101	Structures & Improvements	<del>31.98</del> 14.22	<del>-11.9%</del> -8.1%	
312-101	Boiler Plant Equipment	<del>32.02</del> 14.23	<del>-12.0%</del> -8.1%	
314-101	Turbogenerator Units	<del>32.04</del> 14.23	<del>-12.0%</del> -8.1%	
315-101	Accessory Electric Equipment	<del>32.01</del> 14.22	<del>-12.0%</del> -8.1%	
316-101	Misc. Power Plant Equipment	<del>32.02</del> 14.23	<del>-11.5%</del> -7.9%	
<u>Hoot Lake Plant - Units 2 &amp; 3</u>				
311-102	Structures & Improvements	7.42	-14.3%	
312-102	Boiler Plant Equipment	7.43	-14.3%	
314-102	Turbogenerator Units	7.43	-14.3%	
315-102	Accessory Electric Equipment	7.42	-14.3%	
316-102	Misc. Power Plant Equipment	7.43	-14.2%	
<u>Coyote Station</u>				
311-103	Structures & Improvements	27.41	-8.7%	
312-103	Boiler Plant Equipment	27.42	-8.7%	
314-103	Turbogenerator Units	27.44	-8.7%	
315-103	Accessory Electric Equipment	27.42	-8.7%	
316-103	Misc. Power Plant Equipment	27.44	-8.3%	
<b>HYDRAULIC PRODUCTION</b>				
<u>Hoot Lake Hydro Unit</u>				
331-131	Structures & Improvements	8.40	0.0%	
332-131	Reservoirs, Dams & Waterways	8.40	0.0%	
333-131	Water Wheels, Turbines & Gen.	8.40	0.0%	
334-131	Accessory Electric Equipment	8.40	0.0%	
335-131	Misc. Power Plant Equipment	8.41	0.0%	
<u>Wright Hydro Unit</u>				
331-132	Structures & Improvements	8.40	0.0%	
332-132	Reservoirs, Dams & Waterways	8.41	0.0%	
333-132	Water Wheels, Turbines & Gen.	8.41	0.0%	
334-132	Accessory Electric Equipment	8.41	0.0%	
335-132	Misc. Power Plant Equipment	8.41	0.0%	
<u>Pisgah Hydro Unit</u>				
331-133	Structures & Improvements	8.40	0.0%	
332-133	Reservoirs, Dams & Waterways	8.41	0.0%	
333-133	Water Wheels, Turbines & Gen.	8.41	0.0%	
334-133	Accessory Electric Equipment	8.41	0.0%	
335-133	Misc. Power Plant Equipment	8.41	0.0%	
<u>Dayton Hollow Hydro Unit</u>				
331-134	Structures & Improvements	8.41	0.0%	
332-134	Reservoirs, Dams & Waterways	8.41	0.0%	
333-134	Water Wheels, Turbines & Gen.	8.41	0.0%	
334-134	Accessory Electric Equipment	8.41	0.0%	
335-134	Misc. Power Plant Equipment	8.41	0.0%	
<u>Taplin Gorge Hydro Unit</u>				
331-135	Structures & Improvements	8.39	0.0%	
332-135	Reservoirs, Dams & Waterways	8.41	0.0%	

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334-135	Accessory Electric Equipment	8.41	0.0%	
335-135	Misc. Power Plant Equipment	8.41	0.0%	
<u>Bemidji Hydro Unit</u>				
331-138	Structures & Improvements	8.41	0.0%	
332-138	Reservoirs, Dams & Waterways	8.41	0.0%	
333-138	Water Wheels, Turbines & Gen.	8.41	0.0%	
334-138	Accessory Electric Equipment	8.39	0.0%	
335-138	Misc. Power Plant Equipment	8.41	0.0%	
<b>OTHER PRODUCTION</b>				
<u>Jamestown Unit 1</u>				
341-140	Structures & Improvements	10.35	-1.4%	
342-140	Fuel Holders & Accessories	10.36	-1.4%	
343-140	Prime Movers	10.35	-1.4%	
345-140	Accessory Electric Equipment	10.35	-1.4%	
346-140	Misc. Power Plant Equipment	10.36	-1.4%	
<u>Jamestown Unit 2</u>				
341-142	Structures & Improvements	10.36	-1.4%	
342-142	Fuel Holders & Accessories	10.35	-1.4%	
343-142	Prime Movers	10.35	-1.4%	
345-142	Accessory Electric Equipment	10.36	-1.4%	
346-142	Misc. Power Plant Equipment	10.35	-1.4%	
<u>Lake Preston</u>				
341-141	Structures & Improvements	10.35	-2.4%	
342-141	Fuel Holders & Accessories	10.36	-2.4%	
343-141	Prime Movers	10.35	-2.4%	
345-141	Accessory Electric Equipment	10.35	-2.4%	
346-141	Misc. Power Plant Equipment	10.35	-2.4%	
<u>Fergus Falls Control Center</u>				
343-143	Prime Movers	17.10	0.0%	
<u>Solway Combustion Turbine Plant</u>				
341-144	Structures & Improvements	24.67	-0.4%	
342-144	Fuel Holders & Accessories	24.67	-0.4%	
343-144	Prime Movers	24.67	-0.4%	
345-144	Accessory Electric Equipment	24.67	-0.4%	
346-144	Misc. Power Plant Equipment	24.67	-0.4%	
<u>Langdon Wind Energy Center</u>				
341-160	Structures & Improvements	19.02	-1.5%	
344-160	Generators	19.02	-1.5%	
345-160	Accessory Electric Equipment	19.02	-1.5%	
346-160	Misc. Power Plant Equipment	19.02	-1.5%	
<u>Ashtabula Wind Energy Center</u>				
341-161	Structures & Improvements	19.97	-1.2%	
344-161	Generators	19.97	-1.2%	
345-161	Accessory Electric Equipment	19.97	-1.2%	
346-161	Misc. Power Plant Equipment	19.97	-1.2%	
<u>Luverne Wind Energy Center</u>				

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<u>Account Number</u>	<u>Class of Utility Plant</u>	<u>Remaining Life (Yrs)</u>	<u>Net Salvage (%)</u>	<u>Amortization Period (Yrs)</u>
341-162	Structures & Improvements	20.92	-2.0%	
344-162	Generators	20.92	-2.0%	
345-162	Accessory Electric Equipment	20.92	-2.0%	
346-162	Misc. Power Plant Equipment	20.92	-2.0%	
<b>TRANSMISSION</b>				
353	Station Equipment	53.06	-5.0%	
354	Towers & Fixtures	37.90	-10.0%	
355	Poles & Fixtures	55.58	-50.0%	
356	Overhead Conductor & Devices	53.25	-30.0%	
358	Underground Conductor & Devices	10.86	-5.0%	
<b>DISTRIBUTION</b>				
362	Station Equipment	32.22	5.0%	
364	Poles, Towers & Fixtures	48.68	-75.0%	
365	Overhead Conductor & Devices	44.33	-100.0%	
367	Underground Conductor & Devices	24.81	-5.0%	
368	Line Transformers	28.19	50.0%	
369	Overhead Services	33.52	-150.0%	
369.1	Underground Services	30.89	-20.0%	
370	Meters	20.64	0.0%	
370.1	Load Management Switches	4.42	0.0%	
370.20	Interruption Monitors			5
371.20	Other Private Lighting	17.10	10.0%	
373	Street Lighting & Signal System	15.43	-5.0%	
<b>GENERAL PLANT</b>				
<b>Depreciable</b>				
390	Structures & Improvements	31.91	10.0%	
390.1	General Office Buildings	17.10	51.2%	
390.2	Fleet Service Center Buildings	12.29	38.6%	
390.3	Central Stores Building	21.81	95.5%	
396	Power Operated Equipment	16.79	20.0%	
397.4	Communication Towers	25.05	5.0%	
<b>Amortizable</b>				
391	Office Furniture			15
391.1	Office Equipment			10
391.2	Duplicating Equipment			10
391.5	Computer Systems			5
391.6	Computer Related Equipment			5
393	Stores Equipment			15
394	Tools, Shop & Garage Equipment			15
394.2	Automated Meter Reading Equip.			15
395	Laboratory Equipment			15
397	Communication Equipment			15
397.1	Radio Telecom Equipment			10
397.2	Microwave Equipment			15
397.3	Radio Load Control Equipment			10

Source is Statement A from Foster Report