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7. **BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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In the Matter of the Complaint of
BEAVER COUNTY, et al.,

Complainants,

-VS-

QWEST CORPORATION fka U S WEST
COMMUNICATIONS, INC. fka MOUNTAIN STATES TELEPHONE
& TELEGRAPH SERVICES, INC.,

Respondent.

**DIRECT TESTIMONY OF
ECKHARDT ARTHUR PRAWITT**

Docket No. 01-049-75

Q: What is your name?

A: Eckhardt Arthur Prawitt.

Q: Where do you reside?

A: I am a resident of Salt Lake County, Utah.

Q: Please describe your education after your graduation from high school.

23. A: I attended the University of Utah and took various business and accounting courses at the
24. College of Business, until I graduated in 1973, with a B.S. degree. Since my graduation I have
25. taken various post-graduate classes and seminars emphasizing the valuation of property.

Q: Please describe your employment history.

26.

27:A: Following my graduation, I obtained employment with the Utah State Tax Commission, in the
28. Auditing Division, which position I held until 1978. In that position, I was responsible for auditing
29. local, multi-state and international entities for income, sales, payroll and special taxes. I prepared
30. detailed audit reports and negotiated audit deficiency settlements.

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32. When I left the Utah State Tax Commission in 1978, I obtained employment as the Chief
33. Financial Officer/Comptroller of Vredenburg, Inc., a manufacturing company in Salt Lake County,
34. Utah. In that position, I was responsible for all aspects of financial management for the company,
35. including the preparation of financial statements, operating reports and tax returns. I was also
36. responsible for making investments on behalf of the company, for risk management and for
37. creditor relations. I also served as the administrator of the company's qualified retirement plan.

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39. I left Vredenburg Incorporated in 1984, when I accepted a position with the Utah State Tax
40. Commission, in the Property Tax Division, as a research/valuation analyst. In
41. this position, I was responsible to perform financial valuations as assigned, and to conduct
42. research and investigation relating to valuations. In addition, I was assigned the responsibility to
43. design and code computer software for use in valuation analysis.

44.

45. I received a promotion in 1986 to the position of valuation manager of the Property Tax Division.
46. In that position, I performed and supervised annual financial valuations of multi-state utility and
47. transportation companies, including, without limitation, telecommunications companies, with total
48. values in excess of \$90 billion annually. I initiated and managed the auditing program at the
49. Property Tax Division, part of which consisted of selective audits for errors and other improprieties

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in financial reports, and participated in a variety of studies, including without limitation of such
50. companies' annual cost of capital. I also researched and developed new and more accurate
51. valuation methodologies. I was required as part of my job to testify as an expert witness on behalf
52. of the Property Tax Division concerning the annual assessments made by the Division. I continued
53. in my role as designer and developer of computer programs and automated systems for special
54. applications.

55.
56. In 1992, I left the Utah State Tax Commission and accepted a position with the Utah Association of
57. Counties, as a valuation analyst. In that position, I have acted as both a forensic expert and
58. consultant. I analyze the annual
59. assessments of the Property Tax Division to determine whether those assessments comport with
60. the requirements of fair market value. I also analyze taxpayer contentions and expert testimony
61. concerning the valuation of their property. I prepare independent appraisals of taxpayer property. In
62. all of these functions, I analyze financial information reported by the taxpayers and, when called for,
63. investigate the accuracy and veracity of such statements. I provide forensic analysis and testify
64. before the Utah State Tax Commission and in state or federal court proceedings when called upon
65. to do so. I continue in such employment at present.

66. Q: You are offering testimony in these proceedings as an expert witness. Please describe your areas
67. of expertise.

A: 68. Based on my knowledge, skill, experience, training and education, I am an expert in general
69. accountancy, financial and tax auditing, computer programming, valuation of property and financial
70. assets, including financial valuation of large corporations, reviewing, interpreting and analyzing
71. their financial records, and identifying errors and improprieties in their financial reporting. A copy of
72. my resume is attached as an appendix to this pre-filed direct testimony.

Q: Describe the documents and other data which you reviewed and upon which your opinions in these
73. proceedings are based.

74.
A: I am supplying my testimony in this proceeding as a forensic financial reporting and accounting
75. expert, based on my review and analysis of U.S. West Communications, Inc. and its parent, U.S.
76. West, Inc.'s public financial reports,
77. the information provided by the Division of Public Utilities and Qwest Corporation in discovery and at
78. technical conferences herein, and on other documents located in the public record. In that capacity
79. and based on my own knowledge and experience and my analysis of the documents I have
80. reviewed, I have formed certain opinions. The documents I reviewed and analyzed as part of the
81. grounds for my opinions are of a kind and nature as are ordinarily and reasonably relied on by
82. regulators and other experts in the accounting, financial reporting, auditing and financial valuation
83. fields to form opinions and draw inferences and conclusions.

84.
Q: Please read from page 2 of Qwest's answer to the amended complaint, dated August 9, 2002.

85.
A: Qwest's answer to the amended complaint herein admits that, "In each of the nine years from 1988
86. through 1996, Qwest appealed its centrally-assessed property tax assessments to the Utah State
87. Tax Commission, claiming that its valuation was excessive, thus resulting in an over-assessment of
88. property taxes." Qwest's Answer To Amended Complaint, dated August 9, 2002, at 2 [hereinafter
89. "Answer"]. "In October 1998, the Tax Commission issued a supplemental order, pursuant to
90. stipulation between the Property Tax Division, the Counties and Qwest, resolving these individual
91. appeals on a consolidated basis. The settlement required the Counties to refund \$16.9 million of
92. property tax overpayments and interest to Qwest." *Id.*

93.
Q: Please describe any standard accounting references and/or publicly files documents you reviewed
94. in forming your opinion in these proceedings.

95.
A: In the course of forming inferences and formulating my opinions, I have specifically reviewed

96. various federal regulations, Accounting Principles Board Opinions ("APB Opinions"), 10Ks and
97. 10Qs filed by Qwest, Annual Reports from Qwest filed with the Public Service Commission of
98. Utah, discovery obtained in these proceedings and in technical conferences herein from Qwest
99. and the Division of Public Utilities, filings with the Utah State Tax Commission and the Public
100. Service Commission of Utah, as well as the Third District Court in and for Salt Lake County, Utah
101. and the Utah Supreme Court, analyzed their pertinence to the formation of my opinions and
102. formed opinions based thereon and applying my full background of experience, education, skill
and training.

103. Q: What, if anything, did you specifically notice in Qwest's filings relative to its cash accounts?

104. A: I took specific note that Qwest debited its cash account, no.1130, by \$16,899,000.00, representing
105. the property tax refund. Such debit increases the asset value of that account.

106. Q: What, if anything did you notice of Qwest's operating tax expense account?

107. A: Qwest credited its operating tax expense account, no. 7240.19, by \$11,479,398.00. This credit to
108. operating tax expense results in a proportional increase in net income, which is available for
109. distribution to shareholders.

110. Q: How did Qwest account for the remaining funds represented by the tax refund Qwest received?

111. A: Qwest credited its non-operating income account, no. 7320.90, by \$5,420,422.00. This credit to
112. non-operating income results in a proportional increase in net income, which is available for
113. distribution to shareholders. In addition, this credit appears, in accounting parlance, "below the
114. line," meaning that it is not an operational item that goes into rates of return for regulatory
115. purposes. It therefore avoids the regulatory books and goes straight to the shareholders.

116. Q: Did Qwest, or its precedessors in interest Mountain States Telephone & Telegraph and U. S. West
117. Communications, reach or fall short of earnings projected in filings with the Utah Public Service
118. Commission for the years 1988 through 1996?

119. During the regulatory years 1988 to 1996, U.S. West Communications, Inc. over-earned, in the
120. aggregate, by 3.86 % in its return on rate base and 12.51 % in its return on equity. That means that
121. U.S. West Communications, in the aggregate for those years, had recovered all of its expenses,
122. including all of the property taxes that it had in fact paid, including the full \$16.9 million at issue,
123. from its ratepayers, by virtue of the rates that the Public Service Commission of Utah allowed
124. Qwest to charge, long before it obtained such refund.

125. In the context of public utilities and regulation of rates charged by public utilities, explain what is
126. meant by the term “extraordinary item” or “extraordinary event.”

127. I have specifically reviewed Federal Communications Commission regulation 47 C.F.R. §
128. 32.7600(a), concerning the accounting definition for regulatory

129. purposes of “extraordinary item.” I have also specifically reviewed APB Opinion Nos. 9 and 30 which
130. pertain to “extraordinary events.” Based on my experience, education, skill, training and applicable
131. generally accepted accounting standards, it is my opinion, from an accounting standpoint, that the
132. \$16.9 million property tax refund, regardless of how Qwest booked it, such a decrease in property
133. tax expense qualifies as an “unforeseeable and extraordinary event.” My opinion in this regard is
134. based on the fact that the property tax refund qualifies as both an unforeseeable and
135. extraordinary decrease in Qwest’s property tax expense.

Q: Explain how Qwest’s practice of routinely appealing its property tax assessment in Utah impacts
136. Qwest’s ability to return dividends to its shareholders or results in accounting irregularities.

A: I have considered the fact that Qwest has appealed each year in Utah and, as admitted by Qwest
138. in its Motion For Protective Order On Notice of Rule 30(b)(6) Deposition, at 8, that “while [Qwest]
139. appeals in other states less often” it still does so “on a regular basis.” Based on my auditing
140. experience, this concession, together with the apparent use of property tax appeals as a
141. mechanism in this case to funnel millions of dollars to shareholder return, almost one third (1/3)
142.

143. of which is "below the line," serious red flags are raised concerning U.S. West Communications
144. Inc., now Qwest's, financial accounting practices and its actual motivation to assert property tax
145. appeals for the purpose of driving revenues outside of the regulatory context and to increase the
146. bottom line to shareholders,
147. at the expense of ratepayers. Such a motivation would generally lead to higher stock prices and support
148. large bonuses to Qwest's middle and upper management. I have also reviewed the proceedings
149. in the Matter of the Investigation into the Reasonableness of the Rates and Charges of the
150. Mountain States Telephone and Telegraph Company, Docket No. 88-049-18. I have also
151. reviewed matters of public record as to governmental investigations of financial fraud by former
152. U.S. West Communications officers. I have also reviewed the proceedings in the Matter of the
153. Investigation into the Reasonableness of the Rates and Charges of the Mountain States
154. Telephone and Telegraph Company, Docket No. 88-049-18. I have also reviewed matters of
155. public record as to governmental investigations of financial fraud by former U.S. West
156. Communications officers. The types of financial reporting exposed in those investigations fits
157. generally into a single form of modus operandi, designed to enhance revenue sources for the
158. awarding and payment of compensation to corporate officers. It is therefore my opinion that the
159. financial reporting issues that I identify as red flags in this property tax refund scenario are, to a
160. reasonable certainty, the result of utility misconduct.

161.
162. **CERTIFICATE OF SERVICE**

163. The undersigned hereby certifies that true and correct copies of the foregoing Affidavit of
164. Eckhardt Arthur Prawitt was served via e-mail transmission, this _____ day of December, 2004,
165. to the following:

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