BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF ALL WEST COMMUNICATIONS, INC.'s APPLICATION FOR USF ELIGIBILITY	)))	**Docket No. 11-2180-01**
ALL WEST COMMUNICATIONS, INC., **Applicant**	)))	

REDACTED
DIRECT TESTIMONY
OF

KEVIN J. KELLY

ON BEHALF OF ALL WEST COMMUNICATIONS, INC.

OCTOBER 17, 2011

DIRECT TESTIMONY OF KEVIN J. KELLY

Q. What is your name?

A. My name is Kevin J. Kelly.

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

A. I am the Regulatory Director for TCA, Inc - Telcom Consulting Associates ("TCA"). TCA's business address is 526 Chapel Hills Drive, Suite 100, Colorado Springs, Colorado, 80920. My principal role is directing the TCA Regulatory Team, which analyzes, advocates, and interprets federal and state regulatory actions on behalf of our clients. TCA provides financial, regulatory, marketing and management consulting services to more than 100 small and mid-size rural local exchange carriers ("LECs") and their affiliates throughout the United States.

Q. Briefly describe your educational background and work experience.

A. Prior to joining TCA in 1997, I practiced as Certified Public Accountant ("CPA") for eight years for two regional public accounting firms, Kiesling Associates and Frederick & Warinner. Both of these CPA firms specialized in performing external audits of rural telephone companies - one of the primary aspects of which was to ensure compliance with the Federal Communications Commission's ("FCC") Part 32 accounting rules. I also have been employed by Sprint, in tax and general accounting positions for multiple affiliates; the Kansas Corporation Commission, as a Managing Regulatory Auditor; and Overland Consulting, a regulatory consulting firm.

While I have never testified before the Public Service Commission of Utah ("Commission"), I have testified in numerous regulatory proceedings in multiple states, including: Colorado, Kansas, Wyoming, Nebraska, and New Mexico. Many of these proceedings have involved the determination of the jurisdictional revenue requirement for rate-of-return ("RoR") regulated LECs. Accordingly, I have provided expert testimony during these proceedings on the measurement, gathering, and allocation of the costs necessary to provide regulated telecommunications services in compliance with FCC rules contained in Part 32 (Uniform System of Accounts), Part 64 (Subpart I, Allocation of Costs), and Part 36 (Jurisdictional Separations Procedures).

I am a member of the National Exchange Carrier Association's ("NECA")[1] Cost Issue Task Group ("CITG"), a small group of industry experts that assists NECA staff in the analysis of issues that are complex in nature. Qualifications for CITG membership include: 1) the ability to address a wide scope of issues, 2) subject area expertise in most phases of telecommunications accounting and separations, and 3) the ability to support positions when making recommendations.

I received both a Bachelor of Business Administration, with an accounting major, and a Masters in Business Administration, with an emphasis in finance, from the University of Iowa. I hold the Iowa Board of Accountancy CPA certificate no. 3455.

[1] NECA administers the FCC's access charge regime for more than 1,000 rural LECs. This includes the filing of tariffs, collecting and validating cost and revenue data, ensuring compliance with FCC rules and distributing access charge revenues based on the company's cost of providing interstate access.

Q. On whose behalf are you presenting testimony?

A. I am presenting testimony on behalf of All West Communications, Inc. ("All West") in support of its application for increased support from the Utah Universal Service Fund ("UUSF").

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the unresolved issues remaining in this docket. All West and the Division of Public Utilities ("Division") entered into a Stipulation to resolve the vast majority of issues surrounding the Company's application for increased funding from the UUSF.

Q. Please elaborate.

A. All West and the Division were able to resolve all the issues in the case except for the appropriate amount of depreciation expense. Specifically, the parties disagree on two issues: 1) the normalization of depreciation; and 2) the appropriate application of approved depreciation rates under group asset depreciation accounting to include treatment of fully depreciated accounts. The Stipulation specifically reserved these two issues for hearing before the Commission.

Q. What is the impact on all West's receipt of UUSF of the unresolved depreciation issues?

A. The difference in depreciation between All West and the Division is BEGIN CONFIDENTIAL *** END CONFIDENTIAL. All West contends that normalized depreciation expense for the test period should be BEGIN CONFIDENTIAL *** END CONFIDENTIAL as opposed to the Division's proposal that normalized depreciation expense should be BEGIN CONFIDENTIAL*** END CONFIDENTIAL.[2] Because this is the only unresolved difference in this proceeding, the BEGIN CONFIDENTIAL *** END CONFIDENTIAL difference in depreciation also equates to the difference in UUSF eligibility between the parties.

Q. By way of a background, what is the test period specified in the Application?

A. All West, in its Application proposed a 2010 test year, adjusting for known and measurable post-test year changes. All West and the Division agreed that a 2010 test year, adjusted for post-test year known and measurable changes, is appropriate.

Q. Please explain how All West ascertained normalized depreciation expense for the test period.

A. All West's depreciation expense originated with 2010 actual booked depreciation expense of BEGIN CONFIDENTIAL*** END CONFIDENTIAL[3]. The company then allocated BEGIN CONFIDENTIAL *** END CONFIDENTIAL to non-regulated operations to recognize joint-use assets – resulting in regulated depreciation expense of

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[2] This is the amount of depreciation proposed by the DPU from the Stipulation. However, on October 17, 2011, in response to Data Request No. 2.4 from All West to the Division (dated October 4, 2011) the DPU acknowledged some errors in its previous depreciation worksheets. As a result, the DPU's revised normalized depreciation is now BEGIN CONFIDENTIAL *** END CONFIDENTIAL. All West will review the DPU testimony and will respond to this change as needed in rebuttal testimony.

[3] Application, Section 4, Schedule 4, line 21, column A

BEGIN CONFIDENTIAL *** END CONFIDENTIAL[4]. The allocation of BEGIN CONFIDENTIAL *** END CONFIDENTIAL to non-regulated operations is based on All West's 2010 cost study pursuant to FCC Part 64 rules.

Next, in order to recognize an ongoing level of deprecation based on the most current plant balances, All West included a normalizing adjustment increasing 2010 actual depreciation by BEGIN CONFIDENTIAL *** END CONFIDENTIAL.[5] All West's normalizing adjustment also included a proposal to increase the depreciation rate on buried copper plant from BEGIN CONFIDENTIAL *** END CONFIDENTIAL to BEGIN CONFIDENITAL *** END CONFIDENTIAL. This issue – which results in a pro forma increase in depreciation of BEGIN CONFIDENTIAL *** END CONFIDENTIAL – was resolved in the Stipulation. Accordingly, the Division has included this amount in its proposed depreciation expense of BEGIN CONFIDENTIAL *** END CONFIDENTIAL.

Q. Please explain how All West calculates depreciation expense.

A. As required by FCC Part 32 rules,[6] All West uses a group accounting method (commonly referred to as mass asset accounting) for calculating depreciation. This method computes deprecation for each category of telecommunications plant, rather than individual assets, by applying depreciation rates approved by the Commission to the balance of each category of plant.

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[4] Application, Section 4, Schedule 4, line 21, column C

[5] Application, Section 5, Schedule W/P IS 7, page 1

Q. Why is mass asset accounting required by Part 32?

A. The simplicity of mass asset accounting is its primary attribute, as it eliminates the complexity of depreciating individual assets and recognizing gains or losses on the retirements of individual assets. Providing local exchange service is quite capital intensive, however, many of the assets devoted to this endeavor are quite similar in nature. Accordingly, the FCC requires these assets to be grouped into various plant accounts[7] and depreciated using a composite depreciation rate that is applied to the entire plant account balance. Because individual assets within a plant account may be over- or under-depreciated (depending on how long each individual asset remains in service) the FCC has, for decades, employed mass asset accounting, inclusive of fully-depreciated assets remaining in service, to average these anomalies and produce a representative level of depreciation.

Q. One of the issues reserved for hearing before the Commission is the appropriate application of approved depreciation rates under group asset depreciation accounting to include treatment of fully depreciated accounts. Please describe the process for calculating depreciation expense under mass asset accounting when a plant account becomes fully depreciated.

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[6] § 32.2000(g)
[7] § 32.2000(j)

A. Should a plant account become fully depreciated, the company would immediately stop recording depreciation on that plant account. In other words, under mass asset accounting, plant accounts are precluded from being over-depreciated.

Q. Please explain how fully-depreciated plant accounts become eligible for resumption of depreciation expense.

A. Once new individual assets are acquired and added to a fully-depreciated plant account, mass asset accounting requires the resumption of depreciation expense.

Q. Please explain how mass asset accounting requires the resumption of the calculation of depreciation expense.

A. The resumption of the calculation of depreciation expense under mass asset accounting is performed using the exact same process as was used prior to the discontinuation of depreciation for the plant account. Specifically, the company resumes applying the Commission-approved deprecation rate to the entire balance of the plant account.

Q. Based upon your experience in the industry, is this consistent with the manner in which all other rural LECs calculate depreciation?

A. Yes, it is. During my 30 years in the telecommunications industry, I cannot recall any company calculating depreciation differently than the mass asset accounting process that I have described above. Additionally, under Part 32, it would be improper to use another method of calculating depreciation.

Q. Does All West's independent auditor agree with All West's calculation of depreciation expense?

A. Yes. All West's independent auditors, Kiesling Associates,[8] issued an unqualified opinion to the company's financial statements. In other words, the independent auditors assert that the Company's financial statements present fairly, in all material respects, the financial position, results of operations and cash flows and conform with generally accepted accounting principles ("GAAP"). Had All West calculated depreciation using a method that resulted in a materially lower amount of expense, it is quite likely that the company's independent auditor would not have issued an unqualified opinion to the Company.

Q. Is All West's method of recording of deprecation consistent with the requirements in the federal jurisdiction?

A. Yes. All West is subject to RoR regulation in the interstate jurisdiction and has elected to participate in the NECA access pooling process. This requires All West to file an annual interstate cost study,[9] which is reviewed by NECA for the appropriate treatment of numerous accounting issues, including depreciation. It is my understanding that NECA has never questioned All West's application of mass asset accounting rules.

Furthermore, the Universal Service Administrative Company ("USAC") – who is responsible for administering the federal universal service fund – also performs audits of

[8] Kiesling Associates specializes in auditing rural LECs and performs more than one hundred such audits annually.

[9] All West retains TCA to prepare its annual interstate cost study.

recipients. Numerous TCA clients – including All West – have undergone USAC audits, which can best be described as rigorous and comprehensive. USAC audits involve a review of the company's depreciation calculation, including a request for the Commission order approving the depreciation rates for each plant account. All West underwent a USAC audit in 2009 which resulted in no adverse findings regarding All West's calculation of depreciation. Based upon my experience with the USAC audit process, if All West had used a depreciation method not in compliance with FCC rules, it would have resulted in an adverse audit finding by the USAC auditors.

Q. The other issue reserved for hearing by the Commission is the normalization of depreciation. Can you please describe All West's normalized depreciation calculation?

A. All West normalized depreciation expense by simply applying its Commission-approved depreciation rates to its December 31, 2010 plant balances. The Company's actual depreciation for the test period was then increased to this "normalized" amount in order to reflect the known and measurable level of depreciation that All West will incur on a going-forward basis. [10]

Q. Do revenue requirement determinations typically include an adjustment to normalize depreciation?

A. Yes, the normalization of deprecation is a standard adjustment in forward-looking revenue requirement determinations. The adjustment is necessary to eliminate the impact

[10] Application, Section 5, Schedule W/P IS 7, page 2

on booked depreciation of the timing of additions and retirements during the test period. It is my understanding that the Division has also made a normalizing adjustment to arrive at its proposed depreciation level of BEGIN CONFIDENTIAL *** END CONFIDENTIAL.

Q. Do you have any general comments on the Division's proposed level of depreciation?

A. Yes. The Division's proposed ongoing depreciation is actually BEGIN CONFIDENTIAL *** END CONFIDENTIAL *less* than the Company's recorded 2010 regulated depreciation expense.[11] Frankly, I am struggling to understand the Division's position. However, I will reserve more my more specific comments for rebuttal testimony after I have the opportunity to analyze the calculations by the Division.

Q. Does that conclude your direct testimony?

A. Yes it does.

[11] Because the agreed upon increase in depreciation of BEGIN CONFIENTIAL *** END CONFIDENTIAL was contained in the Division's proposed depreciation, I removed it to provide a more meaningful comparison (BEGIN CONFIDENTIAL *** END CONFIDENTIAL).