BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Carbon-Emery Telephone's Application for an Increase In Utah Universal Service Fund Support	**:**	**Docket No. 15-2302-01 DPU Exhibit 2.0 DIR (REDACTED**

DIRECT TESTIMONY

OF

JOSEPH HELLEWELL
STATE OF UTAH
DIVISION OF PUBLIC UTILITIES

August 21, 2015

I. INTRODUCTION

Q: Please state your name for the record.

A: My name is Joseph Hellewell.

Q: By whom are you employed and what is your business address?

A: I am employed by the Utah Department of Commerce, Division of Public Utilities (DPU). My business address is 160 East 300 South, 4th Floor, Salt Lake City, Utah, 84114.

Q: What is your position with the Division?

A: Utility Analyst II

Q: Please summarize your educational and professional experience.

A: I received a Masters of Accountancy degree and a Bachelor's of Science degree in accounting from the University of Nevada-Las Vegas in 2010 and 2009 respectively. I have been employed with the Division of Public Utilities since February, 2014. Prior to this I have worked as a staff accountant and assistant controller for various businesses for the past ten years.

Q: Have you testified before the Commission on prior occasions?

A: No.

Q: Please describe your participation in the Division's review of Carbon-Emery Telephone's Application for an Increase in Utah Universal Service Fund Support.

A: I have been involved with the review of Carbon-Emery's operations and USF application since the rate case was filed in March 2015.

II. PURPOSE AND SCOPE OF TESTIMONY

Q: What is the purpose of your testimony in these proceedings?

A: I will review four DPU adjustments to the application for increased Utah Universal Service Fund (UUSF). First, an adjustment to depreciation expense. Second, the change of accumulated depreciation presented on DPU Exhibit 1.2 DIR. Third, imputed revenue Carbon-Emery Telephone will receive as it migrates customers from its cable television system back to the regulated telephone company fiber to the home (FTTH) infrastructure. Finally, the fourth adjustment is due to the under-collection of money by Carbon-Emery Telephone based on their DSL tariff rate.

Q: Please describe the DPU adjustment to Carbon-Emery Telephone's 2015 UUSF application with regards to depreciation.

A: I made a [redacted] adjustment to Carbon-Emery Telephone's 2015 UUSF application. This adjustment was based upon Carbon-Emery's decision to use a questionable depreciation method, called mass asset or group depreciation, for the recording and accounting of depreciation expense.

Q: Is group depreciation considered an industry standard?

A: In response to DPU Data Request 3, Carbon-Emery Telephone stated its reasoning for adopting group depreciation was because it was an industry standard. However not all regulated telecom utilities in the state use this group depreciation method. There are telephone utilities in Utah that employ single asset straight-line depreciation. Group depreciation is not clearly defined in any government statute and is implemented and interpreted differently by each organization choosing to use it. Group depreciation as currently used by Carbon-Emery Telephone modifies Commission approved rates and accelerates depreciation, thus inflating the depreciation expense used in calculating revenue requirement and UUSF support. How Carbon-Emery Telephone does this will be explained later in my testimony.

Q: Are there benefits to group depreciation?

A: Since group depreciation treats similar assets as a whole rather than individuals this can reduce unnecessary record keeping and reporting that might be used when needing to calculate depreciation on hundreds of assets.

Group depreciation would also be beneficial to telephone companies in the state as well as to the Division if all the companies used a standardized method for their calculation. This would assist in the review process, and provide an equal footing where by companies could fairly compete with one another.

Q: Despite those benefits, why are you recommending against using group depreciation here?

A: The Division acknowledges the fact that the use of group depreciation can simplify depreciation calculations, especially when large numbers of assets are aggregated into a single group. However, the practice is not recommended for the following reasons:

- ***Depreciation by Computer***: If accounting software is used to calculate depreciation, no labor or time is saved using group depreciation.
- ***Asset Tracking***: It can be difficult to physically track a single asset when it is encompassed in a larger group**.**
- ***Disposal***: Disposal of a single asset in the group requires additional time and calculation to recalculate the remaining group's yearly depreciation expense, negating other conveniences.
- ***Group Characteristics***: An asset may be incorrectly placed into the wrong asset group in order to take advantage of the longer/shorter useful life or salvage value assumptions used for that group. This would effectively accelerate or delay expense recognition for the asset. Certain types of assets are particularly unsuited to group depreciation such as vehicles because of their relatively short depreciable lives, are not bought in bulk, and repairs and maintenance are common to

individual assets. Each of these factors further complicate the depreciation calculation of vehicles making them a poor choice for group depreciation.

- ***Standardization*:** Group depreciation is not used state wide as the default depreciation method and when used each company may use its own variation of this depreciation method since no standard has been approved by the Commission. This lack of standardization would impose an additional workload on the Division for monitoring.
- ***Volatility:*** During the normal business cycle assets are constantly being added and retired. Depreciation expense increases or decreases slightly depending on the number of assets added and their capitalization cost. Depreciation methods that have a fixed life and rate smooth out depreciation expense making it predicable many years in the future. Group depreciation, because of its nature to accelerate depreciation, causes these increases and decreases to become more drastic and volatile. This can cause depreciation expense to become abnormally high one year and abnormally low the next. This makes it difficult to determine the actual ongoing costs and revenues a company incurs during the normal course of business. In a case such as this it is difficult for auditors to determine whether the proposed test year has a high, low, or normal amount of depreciation expense.

Furthermore, while group asset depreciation can provide incentives for increased infrastructure investment, the purpose of the UUSF is to make up shortfalls in revenue for the provision of high cost service at affordable rates. Incentives for investing are not generally permissible uses of the fund. Other incentives may be available through tax law, economic development entities, and otherwise. As yet, the UUSF has not been authorized for such purposes.

Q: How does Carbon-Emery Telephone's use of group depreciation manipulate Commission approved rates?

A: The Public Service Commission of Utah (PSC) established approved depreciation lives and rates in docket 05-2302-01. This docket establishes the useful life and depreciation

rate of each asset category. Carbon-Emery Telephone uses these rates in its initial depreciation calculation, however these rates do not end up being the actual time the assets are depreciated. A clear example of this can be seen in DPU exhibit 2.1. This exhibit is Carbon-Emery Telephone's response to DPU Data Request 1.11 and is entitled Assets and CY 2014 Depreciation (CONF).

Lines 31 through 35 of the attached spreadsheet account for the depreciation of account 2421.00 Aerial Cable. According to docket 05-2302-01 the commission has set this account to be depreciated over 10 years and a yearly depreciation rate of 10% (0.833% per month) as indicated in cell D31. Carbon-Emery Telephone added [redacted]3 in new assets to this account in June of 2014 (seen in cell C32). This new addition will be depreciated over [redacted] instead of the Commission approved rate of 10 years.

Every asset group with new assets added has had those assets' lives effectively reduced by using Carbon-Emery Telephone's version of group depreciation. Mathematically, using already fully depreciated assets in the depreciation base will always result in a higher depreciation expense for the assets with remaining net book value than would be warranted using straight-line depreciation. This inevitably mismatches the depreciation expense and the assets' lives. Thus, to one degree or another, the acceleration of Carbon-Emery Telephone's depreciation of assets under its preferred method, occurs throughout its depreciation accounts. For purposes of the UUSF, this method is not in the public interest.

Q: How does Carbon-Emery Telephone's use of group depreciation inflate depreciation expense?

A: The example above shows Carbon-Emery Telephone's use of group depreciation drastically reduces the amount of time an asset is depreciated. By applying the approved depreciation rate to the total gross value of the group, Carbon-Emery calculates monthly depreciation expense of [redacted] Using approved

depreciation rates, the new asset Carbon-Emery placed in service in June of 2014 should have had a depreciation expense of [redacted] per month [redacted] instead of the [redacted] per month used by Carbon-Emery in its USF application. This inflation of depreciation expense effectively changes the depreciation rates approved by this Commission and leads to an increase in revenue requirement and the amount Carbon-Emery Telephone would receive for UUSF support.

In DPU Exhibit 2.2 inflated depreciation expense is demonstrated again on Carbon-Emery Telephone's buried cable account (2423). By sorting each asset according to the capitalization date we can determine that 426 assets are fully depreciated before the 2014 test year begins. These assets total [redacted] which is being used in Carbon-Emery Telephone's calculation of depreciation expense. The assets with remaining life in the account total [redacted], this amount multiplied by the commission approved rate of 5.0% yields an annual depreciation expense of [redacted]. Carbon-Emery Telephone is claiming a [redacted] expense for this category, which is a difference of [redacted].

Asset groups will likely show a disproportionate increase in the amount of depreciation expense generated when using Carbon-Emery Telephone's version of group depreciation. By keeping fully depreciated assets in the calculation for depreciation expense Carbon-Emery Telephone ensures that its depreciation expense is higher than it would be using standard depreciation methods. For purposes of the UUSF this method is not in the public interest.

Q: You mentioned that Carbon-Emery Telephone uses the commission approved rates in its depreciation calculation, how does Carbon-Emery calculate its depreciation expense?

A: Group depreciation allows a company to group similar assets and depreciate them as you would one asset. So instead of having ten $500 assets you have one $5,000 asset. This allows for a faster and cleaner depreciation calculation. When new assets are purchased

and a new asset is formed, the original asset is not changed after it has be placed in use. Carbon-Emery Telephone does not follow these principles on its books.

In the previous example it is clear that Carbon-Emery Telephone's 2421.00 account is fully depreciated at the end of January 2014 (cell E31). Instead of starting a new asset group when the new asset was put in place in June 2014, Carbon-Emery Telephone added the new undepreciated asset to the fully depreciated assets (cell C32). Carbon-Emery Telephone then applied the commission approved rate to the group. This results in a shorter depreciable life, and a larger depreciation expense.

By adding undepreciated assets to fully depreciated assets Carbon-Emery Telephone effectively suggests that one asset influences the depreciation of another. This allows fully depreciated assets to influence the rate at which new assets are depreciated.

Q: What method did the DPU use to calculate the adjustment to depreciation expense mentioned previously?

A: ***Single Asset Straight Line*** – Perhaps the most simple of all depreciation methods. This method would allow use of Commission approved rates, allow for simple addition and disposal calculations, and could be easily implemented. Straight line depreciation was used for this calculation because of it ease in applying Commission approved rates to the assets held by Carbon-Emery Telephone. This method also has also been used in adjusting depreciation expense in past rate cases and therefore was seen as being fair and reasonable. Straight line depreciation cannot be accelerated or manipulated and thereby matches the proper expense with the proper useful life of the asset.

Q: What other methods could be used as an alternative?

A: Group depreciation as it is being used by Carbon-Emery Telephone is not in the public interest. However there is a variety of alternatives that Carbon-Emery Telephone could

use that would use the Commission approved life and rates, and would be reasonable alternatives for calculating revenue requirement and Utah USF if correctly employed.

- ***Single Asset Straight Line*** – Used by the Division for reasons stated above.
- ***Straight Line Vintage Group Depreciation*** – Carbon-Emery Telephone may use the groups already in place, however instead of modifying a group once it is in place, groups would be recorded in vintages. This would allow a group of similar assets to be bundled and depreciated as one asset, however when a new asset is purchased it would begin a new vintage group and the original group would be unchanged. This method would also allow for Commission approved rates, allow for simple expense calculations and would also be easily implemented.
- ***Net Book Value Group Depreciation*** – This method would be most similar to the method currently used by Carbon-Emery Telephone. Instead of recalculating depreciation expense based of the gross book value of the depreciated assets and the new assets this method would net the book value and the accumulated depreciation of that group then add the new asset to the group and use this figure to calculate depreciation expense. While this method uses more calculation, it eliminates accelerated depreciation, and would be easy for Carbon-Emery Telephone to implement.
- ***Depreciation Studies*** – The PSC could order Carbon-Emery to conduct depreciation studies as are used in other utilities. These studies would be used to set depreciation rates that more accurately reflect the depreciable life of the assets.
- ***FCC Method***: The FCC has developed a formula that has been used to recalculate the depreciation rate based on the plants average remaining life, future net salvage, and depreciation reserve ratio. This formula has been published in several orders. (FCC 00-306, FCC 96-485) From FCC 00-306, "The depreciation rate for an account is a function of the associated plant's average remaining life, future net salvage, and depreciation reserve ratio. The depreciation rate is calculated using the following formula:

Depreciation Rate = 100% - Accumulated Depreciation % - Future Net Salvage %

Average Remaining Life

Both the average remaining life and the future net salvage factors are based upon estimates that require periodic review to ensure their reasonableness."

Q: How would a change in depreciation methods impact Carbon-Emery's previous financial statements?

A: Any change in a depreciation method is considered by GAAP to be a change in accounting estimate and should be accounted for in the period of the change. A change in accounting estimate does not require the restatement of earlier financial statements, nor the retrospective adjustment of account balances. Further, a change for purposes of calculating Carbon-Emery's revenue requirement in a case for support from the UUSF does not necessarily require the company to change it methods of depreciation accounting for other purposes. It is merely used to establish the amount of UUSF support that is in the public interest. Carbon-Emery Telephone is able to organize and operate their financial records in a manner best suited for them, the Division is suggesting that group depreciation is not a suitable method for determining UUSF support and should not adjust any accounting practices of Carbon-Emery Telephone.

Q: Please explain the [redacted] adjustment to accumulated depreciation.

A: The Division has used straight line depreciation to calculate a reduction to Carbon-Emery Telephone's proposed 2014 depreciation expense. This reduction in depreciation expense is offset by the same amount being recorded to Carbon-Emery's accumulated depreciation. Since a new expense is being recorded a new corresponding adjustment should be made as well.

Q: Please describe the DPU adjustment for imputed revenue from migration of cable television customers.

A: Carbon-Emery Telephone is in the process of constructing a fiber to the home (FTTH) network. In doing so, it will migrate current customers receiving internet service from

Emery Telecom and Video (ETV) to the new fiber system. ETV is an unregulated subsidiary of Emery Telephone that operates a cable television network in Emery and Carbon Counties. These customers will bring in additional revenue to Carbon-Emery Telephone based on Carbon-Emery's DSL rates. Carbon-Emery Telephone has identified [redacted] customers that will make this switch paying a rate of [redacted] per month for internet service from the regulated telephone network. This equates to [redacted] annual revenue which is known and measurable and thus imputed to Carbon-Emery Telephone as additional revenue for determining revenue requirement and UUSF support. Please see DPU Exhibit 2.3 for calculations.

Q: Please describe the DPU revenue adjustment for Carbon-Emery Telephone's under-collection of funds based on its DSL revenue requirement.

A: Carbon-Emery Telephone conducts a detailed cost study analysis to determine an accurate tariff rate for DSL customers use of regulated plant. Since the collection of data is so rigorous Carbon-Emery Telephone creates a rate for current billing that is based on data collected 6 months prior. When the actual figures are collected, Carbon-Emery Telephone makes an adjusting entry truing up what was collected with what the revenue requirement should have been. In this case Carbon-Emery Telephone's tariff rate was too low and caused Carbon-Emery Telephone to under-collect revenue below what the revenue requirement would have dictated. This results in and adjustment of [redacted] to Carbon-Emery Telephone's revenue. Please see DPU Exhibit 2.4 for a spreadsheet showing these calculations.

Q: Does this conclude your direct testimony?

A: Yes it does.