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**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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<b>In the Matter of the Emery Telephone's</b>	:	<b>Docket No. 15-042-01</b>
<b>Application for an Increase in Utah</b>	:	<b>DPU Exhibit 2.0 DIR</b>
<b>Universal Service Fund Support</b>	:	<b>(REDACTED)</b>
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**DIRECT TESTIMONY**

**OF**

**JOSEPH HELLEWELL  
STATE OF UTAH  
DIVISION OF PUBLIC UTILITIES**

**August 14, 2015**

**I. INTRODUCTION**

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**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, 4<sup>th</sup> 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 Emery Telephone's Application for an Increase in Utah Universal Service Fund Support.**

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

30 **II. PURPOSE AND SCOPE OF TESTIMONY**

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

**A:** I will review five 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 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. Fourth, is an adjustment due a change of the affordable base rate. Finally, the fifth adjustment is due to the over-collection of money by Emery Telephone based on their DSL tariff rate.

**Q: Please describe the DPU adjustment to Emery Telephone’s 2015 UUSF application with regards to depreciation.**

**A:** I made a [REDACTED] adjustment to Emery Telephone’s 2015 UUSF application. This adjustment was based upon Emery’s decision to use a depreciation method, called mass asset or group depreciation, which yields questionable results for the recording and accounting of depreciation expense.

**Q: Is group depreciation considered an industry standard?**

**A:** In response to DPU Data Request 2, 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 Emery Telephone modifies Commission approved rates and accelerates depreciation, thus inflating the depreciation expense used in calculating revenue requirement and UUSF support. How Emery Telephone does this will be explained later in my testimony.

59 **Q: Are there benefits to group depreciation?**

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

63

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

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

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

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

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

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

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

111

112 **Q: How does Emery Telephone's use of group depreciation manipulate Commission**  
113 **approved rates?**

114 **A:** The Public Service Commission of Utah (PSC) established approved depreciation lives  
115 and rates in docket 94-042-01. This docket establishes the useful life and depreciation

116 rate of each asset category. Emery Telephone uses these rates in its initial depreciation  
117 calculation, however these rates do not end up being the actual time the assets are  
118 depreciated. A clear example of this can be seen in DPU exhibit 2.1. This exhibit is  
119 Emery Telephone's response to DPU Data Request 1.11 and is entitled Assets and CY  
120 2014 Depreciation (CONF).

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122 Line 10 and 11 of the attached spreadsheet account for the depreciation of account  
123 2122.00 Office Furniture. According to docket 94-042-01 the commission has set this  
124 account to be depreciated over 6.67 years and a yearly depreciation rate of 15% (1.25%  
125 per month) as indicated in cell D16. Emery Telephone added [REDACTED] in new assets to  
126 this account in August of 2014 (seen in cell L11). This new addition was depreciated over  
127 2 months instead of the Commission approved rate of 6.67 years.

128  
129 Every asset group with new assets added has had those assets' lives effectively reduced  
130 by using Emery Telephone's version of group depreciation. Mathematically, using  
131 already fully depreciated assets in the depreciation base will always result in a higher  
132 depreciation expense for the assets with remaining net book value than would be  
133 warranted using straight-line depreciation. This inevitably mismatches the depreciation  
134 expense and the assets' lives. Thus, to one degree or another, the acceleration of Emery  
135 Telephone's depreciation of assets under its preferred method, occurs throughout its  
136 depreciation accounts. For purposes of the UUSF, this method is not in the public  
137 interest.

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139 **Q: How does Emery Telephone's use of group depreciation inflate depreciation**  
140 **expense?**

141 **A:** The example above shows Emery Telephone's use of group depreciation drastically  
142 reduces the amount of time an asset is depreciated. By applying the approved  
143 depreciation rate to the total gross value of the group, Emery calculates depreciation  
144 expense [REDACTED] Using approved depreciation rates, the new

145 asset Emery placed in service in August of 2014 should have had a depreciation expense  
146 of [REDACTED] per month [REDACTED] instead of the [REDACTED] per month used by  
147 Emery in its USF application. This inflation of depreciation expense effectively changes  
148 the depreciation rates approved by this Commission and leads to an increase in revenue  
149 requirement and the amount Emery Telephone would receive for UUSF support.

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151 In DPU Exhibit 2.2 inflated depreciation expense is demonstrated again on Emery  
152 Telephone's buried cable account (2423). By sorting each asset according to the  
153 capitalization date we can determine that 24 assets are fully depreciated before the 2014  
154 test year begins. These assets total [REDACTED] which is being used in Emery  
155 Telephone's calculation of depreciation expense. The assets with remaining life in the  
156 account total [REDACTED], this amount multiplied by the commission approved rate of  
157 4.5% yields an annual depreciation expense of [REDACTED]. Emery Telephone is claiming  
158 a [REDACTED] expense for this category, which is a difference of [REDACTED].

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

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

168 **A:** Group depreciation allows a company to group similar assets and depreciate them as you  
169 would one asset. So instead of having ten \$500 assets you have one \$5,000 asset. This  
170 allows for a faster and cleaner depreciation calculation. When new assets are purchased  
171 and a new asset is formed, the original asset is not changed after it has be placed in use.  
172 Emery Telephone does not follow these principles on its books.

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174 In the previous example it is clear that Emery Telephone's 2122.00 account is fully  
175 depreciated (cell E10). Instead of starting a new asset group when the new asset was put  
176 in place in August 2014, Emery Telephone added the new undepreciated asset to the fully  
177 depreciated assets (cell C11). Emery Telephone then applied the commission approved  
178 rate to the group. This results in a shorter depreciable life, and a larger depreciation  
179 expense.

180  
181 By adding undepreciated assets to fully depreciated assets Emery Telephone effectively  
182 suggests that one asset influences the depreciation of another. This allows fully  
183 depreciated assets to influence the rate at which new assets are depreciated.

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

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

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

197 **A:** Group depreciation as it is being used by Emery Telephone is not in the public interest.  
198 However there is a variety of alternatives that Emery Telephone could use that would use  
199 the Commission approved life and rates, and would be reasonable alternatives for  
200 calculating revenue requirement and Utah USF if correctly employed.

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- o ***Single Asset Straight Line*** – Used by the Division for reasons stated above.



- 202           ○ ***Straight Line Vintage Group Depreciation*** – Emery Telephone may use the  
203                                   groups already in place, however instead of modifying a group once it is in place,  
204                                   groups would be recorded in vintages. This would allow a group of similar assets  
205                                   to be bundled and depreciated as one asset, however when a new asset is  
206                                   purchased it would begin a new vintage group and the original group would be  
207                                   unchanged. This method would also allow for Commission approved rates, allow  
208                                   for simple expense calculations and would also be easily implemented.
- 209           ○ ***Net Book Value Group Depreciation*** – This method would be most similar to the  
210                                   method currently used by Emery Telephone. Instead of recalculating depreciation  
211                                   expense based of the gross book value of the depreciated assets and the new assets  
212                                   this method would net the book value and the accumulated depreciation of that  
213                                   group then add the new asset to the group and use this figure to calculate  
214                                   depreciation expense. While this method uses more calculation, it eliminates  
215                                   accelerated depreciation, and would be easy for Emery Telephone to implement.
- 216           ○ ***Depreciation Studies*** – The PSC could order Emery to conduct depreciation  
217                                   studies as are used in other utilities. These studies would be used to set  
218                                   depreciation rates that more accurately reflect the depreciable life of the assets.
- 219           ○ ***FCC Method***: The FCC has developed a formula that has been used to recalculate  
220                                   the depreciation rate based on the plants average remaining life, future net  
221                                   salvage, and depreciation reserve ratio. This formula has been published in  
222                                   several orders. (FCC 00-306, FCC 96-485) From FCC 00-306, “The depreciation  
223                                   rate for an account is a function of the associated plant’s average remaining life,  
224                                   future net salvage, and depreciation reserve ratio. The depreciation rate is  
225                                   calculated using the following formula:

$$\text{Depreciation Rate} = \frac{100\% - \text{Accumulated Depreciation \%} - \text{Future Net Salvage \%}}{\text{Average Remaining Life}}$$

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

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**Q: How would a change in depreciation methods impact 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 Emery’s revenue requirement in a case for support from the UUSF does not necessarily require the company to change its methods of depreciation accounting for other purposes. It is merely used to establish the amount of UUSF support that is in the public interest. 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 Emery Telephone.

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

**A:** The Division has used straight line depreciation to calculate a reduction to Emery Telephone’s proposed 2014 depreciation expense. This reduction in depreciation expense is offset by the same amount being recorded to 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:** 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 County. These customers will bring in additional revenue to Emery Telephone based on Emery’s DSL

260 rates. Emery Telephone has identified [REDACTED] customers that will make this switch paying a  
261 rate of [REDACTED] per month for internet service from the regulated telephone network. This  
262 equates to [REDACTED] annual revenue which is known and measurable and thus imputed to  
263 Emery Telephone as additional revenue for determining revenue requirement and UUSF  
264 support. Please see DPU Exhibit 2.3 for calculations.

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266 **Q: Please describe the DPU adjustment for imputed revenue resulting from the**  
267 **affordable base rate change.**

268 **A:** Emery Telephone currently charges [REDACTED] and [REDACTED] for residential and business  
269 customers respectively. The affordable base rate for residential customers is \$16.50 and  
270 for business customers it is \$26.00. The imputed revenue is a product of the difference in  
271 these rates and the number of residential and business lines. This works out to be a  
272 [REDACTED] adjustment to account for revenue the company would receive if it charged  
273 the affordable base rate. Please refer to DPU Exhibit 2.4 for a spreadsheet showing these  
274 calculations.

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276 **Q: Please describe the DPU revenue adjustment for Emery Telephone's over-collection**  
277 **of funds based on its DSL revenue requirement.**

278 **A:** Emery Telephone conducts a detailed cost study analysis to determine an accurate tariff  
279 rate for DSL customers use of regulated plant. Since the collection of data is so rigorous  
280 Emery Telephone creates a rate for current billing that is based on data collected 6  
281 months prior. When the actual figures are collected, Emery Telephone makes an  
282 adjusting entry truing up what was collected with what the revenue requirement should  
283 have been. In this case Emery Telephone's tariff rate was too high and caused Emery  
284 Telephone to over-collect revenue above what the revenue requirement would have  
285 dictated. This results in an adjustment of [REDACTED] to Emery Telephone's revenue.  
286 Please see DPU Exhibit 2.5 for a spreadsheet showing these calculations.

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288 **Q: Does this conclude your direct testimony?**

289    **A:**    Yes it does.