Q.Please state your name and business address for the record.

A.My name is Sydney Lansing.  My business address is 472 W. Washington Street, Boise, Idaho.

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

A.I am employed by the Idaho Public Utilities Commission as a Staff Auditor in the Accounting Section.

Q.Are you the same Sydney Lansing who previously filed direct testimony in this proceeding?

A.Yes, I am.

Q.What is the purpose of your testimony in this surrebuttal presentation?

A.The purpose of my testimony is to present revised Exhibit No. 101 with all of its pages.  Pages 1, 3, 4, 6, 8, 9, 10, and 12 have been revised; pages 2, 5, 7, and 11 are the same as in direct testimony; page 13 is new to this surrebuttal testimony.  I will also sponsor new Exhibit No. 157 which shows portions of Table 1-A from the 1995 FCC ARMIS Report related to Outside Plant Statistics, particularly showing total fiber optic cable and fiber optic cable in use.  Additionally, I will discuss issues raised by U S WEST witnesses Wright, Elder, and Plummer in their rebuttal testimony.  In particular, I will address settlement issues; plant in service and related adjustments, state effective income tax rate, gross-up factor, and cost allocation.

SETTLEMENT ISSUES RELATED TO EXHIBIT NO. 101, PAGE 1

Q.What agreements were reached at the settlement conference on January 15, 1997 that affect Exhibit No. 101?

A.The Staff and U S WEST agreed to change the Company’s miscellaneous revenues as shown on lines 42 and 43 of Exhibit No. 101 by $10.234 million.  Rent compensation was originally excluded as a contra revenue.

Staff also agreed in principal that three accounts (Capital Leases, Leasehold Improvements, and Intangibles) as well as the true-up to plant in service, were omitted from the Staff’s rate base when comparing the General Ledger to the Subsidiary Ledger.  Staff agreed to audit the three accounts and the true-up in Seattle on January 23 - 24, 1997.  All of the information necessary to complete the audit was not available, so a subsequent audit in Denver was performed on February 3 - 6, 1997.

CAPITAL LEASES, LEASEHOLD IMPROVEMENTS, AND INTANGIBLES

Q.Based on your audits, what do you recommend with respect to Capital Leases, Leasehold Improvements, and Intangibles?

A.I recommend that each of the accounts be included in the rate base as follows.  (Each amount is reported here at the intrastate level with “000" omitted):

Capital Leases - Buildings$4,263

Allocated between Title 61 and Title 62.

Capital Leases - Software$5,495

Directly assigned to Title 62.

Leasehold Improvements$3,676

Allocated between Title 61 and Title 62.

Intangible Assets$   42

Allocated between Title 61 and Title 62.

It is my understanding that U S WEST agrees with these amounts, but not my assignment of the software to Title 62.  The appropriate allocation of the other three items is left to Staff witness Baldwin.

Q.Why do you recommend that the Capital Leases related to the software be directly assigned to Title 62?

A.Despite the two audits and many audit requests, U S WEST has been unable to provide any meaningful information about the purpose or function of the software directly related to the capitalized leases.  Most of the software should be part of the central office switch operation.  (I was provided a list of the features on a switch, but no designation about which features came with the switch and which features were “add-ons” and supplied as part of the leases).  However, my discussion with asset accounting people in Seattle led me to believe that the features covered by the capitalized leases were Custom Local Area Signaling Services (CLASS) services, i.e., Call-forwarding, Caller identification, Automatic callback, Automatic recall, Calling number delivery, Customer originated trace, Distinctive ringing/call waiting, Selective call forwarding, Selective call rejection.  Clearly these features all supply Title 62 services.  Given this information and the failure of the Company to satisfactorily demonstrate the functions of the software leases, I assigned these capital leases to Title 62.

AMORTIZATION OF CAPITAL LEASES, LEASEHOLD IMPROVEMENTS, AND INTANGIBLES

Q.What other adjustments must be made to properly account for Capital Leases, Leasehold Improvements, and Intangibles?

A.Amortization of each account should be included in the calculation of a Title 61 revenue requirement.  I include amortization expense related to  these accounts on line 33 of Revised Exhibit No. 101 as follows.  All amounts are at the Intrastate level with “000" omitted:

Capital Leases - Buildings$  182

Allocated between Title 61 and Title 62.

Capital Leases - Software$1,333

Direct assignment to Title 62.

Leasehold Improvements$  108Allocated between Title 61 and Title 62.

Intangibles$    2

Allocated between Title 61 and Title 62.

DELAYED ADJUSTMENT TO ASSET SUBSIDIARY LEDGER FROM GENERAL LEDGER

Q.What did your audit of the true-up to plant in service reveal?

A.There are three issues: 1) Changing the overhead allocation factors on a retrospective basis rather than a prospective basis;  2) Increasing the rate base at the subsidiary ledger level nine months after the close of the year; and 3)including fiber plant as an increase to rate base.  U S WEST posted an increase in the Subsidiary Ledger in September 1996 as an adjustment to 1995 Plant in Service amounting to $6,328,848 before separations.  The “true-up” occurs only because U S WEST changes the overhead allocation factors for construction projects after the close of the year.  (U S WEST calls these adjustments RUC adjustments.) This procedure increases the plant in service at the subsidiary ledger level for the 1995 test year nine months after the year has ended.  The proper way to change allocation factors is to change on a prospective basis, not on a retrospective basis.

Q.Doesn’t U S WEST make the same type of adjustment every year?

A.In production request number 281, I asked for  “the entries that adjusted the sub ledger during the year 1995 that related to the year 1994.”  The answer provided by U S WEST did not answer the question.  U S WEST answered: “There were no entries to adjust the subsidiary record during 1996 that related to the RUC adjustment for 1995 because the adjustment did not effect the ledger.”  I have not been able to get any meaningful information about the continuity of the procedure.

Q.What do you recommend related to the 1996 “true-up” for 1995?

A.In my Direct testimony I removed from rate base the total difference between the General Ledger and the subsidiary ledger.  I have agreed to include capital leases, leasehold improvements, and intangibles in rate base subject to Title 61 and Title 62 allocation.  However, I disagree with changing the overhead allocation factor on a retrospective basis and I disagree with increasing the cost of the individual assets after the year end.  Therefore, I have left as a reduction to Plant in Service the amount remaining from the adjustment reported in my Direct testimony, $4,314,375 ($6,328,848 X 68.17%)(Exhibit No. 101, page 4, line 3).

Q.You also noted that as part of the “true-up” issue there is an issue related to fiber cable.  What influence does that have on your recommendation?

A.About $3.3 million of the $6.3 million was posted to fiber accounts.  If any of the “true-up” adjustment had been proper, I would have recommended that about 90% of the $3.3 million adjustment be placed in a “plant held for future use” account.

FIBER - LIT VS. DARK

Q.Did you investigate Company witness Plummer’s statement on page 21 of his rebuttal testimony (lines 14-17): “Finally, the actual amount of lit fiber as a percentage of total fiber as reported in the 1994 ARMIS Report was determined to be in error.  The use of actual “lit” fiber rates for Idaho tell a much different story than the erroneous information upon which Staff has relied.”?

A.Yes, I did.  I was surprised to learn for the first time of the U S WEST ARMIS error when I read Mr. Plummer’s statement.  The implication of his statement is that if the proper 1994 amounts are known, one could assume there is a much larger percentage of fiber lit in the 1995 test year than I claimed in my direct testimony.  However, my review of the corrected “Automated Reporting Management Information System” (ARMIS) Report for 1994 revealed that the amount of lit fiber at the end of 1994 was about 11.94% calculated as 13,485 Km of fiber lit out of a total of 112,902 Km of fiber.  The original ARMIS Report for 1994 stated the amount of lit fiber to be 9.89% calculated as 13,485 Km of fiber lit out of a total of 136,281 Km of fiber.

Q.Did the 1994 error (2.05 percentage points) have any influence on the 1995 ARMIS report.

A.No.  The error was confined to 1994.

Q.How did you calculate the amount of lit fiber in 1995?

A.I received the information about the 1995 ARMIS report from U S WEST as a result of Audit Request No. 18A.  The audit request asked for a “List by General Location showing the total number of fiber lines installed and of that total the number of lines lit.  (Idaho South only).”  U S WEST provided to me, as an answer to that request, a copy of Table 1-A of Section 43-08 of the FCC ARMIS Report.  That information states that there was 123,280 Km of fiber in 1995 in Idaho.  The report also states of that amount 12,766 Km of fiber was lit.  (Exhibit No. 157).  See the Idaho row, columns (r)   and (s).  That works out to 10.355% of fiber that was lit  Consequently, I stated that only 10.355% of lit fiber was used and useful.  The remaining balance (89.645%) was properly classified as plant held for future use.  (Direct, page 13).

Q.Has the Company updated its 1995 ARMIS Report?

A.No.  In response to Audit Request No. 167   U S WEST stated: “There are no efforts in progress to find additional errors in the ARMIS Table IA for 1995...”Since U S WEST filed rebuttal testimony I have attempted to verify the statement made by Mr. Plummer in his rebuttal testimony at page 5, line 12, where he states “As of January 7, 1997 the percent fill (or amount of “lit” fiber as a percentage of “total” fiber) was 43% for the state of Idaho.”  From the documents provided in response to audit and production requests, I found that the calculation related to Mr. Plummer’s 43% was not based on the same data as was previously provided to me about lit and dark fiber from the ARMIS Report.  The original information (stated as Km of fiber that came from a financial information data base) was based on the information necessary to file an FCC ARMIS Report related to lit and dark fiber.  The documentation provided to justify Mr. Plummer’s statement in his rebuttal testimony about the 43% fiber fill referred to strands of fiber that came from an engineering data base with no relationship to the financial information.  Distance does not relate to strands.  I was not allowed to discuss this issue with an engineer or any person responsible for the records in order for us to work out the differences.  For comparison there is only a 17% fiber fill in all of U S WEST’s territory according to the ARMIS Report for 1995.  (See Exhibit No. 157).

Q.What do you recommend with respect to the fiber plant in service?

A.I recommend that the Commission reject Mr. Plummer’s assertion for four reasons: 1) Mr. Plummer’s 43% calculation is not comparable to financial data related to the ARMIS report; 2) Mr. Plummer’s 43% is not related to average plant in service for the 1995 test year; 3) The Company has neither changed the 1995 ARMIS report nor supplied comparable data to calculate the 1995 lit fiber; and 4) None of the unlit dark fiber is used and useful, and should be recorded in Plant Held for Future Use, a normal account in the telephone world as evidenced by a special account in the USOA (account 2002).  Consequently, I have not changed my recommendation.  About 10% of the fiber should be included in plant in service and about 90% of the fiber should be considered plant held for future use, because it is not currently used and useful.

1.89% ERROR FACTOR

Q.Does Ms. Wright accept your adjustment for a 1.89% error factor?

A.Partially.  Ms. Wright says: “Mr. Lansing is partially correct in his adjustment for unrecorded retirements.”  (Rebuttal page 29).  Ms. Wright makes a distinction between accounts that I examined in my field audit and those accounts that were not directly examined.  This distinction creates two issues:

1)Should only the accounts related to central office equipment (that I directly examined) be adjusted, or should all of the accounts (including buried plant accounts) be adjusted?

2)Were the errors discovered in the accounts, related only to delayed paperwork in reporting retirements, or are there other human errors as well?

Q.U S WEST witnesses contend that your error factor is unreliable (Elder, rebuttal, page 25) because you did not use a 100% sample of the accounts.  Do you agree?

A.I disagree.  I found an error factor in every location and in every account that I examined, leading me to believe that the error factor is widespread and related to normal human errors, i.e., losing paperwork or not recording proper information on the paperwork, all for a variety of reasons.

Q.Ms. Wright says in rebuttal testimony page 30, line 3: “USWC does not experience the retirement to its other assets as it does to its central office equipment ...”  Do you agree?

A.No, I disagree.  The actual retirements from Account 2211, analog electronic switching, is a little over $43 million for the period 1986 through 1996, a total of 11 years.  That averages to be about $3.9 million per year.  For comparison, the actual retirements for Account 2232, circuit equipment, is over $53 million for the same period and that averages to about $4.8 million per year.  For comparison, Account 2423, buried cable (metallic portion only), had retirements for the same 11 years in excess of $33 million with an annual average of about $3 million.  Clearly, U S WEST does have retirements, similar in magnitude, from outside plant accounts and to suggest that there is no error factor in those accounts is wrong.

Q.What is involved with the delayed paperwork for retirements and the other human errors?

A.Beth Reiman of the Asset Accounting Group for U S WEST informed me that her group made a concentrated effort to gather asset retirement paperwork that had been delayed for some reason.  As a result of that effort, U S WEST booked about $4.4 million in delayed retirements during 1996 (see Wright, rebuttal, page 30).  That is, of course, proper.  However, delayed paper flow is not the only reason for a mismatch between booked assets and the actual assets in service.  There are other human errors, e.g., the individual recording the retirement does not record all of the removed equipment on the retirement documentation, or no retirement documentation was created.  If either of these actions occur, finding the delayed paperwork would not solve the problem.  Additionally, booking an entry in 1996 does not create an appropriate plant in service amount for a 1995 test year and an adjustment is still required for whatever portion of that $4.4 million occurred in 1995.

Ms. Wright says that there is no reason to adjust the 1995 test year because the asset and the accumulated depreciation would be changed by the same amount (rebuttal testimony page 29, lines 10-13).  However, there are other factors related to a revenue requirement than just the asset account and the accumulated depreciation account.  Both the deferred income tax account and the depreciation expense account are affected.

Q.What do you recommend with respect to the error factor related to plant in service?

A.I recommend that the adjustment as originally provided in my direct testimony be accepted as reported on Exhibit No. 101.  The same adjustment is presented on the revised Exhibit No. 101 as part of this surrebuttal presentation.

EAS ADJUSTMENTS

Q.Has Staff made any pro forma adjustments for implementation of EAS?

A.I have made adjustments for EAS at lines 10 and 30 of Exhibit No. 101, page 1.  The calculations of those amounts are presented on Exhibit No. 101, page 10.  Discussion of this adjustment is found in Mr. Eastlake’s surrebuttal testimony at pages 4-5.

GROSS-UP FACTOR AND EFFECTIVE STATE INCOME TAX RATE

Q.U S WEST witness Wright (rebuttal testimony page 33, lines 4-8) indicates that there has been a change in the Income Tax Rate utilized by U S WEST in its gross-up factor.  Instead of utilizing the Idaho statutory rate of 8%, the new rate is calculated to be 6.594% as compared to your calculation of 6.1729%.  Did you verify this?

A.I intended to audit this calculation in Denver the week of February 3, 1997, but was not allowed to talk to anyone that could provide the necessary detail to support the number used in the calculation.  Ms. Wright did provide a work paper that showed the calculation.

The problems with Ms. Wright’s calculation are these: 1) There is an apportionment factor to Idaho (1.72381%) that should come from the multi-state allocation formula calculated on the Idaho state income tax return.  I was shown what was purported to be a theoretical Idaho income tax return for USWC that had a calculated apportionment factor of 2.5556%.  I also looked at what was purported to be a copy of the actual 1995 tax return filed in Idaho.  That return calculated the multi-state apportionment factor to be 2.0213%.  I will utilize 2.0213% in the first step in calculating the effective Idaho income tax rate.

2) There are also amounts contained in Ms. Wright’s work paper for the second step of the calculation that are identified as the “Actual Taxable Income (In Millions)” for “Idaho South” and “USWC”.  The amounts utilized in the second step should not be the ratio of income tax, but should be the ratio of net income between USWC and southern Idaho at the regulated jurisdictional financial statement level.  For further explanation of reasons for this calculation see my direct testimony in this case at pages 25-26.

Q.What do you recommend with respect to the Idaho effective tax rate?

A.I have prepared a revised Exhibit No. 101, page 8, using the apportionment factor from the actual income tax return filed in Idaho for the 1995 taxable year in the first step of the calculation.  That apportionment factor is 2.0213%.  Additionally, I included as the amount for the second step in my calculation, the ratio of USWC income and expenses to southern Idaho income and expenses (2.6196%).  That ratio is calculated utilizing the MR books for USWC and the JR books for southern Idaho.  The effective Idaho income tax rate for 1995 I calculate to be 6.1729% (see revised Exhibit No. 101, page 8).

Q.What are the issues involving the calculation of the gross-up factor?

A.U S WEST witness Wright in her rebuttal testimony (page 32, line 4) changes two numbers that have an influence on the gross-up factor, also known as the income-to-revenue multiplier.  I have been unable to audit the new numbers, but because they both together have a small influence on the final revenue requirement, I have not challenged either number.  Therefore, there is only one difference between the gross-up factor as presented in rebuttal testimony by U S WEST witness Wright, and the gross-up factor that I present in Exhibit No. 101, page 9.  The difference is the influence of the Idaho effective income tax rate (presented in Exhibit  No. 101, page 8 and discussed above).  Ms. Wright recommends an Idaho effective income tax rate of 6.594% (rebuttal testimony page 33, line 7) and I recommend an Idaho effective income tax rate of 6.1729% (see calculation at revised Exhibit No. 101, page 8).  This difference changes the gross-up factor recommended by Ms. Wright (1.6722) as compared to my recommendation of 1.6663 (see calculation at revised Exhibit No. 101,

page 9).

Q.Ms. Wright criticizes your calculation and application of the gross-up factor at page 31 of her rebuttal testimony.  Why don’t you use the embedded income tax expense as discussed in her testimony?

A.I would very much like to utilize the same methodology as Ms. wright, but I cannot.  Ms. Wright starts with income tax expense as booked at the total state level.  Then she makes a one step adjustment that calculates three things at once:  1)FCC part 64  deregulated amounts;  2) FCC part 36 interstate separations amounts; and  3) The allocation between Idaho Title 61 and Title 62.  As discussed in my direct testimony at page 6, I agree with the separations calculations of Ms. Wright’s calculation, but I disagree with the Title 61 vs. Title 62 allocation.  Therefore, I am unable to start at the same place as Ms. Wright.  I have taken a different approach to include the embedded income tax expense in the calculation of the gross-up factor related to the final income tax expense.

Q.U S WEST requests an increase in revenue and Staff recommends a decrease in revenue.  Does this affect the gross-up factor?

A.Yes.  The gross-up-factor is affected differently by the effective tax rate depending on whether the revenue requirement: 1) increases as is recommended by U S WEST; or 2) decreases as is recommended by Staff.

Q.Please discuss the effective tax rate as part of the gross-up factor when the revenue requirement increases.

A.There are, embedded in the booked income tax expense accounts, at least two credits that reduce the income tax expense below the 35% statutory rate.  General business credits that occur almost every year and the amortization of Investment Tax Credits (ITC) that occur every year.  These ITC credits are amortized over the life of the asset that created the ITC.  Additionally, the flow through of certain book-tax-timing differences can either reduce or increase the booked income tax expense.  Therefore, the real income tax expense as booked is less than the 35% statutory rate. The result is an embedded tax cost at an effective income tax rate.  If revenue increases, this results in an increased requirement for income tax expense.  The proper gross-up factor should produce the income tax that will be paid on the additional revenue.  In this case the federal income tax rate that will be paid on all additional revenue will be at the statutory rate of 35%.  Therefore, all increases of revenue from the booked amount for 1995 should be grossed up at the 1.6663 rate which is calculated utilizing the 35% statutory rate for federal income tax.  (Exhibit No. 101, page 9.)

Q.Is there a difference in the proper gross-up factor if the revenue requirement decreases as is recommended by Staff?

A.Yes, there is a difference.  Because there will be no additional income tax to be paid, the gross-up factor should be calculated at the marginal income tax rate that is embedded in the booked income tax expense.  Customers are entitled to the benefit of that embedded reduced tax rate up to the amount of the revenue that produced the embedded tax.  Thus, as the revenue decreases the income tax related to that decrease should be at the embedded tax rate.  The practical effect of utilizing an embedded tax rate is that the embedded income tax expense is allocated between Title 61 and Title 62.  Each group then receives some benefit from the lower effective income tax rate.

The effective USWC income tax rate for 1995 is 30.84%.  I calculated that embedded income tax rate at the intrastate level from the U S WEST fully distributed cost study provided from Audit Request No. 17-D.  Using the effective tax rate instead of the statutory tax rate, I have calculated the gross-up factor for Staff’s reduced revenue requirement at 1.5661.  See page 13 of Revised Exhibit No. 101.

COST ALLOCATION

Q.What part of cost allocation are you discussing?

A.I will discuss the direct assignment of costs, including positions taken by recognized authorities in the cost allocation field.  Specifically, 1) Cost Accounting Standards Board (CASB); 2) FCC Part 64 requirements.

Q.In support of the Company’s use of allocations, Ms. Wright quotes from the Cost Accounting Standards Board (CASB) Standard 403 (beginning on line 13, page 11 of her rebuttal testimony).  Are you familiar with that standard?

A.Yes, I am.  Ms. Wright quotes from Section 403-50 (c)(1).  This section applies to residual expenses required to be allocated pursuant to Section 403-40.  Section 403-40 makes it clear that expenses should be directly assigned to the maximum extent practical and only residual amounts allocated using general allocation factors.

9904.403-40 Fundamental requirement.

(a)(1) Home office expenses shall be

allocated on the basis of the

beneficial or causal relationship

between supporting and receiving

activities.  Such expenses shall be

allocated directly to segments to

the maximum extent practical.

Expenses not directly allocated, if

significant in amount and in

relation to total home office

expenses, shall be grouped in

logical and homogeneous expense

pools and allocated pursuant to

paragraph (b) of this subsection.

Q.Ms. Wright also refers to an FCC decision approving the use of general allocators.  Does the FCC language persuade you to change your position on this issue?

A.No, it does not.  Here again Ms. Wright quotes language referring to common cost pool allocation after direct assignment should have been accomplished.  In fact the Code of Federal Regulations, Title 47, Section 64.901 makes it clear that costs must be directly assigned whenever possible.

Allocation of costs.

(a) Carriers required to separate

their regulated costs from unregulated costs shall use the

attributable cost method of cost

allocation for such purpose.

(b) In assigning or allocating costs

to regulated and nonregulated

activities, carriers shall follow

the principles described herein...

(2) Costs shall be directly assigned to

either regulated or nonregulated

activities whenever possible.

(3) Costs which cannot be directly

assigned to either regulated or

nonregulated activities will be

described as common costs. ... Each

cost category shall be allocated between

regulated and nonregulated activities in

accordance with the following hierarchy:

(i) Whenever possible, common cost

categories are to be allocated based

upon direct analysis of the origin

of the cost themselves.

(ii) When direct analysis is not

possible, common cost categories

shall be allocated based on an

indirect, cost-causative linkage to

another cost category. ...

(iii) When neither direct nor

indirect measures or of cost

allocation can be found, the cost

category shall be allocated based

on a general allocator...”

(Emphasis added.)

My purpose in addressing direct assignment, as compared to the appropriate allocation of joint and common costs discussed by Staff witness Baldwin, is to stress the importance of direct assignment in the several allocation processes that precede the operation of CAAS.  As I pointed out in my direct testimony, costs lose their identity as they move through the series of cost allocations that occur before CAAS, making it impossible for CAAS to correctly assign costs without examining the basic characteristics of each cost as presented in documents of original entry.  To correct for this shortcoming in the Company’s process, Staff witnesses Faunce, Schneider, and Stockton have identified costs that should not be included in cost pools allocated in part to Title 61 services, and Staff witness Baldwin has allocated the remaining cost pools between Title 61 and Title 62.

Q.Does this conclude your surrebuttal testimony in this proceeding?

A.Yes, it does.