Q.Please state your name and business address?

A.My name is Kathleen L. Stockton.  My business address is 472 West Washington Street, Boise, Idaho.

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

A.I am employed as an Auditor by the Idaho Public Utilities Commission.

Q.Please describe your educational background and professional experience.

A.I received my B.B.A. degree majoring in Accounting from Boise State University in December 1992.  Following graduation I was employed by the Idaho State Tax Commission as a Tax Enforcement Technician.  In my capacity as a Tax Enforcement Technician, I performed desk audits on individual state income tax returns.  I was promoted to Tax Auditor, and after meeting the underfill requirements, was promoted to Senior Tax Auditor.  In my capacity as an auditor, I performed audits on Special Fuel and Motor Fuel Tax returns, International Fuels Tax Agreement Returns and Special Fuel User tax returns.  I accepted employment with the Idaho Public Utilities Commission (IPUC; Staff) in July of 1995.  I attended the National Association of Regulated Utilities Commissioners Annual Regulatory Studies program at Michigan State University in the summer of 1996.  I have testified previously in Capital Water’s rate case, Case No. CAP-W-95-1.

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

A.I will present the results of my examination of certain expenses and Company true-ups for the 1995 test year.  Specifically, I recommend the acceptance of six of the true-ups in U S WEST Communications, Inc.    (U S WEST; Company) witness Margaret Wright’s pre-filed testimony.  I propose an adjustment to revenues to impute revenues lost due to employee telephone service  concessions.  I also recommend Staff adjustments to operating expenses, including an adjustment for expenses associated with the President's Club held in 1995 for the employees nominated in 1994, an adjustment for expenses that are for Title 62 services, an adjustment for direct assignment to Title 62 and Title 61 services, and an adjustment for sales and advertising expenses.

Q.Have you prepared any exhibits or schedules in this case?

A.Yes.  I prepared page 11 to Staff witness Lansing’s Exhibit No. 101.

Q.Have you performed an independent review and analysis of U S WEST’s expenses in preparation for your testimony?

A.Yes, I reviewed the information provided in response to the Staff's audit requests, field audit requests, and production requests.  I reviewed the books and records of U S WEST that were provided for the Audit Staff, including the year-end trial balance and the general ledger for both U S WEST Communications, Inc. and southern Idaho.  I performed as detailed an examination of the 1995 Operating Expenses as I was able to, given the size and nature of the various accounting systems employed by U S WEST.

COMPANY TRUE-UPS

Q.Did you audit all the true-ups that Company witness Margaret Wright lists in her testimony?

A.No.  I audited only six of the true-ups.

Q.Where do the true-ups come from?

A.The true-ups I audited are in the “Out of Period Adjustments” section of Ms. Wright’s direct testimony, beginning on page 24.  The true-ups are described on pages 26 through 29 of Ms. Wright’s testimony.

Q.What are your findings?

A.Staff finds that the following six true-ups are acceptable as presented:

1.1994 Incentive Award True-up

(Adjustment 10, Exhibit No. 25, pg. 6)

2.Health Care Reserve True-up (Adjustment

11, Exhibit No. 25, pg. 6)

3.Accident & Damage Reserve Reversal

(Adjustment 12, Exhibit No. 25, pg. 6)

4.1994 Property Tax True-up (Adjustment

14, Exhibit No. 25, pg. 7)

5.Pre-1991 Custom Work Write-Off

(Adjustment 15, Exhibit No. 25, pg. 7)

6.1994 AT&T Rebate True-up (Adjustment

17, Exhibit No. 25, pg. 7)

TELEPHONE CONCESSIONS

Q.Please explain Staff’s adjustment of operating revenues for telephone concessions.

A.The adjustment of $234,036, as an imputation to increase operating revenues, is to account for telephone concessions offered to employees and retirees of U S WEST.  This adjustment imputes revenue that        U S WEST has foregone due to telephone service concessions.  Telephone concessions are free or reduced rates for employees and retirees of U S WEST for basic local telephone service, toll services, and other Title 62 services.  I include the Title 61 revenues to properly match the expenses associated with the employee telephone service concessions included in the test-year results of operations.  This adjustment is shown in Exhibit No. 101, pg. 11.

Q.Please explain U S WEST’s policy regarding telephone service concessions.

A.U S WEST Communications, Inc., Regional Policy and Procedures “RPP 1207 - Telephone Concession Plan” manual was received in response to Staff Audit Request 41.  The manual details the telephone service concessions available to active and retired employees, honoraries and advisors.

In general, all active eligible employees living in a U S WEST Communications service area receive the concession.  The amount of the concession, i.e., free or reduced (by 50%) basic local telephone service, toll service, and other Title 62 services, varies depending upon the length of employment for current employees, when the employee retired, and under what plan, for retirees.

If the individual is an employee with less than 30 years of service, the telephone concession consists of a 50% credit for monthly local service and intraLATA long-distance services.  If the individual is an employee with 30 or more years of service, then the concession is 100% of monthly local service and intraLATA toll.

For retired employees, the concession depends on when they retired.  The concession is generally 100% local service, plus either 100% intraLATA toll, or a $25 or $35 credit for intraLATA toll.  Specific eligibility is dictated by the plan that was in place at the time of retirement.

Honoraries (retired members of the Board of Directors) and Advisors (current members of the State Executive Boards) are also eligible for concession treatment at various percentages depending on when they serve(d) and the region they serve(d).

The telephone concession plan is not limited to basic local service and intraLATA toll.  There are other features, exclusions and limitations as well.  However, the free or reduced local exchange service is the Title 61 service that Staff concentrated on.

Q.Please explain how you calculated the concession adjustment.

A.In response to Audit Request No. 41,        U S WEST supplied Staff with the amount of expense allocated to southern Idaho by reason of a concession in telephone service for the year 1995.  The southern Idaho intrastate expense as a result of the telephone concession policy is $38,824.  During 1995 there were 2,167 southern Idaho individuals receiving telephone service concessions.  The revenues not billed associated with those customers is $468,326.  These revenues include Title 61 revenues from basic local service, Title 62 revenues from intraLATA toll, and other Title 62 services offered in the telephone concession plan.

Staff did not receive the information necessary to divide the foregone revenues of $486,326 into Title 61 and Title 62 services.  Consequently, Staff estimated Title 61 revenues assuming half of the customers receive a 50% concession and the other half receive 100% concession for local service.  Using $12 as the average price for monthly local service in southern Idaho, and applying the above concession percentage, I arrived at an average of $9.00 per month.  Multiplying this amount by the number of individuals for 12 months produced $234,036 in revenues foregone due to local service concessions.  This estimate is conservative because it does not take into account any revenues relating to other Title 61 services that are also available to concession employees such as a free additional line, non-published or non-listed telephone number, etc.

Q.Was telephone service concessions an issue in the last general rate case for U S WEST?

A.Yes, telephone service concessions was an issue that was considered in the last general telephone rate case which was filed by U S WEST’s predecessor, Mountain Bell, in Case No. U-1000-63 in 1982.  Commission Order No. 18188, page 37, addresses telephone service concessions by stating:

The Commission finds that any toll

concessions enjoyed by Company

employees ought to be removed by

January 1, 1984.  After divestiture,

toll concessions will, for the first

time, become an actual out-of-pocket

expense because the existing affiliation

between AT&T and Mountain Bell will be

dissolved.  We do not forbid the Company

from providing such concessions but will

not allow them as a reasonable expense.

The ratepayers should not be in the

position of paying toll carriers for

employee toll calls.

We further direct that the Company

either include in its tariff or file

with the Commission a statement of the

concessions enjoyed by its employees

so that this information is available

to the public.  We will allow the

provision of free local service as a

concession, but point out that such

concessions may hurt the Company from

a customer relations point of view.

U S WEST, formerly Mountain Bell, has failed to follow the directive of the Commission stated in Order No. 18188.  Employee concessions were not included in its filed tariff.  While Staff was supplied with a copy of the Company’s policy, “Telephone Concession Plan”, in response to Audit Request 41, Staff was unable to find a statement that had been formally filed with the Commission so that it would be available to the public.

Q.What is your recommendation?

A.Staff recommends imputing southern Idaho revenues of $234,036.  U S WEST chose to ignore the Commission directive after the last rate increase request.  This imputation adjustment also matches revenues with the expenses associated with the employee telephone service concessions.  Therefore, including the associated revenues is appropriate.

PRESIDENT’S CLUB

Q.On Exhibit No. 101, pg. 11, you have also made an adjustment to 1995 test-year expenses for the President’s Club.  Please explain what the President’s Club is.

A.The President’s Club is a form of employee recognition, similar in character to a bonus or incentive award.  It is an event that is designed to recognize     U S WEST employees that have made distinguished contributions to the Company and their specific organizations.  The criteria for participation varies between organizations, but ultimately, the achievements of the individual employees are being recognized.  According to the response to Audit Request 84, “winners were selected who demonstrated the highest level of performance in overall contribution to the objectives of their organization, e.g., revenue generation, customer service, and leadership.”  There were 2,248 employees of U S WEST Communications in the 1994 President’s Club held in 1995.  The total cost to U S WEST Communications was $5,190,162.

Q.Was President’s Club data supplied for southern Idaho?

A.Staff did not receive a dollar amount specifically prorated to Idaho.  Because this is an expense that comes from U S WEST Communications and is prorated back to all the jurisdictions through the allocation process, the President’s Club expenses charged to Idaho would be indistinguishable in the Idaho expense accounts.  Idaho’s portion would be buried in the        U S WEST Communications amounts allocated to southern Idaho.  Therefore, I calculated the Idaho-specific allocation amount using the overall expense percentage of 2.51% multiplied by the total President’s Club cost to   U S WEST Communications of $5,190,162 for an adjustment of $130,273 before separations; at the Idaho intrastate level the adjustment is $90,409.

Q.Why has Staff proposed this adjustment?

A.This expense should be disallowed as a  Title 61 expense because the Company has not demonstrated it to be beneficial to Title 61 customers.  It does not appear to be a necessary expense for providing basic local telephone service.  Including  expenses for this type of incentive program implies that the customers are only entitled to a level of management that is merely adequate, and that the customer must pay an additional amount to motivate the utility to perform economically, efficiently, and with a high degree of quality and customer satisfaction.  In addition, Title 61 rates are set by the Commission; it is unlikely that selling more Title 61 services would generate sufficient revenue to be recognized.  Revenue generation is not a benchmark that outwardly indicates a positive benefit to the Title 61 customer.  The benefits to the customer of the effects of positive leadership are not easily quantified.

Staff has made several attempts to discern the nature of the qualifications necessary to be nominated to the President’s Club.  U S WEST asserted in response to Staff Audit Request 208 that to provide the documentation necessary to make a determination as to the appropriateness of the expenses incurred for the President’s Club “would not lead to relevant evidence in this proceeding.”

Staff has eliminated the cost of the President’s Club because no records were provided that verified the need for these expenses or their value to the Title 61 customer.  Staff was not able to view the supporting documentation and evidence associated with the 1994 President’s Club.  U S WEST has failed to show that the expenses associated with the President’s Club benefit the Title 61 customers of southern Idaho.  Therefore, Staff adjustment to expenses for the President’s Club removes a total of $90,409 at the Idaho intrastate level.

CHART OF ACCOUNTS

Q.Exhibit No. 101, pg. 11, details the direct assignment of expenses that are not Title 61 expenses under the heading “Chart of Accounts.”  Please provide a definition of, and a source for “Chart of Accounts.”

A.The Chart of Accounts is a listing of all the accounts and sub-accounts used in an accounting system.  The Chart of Accounts used is from “Part 32 - Uniform System of Accounts for Telecommunications Companies.”  This accounting system is required by the Federal Communications Commission for telecommunications companies.  An accounting system generally consists of a chart of accounts, various sub-systems, sub-accounts and subsidiary records.  An accounting system is used by a company to provide the necessary financial information to users, and to meet their legal and other responsibilities.  An account is a specific element or area of a chart of accounts used to record, classify and accumulate similar financial transactions as a result of the Company's operations.  The Uniform System of Accounts is a financial accounting system which reports the results of operational and financial events in a manner which enables both management and regulators to assess the results of operation for a specified period.  The FCC Uniform System of Accounts provides a general description of the kinds of transactions that make up each account in the Chart of Accounts.

Q.How did you arrive at the “Chart of Accounts” adjustment?

A.I arrived at this adjustment by making a detailed examination of the Chart of Accounts for        U S WEST for southern Idaho operations.  I examined all the expense account and sub-account categories.  Using the ending balance of the Idaho F.R. (Jurisdictional) books for the 6000-series and 7000-series accounts that are above the line, I created a schedule of all 6000 and 7000 accounts, with all the sub-accounts that had dollar amounts in them at the end of the year corresponding to southern Idaho intrastate operations.  I examined each sub-account title and categorized each sub-account as either a Title 61, Title 62, or a combination of Title 61 and Title 62.  I made an adjustment for each sub-account that had an account title that indicated it was not a Title 61 expense or a combination expense.  For example, I removed the balances from sub-accounts such as “Voice Messaging - other expenses”, “Cellular Expense,” “Coin Operated Expense,” “Inmate Services - Expense,” and “Access Expense - Intrastate.”

Q.Why is it appropriate to adjust for expenses that are not Title 61 or combination expenses?

A.The 1995 test-year revenues are Title 61 revenues only.  It is appropriate to match these revenues with the Title 61 expenses; removing the Title 62 expenses allows for an appropriate matching of revenues with expenses.

Q.What is the amount of the adjustment associated with your examination of the Chart of Accounts?

A.The adjustment to expenses as a result of my examination of the Chart of Accounts is $9,827,635.

DOCUMENTS OF ORIGINATING ENTRY

Q.You also make an adjustment as a result of your examination of documents of originating entry.  How is this adjustment different from the “Chart of Accounts” adjustment?

A.The “Chart of Accounts” adjustment is made by examining the title of the accounts with positive ending balances for the operating and other expense accounts.  No specific journal entries were examined.  Staff was auditing specifically for accounts and sub-accounts that have titles that are for expenses for services that are not Title 61 services.  The Uniform System of Accounts does not distinguish between Title 61 expenses and Title 62 expenses.  The split between   Title 61 and Title 62 services is unique to Idaho and is not addressed at the federal level, therefore, the USOA Chart of Accounts is not designed to distinguish between a Title 61 expense and a Title 62 expense.  The examination of the actual journal entries that make up the balances in the accounts resulted in a separate adjustment within each account examined.  The “Chart of Accounts” adjustment removed the total amount of the account balance for accounts that were not for Title 61 services.

Q.What authority does the Commission have over the Company’s accounting?

A.The Idaho Public Utilities Commission is authorized by Title 61, Section 524 to establish a system of accounts for the public utilities under its jurisdiction.  The IPUC has done so with Rule 103 (IDAPA 31.12.01.103).  Rule 103 states:  “The Commission adopts by reference the Uniform System of Accounts for Class A and B Telephone Utilities contained in the Code of Federal Regulations, Title 47, Part 32,...All Class A  and B telephone corporations subject to the regulatory authority of the Idaho Public Utilities Commission are required to maintain their regulatory books according to the system of accounts adopted by this rule.”

Q.In the Federal Communications Commission (FCC) Part 32 - Uniform System of Accounts, § 32.12(b) “Records”, it states:  “The company’s financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts.  The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this [FCC] Commission.”  Did you examine every document of originating entry for all the operating expense accounts included in the test year?

A.No.  Due to U S WEST’s insistence that to produce any source documents for any accounts at all would be voluminous and burdensome, a compromise was reached whereby I would examine documents of original entry for a one-month period for ten expense accounts.   I would not be examining all entries in the ten accounts, only the documents of original entry for a sub-account of each of the ten accounts.

Q.Which accounts were examined and for what months?

A.The ten sub-accounts that were examined are:

1.6124.19 for the month of November 1995

2.6512.199 for the month of April 1995

3.6722.9 for the month of February 1995

4.6611.9 for the month of June 1995

5.6612.9 for the month of November 1995

6.6613.9 for the month of December 1995

7.6724.9 for the month of March 1995

8.7160.2 for the month of December 1995

9.6728.99 for the month of July 1995

10.6723.9 for the month of April 1995

Q.Please describe your audit procedures.

A.Upon receiving a copy of each sub-account’s journal entries for the chosen month, I was again asked to compromise on the number of documents that I would be able to look at.  I selected journal entries from the specified month of the southern Idaho ledger, as well as the U S WEST Communications ledger for each sub-account.  I will refer to the U S WEST journal entries as “Headquarters” since that is how the accounting system at  U S WEST distinguishes their journal entries from the jurisdictional accounts, such as the southern Idaho ledger, which is referred to in the accounting system as “Idaho.”  It is appropriate to look at journal entries from Headquarters because all Headquarters' expenses are prorated out to the jurisdictions.

From the initial listing of over 14,000 journal entries selected, a sample of 206 was selected for examination.  Staff received some of the originating entry documentation for these 206 journal entries.  Of the 206, documentation for five journal entries could not be located.  An analysis of the journal entries was performed by sub-account.

Staff categorized the journal entries as either being a Title 61 expense, a Title 62 expense, a restructuring or re-engineering expense, or a combination  Title 61/Title 62 expense.  The term “re-engineering” refers to the 1993 Restructuring Plan used by U S WEST in their re-engineering efforts.  (Please refer to the testimony of Staff witness Schneider for an examination of the re-engineering efforts undertaken by U S WEST.)  The entries were separated into Idaho-specific entries and Headquarters entries.

Q.Did the documents examined contain sufficient support for the expenses?

A.No.  U S WEST did not satisfactorily respond to Staff’s audit requests.  Staff Audit Request No. 127 was the final request in a series of requests submitted in an attempt to acquire the necessary source documents.  The Staff asked for, as a minimum, for each journal entry:  the source document, the invoice, the authorization for payment, and the journal entry for the posting.  In many instances, only the journal entry was provided.  Oftentimes, the invoice and the authorization for payment was provided, but rarely the source document that initiated the transaction.  A monthly statement with “for services rendered” is not an appropriate response to Staff’s request.  However, many of the documents supporting the journal entry selected were just such a response.  If a company had been hired to do consulting work culminating in product “Z” and the monthly billing was for “contracted services”, only the monthly billing was provided.  In most cases, no documentation that would serve to verify the necessity of the expenses, or the nature of the expenses so that it could be determined if they had been properly booked, was provided in the response to Audit Request 127.  Many of the expenses had, in reality, no supporting documentation, and it would have been appropriate to make an adjustment to eliminate all of the journal entries with no supporting documentation.

Q.What was your general intent when examining the documents of original entry for the journal entries?

A.The intent of my examination of the various invoices, authorization for payment, and any other documentation was threefold.  First, I wanted to determine that the entry was properly classified and booked to the proper account using the Uniform System of Accounts.  Second, was to determine if direct assignment, as the cost allocation policy specifies to be done when it is possible to do so, was in fact being done.  Finally, I wanted to determine which category each entry fell into:  Title 61, Title 62, re-engineering, or combination Title 61/Title 62.

Q.Did you remove the Idaho-specific Title 62 entries?

A.Yes.  It is appropriate to remove those amounts that can be specifically identified as Title 62 expenses.  These items could have and should have been directly assigned to Title 62.  U S WEST has not shown Staff that they are directly assigning expenses as called for in its Cost Accounting Policy.  From the limited exposure to actual documents of originating entry, it is apparent that many expenses could have been directly charged to the jurisdictions that benefit from them.  Instead, they are put in the allocation pools and prorated back to all the jurisdictions.  For example, one journal entry (Serial Number 180) consisted of four invoices for payment for application software.  Each invoice is for a separate location.  This journal entry was paid by U S WEST Communications and prorated to all jurisdictions when it should have been directly charged to only the jurisdictions that would use the application software at each location.  Because each location has a separate bill, it is possible to directly assign the costs to the jurisdictions that use the application software at that particular location.   Another journal entry (Serial Number 202) is for labor and expenses for installation of computer support hardware, orientation and training for five separate invoices.  Each invoice corresponds to a separate work order and location.  This journal entry amount was allocated from Headquarters and should have been directly assigned to each work location and the costs directly assigned to the jurisdictions utilizing the services of the work locations.  Each location had a separate billing and invoice; direct assignment was possible.  Yet another example of a cost being put into the allocation pools when it could be directly assigned involves marketing efforts in specific jurisdictions.  Serial Numbers 84, 185, 95, 97, 87, 88, 93, and 94 pertain to expenses that have been put into the allocation pools when the invoice states at which jurisdictions the marketing efforts were targeted.  These expenses could have been directly assigned to the jurisdictions benefiting from the marketing efforts.  Instead, the expenses were charged to Headquarters and prorated out to all jurisdictions through the allocation pools.

Q.What is your adjustment as a result of your analysis of the information provided by U S WEST in their response to Staff Audit Request No. 127?

A.The resulting adjustment to southern Idaho operating expenses is $857,352 and is summarized on Exhibit No. 101, pg. 11.  While source documents for expenses that go into the allocation pools from Headquarters were examined, I made no adjustments to the Headquarters accounts.  The allowance or disallowance of the Headquarter’s entries are discussed in Staff witness Faunce’s testimony.  The purpose of my audit was to distinguish between, and directly assign, southern Idaho expenses to either Title 61 or Title 62 services.

Q.What would the adjustment have been if the approach had been to apply a percentage of Title 62 expenses based on the sample and project the percentage to each account sampled or to all expenses above the line?

A.Taking the total dollar amount that I found to be related Idaho-specific Title 62 services, and dividing the dollar amount that I found to be Idaho-specific, results in 55.5% of the total sample dollars related to Title 62 services.  If I had used for the adjustment, the total of all sampled account year-end balances on an Idaho intrastate basis of $15,376,838, then the adjustment would be $8,535,348.

ADVERTISING EXPENSES

Q.Finally, did you also make an adjustment to advertising expenses?

A.Yes.  I adjusted the advertising expenses in Accounts 6613 and 6722, as shown on Exhibit No. 101,   pg. 11.

Q.What types of advertising does U S WEST include in their Operating Expenses?

A.U S WEST includes four types of advertising:  Promotional (Product) Advertising, Informational Advertising, Image (Corporate Brand) Advertising, and Other General Advertising.

Q.Why did you make the adjustment for advertising expenses?

A.I made the adjustment because the Commission has historically disallowed advertising expenses that are promotional and corporate advertising.  These types of expenses are not appropriate for ratemaking.  In         U S WEST’s last rate case (No. U-1000-63) corporate image advertising expenses were excluded from operating expenses because the Commission found very little, if any, benefit flowing to the customers from this type of advertising.  To exclude promotional and corporate image advertising is consistent with the long-held Commission practice of not allowing promotional advertising.  Promotional advertising generally does not benefit or educate customers.  Promotional, corporate, and image advertising should be below-the-line expenses and borne by the shareholders.  This type of advertising does not provide any known or measurable benefit to Idaho Title 61 customers.  The advertising adjustment is consistent with previous Commission decisions in that the expense of image, promotional, and corporate advertising that relates primarily to shareholders should not be charged to customers.

Q.How did you arrive at the advertising adjustment amount?

A.I arrived at the amount using Company-supplied information in response to Staff Audit Requests 76, 135, 204, 206, and 207.  U S WEST identified the amounts in the four advertising categories by account number.       U S WEST supplied Staff with the amount of each type of advertising by the amount allocated from U S WEST Communications, Inc. and the amount directly charged to Idaho.

Q.Was all of the advertising in Accounts 6613 and 6722 included in Staff’s advertising adjustment?

A.No.  The amount in the Informational Advertising was not included in the adjustment.  Informational advertising is beneficial to the Title 61 customers.  The amount in the Other General Advertising was not included in the advertising adjustment.  The advertising included in this account is also beneficial to Title 61 customers.

Q.What is the total amount of the Staff advertising adjustment?

A.The total Staff advertising adjustment is $784,630 and is found on Exhibit No. 101, pg. 11.

Q.Does this conclude your direct testimony?

A.Yes.