Exhibit No. T-246 (NWH-5T)
Docket No. UT-020406

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATION OF THE PACIFIC NORTHWEST, INC.	)	
	)	**Docket No. UT-020406**
Complainant,	)	
	)	
v.	)	
	)	
VERIZON NORTHWEST INC.	)	
	)	
Respondent	)	

SURREBUTTAL TESTIMONY OF

NANCY HEURING

ON BEHALF OF

VERIZON NORTHWEST INC.

FEBRUARY 24, 2003

1 **I. INTRODUCTION**

2

3 **Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.**

4 A. My name is Nancy Heuring. I am Director – Regulatory Accounting. My business

5 address is 600 Hidden Ridge, Irving, Texas.

6

7 **Q. DID YOU FILE DIRECT TESTIMONY IN THIS CASE?**

8 A. Yes. I filed direct testimony on December 3, 2002.

9

10 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

11 A. My testimony (1) rebuts Betty A. Erdahl's intrastate earnings presentation for the

12 Washington operations of Verizon Northwest ("Verizon" or "Company"); and (2)

13 explains why AT&T's calculation of earnings adjustments is wrong. Verizon is most

14 certainly *not* overearning.

15

16 **Q. WHAT FINANCIAL EXHIBITS ARE YOU PRESENTING IN SUPPORT OF**

17 **THIS TESTIMONY?**

18 A. Exhibits NWH-6 through NWH-9 provide a summary of the financial data and

19 calculations used in my testimony, as follows:

20

21 NWH-6 Results of Operations

22 NWH-7 Results of Operations Summary

1 NWH-8 Revenue Requirement

2 NWH-9 Correct Interstate Growth Adjustment

3

4 ## II. STAFF'S EARNINGS ANALYSIS

5

6 **Q. PLEASE SUMMARIZE MS. ERDAHL'S PRESENTATION OF VERIZON'S**
7 **EARNINGS.**

8 A. Ms. Erdahl attempts to demonstrate that the intrastate return for the Washington
9 operations is in excess of the last authorized rate of return. Her earnings presentation
10 is seriously flawed.

11

12 First, she uses stale 2001 financial data versus using 2002 data that more accurately
13 reflects the *current* financial condition of the intrastate Washington operations.

14

15 Second, in using the 2001 data, Ms. Erdahl makes self-serving adjustments for only
16 certain known and measurable items occurring after the year 2001 that increase the
17 Company's rate of return but totally ignores similar known and measurable items that
18 decrease the Company's return.

19

20 Third, Ms. Erdahl presents a proforma adjustment for an increase in revenues related
21 to a rate change that may be measurable but is certainly not known. At the same time
22 Ms. Erdahl ignores known items because she believes they are not measurable. In

1 addition, she makes what she classifies as a known and measurable adjustment to
2 access revenue and expense even though she has no support for this adjustment.
3
4 Fourth, Ms. Erdahl proposes flawed ratemaking adjustments related to yellow pages[1]
5 and separations[2] but ignores supportable ratemaking issues raised by the Company.
6 Ms. Erdahl ignores a real issue related to the serious capital recovery deficiency that
7 has built up over time. Any true resolution of this issue will negatively affect future
8 earnings to pay for the commission's outdated capital recovery policies. In addition,
9 she selectively dismisses recognition of merger costs while fully realizing the
10 associated benefits.
11
12 I will address each of these deficiencies in Ms. Erdahl's earnings presentation further.
13 In addition, I will present the year-end 2002 financial results, which confirm that
14 Verizon is indeed earning well below its authorized return.
15
16 **Q. PLEASE ADDRESS THE USE OF 2001 FINANCIAL DATA.**
17 A. In my direct testimony, I presented financial data for the periods 2000, 2001 and year-
18 to-date annualized September 2002. Multiple time periods were presented to display
19 the downward pressure that access line loss and minutes of use loss has had on the
20 intrastate return. The focus of the earnings presentation was on the most current data
21 available at the time of the filing, which was through September 2002.

[1] Verizon witness Dennis Trimble addresses the Yellow Page adjustment. I address the proper accounting treatment of yellow page revenues on Verizon Northwest's books.
[2] Verizon witness Duane Simmons addresses the flaws in the separations adjustment. I address the mathematical errors in the calculation of the separations adjustment.

1 Ms. Erdahl discarded the 2002 financials entirely because they contain lower net revenues than might be expected in a "normal" test period (Erdahl, page 10). In doing so, Ms. Erdahl has ignored the plain truth that the 2002 results are known, current and represent what has unfortunately become a trend of declining intrastate net revenues. Like it or not, the 2002 results cannot simply be ignored.

Interestingly enough, Ms. Erdahl then criticizes the presentation of the 2001 financials in identifying what she deems as omissions (Erdahl, page 3) in the calculation of the 2001 "test year" return. As noted above, the 2001 results were presented only for comparison purposes, not to establish a test year return. Ms. Erdahl then proceeds to make numerous errors in her effort to use *stale* data to represent the *current* financial condition of the Company. These errors are discussed below in further detail.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS MS. ERDAHL PROPOSES TO THE COMPANY'S YEAR 2001 FINANCIALS.

A. Ms. Erdahl presents five adjustments that she categorizes as either "known and measurable" or "ratemaking" adjustments.[3] What distinction she is making between these two categories is not clear.

[3] The two adjustments categorized as "known and measurable" are labeled Rate Increase Directory Assistance and Adjust Oct. Nov. Rev and Exp to Normalize. The three adjustments categorized as "ratemaking" are labeled as Line Sharing, Correct Interstate Growth Mismatch and Directory Publishing Imputation.

1 WAC 480-09-330 identified two types of adjustments to booked operating results:

2

3 1) Restating actual adjustments which adjust for items in the booked results
4 which can distort test period earnings or which adjust financials from an
5 as-recorded basis to a basis acceptable for rate making; and

6

7 2) Proforma adjustments which give effect for the test period to *all* known
8 and measurable changes which are not offset by other factors.

9

10 Regardless of the label placed on the five adjustments Ms. Erdahl proposes,
11 adjustments to the booked results must be known with some certainty and must be
12 quantifiable. In addition, a consistent approach must be applied in adjusting the base
13 financials to ensure that offsetting issues are properly considered. Ms. Erdahl
14 selectively applies the known and measurable criteria to improperly inflate the
15 intrastate rate of return.

16

17 **Q. PLEASE ADDRESS MS. ERDAHL' SELECTIVE USE OF PROFORMA**
18 **ADJUSTMENTS.**

19 A. In adjusting the 2001 financials to create a test year, Ms. Erdahl includes an
20 adjustment to increase revenues for line sharing. This new revenue stream became
21 effective in 2002.

22

1 While Verizon does not disagree that a proforma for this known and measurable item
2 would be appropriate if using a 2001 test year, Ms. Erdahl fails to include proforma
3 adjustments for all of the other known and measurable changes in revenues which
4 occurred after 2001. For example, Exhibit NWH-4 clearly shows that local network
5 service revenue declined from $268M in 2001 to $259M in 2002. In addition, the
6 response to data request number 56 clearly shows that access lines, which are the
7 source of local network service revenues, declined from 914,889 to 901,409 between
8 2001 and 2002. Yet, Ms. Erdahl makes no proforma adjustment for this $10M
9 decline in revenue but selectively chooses to include a proforma for a $3.4M increase
10 in line sharing revenue.
11
12 This is just one of many examples of the biased view presented by Ms. Erdahl and
13 further demonstrates the inappropriateness of using 2001 financial data when more
14 recent data is available.
15
16 Further, instead of using the actual revenue data provided in response to WUTC Staff
17 Data Request No.65, Ms. Erdahl performs her own calculation. Actual year 2002
18 intrastate line sharing revenue equals $2.7M. Ms. Erdahl's proforma is overstated.
19
20 **Q. PLEASE HIGHLIGHT THE FLAWED BASIS FOR THE TWO**
21 **ADJUSTMENTS MS. ERDAHL CATEGORIZES AS "KNOWN AND**
22 **MEASURABLE" – DIRECTORY ASSISTANCE AND REVENUE AND**
23 **EXPENSE NORMALIZATION.**

1 A. Ms. Erdahl includes a proforma revenue adjustment for an increase in directory
2 assistance rates even though the Company has not initiated the steps required to raise
3 the applicable rates. While a rate change may meet the definition of measurable
4 through application of an incremental price to restated volumes, this adjustment
5 surely does not meet the definition of known.[4]
6
7 The basis for the revenue and expense normalization Ms. Erdahl proposes is similarly
8 flawed. Ms. Erdahl justifies her adjustment simply on the basis of making October
9 and November 2001 revenues and expenses "more representative of the other months
10 during the year". Her calculation to increase revenue arbitrarily brings November
11 revenues to an amount equivalent to what she estimates for December revenues. At
12 the same time, she provides no support whatsoever to her adjustment to decrease
13 expenses. As the Company has explained to Ms. Erdahl verbally and in response to
14 data request number 52, the revenues and expenses for the annual 2001 period are
15 properly stated. The fluctuation in the booked monthly financial results is not
16 indicative of an issue requiring adjustment but merely reflects the normal variation in
17 monthly results. In addition, Ms. Erdahl's speculation related to the reintegration of
18 VADI is simply not correct and is unsupported by any evidence whatsoever.
19
20 **Q. PLEASE CONTRAST THESE TWO ADJUSTMENTS WITH MS. ERDAHL'S**
21 **DISMISSAL OF ACTUAL 2002 UNCOLLECTIBLE REVENUES.**

[4] Further, Mr. Fulp addresses the flaws in the actual calculation of the proforma directory assistance adjustment proposed by Ms. Erdahl.

1 A. In the case of the directory assistance adjustment, Ms. Erdahl increases 2001 booked
2 revenue for a non-existent rate increase. Likewise, Ms. Erdahl increases 2001 booked
3 revenue and decreases 2001 booked expense with absolutely no support even though
4 she characterizes all of these adjustments as known and measurable.
5
6 Conversely, Ms. Erdahl characterizes the higher level of booked uncollectible
7 revenues in 2002 as known but not measurable and, as such, makes no proforma
8 decrease to 2001 revenues.
9
10 Clearly, the 2002 booked amounts are measurable. Verizon records uncollectible
11 revenues in accordance with Financial Accounting Standard No. 5, Accounting For
12 Contingencies,[5] which states that a contingency exists if at the date of its financial
13 statements an enterprise does not expect to collect the full amount of its account
14 receivable. Under this circumstance, an accrual for a loss contingency must be
15 charged to income if both of the following conditions are met: 1) it is probable that as
16 of the date of the financial statements, an asset has been impaired or a liability
17 incurred based on subsequent available information prior to the issuance of the
18 financial statements; 2) the amount of the loss can be reasonably estimated.
19
20 The booked uncollectible amounts are measurable under generally accepted
21 accounting principles and should not be ignored in the staff's financial presentation.
22

[5] FASB Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies", Para. 8.

1 **Q. PLEASE SUMMARIZE MS. ERDAHL'S SELECTIVE PRESENTATION OF**
2 **RATEMAKING ADJUSTMENTS.**
3 A. Ms. Erdahl proposes ratemaking adjustments related to yellow page revenues and
4 separations but ignores ratemaking adjustments related to capital recovery and merger
5 costs. Mr. Trimble and Mr. Simmons address the two ratemaking adjustments
6 proposed by Ms. Erdahl. I address capital recovery and merger cost followed by a
7 discussion of the mathematical errors in the separations calculation.
8
9 **Q. MS. ERDAHL CRITICIZES THE PRESENTATION OF THE IMPACT ON**
10 **VERIZON'S EARNINGS OF THE RECOMMENDED CORRECTION OF**
11 **THE CURRENT RESERVE DEFICIENCY. IS HER DISMISSAL OF THIS**
12 **ADJUSTMENT APPROPRIATE?**
13 A. No. The last depreciation study filed by Verizon was in 1999, not in 1996 as Ms.
14 Erdahl states (Erdahl, page 11). The outcome of that study was to substantially
15 increase depreciation expense in recognition of woefully low intrastate depreciation
16 reserve. The intrastate accumulated depreciation reserve levels in Washington are the
17 lowest for any Verizon territory.
18
19 **Q. MS ERDAHL ASSERTS THAT IF VERIZON WOULD LIKE TO FILE A**
20 **DEPRECIATION CASE IT SHOULD DO SO. HAS VERIZON BEEN**
21 **TAKING ACTIONS LEADING TO A DEPRECIATION FILING?**
22 A. Yes. Discussions have been held with members of Verizon and the Commission staff
23 to discuss depreciation study parameters and information required by the commission

1 to consider depreciation changes. In the last study, Verizon requested significantly
2 more depreciation expense than was awarded by the Commission. Indications at that
3 time were that evidence was required of capital expenditures for the less financially
4 attractive areas in Verizon's service territories. Verizon complied with that request.
5 We complied in the spirit of cooperation with the Staff's requests, even though the
6 preponderance of competition for Verizon in the state of Washington is sufficient to
7 justify the depreciation expense increases requested in 1999.
8
9 **Q. WHY HASN'T A STUDY BEEN SUBMITTED TO THE COMMISSION**
10 **STAFF FOR REVIEW?**
11 A. In meetings held with the commission staff in September 2002, the staff stated that
12 they would not be able to devote time to a depreciation filing until late spring of
13 2003. As such, the Company has been working toward a filing in that time frame to
14 accommodate the staff's schedule.
15
16 A study is now planned for the first quarter of 2003 using the most current accounting
17 data. A depreciation study using the impact of competition on Verizon will yield a
18 depreciation expense increase of nearly $70 million annually. It is unfortunate that
19 Ms Erdahl is hiding behind the timing of this study while refusing to recognize the
20 impact on future earnings of an alarming capital recovery deficiency.
21
22 Ms. Erdahl's dismissal of the capital recovery deficiency is inappropriate and
23 artificially increases Veizon's going level return.

1 **Q. PLEASE SUMMARIZE MS. ERDAHL'S REJECTION OF MERGER COSTS.**

2 A. Ms. Erdahl states that merger costs should not be included in expenses for rate setting
3 but then states that these costs were considered when establishing rates at the time of
4 the merger. Her position is not clear.

5

6 **Q. PLEASE EXPLAIN WHAT MERGER COSTS ARE AND HOW THEY**
7 **RELATE TO MERGER SAVINGS.**

8 A. Merger costs represent expenditures required to integrate the companies' operations
9 in order to achieve a subsequent savings stream. Some examples of these costs
10 include branding, real estate consolidations, departmental integration initiatives,
11 relocation, systems, training staff, and other related costs. The timing of these costs
12 depends on the type of costs that are involved. For example, while branding and
13 departmental integration costs were generally incurred at the merger's close, a longer
14 time frame is required to complete system conversion and integration efforts.

15

16 Merger savings are the reduction in overall expenses incurred by the merged
17 company compared to the expenses that would have been incurred by the respective
18 merger partners absent the merger. Examples of expense savings opportunities
19 include eliminating redundant functions, increasing economies of scale, and adopting
20 the most efficient business methods, or "best practices."

21

1 **Q. PLEASE EXPLAIN HOW MERGER COSTS AND SAVINGS ARE**
2 **REFLECTED IN THE COMPANY'S PRESENTATION OF EARNINGS.**
3 A. Savings and costs are reported appropriately in the years in which they occur. For the
4 purposes of the financial presentation in this case, merger costs were removed from
5 each year's cost of service as a nonrecurring item. The corresponding savings
6 remained in each respective year. The total merger costs incurred were then
7 amortized over a reasonable period in the going forward cost of service.
8
9 **Q. WHAT IS THE APPROPRIATE TREATMENT OF MERGER COSTS AND**
10 **SAVINGS?**
11 A. Under cost of service regulation, it is appropriate to include the costs incurred to
12 generate an expense savings as an offset to the going level of reduced expense. As
13 such, the amortization of any significant one-time expenses is appropriate over the
14 expected duration of the new rates to ensure that rates are set reflecting a realistic
15 ongoing level of expenses.
16
17 Ms. Erdahls inappropriately ignores merger costs incurred to achieve the merger
18 savings and artificially increases Veizon's going level return.
19
20 **Q. PLEASE EXPLAIN THE ERRORS IN MS. ERDAHL'S CALCULATION OF**
21 **THE INTERSTATE GROWTH MISMATCH ADJUSTMENT.**
22 A. Mr. Simmons explains in his testimony why Ms. Erdahl's separations adjustment is
23 not appropriate. In addition, her adjustment is mathematically flawed. Ms. Erdahl

1 calculates an artificial increase in interstate expense and investment as if the growth
2 in these components had remained constant with the growth in interstate revenues. In
3 doing so, Ms. Erdahl fails to take into account the growth that actually did occur in
4 the interstate expense and investment components.
5
6 For example, Ms. Erdahl calculates that interstate investment grew 16% and that
7 interstate revenue for the same period grew 33%. She then calculates the dollar
8 amount of growth that would have occurred at a 33% growth rate. This resulting
9 growth amount is used as an adjustment to decrease interstate investment.
10
11 This adjustment is overstated and ignores the fact that the interstate investment had
12 already grown by 16%. To reflect an interstate investment growth at 33% would
13 require an adjustment of the incremental difference between the actual interstate
14 investment (which grew at 16%) and the hypothetical interstate investment (grown at
15 33%). The resulting incremental difference in the investment balances would
16 represent the shift required to meet the adjustment described by Ms. Erdahl. Exhibit
17 NWH-9 corrects the mathematical errors in Ms. Erdahl's presentation.
18
19 **Q. PLEASE SUMMARIZE THE FLAWS IN MS. ERDAHL'S PRESENTATION**
20 **OF THE COMPANY'S EARNINGS.**
21 A. Ms. Erdahl grossly overstates the intrastate rate of return by 1) using 2001 financial
22 results, 2) making adjustments for directory assistance and revenue and expense
23 normalizations which have no support, 3) increasing revenue for line sharing which

1 originated after her test period without making corresponding adjustments for similar
2 known and measurable changes which decrease the return, 4) improperly reflecting an
3 unsupported yellow page imputation and separations shift and 5) ignoring the dire
4 capital recovery situation and merger costs.
5
6 **Q. IS THE COMPANY EARNING IN EXCESS OF THE AUTHORIZED LEVEL?**
7 A. Absolutely not. The rate of return for intrastate operations of Washington was 1.92%
8 for the twelve-month period ended December 2002. Exhibit NWH-6 provides the
9 results of operations supporting this return. In addition, Exhibit NWH-7 compares
10 the results of operations for the years 2000, 2001 and 2002. This comparison
11 highlights the decline in net revenues during a period of continued investment.
12
13 As shown on Exhibit NWH-8, the results produce a revenue deficiency of $120.3M
14 compared to the authorized return of 9.76%. Every $15.4 million reduction in
15 intrastate access revenues would cause the rate of return to drop by approximately
16 100 basis points.
17
18 Ms. Erdahl proposed adjustments equating to 612 basis points. Ignoring the
19 numerous problems with her adjustments and the fact that certain adjustments are
20 accounted for in the actual 2002 results, adding 612 basis points of hypothetical
21 adjustments to the base 2002 earnings of 1.92% still produces a return below 9.76%.
22 Even using Ms. Erdahl's unsupported adjustments, Verizon is not overearning and
23 cannot absorb a rate decrease as Ms. Erdahl suggests.

III. AT&T'S EARNINGS ADJUSTMENTS

Q. PLEASE SUMMARIZE THE EARNINGS ISSUES PRESENTED BY AT&T'S TESTIMONY AND VERIZON'S POSITION ON EACH ISSUE.

A. AT&T witness Lee Selwyn claims that Verizon improperly states its intrastate rate of return due to 1) the understatement of certain revenue categories and 2) the use of an inflated rate base (Selwyn Rebuttal, page 4, line7-8). The two revenue categories that Dr. Selwyn claims are understated in the presentation of Verizon's intrastate return for the state of Washington are 1) revenues earned and recognized by the affiliate Verizon Information Services and 2) an artificial revenue related to Verizon Long Distance.

Dr. Selwyn is simply wrong on these issues. As I explain below, the books and records of Verizon reflect the proper level of revenues and rate base. No adjustment is required for these items.

Q. WHAT REVENUES ARE REFLECTED ON THE BOOKS OF THE WASHINGTON OPERATIONS OF VERIZON NORTHWEST?

A. The books and records are maintained in accordance with WAC 480-120-031 which adopted the Uniform System of Accounts Part 32 as prescribed by the Federal Communications Commission ("FCC"). Section 32.4999 (a) explains the purpose of the revenue accounts:

1 > The revenue accounts are intended to include the actual cash inflows
2 > (or equivalents) that have or will occur as a result of the company's
3 > ongoing major or central operations during the period.

4

5 Sections 32.4999 (d) further clarifies revenue recognition:

6

7 > Credits shall be made to the appropriate revenue accounts when such
8 > revenue is actually earned.

9

10 **Q. DO THE REVENUES THAT DR. SELWYN CLAIMS SHOULD BE**
11 **CONSIDERED MEET THE CRITERIA FOR RECORDING IN THE BOOKS**
12 **AND RECORDS OF THE WASHINGTON OPERATIONS?**

13 A. No. As Mr. Dennis Trimble explains further, the revenues associated with yellow
14 page advertising are earned by Verizon Information Services and are appropriately
15 reflected in *their* books and records. In addition, as Mr. Fulp explains, there is no
16 actual cash inflow or earned revenue associated with the adjustment Dr. Selwyn
17 proposes related to Verizon Long Distance.

18

19 **Q. WHAT REVENUES ARE REFLECTED IN THE SEPARATED RESULTS**
20 **SUMMARY QUARTERLY COMPLIANCE REPORT THAT SERVED AS**
21 **THE BASIS FOR THE INTRASTATE EARNINGS PRESENTATION IN**
22 **NWH-2?**

1 A. The compliance report is prepared in accordance with WAC 480-120-031(9).

2

3 The periodic results of operations statements shall be on a
4 "commission basis" and restated for out-of-period items, nonoperating,
5 nonrecurring, extraordinary items, or any other item that materially
6 distorts test period earnings or expenses. By use of notes, an
7 explanation of the restating adjustments shall accompany the results of
8 operations statement.
9
10 "Commission basis" means that the rate base includes those standard
11 rate base components that have been historically accepted by the
12 commission for ratemaking. "Commission basis" does not include
13 new theories or approaches which have not been previously addressed
14 and resolved by the commission.
15

16 **Q. DO THE REVENUES THAT DR. SELWYN CLAIMS SHOULD BE**
17 **CONSIDERED MEET THE CRITERIA FOR INCLUSION IN THE**
18 **COMPLIANCE REPORT THAT PRESENTS THE INTRASTATE**
19 **EARNINGS FOR THE WASHINGTON OPERATIONS?**

20 A. No. Clearly, no adjustment is required for the proposed revenue adjustment related to
21 Verizon Long Distance. Likewise, as Mr. Trimble explains, the current contractual
22 relationship between Verizon Northwest and Verizon Information Services has not
23 been the subject of ratemaking before this commission.

24

25 **Q. DO YOU HAVE OTHER CONCERNS WITH THE PROPOSED REVENUE**
26 **ADJUSTMENTS?**

27 A. Yes. As noted above, the Washington Utilities and Transportation Commission
28 ("WUTC") requires the use of Part 32 for maintaining the books and records. FCC
29 Part 32 is based on and consistent with generally accepted accounting principles:

> "[t]he [Uniform System of Accounts] has been designed to reflect stable, recurring financial data based to the extent regulatory considerations permit upon the consistency of the well established body of accounting theories and principles commonly referred to as generally accepted accounting principles."[6]

In addition, fundamental principles enunciated by the Financial Accounting Standards Board (FASB) state that the "role of financial reporting requires it to provide evenhanded, neutral or unbiased information."[7] To be "neutral", the FASB principles require that "accounting information must report economic activity as faithfully as possible, without coloring the image it communicates for the purpose of influencing behavior in some particular direction.[8]

Reflecting revenues earned and recognized by an affiliate company and reflecting revenues where no cash flow exists not only violates specific accounting rules but also runs counter to the basic principles of presenting fairly stated financials.

Q. PLEASE ADDRESS DR. SELWYN'S CLAIM THAT THE RATE BASE USED IN THE EARNINGS CALCULATION IS OVERSTATED.

A. Dr. Selwyn references a draft audit report related to a physical inventory verification of other states to extrapolate an impact of supposedly missing items onto the Washington operations. Mr. Fulp addresses the flaws in Dr. Selwyn's reliance on this report. As I explain below, the rate base for the Verizon Northwest Washington operations is properly stated and no adjustment is required.

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[6] 47 U.S.C. 154(i), 51 FR 43499, Dec 2, 1986.
[7] FASB Statement of Financial Accounting Standards No. 1, "Objectives of Financial Reporting by Business Enterprises," Para. 33.
[8] FASB Statement of Financial Accounting Standards No. 2, "Qualitative Characteristics of Accounting Information," Para. 101 (emphasis in original).

1 **Q. PLEASE EXPLAIN THE PROPER PART 32 ACCOUNTING TREATMENT**
2 **RELATED TO UNVERIFIED OR MISSING PLANT AS A RESULT OF A**
3 **PHYSICAL VERIFICATION.**

4 A. The correct accounting treatment for unverified items would be to retire the assets
5 from the plant accounts. The FCC's Part 32 accounting rules require that:
6

7 [w]hen any item of property subject to plant retirement accounting is
8 worn out, lost, sold, destroyed…is withdrawn or for any other reason
9 is retired from service, the plant accounts applicable to that item shall
10 be credited with the original cost of the plant retired whether replaced
11 or not…[Part 32.2000(d)]

12 and

13 For items included on the retirement units list, the original cost of any such
14 items retired shall be credited to the plant account and charged to Account
15 3100, Accumulated Depreciation, whether or not replaces [Part 32.2000(d)(i)].
16

17 Under Part 32 accounting, if plant were determined to be missing, the correct
18 accounting procedure would be to retire the plant in the continuing property record
19 and reflect the retirement in the books by crediting the appropriate Part 32 plant
20 accounts and debiting the accumulated depreciation account. The reduction in
21 telephone plant in service from a retirement is just offset by an equal decrease in
22 accumulated depreciations, so that the rate base remains unchanged.
23

24 **Q. DR. SELWYN'S ADJUSTMENT ACTUALLY RESULTS IN A REDUCTION**
25 **TO RATE BASE. PLEASE EXPLAIN THE ERRORS IN HIS**
26 **CALCULATION.**

1 A. First, even if an adjustment were required, it would result in an equal decrease to the
2 plant investment and the associated reserve as discussed above. Instead of preparing
3 the adjustment consistent with Part 32 rules, Dr. Selwyn develops an adjustment
4 which maintains the same relationship of accumulated reserve to total plant on a
5 before and after adjusted basis. There is no basis under Part 32 accounting rules for
6 computing the adjustment in this manner except to improperly reduce the Company's
7 rate base.
8
9 Second, as Mr. Fulp explains, the results of physical verifications specific to the
10 Washington plant in service have already been properly recorded in the Washington
11 books and records. An extrapolation of an improperly calculated adjustment for
12 questionable results of a physical verification conducted on states other than
13 Washington is totally unnecessary.
14
15 **Q. PLEASE SUMMARIZE THE TRUE IMPACT OF DR. SELWYN'S**
16 **PROPOSED ADJUSTMENTS.**
17 A. As discussed in the testimony, none of Dr. Selwyn's adjustments have any merit and,
18 as such, they have no impact on the actual intrastate rate of return for the Washington
19 operations.
20
21 **Q. DR. SELWYN CONCLUDES THAT THE WUTC SHOULD CONSIDER THE**
22 **EARNINGS OF THE COMBINED REGULATED**
23 **INTRASTATE/INTERSTATE OPERATIONS (PAGE 43) AS WELL AS**

1 **EARNINGS OVER SEVERAL ACCOUNTING PERIODS (PAGE 42). PLEASE COMMENT.**

3 A. The merits of Dr. Selwyn's position are discussed in the surrebuttal testimony of Dr. Danner and Mr. Fulp. However, as demonstrated in the financials presented in NWH-6 and NWH-7, the return has declined in each period since the year 2000 for intrastate operations and total regulated operations. Verizon's intrastate return utilizing the twelve month-to-date period ended December 2002 is 1.92% and the total regulated return is 8.14%. Additionally, it should be noted that this return does not take into consideration the continued decline in access lines due to competition or the increase in pension cost.[9] Simply stated, the Company does not have excess earnings.

12

13 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

14 A. Yes.

[9] In Form 8-K filed with the Securities and Exchange Commission on December 5, 2002, Verizon Communications Inc. announced that non-cash pension income would decline between 27 and 33 cents per share. Current conditions in the securities markets caused the company to lower its expected return on plan assets and discount rate assumption for 2003. This, coupled with rising medical and prescription drug costs that increased the medical cost trend rate assumption, result in the decrease in pension income in 2003.