**FLORIDA PUBLIC SERVICE COMMISSION**

 **Fletcher Building**

 **101 East Gaines Street**

 **Tallahassee, Florida 32399-0850**

 **M E M O R A N D U M**

 **September 30, 1993**

**TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING**

**FROM : DIVISION OF AUDITING AND FINANCIAL ANALYSIS (LEE, JOHE)**

 **DIVISION OF COMMUNICATIONS (WIDELL)**

 **DIVISION OF LEGAL SERVICES (MURPHY)**

**RE : DOCKET NO. 921278-TL - INDIANTOWN TELEPHONE SYSTEM, INC. - REVIEW OF CAPITAL RECOVERY REQUIREMENTS OF INDIANTOWN TELEPHONE SYSTEM, INC.**

**AGENDA : 10/12/93 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\921278.RCM**

 **R:INDIANTO.WK3**

 **DISCUSSION OF ISSUES**

**ISSUE :** Should the current depreciation rates and capital recovery schedules for Indiantown Telephone System, Inc. (Indiantown or Company) be changed?

**RECOMMENDATION:** Yes. A review of the Company's plans and activity indicates the need for revising depreciation rates and recovery schedules. (LEE)

**STAFF ANALYSIS:** Under Rule 25-4.0175, Florida Administrative Code, telephone companies are to file a comprehensive depreciation study at least once every three years from the submission date of the previously filed study. Indiantown has filed this current study in keeping with this rule as its last study was submitted in December, 1989 with depreciation rates effective January 1, 1990.

 Since the time of the last represcription, net plant balances have changed and technological impacts on life and salvage have changed indicating a need for a review and revised rates where appropriate. In addition, current Company plans are to replace remaining aerial and air core buried metallic cables with filled buried metallic cable by year-end 1994.

**ISSUE 2:** What should be the implementation date for the new rates and capital recovery schedules?

**RECOMMENDATION:** January 1, 1993. (LEE)

**STAFF ANALYSIS:** All supportive data and calculations have been made abutting the Company's requested implementation date of January 1, 1993. Staff, therefore, recommends approval of this date.

**ISSUE 3:** Should any corrective reserve measures be made?

**RECOMMENDATION:** Yes. Staff recommends that the corrective reserve measures as shown on Attachment A, page 13, be made. In addition, the Company should record $247,758, total company, of depreciation expense to correct the remaining net reserve deficiencies identified on Attachment A. This action will bring each affected account's reserve more in line with its calculated theoretical level. (LEE, JOHE)

**STAFF ANALYSIS:** The recommended reserve allocations are basically moving dollars from subaccounts which have been over-accrued in the past to those which are now seen as being in need of additional reserve. As of 1/1/93, the Aerial Metallic Cable account, Account 2421, shows a negative reserve balance of $29,536. The cause for this deficiency was a large retirement (about 87% of the account investment) occurring in 1991. This unusual activity was unforeseen at the time of the last study and therefore was not considered in the design of the currently prescribed depreciation rate. Staff recommends that the apparent reserve surplus that exists in Construction Equipment, Account 2116.1, be transferred to help alleviate the aerial cable deficiency. This will leave a residual deficiency of $34,303 in the Aerial Cable account. In addition, there is a perceived deficiency of $213,455 in the Buried Cable-Filled account.

 The Company's Earnings Surveillance Report for 12 month ended June 30, 1993 indicates an achieved return on equity (ROE) of 20.33%, 6.63% above the maximum authorized ROE. This equates to approximately $200,000 in excess revenues. Based on seven months of actual financial data, Staff has forecasted the Company's earnings for 1993. Included in Staff's forecast of Indiantown's earnings is the recently approved intraLATA toll rate reduction. The Commission approved Indiantown's proposed MTS rate reduction of approximately $208,000 annually, at the September 28th Agenda Conference. If no protest is filed on timely manner, the rate reduction will be effective on October 2. Staff believes that the Company's earnings will improve even more by the end of the year. The Company submitted a letter of agreement, dated February 3, 1993, to cap its 1993 earnings at its maximum authorized ROE. Staff believes that there will be sufficient earnings in 1993 to write off the remaining $247,758 in depreciation reserve deficiencies as identified on Attachment A.

 On Attachment A, Staff has identified various asset accounts with depreciation reserve imbalances which aggregate to a net deficiency. Reserve deficiencies are primarily a matter of differences in current and past projections, or past projections not matching actual activity. Staff believes that such deficiencies should be recovered as early as possible, unless such recovery prevents the Company from earning a fair and reasonable return on its investments. Staff's forecast of the Company's 1993 earnings indicates that there are sufficient earnings to absorb the identified deficiencies. Therefore, Staff recommends that the Company record $247,758, total company, of depreciation expense to correct the remaining reserve deficiencies identified on Attachment A.

 The recommended reserve transfers impact no accounts which involve arrangements with other affiliated or non affiliated companies. However, in light of the possible impact on cost allocations and jurisdictional separations, the Company should make corresponding entries to the related depreciation expense accounts.

**ISSUE 4:** Should any capital recovery schedules be prescribed?

**RECOMMENDATION:** Yes. Staff recommends that the recovery schedules shown on Attachment C, page 16, be approved. (LEE)

**STAFF ANALYSIS:** While current Company plans do not call for any near-term retirement of central office equipment, there are plans to replace the remaining aerial and air core buried cables with filled metallic buried cable by year-end 1994. Maintenance has been the major contributing factor towards this replacement program. In accord with its planning, the Company has proposed recovery schedules addressing the associated unrecovered costs of this retiring equipment over the 1993 and 1994 time period. This action is reasonable and acceptable.

 During the course of this study review, the Company found that the reported investment of $1,265 associated with telephone devices for the deaf, Account 2362.1, represented plant no longer in service that should have been previously retired. This retirement results in a slight negative reserve that Staff recommends be recovered during 1993.

**ISSUE 5:** What are the appropriate depreciation rates and recovery/amortization schedules?

**RECOMMENDATION:** Attachment B, page 14, shows the Staff-recommended depreciation rates and recovery/amortization schedules. As shown on Attachment C, pages 15-16, the recommended resultant annual increase in depreciation expense from Staff-recommended rates is approximately $257,000 based on January 1, 1993 investments. This increase includes $247,758 in additional depreciation expense to be recorded in 1993 to correct perceived reserve deficiencies. (LEE)

**STAFF ANALYSIS:** Staff recommendations are the result of a comprehensive review of the Company's depreciation study. Attachment B presents a comparison of the Company proposal and Staff-recommended rate parameters (life, salvage, and reserve). Company and Staff are in basic agreement on life and salvage for a majority of accounts. A consistent difference, however, between the positions of the Company and Staff is in the reserve position. The Company proposal is based on an estimated reserve position whereas Staff has used the actual January 1, 1993 reserve balance. A brief discussion of salient matters is set forth below.

General Support Assets

 The recommended lives for these accounts simply reflect an update of activity since the last study. Net salvages for the buildings accounts and construction equipment represent no change from that currently prescribed. There is a minor difference, however, in the net salvage proposed by the Company and that recommended by Staff for passenger cars. Typically, for these vehicles, net salvage across the State ranges from 10% to 20%. We can find no reason why similar activity should not be expected to be incurred from any passenger cars purchased by Indiantown. Our recommendation is to retain the currently prescribed net salvage factor of 10%. The net salvage factor proposed for Light Trucks is in line with the activity of the account and is acceptable to Staff.

Central Office Assets

 There is no disagreement between the positions of the Company and the Staff for any of these accounts regarding appropriate life and salvage factors. The life factors reflect the prospective impacts of network upgrading throughout the State. The expected life of upgradeable digital switchers remains problematic. A blending of projections of upgrade retirements as projected by various sources comports with the Company's proposed remaining life indicating that about 30% of the current embedded investments will have been retired by about 2004.

 The analog carrier account investment represents primarily analog subscriber carrier with just over 10% being private line special circuit equipment. According to the Company, much of this equipment serves only for emergency or short-term use. As digital loop carrier or concentrators are placed, analog loop treatment will not be required. The Company proposal reflects an update of activity since the last study and is acceptable to Staff. However, this account should be monitored for any significant developments affecting its life expectancy.

 The make-up of the digital carrier account has changed since the last depreciation review following the retirement of analog trunk carrier equipment. About 75% of this account is now comprised of line concentrator equipment which is not expected to be impacted by the move to the synchronous optic network. For this reason, the Company's proposed remaining life is acceptable to Staff.

 While the Company and Staff agree with service life and net salvage factors for the fiber optic carrier account, Staff's position is to retain a whole life rate at this time rather than moving to a remaining life rate as proposed by the Company. Considering the anticipated growth in investment, the age of the account will remain very young resulting in essentially no difference between the service life and remaining life. Considering that this equipment is not SONET compatible, the Company should monitor the status of this account for possible impacts from the deployment of SONET equipment.

 At the time of the last study, even though the Stuart West remote terminal was expected to be replaced with a stand alone switch due to increased growth demands, no building in the area had yet begun. Given the present economy, the fact that growth has stalled, and currently there are no specific plans regarding replacement, continuation of the currently prescribed factors is acceptable to Staff.

Information Origination/Termination Assets

 The Company's proposed remaining lives simply reflect an update of age since the last study review. These are reasonable and acceptable to Staff.

Cable and Wire Facilities

 According to the Company, of the $26,922 remaining in the Poles account, $8,450 represents stub poles used as pedestal supports, which should be reclassified to the Buried Cable Account. Staff has calculated the associated reserve amount to be $6,020. The investment and reserve shown on Attachment C for this account are reflective of this reclassification.

 The difference in the positions between the Company and the Staff regarding the Poles account lie in the net salvage projections. Where the Company has proposed a negative 50% net salvage, Staff is recommending a negative 30% net salvage based on a review of historical salvage experience and taking into consideration the labor intensiveness of the account.

 Current industry projections for metallic cables reflect the scenario of a general phase-out of interoffice facilities by about 2000; feeder cable between 2005-2012; distribution facilities a few years later. Staff recommendations recognize these projections taken with the premise that the impact on the smaller companies will generally lag that experienced by the larger companies which serve the more metropolitan high-tech areas.

 Whole life rates are recommended to be continued for the fiber cable accounts. The buried account is currently the only fiber account with investment. The Company has proposed to move to a remaining life rate at this time. However, considering the expected near-term growth in investment, the age will remain relatively young resulting in essentially no difference between service life and remaining life. Staff therefore recommends continuation of a whole life rate.

 The remaining life for conduit is simply reflective of the activity during the past three years since the last study review.

**ISSUE 6:** Should the current amortization of investment tax credits (ITCs) and the flowback of excess deferred income taxes be revised to reflect the approved depreciation rates and recovery schedules?

**RECOMMENDATION:** Yes. The current amortization of ITCs and the flowback of excess deferred income taxes should be revised to reflect the approved depreciation rates and recovery schedules. Also, the utility should be required to file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes at the same time it files its surveillance report. (HICKS)

**STAFF ANALYSIS:** In issues previously addressed, Staff recommends revisions to Indiantown's depreciation rates and capital recovery schedules, to be effective January 1, 1993. Revising a utility's depreciation rates usually results in a change in its rate of ITC amortization and flowback of excess deferred income taxes.

 Section 46(f)(6) of the Internal Revenue Code (IRC) states that the amortization of ITCs should be determined by the period of time used in computing depreciation expense for purposes of reflecting regulated operating results of the utility. Since Staff is recommending a change in depreciation rates, it is also appropriate to change the amortization of ITCs.

 Section 203(e) of the Tax Reform Act of 1986 (TRA) prohibits rapid write-back of protected (depreciation related) deferred taxes. In addition, Rule 25-14.013, Accounting for Deferred Income Taxes under SFAS 109, Florida Administrative Code (F.A.C), prohibits, without good cause shown, excess deferred income taxes associated with temporary differences from being reversed any faster than allowed under Section 203(e). Therefore, both the TRA and Rule 25-14.013, F.A.C., prohibit faster write-off of protected excess deferred taxes. Consequently, Staff believes that the flowback of excess deferred taxes should be altered to comply with the TRA and Rule 25-14.013, F.A.C.

 The Company has submitted detailed workpapers quantifying the impact of the proposed depreciation rates on the amortization of ITCs and the flowback of excess deferred income taxes. Staff has reviewed the calculations and believe they are accurate. However, the amounts reflected on the workpapers will change based on staff's recommended depreciation rates.

 Staff recommends that the current amortization of ITCs and the flowback of excess deferred income taxes be revised to reflect the approved depreciation rates and recovery schedules. Also, the utility should be required to file detailed calculations of the revised ITC amortization and flowback of excess deferred taxes at the time it files its surveillance report.

**ISSUE 7:** Should this docket be closed?

**RECOMMENDATION:** Yes, assuming no protests to the Proposed Agency Action Order are filed. (LEE)

**STAFF ANALYSIS:** In Staff's opinion, no further action is necessary if no protests to the PAA Order are filed.

 Attachment A

 Page 1 of 1

 **INDIANTOWN TELEPHONE SYSTEM, INC.**

 **1992 STUDY**

 **CORRECTIVE RESERVE TRANSFERS**

 Calculated

 1/1/93 Theoretical Reserve Restated

 Book Reserve Reserve Imbalance Reserve

Construction Equip. $ 11,405 $ 8,668 $ 2,737 $ 8,668

Aerial Met. Cable (29,536) 7,504 (37,040) 7,504

Buried Met. Cable - Filled 1,151,056 1,364,511 (213,455) 1,364,511

 Net (247,758)\*\*

\*\* The net deficiency should be written off during 1993

 INDIANTOWN TELEPHONE SYSTEM, INC.

 1992 STUDY

 COMPARISON OF RATES AND COMPONENTS

 CURRENT COMPANY PROPOSAL STAFF RECOMMENDATION

 AVERAGE REMAINING AVERAGE 1\1\93 REMAINING AVERAGE 1\1\93 REMAINING

ACCOUNT REMAINING NET LIFE REMAINING NET ESTIMATED LIFE REMAINING NET BOOK LIFE

 LIFE SALVAGE RESERVE RATE LIFE SALVAGE RESERVE RATE LIFE SALVAGE RESERVE RATE

**GENERAL SUPPORT ASSETS** (YRS.) (%) (%) (%) (YRS.) (%) (%) (%) (YRS.) (%) (%) (%)

 Motor Vehicles‑Passenger Cars 6.0 10.0 36.67 8.9 8.0 7.0 0.00 11.6 \* 8.0 10.0 0.00 11.3 \*

 Motor Vehicles‑Light Trucks 4.9 7.0 35.74 11.7 4.4 15.0 33.63 11.7 4.4 15.0 34.77 11.4

 Construction Equipment 6.6 10.0 82.58 1.1 4.5 10.0 85.88 0.9 4.5 10.0 65.25 \*\* 5.5

 Buildings‑Office 23.0 10.0 32.94 2.5 21.0 10.0 35.54 2.6 21.0 10.0 35.01 2.6

 Buildings‑Single‑Unit 24.0 0.0 16.16 3.5 18.6 0.0 22.92 4.1 18.6 0.0 26.66 3.9

 Buildings‑Plant 29.0 5.0 17.57 2.7 27.0 5.0 19.65 2.8 27.0 5.0 19.85 2.8

**CENTRAL OFFICE ASSETS**

 Digital Switching 12.6 0.0 20.62 6.3 10.3 0 29.43 6.9 10.3 0.0 29.58 6.8

 Analog Carrier 3.4 (5.0) 74.59 8.9 3.1 0 93.20 2.2 3.1 0.0 92.96 2.3

 Digital Carier 6.6 0.0 22.25 11.8 7.6 0 49.20 6.7 7.6 0.0 49.17 6.7

 Fiber Optic Carrier 10.0 0.0 0.00 10.0 8.5 0 13.78 10.1 10.0 0.0 13.75 10.0 \*

 Stuart West 3.0 0.0 81.10 6.3 11.8 0 100.00 8.5 \* 11.8 0.0 100.00 8.5 \*

**INFORMATION ORIG/TERM ASSETS**

 Paystations 3.3 0.0 83.21 5.1 6.3 0.0 40.63 9.4 6.3 0.0 38.18 9.8

 Terminating Equipment 6.0 0.0 41.76 9.7 6.9 0.0 39.11 8.8 6.9 0.0 39.16 8.8

**CABLE & WIRE FACILITIES**

 Poles 11.9 (60.0) 62.55 8.2 11.1 (50.0) 66.79 7.5 11.1 (30.0) 71.24 5.3

 Aerial Cable ‑ Fiber 20.0 (5.0) 0.00 5.3 20.0 (15.0) 0.00 5.8 \* 20.0 (15.0) 0.00 5.8 \*

 Undgd. Cable ‑ Metallic 13.9 (5.0) 31.33 5.3 12.1 (5.0) 42.25 5.2 11.4 (5.0) 42.12 5.5

 Undgd. Cable ‑ Fiber 20.0 (5.0) 0.00 5.3 20.0 (5.0) 0.00 5.3 \* 20.0 (5.0) 0.00 5.3 \*

 Buried Cable‑Metallic‑Filled 14.3 (5.0) 27.78 5.4 11.0 (5.0) 28.81 6.9 11.0 (5.0) 34.53 6.4

 Buried Cable ‑ Fiber 20.0 (5.0) 0.00 5.3 18.5 (5.0) 7.35 5.3 20.0 (5.0) 7.16 5.3 \*

 Conduit 47.0 (5.0) 6.21 2.1 44.0 (5.0) 12.33 2.1 44.0 (5.0) 12.33 2.1

**AMORTIZATION**

 Other Work Equipment 7 Year Amortization 7 Year Amortization 7 Year Amortization

 Furniture 10 Year Amortization 10 Year Amortization 10 Year Amortization

 Office Support Equipment 7 Year Amortization 7 Year Amortization 7 Year Amortization

 Company Communications 5 Year Amortization 5 Year Amortization 5 Year Amortization

 General Purpose Computers 5 Year Amortization 5 Year Amortization 5 Year Amortization

**RECOVERY SCHEDULES**

 Devices for the Deaf 3.2 0.0 90.12 3.1 3.7 0.0 99.45 0.1 1 Year Recovery Schedule

 Aerial Metallic Cable 12.9 (30.0) 43.57 6.7 2 Year Recovery Schedule 2 Year Recovery Schedule

 Air Core Metallic Buried Cable 5.4 (5.0) 67.20 7.0 2 Year Recovery Schedule 2 Year Recovery Schedule

 \* Denotes Whole Life Rate

 \*\*Denotes restated reserve

 INDIANTOWN TELEPHONE SYSTEM, INC.

 1992 STUDY

 COMPARISON OF EXPENSES

 CURRENT COMPANY PROPOSAL STAFF RECOMMENDATION

 CHANGE CHANGE

ACCOUNT 1/1/93 1/1/93 IN IN

 INVESTMENT RESERVE RATE EXPENSES RATE EXPENSES EXPENSES RATE EXPENSES EXPENSES

**GENERAL SUPPORT ASSETS** ($) ($) (%) ($) (%) ($) ($) (%) ($) ($)

 Motor Vehicles‑Passenger Cars 0 0 8.9 0 11.6 \* 0 0 11.3 \* 0 0

 Motor Vehicles‑Light Trucks 103,481 35,976 11.7 12,107 11.7 12,107 0 11.4 11,797 (310)

 Construction Equipment 13,284 8,668 \*\* 1.1 146 0.9 120 (26) 5.5 731 585

 Buildings‑Office 338,336 118,466 2.5 8,458 2.6 8,797 339 2.6 8,797 339

 Buildings‑Single Unit 39,302 10,477 3.5 1,376 4.1 1,611 235 3.9 1,533 157

 Buildings‑Plant 471,769 93,664 2.7 12,738 2.8 13,210 472 2.8 13,210 472

 Subtotal 966,172 267,251 34,825 35,845 1,020 36,068 1,243

**CENTRAL OFFICE ASSETS**

 Digital Switching 1,308,691 387,152 6.3 82,448 6.9 90,300 7,852 6.8 88,991 6,543

 Analog Carrier 178,771 166,187 8.9 15,911 2.2 3,933 (11,978) 2.3 4,112 (11,799)

 Digital Carrier 802,516 394,590 11.8 94,697 6.7 53,769 (40,928) 6.7 53,769 (40,928)

 Fiber Optic Carrier 167,390 23,016 10.0 \* 16,739 10.1 16,906 167 10.0 \* 16,739 0

 Stuart West 79,952 79,952 6.3 5,037 8.5 \* 6,796 1,759 8.5 \* 6,796 1,759

 Subtotal 2,537,320 1,050,897 214,832 171,704 (43,128) 170,407 (44,425)

**INFORMATION ORIG/TERM ASSETS**

 Paystations 32,911 12,566 5.1 1,678 9.4 3,094 1,416 9.8 3,225 1,547

 Terminating Equipment 46,632 18,259 9.7 4,523 8.8 4,104 (419) 8.8 4,104 (419)

 Subtotal 79,543 30,825 6,201 7,198 997 7,329 1,128

**CABLE & WIRE FACILITIES**

 Poles 18,472 # 13,159 # 8.2 1,515 7.5 1,385 (130) 5.3 979 (536)

 Aerial Cable ‑ Fiber 0 0 5.3 \* 0 5.8 \* 0 0 5.8 \* 0 0

 Undgd. Cable ‑ Metallic 128,100 53,954 5.3 6,789 5.2 6,661 (128) 5.5 7,046 257

 Undgd. Cable ‑ Fiber 0 0 5.3 \* 0 5.3 \* 0 0 5.3 \* 0 0

 Buried Cable‑Metallic‑Filled 3,952,123 # 1,364,511 #\*\* 5.4 213,415 6.9 272,696 59,281 6.4 252,936 39,521

 Buried Cable ‑ Fiber 379,559 27,183 5.3 \* 20,117 5.3 20,117 0 5.3 \* 20,117 0

 Conduit 158,155 19,508 2.1 3,321 2.1 3,321 0 2.1 3,321 0

 Subtotal 4,636,409 1,478,315 245,157 304,180 59,023 284,399 39,242

Depreciation Rate Total 8,219,444 2,827,288 563,362 581,274 17,912 560,550 (2,812)

Amort. and Recovery Schedules 719,058 459,233 82,279 117,652 35,373 94,451 12,172

Reserve Deficit 1993 Write‑Off 247,758 247,758

 GRAND TOTAL 8,938,502 3,286,521 583,294 636,579 53,285 840,412 257,118

 \* Denotes Whole Life Rate

 # Denotes restated investment and reserve

 after reclassification of stub poles.

 \*\* Denotes restated reserve after corrective measures.

 INDIANTOWN TELEPHONE SYSTEM, INC.

 1992 STUDY

 COMPARISON OF EXPENSES

 CURRENT COMPANY PROPOSAL STAFF RECOMMENDATION

 CHANGE CHANGE

 1/1/93 1/1/93 IN IN

ACCOUNT INVESTMENT RESERVE RATE EXPENSES SCHEDULE EXPENSES EXPENSES SCHEDULE EXPENSES EXPENSES

 ($) ($) (%) ($) (%) ($) ($) ($) ($)

 **AMORTIZATION**

 Other Work Equipment 79,199 44,656 7 Yr. Amort. 7,823 7 Yr. Amort. 7,823 0 7 Yr. Amort. 7,823 0

 Furniture 36,324 24,661 10 Yr. Amort. 2,102 10 Yr. Amort. 2,102 0 10 Yr. Amort. 2,102 0

 Office Support Equipment 64,746 17,594 7 Yr. Amort. 8,000 7 Yr. Amort. 8,000 0 7 Yr. Amort. 8,000 0

 Company Communications 27,741 14,423 5 Yr. Amort. 3,420 5 Yr. Amort. 3,420 0 5 Yr. Amort. 3,420 0

 General Purpose Computers 225,989 134,942 5 Yr. Amort. 41,002 5 Yr. Amort. 41,002 0 5 Yr. Amort. 41,002 0

 **RECOVERY SCHEDULES**

 Devices for the Deaf 0 (7) 3.1 0 0.1 0 0 1 Year 7 7

 Aerial Metallic Cable 7,386 7,504 \*\* 6.7 495 2 Year 19,022 18,527 2 Year 990 495

 Air Core Metallic Buried Cable 277,673 215,460 7.0 19,437 2 Year 36,283 16,846 2 Year 31,107 11,670

 Amort. and Recovery Sch. Total 719,058 459,233 82,279 117,652 35,373 94,451 12,172

 \*\* Denotes restated reserve after corrective measures.