



Practical Application of Cost Studies

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Discussion

- What is separations?
- Managing interstate settlements and universal service fund support
 - ▣ Allocation factors
 - ▣ Asset decisions
 - ▣ Recording expenses
- Applying your specific results

Separations

- Separations rules are codified in the Code of Federal Regulations (CFR), Part 36
- Primary purpose of Part 36 is to assign “property costs, revenues, expenses, taxes and reserves between state and interstate jurisdictions”
- Separation to jurisdictions is based on function

 Direct Assignment and Allocation

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How Separations Works

- Answer #1:

You don't care

- Answer #2:

You don't need to know, that is
Alexicon's job

- Real Answer:

You just need to know how to help
and not hurt your company's results

Managing Results

- Interstate settlements and universal service fund amounts are products of complex formulas and allocations
 - We understand how the rules work to maximize results
 - There are some universal concepts that apply to all companies
 - Other decisions depend on the individual telco's allocation factors

Universal Concepts: Regulated vs. Non-Regulated

- Only plant and expenses associated with regulated telecommunications qualify for rate-of-return recovery and USF
- Non-regulated activities include:
 - ☐ Internet, CATV, Wireless, and Long Distance
 - ☐ Payphone
 - ☐ Voice Mail
 - ☐ Inside Wire Maintenance
 - ☐ Customer Premise Equipment

Regulated vs. Non-Regulated (cont'd)

- Ideally, procedures should be instituted to minimize any allocation to non-regulated activities:
 - EXAMPLE: Service Tech receives a call to check on CATV service. While out on call, also check the NID and/or pedestal so that a portion of the time is regulated telephone.

Universal Concepts: Assets

- Companies earn a set profit on telecom plant investment (rate-of-return)
- But all assets are not treated equally in separations and USF formulas
 - ▣ Switching is weighted for greater interstate recovery
 - ▣ Local circuits and local cable & wire facility are used to calculate USF support

Universal Concepts: Assets (cont'd)

- Leasing general support facility assets may be better than purchasing
 - Increases the influence of favorable interstate allocation factors applied to other assets and expenses

Universal Concepts: Expenses

● Best Accounts:

- ☐ Cable & Wire Expense
- ☐ General Support Expense
- ☐ Network Operations Expense

● Good Accounts:

- ☐ COE Switching Expenses
- ☐ COE Transmission Expense

Universal Concepts: Expenses (cont'd)

● Fair Accounts:

- ☐ Customer Services Expense
- ☐ Marketing Expense
- ☐ Corporate Operations Expense ***

● Bad Accounts:

- ☐ Other Billing & Collection Expense
- ☐ Message Processing Expense

Expense Limitations

- Corporate Operations Expenses are “capped” for federal USF purposes.
 - ☐ Includes Executive & Planning, Accounting, Legal, Human Resources, External Relations, and Information Management.
- Once a company reaches the limit that the FCC allows for these types of expenses, further support is disallowed.

Company Specific Decisions

- There are two main pages in your cost study that will help manage your results:
 - ▣ Rate Base summary by jurisdiction
 - ▣ Operating Expense summary by jurisdiction
- These pages will show you how much of a given account is allocated to interstate and to local
- Alexicon is adding a USF break-out from local to assist with decision-making

Assets

(a)	(b)	(d)	(e)	(f)	(g)	(h)
Line	Account/Category	Total Amount	Interstate	State InterLA TA	State IntraLA TA	Local
41	<u>Account 2001 - Total Plant in Service</u>					
42	Account 2110 - General Support Facilities	100.0000%	45.4266%	9.2351%	24.8771%	20.4612%
43	Account 2210 - Central Office Switching	100.0000%	69.0969%	4.2846%	11.6185%	15.0000%
44	Account 2220 - Operator Systems	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
45	Account 2230 - COE Transmission - Cat. 4.1	100.0000%	24.5397%	12.3021%	31.3911%	31.7671%
46	Account 2230 - COE Transmission - Cat. 4.2	100.0000%	79.7892%	5.0920%	15.1187%	0.0000%
47	Account 2230 - COE Transmission - Cat. 4.3	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
48	Account 2310 - Information Orig/Term Equip	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
49	Account 2410 - C&WF Cat. 1	100.0000%	24.8020%	12.4336%	31.7267%	31.0377%
50	Account 2410 - C&WF Cat. 2	100.0000%	91.7270%	0.0973%	8.1758%	0.0000%
51	Account 2410 - C&WF Cat. 3	100.0000%	36.2160%	13.9037%	49.8802%	0.0000%
52	Account 2410 - C&WF Cat. 4	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
53	Account 2680 - Amortizeable Tangible Assets	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
54	Account 2690 - Intangible Assets	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
55	Total Account 2001 - TPIS	100.0000%	45.4266%	9.2351%	24.8771%	20.4612%

Asset Decisions

- As you can see, there are significant differences in the level of recovery based on asset type for this Company:
 - ☐ Support Assets: 45% is allocated to interstate
 - ☐ Switching: 69% is allocated to interstate
 - ☐ Toll Circuits: 80% is allocated to interstate
 - ☐ Interexchange C&WF: 92% is interstate

Expenses

(a)	(b)	(d)	(e)	(f)	(g)	(h)
Line	Account/Category	Total Amount	Interstate	State InterLATA	State IntraLA TA	Local
84	<u>Plant Specific Operations Expense</u>					
85	Account 6110 - Network Support Expense	100.0000%	45.4266%	9.2351%	24.8771%	20.4612%
86	Account 6120 - General Support Expense	100.0000%	45.4266%	9.2351%	24.8771%	20.4612%
87	Account 6210 - Switching Expense	100.0000%	65.0010%	5.9969%	16.3800%	12.6222%
88	Account 6220 - Operator Systems Expense	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
89	Account 6230 - Transmission Expense	100.0000%	65.0010%	5.9969%	16.3800%	12.6222%
90	Account 6310 - Info Orig/Term Expense	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
91	Account 6410 - Cable and Wire Facilities Exp.	100.0000%	28.7092%	12.0007%	32.1340%	27.1561%
92	Total Plant Specific Operations Expense	100.0000%	49.4576%	8.5682%	23.1273%	18.8469%
94	<u>Plant Non-Specific Expense</u>					
95	Account 6510 - Other P,P & E Exp.	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
96	Account 6530 - Network Operations Expense	100.0000%	45.4266%	9.2351%	24.8771%	20.4612%
97	Account 6540 - Access Expense	100.0000%	100.0000%	0.0000%	0.0000%	0.0000%
98	Total Plant Non-Specific Operations Expense	100.0000%	53.7435%	7.8277%	21.0859%	17.3429%

Expenses (cont'd)

100	<u>Depreciation and Amortization</u>					
101	Account 6561 - Depreciation of Plant in Service	100.0000%	52.6161%	7.9828%	21.5748%	17.8263%
102	Account 6562 - Deprec. of Plant Held for Future Use	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
103	Account 6563 - Amortization of Tangible Assets	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
104	Account 6564 - Amortization of Intangible Assets	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
105	Account 6565 - Amortization of TPAA	0.0000%	0.0000%	0.0000%	0.0000%	0.0000%
106	Total Depreciation and Amortization Expense	100.0000%	52.6161%	7.9828%	21.5748%	17.8263%
108	<u>Customer Operations Expense</u>					
109	Account 6610 - Marketing Expense	100.0000%	35.0077%	3.2045%	23.9062%	37.8816%
110	Account 6621 - Operator Services	100.0000%	21.5113%	8.3026%	20.9964%	49.1897%
111	Account 6622 - Number Services	100.0000%	21.5113%	8.3026%	20.9964%	49.1897%
112	Account 6623 - Customer Services	100.0000%	41.3921%	8.0057%	19.9538%	30.6484%
113	Total Customer Operations Expense	100.0000%	39.4816%	7.5844%	20.3864%	32.5477%
115	<u>Corporate Operations Expense</u>					
116	Account 6710 - Executive and Planning Expense	100.0000%	47.0820%	8.3166%	22.4281%	22.1733%
117	Account 6720 - General and Administrative Expense	100.0000%	58.1891%	7.1600%	17.8514%	16.7994%
118	Total Corporate Operations Expense	100.0000%	55.1799%	7.4734%	19.0914%	18.2554%

Expense Decisions

- For this Company several expense types have better interstate recovery:
 - ☐ Switching and Circuit expenses
 - 65% is allocated to interstate
 - ☐ General & Administrative expenses
 - 58% is allocated to interstate
 - Must still remember the corporate operations expense limitation for USF

Warning Label

- Separations factors have primary, secondary and tertiary effects
- Any significant investment or operational change should be modeled to determine the effects on interstate settlements and universal service fund support
- Use your consultant!

Questions?