a. NECA Continually Strives to Improve Its Procedures for Monitoring Pool Reports For Compliance With Commission Rules.

The Safeguards Report provides an overview of NECA's procedures for assuring pool integrity, including NECA's settlement processing system controls and its cost study review process. The auditors compared these controls and procedures with those in place in 1988, and found that the changes NECA had made to its operations "significantly enhanced the safeguards against potential manipulation of pooling information."[45]

Since the Safeguards Report was issued NECA has made substantial efforts to improve its cost study review and validation procedures. In 1992, for example, NECA revised its annual corporate goals and objectives by adding additional specific objectives to ensure the accuracy of the revenue distribution process.

In pursuit of these objectives, NECA continued to complete mechanized as well as manual "streamlined" cost study validations on all of its cost company study areas in 1992. In response to concerns expressed by the Safeguards Report, NECA redesigned its validation process as a Cost Analysis Program. In July 1992, extensive revisions and enhancements were made to the Cost Analysis Procedures.

As part of this process, NECA developed an additional manual review process to supplement the cost study validations conducted by NECA regional personnel. The Focused Cost Study Review (FCSR)

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[45] Safeguards Report at 7-9.

emphasizes regional review activity for compliance with Commission rules in specific priority subject areas. Some of the selection sources for 1992 FCSRs included follow-ups of issues identified in NECA's Cost Issues Resolution Process (discussed in detail below), changes in Commission rules, and analyses of common deficiencies in cost studies.

NECA has an on-going update process for its Cost Analysis Procedures, which seeks to improve cost study review methods by updating them on a quarterly basis. NECA is now in the process of reviewing its FCSR procedures to establish consistent guidelines within each subject matter selected for review. Finally, NECA has enhanced its former Detailed Cost Study Review (DCSR) procedures to validate the streamlined cost study review process itself, and to identify those risk areas that may require additional validation.

These efforts reflect NECA's ongoing commitment to provide additional assurance that NECA pooling data is being monitored for compliance with Commission rules.[46]

b. NECA has Substantially Improved Its Cost Issues Resolution Process Since the Safeguards

the Manual "is an effective tool" for purposes of assuring compliance with Commission rules.[47] The Commission expresses concern, however, that NECA includes interpretations in the manual "only after circulating them throughout NECA's cost study membership." The Commission states that, while it does not object to consultations between NECA and its members, it believes that NECA's efforts to understand a rule's meaning "should not focus on developing either an industry consensus regarding that meaning or an interpretation that accommodates divergent LEC viewpoints."[48] According to the Commission, such efforts are "unlikely to lead to a correct interpretation;" instead, "NECA must exercise its own independent interpretive judgment and then implement its interpretation."[49]

NECA's Cost Issues Resolution Process has undergone substantial development since the independent auditor conducted the safeguards review. In particular, NECA's administrative procedures governing the cost issues resolution process have been extensively revised. The Cost Issues Manual now emphasizes NECA's obligations to ensure that settlement data is accurate and in compliance with Commission rules and orders, and explains NECA's procedures for circulating issues among member companies and consultants, review

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[47] NPRM at ¶ 28.

[48] Id.

[49] Id. at ¶ 29. The Commission indicated that its staff is available to assist NECA's interpretative efforts through informal discussions, and that NECA may also file petitions for declaratory rulings, which the Commission states will be acted upon "as early as practicable."

of issues by senior NECA management, and referral of issues to the Commission.

The revised Cost Issues Manual clearly states that when issues are published in the manual, exchange carriers are required to submit data to the pools according to the resolution. The Manual explains that issues will be referred to the Commission when it appears that there is uncertainty about the proper interpretation of the issue. When an issue is formally referred to the Commission, NECA may publish an interim resolution providing guidelines for member companies to follow pending Commission action.

The manual also describes procedures for providing the Commission with "early warning" of issues as they arise, as recommended by the independent auditor. Before referring an issue to the Commission through a formal petition for declaratory ruling, NECA's practice is to discuss issues informally with Commission staff, including a brief discussion about the issue, explanation of differences that exist between various approaches, and possible solutions to resolving the issue.

While NECA actively seeks input from member companies in examining cost issues, resolution of an issue does not depend on obtaining consensus among NECA's members. NECA understands its obligation to apply Commission rules and orders correctly in the pooling process and administration of support funds. NECA frequently makes determinations where industry consensus does not exist. If the rules do not provide adequate guidance for a

determination, NECA's practice is to seek Commission clarification.

There is, however, good reason to circulate proposed issue resolutions among member companies prior to resolution. Cost issues are often extremely complex. New technologies and varying deployments of these technologies create new issues for resolution. NECA staff may not be aware of all of the plant configurations in place at member companies that may affect accounting methods and separations procedures. Member companies and their consultants often devote significant resources to analyzing rule applications. By circulating proposed cost issue resolutions among member companies prior to final resolution of an issue, NECA is able to take full account of these facts and alternative viewpoints in its own analyses.[50]

NECA believes that, as a matter of fairness, it should provide its members with the opportunity to discuss issue resolutions before making adjustments to a company's pooling data. By discussing the reasons for an interpretation with the member company, misunderstandings and needless controversy can be avoided. Affording member companies due process is essential to maintaining their confidence in the NECA pools and its administration of programs that are important to them. Implementation of complex rule interpretations is aided greatly through the cooperation of a well-informed membership.

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[50] NECA also solicits comments from telephone industry outside groups, such as the USTA separations committees and NTCA. This ensures that all interested parties have an opportunity to express their views on an issue.

2. <u>On-line Access To NECA Data Bases.</u>

The NPRM proposes that NECA be required to provide on-line, dial-up access to its computer-based files of cost and demand data submitted by ECs in connection with tariff filing and revenue distribution data. The Commission notes that NECA's files constitute "a relatively complete source of company-specific data on NECA pool participants. The files also contain extensive information that non-pooling companies submit to NECA to enable it to administer the USF, lifeline assistance, and long term support programs."[51] The Commission indicates that such access should be provided only after safeguards are in place to guarantee data base integrity and prevent unauthorized access.

The Commission should not require NECA to provide on-line access to its data bases. Such access does not appear to be necessary, since the Commission currently receives detailed data from NECA on diskette. For example, NECA currently provides its filed data on USF, Network Usage (including monthly Access Minutes of Use reports) and access tariff cost and demand data in electronic form. These data reports permit the Commission and other interested persons to conduct meaningful "mechanized" review of NECA data reports as they exist in final form in support of NECA filings.

In contrast, much of the data in NECA computer files are

eventually finalized, and are reported to the Commission in a useful format in the reports discussed above. A considerable amount of NECA staff and computer resources are required to prepare these data for analysis and to compile information into meaningful reports for eventual filing with the Commission. NECA has always attempted to provide responsive and timely analyses of its data to the Commission upon request. Such targeted inquiries make for efficient use of EC, NECA and Commission resources. Providing access to preliminary data in raw form would require substantial further analyses by NECA and the Commission, and would not provide any additional assurance with respect to accuracy or compliance with Commission rules.

Implementation of on-line access would also place extremely disproportionate burdens on NECA pool members as compared to non-pooling companies. No other carriers, including Tier I ECs, are required to provide the Commission with access to their internal computer databases. Requiring NECA pool ECs to provide such information would be unfair and inconsistent with the Commission's decisions in CC Docket No. 87-339 (Monitoring Docket) and with Commission rules governing ARMIS reporting and small EC tariff filings, which generally seek to minimize filing requirements for smaller entities.

Finally, subjecting NECA pool ECs to intrusive electronic monitoring requirements would create strong incentives for companies to leave the pool and file their own tariffs, a result inconsistent with the recommendations of the Safeguards Report and

with Commission policies. For all of these reasons, NECA recommends that the Commission refrain from imposing any requirement that NECA provide on-line access to NECA data bases.

### C. STRENGTHENING NECA'S INTERNAL PROCEDURES

#### 1. Certification of Cost Studies.

The NPRM notes that NECA has expanded and improved its programs for educating its staff and member companies regarding Commission requirements. The Commission expresses a concern, however, that NECA's programs may not give employees adequate guidance for when "they instruct LECs how to comply with our rules and review LEC submissions for compliance."[52] The Commission suggests that it might help NECA detect instances of noncompliance if responsible EC officers or employees were required to certify whether data submitted to NECA comply with the rules.[53]

NECA currently verifies that all cost data is derived from audited financial reports of ECs. In the few cases where EC data is not audited, NECA requires certification of these financial data by an officer of the company.

NECA currently requires certification of USF data reports. NECA has also required ECs to provide data certification in specific instances. Examples include reports recently submitted on RAO 21 implementation and claims submitted in 1988 by average schedule companies for supplemental settlements to compensate for the costs of implementing the Commission's new Part 32 accounting

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[52] Id. at ¶ 36.

[53] Id. at ¶ 37.

rules.[54]

NECA does not currently require certification of cost studies, since these studies are subject to extensive review and are verified by reference to audited financial data. NECA recognizes, however, that a certification requirement for cost studies may provide additional assurance with respect to submitted data, and would serve to highlight the importance of Commission rule compliance in pool reporting. Accordingly, effective with the current reporting year (1992 cost studies) NECA will require that all final data submitted to NECA either electronically or in written form be certified as accurate and in compliance with Commission rules.

2. NECA's Incentive Compensation Plan Is Appropriate and Promotes Full Compliance with Commission Rules.

The Commission has proposed that it may require submission of NECA's current Incentive Compensation Plan (Plan) and has asked for comments on precluding payments under the Plan, pending that review.[55] The Commission bases these proposals on a concern first raised in the Safeguards Report that NECA's Plan may have improper incentives that could undermine NECA's administration of the CL and TS pools and thereby reward noncompliance with Commission rules.[56] As demonstrated below, submission of the Plan should not be

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[54] See Petition of National Exchange Carrier Association,Inc. for Approval of Average Schedule Supplemental Disbursement, Memorandum Opinion and Order, 3 FCC Rcd 4164-65 (1988).

[55] NPRM at ¶ 41.

[56] Id. at 40 and 41.

required because the current Plan objectives are firmly linked to compliance with Commission rules, do not contain any improper incentives, and conform with the Safeguards Report recommendation.[57]

NECA initiated an incentive pay plan in 1987 that contains various objectives, including an earnings component that measures NECA's Common Line and Traffic Sensitive pools' earnings as they relate to the authorized rate of return. In its recommendations, the independent auditor stated that the incentive for achievement of earnings targets must be balanced with an incentive to ensure adherence to the rules. The Safeguard Report stated that the Plan should "reduce the emphasis on achieving earnings targets and explicitly include an incentive to institute procedures that ensure compliance with the Commission's rules throughout the organization."[58]

When the Plan was instituted by the Board in 1987, it was modeled after several telecommunications industry incentive compensation plans as recommended by NECA's external compensation consultant. By putting a portion of basic pay at risk for incentive purposes, incentive compensation plans enable corporations to control costs and promote efficiencies. An earnings component similar to NECA's is a quantifiable measure that

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[57] The submission of this Plan would also not comport with the Commission's original intent of removing itself from a private corporation's consideration of staffing and contracting decisions. See note 13 supra.

[58] Safeguards Report at 32.

is present in incentive compensation plans throughout corporate America, and significantly, throughout the telecommunications industry. NECA's Plan is carefully reviewed annually to ensure that its components are balanced properly, reflect compliance with Commission rules, and encourage excellent organizational performance.[59]

The Safeguards Report recognized that an earnings objective relates to member service expectations and is a legitimate goal for NECA:

> We agree with NECA management that achievement of the "highest allowable earnings" is a reasonable goal and that an adequate return is necessary to retain ECs in the voluntary CL and TS pools. NECA needs to attract and retain quality management talent, and must reward them based on their value in the marketplace and their performance in their job.[60]

NECA believes that an earnings component should be included in the corporate incentive compensation plan. Pool participants rely on NECA for recovery of interstate costs and achievement of interstate earnings. NECA ECs expect NECA staff to put in the same kind of effort to achieve good earnings that non-pooling companies put forth when filing their own tariffs.

which compensation is affected by earnings performance.[61] NECA further stated that compliance with Commission rules is a condition of NECA employment and integral to achievement of all corporate and individual objectives.[62] As discussed in Section IB, Commission rule compliance permeates every internal and external manual and procedure that NECA produces.[63] NECA has also published and distributed annotated Commission rules to keep its members and the industry up-to-date on Commission rule changes.

NECA's current Plan is substantially different from the Plan reviewed by the independent auditor in 1991 and NECA believes the Plan now conforms with the auditor's recommendation. In NECA's most recent annual evaluation of the Plan, it made additional changes to reduce further the weight given earnings by the Plan. The earnings component is no longer weighted heavier than any other component. The shift in weighting was made in favor of measures that emphasize rule compliance in pool reporting and service. A measure has also been added to the earnings component to measure compliance with the rules in the achievement of the authorized rate

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[61] Id. at Attachment II page 10 of 19. The independent auditor recognized this reduction at page 10 of Attachment I of the Safeguards Report.

[62] NECA staff members found violating Commission rules are subject to disciplinary action up to and including dismissal. This language is found in NECA's Ethics Policy statement which is signed by each staff member.

[63] NECA's Agreement for the Distribution of Interstate Access Revenues with member companies has always required the parties to comply with the rules. NECA's Vision Statement which has been approved by the Board and distributed to all employees, underscores the importance of compliance with Commission rules.

of return. Thus, all components of NECA's Plan, including the

process in response to concerns raised in the Safeguards Report.[65] These improvements include additional manual review processes, new Focused Cost Study Review (FCSR) procedures, quarterly update procedures, and enhancements to the formal Detailed Cost Study Review procedures. NECA will continue in future years to examine its procedures for reviewing cost studies, and will seek to keep the Commission informed of progress in this area.

4. Independent Audits For Non-Pooling ECs.

The NPRM rejects the independent auditor's recommendation to "outsource" to NECA the responsibility of reviewing cost studies of non-pooling ECs. The Commission states its concern, however, that ECs may leave NECA's pools in order to avoid NECA's review processes. The Commission suggests that it might require a sample of rate of return ECs that file their own tariffs to retain independent auditors to report annually on the sufficiency of these ECs' cost studies, and invites comments on the costs and benefits of such a proposal. The Commission also invites comments on alternative measures that might achieve comparable benefits at lower costs.[66]

NECA agrees with the Commission that it should not be made responsible for review of non-pool ECs cost study data. NECA also believes that it is critical that the any rules adopted in this proceeding do not create artificial incentives for companies to leave the pool.

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[65] See pp. 20-24 supra.

[66] NPRM at ¶ 46.

## III. CONCLUSION

Since its inception, NECA has had sound procedures and controls in place to ensure compliance with Commission's rules and fulfill its corporate obligations. NECA has demonstrated its willingness to initiate improvements to its safeguards and will continue to take such actions.

NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.

Respectfully submitted,

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# NECA's Cost Study Review Process

NECA's Cost Study Review Process consists of four interrelated sub-processes: the Cost Study Validation process, the Forecast process, the Pooling and Settlements process and the Cost Issues Resolution process. The primary objective of NECA's Cost Study Review Process is to provide reasonable assurance of the accuracy and conformance with Commission rules of pool data submitted by member companies used for pool settlements and access tariff filings. The current process, which was introduced in mid-1990, emphasizes the development of accurate exchange carrier (EC) cost forecasts and related cost studies for all cost ECs. This program resulted in a shift from performing detailed cost reviews for a limited number of sampled ECs to a broader and more streamlined cost study validation process. NECA's Cost Analysis Managers now perform cost study validations for all pool companies required to submit cost studies, resulting in greater assurance of the accuracy and conformance with Commission rules of final pool settlements and annual cost forecasts. In addition, NECA's Cost Issues Resolution Process provides early identification of issues that may require interpretation or clarification of Commission rules.

NECA continuously seeks ways to improve its procedures to ensure rule compliance by all pool participants. Since the Commission and independent audits, NECA has taken steps to enhance its Cost Study Review Process, including enhanced review procedures to validate the streamlined Cost Study Validation Process and Focused Cost Study Reviews for areas identified as having high risk based on prior experience or other relevant factors. Cost Study Review Process procedures are formally reviewed and updated on a quarterly basis or whenever a major policy change occurs.

The purpose and description of each of the Cost Study Review Processes are detailed below.

## 1. Cost Study Validation Process

The objectives of the Cost Study Validation Process are to identify and resolve significant discrepancies/differences among and within EC cost studies in order to obtain reasonable assurance of EC compliance with Commission rules and NECA procedures. NECA streamlined this process so that it could be used to review each of the hundreds of cost studies submitted to NECA every year. The various steps in the process are described below.

The Desk Check review examines those elements which can be readily checked upon receipt of a cost study. The primary purpose of the Desk Check review is to ensure that

a sample of ECs each year. These reviews are intended to validate the streamlined cost study review process itself. The RSVPs involve an in-depth review of large and high risk cost study items and separation factors, performed independent of the streamlined process, including on-site reviews at ECs as required. The results of the RSVP will be compared to the results of the streamlined Cost Study Validation Process to ensure that the streamlined process continues to identify material cost study errors and/or deviations from Commission rules. An evaluation will then be made to determine whether the streamlined process needs to be revised or enhanced based on these reviews.

In addition to the validation processes noted above, supplementary Focused Cost Study Reviews (FCSR) are also performed by NECA regional personnel for areas identified as having high risk based on prior experience, regulatory rule changes or other relevant factors. FCSRs focus on one or more specific areas with emphasis on compliance with specific Commission rules or NECA procedures as opposed to a broad comprehensive review. Topics which may warrant a FCSR include follow-ups of items identified in NECA's Cost Issues Resolution Process, common problem areas noted in cost studies during the streamlined cost study validation or RSVP processes, recent changes in Commission rules and external industry events.

The combination of the Streamlined Cost Study Validation Process, RSVP reviews and FCSRs provide a comprehensive review program which provides reasonable assurance that the cost studies of NECA pool members are accurate and conform to Commission rules and NECA procedures.

# 2. Forecast Process

The objective of the Forecast Process is to provide reasonable cost forecasts which are used in developing the annual access tariff filings in accordance with FCC rules.

A mechanized model forecast program is used by the Cost Analysis Managers to produce initial three-year cost forecasts for each cost company. The Model Forecast Program automatically aggregates input from the prior year's validated cost study into the Tariff Review Plan (TRP) format. The TRP is the level of detail acceptable to the Commission for tariff filings and has been adopted by NECA as the common level for forecast input. This input level allows a more refined application of separations factors to respective accounts. The prior year's cost study amounts, which have been previously validated for compliance with FCC rules, are adjusted for anticipated growth factors, changes in EC operational characteristics and any known changes in FCC rules from the prior year. The Cost Analysis Managers then discuss the NECA forecasts with each EC

or their consultant. The ECs can also provide their own forecasts which are then compared with the NECA forecast for consistency and reasonableness. Any significant differences are investigated and resolved. Having each EC/consultant review their cost forecast ensures that all relevant company specific information related to EC construction plans and operational changes is taken into account before further processing takes place.

In addition to the above, the Cost Analysis Managers develop trend analysis reports at the TRP level of detail. These reports compare prior and current year cost studies with all three forecast years to identify large or unusual trend variances. These inconsistencies are investigated and reviewed for reasonableness and compliance with FCC rules and NECA procedures before the current year's forecast is finalized for ratemaking purposes.

The above review steps in the Forecast Process provide reasonable cost forecasts developed in compliance with FCC rules and NECA procedures for each cost company participating in the NECA pools.

# 3. Pooling and Settlements Process

The objective of the Pooling and Settlements Process is to assure that monthly settlements are reasonable as compared with validated cost studies and annual cost forecasts. NECA personnel perform both pre- and post-settlement analysis on monthly settlement data submitted by ECs/consultants.

A pre-Settlement Analysis is performed for all ECs. Questionable EC data is identified and corrected, if necessary, as follows: Those ECs that have reported data which is significantly out-of-range are reviewed to determine the reasons for the out-of-range inputs. This review may consist of an analysis of the EC's historical or forecast data, or contact with the ECs for an explanation. NECA personnel also verify that adjustments are received from specific ECs to correct problems identified during the previous month's post processing analysis. In addition, NECA performs a reasonableness review at the total pool level to ensure that all significant variances have been detected.

A post-Settlement Analysis is performed to determine if ECs are in compliance with the NECA Pool Administration Procedures with regard to truing-up data estimates within the specified timeframes. If an EC has not trued-up as specified, NECA will then review its file on the EC for possible explanations or contact the EC for an explanation.

Another post-processing analysis performed compares the EC's latest monthly pool input data for the past several months. This is done to identify any anomalies in data submitted by the ECs. If further analysis does not provide a reasonable explanation for any significant deviations, the discrepancies are investigated and resolved with the EC.

In addition to the above, various analyses are conducted each month after monthly

# Summary

In summary, NECA's Cost Study Review Process, consisting of the Cost Study Validation process, the Forecast process, the Pooling and Settlements process and the Cost Issues Resolution process, is a comprehensive review program which provides assurance to NECA's member companies, the NECA Board of Directors, the Commission and other interested parties of the accuracy and conformance with Commission rules and NECA procedures of member company pooling information used for monthly pool settlements and annual access tariff filings.

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