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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
AT&T Communications	)	CC Docket No. 94-139
Tariff F.C.C. Nos. 1 and 13	)	
Transmittal Nos. 7322 and 7848	)	
	)	
Bell Atlantic Telephone Companies	)	DA 95-2407
Tariff F.C.C. No. 1,	)	
Transmittal Nos. 704 and 747	)	

DIRECT CASE OF BELL ATLANTIC

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January 2, 1996

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SUMMARY OF BELL ATLANTIC DIRECT CASE

The sole remaining issue associated with the investigation of tariff changes based on exogenous treatment of costs associated with Statement of Financial Accounting Standards No. 112 ("SFAS 112") is whether Bell Atlantic[1] and AT&T avoided double counting cost changes that are already reflected in the GNP-PI index used in the price cap formula. The answer for Bell Atlantic is no. While no offset of SFAS 112 costs to avoid double counting GNP-PI impacts was necessary, Bell Atlantic conservatively used the same offset as it had for costs associated with the adoption of Statement of Financial Accounting Standards No. 106, ("SFAS 106"),[2] thereby ensuring that even a theoretical chance of double counting was eliminated.

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[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

[2] ***See 1993 Annual Access Tariff Filings***, CC Docket No. 93-193, Phase I, Summay of Bell Atlantic Direct Case at 4-5 (filed Aug. 14, 1993) ("Bell Atlantic SFAS 106 Direct Case").

To the extent issues designated by the Commission[3] go beyond the limited question of potential double counting, they have no bearing on the decision here. Consequently the Commission should close its investigation of Bell Atlantic's tariff change.

1. The Issue Before the Commission is Narrowly Limited.

As the Commission recognized,[4] the investigation here is governed by the D.C. Circuit's decision regarding exogenous treatment of SFAS 106 costs. As with SFAS 106, the costs here are associated with a change in accounting rules that requires accrual accounting for certain benefit costs. There is no basis in fact or under the Commission rules that were in effect at the time these costs were incurred for different treatment of these two accounting changes.

The court of appeals order clarified that, under Commission rules at the time these costs were incurred, there were only two requirements for exogenous treatment of costs associated with a change in Generally Accepted Accounting Principles ("GAAP"). Such accounting changes must be adopted by the Commission -- "the 'control' test" -- and the associated costs "must be shown not to involve double counting with the GNP-PI adjustment."[5]

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[3] Order Designating Issues for Investigation (Com. Car. Bur. rel. Nov. 30, 1995)("112 Investigation Order").

[4] 112 Investigation Order, ¶ 10.

[5] *Southwestern Bell Telephone Company v. FCC*, 28 F.3d 165, 168 (D.C. Cir 1994).

The appeals court found that "an FASB change adopted by the Commission" -- as SFAS 112 was[6] -- "is not a change under control of the carrier. . . ."[7] The change therefore satisfies the control criterion.

Thus, as with the SFAS 106 investigation, the ***only*** question before the Commission is the second test for exogenous treatment of costs -- whether exogenous treatment of SFAS 112 costs would double count impacts already reflected in the price cap formula through the GNP-PI component.

2. There is No GNP-PI Double Counting.

The amount of SFAS 112 adoption costs afforded exogenous treatment in Bell Atlantic's tariffs was properly calculated to eliminate double counting. An analysis performed by Andrew Abel and Peter Neuwirth demonstrated that the transition obligation -- the catch-up cost associated with the adoption of SFAS 112 -- is a sunk cost that will have ***no*** impact on forward looking marginal costs, and therefore cannot impact the GNP-PI.[8] For Bell

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[6] ***See*** Responsible Accounting Officer Letter No. 22, 8 FCC Rcd 4111 (Com. Car. Bur. 1993) ("112 Adoption Letter").

[7] ***Southwestern Bell***, 28 F.3d at 170.

[8] ***See*** Neuwirth & Abel, Analysis of Impact of SFAS 106 Costs on GNP-PI (Feb. 18, 1992) (attached hereto, Direct Case, Tab J, Exh. 24-d); ***and see*** Neuwirth & Abel, Update of Analysis of Impact of SFAS 112 on the GNP-PI at 2 (Dec. 29, 1995) (attached hereto, Direct Case, Tab J, Exh. 24-b) ("Report Update"). Although not included in Bell Atlantic's filing, the impact of continuing SFAS 112 costs on the GNP-PI were determined to be "much smaller than the increase in marginal costs associated with SFAS 106." Report Update at 2.

Atlantic, the entire amount at issue is the transition obligation,[9] thus the appropriate offset should be zero. Bell Atlantic nonetheless included the same offset that was found to be appropriate for SFAS 106.[10] Thus, if anything, Bell Atlantic has erred by ***overcompensating*** for the nonexistent GNP-PI impact of SFAS 112. No further adjustments are necessary.

3. Additional Inquiries are Irrelevant.

As with the SFAS 106 Investigation Order, the data requests here stray well beyond the limited issue of GNP-PI double counting. While Bell Atlantic again responds to all of the requests, the bulk of these requests clearly exceed the mandate of the court of appeals. Whatever the intrinsic merits of other potential requirements for exogenous treatment, they are a "basis for ***amending*** [the Commission's] current rule, not for concocting a new rule in the guise of applying the old."[11]

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[9] ***See*** Exhibit 20-1-A, Workpaper 6-40-1 (revised).

[10] Even for SFAS 106, that amount is overstated. ***See*** Bell Atlantic SFAS 106 Direct Case at 4-5.

[11] ***Southwestern Bell***, 28 F.3d at 173. The Commission has amended its rule for exogenous treatment of accounting changes and in doing so has selectively removed exogenous treatment of these costs for the price cap regulated local exchange carriers ("LECs"), starting with their 1995 annual tariffs. ***See Price Cap Performance Review for Local Exchange Carriers***, First Report and Order, CC Docket No. 94-1, ¶¶ 292-314 (rel. April 7, 1995); ***but see*** Petition for Review, ***Bell Atlantic v. FCC***, No. 95-1217 (D.C. Cir. Apr. 19, 1995). Regardless of whether that change is a lawful amendment of the price cap rules, there can be no dispute that the tariffs under investigation here were not affected by the subsequent rule change because the costs were incurred and the rates were adjusted prior to the rule change.

For example, Issue E questions whether exogenous treatment should be limited to those benefit costs that are funded. Effectively, this asks whether to abandon the accrual accounting underlying SFAS 112 and limit exogenous treatment to actual payments (either to employees or to a benefit fund). Such a limitation cannot be found in Commission rules, and was clearly rejected by the court of appeals when it found that costs associated with a change to accrual accounting qualify as exogenous costs because they are real costs beyond the control of the LECs.

Issue F, which asks whether exogenous treatment should be limited to accruals for vested benefits, also invites new limitations that do not exist in the rules. If the Commission had wanted to limit the type of benefits that could be accrued under SFAS 112, it could have rejected the GAAP accounting change and prospectively mandated an alternate change in Commission accounting rules. Having adopted the change without modification however,[12] the Commission is precluded from considering such limitations in its determination of exogenous costs.

The Commission also seeks data concerning benefit changes subsequent to adoption of SFAS 112.[13] These changes are under the control of the company and are ***endogenous*** costs. The ***exogenous*** costs at issue are the additional costs associated with the transition from pay-as-you-go accounting to the accrual

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12 ***See*** 112 Adoption Letter.

13 ***See*** 112 Investigation Order, ¶ 12.

accounting required by SFAS 112. As the court of appeals understood, the event creating the exogenous costs was not the requirement to pay benefits. Rather, it was the change in accounting rules that was beyond the companies' control.[14] Thus, all questions that relate to benefit changes subsequent to adoption of SFAS 112 are irrelevant to the exogenous costs that are the subject of the Commission review.[15]

In addition, the Commission questions whether exogenous treatment may be limited to SFAS 112 costs incurred on or after January 1, 1994.[16] While that date was the latest date by which SFAS 112 adoption was allowed, companies were "encouraged" to implement the rule change "earlier".[17] Bell Atlantic's adoption was consistent with the 112 Adoption Letter. The order could have been date restrictive, but it was not. Having failed to make such restrictions at the time, however, the Commission

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[14] ***See Southwestern Bell*** 28 F.3d at 169-170. Indeed, for Bell Atlantic, all of the costs at issue are the "transition obligation" costs. The transition obligation is actually a one-time cost that reflects the unfunded liability for benefits earned prior to implementation of SFAS 112. Despite the Commission's order to amortize the impact of these costs, those costs were fully incurred as of the time of SFAS 112 adoption.

[15] Price cap regulation already accounts for future changes in benefit costs. On an industry-wide basis, future adjustments to the price cap formula's productivity factor would be reflective of industry productivity growth which implicitly reflects, among other things, various endogenous changes, including future changes in benefit-related expenses.

[16] 112 Investigation Order, Issue B.

[17] Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits," ¶ 12 (Nov. 1992).

cannot now adjust its rules and suggest that such adoption was not authorized by the Commission.

Conclusion

Bell Atlantic's request for exogenous treatment of SFAS 112 costs is consistent with the Commission requirements in place at that time. The Commission should close its investigations without modification to the tariffed rates.

Respectfully submitted,

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January 2, 1996

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Issue A: **Have AT&T and Bell Atlantic correctly calculated the gross amount of SFAS-112 costs that may be subject to exogenous treatment under price cap regulation?**

RESPONSE

Bell Atlantic's direct case calculations of exogenous cost amounts are correct and consistent with the rules in place at the time the exogenous filing was made.

Bell Atlantic has followed prevailing Generally Accepted Accounting Principles (GAAP) in calculating the total SFAS 112 costs that underlie the exogenous cost calculations provided in FCC Tariff No. 1, Transmittal Nos. 704 and 747. These tariff filings reflect exogenous recovery of 1993 incremental SFAS 112 expenses, associated with Bell Atlantic's adoption of the SFAS 112 accounting methodology in 1993.

The adoption of SFAS 112 was an accounting change for Bell Atlantic, since the Company previously accounted for postemployment benefits on a cash basis composed mainly of a pay-as-you-go expense recognition for management and associate workers compensation and severance benefits and associate long term disability (LTD) benefits. Management LTD benefits were funded from trust contributions based upon an actuarial estimate of current year claims for management employees.

The original SFAS 112 costs were derived in conformance with the guidelines specified by the Financial Accounting Standards Board (FASB) in its publication of SFAS 112, and as set forth in the Commission's Responsible Accounting Officer (RAO) Letter 22. Postemployment benefit cost calculations were derived by Bell Atlantic Corporation's independent actuaries using a SFAS 5 approach based upon historical claims data. In addition, an audit of Bell Atlantic's 1993 financial statements by the Company's external auditors did not evidence any SFAS 112 concerns.

In calculating the incremental SFAS 112 expense subject to exogenous treatment, Bell Atlantic properly removed pay-as-you-go amounts (i.e. contributions from Company assets [cash payments], VEBA funded trust contributions and other previously recognized costs) from its total SFAS 112 expense. This ensured that Bell Atlantic would not "double-recover" costs that were embedded in rates at the inception of price caps, or recover costs that could be considered endogenous.

In addition, Bell Atlantic did *not* include separations pay plan (severance) benefit costs in its initial adoption of SFAS 112. Because of Bell Atlantic's history of using other incentives to achieve force reduction objectives, the cost of separation pay plan benefits was not reasonably estimable at the time of adoption of SFAS 112[1].

The specific methodology employed by Bell Atlantic to fairly distribute these costs to interstate price cap baskets for exogenous ratemaking is addressed in the response to Issue C and paragraph 20.

Paragraph 17

AT&T and Bell Atlantic are directed to describe each type of postemployment benefit covered by the SFAS 112 accounting rules that the Company provides to former and inactive employees, their beneficiaries, and any covered dependents. Such benefits include, but are not limited to, the following: salary continuation; supplemental unemployment benefits; severance benefits; disability-related benefits; job training and counseling; and continuation of benefits, such as health care benefits and life insurance.

RESPONSE

Benefits provided under SFAS 112 by Bell Atlantic to its employees include workers compensation, long-term disability (LTD), disability pension and severance. However, upon its initial adoption of SFAS 112 in 1993, Bell Atlantic did not include severance benefits in the calculation of costs. Therefore, these costs were not included in the exogenous tariff filing included in Transmittal No. 704, and thus subsequent discussions of benefits provided under SFAS 112 throughout this direct case will be limited to workers compensation, LTD and disability pension. Also, the management disability pension plan has been replaced by a defined benefit plan effective January 1, 1996. See Response to paragraph 30 below. Unless otherwise noted, responses here refer to the plan in effect at the time of the adoption of SFAS 112.

[1] SFAS 112 requires that liabilities associated with severance benefits be accounted for in accordance to SFAS 43 *Accounting for Compensated Absences,* which specifies four criteria for determining a liability, with the fourth criterion stating that the cost must be "reasonably estimable".

Paragraph 17 (continued)

The parties are directed to include the following for each of the postemployment benefits provided by the company:

Paragraph 17-1

A description of the specific benefits provided to employees under each type of benefit package (i.e., the combination of benefits offered to any employee);

RESPONSE

A description of the benefits to which management and associate network service group (NSG)[2] employees are entitled, follows:

Workers Compensation - Workers Compensation is a self-insured benefit that includes the cost of wage replacement, medical benefits, and award amounts resulting from individual state workers compensation statutes that are provided to an employee as a result of a job related injury. Workers compensation benefits are based upon an employee's salary and wages and years of service with offsets for benefits provided by state government workers compensation awards

Long-term Disability (LTD) - Long-term disability (LTD) is a self insured benefit that provides partial wage replacement to employees during disabilities resulting from non-work related illnesses or injuries. LTD benefits are based upon the employee's salary and wages. Management employees make an annual election for 40%, 50%, 60%, or 70% salary level coverage. Associates receive 50% LTD salary and wage coverage.

Disability Pension - A disability pension benefit provides a retiree wage replacement that resembles an undiscounted service pension for an employee with the respective service requirement and offsets benefits that would be received under the long-term disability plan. Disability pension benefit levels are determined in accordance with the associate and management pension plans.

[2] Network Service Group (NSG) employees represent the employees who work for the regulated operations of the 7 Bell Atlantic operating telephone companies and Bell Atlantic Network Services, Inc. (the centralized network services company).

Paragraph 17-2

A statement specifying the types of persons eligible to receive each type of postemployment benefit (i.e., employees, their beneficiaries or dependents);

RESPONSE

An NSG associate or management employee is eligible for workers compensation type benefits on the employee's first day of employment if he/she is unable to work due to a Company job-related accidental injury.

Active NSG management employees who are scheduled to work 25 or more hours a week may participate in the management long term disability plan. Generally, full time and part time associates who have at least six months of service are eligible for long term disability benefits under the associate plan.

An NSG associate or management employee is eligible to receive a disability pension if all of the following criteria are met:

- the employee is a participant in either the associate or management pension plans, and suffers a total disability entitling the employee to short term disability benefits;
- the employee has completed 15 or more years of retirement eligibility service;
- the employee is still disabled after short term disability benefits run out;
- the employee is not eligible for a service pension or elects to defer service pension benefits until age 65.

Paragraph 17-3

A statement as to how long each benefit would continue after separation from the company;

RESPONSE

Associate and management workers compensation type benefits continue as long as the participant is disabled, or for six years if the participant is partially disabled. These benefits will cease no later than the commencement date of any pension benefits that the participant may be eligible to receive.

Long term disability benefits continue until an individual is no longer disabled, or until death, whichever comes first.

Disability pension benefits continue until the participant dies, recovers from the total disability, or reaches age 65, whichever comes first.

Paragraph 17-4

In the case of salary continuation, supplemental unemployment, and severance benefits, an explanation of how the company computes the amount received by the employee;

RESPONSE

Under the management LTD plan, participants may receive 40%, 50%, 60%, or 70% of basic salary up to a monthly maximum benefit of $15,000 offset by certain other sources of disability income . Other sources of disability income that will reduce management LTD benefits include

- Disability, service, or deferred vested pension benefits;
- Unemployment compensation; and
- Any federal or state disability benefits, including workers' compensation or similar disability benefits, and social security; but nor including veterans' benefits.

Associates receive 50% of their monthly base earnings offset by other sources of disability income which include:

- Any federal of state disability benefits, including social security, workers' compensation or similar disability benefits, but excluding veteran's benefits; and
- Any benefits received from the Company pension plans.

Medical and dental benefits for management and associate LTD plan participants are provided under the Company retiree medical plans.

Management workers compensation salary replacement benefits are based upon the participant's years of service. The workers compensation salary replacement benefit will be offset by the following sources of income:

- Disability, service, or deferred vested pension benefits;
- Unemployment compensation; and
- Any federal or state disability benefits, including workers' compensation or similar disability benefits, and social security; but nor including veterans' benefits.

The level of the management participant's workers compensation benefit is illustrated in the following table (which was effective January 1, 1995):

Term of Employment *(as of 8th calendar day of absence)*	**Maximum weeks at 100% Pay** *(subject to proration for part-time service)*	**Maximum weeks at 50% Pay** *(subject to proration for part-time service)*
Less than 2 full years	2	24
At least 2 full years, but less than 5 full years	4	22
At least 5 full years, but less than 10 full years	8	18
At least 10 full years, but less than 15 full years	13	13
15 or more full years	26	0

After the 26th week a management employee may receive benefits under the Management Long Term Disability Plan. Workers compensation related medical costs are paid by the Company to the extent that the costs do not exceed the state government workers compensation medical fee standards. The participant is provided with other health and welfare benefits that were in effect at the time of the job related injury.

Associate workers compensation benefits are also based upon the participants years of service as set forth in the following table:

Net Credited Service Of...	Provides Full Pay For Up To...	Then Half Pay for as Long As You're Totally Disabled
Up to 15 years	13 weeks of disability	
15 to 20 years	26 weeks of disability	
20 to 25 years	39 weeks of disability	
25 years of more	52 weeks of disability	

Associate workers compensation company paid benefits will be reduced by state statutory workers compensation awards. Workers compensation related medical costs are paid by the Company to the extent that the costs do not exceed the state government workers compensation medical fee standards. The participant is provided with other health and welfare benefits that were in effect at the time of the job related injury.

Paragraph 17-5

For disability related-benefits, a description of all benefits provided by the Company's disability plan and any workers' compensation plans;

RESPONSE

See response to Paragraph 17-4.

Paragraph 17-6

A statement of whether employees are required to contribute to the cost of the postemployment benefit, including the amount of the company's and the employees' contribution.

RESPONSE

Management employees do not contribute to the cost of their workers compensation benefits. Under existing contracts, associate employees are not required to contribute to the cost of their LTD or workers compensation benefits. Management employees are provided a cafeteria style benefits selection, with amounts allocated to cover specific benefits. Management LTD benefit coverage is provided at 50% of base salary. Should the management employee select a coverage level greater than 50%, then the employee must pay the difference between the level selected and the 50% level. The employee also has the option of selecting 40% coverage, with the cost savings applied against the employee's out-of-pocket contribution for other benefit selections.

Management and associate employees are not required to contribute to the cost of their disability pension benefits.

Paragraph 18

We direct AT&T and Bell Atlantic to explain the derivation of the amount of incremental costs that is the basis of their exogenous claims, including:

Paragraph 18-1

The date the company implemented SFAS-112.

RESPONSE

The Company notified the Commission on September 27, 1993 of its intended adoption in the 4th quarter of 1993 of SFAS 112, *Employers' Accounting for Postemployment Benefits,* effective January 1, 1993 for both regulatory and external reporting purposes. On January 3, 1994, Bell Atlantic confirmed with the Commission the Company's intention to follow the new accounting standard retroactive to January 1, 1993.

<u>Paragraph 18-2</u>

Provide the cost basis of the pay-as-you-go amounts that supported the rates in effect on the initial date that the carrier became subject to price cap regulation.

RESPONSE

The rates in effect on January 1, 1991, the initial date the company became subject to price cap regulation, were based on prospective 1990/1991 tariff year costs. Essentially, the initial price cap rates reflected the prospective costs that supported the 1990 annual access tariff filing, which became effective July 1, 1990. This 1990 tariff filing was then amended to incorporate FCC required adjustments for items determined to be exogenous, related to: 1) the reduction in the authorized rate of return from 12.00% to 11.25%, 2) the change in Long Term Support, and 3) FCC Erratum. Please see column (G) of Exhibit 18-2-A for the split year pay-as-you-go amounts that supported the company's initial price cap rates.

<u>Paragraph 18-3</u>

Provide the effect of the price cap formula on that amount up to the date of conversion to SFAS-112.

RESPONSE

Bell Atlantic adopted SFAS 112 effective January 1, 1993. The effect of the price cap formula on Bell Atlantic's pay-as-you-go costs up to the date of the company's conversion to SFAS 112 is detailed in Exhibits 18-3-A and 18-3-B.

<u>Paragraph 18-4</u>

The carrier's actual cash expenditures related to SFAS-112 for each year since the implementation of price caps, prior and following the implementation of SFAS-112 accounting methods;

RESPONSE

See Exhibit 18-4-A. Changes in cash amounts in years subsequent to 1993 (the year Bell Atlantic implemented SFAS 112 and the base period for exogenous treatment of associated costs) are endogenous to the price cap formula. These changes, similar to changes in salaries and wages, are reflected in the GNP-PI component of the price cap formula. Any attempt to capture these changes in other components of the price cap formula (i.e., exogenous costs component) would, in effect, double count the variances in cash amounts .

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Paragraph 18-5

The presentation of the actual cash expenditures in reports to the Securities and Exchange Commission (SEC) and to shareholders each year since the implementation of price caps to the present, including specific citations to or excerpted materials from, such reports to indicate the amount of liability each party has projected for postemployment benefits.

RESPONSE

Excerpts from Bell Atlantic Corporation's 1992-1994 Annual Reports are attached. These excerpts describe the accounting treatment employed by Bell Atlantic for determining the postemployment benefit expense for the Corporation.

The 1993 annual report describes the change in accounting procedure upon adoption of SFAS 112. This disclosure reflects all Bell Atlantic employees covered by postemployment benefits, whereas interstate regulatory reports, exogenous cost workpapers and exhibits within this Direct Case reflect only regulated network services group employees.

Exhibits

Exhibit 18-5-A -- 1992 Annual Report - Page 31
Exhibit 18-5-B -- 1993 Annual Report - Page 31
Exhibit 18-5-C -- 1994 Annual Report - Page 37

(NOTE: The 1991 Annual Report did not contain a separate disclosure for Postemployment Benefits).

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Paragraph 18-6

Describe the forms of postemployment benefit accrual accounting, if any, that were utilized before the effective date of price cap regulation.

RESPONSE

Prior to its adoption of SFAS 112, Bell Atlantic accounted for the cost of most postemployment benefits on a pay-as-you-go basis, with the exception of severance benefits. The Company recorded probable and estimable significant severance costs, related to Force Management Plans (FMPs), in accordance with SFAS 5. FMPs reflected non-recurring costs for which Bell Atlantic established short term accruals. The Company did not, as a matter of practice, accrue for severance costs unrelated to FMPs. As noted in the Company's response to paragraph 17, upon its initial adoption of SFAS 112 in 1993, Bell Atlantic did not include severance benefits in the calculation of costs. Therefore, these costs were not included in the exogenous tariff filing included in Transmittal No. 704.

Also, in 1989, Bell of Pennsylvania (now Bell Atlantic - Pennsylvania) recorded a one-time $9 million accrual for employee Worker's Compensation benefits, to comply with statutory requirements in the state of Pennsylvania. This liability remained on the Company's financial books until Bell Atlantic Corporation adopted SFAS 112. It should be noted that Bell Atlantic properly removed this cost in determining its incremental SFAS 112 costs. See Exhibit 26-B for the valuation of SFAS 112 costs related to Worker's Compensation benefits.

Paragraph 18-7

Describe the type and provide the level of SFAS-112 type expenses reflected in rates before they were adjusted for any exogenous treatment related to SFAS-112.

RESPONSE

See company's response to paragraph 17-1 for a description of the types of postemployment benefits provided to employees. Prior to its adoption of SFAS 112, Bell Atlantic accounted for the cost of most postemployment benefits on a pay-as-you-go basis, with the exception of severance benefits (see companies response in paragraph 18-6). The company properly removed these cash expenses and other previously recognized costs from its total SFAS 112 expense in calculating the incremental SFAS 112 expense subject to exogenous treatment. See Exhibit 18-2-A for pay-as-you-go costs.

ISSUE B: Should exogenous claims be permitted for SFAS-112 costs incurred prior to January 1, 1994, the Commission's date for mandatory compliance?

<u>Paragraph 19</u>

AT&T and Bell Atlantic have included, in their claims for exogenous treatment of SFAS-112, cost incurred before January 1, 1994, which is prior to the date that the Bureau authorized adoption of SFAS-112 accounting. The Commission seeks comment on whether costs incurred prior to the Commission's date for mandatory compliance with SFAS 112 are eligible for exogenous treatment.

RESPONSE

Exogenous claims for SFAS-112 prior to January 1, 1994 should be permitted. These are real costs that would otherwise be excluded. The Commission authorized the change to SFAS 112 accounting, and mandated that the changeover be made "no later than January 1, 1994".[3] Bell Atlantic complied and adopted SFAS-112 effective January 1, 1993, pursuant to the FASB's encouragement to apply the standard early.[4] On September 27, 1993, Bell Atlantic notified the Commission of its intent to adopt SFAS-112 and filed for exogenous treatment in October 1994. Because the incremental costs resulting from this new accounting standard were not reflected in the base period costs for Price Cap Indices, the costs fell under the Commission's definition of authorized costs subject to exogenous under the Price Cap guidelines.[5] To meet the requirements of exogenous treatment, such costs must be mandated by the Commission (outside the carrier's control) and must be shown not to involve double counting with the GNP-PI adjustment.

There is no basis for the Commission to disallow these costs as exogenous. The D.C. Circuit of the United States Court of Appeals, in its SFAS 106 decision, agreed that this type of accounting change approved by the Commission is a mandatory change outside the control of the LECs and should be treated as exogenous[6]. In the Order Designating Issues for Investigation, the Commission acknowledged that "the Court held that under our rules, GAAP changes, once mandated by the Commission, are treated the same as changes made

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[3] RAO Letter 22, *Re: Uniform Accounting for Postemployment Benefits in Part 32,* FCC, June 19, 1993.

[4] *SFAS No. 112 "Employers Accounting for Postemployment Benefits"*, FASB, November 1992, par. 12.

[5] Section 61.44(c) of the Commission's rules identified exogenous cost changes that the Commission will permit or require under Price Cap rules.

[6] ***Southwestern Bell Tel. Co. v. FCC***, 28 F.3d 165, 169-70 (D.C. Cir. 1994).

by the Commission to the Uniform System of Accounts, and thus are entitled to automatic exogenous treatment".[7]

Moreover, since the financial impact of the change to SFAS 112 is predominantly a one-time transition from a modified cash basis of accounting to accrual accounting, the timing of the event is irrelevant to the question determining whether exogenous treatment should be permitted. The same relative cost would have been incurred whether the standard was adopted in 1993, or 1994. The Commission's "mandatory date" of compliance was an outer threshold, in which adoption of the standard was to have occurred *no later than* the mandatory date. Companies embracing the Commission's words of "Carriers will adopt SFAS 112 for regulatory accounting purposes using the same effective date they use for financial reporting purposes, but *no later than* January 1, 1994"[8] (emphasis added) should not be arbitrarily penalized by the Commission at a later date for following the Commission's direction.

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[7] CC Docket No. 94-139, In the Matter of Bell Atlantic Telephone Companies Tariff F.C.C. No.1 Transmittal Nos. 704 and 747, *Order Designating Issues for Investigation*, Released November 30, 1995.

[8] RAO Letter 22, *Re: Uniform Accounting for Postemployment Benefits in Part 32*, FCC, June 19, 1993.