

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

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| In the matter of |) | |
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| 1998 Biennial Regulatory Review -- |) | CC Docket No. 98-81 |
| Review of Accounting and Cost |) | |
| Allocation Requirements |) | |
| |) | |
| United States Telephone Association |) | ASD File No. 98-64 |
| Petition for Rulemaking |) | |

REPLY COMMENTS OF GTE

Dated: September 4, 1998

GTE Service Corporation and its affiliated
domestic telephone operating companies

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SUMMARY

The comments submitted to date in this proceeding demonstrate broad support for streamlining the current accounting and cost allocation rules. Fifteen of the sixteen parties filing comments in this proceeding urge the Commission to “repeal or modify any regulation it determines to be no longer necessary in the public interest” as required by Section 11 of the Communications Act. A significant number of parties urge the Commission to go beyond its tentative conclusions in the NPRM and embark on a course of action that will lead to truly meaningful accounting. Only MCI supports the continued imposition of unnecessary and burdensome Class A accounts on LECs through a series of inaccurate facts and flawed conclusions.

In these reply comments, GTE responds to Commissioner Furchtgott-Roth’s invitation for LECs to submit evidence of the additional costs imposed by maintaining Class A accounts. A letter prepared by Arthur Andersen LLP demonstrates that a move to Class B accounting will reduce LEC’s costs.

MCI objects to permitting LECs to adopt Class B accounting on the mistaken premise that Class B accounts will limit the Commission in several ways. A careful examination of MCI’s arguments, however, reveals that in each example, Class B accounting simply will not interfere with the Commission’s ability to carry out its responsibilities. The record demonstrates that all of the Commission’s reasons for continuing to impose Class A accounting on large LECs are flawed. Forcing large LECs to continue to use Class A accounting will only serve to put such carriers at a competitive disadvantage.

Finally, a number of parties support GTE's position that the FCC's proposed CAM changes do not go far enough to embrace the spirit of Section 11 of the Act. These parties agree with GTE that the Commission should (1) allow all carriers to base their CAMs on Class B accounts; (2) require CAM audits every two years; (3) modify the requirements to quantify CAM changes; and (4) allow carriers to avoid costly annual studies when the results of the studies show little or no change from year to year.

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REPLY COMMENTS OF GTE

GTE Service Corporation and its affiliated domestic telephone operating companies (collectively "GTE")¹ respectfully submit reply comments in response to the *Notice of Proposed Rulemaking* in the above-captioned proceeding.² In the *NPRM*, the Federal Communications Commission ("FCC" or "Commission") proposes to modify its Part 32 accounting and cost allocation rules to (1) allow mid-sized carriers currently required to use Class A accounts to use Class B accounts; (2) reduce the frequency

¹ GTE's domestic telephone operating companies are: GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., and Contel of the South, Inc.

² 1998 Biennial Regulatory Review – Review of Accounting and Cost Allocation Requirements, *Notice of Proposed Rulemaking*, CC Docket No. 98-81, FCC 98-108 (released June 17, 1998) (hereinafter "*NPRM*").

with which mid-sized carriers must perform cost allocation manual ("CAM") audits; and
(3) eliminate or consolidate certain accounts in the Uniform System of Accounts.

I. INTRODUCTION

The comments submitted to date in this proceeding demonstrate broad support for streamlining the current accounting and cost allocation rules. Fifteen of the sixteen parties filing comments in this proceeding urge the Commission to "repeal or modify any regulation it determines to be no longer necessary in the public interest" as required by Section 11 of the Communications Act ("the Act").³ A significant number of parties urge the Commission to go beyond its tentative conclusions in the NPRM and embark on a course of action that will lead to truly meaningful accounting reforms – reforms that eliminate unnecessary costs and treat all carriers equally regardless of size or incumbency. Only MCI supports the continued imposition of unnecessary and burdensome Class A accounts on LECs through a series of inaccurate facts and flawed conclusions. In these reply comments, therefore, GTE focuses largely on the arguments made by MCI.

II. DISCUSSION

A. **Eliminating the requirement to maintain Class A accounts will substantially reduce LECs' accounting costs.**

In his separate statement accompanying the *NPRM*, Commissioner Furchtgott-Roth expressed concern that the tentative decision to withhold Class B relief from the largest LECs was not based on a cost/benefit analysis. Commissioner Furchtgott-Roth

³ 47 U.S.C. § 161.

invited parties who would continue to be required to follow the Class A requirements to comment on the specific burdens that these requirements impose.⁴

MCI addresses the cost issue in its Comments. It suggests that the costs of complying with Class A accounting and current CAM requirements are minimal. It argues that because LECs have been designed their automated accounting systems to use Class A accounting, the cost of continuing to use Class A accounting are low.⁵

MCI's arguments, however, are contradicted by the findings of GTE's independent public accountant, Arthur Andersen LLP. GTE requested that Arthur Andersen examine the impact of allowing GTE to use Class B accounts, and on Arthur Andersen's ability to prepare an auditor's report on financial statements filed with the Securities and Exchange Commission and the ARMIS Joint Cost Report (Report 43-03) filed with the FCC.⁶ The Arthur Andersen Letter concludes that the ability to use simplified time reporting processes and the opportunity to further consolidate like costs within the Class B account structure for allocation purposes would likely lead to reductions in audit efforts and fees. Moreover, the Arthur Andersen Letter echoes GTE's previous comment that relaxing the requirement that carriers perform an annual

⁴ *NPRM* at 16, Separate Statement of Commissioner Harold W. Furchtgott-Roth.

⁵ MCI Comments at 5.

⁶ Letter from Arthur Andersen LLP to Brian T. Holland, Manager, Financial Policies, GTE Service Corporation, dated July 27, 1998, ("Arthur Andersen Letter") (appended hereto as Attachment A).

audit of reported cost allocation data would result in a substantial reduction of fees.⁷ In addition, it stands to reason that fewer accounts will ultimately lead to recurring cost reductions in the areas of data processing and storage, external/internal reporting, account verification, and more.

GTE agrees with Commissioner Furchtgott-Roth that the FCC must weigh these costs against the benefits provided by maintaining the Class A accounting requirement. As discussed below, GTE believes that the benefits provided by requiring carriers to maintain Class A accounting are minimal and do not justify the burden imposed.

B. Allowing LECs to use Class B accounts will not limit the Commission's ability to meet its responsibilities.

MCI objects to permitting LECs to adopt Class B accounting on the mistaken premise that Class B accounts will limit the Commission in several ways.⁸ A careful examination of MCI's arguments, however, reveals that in each example, Class B accounting simply will not interfere with the Commission's ability to carry out its responsibilities. Under Class B accounts, the Commission will continue to have all the information necessary to carry out its obligations in the competitive telecommunications environment.

As further support for the adequacy of Class B accounting, the Arthur Andersen Letter concludes that Class B accounts are sufficient to conform with both generally accepted accounting principles ("GAAP") and generally accepted auditing standards

⁷ Arthur Andersen Letter at 2; GTE Comments at 15. GTE stated in its comments that it spends one million dollars annually complying with this requirement.

⁸ MCI Comments at 3.

("GAAS"). In addition, Arthur Andersen concludes that Class B accounts are sufficient for the Commission to meet its requirements.⁹

GTE's reply to the specific problems raised by MCI follows.

1. Allowing GTE to use Class B accounts will not impact the FCC's ability to conduct tariff investigations.

MCI argues that reporting under Class A is necessary for tariff investigations. It claims that the Commission has relied on Class A accounting detail recently in determining that proposed rates by price cap LECs were unreasonable.¹⁰ GTE disagrees.

Regardless of whether a carrier uses Class A or Class B accounts, the supporting detail for each transaction will remain the same. Only the aggregation level of the transactions differs. It is the underlying detail and not the account totals that are useful when the Commission investigates tariff filings. As GTE discussed in its comments, the lobbying expense example referenced in footnote 19 of the NPRM would have resulted in the same finding regardless of whether the carrier used Class A or Class B accounts.¹¹ Tariff investigations are not conducted at the account level of detail. Auditors do not rely solely on account titles when verifying the accuracy of a company's records. Rather, standard auditing procedures require a review of the underlying transactional detail – detail that would not be affected by the adoption of

⁹ Arthur Andersen Letter at 2.

¹⁰ MCI Comments at 3-4.

¹¹ GTE Comments at 11.

Class B accounting. Thus, MCI is incorrect in its assertion that Class B accounts will limit the Commission's ability to investigate carrier's tariff filings.

2. Class B accounting will not impact the Commission's ability to identify cost misallocations.

MCI contends that the level of detail of the Class A accounting rules allows the Commission to identify cost misallocations beyond those revealed by the Class B system of accounts.¹² Again, MCI is incorrect.

As with tariff investigations, in order to identify cost misallocations auditors rely on underlying transactional detail and not on the account level balances. Whether the data is reported in a Class B account or a Class A account, the underlying detail will always be available to auditors to support the given transactions. The more detailed Class A requirement, therefore, only serves to place unnecessary reporting burdens and costs on companies without any actual corresponding benefits.¹³ Thus, SBC states that "[t]he only necessary difference in the CAM [under Class B accounts] is that the cost pools will be organized under a fewer number of accounts. This is merely a difference in form that does not have any substantive impact on the accuracy of cost allocations."¹⁴

¹² MCI Comments at 4.

¹³ For a detailed discussion of how the Class B accounts would not affect cost allocations or hinder the identification of misallocations, see Ameritech Comments, Attachment 4.

¹⁴ SBC Comments at 15.

3. Class B accounting would not affect regulators' ability to improve cost allocations, determine pole attachment fees, or estimate ILECs' costs of providing wholesale services.

MCI states that the FCC and state regulators have relied on Class A accounting detail to improve cost allocations, determine pole attachment fees, and estimate ILECs' avoided costs of providing wholesale services.¹⁵ Again, however, MCI would have the Commission believe that the underlying transactional detail would be lost if Class B accounts were used instead of Class A accounts. As GTE has shown, adopting Class B accounting does not eliminate the Commission's ability to establish and monitor standards or evaluate industry information. Reducing the number of accounts only relieves the carriers of the cost burden associated with maintaining Class A accounts. Arthur Andersen concurs, stating that "if a Class B account structure were adopted for all LECs, subsequent regulatory processes including Part 64 common cost allocations, Part 36 jurisdictional separations and rate development under Part 69 access charge rules would be largely unaffected."¹⁶

¹⁵ MCI Comments at 4.

¹⁶ "Accounting Simplification in the Telecommunications Industry," submitted by Arthur Andersen as an *ex parte* presentation in CC Docket No. 98-81, on July 15, 1998 ("Arthur Andersen Paper"). As GTE noted in its comments, the Arthur Andersen Paper concludes that Part 36 and 69 rules are already based on Class B accounting detail, therefore no changes to these rules would be necessary. See GTE Comments at 12, *citing* Arthur Andersen Paper at 23. See also BellSouth Comments at 23.

4. Requiring GTE and other large ILECs to provide Class A level of detail puts such carriers at a competitive disadvantage.

MCI argues that the highly aggregated local service revenue reporting under Class B accounting would limit the FCC's ability to track competitive changes in local markets. It contends that Class B accounting would not allow the Commission to see changes in basic area revenue disaggregated from extended area revenue, cellular revenue, local private line revenue, and other revenue sources.¹⁷

Requiring some LECs to publicly provide a Class A level of detail places such LECs at a competitive disadvantage vis-a-vis their competitors. Information regarding revenue sources is extremely sensitive and could be used by competitors not required to provide such information to gain an unfair competitive advantage. Accordingly, GTE objects to being required to provide revenue source information publicly in the context of Class A account detail. Rather, should the Commission wish see such commercially sensitive information in carrying out its regulatory responsibilities, it can require carriers to provide such information, but in a form that would prevent competitors from gaining access to the information. Once again, Class B accounts will not limit the Commission's ability to carry out its responsibilities.

C. Class B accounting is appropriate for all carriers.

A number of parties join GTE in urging the Commission to extend the opportunity to use Class B accounts to all carriers regardless of size and particularly for carriers under price cap regulation. Thus, SBC states:

¹⁷ MCI Comments at 4-5.

It is simply not in the public interest to continue requiring price cap ILECs to comply with excessively and unnecessarily detailed accounting, recordkeeping and cost allocation requirements, designed for a rate-of-return environment, when their competitors' activities are not subject to any of the same type of regulatory impediments at all.¹⁸

Similarly, BellSouth notes the bizarre paradox that results if the NPRM's tentative conclusion to limit relief only to mid-sized LECs and deny relief to price cap LECs is adopted, stating that "the Notice proposes to reduce regulation of carriers for which the regulation was designed, but keep the regulation on those carriers to which it no longer applies."¹⁹

Parties also agree with GTE's assertion that the volume of transactions involving competitive transactions should not be the basis for excluding large LECs from the relief Class B accounts afford. The more relevant examination is the ratio of regulated to unregulated activity.²⁰ BellSouth, for example, states that "the volume of transactions involving competitive services is not an appropriate benchmark for assessing the risk that ratepayers will attempt to cross-subsidize competitive services. Instead a more appropriate benchmark is the relative amount of resources devoted to providing competitive services."²¹

¹⁸ SBC Comments at 5.

¹⁹ BellSouth Comments at 4.

²⁰ GTE Comments at 7-9.

²¹ BellSouth Comments at 11.

Moreover, SBC argues that "in most cases, the mid-sized ILECs have a higher level of nonregulated activity than the SBC LECs."²² Since the large LECs have approximately the same small percentage of nonregulated activities as the mid-size LECs, and the large LECs have the added protection against cross-subsidizing that price cap regulation affords, there is no valid reason to deny large LECs the ability to use Class B accounting.

D. Section 11 requires the Commission to consider CAM changes beyond those currently proposed in the NPRM.

A number of parties support GTE's position that the FCC's proposed CAM changes do not go far enough to embrace the spirit of Section 11 of the Act. GTE asked the Commission to (1) allow all carriers to base their CAMs on Class B accounts; (2) require CAM audits every two years; (3) modify the requirements to quantify CAM changes; and (4) allow carriers to avoid costly annual studies when the results of the studies show little or no change from year to year.²³

SBC agrees with GTE that all carriers should be able to base their CAMs on Class B accounts. It states, that "[s]ince the maintenance of Class A accounts makes no difference in the accuracy of cost allocation or the prevention of cross-subsidy, there

²² SBC Comments at 9. *See also* Ameritech Comments at 5; BellSouth Comments at 11.

²³ GTE Comments at 13-16.

is no reason to limit the relief from Class A accounting requirements to mid-sized LECs, as the NPRM proposes."²⁴

As the Arthur Andersen Letter explains, "[i]n a Class B accounting environment, cost pool and regulated / nonregulated apportionment processes would serve to continue to properly categorize costs into like categories and facilitate an accurate, efficient and effective allocation of costs between regulated and nonregulated activities."²⁵

GTE is currently spending approximately one million dollars annually to meet the audit requirements of the current rules.²⁶ The Arthur Andersen letter addresses how these fees may be affected if GTE were allowed to adopt Class B accounting rules. The letter states, "[s]implification of time reporting processes and the opportunity to further consolidate like costs within Class B account structure for allocation purposes would likely lead to reductions in audit efforts and fees."²⁷ In addition, should the Commission permit biennial attestation examinations of its CAM instead of the current requirement, GTE would "benefit from a more substantial reduction in fees."²⁸ Thus, given that CAMs based on Class A accounts provide no greater detail or refinement

²⁴ SBC Comments at 20. In addition, Ameritech states that "[a]t a minimum, all carriers should be allowed to use Class B cost allocations and obtain audits every two years in stead of annually." Ameritech Comments at 11

²⁵ Arthur Andersen Letter at 2.

²⁶ GTE Comments at 13.

²⁷ Arthur Andersen Letter at 2.

²⁸ *Id.*

than CAMs based on Class B accounts, and Class B CAMs combined with biennial audits provide substantial cost savings to carriers, there is no question that the public interest is served by allowing all carriers to adopt CAMs based on Class B accounts.

Regarding the need to quantify CAM changes, BellSouth concurs with GTE and states that price cap carriers, "should no longer be required to expend resources to estimate the quantification of CAM changes."²⁹ In addition, GTE agrees with BellSouth's recommendation to eliminate the requirement for network usage forecasts and the requirement to value services provided between affiliates at fully distributed costs. Neither of these requirements is required to protect ratepayers under price cap regulation and should be eliminated under the Section 11 review process.

²⁹ BellSouth Comments at 15.

III. CONCLUSION

The FCC's proposal to require large ILECs to maintain a Class A level of accounting does not provide significant benefits to the FCC or the public. By contrast, this requirement does impose a substantial burden on GTE. Accordingly, the public interest will only be served by allowing all carriers to move to Class B accounting. The record also supports more meaningful reform of the accounting rules than the proposals in the *NPRM*. To comply with Section 11 of the Act, the Commission must consider the recommendations made by the USTA and Arthur Andersen. The Commission's ultimate goal should be to permit LECs to follow GAAP accounting practices.

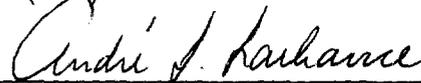
Dated: September 4, 1998

Respectfully submitted,

GTE Service Corporation and its affiliated
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ATTACHMENT 1

ARTHUR ANDERSEN

July 27, 1998

Arthur Andersen LLP

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Dear Mr. Holland:

We are writing this letter in response to your questions regarding whether the adoption of the Federal Communications Commission's (FCC) Class B accounting requirements for the incumbent local exchange carriers (ILECs) would impact our ability to render our auditors' reports on: (1) GTE's financial statements filed with the Securities and Exchange Commission (SEC) and distributed to shareholders and the investment community and (2) the Company's ARMIS Joint Cost Report (Report 43-03) filed with the FCC.

As independent public accountants, we believe that the above audit opinions may continue to be rendered should the GTE Telephone Companies be allowed to maintain their accounts pursuant to the FCC's Class B requirements.

Financial Statement Audits

The purpose of an audit of financial statements is to opine as to whether such financial statements present fairly, in all material respects, the Company's financial position, results of operations and cash flows in conformity with generally accepted accounting principles (GAAP). GAAP does not prescribe a specific degree of detail to which subject companies must keep their books of account (underlying records in support of the financial statements). GAAP and corresponding SEC Rules (Regulation S-X) prescribe only the required elements of financial statements, including the detailed financial statement line items required to be reported. Charts of accounts facilitate the accumulation and reporting of accounting transactions within the above required financial statement captions.

Financial statements could be prepared and audits of such financial statements performed in accordance with generally accepted auditing standards (GAAS) should the Company be allowed to adopt Class B level accounting. GAAS require that auditors consider audit risk and materiality and obtain sufficient evidential matter in order to evaluate whether the financial statements taken as a whole are presented fairly, in all material respects, in conformity with GAAP. The level of detail required for Class B carriers would be sufficient to continue to allow us to comply with this requirement.

ARTHUR ANDERSEN

GTE Corporation

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July 27, 1998

Part 64 Common Cost Allocation Audits

As independent auditors, we will still be able to render an opinion for Part 64 purposes if the Company moves to a Class B chart of accounts. As discussed in our position paper entitled "Accounting Simplification in the Telecommunications Industry" filed with the FCC on July 15, 1998, the Part 64 cost allocation process, while based on a Class A level of account detail today, could be converted to a Class B level without a significant impact on cost allocation results. In a Class B accounting environment, cost pool and regulated / nonregulated apportionment processes would serve to continue to properly categorize costs into like categories and facilitate an accurate, efficient and effective allocation of costs between regulated and nonregulated activities. Assuming the necessary modifications to the Company's Cost Allocation Manual are made to reflect the cost causation principles inherent in FCC Docket No. 86-111, we would still be able to render our "presents fairly" auditors' report.

In addition, we believe that the audit fees for Part 64 work might decrease if the Company were able to move to Class B accounting. Simplification of time reporting processes and the opportunity to further consolidate like costs within the Class B account structure for allocation purposes would likely lead to reductions in audit efforts and fees. Additionally, if the FCC were to adopt its proposal to conduct a biennial attestation examination instead of the current annual GAAS audit, the Company would benefit from a more substantial reduction in fees.

In summary, the additional reporting requirements for Class A companies do not contribute to independent accountants' ability to render an opinion on financial statements or the FCC Report 43-03. The Class B chart of accounts is sufficient to meet both GAAP and GAAS requirements.

Very truly yours,

ARTHUR ANDERSEN LLP

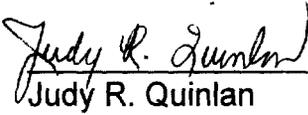
By



Carl R. Geppert

Certificate of Service

I, Judy R. Quinlan, hereby certify that copies of the foregoing "Reply Comments of GTE" have been mailed by first class United States mail, postage prepaid, on September 4, 1998 to all parties of record.



Judy R. Quinlan