EX PARTE OR LATE FILED

BELLSOUTH

ORIGINAL

Mary L. Henze
Executive Director
Executive and Federal Regulatory Affairs

Suite 900
1133 - 21st Street N.W.
Washington, D.C. 20036-3351
202 463-4109
Fax 202 463-4631
henze.mary@bsc.bls.com

September 23, 1998

Ex Parte

RECEIVED

SEP 23 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 98-81, In the Matter of 1998 Biennial Regulatory Review—Review of Accounting and Cost Allocation Requirements

ASD File No. 98-64, United States Telephone Association Petition for Rulemaking

CC Docket No. 96-150, In the Matter of the Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996

Dear Ms. Salas:

In accordance with the Commission's rules, please be advised that on September 22, 1998, Carl Geppert of Arthur Andersen, Jeannie Fry representing SBC Communications, Tony Alessi representing Ameritech, Jerry Asch representing Bell Atlantic, and the undersigned, representing BellSouth met in separate meetings with the following:

- Yog Varma, Ken Moran, Tim Petersen, Doug Slotten, Joann Lucanik, and Richard Cameron, all of the Common Carrier Bureau
- Kyle Dixon, Legal Advisor to Commissioner Powell
- Jim Casserly, Legal Advisor to Commissioner Ness
- Tom Powers, Legal Advisor to Chairman Kennard

No. of Copies rec'd 0+5
List A B C D E

The purpose of the meetings was to discuss and answer questions regarding Arthur Andersen's paper, *Accounting Simplification in the Telecommunications Industry*. A summary of the discussion is outlined in the attachment.

Prior to the release of the Accounting Notice, Arthur Andersen began development of the position paper to provide critically needed analysis of the Commission's USOA. The conclusion reached in this accounting position paper is that extensive reform of USOA well beyond that contemplated in the Accounting Notices, is urgently needed. These recommendations can be adopted now to ease the recordkeeping burdens on **all** LECs with the ultimate goal being full reliance on Generally Accepted Accounting Procedures (GAAP).

The proposals for simplification and/or elimination discussed in the position paper should be adopted expeditiously by the Commission. They provide a framework for a *transition* from today's detailed Part 32 regulatory accounting and recordkeeping requirements to more of a "level playing field" where all carriers are subject to the same requirements under GAAP.

Please include this letter in the record of these proceeding in accordance with Section 1.1206(a)(2) of the Commission's Rules.

If you have any questions regarding this matter, please do not hesitate to contact me at (202) 463-4109.

Sincerely,

Mary L. Henze

Attachment

cc:	R. Cameron	J. Casserly	K. Dixon
	J. Lucanik	K. Moran	T. Petersen
	T. Powers	D. Slotten	Y. Varma

ACCOUNTING SIMPLIFICATION
IN THE TELECOMMUNICATIONS INDUSTRY

- **The existing Part 32 USOA does not represent the current regulatory or competitive paradigm.**
  - Original objective of producing meaningful financial, management and regulatory information no longer being achieved.
  - Details no longer relevant under pure price cap regulation.
- **Part 32 needs to be streamlined now.**
- **Long-term objective should be full reliance on GAAP.**

Areas of Greatest Opportunity

- **Part 32 Account Structure and Accounting Requirements**
  1. Class B Level
  2. Expense matrix categorization
  3. Part 32 materiality standards
  4. Advance notification requirements

- **Property Records and Depreciation**
  1. Permit the accounting and tracking of plant assets consistent with management requirements and GAAP
  2. Allow carriers to set depreciation rates and methods based on GAAP.

- **Affiliate Transaction Rules**
  1. Eliminate asymmetrical affiliate transaction rules for services.
  2. Expand the FMV exemption
     - materiality-based
     - support service affiliates

RULE ENFORCEMENT CONTINUES TO BE EFFECTIVE

	Existing Rules	Streamlined Rules	Commission Staff Enforcement-Still Effective
I.	USOA Structure		
	A. Class A/B- LECs with operating revenues exceeding $112 M must utilize Class A accounts (261 accounts)	• All LECs may use abbreviated Class B accounts (109 accounts). Class A accounts are merely aggregated to a summary level for B.	• Still maintains auditable financial presentation. • Separations (Part 36) is structured to work in a class B environment. • Part 64 (CAM) principles and procedures still function in a Class B environment. • LECs will continue to track necessary cost information via sub accounts / accounting codes for calculating pole attachment rates and Universal Service reporting. Small LECs currently utilize Class B and are able to comply with these rules.
	B. Expense Matrix – Each cost account must maintain its cost segregated into salaries & wages, benefits, rents, and other expenses.	• Eliminate this "matrix" of cost categorization which is complicated and prone to a significant level of detail categorization for each accounting cost transaction.	• LECs will continue to maintain the wage categorization for cost accounts which is the most useful information in the matrix. • This matrix of detail creates a significant amount of burdensome transactional work which provides unknown informational benefit regulatory, financial and managerial purposes.
	C. Materiality – Part 32 affords no recognition to the GAAP convention of materiality. Part 32 must be followed exactly as prescribed irrespective of the materiality of the transactions. Expense Limits – Part 32 allows disbursements of up to $2000 to be expensed for support assets e.g. furniture and office equipment. There is no latitude in expensing network equipment i.e. all network disbursements are capitalized.	• Materiality standards should be a fundamental part of Part 32 as it is in Generally Accepted Accounting Principles. • LECs should be allowed to employ a materiality standard as agreed upon with its public accounting firm. This should include authority to expense all minor disbursements.	• Only material accounting impacts should be subject to regulatory scrutiny. • Rules would still be enforceable and millions of transactions per year for each Tier 1 LEC would be simplified or eliminated. Agreed to expense limits are still subject to FCC review under materiality standard, while tracking minor network items would be eliminated. • These expense limits can be enforced and audited more easily than the existing rules due to the elimination of accounting for these smaller dollar items.

	Existing Rules	Streamlined Rules	Commission Staff Enforcement-Still Effective
II.	Property Records		
	• Must maintain detailed property records with description, date of placement, essential details of construction, and original cost maintained for the life of the property irrespective of materiality. Record must provide location for verification in such a manner that it can be readily spot checked. • Commission Audit Staff interprets rules to mean that property records includes exact bay/shelf location of each detailed piece of equipment. • Property records are defined in great detail in a property record plan. A revised plan must be filed with the Commission in order to change the definition of even one property record.	• Eliminate detail and allow aggregation of property records at a more manageable level. Eliminate the Commission filing requirement for changing property record definitions. • Allow property record information to comply with GAAP standards for support of property records i.e. demonstration of the existence of the asset would suffice. (See below) • GAAP requires maintenance of internal control systems which provide for the verification of the assets.	• Staff would still be able to conduct audits and verify the existence of property. In some cases, this would take the form of a internal control audit of the assets when capitalized and retired.

	Existing Rules	Streamlined Rules	Commission Staff Enforcement-Still Effective
III.	Establishment of depreciation rates		
	• Rates are set through a formal collaborative 3-way process based on an extremely detailed analysis of asset lives, retirement data, and technology information related to future expected lives. • Also, "streamlined" techniques are available to change rates within preestablished ranges or guidelines. Frequently, LECs are constrained within these ranges such that it is necessary to file the complete data analysis referenced above instead of utilizing the streamlined technique.	• Allow LECs the ability to change depreciation rates based upon economic lives. These changes would be reviewed as a part of the annual financial audit of the LEC by the outside auditor. This review satisfies the GAAP standard.	• Depreciation rates are reviewed by the LEC's public accounting firm and publicly made available. • LEC 10K report contains information on asset lives. • Depreciation rate changes have no effect on customer rates because exogenous treatment is not permitted in a price cap environment for Tier 1 LECs.

	Existing Rules	Streamlined Rules	Commission Staff Enforcement-Still Effective
IV.	Affiliate Transaction Rules		
	• Affiliate transaction pricing of goods and services sold by the Telco to affiliates will be established utilizing a tariff rate if available, or in the absence of that, a prevailing price applicable to assets / services in which the Telco sells to outside customers. • Prevailing price use is restricted to the sale of goods and services where the LEC can demonstrate that at least 50% of the sales for that specific service or asset are made to outside non-affiliated parties. (This is not applicable to transactions with a 272 subsidiary.) • In the absence of the above tariff or prevailing price, the rules require LECs to determine the transfer price of assets or services sold to an affiliate as the higher of cost or a fair market value price. • Items purchased by the Telco are priced at a prevailing price if applicable and in lieu of that at the lower of cost or FMV. • Purchases by a Telco from a corporate "administrative" affiliate which exists solely to provide services for other affiliates is priced at cost precluding the FMV comparison.	• Existing rules are complicated and require unnecessary costly FMV studies in order to carry out what outside firms consider routine transfer pricing decisions. Current rules should be revised as follows: • Eliminate the 50% outside party requirement in regards to establishing a prevailing price. • Eliminate the asymmetrical valuation rules for services where FMV is compared to cost. The transfer would simply be carried out at cost in that instance. • If the FMV comparison continues to be a mandate, FMV pricing should only be required if sales of a particular product to affiliates exceed $1 million. • FMV prices would be recalculated / restudied only on a periodic basis e.g. every three years. • Expand the administrative affiliate exception to encompass: • Telco sales of services and products which are only offered for use by other affiliates.	• These streamlined recommendations still are enforceable and in fact would be much easier to audit since pricing would rely more upon prevailing prices or original cost. • FMV studies and analysis would be eliminated or significantly reduced. FMV studies are costly and time consuming and generally don't produce results materially different than the cost based pricing.