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August 24, 1999

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ex Parte

Ms. Magalie R. Salas
Secretary
Federal Communication Commission
Room TW-A325, The Portals
445 Twelfth Street
Washington, D.C. 20554

Re: CC Docket No. 99-253, In the Matter of Comprehensive Review of the
Accounting Requirements and ARMIS Reporting Requirements for
Incumbent Local Exchange Carriers: Phase 1

Dear Ms. Salas:

In accordance with the Commission's rules, please be advised that on August 23, 1999, Mr. Pat Doherty, Ms. Jeannie Fry, and the undersigned, representing SBC Communications Inc. (SBC) and Ms. Debbie Webber and Mr. John Putnam representing Ernst and Young LLP (EY) and Mr. John Zorne representing Sprint Corporation met with following from the FCC Accounting Safeguards Division: Mr. Tim Peterson, Deputy Division Chief, Ms. JoAnn Lucanik, Assistant Division Chief, Mr. Hugh Boyle, Chief, Audits Branch, Mr. Jose Rodriguez, Chief, Accounting Systems Branch, Mr. Bob Hood, Deputy Chief, Audits Branch, Mr. Joe Watts, Mr. Andy Skadin, Mr. Mark Gerner, Mr. Alex Chan, Ms. Sherry Herauf, Mr. John Hayes, Mr. Bob King, Mr. Jeff Stover, Mr. Brett Kissel, Mr. Larry McKinley, Mr. Henry Morrow, Ms. Debbie Weber, and Ms. Connie Hellmer.

The purpose of the meeting was to present the differences between a "presents fairly" audit and an "attestation" audit in reference to third party audits on Cost Allocation Manuals (CAM) required for both mid-size and large carriers. Ernst and Young stated that the transition from an "presents fairly" audit to an "attestation" audit in which the focus will shift from quantitative measurements to compliance could result in approximately a 40% reduction in audit fees. However, EY emphasized that in an "attestation audit," both audit costs and procedures will be largely dependent on the language contained in the management assertion. This information was presented at the request of the Accounting Safeguards staff.

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In addition, SBC distributed an outline of the comments it filed on August 23, 1999 regarding the accounting simplification measures proposed in CC Docket No. 99-253. Specifically, SBC agreed with the Commission's proposals for the accounting simplifications as outlined by the Commission in Phase 1. However, SBC also encouraged the Commission to take even greater measures to achieve accounting simplification in the Phase 2 process. Attached is a copy of the presentation materials distributed at this meeting.

An original and one copy of this letter and the attachments are being submitted. Acknowledgement and date of receipt of this transmittal are requested. A duplicate transmittal letter is attached for this purpose.

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

If you have any questions on this, please do not hesitate to contact Ms. Liz Geddes at 202-326-8842.

Sincerely,

A handwritten signature in black ink that reads "Liz Geddes". The signature is written in a cursive, flowing style.

Attachments

CC: Mr. Tim Peterson
Ms. JoAnn Lucanik
Mr. Jose Rodriguez
Mr. Hugh Boyle
Mr. Bob Hood
Mr. Joe Watts
Mr. Andy Skadin

Cost Allocation Manual (CAM) Audits

**Presentation to the
Accounting Safeguards Division
of the
Federal Communications
Commission**

August 23, 1999

 **ERNST & YOUNG LLP**

CAM Audit Overview

- ✱ **Lessons From 11 Years of CAM Audits**
- ✱ **Presents Fairly vs. Attestation**
- ✱ **86-111 Background**
- ✱ **Management Assertion and Opinion**
- ✱ **Quantification of Errors**
- ✱ **ARMIS 43-03 Adjustment Threshold**
- ✱ **Mid-Size Company Order**
- ✱ **Impact on Audit Fees**
- ✱ **FCC Spreadsheet Changes**

Lessons From 11 Years of CAM Audits

- **FCC staff participation in:**
 - ❖ **Scope and procedures**
 - ❖ **Packaging of workpapers and results**
 - ❖ **Disposition of exceptions**
- **Adaptation of Procedures to new Policies and Rules**
- **Across the industry - highly successful implementation of CAM and CAM audits**
- **Decisions made by the FCC on the NPRM Should take this History into Consideration**

Presents Fairly Vs. Attestation

	Presents Fairly	Attestation
Focus	Quantitative	Compliance
Procedures	Based on Management Financial and Compliance Assertion	Based on Management Compliance Assertion
Materiality	Based on Amounts in ARMIS 43-03	Based on CAM Compliance
Errors	Only Reported When Determined to Impact 43-03 Opinion	Evaluated Regardless of Dollar Amount

86-111 Background

- ✱ **CAM Audits are tools for FCC regulatory oversight**
- ✱ **FCC Established the Performance Criteria and Independent Auditor Compares Performance to Criteria**
- ✱ **Sole Purpose for the CAM Audit is the Execution of the FCC Oversight Responsibilities**
- ✱ **FCC Conducts Audits on Other Topics at Different Depth**
- ✱ **Ability to Reduce CAM Audit Work is Directly Related to:**
 - ❖ **Changing Needs of the FCC**
 - ❖ **Evaluation of Risk**
 - ❖ **Rapidly Evolving Industry Landscape**

Management Assertion and Opinion

- ★ FCC will participate in defining the scope and procedures of the Management Assertion**
- ★ Review and discussion of examples**

Quantification of Errors

- ✱ It is necessary to quantify all errors in a Fairly Presents engagement to determine if the auditor's opinion will require revision.
- ✱ In an Attestation engagement errors need not be quantified, but would be reported as material noncompliance with the CAM.
 - ❖ It is possible to attempt quantification of errors to meet the FCC's needs in an Attestation engagement.

ARMIS 43-03 Adjustment Threshold

- ✱ **Currently, the FCC requires all errors greater than \$1 million to be adjusted**
 - ❖ **Opinion materiality significantly higher**
 - ❖ **Cost/Benefit?**
- ✱ **USTA position - Two Percent of Non-Regulated expenses**
 - ❖ **Estimated savings - \$10,000 per company in audit costs**

ARMIS 43-03 Adjustment Bars

	<i>Southwestern Bell</i>			
	Regulated		Nonregulated	
	<i>Revenue</i>	<i>Expenses</i>	<i>Revenue</i>	<i>Expenses</i>
Total	\$10,021,623,000	\$7,421,751,000	\$991,369,000	\$799,498,000
\$1 Million Threshold	0.010%	0.013%	0.101%	0.125%
2% Threshold	\$200,432,460	\$148,435,020	\$19,827,380	\$15,989,960
5% Threshold	\$501,081,150	\$371,087,550	\$49,568,450	\$39,974,900

	<i>Pacific Bell</i>			
	Regulated		Nonregulated	
	<i>Revenue</i>	<i>Expenses</i>	<i>Revenue</i>	<i>Expenses</i>
Total	\$8,685,437,000	\$6,507,793,000	\$483,116,000	\$644,887,000
\$1 Million Threshold	0.012%	0.015%	0.207%	0.155%
2% Threshold	\$173,708,740	\$130,155,860	\$9,662,320	\$12,897,740
5% Threshold	\$434,271,850	\$325,389,650	\$24,155,800	\$32,244,350

	<i>Nevada Bell</i>			
	Regulated		Nonregulated	
	<i>Revenue</i>	<i>Expenses</i>	<i>Revenue</i>	<i>Expenses</i>
Total	\$170,293,000	\$160,166,000	\$42,293,000	\$18,293,000
\$1 Million Threshold	0.587%	0.624%	2.364%	5.467%
2% Threshold	\$3,405,860	\$3,203,320	\$845,860	\$365,860
5% Threshold	\$8,514,650	\$8,008,300	\$2,114,650	\$914,650

Mid-Size Company Order

- ★ **Order released June 30, 1999 - Issues**
 - ❖ **Attestation Engagement - Management Assertion**
 - ❖ **two year audit period - logistics**
 - ❖ **CAM based on Class B accounts - compliance with other orders**
 - ❖ **Effective Date**

Impact on Audit Fees

- ✱ **Change to two year reporting period**
- ✱ **Increase in adjustment threshold**
- ✱ **Focus on compliance testing**
- ✱ **Increased threshold for FMV studies**
- ✱ **Elimination of detailed ARMIS 43-03 testing**
- ✱ **Reduced scope of FCC spreadsheet package**
 - ❖ **Estimated decrease in audit fees: 40%**

FCC Spreadsheet Changes

- ★ **10-K Reconciliation**
- ★ **Asset Transfers**
- ★ **Chaining Transactions**
- ★ **Affiliate Transactions**
- ★ **Competitive & Universal Services**
- ★ **Part 32 Testing Coverage**
- ★ **CAM Changes**

FCC Spreadsheet Changes

- ✱ **Sampling**
- ✱ **Special Studies**
- ✱ **Transaction Code Testing**
 - ❖ **Spreadsheet package should be reduced in scope given shift to Attestation engagement. This could result in approximately \$10,000 in audit savings per Company.**