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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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

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REPLY COMMENTS of the GENERAL SERVICES ADMINISTRATION

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Summary

In these Reply Comments, GSA responds to requests by incumbent carriers to sharply reduce accounting and reporting requirements for the large LECs. In its initial Comments, GSA acknowledged that some of the proposals to simplify accounting procedures and eliminate or consolidate tables in the ARMIS 43–02 report should be adopted. However, GSA explains in these Reply Comments that some proposals by incumbent carriers go much too far in reducing the ability of the Commission and state regulators to maintain surveillance in view of the market power that the large LECs still exert over end users and potential competitors.

At the outset, GSA urges the Commission to reject requests to eliminate the requirements for large LECs to maintain data in expense matrices. The Commission has identified specific needs for this data, especially in updating the price cap system that is used as the principal check on the LECs' charges for access services. The LECs contend that they can voluntarily comply with any requests for data on an "as–needed" basis. However, if the carriers object so strongly to requirements that they maintain data, it is not likely that they will be fully responsive in providing data expeditiously when compliance is only voluntary.

Second, GSA recommends that the Commission not adopt proposals to discontinue annual financial audits of the large LECs by outside firms. GSA explains that financial reporting procedures that are required by other regulatory agencies are not substitutes for the Commission's auditing requirements for large LECs

Finally, GSA urges the Commission to place little weight on claims that financial data in several ARMIS reports is alternatively available in the LECs' submissions to the SEC. Reports to the SEC are consolidated for all reporting units with common ownership, regardless of their functional diversity. If the Commission needs data on the regulated telecommunications activities of the large LECs, it will be necessary to continue ARMIS financial reports.

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REPLY COMMENTS
of the
GENERAL SERVICES ADMINISTRATION

The General Services Administration ("GSA") submits these Reply Comments on behalf of the customer interests of all Federal Executive Agencies ("FEAs") in response to the Commission's Notice of Proposed Rulemaking ("Notice") released on July 14, 1999. The Notice seeks comments and replies on steps that can be implemented as the first phase of a comprehensive review of the Commission's accounting and ARMIS reporting requirements.

I. INTRODUCTION

On June 30, 1999, the Commission specified procedures to streamline accounting and reporting requirements for the large LECs.[1] In the *Accounting*

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1 *1998 Biennial Regulatory Review — Review of Accounting and Cost Allocation Requirements, et al.*, Report and Order in CC Docket No. 98-81, Order on Reconsideration in CC Docket No. 96-150, Fourth Memorandum Opinion and Order in AAD File No. 98-43, FCC 99-106, released June 30, 1999 ("*Accounting Reductions Report and Order*"); and 1998 Biennial Regulatory Review — Review of ARMIS Reporting Requirements, Petition for Forbearance of the Independent Telephone and Telecommunications Alliance, *Report and Order in CC Docket No. 98-117, Fifth Memorandum Opinion and Order in AAD File No. 98-43*, FCC 99-07, released June 30, 1999 ("*ARMIS Reductions Report and Order*").

Reductions Report and Order, the Commission observed that additional streamlining may be warranted, but stated that additional modifications would be adopted only after the views of all concerned parties had been considered.[2] The Notice advances this process by proposing additional changes in accounting rules, and describing potential reductions in ARMIS reporting requirements.[3]

GSA has a vital stake in this proceeding because Federal agencies are end users of telecommunications services and facilities provided by all large carriers subject to the Commission's accounting and reporting regulations. From their perspective as end users, the FEAs have consistently supported the Commission's efforts to bring the benefits of competitive markets to consumers of all telecommunications services.

GSA submitted Comments in response to the Notice on August 23, 1999. In its Comments, GSA emphasized the importance of balancing requirements for effective regulatory controls with the need for less burdensome surveillance in order to increase the opportunities for end users to benefit from more competition for telecommunications services. To avoid unnecessary surveillance, GSA concurred with many of the proposed changes in accounting procedures outlined in the Notice.[4] GSA also agreed with a number of the proposals to eliminate and consolidate tables presenting organizational and administrative information in the ARMIS 43–02 report.[5]

On the other hand, GSA urged the Commission to maintain the level of regulatory surveillance that is appropriate for the continuing market power of the large

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2 *Accounting Reductions Report and Order*, para. 6.

3 Notice, para. 6.

4 Comments of GSA, pp. 12–15.

5 *Id.*, pp. 16–17.

LECs.[6] To maintain this surveillance, GSA explained that the Commission should continue the requirements for large LECs to maintain accounting data in expense matrices, maintain requirements for annual financial audits by independent firms, and continue a number of ARMIS reports that have value to the Commission and state regulators.[7]

Five large incumbent LECs, an association of these carriers, and one state regulatory agency submitted comments in response to the Notice. In these Reply Comments, GSA responds to the positions advanced by these parties.

II. THE COMMISSION SHOULD REJECT REQUESTS BY INCUMBENT CARRIERS TO ABOLISH THE REQUIREMENTS TO MAINTAIN ACCOUNTING DATA IN EXPENSE MATRICES.

A. Carriers do not specify how the Commission and state regulators will obtain the necessary data through voluntary means.

The large incumbent LECs contend that the Commission should eliminate the requirements for them to maintain accounting data in expense matrices. For example, GTE Service Corporation and its affiliated local exchange telecommunications companies ("GTE") states that it is not aware of any regulatory process that is dependent on the level of detail contained in expense matrices.[8] In any event, if the Commission requires detail for "specific" calculations, an *ad hoc* request procedure would be far more efficient.[9]

Similarly, BellSouth asserts that preparation of the information provided in the expense matrix, and the associated reporting process, is "burdensome for the modest

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6 *Id.*, pp. 3–8.

7 *Id.*, pp. 3–18.

8 Comments of GTE, p. 3.

9 *Id.*

benefit that the matrix provides."[10] BellSouth acknowledges that some data in expense matrices are used for price cap performance/productivity factor calculations, as well as jurisdictional separations, universal service support, and service quality studies.[11] Nevertheless, according to BellSouth, the needs for data in the expense matrices are "narrow" so that carriers can provide the information necessary to meet these needs on an "as–needed" basis.[12]

GSA explained in its Comments that the Notice cites many applications of the data, including analysis of carriers' expenses, studies and trend analyses, and the Commission's overall monitoring efforts.[13] Although large LECs would be capable of meeting requests on an "as–needed" basis, this is a cumbersome procedure at best, particularly when information is necessary for a multiplicity of functions. Moreover, the scope of the objections to requirements that accounting data be maintained is a prelude to responses that may be expected when "as–needed" requests are actually made. If the large LECs object so strongly to regulations that they maintain data, it seems unlikely that they will be fully responsive in providing data expeditiously when compliance is purely voluntary.

Moreover, even if the Commission could obtain interstate data on an "as–needed" basis, voluntary compliance would be extremely cumbersome at the intrastate level. As GSA explained, the Commission's accounting rules apply to all costs incurred by the carriers — not just the costs of the resources used to provide interstate services.[14] Although some state regulators may have relaxed accounting

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10 Comments of BellSouth, p. 3.

11 *Id.*

12 *Id.*

13 Comments of GSA, p. 6, citing Notice, para. 7.

14 Comments of GSA, p. 5.

requirements or may employ subsidiary accounting records for use in local ratemaking, other bodies undoubtedly depend upon the Commission's maintenance of appropriate accounting, cost allocation and jurisdictional separations rules. Diverse and potentially incompatible systems for the various states would be expensive to administer, difficult for interconnecting carriers to use, and confusing for end users such as the FEAs who require telecommunications services throughout the nation.

The Commission's uniform accounting system provides a focal point that is especially valuable because local exchange services are less competitive than interstate message toll services. There is far less competition for local services, and particularly for local exchange services offered to users outside of major metropolitan areas. State regulators should continue to maintain control over the rates, terms and conditions for these services. As GSA explained, this surveillance is partly conducted using accounting systems and data that the Commission proposes to eliminate.[15]

B. Incumbent carriers fail to account for wide disparities in market power between large and mid–size LECs.

Several large carriers contend that expense matrices should be eliminated because they represent distinctions in the treatment of different groups of LECs. For example, U S WEST contends that the Commission should no longer continue to subject telecommunications carriers to a "two tier system" where large LECs are subject to a wide array of accounting and reporting regulations while other telecommunications providers face few, if any, such requirements.[16]

Similarly, Ameritech observes that the United States Telephone Association ("USTA"), SBC Communications, and other parties have advocated "accounting and

15 *Id.*

16 Comments of U S WEST Communications, Inc. ("U S WEST"), p. 2.

reporting simplification" over the past eighteen months.[17] According to Ameritech, the Commission has provided only limited relief to mid–size carriers and virtually none to large carriers in spite of these requests.[18]

From their perspective as end users, GSA urges the Commission to conclude that the significant distinctions between the large LECs and other carriers justify <u>different</u> accounting and reporting requirements. In the *Accounting Reductions Report and Order* the Commission ruled that only the Bell Operating Companies ("BOCs") and GTE would henceforth be considered as the Class A carriers subject to more extensive accounting requirements.[19] As GSA noted in its Comments, the aggregate annual revenues for the BOCs and GTE are approximately $100 billion, and the revenues for even the smallest of these firms, U S WEST, exceed $10 billion.[20] Their revenue base provides large LECs with far greater capabilities to meet accounting and reporting requirements than Class B carriers.

In addition to their greater resources, the large LECs have more opportunities to engage in cross–subsidies. The Commission recently observed that since large LECs have greater volumes of non–regulated services than small and mid–size carriers, they have more opportunities to shift costs from more competitive to less competitive services.[21] Thus, reductions in surveillance for large LECs may lead to "a greater risk of harm to consumers and competitors from such cross–subsidization."[22]

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17 Comments of Ameritech, p. 2.

18 *Id.*

19 *Accounting Reductions Report and Order*, para. 25.

20 Industry Analysis Division, *Preliminary Statistics of Communications Common Carriers*, May 28, 1999, Table 1.1.

21 *ARMIS Reductions Report and Order*, para. 28.

22 *Id.*

In March 1999, many competitive carriers submitted comments in response to a petition by the Bell Atlantic Telephone Companies for forbearance from regulation as a dominant carrier in most of the jurisdictions that it serves. The competitors explained that the incumbent LEC has wide market power in providing special access services throughout its service area.[23] From the competitors' perspective, this market power is demonstrated by the incumbent carrier's propensity:

- to impede collocation of competitors' facilities;
- to refuse to provide competitors with unbundled network elements ("UNEs"); and
- to deny competitors efficient access to operations support systems ("OSS") that they need to serve their own customers.[24]

According to the competitors, reductions in the Commission's surveillance will enhance the incumbent carriers' ability to maintain these obstacles to competition.

GSA also explained that there is ample evidence of the market power enjoyed by the large LECs under the Commission's jurisdiction.[25] Indeed, the market power of these carriers is demonstrated by the level of earnings that they have achieved. According to a report released recently by the Industry Analysis Division, the interstate rates of return of the BOCs ranged from 10.78 percent to 22.72 percent for the year

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23 *In the Matter of the Petition of Bell Petition of Bell Atlantic Telephone Companies for Forbearance from Regulation as Dominant Carriers in Delaware, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Washington, D.C., Vermont and Virginia*, CC Docket No. 99-24, Comments of Association for Local Telecommunications Services, pp. 5-8; Opposition of AT&T Corp., pp. 4-14; Comments of Cablevision Lightpath, Inc., pp. 1-4; Opposition of Competitive Telecommunications Association/America's Carriers Telecommunication Association, pp. 3-8; Joint Comments of CTSI, Inc. and RCN Telecom Services, Inc., pp. 6-10; Comments of Hyperion Telecommunications, Inc., pp. 5-7; Comments of KMC Telecom, Inc., pp. 4-7; Opposition of MCI WorldCom, Inc., pp. 6-7; Comments of MediaOne Group, Inc., pp. 2-3; Comments of Network Plus, Inc., pp. 6-9; Opposition of Sprint Corporation, pp. 6-11; Opposition of Time Warner Telecom, pp. 11-12; and Comments of xDSL Networks, Inc., pp. 4-5.

24 *Id.*

25 Comments of GSA, p. 4.

ended December 31, 1998.[26] The corresponding rate of return for all of the GTE companies was 21.75 percent.[27]

Since GTE and the BOCs are not required to share their excess earnings with consumers, both end users and competitive carriers must depend upon effective operation of the Commission's price cap formula. The high earnings levels for these carriers demonstrate that they have enjoyed productivity gains far in excess of the 6.5 percent productivity factor, including the 0.5 percent consumer productivity dividend, established by the Commission in 1997.[28]

In the Notice, the Commission observes that data in expense matrices "would be needed for future productivity studies if the price cap formula is revised."[29] In comments addressing procedures for universal service funding, interexchange carriers explained that the productivity factor should be increased to 8.4 percent to match the productivity gains that the LECs are experiencing.[30] From an end user's perspective, it appears that the LECs' earnings ratios would support an increase in the productivity factor of the magnitude recommended by the interexchange carriers, or even more. At the minimum, it is vital for the Commission to maintain the capability to evaluate productivity improvements, because price cap systems that do not reflect the gains that GTE and the BOCs are achieving require competitive carriers and end users to pay too much for telecommunications services.

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26 *Interstate Rate of Return Summary*, Industry Analysis Division, May 13, 1999.

27 *Id.*

28 *In the Matter of Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94–1, Fourth Report and Order, released May 21, 1997, para. 8.

29 Notice, para. 7.

30 *In the Matter of Federal–State Joint Board on Universal Service*, CC Docket No. 96–45, and Forward–Looking Mechanism for High–Cost Support for Non–Rural LECs, CC Docket No. 97–160, Comments of AT&T Corp. and MCI Telecommunications Corp., p. 46.

III. CONTRARY TO ASSERTIONS BY INCUMBENT CARRIERS, THE COMMISSION SHOULD NOT DISCONTINUE ANNUAL FINANCIAL AUDITS BY OUTSIDE FIRMS.

In addition to eliminating the requirements for expense matrices, large LECs ask the Commission to discontinue regulations mandating annual financial audits by accounting firms. GSA urges the Commission not to heed these requests because annual financial audits provide vital protections for end users.

In the *Accounting Reductions Report and Order*, the Commission relaxed the requirements for outside audits of mid–sized LECs in two respects.[31] First, the Commission changed the audit cycle from annual to biennial.[32] Second, the Commission changed the type of review from a "financial audit" to an "attestation."[33] The former procedure requires the independent auditor to provide a "positive opinion" that the financial data are fairly reported, while the latter requires the auditor to certify that specific assertions by management are fairly stated. Incumbent carriers responding to the Notice ask the Commission to employ the "attestation" approach for them as well.

For example, Ameritech states that it "supports the application of an attestation audit every two years for the prior two–year period, as opposed to the current requirement for annual audits requiring a positive opinion."[34] Moreover, Ameritech asserts that the parameters of the attestation audit should conform to Generally Accepted Auditing Standards ("GAAS"), which do not employ the chart of accounts used by the Commission for regulating the activities of LECs for many years.[35]

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31 *Accounting Reductions Report and Order,* para. 21.

32 *Id.*

33 *Id.*

34 Comments of Ameritech, p.6.

35 *Id.*

SBC Communications and other carriers recommend that the Commission relax surveillance even more significantly.[36] In their joint comments, these carriers contend that instead of auditing two years of data biennially, the auditor should look at only one of the two years on this cycle.[37]

GSA urges the Commission to reject requests to employ a biennial audit cycle. An annual cycle is the standard employed by the Securities and Exchange Commission ("SEC") and other regulatory agencies.[38] Moreover, if the Commission should adopt any longer cycle for either financial or attestation audits of carriers under its jurisdiction, GSA urges the Commission to require that all data within the period be subject to review. The recommendation by SBC and other carriers that the audit encompass only entries in every other year would allow carriers to time transactions so that they are shielded from regulatory review.

Also, as GSA has explained, the previously ordered reductions in auditing requirements for mid–size LECs should not serve as a basis for reductions in the auditing requirements for the large LECs.[39] Large LECs not only have far greater resources, they also have more opportunities to engage in anti–competitive actions.

Moreover, as GSA explained, financial reporting systems that may still be required by other regulatory agencies such as the SEC are not substitutes for the Commission's surveillance of large LECs.[40] The Commission needs to have direct access to data that is directly pertinent to its own regulatory focus. Therefore, the

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36 Comments of SBC Communications Inc., Southwestern Bell Telephone Co., Pacific Bell, Nevada Bell, and the Southern New England Telephone Co., p. 4.

37 *Id.*

38 Comments of GSA, pp. 9–10.

39 *Id.*, pp. 10–11.

40 *Id.*, pp. 9–10.

Commission should continue to require financial audits relating to the regulated interstate telecommunications activities of these diversified firms.

IV. THE COMMISSION SHOULD NOT HEED REQUESTS TO ELIMINATE VITAL ARMIS REPORTING REQUIREMENTS

Incumbent carriers report a wide variety of financial information in the Uniform System of Accounts through the ARMIS 43–02 report. This ARMIS report consists of 27 tables organized into three "series" or groups:

- the "C" series of tables that provide corporate organizational information;
- the "B" series of tables that provide information on balance sheet accounts; and
- the "I" series of tables that provide information on income and expense accounts.[41]

The Commission proposes to streamline the ARMIS 43–02 Report by eliminating 14 tables distributed among the three series.[42] The incumbent LECs concur with this proposal in their comments. For example, BellSouth states that "each of these changes will result in a benefit for future ARMIS reporting."[43] Moreover, incumbent LECs contend that the Commission should even go farther in reducing reporting requirements. For example, Ameritech asserts that the relief should address 21, instead of 14 tables.[44] Also, USTA maintains that "the majority of the reports in ARMIS have long outlived their usefulness and should ultimately be eliminated."[45]

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41 *Id.*, para. 22.

42 *Id.*, para. 23.

43 Comments of BellSouth, p. 11.

44 Comments of Ameritech, p. 9.

45 Comments of USTA, p. 9.

As GSA explained in its Comments, steps to eliminate and consolidate Series "C" tables, and to increase reporting thresholds for tables in all series, will not impair regulatory surveillance.[46] However, GSA also explained that the Commission should not eliminate the requirements for reporting vital financial data in Series "B" and "I" tables without clear identification of an alternative means for obtaining this data.[47]

The discussion in the Notice indicates that the tables to be eliminated, while supporting in nature, have significant value in several regulatory functions. The primary issue is thus whether "information concerning these accounts are readily available from other sources, such as the carrier's annual 10–K Report to the SEC or internal records."[48] SBC Communications asserts in its comments that incumbent carriers should not be required to report any data that is in the public filings by these companies to the SEC.[49] However, neither SBC nor any other incumbent LEC submitting comments in response to the Notice addresses the problem of aggregation in reports to the SEC.

As GSA explained, SEC reports are generally consolidated for all units with common ownership, regardless of their functional diversity.[50] Thus, the operations of all subsidiaries of the large incumbent LECs may be consolidated as long as they do not have separate stock issues.[51] As a result, SEC reports do not specifically identify transactions and account balances pertinent to the regulated telecommunications activities of the incumbent LECs.

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46 Comments of GSA, pp. 16–19.

47 *Id.*

48 Notice, para. 27.

49 Comments of SBC, p. 9.

50 Comments of GSA, p. 11.

51 *Id.*

Other than SEC reports, the only approach for obtaining financial data identified in the Notice is through special requests of the carrier.[52] Responses to such requests would be voluntary, and are likely to be slow and incomplete. In short, if the Commission needs specific information, it would be preferable to continue the present ARMIS reporting procedures for financial data.

52 *Id.*, p. 18.

V. CONCLUSION

As a major user of telecommunications services, GSA urges the Commission to implement the recommendations set forth in these Reply Comments.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, MICHAEL ETTNER, do hereby certify that copies of the foregoing "Reply Comments of the General Services Administration" were served this 9th day of September, 1999, by hand delivery or postage paid to the following parties.

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