records.[47] As Mr. Geppert states: "AA's testing should demonstrate that the ASD's audit results are flawed and that the ASD was remiss in its responsibility to follow-up on the information provided by the Company."[48]

However, one thing can be said in response to the Commission's inquiry (i.e., Issue 3). That is, if the objective of the audit was to determine compliance with the Commission's continuing property recordkeeping requirements, as the ASD asserts, any corrective action should be limited to continuing property records and procedures rather than extended to include adjustments to accounting records as the ASD proposes. It is impossible for the ASD to draw any valid conclusions with respect to the overall level of U S WEST's hardwired COE investment -- given the deficiencies in the audit's sampling, rescoring and estimation techniques.

Issue 4: What accounting adjustments, if any, should be made to account for "missing" plant.

Response:

No accounting adjustments should be made for "missing" plant as a result of the ASD's audit. The ASD's estimates of missing plant are, at best, speculative and its highly-questionable methodology does not pass statistical scrutiny. Furthermore, the focus of the ASD's audit was on the accuracy of U S WEST's continuing property records for hardwired COE, not on the accuracy of COE plant

[47] Of the 20 CPR line items in the three COs that the ASD classified as "not found/unverifiable," AA was able to physically verify five of those items and partially found two others. Three additional items represented mobile equipment that should not have been in the sample and eight other items represented items that U S WEST had retired after the ASD's field audit. AA only classified five items as "not found." Id. at 14.

accounting records. In fact, the audit even fell short in that regard, since the auditors were solely concerned with detecting instances of potential overstatement -- instances of understatement were not considered.[49]

Thus, it would be inappropriate to make any accounting adjustments as a result of the ASD's estimate of "missing" COE plant. However, it should be noted that in responding to the results of the ASD's field audit U S WEST extensively investigated all instances where auditors reported that a COE hardwired asset could not be found. In the course of this investigation, U S WEST verified that some of these assets that could not be found should have been retired previously. In such cases, U S WEST updated its records by processing a retirement. Of the $13.6 million of assets included in the ASD's sample of hardwired COE investment, U S WEST retired assets with a value of approximately $540,000, or 4% of the total sample value. This level of "delayed" retirements is well within the range of reasonableness.

Issue 5: What accounting corrections, if any, should be used to resolve the undetailed investment identified in the audit reports.

Response:

No corrections to U S WEST accounts are required as a result of undetailed investment identified in the draft audit report.[50] The report incorrectly indicates

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[48] Id.

[49] Id. at 9.

[50] U S WEST regrets the perception reflected in the draft audit report that U S WEST was not responsive to requests from auditors associated with Undetailed Investment. This was not U S WEST's intent. Subsequent to the audit staff's September 9, 1997 request for supporting documents for 200 undetailed items,

that U S WEST had $218.6 million in regulated Undetailed Investment as of June 30, 1997.[51] As of August 6, 1998, U S WEST's balance in the Undetailed Investment category stood at $145.6 million and U S WEST reported this to the ASD in its August 19, 1998 response.[52] As of January 7, 1999, U S WEST had cleared all but $1.7 million from the regulated portion of its Undetailed Investment category.[53] However, this level continually fluctuates since Undetailed Investment is largely a clearing category with amounts regularly flowing in and out of it (i.e., as costs are assigned to specific detailed items). Any costs assigned to the Undetailed Investment category should be cleared by the end of the year following the calendar

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there were discussions with the staff regarding the onerous nature of their request and the possible use of a sample. These discussions led to the January 16, 1998 request. U S WEST submitted its response to this request on February 18, 1998. Prior to the issuance of the draft report in July 1998, there was no indication from the audit staff that U S WEST's response was in any way inadequate.

U S WEST believes that its January 11, 1999 response clarified that a significant portion of the $218.6 million which the ASD references as undetailed regulated COE investment was in fact unregulated investment -- which is beyond the scope of the audit of hardwired COE investment. U S WEST assigned unregulated equipment and non-COE investment to the Undetailed Investment category in order to use the PICS-DCPR process to track this investment. While unregulated investment was contained in U S WEST's network records (i.e., DCPR), it was never recorded in U S WEST's regulated books of account.

[51] Draft Audit Report at 12.

[52] Further investigation of U S WEST's August 1998 Undetailed Investment balance of $145.6 million indicated that it was made up of three components: (1) $14.6 million of investment amounts that was to be cleared by the end of the year following the calendar year in which the costs were incurred; 2) $106.6 million of unregulated investments and non-COE which is outside the scope of the audit; and 3) $24.4 million of investment amounts that are pre-1996 and were not cleared-out in a timely fashion. U S WEST Response at 23-24.

[53] Id.

year in which the amounts originated. In the past, this has not always happened as promptly as it should at U S WEST.

To summarize, U S WEST believes that use of the Undetailed Investment category is appropriate and necessary. No amounts have been inappropriately assigned for regulatory purposes as a result of U S WEST's use of the Undetailed Investment category. As such, there is no basis for ASD's recommendation that U S WEST should write-off $218.6 million from its COE accounts nor are any other accounting "corrections" justified.

Issue 6: The recommendation of the auditors that the companies should be required to engage independent firms to perform an inventory of their entire central office equipment and provide the results to the Commission, and that the Commission should analyze the results of the inventory and direct the companies to make necessary entries to correct their CPRs and account balances;

Issue 7: The recommendation of the auditors that, in order to improve the likelihood that the CPRs will be maintained correctly in the future, the companies should be required to engage independent auditors to review their practices, procedures, and controls for maintaining CPRs and to make recommendations for improving these systems so that the CPR plant balances can be maintained in compliance with the Commission's rules (parties should address the specific recommendations concerning the practices, procedures, and controls addressed by the auditors in the recommendations sections of the audit reports);

Response to Issues 6 and 7:

The ASD's recommendations contained in Issues 6 and 7 must be viewed within the proper context. That is, these recommendations are based on the ASD's conclusions that a significant portion of U S WEST's hardwired COE investment is missing and cannot be accounted for. U S WEST strongly disagrees with this

conclusion. As has been demonstrated elsewhere in these comments and in Mr. Geppert's Declaration, the ASD's audit is fatally flawed and the findings are at best speculative. As such, it is not at all clear that there is a problem with U S WEST's CPRs (or its practices and procedures for maintaining CPRs) or the magnitude of the problem if one exists. But it is clear that the ASD's recommendations are not the product of an unbiased factual inquiry.

It would be putting the "cart before the horse" to adopt the ASD's recommendation that U S WEST and the other RBOCs "be required to engage independent firms to perform an inventory of their entire central office equipment." At best, the ASD's recommendation is premature. In U S WEST's case such an inventory would cover approximately 500,000 CPR line items which are contained in over 1,700 wire centers throughout a 14-state area. Such an inventory would be a vast and costly undertaking. Even if the ASD's audit findings were not the product of highly-questionable statistical inferences, it would not make any sense to conduct a complete COE inventory until an evaluation of existing practices, procedures, and controls for maintaining CPRs were first completed. As Mr. Geppert observes, "[f]urther substantive audit procedures, such as the performance of a complete physical verification of all COE as recommended by the ASD, should not be performed until the procedures and controls review [of CPR] discussed above

is completed."[54] Even if the Commission determines that physical verification is necessary, any such inventory should focus on high dollar value items.[55]

The recommendation that the companies' CPR procedures and controls be reviewed by an independent auditor is not without merit. U S WEST recognizes the value of periodically reviewing and, if necessary, revising its CPR procedures and controls. It is essential that any such review be conducted in a professional and unbiased manner and focus on both U S WEST's compliance with existing Commission continuing property recordkeeping rules and the costs/burdens associated with complying with current rules. Not only would such a review assist U S WEST in refining its processes, but it would also provide the Commission with information as to how its rules might be simplified or interpreted to enhance compliance. It might also provide a basis for eliminating rules or interpretations of rules that are no longer useful or relevant. However, any such review should precede any action on any of the ASD's other recommendations.

Issue 8: What ratepayer impact, if any, the alleged discrepancies in the CPR may have had, e.g., through the derivation of the Commission's price cap rates, including re-initialization of price caps, sharing, lower formula adjustments, exogenous cost calculations, and changes to or setting of the productivity factors, joint cost allocations, separations, access charges, and ultimately ratemaking;

Response:

This question suggests that the alleged discrepancies discovered as a result of the ASD's audits of RBOC continuing property records may have a direct impact on

[54] Attachment 1, U S WEST Response, Geppert Declaration at 8.

[55] Id.

customer rates. That suggestion is simply incorrect. The alleged discrepancies in the CPRs of U S WEST and the other RBOCs, even if true, would have no impact on customer rates under either rate of return regulation or price cap regulation. In order to conclude that there might be a rate impact as a result of the CPR audit's alleged findings of "missing" plant, one must assume first that these assets have not been retired in the accounting records. Even then, the relationship is tenuous at best and as is demonstrated by Dr. Taylor's Affidavit submitted in the United States Telephone Association's filing in this proceeding that any such impact would be immaterial.[56]

Under traditional rate of return regulation, rates are based on accounting costs, not CPRs. The CPR audit did not even purport to review accounting costs. As such, it is impossible to draw any valid conclusions with respect to the impact of the ASD's estimates of "missing" plant on accounting costs, if any. Price cap regulation, on the other hand, severs the link between customer rates and accounting costs. Thus, rates are not determined by costs but by the price cap formula. The only possible way for a price cap company's rates to be affected by changes in costs would be through the impact of delayed retirements on the lower formula adjustment or the sharing mechanism, both of which are triggered by rate of return thresholds.

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[56] Dr. Taylor's Affidavit provides a detailed analysis of how the failure to retire assets in a timely manner might impact rates under both rate of return regulation and price cap regulation. Rather than to try to duplicate Dr. Taylor's thorough analysis herein, U S WEST adopts his Affidavit in its entirety and incorporates it by

Assuming arguendo that the ASD's audit findings are applicable to RBOC accounting costs, the question then is what is the impact of delayed retirements on the rate base and depreciation expense. Under remaining life depreciation, delaying retirements has no effect on the rate base since as Taylor notes "[n]et plant is unchanged when telecommunications plant in service and accumulated depreciation are both reduced by the amount of the plant retired."[57] Also, there is little if any impact on depreciation expense and revenue requirements.

> In theory, remaining life depreciation is self-correcting, but, in practice, depreciation rates are not recalculated instantly, and retirements can affect the allowed average remaining lives of the assets. However, the direction of these effects on depreciation expense cannot be calculated and the magnitude of the effects is small because the assets to be retired are a small fraction of plant in service.[58]

Since delayed retirements have no material effect on revenue requirements, they also would not affect price cap companies subject to sharing or the lower formula adjustment.[59] Dr. Taylor concludes that: "[t]he RBOCs alleged delay in retiring assets did not cause customers to pay more or less than they would have paid had the assets been properly retired on the CPR."[60]

Lastly, any alleged discrepancies in CPRs could not have an impact on the

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reference in these comments. Comments of the United States Telephone Association filed herein Sep. 13, 1999 ("Taylor Affidavit").

[57] Id. at 7.

[58] Id. at 9.

[59] Id. at 11. Dr. Taylor also demonstrates that delayed retirements have no affect on exogenous cost adjustments and LEC productivity offsets. Id. at 12-13.

[60] Id. at 15.

initial level of price cap rates. First, the ASD's audit was conducted in the fall of 1997 whereas the RBOCs became subject to price cap regulation beginning in 1991 (i.e., using rates that were in effect in 1990). As such, it is impossible to draw any conclusions with respect to "missing" COE plant in 1990 at the inception of price cap regulation -- more than seven years before the CPR audit was performed. Second, even if data were available on "missing" plant in 1990, initial price cap rates would not have been affected by the failure to retire plant in a timely manner because revenue requirements would have been unaffected, as discussed above.

Issue 9: Whether the property record discrepancies have any impact on (1) calculations under the Telecommunications Act of 1996 relating to (a) universal service support and (b) pricing of unbundled network elements, and (2) the merits of "takings" claims and "stranded costs" recovery;

Response:

The calculation of universal service support and pricing of unbundled elements under the Telecommunications Act of 1996 are unaffected by the result of these audits. The Commission has ruled that unbundled network element ("UNE") pricing should be based on forward-looking costing principles. Additionally, the Commission has been developing a forward-looking costing approach to universal service funding. Since these methods rely on a hypothetical network that assumes equipment and costs that don't reflect the costs of our existing network the impact of the ASD staff's findings could never have any impact. However, as shown in the response to Issue 8 even if these prices were based on historical cost there would be

no impact.

As discussed above, the findings of the ASD's staff would have no bearing on takings and stranded costs claims. First, the audit procedures were flawed and cannot be used to extrapolate sample results to U S WEST's entire hardwired COE investment. Second, U S WEST's subsequent investigation indicated that less than 4% of the sampled equipment could not be found and needed to be retired. After considering depreciation on the retired equipment the impact was less than 1% of the sampled equipment. This is well within the bounds of normal retirement accounting. Third, regardless of when equipment is retired, the basis for stranded costs and takings claims is net book value of plant, not gross plant. It is also not unusual, because of regulatory lag and inadequate prescribed depreciation rates, for recovery of costs to continue after an asset has been retired.

Issue 10: Any other issue or issues pertinent to the audit reports or the company responses. These issues may include but are limited to: (1) the benefits of compliance with our rules, as well as the consistency of these rules with other statutory and regulatory policies; (2) the reasonableness of the auditors' interpretations of the CPR requirements; (3) the history and consistency of the FCC's procedure and enforcement of these requirements; and (4) what other federal and state agencies do and what Generally Accepted Accounting Principles (GAAP) requires to ensure the accuracy of books and records.

Response:

U S WEST is of the opinion that the Commission's CPR rules, as applied, are significantly more complex than they need to be. This issue was addressed in some detail in a paper that Arthur Andersen submitted on behalf of a number of local

exchange carriers ("LEC") in the Biennial Review in 1998.[61] AA recommended that the Commission reduce the level of detail currently required to be maintained in the CPR, such as detailed plant subaccount, record category and bay/shelf/rack location. The requirement for such excessive detail is not found in the Commission's rules -- but is something that has evolved over time. Clearly, circumstances have changed. The Commission should permit U S WEST and other LECs subject to the Part 32 Rules to define and track property units at a level necessary to manage their businesses. Similarly, AA recommended that the Commission establish a minimum threshold for tracking COE (and other telecommunications plant) in order to avoid incurring unnecessary expense when there are few if any benefits from tracking items of small value. In fact, focusing on tracking individual investment items rather than the value of the items can be both expensive and misleading.[62] The costs incurred by U S WEST to maintain CPRs for these items of de minimis value clearly outweigh any conceivable benefit derived from maintaining CPRs for these assets.

The current level of detail in the Commission's CPR requirements is not necessary to satisfy GAAP. All companies, including the RBOCs, must maintain sufficient internal controls in order to safeguard assets and ensure that their financial accounts and records are accurately stated as prescribed by rules

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[61] "Accounting Simplification in the Telecommunications Industry," Prepared by Arthur Andersen LLP, July 15, 1998, and "Supplement to July 15, 1998 Position Paper," Prepared by Arthur Andersen LLP, November 10, 1998 (hereinafter referred to as the "Arthur Andersen Paper").

[62] See note 9 above.

promulgated by GAAP, the Securities and Exchange Commission and the Internal Revenue Service. The adoption of less restrictive and less detailed CPR requirements would not conflict with GAAP requirements. The guiding principle should be to balance the level of property record detail with the business needs of the affected companies. The Commission followed this principle when it modified its record retention requirements in the mid-1980s and should take the same approach with CPR requirements.[63]

IV. CONCLUSION

As the foregoing demonstrates, the ASD's audit of U S WEST's CPR for hardwired COE is fatally flawed. As such, there is no basis to support the ASD's findings or for the Commission to take any actions on these flawed findings.

Respectfully submitted,

U S WEST COMMUNICATIONS, INC.

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Of Counsel,
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September 23, 1999

[63] Report and Order, 60 P&F 2d 1535 ¶ 32 "We believe the carriers' need for records for their own business operations and to meet the recordkeeping requirements of other agencies will assure the availability of the records needed by this Commission for regulatory purposes."

ATTACHMENT 1

USWEST

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R. William Johnston
Executive Director - Federal Regulatory

January 11, 1999

Mr. Robert Hood
Acting Chief - Audits Branch
Accounting Safeguards Division
Common Carrier Bureau
Federal Communications Commission
Room 257
2000 L Street, N.W.
Washington, DC 20036

RE: U S WEST, Inc.'s Response to Draft Audit Findings - Audit of Continuing Property Records

Dear Mr. Hood:

We appreciate the opportunity to respond to the Accounting Safeguards Division's ("ASD") draft report of its audit of U S WEST's continuing property records for hard-wired central office equipment. While we strongly disagree with ASD's conclusions, we believe this response will help ensure that the Commission's action on this report will be fair, complete and objective.

If you have any questions on U S WEST's Response, please contact me.

Sincerely yours,

Bill Johnston

Bill Johnston

U S WEST, INC.'S RESPONSE TO DRAFT AUDIT FINDINGS
AUDIT OF CONTINUING PROPERTY RECORDS

EXECUTIVE SUMMARY

In this response, U S WEST addresses the substantive issues raised by the Commission's Accounting Safeguards Division ("ASD") in its draft report, dated December 22, 1998, on its audit of continuing property records ("CPR") for hard-wired central office equipment. ASD's findings in its December report are virtually unchanged from its July draft. This is extremely disappointing to U SWEST – not only because ASD failed to reflect any data contained in U S WEST's August 19, 1998 submittal but because U S WEST personnel spent thousands of hours examining archived records, some of which were decades old, in a futile attempt to correct deficiencies in ASD's draft audit. Furthermore, it is contrary to generally accepted government auditing standards ("GAGAS") and raises serious questions with respect to the purpose of the audit.

U S WEST has found nothing in ASD's December audit report that would cause it to revise its conclusions that the audit is fatally flawed and provides no basis for drawing any valid conclusions with respect to U S WEST's COE hard-wired investment. Among other things the audit report provides no explanation as to:

> why ASD failed to follow-up on U S WEST's documentation indicating that the majority of ASD's audit findings were resolved
>
> why ASD proposes a significant write-down when U S WEST provided ASD with data indicating that a majority of the equipment was found
>
> why ASD proposes writing-off Undetailed Investment when U S WEST has provided a full explanation of the amounts in this category

why ASD declines to follow generally accepted government auditing standards

why ASD excluded 500 U S WEST offices in selecting its audit sample

the rationale for using a large number of strata with relatively few central office selections per strata

why the "random" selection process was based on units without consideration of the dollar-value of CPR items

how ASD's "estimates" can be of any predictive value given that the range of uncertainty is very large ($394.8 million)

why ASD did not consider "understatement" errors as well as errors of "overstatement"

While each of the above items by itself may be explainable, as a whole, it is impossible to adequately explain away all the statistical and non-statistical issues associated with ASD's audit.

At an absolute minimum, the Commission should direct ASD to revise its audit report to reflect the additional items identified as found in U S WEST's August 19, 1998 submission. Furthermore, the Commission should abstain from drawing any conclusions with respect to U S WEST's COE hard-wired investment, as a whole, until ASD provides answers some basic questions associated with how it selected the sample used in the U S WEST field audit and ASD validates its sampling methodology.

U S WEST acknowledges that its CPR records are not error-free. This would be unheard of given the detailed nature of the Commission's Part 32 rules which require CPR cost support data to be maintained for the life of the equipment regardless of the value of the investment. U S WEST also acknowledges that its

internal processes for maintaining CPR records could be improved and that it is taking steps to correct any deficiencies in its processes. U S WEST is willing to work with the Commission to address concerns that the Commission might have with respect to U S WEST's records. However, U S WEST would be remiss if it did not express both its concern and dissatisfaction with ASD's December audit report. This report neither recognizes the extraordinarily detailed and burdensome nature of the Commission's CPR recordkeeping rules, nor U S WEST's efforts to comply with these rules and correct inaccuracies in ASD's field audit.

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U S WEST, INC.'S RESPONSE TO DRAFT AUDIT FINDINGS AUDIT OF CONTINUING PROPERTY RECORDS

In this response, U S WEST, Inc. ("U S WEST") addresses the substantive issues raised by the Federal Communications Commission's Accounting Safeguards Division ("ASD") in its draft report, dated December 22, 1998, on its audit of continuing property records ("CPR") for hard-wired central office equipment ("COE") and "undetailed" investments and "unallocated" other costs.[1] This response incorporates much of the same material that U S WEST submitted to ASD on August 19, 1998[2] in responding to ASD's earlier draft audit report provided on July 20, 1998.[3]

I. INTRODUCTION

ASD's findings in its December report are virtually unchanged from its July draft report. This is extremely disappointing to U S WEST – not only because ASD failed to reflect any data contained in U S WEST's August 19, 1998 submittal but because U S WEST personnel spent thousands of hours examining archived records, some of which were decades old, in a futile attempt to correct deficiencies in ASD's draft audit.[4] Not only did U S WEST submit detailed information on items that

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[1] See attachment to letter from A. Mulitz, FCC to K. Abernathy, U S WEST, Inc., dated Dec. 23, 1998.

[2] See letter from K. Abernathy, U S WEST, Inc. to K. Ackerman, FCC, dated Aug. 19, 1998.

[3] See attachment (referred to herein as "July Report") to letter from H. Boyle, FCC to K. Abernathy, U S WEST, Inc., dated July 20, 1998.

[4] During the April-August 1998 timeframe alone, U S WEST spent over $600,000 examining the contents of the approximately 12,000 boxes of COE records in its archives in order to respond to audit inquiries and ASD's draft audit report.

ASD classified as "not found" or "partially found" in its field audit, U S WEST also engaged an outside statistical expert, Deloitte & Touche, LLP, to examine the sampling methodology used in ASD's audit and provided this analysis to ASD.

None of this information is reflected in ASD's December audit report. It appears that ASD did not even consider U S WEST's submission in finalizing its audit report. This is contrary to both Generally Accepted Auditing Standards (or "GAAS") and Generally Accepted Government Auditing Standards (or "GAGAS") and should not be countenanced by the Commission.[5]

At an absolute minimum, the Commission should direct ASD to revise its audit report to reflect the additional items identified as found in U S WEST's August 19, 1998 submission. Furthermore, the Commission should abstain from drawing any conclusions with respect to U S WEST's COE hard-wired investment, as a whole, until ASD provides answers to some basic questions associated with how it selected the sample used in the U S WEST field audit and ASD validates its sampling methodology.[6]

It is unconscionable for ASD to recommend that U S WEST "write-down" its COE investment by almost $600 million when it has failed to consider detailed U S WEST input on sample items and it continues to rely on a highly questionable,

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[5] See Attachment 1 hereto, Declaration of Carl R. Geppert of Arthur Andersen, LLP at 4-5 ("Geppert Declaration").

[6] The table of observations in Attachment 2 hereto, letter, dated Jan. 8, 1999, from Ann Thornton, National Director - Data Quality and Integrity Service Line, Deloitte & Touche, LLP ("Jan. 8, 1999 Thornton Letter"), confirms the fact that ASD has neither acknowledged nor responded to virtually any of the numerous concerns that

if not fatally flawed sampling methodology. The Commission should also acknowledge that even if U S WEST's accounting records overstated its COE investment somewhat, there would be no impact on consumer rates due to the fact that Commission rules require telephone companies such as U S WEST to use mass asset accounting and remaining life depreciation.[7]

U S WEST acknowledges that its CPR records are not error-free. This would be unheard of given the detailed nature of the Commission's Part 32 rules, which require CPR cost support data to be maintained for the life of the equipment regardless of the value of the investment.[8] U S WEST also acknowledges that its internal processes for maintaining CPR records could be improved and that it is taking steps to correct any deficiencies in its processes. U S WEST is also willing to work with the Commission to address concerns that the Commission might have with respect to U S WEST's records. However, U S WEST would be remiss if it did not express both its concern and dissatisfaction with ASD's December audit report. This report neither recognizes the extraordinarily detailed and burdensome nature of the Commission's CPR recordkeeping rules nor U S WEST's efforts to comply with these rules and correct inaccuracies in ASD's field audit.

U S WEST raised in its August 19, 1998 submission with regard to ASD's statistical sampling methodology.

[7] See Geppert Declaration at 8-9.

[8] This means that in a perfect world U S WEST would have in its archives the original invoice for an item of COE investment with a value of $5.00 that was purchased twenty years ago. Clearly, no unregulated business would maintain such records on inconsequential items – the costs would far outweigh any potential benefits.

In the sections that follow U S WEST has attempted to organize its comments in the same manner as the December draft audit report. Much of this material is identical to the information contained in U S WEST's August 19, 1998 response since ASD's December report is so little changed from its July draft.

II. THE COMMISSION MUST BE MINDFUL OF THE METICULOUS NATURE OF ITS PART 32 RULES IN EVALUATING CPR AUDIT RESULTS

The Part 32 rules which establish accounting and recordkeeping requirements for hard-wired COE investment are significantly more detailed than that required to satisfy Generally Accepted Accounting Principles ("GAAP") or other Commission rules pertaining to the treatment of telecommunications plant (*e.g.*, expensing general support assets). As Arthur Andersen, LLP (or "Arthur Andersen") noted in its July 15, 1998 letter addressing Accounting Simplification:

> The level of detail at which accounts, subaccounts and detailed plant record categories are defined far exceed the recordkeeping necessary to verify the existence of plant assets and support the asset balances presented in the financial statements.[9]

The true nature of the burden associated with current CPR recordkeeping requirements does not become clear until it is spelled out in more detail:

> The CPRs must be established and maintained in subaccounts for each accounting area. Within each accounting area, each property record unit must be listed separately with its original cost, description, location, date of placement and details of construction. This detail is required so as to provide for information necessary to remove original cost upon the retirement of a property unit. All changes to the CPR (other

[9] Letter from C. Geppert, Arthur Andersen, LLP to M. Salas, FCC, dated July 15, 1998, with attached "Accounting Simplification in the Telecommunications Industry" at 25.

> than changes due to telecommunications plant addition and retirement activity) must be submitted to the FCC. A complete description of each property record unit must include the identification of the construction work order, year of installation, specific location within each accounting area to ensure proof of physical existence and the property record unit's identification number. The CPR must disclose the age of existing property, and supplemental records to the CPR must disclose the service life of property retired. In addition, the source of all entries into the CPR must be referenced which supports the quantities and costs recorded in the CPR.[10]

The net result of these requirements is that U S WEST has to maintain CPRs on hundreds of thousands of items (*i.e.*, over 500,000 items) related to hard-wired COE investment regardless of value. This excessive level of detail not only increases the cost and burden of recordkeeping but inevitably results in a greater likelihood of errors than would be the case if local exchange carriers ("LECs") were able to track assets at a more reasonable level of detail.

The excessive level of detail required by the Commission's rules also could have a significant impact on audit results if audits are not designed to reflect the wide variation in the dollar-value of COE investment items. The fact that ASD failed to take into account the value of COE line items when selecting the sample for its CPR audit should immediately raise questions with respect to the validity of ASD's findings.[11] It should be noted that of the 1,188 items in 33 U S WEST Central

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[10] Id. at 28.

[11] "Random selection was used [by the ASD] to select line items in each selected office. Typically, when sampling from accounting populations, consideration is given to using dollar-based selection techniques, rather than simple random selections, to allow appropriate coverage of higher dollar items. This is particularly relevant in tests of physical existence if high-dollar items are more likely to be

Offices that ASD selected for its field audit – 449 items or 38% had an original cost of less than $2000 per item.[12] These 449 items only represented 3% of the total value of all 1,188 items in ASD's sample.[13] If anything ASD's audit demonstrates both the unreasonableness of the Commission's existing Part 32 recordkeeping requirements for CPRs and the futility of attempting to use a sample so heavily-weighted with low value items to draw conclusions with regard to U S WEST's overall hard-wired COE investment.

III. ASD's AUDIT NEITHER COMPLIES WITH GENERALLY ACCEPTED AUDITING STANDARDS ("GAAS") NOR GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS ("GAGAS")

In preparing its December audit report, ASD all but ignored U S WEST's August 19, 1998 submission in response to ASD's July draft report. Clearly, this is contrary to both GAAS and GAGAS.[14] As Mr. Geppert of Arthur Andersen, LLP notes in his attached Declaration, "[m]any government agencies, including the U. S. General Accounting Office ("GAO"), follow generally accepted auditing standards ("GAGAS") in conducting their audits. These rules codified in Government Auditing Standards, [footnote omitted] specify that 'auditors should report the views of responsible officials ...concerning auditors' findings, conclusions and

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located than small-dollar items, due to such factors as physical size and the extent of controls over more valuable assets." See letter from A. Thornton, Deloitte & Touche, L.L.P. to K. Ringsdorf, U S WEST, Inc., dated Aug. 18, 1998 at 2-3 ("Aug. 18, 1998 Thornton Letter").

[12] This number excludes the 14 items that had an in-place cost of zero. See Geppert Declaration at 10.

[13] Id.

[14] Id. at 4-5.