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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

October 12, 1999

Ex Parte

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

Re: In the Matter of MCI WorldCom Inc.'s Freedom of Information Act Request and In the Matter of Bell Atlantic's Freedom of Information Act Request, CC Docket No. 99-117, ASD File No. 99-22

In accordance with the Commission's rules, please be advised that on October 8, 1999, Greg Vogt and the undersigned, representing SBC Communications Inc. (SBC) met with Ms. Linda Kinney, Legal Advisor to Commissioner Ness, to discuss the Freedom of Information Act Requests listed above, the disclosure of information being requested and the opposition filed by SBC with the FCC on July 9, 1999 and the Application for Review filed on August 3, 1999.

SBC expressed concern in this meeting about the precedent the FCC might set if it chose to release of detailed audit information to the public, particularly any auditor workpapers. First of all, the FCC has a longstanding policy of protecting the confidentiality of materials submitted by carriers in the course of audits. And, any release of the audit workpapers is contrary to auditing practices and standards. Deviations from the Commission's policy have only occurred rarely, and then only by making aggregate summary detail available because of an overriding public interest consideration. Moreover, the disclosure of highly confidential vendor-specific information including vendor contracts, pricing information and invoices, is contrary to treatment afforded by this Commission of such information and, is inappropriate, given the position concerning cost taken by the FCC in its audit reports.

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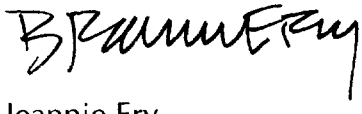
Regardless, the FCC has already released a plethora of information regarding the CPR Audits, such that MCI should already have enough material to effectively evaluate and make comments on Issue No. 2 of the NOI. However, as noted in the Application For Review filed on August 3, 1999 by the SBC LECs, if the Commission believes that it is necessary to release additional materials, the SBC LECs contend that this material should be restricted to Issue No. 2 (including removal of the materials related to the "undetailed" information), that specific cost should be redacted and that they be allowed a brief period of time, such as 10 working days, to review the notebooks and other materials to be disclosed to assure that broad disclosure, in violation of the Protective Order does not occur.

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

Sincerely,



Jeannie Fry
Director, Federal Regulatory

Attachments

Cc: Mr. Ken Moran, Chief, Accounting Safeguards Division
Mr. Andy Mulitz, Chief, Legal Branch, Accounting Safeguards Division
Ms. Lisa Zaina, Deputy Chief, Common Carrier Bureau
Ms. Deena Shetler, Common Carrier Bureau
Ms. Susan Steiman, Office of the General Counsel
Ms. Linda Kinney, Office of Commissioner Ness
Ms. Dorothy Atwood, Office of Chairman Kennard

MCI FOIA Request

- Background

- The Commission issued an NOI with respect to the conduct and significance of its audit of continuing property records (CPRs) associated with central office equipment.
- MCI filed a narrow FOIA request focused on Issue No. 2 in the NOI, seeking access to certain FCC auditor's workpapers and carrier documents showing that equipment existed.
- This information contains highly confidential equipment pricing and other information that is proprietary not only to SBC, but also to third party equipment manufacturers.
- The FCC staff ordered a broader release of audit materials to anyone who was participating in this docket, subject to a protective order.

- The Commission should reverse this Bureau decision because it is not necessary to respond to the NOI.

- Sufficient information exists, on the record, for comment; additional detailed information contained in these records is not necessary. MCI stated that the only reason it needed the material was for purposes of commenting on Issue No. 2 with regard to the correctness of the auditor's scoring procedures. This rationale does not require further detailed information, such as vendor invoices.
- SBC already offered to provide redacted information, limited to Issue No. 2, pursuant to a protective order that would give the information that MCI needs in order to conduct the indicated evaluation. SBC began negotiations with MCI, but no agreement was reached prior to the release of the Bureau ruling.

- The grant of MCI's request for sensitive audit materials sets a dangerous precedent.

- In the past, the FCC has only released summary audit data, if anything.
- The FCC in the past has always carefully guarded individual company information, particularly vendor specific information, except where absolutely necessary.
- It is doubtful that the Commission's NOI could be classified as a novel situation that could limit this precedent to the current proceeding: The Commission seeks public comment on accounting issues all the time.

- The need for comment about this issue is quickly waning.

- The joint IXC/ILEC proposal on access reform obviates any further need for federal review of SBC's CPR process.

Audit Assertion: Existence

MCI/WorldCom FOIA Request	Bureau Decision	Notes
Requests any materials that explain why items were "not found" and should be rescored: Company: • Narrative explainations, • Supporting documentation FCC: • Letters sent to Company w/ results • Workpapers showing item by item scoring supporting: (1) 1997-98 Letters, (2) July '98 draft reports and (3) Dec '98 draft reports	• Bureau letter and protective order is not restrictive to the issue of whether or not items existed. Both allow parties to review and examine any and all documentation, including those related to cost or specific prices paid for equipment. • Bureau letter and protective order allows for all items to be provided, not just items scored as "not found" (which are the only ones pertinent to Issue No.2).	• Although the FCC requested cost support documentation to determine whether the costs stated in the Company's CPR were recorded accurately and in accordance with the Commissions rules, it deferred any decisions related to cost. SWBT's report, for example, states: "For purposes of this report, we assume that the original costs recorded on its CPR are correct". Thus, it is inappropriate to provide specific cost data. • MCIWorldCom request is narrowly focused on existence of those items scored as "not found" for purposes of commenting on Issue No. 2.
MCI/WorldCom requests this to help address Issue No. 2: "...the"validity and reasonableness... in determining whether to rescore or modify [scoring]...that equipment was 'not found'."	Bureau letter states that inspection is allowed only to the extent necessary to allow parties to prepare comments w/ regard to Issue No. 2, however, the Protective Order contradicts this by allowing full access to any and all audit documents and audit work papers whether or not associated w/ not found items that are the only subject of Issue No.2. Protective Order also admits that rescoring procedures were described in the *Public Notice*.	• FCC Reports state that items were scored for existence—e.g., found, not found, partially found or unverifiable. *Public Notice* provided detailed description of the methodology. • FCC Audit Reports also state that it defers all decisions related to cost.
Commission has released summary data in the past when not commercially sensitive and compelling pubic interest favors disclossure	Bureau letter and Protective Order allows for unprecedented access to the detailed audit workpapers and company raw audit data.	If, in spite of SBC's strenuous objections, the FCC determines that raw audit data will be provided (contrary to the FCC's prior decisions), any disclosure should be strictly limited to that which is pertinent to Issue No. 2. Also, summary information can be readily provided with specific cost data redacted. Specific invoices, and similar cost information, can be easily and readily redacted.
Harm for disclosure is mitigated by protective order	Protective Order apparently allows unlimited access to auditors' notebooks without distinguishing contents. Protective Order does not restrict access to any documents nor provide the Companies a right of first review to ensure that cost data or other documents unrelated to Issue No. 2 have not been inadvertently provided to those parties which sign the Protective Order.	Harm is not mitigated by the Protective Order. Companies could readily redact specific cost data. In addition, Companies should have the right of first review to ensure that non-Issue No. 2 documents and cost support is not provided.

Audit Assertion: Existence

Does not mention "undetailed"	On its own initiative, the Bureau added "undetailed" investment to the material released pursuant to Protective Order without any explanation.	Undetailed should be removed from the body of the Protective Order since this information is not relevant to Issue No. 2 and is clearly not within the scope of MCI's request.
Does not mention or justify any need to see cost	Protective Order does not limit access to cost data.	Summary information can be readily provided with cost data redacted. Cost data is not relevant to Issue No. 2 nor to the assertion of the "Existence of Items", which was the basis for the audit.

I. Executive Summary

1. The Audits Branch[1] examined the accounting records of the Southwestern Bell Telephone Company ("SWBT")[2] related to central office equipment ("COE")[3] to determine whether its reported investment in COE represents property used and useful in the provision of telecommunications services. We compared descriptions of equipment in SWBT's basic property records to its physical equipment to verify the existence of the equipment described in the records and recorded in the plant accounts. The basic property records we audited consist of the carrier's continuing property records ("CPR") and records supplemental thereto.[4] The Commission's rules require carriers to maintain updated descriptions and locations of each of their in-service plant assets so that the equipment may be readily spot-checked for proof of physical existence.[5] Accurate plant account balances are important because policymakers use them to evaluate, among other things, financial results, regulated/nonregulated cost allocations, jurisdictional separations allocations, depreciation rates, initial prices, low-end earnings adjustments and productivity factors for price cap companies, inputs for forward-looking cost models for calculating universal service support, interconnection agreements, and access charges.

2. We find that SWBT has not maintained its basic property records and CPR in a manner consistent with the Commission's rules. Our audit found deficiencies in SWBT's CPR for COE items relating to: (1) Hard-wired Equipment which consists of permanent equipment requiring complicated installation such as telephone switches and circuit equipment and (2) Undetailed Investment and Unallocated Other Costs, which entail amounts of investment that are not readily associated with specific, identifiable units of equipment. We consider these deficiencies to be substantive in that the carrier's CPR contained inadequate or no asset

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[1] The Audits Branch is located in the Accounting Safeguards Division of the Common Carrier Bureau. The Audits Branch is responsible for, among other things, conducting field audits and investigations of regulated carriers; reporting results of field audits and investigations; assisting in the evaluation of findings; and recommending follow-up action to correct deficiencies, including changes and improvements in carrier accounting and reporting systems and other related procedures.

[2] Southwestern Bell Telephone Company is a subsidiary of SBC Communications, Inc., and provides local telephone service to customers in Arkansas, Kansas, Missouri, Oklahoma and Texas. On April 1, 1997, SBC Communications completed its merger with Pacific Telesis, the holding company of Pacific Bell and Nevada Bell. For the purposes of this report, we will be referring to Southwestern Bell Telephone only.

[3] COE generally includes switching and circuit equipment recorded in Part 32 accounts 2211 (Analog electronic switching), 2212 (Digital electronic switching), 2215 (Electro-mechanical switching), 2220 (Operator systems), 2231 (Radio systems), and 2232 (Circuit equipment). 47 C.F.R. §§ 32.2211, 32.2212, 32.2215, 32.2220, 32.2231, 32.2232.

[4] *See* 47 C.F.R. § 32.2000(e)(3).

[5] 47 C.F.R. § 32.2000(f)(5).

Additional Classifications of Evidence Some auditors identify additional subdivisions of audit evidence beyond the elements of the audit equation of underlying accounting data and corroborating information. For example, evidence might be classified as to whether it is internal or external to the company or developed by the auditor. Also, evidence might be classified as physical, documentary, oral, visual, or mathematical. These distinctions are not critical as long as the auditor recognizes the difference between audit procedures and audit evidence. Usually one is clear when the other is specified. For example, documentary evidence is obtained by inspection, tracing, and vouching; physical examination obviously produces physical evidence. However, the auditor cannot lose sight of the fact that evidence is not produced merely by applying procedures. It is essential to obtain and evaluate enough valid and relevant evidential matter. The characteristics of relevance and validity as they relate to substantiating assertions in financial statements are discussed in the next section.

Financial Statement Assertions and Audit Objectives

"Assertions," according to SAS No. 31 (AU 326.03), "are representations by management that are embodied in financial statements." In effect, by presenting financial statements, management is stating, either explicitly or implicitly, certain things about the company's financial position and operations.

The broad categories of assertions and a brief explanation of each follows:

- *Existence or Occurrence* Reported assets and liabilities actually exist at the balance sheet date, and transactions reported in the income statement actually occurred during the period covered.
- *Completeness* All transactions and accounts that should be included in the financial statements are included, or there are no undisclosed assets, liabilities, or transactions.
- *Rights and Obligations* The company owns and has clear title to the assets, the liabilities are obligations of the company, and the company was actually a party to reported transactions.
- *Valuation or Allocation* The assets and liabilities are valued properly, and the revenues and expenses are measured properly.
- *Presentation and Disclosure* The assets, liabilities, revenues, and expenses are properly described and disclosed in the financial statements.

The auditor needs to obtain evidential matter that supports each of the assertions for every material component of the financial statements. A component of the statements may be an account balance (or group of account balances) or a class of transactions, and the broad categories of assertions encompass both transactions and balances.

Developing Audit Objectives The categories of assertions provide a framework for developing specific audit objectives. An auditor develops specific audit objectives for each material account balance or class of transactions. An audit objective is an assertion translated into terms that are specific to the particular

D.R. Carmichael and John J. Willingham
Auditing Concepts and Methods:
A Guide to Current Auditing Theory & Practice,
Fifth, Edition 1989, pp. 80-81

balance or class, the entity's circumstances, the nature of its econom and the accounting practices of its industry.

As an example of the development of specific audit objectives for balance of inventory of a manufacturing company, consider the follo of assertions and objectives adapted from SAS No. 31:

Financial statement assertion	Illustrative audit objectives
Existence or occurrence	Inventories included in the balance sheet physically exist.
	Inventories represent items held for sale in the normal course of business.
Completeness	Inventory quantities include all products, materials, and supplies on hand.
	Inventory quantities include all products, materials, and supplies owned by the company that are in transit or stored at outside locations.
	Inventory listings are accurately compiled and the totals are properly included in the inventory accounts.
Rights and obligations	The company has legal title or similar rights of ownership to the inventories. Inventories exclude items billed to customers or owned by others.
Valuation or allocation	Inventories are properly stated at cost (except when market is lower).
	Slow-moving, excess, defective, and obsolete items included in inventories are properly identified and valued.
	Inventories are reduced, when appropriate, to replacement cost or net realizable value.
Presentation and disclosure	Inventories are properly classified in the balance sheet as current assets.
	The major categories of inventories and their bases of valuation are adequately disclosed in the financial statements.
	The pledge or assignment of material inventories is appropriately disclosed.

After the auditor has developed specific audit objectives for a particular account balance or class of transactions, the next step is to select audit procedures to achieve those objectives.

Selecting Audit Procedures The selection of particular procedures to achieve specific audit objectives is influenced by the following considerations:

- The nature and materiality of the particular component of the financial statements (account balance or class of transactions)
- The nature of the audit objective to be achieved
- The assessed level of control risk

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Federal Communications Commission
Common Carrier Bureau
Accounting Safeguards Division

DECEMBER 22, 1998

Audit of the Continuing Property Records of Southwestern Bell Telephone Company As of June 30, 1997

(From FCC's WEBSITE)

descriptions, inaccurate quantities, missing and inaccurate location descriptions--errors that clearly violate the requirements specified in the Commission's rules for maintaining property records.[6] SWBT's recordkeeping deficiencies raise questions about the integrity of its property records and the plant investment balances recorded in its COE accounts.

3. Specifically, in our audit of a random sample of 1,080 line-items[7] from SWBT's CPR for Hard-wired Equipment, we found that 21.8 percent of the records that we sampled contained substantive deficiencies and did not comply with the Commission's rules. Of these deficient records, 8.8 percent described equipment that could not be found by the auditors or by company representatives ("not found" equipment). The remaining 13.0 percent could not be verified with certainty because the equipment shown to the auditors could not be matched to the record in some important respect such as location or description. Based on these findings, we estimate that SWBT's investment related to Hard-wired Equipment is overstated by approximately $221.7 million. This estimate, however, does not take into consideration the amount of equipment in the 13.0 percent of sampled records that could not be verified definitively.

4. In addition to finding errors in SWBT's CPR for Hard-wired Equipment, we found that a significant number of line-items in SWBT's CPR contain the notation "Undetailed Investment" or "Unallocated Other Costs." These items had no description of either the equipment or its location, in apparent violation of the Commission's rules. We found 46,900 such line-items representing $923.8 million in Undetailed Investment. SWBT has not shown any specific physical plant or provided sufficient or convincing cost support data relating to any of the line-items for Undetailed Investment. We also found more than 66,800 line-items representing $157.4 million in Unallocated Other Costs. We are deferring final determination on the amounts associated with Unallocated Other Costs until we receive sufficient documentation from the company explaining the nature of these costs.

5. The Audits Branch provided its results to SWBT and requested SWBT to correct and explain any decision it believed was made in error. Further, we sent a draft audit report to SWBT with a request for comment on factual errors or omissions. After reviewing SWBT's responses, we made appropriate adjustments as warranted and provided a revised report

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[6] *E.g.*, Section 32.2000(f)(5) specifically states that "[t]here shall be shown in the continuing property record or in the record supplements thereof, a *complete description* of the property record units in such detail as to identify such units. The description shall include the identification of the work order under which constructed, the year of installation ... *specific location* of the property within each accounting area in such a manner that it can be readily spot-checked for proof of physical existence ... " (emphasis added).

[7] A "line-item" or record in the CPR provides information necessary to identify the location, quantity, vintage, account code, and dollar investment for specific equipment.

We traveled to each location specified in the sampled CPR, and determined, through a physical inspection, whether the equipment was installed and whether the CPR description, location, and quantity were accurate and complete. We also requested cost support documentation to determine whether the costs stated in SWBT's CPR were recorded accurately and in accordance with the Commission's rules. These efforts and results are discussed in the following paragraphs.

A. Verification Process.

18. In order to verify the existence of equipment listed on the CPR, we selected 30 different central office locations. Prior to visiting the selected offices, we notified SWBT and requested the assistance of technical staff familiar with the COE in these offices. Generally, three or more company employees accompanied us during the verification process. Upon arrival at the central office location each morning, the selected sample was presented to SWBT's technical staff. With SWBT's technical staff, we then jointly attempted to locate the sampled equipment. When the equipment was not found in the location specified in the CPR or when the CPR did not contain a specific equipment location, we provided company personnel an opportunity to locate the equipment elsewhere within the office. In the course of this process, we were often taken to other locations in the office and shown items on different frames than those listed in the CPR. Items were considered not found only when the sampled equipment could not be located anywhere in the central office.

B. Records Examined

19. A sample of 1,080 records was randomly selected[28] for audit from SWBT's Hard-wired Equipment items listed on SWBT's CPR for its COE. The 1,080 line-items consisted of 36 randomly-selected items from each of the 30 selected central office locations we visited. With assistance from SWBT personnel as described above, we attempted to verify the existence of the property recorded in the 1,080 line-items. We encountered numerous problems in our attempts to verify the sample. These problems were sometimes the result of deficiencies in the records, such as a lack of specificity as to location, description, or quantity, and sometimes the result of discrepancies between the record and the equipment we were shown. Of the 1,080 line-items, 235 line-items (21.8 percent of the sampled items) were found to be seriously deficient in that we were shown no equipment, were shown equipment of less quantity than the records indicated, or were shown equipment that we could not verify with certainty due to discrepancies between the record and the equipment shown. Although less serious, we also encountered problems with some of the other 845 line-items that we marked as found. In some instances there were misleading or inconsistent floor indications in these records. In other instances, descriptions of the items were incomplete. The problems encountered in the verification process are discussed in greater detail in Appendix C.

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[28] The statistical sampling plan for randomly selecting the 1,080 line-items is discussed in detail in Appendix B. The 1,080 line-items were selected from 30 SWBT offices as representative of the entire SWBT operating area covering the states of Arkansas, Kansas, Missouri, Oklahoma, and Texas. (*See* Appendix B for an overview of the statistical sampling plan and audit sample selection process.)

E. Examination of Cost Support Documents.

24. The USOA requires that the CPR include the original cost of all property record units.[35] Further, the rules require that "[a]ll drawings, computations, and other detailed records which support quantities and costs or estimated costs shall be retained as part of or in support of the continuing property record."[36] To confirm that SWBT's practices, procedures, and controls are effective in ensuring that accurate costs and quantities are recorded in the CPR, we requested the supporting invoices, work orders, and other construction documentation for the material and in-place costs.[37]

25. In a letter dated September 19, 1997, we requested cost documentation for 1,080 audited sample line-items to be provided by October 3, 1997.[38] SWBT responded that it would be unduly burdensome for them to provide this cost documentation by the date requested. On January 6, 1998, we submitted a cost support request based on a sample of 50 randomly selected Hard-wired Equipment COE line-items. We requested data for this sample so that we could determine whether cost support for all the data specified in the September 19, 1997 request would be necessary.[39] While SWBT has provided some cost documentation for the 50

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the total missing Hard-wired Equipment cost to lie between $105.3 million and $338.1 million, with the most likely value for this cost centered around our best estimate of $221.7 million. (*See* pages 12 through 14 of Appendix B).

[35] 47 C.F.R. § 32.2000(f)(2)(iii).

[36] 47 C.F.R. § 32.2000(f)(8).

[37] The in-place cost includes the material cost of the equipment as well as the cost to install and put the equipment into service.

[38] Letter from Joseph Paretti, FCC, to B. Jeannie Fry, SWBT, dated September 19, 1997.

[39] Because the carrier stated that complying with our document requests within the given deadline would be onerous, we modified the request to include documentation of a random selection of only 50 hard-wired line- item-listings. Letter from Kenneth Ackerman, FCC, to B. Jeannie Fry, SWBT, dated January 6, 1998. In correspondence dated January 20, 1998, SWBT said it would provide some of the cost support by our deadline and would give us an estimated completion date for the remainder of the Hard-wired Equipment line-items on that date. On February 6, 1998, SWBT told us the remaining cost support would be provided fully by April 15, 1998. On August 6, 1998, SWBT gave us cost support for six remaining items. After this data is reviewed, we will determine if cost support for additional hard-wired line-

hard-wired line-items, we do not find that the documentation provided to date is adequate to support fully the in-place cost recorded for these assets.

26. In summary, we have requested data from SWBT to verify the original costs of the property record units listed on its CPR. SWBT, however, has not provided sufficient documentation for us to make a determination that these costs were recorded accurately. We, therefore, have decided to suspend judgment temporarily on the accuracy of the original costs recorded on SWBT's CPR. For the purpose of this report, we assume the original costs recorded on its CPR are correct. At some later date, we will investigate these costs and determine their validity. After we receive and analyze the cost support, we intend to issue a separate report on the matter of cost support.

V. Results for Unspecified Items

27. SWBT's CPR for its COE consists of a total of 592,000 records. Of this total, we found a large number of SWBT's CPR records contained neither equipment descriptions nor location descriptions. In its CPR, SWBT refers to many of these items as Undetailed Investment (46,900 records) or Unallocated Other Costs (66,800 records). Because there were no equipment or location descriptions in these records, we were unable to locate physically the assets relating to these records.

A. Undetailed Investment

28. We identified approximately 46,900 records representing $923.8 million[40] of Undetailed Investment. SWBT stated that these records represent costs associated with assets that for some reason it did not detail in its CPR. The explanation that SWBT offered for these records is that the majority represent investment installed prior to the implementation of SWBT's detailed property recordkeeping system in 1983.

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items is necessary.

[40] Subsequent to the audit fieldwork, in a letter dated December 16, 1998, SWBT claimed to have reduced its Undetailed Investment to $207.3 millions as of November 30, 1998, by retirements or by detailing equipment not previously detailed on its CPR. Because the carrier was not able to show us any of this equipment during the audit and because the carrier's subsequent claim to reduce the Undetailed Investment balance was not accompanied by documentation, we are unable to evaluate this claim. To do so, a detailed examination of the carrier's workpapers and accounting entries is required. Further, since the claim relates to the period after our on-site work, certain follow up verification procedures are necessary to adjust the audited Undetailed Investment Balance reflected on the CPR.

B. Unallocated Other Costs

31. SWBT's CPR contains another type of entry with no equipment description or frame designation, called "Unallocated Other Costs." We found more than 66,800 such entries representing $157.4 million in investment. According to SWBT, Unallocated Other Costs represent hard-wired related costs that cannot be allocated initially to specific items of equipment.[46] We have requested information from SWBT to verify the validity of these entries.[47] After we receive and review SWBT's cost documentation, we intend to issue a further report on the matter of Unallocated Other Costs.

VI. Duration and Extent of the Problem

32. We have found numerous substantive deficiencies in SWBT's CPR. We first became aware of the nature and scope of this problem during our 1994 audit of SWBT's CPR. That audit demonstrated that the problems were so pronounced and prevalent as to make it highly unlikely that the errors had developed in a relatively short period of time.

33. Our current audit findings make it even clearer that SWBT's CPR problems are longstanding. Based on our current audit we estimate, as detailed in Appendix B, that over 215,400 records, or more than 36 percent of the records within the scope of this audit, are inaccurate or deficient in some important respect.[48] It is unlikely that such a large number of

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[46] This characterization of Unallocated Other Costs is found in an attachment to a letter dated October 3, 1997 from B. Jeannie Fry, SWBT to Kenneth Ackerman, FCC.

[47] As with the Undetailed Investment, the auditors also requested that SWBT provide cost support for the Unallocated Other Costs during our August field work and in a letter dated September 9, 1997. SWBT did not provide the requested cost-support documentation and asserted that it would be difficult to meet the requested deadlines. In order to allow SWBT to prioritize its resources in providing the cost-support documentation, in the January 6, 1998 letter to SWBT, the auditors requested that SWBT provide a schedule of dates by when it could provide the cost support documentation for the sample of Unallocated Other Costs. SWBT responded that it would provide the cost support for Unallocated Other Costs by June 4, 1998. Letter from B. Jeannie Fry, SWBT, to Kenneth Ackerman, dated January 20, 1998. To date, we do not have sufficient documentation to determine the nature of the costs described in SWBT's CPR as Unallocated Other Costs.

[48] The scope of the audit included approximately 592,000 records, of which 478,300 records represented Hard-wired Equipment, 46,900 records reflected Undetailed Investment, and 66,800 records represented Unallocated Other Costs. Of these records, we estimate based upon our statistical sample that about 215,400 were inadequate or contained serious errors,

of SWBT's records. The current audit demonstrates that substantive problems of the same nature as those discovered in 1994 still persist.

37. The inability of the company to demonstrate the existence of such a high percentage of the equipment contained in its records raises significant questions about the valuation of SWBT's plant accounts. At its worst, failure to provide sufficient and convincing documentation for the acquisition of the assets in question and for their placement into regulated accounts raises doubts about whether policymakers can rely on these records.

38. We believe corrective action concerning the accounting treatment of the overstated amounts is necessary to address the deficiencies found in our audit. We believe that the amounts associated with Hard-wired Equipment that was not found ($221.7) and Undetailed Investment that could not be substantiated ($923.8 million) should be written-off SWBT's plant accounts.

39. In addition, we believe further corrective action involving a complete inventory and audit of SWBT's CPR, practices, procedures, and controls are necessary to bring SWBT into compliance with the Commission's rules. A carrier's CPR consists of a large number of individual line-items, each of which represents one or more specific items of equipment. The only way to ensure a CPR line-item is correct is to examine the corresponding equipment items. The only way to validate all of the line-items in a CPR is to conduct an inventory of the entire CPR. The current audit findings demonstrate that SWBT's CPR for its COE has serious and numerous deficiencies. Because its CPR contains thousands of records that are apparently not associated with plant used and useful in the provision of telecommunications service,[50] we conclude that the only practical way to resolve all of these deficiencies is for SWBT to engage an independent firm to perform an inventory of its entire COE and provide the results to the Commission.[51] In addition, SWBT should engage an independent firm to review its practices, procedures, and controls for maintaining its CPR and to make recommendations for improving these systems so that SWBT's CPR and plant balances can be maintained in compliance with the Commission's rules.

40. Finally, we identified an additional $157.4 million of Unallocated Other Costs investment for which the carrier apparently has not kept sufficient records. These records

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[50] We estimate that 101,700 line-items for Hard-wired Equipment are inaccurate. In addition, 46,900 line-items reflect Undetailed Investment and another 66,800 records reflect Unallocated Other Costs.

[51] Audit by an independent firm will also be an effective means of following up on and confirming SWBT's reduction of SWBT's Undetailed Investment subsequent to our on-site audit work as discussed *supra* in fn. 39.

contain no asset descriptions and no specific locations. We have serious concerns about the proper accounting treatment of much of this cost, including whether these line-items should remain on the carrier's CPR and plant account balances. We are still considering this issue, however, and will make a decision upon further review of the carrier's documentation for this type of investment.

VIII. Recommendations

41. We recommend the following actions:

42. SWBT should write off $1,145.5 million from its central office equipment to remove the estimated cost of its missing Hard-wired Equipment ($221.7 million) and Undetailed Investment ($923.8 million) from its central office equipment accounts.

43. The accounting recommendation in Paragraph 42 above requires SWBT to write off an amount based on statistical inferences drawn from the current audit. In order to correct its CPR, SWBT should be required to engage an independent firm to perform an inventory of its CPR and provide the results to the Commission. We recommend that the Commission analyze the results of this inventory and direct SWBT to make all entries necessary to correct further its CPR and account balances.

44. In order to improve the likelihood that its CPR will be maintained correctly in the future, SWBT should be required to engage an independent auditor to review SWBT's practices, procedures, and controls for maintaining CPR and to make recommendations for improving these systems so that SWBT's CPR and plant balances can be maintained in compliance with the Commission's rules. Based on the audit, SWBT should develop and submit to the Commission for approval a plan of corrective action for maintenance of its CPR. At a minimum, the scope of the independent audit should include a review of: (1) the existing internal controls related to prevention, detection, and correction of errors on a timely basis; (2) existing automated systems that serve to eliminate or reduce the potential for errors and that provide an appropriate audit trail for verification of the CPR; and (3) the controls and processes necessary to comply with the Commission's rules pertaining to the CPR.