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PUBLIC VERSION

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

ORIGINAL

In the Matter of

Ameritech Corporation Telephone
Operating Companies', et al.,
Continuing Property Records Audit

)
)
) CC Docket No. 99-117
) ASD File No. 99-22
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BELL ATLANTIC REPLY COMMENTS ON
NOTICE OF INQUIRY

PUBLIC VERSION

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TABLE OF CONTENTS

I.	Introduction and Summary	1
II.	The Audit Process Was Flawed	3
	The long distance carriers fail to account for the lack of communication from the audit staff concerning procedures	3
	Whatever the basis of the rescoring, it was inconsistent	4
	Contrary to claims of the long distance carriers, the rescoring resulted in the categorization of more equipment as “missing”	5
	The audit staff only audited in one direction	6
	The time of the initial inspection was limited	6
III.	The Audit Staff’s Statistical Extrapolation Was Improper	7
IV.	The Draft Audit Report Provides No Basis To Question The Reasonableness of Current Rates	9
V.	Undetailed Records Cannot Be Considered “Missing” Plant	13
	Conclusion	15
	ATTACHMENT 1	CONFIDENTIAL
	ATTACHMENT 2	CONFIDENTIAL
	ATTACHMENT 3	Comparison of Items Scored “Missing” Initial Inspection to Final Report
	ATTACHMENT 4	CONFIDENTIAL
	ATTACHMENT 5	CONFIDENTIAL
	ATTACHMENT 6	Declaration of Fritz Scheuren and Edward J. Mulrow
	ATTACHMENT 7	CONFIDENTIAL
	ATTACHMENT 8	Affidavit of Ronald E. White

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)	
)	
Ameritech Corporation Telephone)	CC Dkt. No. 99-117
Operating Companies', et al.,)	ASD File No. 99-22
Continuing Property Records Audit)	

BELL ATLANTIC¹ REPLY COMMENTS ON NOTICE OF INQUIRY

I. Introduction and Summary

In its responsive report, Bell Atlantic demonstrated that the audit of central office equipment was a flawed exercise. In particular, the procedures of the inspections were one-sided and deficient. Auditors were only given minutes to find an item. The staff refused to discuss the documentary evidence submitted by Bell Atlantic, and refused to re-inspect the audit sites, even when informed by Bell Atlantic that the item had been in the office all along and for various reasons was overlooked in the initial review.

Because the audit process was deficient, the results are defective. In reality, Bell Atlantic found fully 97% of the items included in the audit staff's sample, and the bulk of the remaining 3% either have been accounted for as retirements or otherwise cannot fairly be characterized as "missing."

¹ The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

Not surprisingly, AT&T and MCI witnesses attempt to bolster the audit results as best they can. They claim they can do so because, while auditors were given strict instructions after the inspections never to discuss their review of Bell Atlantic's records with Bell Atlantic's own employees, the audit staff "responded freely and completely" to all of AT&T's questions. AT&T Comments at 15. But their efforts fail and the staff's results remain "indefensible." Furchtgott-Roth Statement at 10.

Despite their efforts to paint the audit in the most positive light possible, the long distance carriers supporting the audit report do not even attempt to dispute many of the basic facts that underlie Bell Atlantic's concerns about this audit:

- They do not dispute that the staff audited only the continuing property records and never looked at Bell Atlantic's regulated books of account. They do not dispute that the regulated books of account – and not the records audited by the Commission staff – are the basis for calculating regulated returns and for other regulatory cost calculations.
- They do not dispute that, despite repeated invitations by Bell Atlantic, there has never been a follow-up re-inspection by the audit staff to verify Bell Atlantic claims concerning identification of equipment that the audit report still classifies as "missing."
- The long distance carriers do not dispute that the standards which the staff purported to rely on for considering requests by carriers to reclassify results for equipment characterized as "missing" were not released until April 7, 1999 – two years after the start of the audit.
- The long distance carriers also do not dispute most of the fundamental analysis by the statistical experts who uncovered biases and flaws in the audit procedures, including a sizable (more than 40%) margin of error.

In sum, even before addressing the claims made in the comments in support of the audit, the Commission should conclude that the audit was flawed and that no further action should or can be taken based on the audit report. Moreover, the arguments that the long distance carriers do make in support of the audit are themselves flawed and add nothing to support the audit reports.

II. The Audit Process Was Flawed

The long distance carriers argue that the procedures in general and the post-inspection rescoring of items in particular were reasonable and, if anything, favored Bell Atlantic and the other audited companies. This is demonstrably false for at least five reasons.

First, the long distance carriers fail to account for the lack of communication from the audit staff concerning procedures. The standards for evaluating evidence submitted by carriers to support the rescoring treatment of equipment originally classified as “missing” to “found” were not released until after the audit report evaluating the evidence was released to the public. Indeed, these standards do not appear to even have been written until after the time that the staff evaluations took place.²

These standards affirmed that the “best evidence” to verify the existence of an item was physical inspection, yet the staff refused to allow re-visits to confirm that Bell Atlantic has located a “missing” item. Indeed, the auditors own records include **[Begin Confidential]**

² **[Begin Confidential]**

[End Confidential] Indeed, the staff has failed to respond to Bell Atlantic’s queries as to when the procedures document was actually prepared.

[End Confidential]. See Attachment 1.

In preparation of its inevitable positive review of the audit staff's procedure, AT&T, by its own account, "received full cooperation from the audit Staff, who responded freely and completely to their inquiries." AT&T Comments at 15. In contrast, despite repeated attempts, Bell Atlantic inquiries about its own audit and the sufficiency of the submitted support documentation were unanswered by the staff. Indeed, Bell Atlantic was not even allowed to walk the audit staff through the detailed documentation offered to support the so called "missing" items. In many instances, dialogue with the audit staff may have provided the needed clarification or understanding to warrant favorable re-scoring of sample items.

Second, whatever the basis of the rescoring, it was inconsistent. AT&T and MCI claim that in the rescoring process the auditors gave Bell Atlantic credit for situations where the equipment was not readily identifiable in a single visit, yet could be shown to be present.³ AT&T and MCI base this claim on the criteria in the after-the-fact procedures released by the audit staff. As Bell Atlantic previously explained, in some instances the staff did give Bell Atlantic credit, but in many other instances, relying on virtually identical facts and regardless of the criteria in the procedures, the audit staff continued to categorize equipment as missing. See Bell Atlantic comments at pages 6, 7. For examples, see Attachment 2.

³ These situations included: items that were actually embedded in larger pieces of equipment; items found at the central office, but at a different location than the one indicated in the property records; and items retired between the time that the auditors obtained the property record listing and the date of the inspection. See AT&T at pages 20-21 and MCI at page 19.

Third, contrary to claims of the long distance carriers, the rescoring resulted in the categorization of more equipment as “missing.” Even taking into account the value of items that were recognized by the staff as no longer “missing,” there is still a substantial net increase in “missing” equipment as scored by the staff. *See* Attachment 3. Moreover, because the staff did give Bell Atlantic credit for finding some of the items, that net increase in “missing” equipment required rescoring *even more* equipment from other categories after the initial inspection to being treated as “missing” in the final report. In fact, almost half of the equipment considered by the staff as “missing” in the final report was not classified as “missing” by the staff in the initial inspections. *Id.*

AT&T’s testimony that the rescoring benefited Bell Atlantic is based on distortions of the record. In fact, AT&T’s analysis of the FCC audit staff’s rescoring is inconsistent with the actual rescoring done by the audit staff and is internally inconsistent – the same type of rescoring is treated different ways by AT&T without reason or explanation. For example, **[Begin Confidential]**

. **[End**

Confidential] *See* Attachments 4 and 5 detailing deficiencies in AT&T’s rescoring analysis. Because of these deficiencies, AT&T’s summaries of the rescoring are simply wrong and cannot be relied upon here.

The long distance carriers mistakenly argue that rescoring “missing” items as “found” unreasonably favors the audited companies. In fact, that is just how the process should have worked. After the initial inspection, Bell Atlantic should have been given a

reasonable opportunity to show that it found equipment initially classified as “missing.” In contrast, there is no basis for downward reclassification – treating items that appeared to have been found at the initial audit as missing. Nevertheless, the audit staff did just that to the detriment of the audited companies.

Fourth, the audit staff only audited in one direction. The audit staff checked whether equipment listed in the property records could be immediately identified. They jumped to the conclusion that equipment was missing without doing any checks to see whether an offset was necessary for equipment in the central offices that could not be readily linked back to a specific property record. AT&T tries to minimize this failure by arguing that the only way such a problem could occur is if the equipment is “missing from the corporate books.” AT&T Comments at 4. Putting aside the fact that Bell Atlantic’s continuing property records are separate and distinct from Bell Atlantic’s corporate books, AT&T’s argument misses the point. The simple fact is that an item may not be “missing” at all -- just not immediately identifiable in the records. Without even making the effort to check for additional equipment, it is not reasonable to assume that there is no offset and that no two-way audit is required. *See* Attachment 6, Declaration of Fritz Scheuren and Edward J. Mulrow.

Fifth, the time of the initial inspection was limited. AT&T argues that the auditors stayed until Bell Atlantic’s own personnel accepted that an item “could not be found.” AT&T Comments at 14. This is simply not true. The audit staff allowed a limited time for each audit site, resulting in only minutes being spent locating each item. The only thing “accepted” by Bell Atlantic at the time was it could not identify the equipment to the satisfaction of the audit staff without further review. Based on that

further review, Bell Atlantic was able to find the vast majority of equipment classified by the audit staff as “missing.” Clearly the equipment could be found, just not on the rigid terms of the initial inspection.

III. The Audit Staff’s Statistical Extrapolation Was Improper

In its responsive report, Bell Atlantic included statistical testimony from a major accounting firm demonstrating that the statistical extrapolation used to justify expanding a limited sample of items into dollar-based conclusions relating to the entire rate base were so biased and flawed as to be meaningless. AT&T’s expert testimony not only concedes bias and error may have been demonstrated, but where one of its experts argues that the end result of the audit is still appropriate to rely on, he is contradicted by the statistical textbooks written by another of AT&T’s own experts.

In the attached declaration, Dr. Fritz Scheuren and Dr. Edward Mulrow reaffirm that the “precision of the audit estimates is too poor to be of any credible use.” Attachment 6, ¶ 2.9 (“Scheuren Reply”). In extrapolating the sample to the entire rate base, the FCC’s audit staff has already recognized an astounding 40% margin of error. *See* Bell Atlantic Responsive Report at 11. In fact, as Dr. Scheuren testified, after correcting for other errors, the actual margin of error is even greater. Bell Atlantic Comments at 4 (calculating an actual margin of error of 65-70%). Even AT&T’s in-house witness testifying on statistical issues, Bell, agrees that the margin of error exceeds the already sizable staff calculation. *See* Scheuren Reply, ¶ 8.1.

Despite the wide range in the staff results, Bell still argues that the staff was correct in picking a single point -- the midpoint of the range of results -- as a reasonable extrapolation for the value of equipment that is “missing.” But this arbitrary assumption

is not supported by data. As Ernst & Young explain, in order to pick a single number, the only point that may be relied on is the lowest point within the confidence interval. Based on the results here, that means that the data do not support a conclusion that there is any missing equipment in the general rate base.⁴

This conclusion is not only supported by the Committee on Applied and Theoretical Statistics of the National Research Council and the Internal Revenue Service,⁵ it is also supported by AT&T's external witness, Dr. Loebeckke, who is also a statistical expert, although he does not testify as one here. In a textbook authored by Dr. Loebeckke, he makes clear (contrary to AT&T's assertions) that it “would be wrong to conclude” that the error rate for an entire population is the same as the sample because “the odds of this being the case are just too low.” Scheuren Reply, ¶ 4.2 (quoting Arens and Loebeckke, *Applications of Statistical Sampling to Auditing*). Instead, Dr.

⁴ See Scheuren Reply, ¶ 12.1. AT&T also makes the argument that because some small portion of the sample could not be identified by Bell Atlantic, then Bell Atlantic is precluded from arguing that the confidence interval extends the range of “missing” equipment to zero. But this distorts Bell Atlantic’s position. The amount of equipment that could not be specifically found or identified is just 0.008% of Bell Atlantic’s investment base. The fact that the confidence interval on the sample extends past zero means that, beyond the items in the sample that could not be identified (which includes items like metal frames that were clearly present in the central offices and just could not be uniquely identified), no statistically valid extrapolation is possible. *Id.*, ¶ 7.3.

⁵ AT&T argues that the IRS recommendations should be ignored because AT&T and other customers are stakeholders here. AT&T Comments at 28. The Commission has already found Bell Atlantic’s rates to be just and reasonable and this is not a new rate case. AT&T and other customers are not direct stakeholders in the audit process – indeed federal law makes audit submissions secret from such third parties. 47 U.S.C. § 220(f). AT&T is no different than third parties who claim an economic interest in individual tax payers paying their full share owed. Regardless, as Dr. Scheuren explains, the IRS example is analogous because in both cases, the subject of the audit had no say in the audit design, and should not be made to suffer if the level of precision is too lax. Scheuren Reply, ¶ 5.6 and 5.7.

Loebecke insists that auditors must compute the outer precision limits of the sample results, just as Dr. Scheuren did in his testimony.

IV. The Draft Audit Report Provides No Basis To Question The Reasonableness of Current Rates

Just as Bell Atlantic stated in its responsive report, the long distance carriers recognize that there is no direct link between the continuing property records and the setting of any rate. Indeed, under current price cap regulation, there is no link between regulated costs and rate setting. Even under prior regulation, cost benchmarks that impacted rates were based on balances in the regulated books of account, not the property records audited here. *See* Bell Atlantic Responsive Report at 12. The long distance carriers attempt to argue that the property records are linked to the accounting records, but this argument is flawed and must be rejected.

The long distance carriers first attempt to avoid the need for linkage by arguing that the audit proved that the plant never existed, but this is a contrivance of the long distance carriers. The audit report makes no such suggestion, and certainly the audit itself does not contain any analysis that could support such a conclusion. Indeed, included in the small amount of equipment that Bell Atlantic could not specifically locate, is equipment for which Bell Atlantic nevertheless submitted specific documentation showing that the equipment had been in place and had been retired. The long distance carriers offer no rebuttal to this evidence.

Regardless, the long distance carriers do not challenge the adequacy of Bell Atlantic's accounting safeguards which ensure that no investment cost can go onto Bell Atlantic accounting records without the money actually having been spent on the specified equipment.

Ultimately, the long distance carriers argue that delayed retirements impact rates, but again they are wrong. As Bell Atlantic demonstrated, the link between the property records and account balances is the processing of retirements. But because of the self-correcting method of calculating depreciation, delays in recording retirements do not result in increased rates. The long distance carriers argue otherwise, but their arguments are based on unrealistic assumptions that are inconsistent with their own rhetoric.

In Bell Atlantic's Responsive Report, depreciation expert Dr. Ronald White testified that there is no fixed relationship between a failure to retire plant and the revenue requirement – “[t]he amount, timing and present value of annual revenue requirements may increase, decrease or remain unchanged, depending upon the direction of movement in the composite remaining life of a plant category.” Bell Atlantic Responsive Report at 15, quoting Dr. White's attached affidavit.

MCI's witness disputes Dr. White by doing his own calculation which purports to show an increase in depreciation expense. MCI comments, Attachment 2, Snavelly King Report, page 8. But MCI's calculation is based on unrealistic assumptions. In particular, MCI assumes that all equipment of a certain age is retired all at once, rather than over a period of years and that all “missing” equipment dates back to the earliest point when equipment of that type was installed.⁶ These “incorrect and naïve” assumptions produce unrealistic results. Attachment 8, White Reply Declaration, ¶ 18. In his reply

⁶ MCI's witness here argues that if retirements had been higher in the past, depreciation expense would have been lower. This directly contradicts the prior testimony of Mr. Lee's firm in depreciation proceedings, where it has consistently argued that authorized lives should be based on “derived” lives, which means that increased retirements result in higher depreciation rates. *See, e.g.*, Snavelly, King & Associates, Inc. Report Regarding 1989 Depreciation Rate Study for the Pennsylvania Office of Consumer Advocate at 5-6 (filed Feb 2, 1989).

declaration, Dr. White reruns the test done by MCI's witness, but uses actual data – i.e. he uses the actual vintages of the equipment claimed to be missing by the FCC audit staff, and he allows retirements to occur over a period of years, relying on the life curve used for depreciation calculation today by Bell Atlantic under FCC approval. Making these corrections to MCI's calculations, the results are perfectly consistent with Dr. White's original prediction: even assuming that Bell Atlantic had failed to retire all of the equipment claimed as missing by the audit staff, depreciation expense is virtually unaffected.⁷ See Attachment 7 and White Reply Declaration.

The long distance carriers also argue that because there is an annual reconciliation between the continuing property records and the account balances, any supposed error in the property records directly translates into an accounting records error. This argument misconstrues the annual reconciliation process. Commission rules do not require that each entry in the property records be reflected in the accounting records, but rather that the two records are equal "in the aggregate." 47 C.F.R. § 32.2000 (e)(2). Generally, the accounting records have the higher cost balance because they reflect the actual dollars spent and thus capture the capitalized labor costs associated with the installation of equipment. These costs are incorporated into the property records as part of the annual reconciliation process – the additional dollars in the accounting records are apportioned to individual pieces of equipment to reflect labor costs. As a result, if the level of property investment is overstated in the property record, then a smaller amount of labor costs would need be added to each of the property records, but the overall investment

⁷ In fact, failure to retire even the levels alleged by the audit staff actually results in a slightly higher depreciation expense. Under MCI's argument, rate payers would have been very slightly better off as a result.

would remain the same to balance to the books of accounts. Even in this scenario, there is no impact on the accounting records. The only way in which the property records impact the accounting records is through accounting entries reflecting plant retirement, but as discussed above, delayed retirements would not result in higher rates.

Even if the long distance carriers could demonstrate an impact on past rates of return, they do not make the case that the results of the present audit can be assumed to have been the same since the dawn of price caps. The Commission's decision not to waste time and resources to do an investigation at the inception of price caps is dispositive on that point. *See Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786 at ¶ 273 (1990). Indeed, almost half of the items claimed to be missing were not even put into service until after the inception of price caps. There is simply no way the Commission has a record to make conclusions about either the quality of records or the level of equipment ten years ago.

In addition, while deficiencies in the audit and the complete failure to link to the actual books of account make any write-off of assets unsupportable, even if there were a justification, none of the commenters explain how the staff's proposal to "write-off" millions in investment could be done consistent with Commission rules. As demonstrated in Bell Atlantic's responsive report, Commission rules do not provide for such a write-off. Without a link to the books of account, there is also no way to ascertain what equipment the staff claims should be written off. Moreover, even the staff report does not claim that the audit is statistically significant for the individual operating companies that own the equipment, so that there is no valid basis to apportion the proposed illegal write-off among affiliated carriers. *See Bell Atlantic Comments at 10.*

V. Undetailed Records Cannot Be Considered “Missing” Plant

Not surprisingly, the long distance carriers support the audit report’s characterization of undetailed plant as “missing.” But the long distance carrier’s comments fail to address Bell Atlantic’s responsive report, which explained why the undetailed records represent legitimate investment.

Contrary to the claims of the long distance carriers, in fact there are a number of details in the property records themselves concerning this plant including vintage year, central office location, and equipment type (circuit or switching). Indeed, the long distance carriers rely on this information to argue that the vintage of the undetailed equipment is too recent to include as undetailed.

The long distance carriers complain that much of the undetailed equipment post-dates the initial conversion to the property records codes. This argument ignores Bell Atlantic’s prior explanation concerning the classification of this equipment. Much of the undetailed investment is associated with remote locations – equipment dedicated to a single customer on that customer’s premises. *See* Bell Atlantic Responsive Report at 20. These locations did not become part of detailed property records until 1991. Previously, investment in this equipment was tracked through manual records. Because such tracking did not include sufficient detail to code the equipment under the detailed property record system, the equipment was classified as undetailed in the same way preexisting plant was treated as undetailed at the time of the original records conversion.

There are approximately *thirty thousand* remote customer premises locations, each with only a small amount of equipment. As a result, it is prohibitively expensive and makes no economic sense to inventory the equipment at all these locations. Indeed,

these locations were not part of the staff's audit and have never been inspected by the audit staff. Whenever there is a wholesale replacement or retirement of equipment at a remote location, however, Bell Atlantic retires all the undetailed investment for that location. Bell Atlantic Responsive Report at 20. Thus, as this equipment is replaced over time, Bell Atlantic is moving to a full record for equipment at these locations. In the meantime, there is no basis for a claim that this equipment is "missing."

The remainder of the undetailed investment is either investment that is temporarily classified as undetailed or is technically unallocated investment. In several accounting simplification projects, New York Telephone eliminated non-standard account codes. As a result, certain unallocated investment was reclassified as undetailed to allow for specific investment identification (such identification cannot be assigned to investment classified as unallocated).

The long distance carriers also complain that older vintage undetailed equipment is "missing." In effect, their argument is that an FCC staff interpretation of the rules that has been undisturbed for thirty years should be overturned and that the local carriers should be penalized retroactively for that change. The interpretation from the Common Carrier Bureau allowed AT&T and its progeny to continue to use undetailed identification for plant that had been in place at the time of the adoption of the property record codes. Letter from Kelly Griffith on behalf of the Chief, Common Carrier Bureau to Alexander L. Stott, Vice President and Comptroller, AT&T (Dec. 24, 1968).

Regardless, the vast of majority of undetailed plant has been retired and removed from Bell Atlantic's books and records.⁸ The rest of the undetailed investment (in central office locations) is being retired according to its age. Any equipment more than ten years old has already been retired. Each year, any portion of the remaining investment that becomes ten years old is also retired. This process, which was reviewed with the Commission staff in 1995, will virtually eliminate undetailed investment over the coming years.

Conclusion

The Commission should reject the audit staff reports, terminate the audit without further action, and instead open a rulemaking to eliminate FCC property record requirements.

Respectfully submitted,



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October 25, 1999

⁸ The long distance carriers cite to a D.C. Commission case to bolster their claims that undetailed equipment is "missing" and should impact rates. But Bell Atlantic-DC's explanation of its expense classification was sufficient for the D.C. Commission and no rate adjustment resulted. Instead, the Commission ordered that Bell Atlantic and the staff work together to identify whether there are areas that need greater clarity and accuracy. *Public Service Commission of the District of Columbia*, Formal Case No. 850, Order No. 9927 (rel. Jan. 27, 1992).

ATTACHMENT 1

Examples of FCC Auditor Notes

REDACTED

CONFIDENTIAL-- NOT FOR PUBLIC INSPECTION

ATTACHMENT 2

Examples of Items for which Bell Atlantic
submitted Explanation

REDACTED
CONFIDENTIAL -- NOT FOR PUBLIC INSPECTION

FCC CPR Audit

Comparison of Items Scored "Missing" Initial Inspection to Final Report

<u>Rescored (From - To)</u>	Bell Atlantic - North	Bell Atlantic - South	Bell Atlantic - Total
	<u>In-Place \$(000)</u>	<u>In-Place \$(000)</u>	<u>In-Place \$(000)</u>
From "Missing":			
3 to 1	(17)	(49)	(66)
3 to 2		(1)	(1)
3 to 4	(118)	(172)	(290)
To "Missing":			
4 to 3	1022	653	1675
Net - From/To "Missing"	887	431	1318
Total Initial "Missing" (3s)	708	1541	2249
Total Final "Missing" (3s)	1595	1972	3567
Percent Increase	125%	28%	59%

ATTACHMENT 4

FCC Scoring vs. AT&T

REDACTED

CONFIDENTIAL -- NOT FOR PUBLIC INSPECTION

ATTACHMENT 5
FCC Scoring vs. AT&T

REDACTED
CONFIDENTIAL -- NOT FOR PUBLIC INSPECTION

DECLARATION OF FRITZ SCHEUREN AND EDWARD J. MULROW

1 Introduction.

1.1 We are statistical consultants engaged by Bell Atlantic Telephone Companies, BellSouth Telecommunications, and SBC Telecommunications, Inc. (subsequently referred to as “the RBOCs”) to evaluate the Continuing Property Records (CPR) audits conducted by FCC staff in 1997.^{1,2,3,4,5} The scope of our work was limited, however, to the sampling design employed in the audits and to the statistical aspects of its execution. In carrying out this work we independently examined each client RBOC’s data pertaining to the CPR audits. In January of 1999, we publicly filed our opinions on each client RBOC’s audit conducted by the FCC. These opinions may be found in the appendices or exhibits of each RBOC’s response to the audit of continuing property records.^{6,7,8}

1.2 Dr. Scheuren has been a professional mathematical statistician for more

¹ Federal Communications Commission Common Carrier Bureau Accounting Safeguards Division, *Audit of the Continuing Property Records of the NYNEX Telephone Operating Companies Also Known As Bell Atlantic North As of March 31, 1997*, December 22, 1998

² Federal Communications Commission Common Carrier Bureau Accounting Safeguards Division, *Audit of the Continuing Property Records of Bell Atlantic Telephone Operating Companies Also Known As Bell Atlantic (South) As of March 31, 1997*, December 22, 1998

³ Federal Communications Commission Common Carrier Bureau Accounting Safeguards Division, *Audit of the Continuing Property Records of BellSouth Telecommunications, Inc. As of July 31, 1997*, December 22, 1998

⁴ Federal Communications Commission Common Carrier Bureau Accounting Safeguards Division, *Audit of the Continuing Property Records of Southwestern Bell Telephone Company As of June 30, 1997*, December 22, 1998

⁵ Federal Communications Commission Common Carrier Bureau Accounting Safeguards Division, *Audit of the Continuing Property Records of the Pacific Bell and Nevada Bell Telephone Companies As of June 30, 1997*, December 22, 1998

⁶ *Response to Audit Staff Draft Report of Findings Related to Audit of Continuing Property Records of Bell Atlantic*, January 11, 1999, Appendix A

⁷ *BellSouth’s Response to Audit of Continuing Property Records of BellSouth Telecommunications As of July 31, 1997*, January 11, 1999, Exhibit 1

⁸ *Reply to December 22 1998 Draft Report of the Federal Communications Commission Accounting Safeguards Division Audit of Nevada Bell, Pacific Bell and Southwestern Bell Telephone Company*, January 11, 1999, Attachment B

AFFIDAVIT OF FRITZ SCHEUREN
AND EDWARD J. MULROW
DOCKET NO. 99-117

1.2 Dr. Scheuren has been a professional mathematical statistician for more than 25 years. He is an internationally known sampling expert, and has published widely on survey design and other statistical problems – authoring, co-authoring or editing nearly 150 books, monographs, and papers.

1.3 When the work of evaluating the CPR audits began, Dr. Scheuren was a Principal with Ernst & Young, LLP. He has subsequently taken a position as a Senior Fellow at The Urban Institute. He is currently overseeing the National Survey of America's Families, a large complex survey with a dual frame design. However, he continues to consult with the statistical staff at Ernst & Young LLP.

1.4 Dr. Edward Mulrow is a senior manager with Ernst & Young, LLP. He has overseen all Ernst & Young's work involved in evaluating the CPR audits. He has a Ph.D. in statistics from Colorado State University, and has over 13 years of experience in statistical consulting. His experience in sampling statistics before coming to Ernst and Young, LLP was obtained while working at the Internal Revenue Service (IRS) and for the National Opinion Research Center at the University of Chicago (NORC). There he designed and built a prototype sample system that is used to maintain all NORC's national survey frames.

2 Purpose and Summary of the Affidavit.

2.1 The purpose of this filing is to respond to the statistical issues and concerns raised in affidavits submitted by the AT&T Corporation⁹ and its experts Dr. Robert Bell¹⁰ and Mr. James Loebbecke.¹¹ It should be said at the outset that none of what we read changes our previously stated conclusions. We continue to believe that –

⁹ *Comments of the AT&T Corp. (Public Version) Before the Federal Communications Commission*, Washington, D.C. 20554, CC Docket no 99-117 ASD file No. 99-22, September 23, 1999

¹⁰ *Affidavit of Robert M. Bell, Ph.D. (Public Version) Before the Federal Communications Commission*, Washington, D.C. 20554, CC Docket No. 99-117, ASD File No. 99-22, September 23, 1999

¹¹ *Affidavit of James K. Loebbecke, CPA (Public Version) Before the Federal Communications Commission*, Washington, D.C. 20554, CC Docket No. 99-117, ASD File No. 99-22, September 23, 1999

The estimates in the FCC's draft audit reports contain biases and are inaccurate.

Given these errors and biases, the amounts reported by the FCC audit staff as overstated investment are unsound and cannot be fairly relied upon.

2.2 We confess some surprise in what, for us, is a major omission in the AT&T filing – the issue of the uncertainty of the estimates of missing plant in the CPR audits.

2.3 All the submissions lack a candid discussion of the poor precision in the estimated values of the property record audits. Such precision considerations are essential when determining whether the estimates are credible enough to use as a basis to justify action against the RBOCs. It remains our opinion that they are not. (See Section 3.)

2.4 The margin of error of an estimate, which is related to its confidence bounds, reflects the precision of an estimate.¹² The degree of precision can be controlled through the design of the sample. A high degree of precision may call for a costly sampling plan, so it is up to the those who are in control of the audit process to determine the trade-offs between sampling cost and the benefits of high precision. For this reason, the staff should assess the amount of alleged overstated property using a lower confidence bound. One of AT&T's own experts agrees (in other writings) that the confidence bound rather than a point estimate is the appropriate measure. (See Sections 4 & 5)

¹² "Precision" is another term for "margin of error." This is closely linked to the confidence level. Suppose for example, an estimate is reported to be 150 plus or minus a margin of error of 10 at the 95 percent confidence level. Then if you were to add and subtract 10 from 150 you would obtain the interval 140 to 160. This is the confidence interval. To say that there is 95 percent confidence means that if you could repeat the sampling process under identical circumstances using the identical sample design but different random selections, then 95 out of 100 times the true value that is being estimated would fall inside the confidence interval. Five times out of 100, it would not.