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Ms. Magalie Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: CC Docket No. 99-117, ASD File No. 99-22

Dear Ms. Salas:

Enclosed for filing, please find an original plus four copies of the public version of Reply Comments of AT&T Corp. in the above referenced proceeding. A proprietary version of this document is being filed concurrently. Please contact the undersigned with any questions.

Yours truly,

David M. Levy

David M. Levy

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

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matters of:	
Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit	
Bell Atlantic (North) Telephone Companies' Continuing Property Records Audit	
Bell Atlantic (South) Telephone Companies' Continuing Property Records Audit	CC Docket No. 99-117
BellSouth Telecommunications' Continuing Property Records Audit	ASD File No. 99-22
Pacific Bell and Nevada Bell Telephone Companies' Continuing Property Records Audit	
Southwestern Bell Telephone Company's Continuing Property Records Audit	
US West Telephone Companies' Continuing Property Records Audit	

ORIGINAL

REPLY COMMENTS OF AT&T CORP.

(PUBLIC VERSION)

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TABLE OF CONTENTS

INTRODUCTION AND SUMMARY 1

ARGUMENT 4

I. THE STANDARD SAMPLING TECHNIQUES EMPLOYED BY THE STAFF WERE VALID AND PROPER. 4

A. A "One-Way Audit" Was Proper. 5

B. No Material Bias Occurred. 6

C. The Staff Properly Computed Estimates Using Gross Book Value of Missing HWCOE. 9

D. The Staff Properly Stratified By Central Office Size. 9

E. The Staff Properly Audited Items of All Costs. 10

II. THE AUDIT SCORING PROCEDURES WERE REASONABLE AND, IN FACT, OVERLY GENEROUS TO THE RBOCS. 11

A. The RBOCs Received Ample Notice And Time To Prepare For Their Audits. 12

B. The On-Site Inspections Were Conducted In A Highly Professional Manner. 13

C. The Staff's Rescoring Procedures Were Reasonable. 16

1. The Staff Carefully Considered The RBOCs' Post-Audit Submissions. 16

2. The Staff's Rescoring Standard Was Reasonable. 17

3. Much Of The RBOCs' Alleged "Documentation" Was Insufficient Under Any Reasonable Standard. 19

4. The Staff's Rescoring Standard Was Consistently Applied. 23

5. The Staff's Rescoring Standard Did Not Violate The Administrative Procedure Act Or Otherwise Prejudice The RBOCs. 24

D. The Audit Procedures Complied With GAAS And GAGAS. 26

E. Reports Of Accounting Firms Hired To Refute The Staff Report Are Devoid Of Probative Evidence. 30

III. THE STATISTICAL PLAN WAS PROPERLY CARRIED OUT USING THE ACCURATE DATA COLLECTED BY THE AUDITORS 33

IV. THE ESTIMATED $2.9 BILLION OVERSTATEMENT OF THE RBOCS' HWCOE CPR PLAINLY WARRANTS CORRECTIVE ACTION 35

A. Ratepayer Impacts 36

B. Accounting Corrections for Missing HWCOE 39

C. Accounting Corrections to Resolve "Undetailed Investment." 42

D. Future Audit Requirements 43

V. OTHER ISSUES 43

CONCLUSION 45

REPLY COMMENTS OF AT&T CORP.

Pursuant to the Commission's *Notice*[1], AT&T Corp. ("AT&T") hereby submits its reply comments concerning the accounting practices of the captioned companies, and the issues arising from the audits of their hard-wired central office equipment ("HWCOE") by the Common Carrier Bureau Staff ("Staff"). These reply comments, like AT&T's initial comments, are preliminary. Only Bell Atlantic has permitted the Commission to allow examination of the work papers underlying the Commission and RBOC analyses of the audits to AT&T and other interested parties. While Ameritech has disclosed a small subset of its underlying documentation, the items disclosed are so selective and heavily redacted as to be virtually unintelligible. And the other holding companies that challenge the Commission's audit results – BellSouth, Pacific Bell/Nevada Bell, Southwestern Bell and U S WEST – still refuse to permit others to inspect the property records and other work papers needed to test their criticisms of the audit results.

INTRODUCTION AND SUMMARY

The initial comments of the Regional Bell Operating Companies ("RBOCs") offer no legitimate challenge to the central finding of the Commission's audit Staff: literally *billions* of dollars of investment on the RBOCs' books reflect equipment either never placed in service or long since retired. The centerpiece of the RBOCs' September 23 comments—the testimony of the accounting firms hired by the RBOCs' to "rescore" the CPR entries found missing by the

[1] Notice of Inquiry, *Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit*, 14 FCC Rcd. 7019 (1999).

audit Staff—is little more than an extravagant public relations gambit. The accountants' reports are essentially black boxes. Almost none of the source documents purportedly relied on by the accountants in reenacting the audits have been released to the public. Hence, the accountants' results can be neither tested nor replicated. What little information can be discerned about the rescoring indicates that the accountants' rescoring judgments were extremely overgenerous to their RBOC clients. Even so, the accountants' reports confirm that most of the items found missing by Staff were actually missing.

The RBOCs' assault on the sampling procedures underlying the audits remains without substance. The stratified sampling procedures were designed by accounting and statistical experts on the Commission's Staff, adhered to widely used and generally accepted sampling practices, and were reasonably calculated to produce accurate and reliable results. The RBOCs again have failed to show that any of the alleged flaws in the sample design have—or are likely to have—any material effect on the results obtained by the audit Staff. The only plausible inference from the RBOCs' continued failure of proof is that the effects of the supposed sampling errors are immaterial, or that the samples *understate* the overall percentage of HWCOE that is missing.

The RBOCs' critiques of the audit scoring and rescoring procedures are equally misguided. Even the RBOCs admit that they cannot find many of the items selected for verification. Moreover, any bias in the scoring standards was in the RBOCS' favor. The audit Staff bent over backwards to enable the RBOCs to show that items on the companies' books actually remained in service, and even scored items as "unverified" that should have been reported as missing. The RBOCs' criticisms of the rescoring procedures amount to little more

than dissatisfaction that the audit Staff declined to accept on faith all of the RBOCs' post hoc speculation about the location of the missing assets.

The RBOCs' criticisms of the statistical point estimates and confidence intervals obtained by the audit Staff are also without merit. None of the RBOCs offer a legitimate reason for basing the estimated value of missing equipment on the lower (or, conversely, the upper) end of the confidence interval rather than the point estimate. In any event, the RBOCs have grossly overstated the breadth of the relevant confidence interval. The *reducto ad absurdum* of the RBOCs' statistical arguments is their claim that the bottom of the confidence interval is below zero—a logical impossibility.

The only options lawfully open to the Commission are reducing the RBOCs' rate bases by the share of phantom assets (and requiring related adjustments to the RBOCs' books), or sponsoring a full-blown audit of each RBOC (and requiring similar audits in the future). The Commission cannot simply sweep the evidence under the rug, as the RBOCs seek. The evidence strongly indicates that the RBOCs have maintained inflated books (either willfully or through neglect), and are collecting millions of dollars of windfall annually as a result.

ARGUMENT

I. THE STANDARD SAMPLING TECHNIQUES EMPLOYED BY THE STAFF WERE VALID AND PROPER.

The RBOCs' September 23 comments on the sampling techniques underlying the audits are insubstantial.[2] As AT&T explained in its opening comments, the Staff's statistical sampling plan for estimating the proportion and value of missing HWCOE was a textbook application of two-stage stratified sampling, a rigorous, flexible, and cost effective method of accurately estimating the characteristics of large populations of varying size.[3] By implementing the two-stage stratification design, the Staff was able to collect more information and data for a given cost than it would have been able to collect using an alternative design.[4] For this reason, the Staff obtained more reliable estimates, in the sense of lower variance for a given cost, than the estimates that could have been obtained using other sampling procedures.[5] The RBOCs'

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[2] Notice of Inquiry, *Comments of BellSouth* at 13-14, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("BellSouth Comments"); Notice of Inquiry, *Bell Atlantic Comments* at 3, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("Bell Atlantic Comments"); Notice of Inquiry, *Comments of Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell* at 7-9, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("SBC Comments"); Notice of Inquiry, *Comments of US WEST* at 5-8, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("US WEST Comments"); Notice of Inquiry, *Comments of Ameritech* at 10-12, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("Ameritech Comments").

[3] For a complete discussion of the benefits of two-stage stratification procedures, *see* Notice of Inquiry, *Comments of AT&T Corp.* at 7-9, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("AT&T Comments"). *See also id.* Exh. A, ¶ 1 ("Bell Aff."); Notice of Inquiry, *Comments of Eliot Spitzer, Attorney General of The State of New York.* at 2-4, CC Docket No. 99-117, ASD File No. 99-22 (Sept 23, 1999) ("New York Comments") ("the audit appears to have been carried out with thoroughness and rigor"); William Cochran, *Sampling Techniques* 292-318 (3d ed. 1977) ("Cochran"); Paul S. Levy & Stanley Lemeshow, *Sampling of Populations: Methods and Applications* 121-89 (1999) ("Levy").

[4] *See* AT&T Comments at 8; Reply Affidavit of Dr. Robert Bell at ¶¶ 7-8 ("Bell Reply Aff.") (attached hereto as Appendix A).

[5] *See* Bell Reply Aff ¶ 7.

criticisms of the survey design provide no basis, either individually or collectively, for rejecting the audit results as unreliable or biased.

A. A "One-Way Audit" Was Proper.

As AT&T explained in its September 23 comments, the Staff's decision to conduct a one-way audit rather than a two-way audit provides no basis for assuming away the problem of unrecorded HWCOE. The RBOCs have ample incentive to include every piece of HWCOE in the CPR because those records can have a significant effect on the RBOCs' rate base, depreciation rates and other important ratemaking determinants.[6] Moreover, only the RBOCs have access to the information needed to prove or disprove the existence of unrecorded information; it is telling that they have provided no such information. AT&T Comments at 11-12.

The RBOCs' September 23 comments on the two-way audit issue merely underscore the pretextual nature of their criticisms. Southwestern Bell, while asserting that it once found $120 million of HWCOE not listed in its CPR, offers no documentation or evidence that would allow anyone to test or verify this claim. SBC Comments at 7. The other RBOCs do not even *assert* that they have ever had significant amounts of unrecorded HWCOE.

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[6] *See* Part IV., *infra*.

B. No Material Bias Occurred.

The RBOCs claim that the audit designs suffer from "potential" sources of bias,[7] but fail to provide an iota of evidence that any material bias has actually occurred. Indeed, where the potential existence of bias is testable, the RBOCs' own experts agree that the magnitude of the bias is negligible and that the direction of any potential bias is indeterminable.[8]

Statistical Bias. Several RBOCs note that the estimators used by the Staff in theory could suffer from statistical bias.[9] Even the RBOCs' own experts concede, however, that the magnitude of such bias is negligible.[10] Moreover, the direction of any such bias is indeterminable, *i.e.*, it is equally likely that any bias *lowered* the Staff's estimates of the proportion and value of missing HWCOE. Finally, and most importantly, the scientific community prefers the highly accurate estimates used by the Staff over alternative unbiased, but less accurate, estimates. *See* Bell Reply Aff. ¶ 16.

Use Of Multiple Audit Teams. The RBOCs' continued insistence that the Staff's use of multiple audit teams somehow biased the Staff's estimates is a makeweight.[11] It is common practice to employ multiple audit teams in a project as vast as the one undertaken by the Staff;

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[7] *See, e.g.*, Ameritech Comments at 10-11; SBC Comments at 6 & Exh. A at 12-16; BellSouth Comments at 14-15 & Exh. 3, at 4-5; Bell Atlantic Comments at 3; Ex Parte Letter From Arthur Andersen, PricewaterhouseCoopers, and Ernst & Young at 1, filed Sept. 22, 1999.

[8] SBC Comments, Exh. A at 12-16; BellSouth Comments, Exh. 3, at 4; Notice of Inquiry, *Response to Audit Staff Draft Report of Findings Related to Audit of Continuing Property Records of Bell Atlantic,* Exh. 2, at 5, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("Bell Atlantic Response").

[9] *See, e.g.*, BellSouth Comments, Exh. 3, at 4; SBC Comments, Exh. A at 12-16; Bell Atlantic Response, Exh. 2, at 4.

[10] *Id.*

[11] *Id.*

indeed, the notion that a professional auditing firm would use only one audit team to conduct audits at more than 250 central offices is ludicrous. Each Staff team operated with identical written forms that they were trained to complete in an accurate and consistent manner. The consistency of the teams' findings was further ensured by back-at-the-office comparisons. And each audit team was accompanied by RBOC personnel who served as an additional check on the actions of the Staff auditors. If anything, Staff's use of multiple audit teams actually *reduced* the potential for bias by ensuring that faults in any individual team's execution of the audit procedures could not prejudice the results of the entire audit.

Exclusion of Very Small Or Remote Offices. The RBOCs' continued claim that bias resulted from the Staff's exclusion from the samples of very small offices (those with fewer than 100 CPR line items) and inaccessible offices remains meritless.[12] As AT&T has noted, excluding particular offices can introduce bias only if both of two conditions hold: (1) the proportion of missing items in those offices differs greatly from the proportion in larger offices; and (2) a substantial proportion of all items were in those offices. AT&T Comments, Att. 1, ¶¶ 18-19 ("Bell Aff.").[13] The RBOCs continue to offer no evidence that either condition holds. *See* Bell Reply Aff. ¶ 31.

There is no *a priori* reason to believe that small or relatively inaccessible offices would have relatively less missing equipment than the average office in the RBOC's universe. Resolving this issue as a factual matter requires information that the RBOCs alone control. Their

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[12] For Bell Atlantic North/NYNEX and Bell Atlantic South, the audits even included offices containing fewer than 100 CPR items.

[13] *See also* AT&T Comments at 9-10.

failure to produce this information warrants the inference that the unsampled offices have at least as high (if not a higher) percentage of missing HWCOE as the sampled offices.

There is likewise no *a priori* reason to expect the excluded offices to represent a large share of the total population of HWCOE. In fact, the opposite is true: large offices "house the lion's share of all RBOC hard-wired . . . equipment." Bell Aff. ¶ 13. Nor is there any reason to believe that the few excluded out-of-the-way offices hold a particularly large share of the total population of HWCOE.

In all events, at a minimum, the Staff's audit clearly indicates that the central offices that were included as potential candidates for an on-site visit—*i.e.* the central offices with more than 100 units of HWCOE—are missing significant amounts of HWCOE valued in the hundreds of millions of dollars. Thus, the RBOCs' arguments that the Staff's statistical results should be disregarded because of the Staff's practical considerations are devoid of any basis in fact or logic.[14]

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[14] The RBOCs' claim that the Staff has injected significant bias by sampling equipment at a central office in North Carolina is also without merit. *See, e.g.*, BellSouth Comments at 15. As the Staff have explained, an office in North Carolina was randomly selected simply "to ensure that every state was represented." BellSouth Rpt., App. B at 6. Moreover, the inclusion of the North Carolina office can only affect the Bellsouth audit. The extent of any affect on the BellSouth office can easily be measure by the Staff and corrected for. Bell Reply Aff. ¶ 33-36. In any event, the RBOCs have offered no evidence that the North Carolina office had a higher percentage of phantom investment in its CPR than the average BellSouth office, or the average of the BellSouth offices sampled by the audit staff. *Id.*

C. The Staff Properly Computed Estimates Using Gross Book Value of Missing HWCOE.

The RBOCs assert that the estimates of missing HWCOE are exaggerated because the Staff used the gross book value of the missing items rather than the net value of those items.[15] As an initial matter, because the Commission contrasts the quantity of missing plant to the gross quantity of such plant maintained on the RBOCs' books, it is only consistent to use the gross book value of this missing plant. Moreover, the RBOCs have failed to show that any of the HWCOE listed in the CPR but missing from the central offices during the audits was *ever* put in service. In light of the RBOCs' failure of proof, Staff's decision to value the missing HWCOE at its non-depreciated – *i.e.*, book – value was the only reasonable course. In any event, if a RBOC uses a pooled depreciation method, a retirement is recorded by debiting and crediting the asset cost to accumulated depreciation and cost, respectively. Hence, the gross asset value (cost) is the appropriate figure to estimate.

D. The Staff Properly Stratified By Central Office Size.

The RBOCs contend that the accuracy of the Staff's estimates would have been improved by "stratify[ing] the line items by in-place cost within the selected locations." BellSouth Comments, Exh. 3, at 3 n.2.[16] As AT&T has previously explained, this strategy could narrow the existing confidence intervals *only* if the distribution of cost for sampled items differed significantly from the population as a whole.[17] But, as noted by Chairman Kennard, Staff's

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[15] SBC Comments at 12.

[16] *See also* SBC Comments at 2 & Exh. A at 4; US WEST Comments at 5-6 & Att. 1 at 2-3 & Att. 2 at 8; Bell Atlantic Comments at 3; BellSouth Comments at 13-14.

[17] Bell Aff. ¶ 16-17.

stratification method ensured a "representative sample of high, medium, and low value items from all sizes of central offices." Letter from Chairman Kennard, FCC, to Reps. Tauzin and Dingell, Committee on Commerce at 6 (Feb. 24, 1999) ("Chairman's Letter"). That is, the sample collected by the Staff has essentially the same proportion of expensive and inexpensive items as actually exist among all central offices. Chairman's Letter at attached graph (entitled *CPR Audits, Percentage of Records By Dollar Range Comparison of Population and Sample BOC Total*). Thus, the additional stratification suggested by the RBOCs would have been superfluous. Bell Aff. ¶ 17 ("claims . . . that the FCC Staff should have performed additional stratification merit no weight").

Moreover, the Staff expressly accounted for the differences in the average cost of missing items relative to the average cost of all items in the population. As noted by Chairman Kennard, if "mostly low-cost items were missing, the projected missing amount would be relatively low in comparison to the projection if relatively high-cost items were missing." Chairman's Letter at 7. The "average cost per missing items was generally 80 percent [lower than] . . . the average of all cost for all plant." *Id.* The Staff adjusted its projections to reflect this difference, thereby significantly *lowering* the Staff's projections. *Id.*

E. The Staff Properly Audited Items of All Costs.

Certain RBOCs assert that the Staff should have excluded HWCOE valued at less than $2,000 from the audits because "[m]icromanagement" of such investment is contrary to the "procompetitive deregulatory policy framework" of the 1996 Act. Ameritech Comments at 30 & Att. A at 15. The Commission's regulations, however, provide no record-keeping exceptions for items valued below $2,000. Moreover, items below the $2,000 threshold are extremely

important to record accurately, because they collectively account for a vast amount of the RBOCs' HWCOE.[18] Exempting CPR entries below the threshold from regulatory oversight would inflict a massive breach in the integrity of the CPR as a safeguard for captive ratepayers.

II. THE AUDIT SCORING PROCEDURES WERE REASONABLE AND, IN FACT, OVERLY GENEROUS TO THE RBOCS.

The RBOCs' continued assault on the audit staff's standards and procedures for scoring and rescoring the missing items is an inversion of reality. If the Staff's scoring and rescoring procedures suffered from bias, the bias was in the RBOCs' favor. For example, notwithstanding that the RBOCs received ample notice and time to prepare for the audits and that the audit Staff remained at each central office until the RBOCs' own personnel agreed that missing items could not be found, the RBOCs were given *four* subsequent opportunities to provide credible evidence that the missing equipment had in fact been "found." When the RBOCs provided some evidence of an item's existence, but the evidence was less than fully persuasive, the Staff frequently scored the item as "unverified" rather than "not found," and thus created a large category of items for which accounting adjustments likely should have been recommended in the report, but were not. The RBOCs were asked to provide explanations and documentation showing that certain items initially classified as "unverified" or "not found" should have been reclassified as "found," but were not asked to provide documentation that would have allowed the Staff to conclude that certain items classified as "found" or "unverified" should have been classified as

[18] Ameritech Comments at 30 (citing Ameritech Comments, Att. A at 15) ("over one third [of the sampled items] were valued under $2,000") .

"not found." As a result, the vast majority of rescored items (80 percent, in the case of Bell Atlantic) were rescored in the RBOC's favor. When viewed against this background, the RBOCs' claims of unreasonableness simply ring hollow. *See, e.g.*, New York Comments at 4, 6 ("the audit appears to have been carried out with thoroughness and rigor" and the RBOCs' contrary "arguments are unconvincing").

The RBOCs respond that their own accounting firms have given them a clean bill of health.[19] The Commission can lawfully give no weight to these reports, because the RBOCs continue to withhold approval to release the data needed by AT&T and other third parties to test and verify the propriety of most of the scoring changes advocated by the RBOCs. Moreover, what little data the RBOCs have produced make clear that their hired auditors' rescoring determinations are questionable or facially incorrect. The auditors' labors merely underscore that unverifiable audit reports are no substitute for subjecting the RBOCs' claims to testing through discovery and rebuttal testimony by other interested parties.

A. The RBOCs Received Ample Notice And Time To Prepare For Their Audits.

The Commission's rules put the RBOCs on permanent notice that they are required to maintain, on an on-going basis, 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. 47 C.F.R. § 32.2000(f)(5). As the Attorney General of the State of New York states, "[t]he FCC's regulations clearly require that each telephone company maintain its continuing property

[19] *See* BellSouth Comments Exh. 1 & Exh. 3; SBC Comments, Exh. A & Exh. 2; US WEST Comments Exh. A & Exh. B.

records in a complete, accurate, and up to date fashion so as to facilitate just the kind of audit under review here." New York Comments at 6-7. In addition, the Staff expressly informed the RBOCs that such audits would be performed, and even provided them with advance notice of the locations that would be audited. *See, e.g., Audit of the Continuing Property Records of the NYNEX Telephone Operating Companies Also Known As Bell Atlantic North As of March 31, 1999,* ¶ 18 (FCC Dec. 22, 1998) ("BA-North Rpt."). Staff also informed the RBOCs that they could line up any resources they deemed necessary to locate any items contained in the CPR, and expressly requested the assistance of RBOC personnel familiar with the equipment and offices to be audited. *Id.* Accordingly, "there was ample warning and opportunity for [the RBOCs] to bring [their] continuing property records into compliance with the FCC's rules," New York Comments at 7, and the RBOCs have no legitimate excuse for their failure to locate a significant number of sampled items at the time of the on-site inspection.

B. The On-Site Inspections Were Conducted In A Highly Professional Manner.

The comments likewise confirm that the on-site inspections were conducted in a highly professional manner.[20] The Staff's procedures were field-tested in advance of the actual field visits, RBOC personnel supported the Staff's verification process at each location, and RBOC personnel were given an unlimited opportunity to locate equipment elsewhere within an office when the equipment was not found at the location indicated by the CPR. *See* AT&T Comments

[20] *See, e.g.,* MCI Comments at 7 ("the audits were planned and conducted in a professional manner."); New York Comments at 4 ("the audit appears to have been carried out with thoroughness and rigor . . .").

at 16-18. All of this on-site audit work was well-supervised and reviewed, and the Staff's workpaper documentation was clear, concise, consistent, and complete. *Id.* at 18. Accordingly, there is no reasonable basis for disparaging the reliability of the audit Staff's workpapers or the initial scorings. And, as the Florida PSC notes, "the results indicate there are problems in [the RBOCs'] CPRs worthy of corrective action." Notice of Inquiry, *Comments of the Florida Public Service Commission* at 2, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("Florida Comments").

The RBOCs' claim that the Staff's on-site audit procedures were overly restrictive is wholly unsupported. The RBOCs allege that the audit Staff allowed only six hours to physically inspect each office, and thus had an average of only 10 minutes to search for each of the 36 sampled items.[21] This allegation is false in several respects. First, the auditors' visits were not limited to six hours. Rather, the auditors remained at each central office location until the RBOCs' *own personnel* agreed that the missing items could not be found and that a exhaustive search for the sample items had been performed. Loebbecke Reply Aff. ¶ 9. Second, each team of auditors visiting a central office was split into two groups, each of which was assigned to cover only 18 sampled items per day, and thus had, on average, well above 20 minutes to search for each of the sample items. Third, the RBOCs' own personnel also assisted in the search, and thus further increased the Staff's ability to rapidly locate the sampled items. Fourth, to the extent the RBOCs' CPR records accurately identified the location of a sampled item, that item was found almost immediately, thus leaving significant amounts of extra time to locate the hard-to-

[21] *Id.*

find/missing items. In short, the RBOCs were given a virtually unlimited opportunity to locate the sampled equipment, and simply failed to do so.

In addition to concocting nonexistent limitations on the competence and working time of the audit Staff, the RBOCs also ignore the heavy bias in their favor produced by the Staff's standards for initial scoring during the on-site inspection. The standards for classifying an item as "not found" were very stringent: items were considered not found only when, after an exhaustive search by both the auditors and RBOC personnel, "the sampled equipment could not be located *anywhere* in the central office." BA-North Rpt. ¶ 18 (emphasis added). By contrast, an item was classified as "unverified" if the auditor had some reason to believe, but was uncertain, that an item had been located. BA-North Rpt., App. C at 1-2 (Problems Encountered In The Verification Process). As Professor Loebbecke explains, this scoring system gave the RBOCs the benefit of the doubt by classifying a large number of items that could not be verified with certainty as "unverified" rather than "not found." AT&T Comments, Exh. C, ¶ 11 ("Loebbecke Aff."). And because a significant fraction of the "unverifiable" items are likely to be missing, and should have been scored as "not found," the tallies of "not found" items in the audit reports imply a significant underestimate of the total dollar amount of missing equipment. *Id.*

The procedures used by the Staff to conduct the audit, the comprehensive and clear reports issued by the Staff to explain exactly what statistical procedures were applied to the data, and the Staff's repeated requests for comment from the RBOCs on the audit procedures also speak well of the Staff's professionalism. What is unprofessional is the RBOCs' strategy of criticizing the Staff's survey design and scoring decisions while refusing to disclose information

in the RBOCs' exclusive possession that the Staff and interested third parties would need to determine the legitimacy (if any) of the RBOCs' criticisms.

C. The Staff's Rescoring Procedures Were Reasonable.

The other parties' initial comments further demonstrate that the Staff's rescoring procedures were reasonable.[22] Despite the RBOCs' obligation under the Commission's rules to maintain accurate CPR records so that the equipment may be readily spot-checked for proof of physical existence, the Staff gave the RBOCs *four* additional opportunities after the on-site inspections to document the location of items tentatively scored as "not found." Incredibly, notwithstanding these numerous opportunities, RBOCs, like Bell Atlantic, claim that they "had no opportunity to undo the damage of [the] initial inspections." Bell Atlantic Comments at 6. To the contrary, the RBOCs were afforded numerous such opportunities, yet they failed to provide persuasive evidence of the existence of a significant number of missing items. Accordingly, the Staff properly scored these items as "not found."

1. The Staff Carefully Considered The RBOCs' Post-Audit Submissions.

The RBOCs' principal complaint is that their post-inspection explanations and documentation were essentially ignored by the Staff, and that the Staff did little more than shuffle around the categorizations of a few items without making any substantial changes. *See, e.g.*, Bell Atlantic Comments at 6 ("The bulk of the evidence that Bell Atlantic subsequently uncovered and presented to the FCC staff was either ignored or rejected."); SBC Comments at

[22] *See, e.g.*, MCI Comments at 14 ("the rescoring process favored the RBOCs"); New York Comments at 7.

16-17 ("'[D]ocumentation was apparently not fully taken into account [by the Staff]. The [auditors] changed very few items to a found designation based on additional supporting documentation.'") (quoting Ameritech Response at 5). This complaint, however, is utterly baseless. The Staff gave careful consideration to *all* of the RBOCs submissions "and made appropriate adjustments as warranted." BA-North Rpt. ¶ 20. **[***BEGIN BELL ATLANTIC PROPRIETARY***]**

[*END BELL ATLANTIC PROPRIETARY***]** Thus, contrary to the RBOCs' suggestion, the Staff did not ignore the RBOCs submissions; it merely found that some of the RBOCs' after-the-fact "documentation" provided an insufficient basis for rescoring certain items originally classified as "not found."

2. The Staff's Rescoring Standard Was Reasonable.

The RBOCs also contend that the Staff's rescoring standard was unreasonable. Specifically, the RBOCs allege that Staff's rescoring was characterized by "[a] nearly exclusive reliance on physical inspection as the only competent evidential matter considered." Ameritech Comments at 13; *see also, e.g.,* Bell Atlantic Comments at 6. Heavy reliance on the initial physical inspection is entirely proper in this context because the inspection was conducted with such rigor and is the most reliable safeguard against phantom costs and inaccurate books. Loebbecke Reply Aff. ¶ 18.

Moreover, the RBOCs' allegation significantly overstates the stringency of the Staff's rescoring standard. As the Staff has explained, "[t]he basic standard that companies were required to meet in order to have an item re-scored was to provide adequate and convincing evidence that the facts were different than appeared at the time of the auditors' on-site inspection."[23] Such "adequate and convincing evidence" included "relevant source documentation and engineering drawings." *Id.*

For example, "[i]f the company provided original invoices showing that only 4 units had been installed and the equipment descriptions, dates of purchase, and costs stated on the invoices matched the information on the CPR, the auditors determined that the evidence was probative . . . and that a re-scoring . . .was warranted." *Id.* Even when the company failed to provide such source documentation, if the Staff was able to determine that "the recorded cost [in the CPR] fully appeared to support a lesser quantity than recorded, the auditors generally rescored the 'not found' designation." *Id.* Similarly, "[i]f the company . . . provided evidence (*e.g.*, an engineering drawing or a manufactured schematic) demonstrating that [an item could not be seen because it was embedded in another item], the auditor classified the item as 'found')." *Id.* Indeed, even if *no* evidence was provided to support the RBOC's claim that the item was embedded, the item "remained scored as 'unverified.'" *Id.* Thus, contrary to the RBOCs' assertions, they were able to obtain a rescoring of an item merely by submitting relevant

[23] Public Notice at 2, *The Accounting Safeguards Division Releases Information Concerning Audit Procedures For Considering Requests By The Regional Bell Operating Companies To Reclassify Or "Rescore" Filed Audit Findings Of Their Continuing Property Records*, DA 99-668 (Apr. 7, 1999) ("*Rescoring Report*").

supporting documentation and, as described above, a significant number of items were in fact rescored based on that documentation.

A more lenient rescoring standard would have been completely inappropriate. Florida Comments at 4-5 (Staff's rescoring standard was "reasonable"); New York Comments at 7 (rejecting Bell Atlantic's "post-audit attempt to rehabilitate its deficient continuing property records"). As described in AT&T's initial comments, the auditors became familiar with the layout and equipment at each inspection site, and thus were in a unique position to judge the credibility of the RBOCs' explanations and documentation. Moreover, the searches were conducted jointly with RBOC personnel, who presumably were both knowledgeable and motivated to find the requested equipment. And, as described above, the Staff's *initial* scoring was very lenient – allowing potentially missing items to be classified as "unverified" even though Staff could not reasonably determine whether the items shown to the auditors were the actual items listed on the CPR. Against this background, the Staff reasonably required a persuasive showing of evidence before rescoring items initially classified as "not found."

3. Much Of The RBOCs' Alleged "Documentation" Was Insufficient Under Any Reasonable Standard.

In any event, much of the RBOCs' proffered post-inspection "documentation" was insufficient, under any reasonable standard, to persuade an experienced auditor to discount the validity of his or her eyewitness inspection and determine that the missing equipment had been found. Indeed, this conclusion is confirmed by the RBOCs' own accounting firms, who have determined that a significant amount of equipment listed in the CPRs is in fact missing. When the RBOCs' own accountants fail to find items for which the RBOCs have submitted

documentation purportedly establishing that the items exist, the validity of the documentation is plainly called into question.

The RBOCs again simply misrepresent the Staff's procedures for scoring an item as "not found." Contrary to the RBOCs' assertions, items found in other locations, items with no location information at all, items retired between the date of the sample report and the physical verification, items embedded in other items, and items affected by CPR misstatements were *not* scored as missing. Instead, all of these items either were scored as "found" or "unverified," and thus no accounting adjustments were recommended for such items.[24]

Furthermore, the Staff's *Rescoring Report* (at 2-4) demonstrates that the Staff rejected the RBOCs' documentation evidence only when, in the Staff's experienced professional judgment, the evidence did not provide a reasonable basis for rescoring the items. For example, "auditors did not find source documentation sufficient where the information on the invoices did not match the descriptions and/or the costs of the equipment listed in the CPRs." *Id.* at 2-3. And "where the companies provided non-source documentation, *e.g.*, internal documents that were not contemporaneous with the equipment purchase or installation, the auditors generally found the evidence was inadequate." As the Florida PSC notes, this approach is eminently reasonable. Florida Comments at 4-5. "[S]ource documents that contain cost amounts, signatures, dates, and other information offer the most convincing evidence relative to the installation and removal of equipment." *Id.* at 4. Thus, "[i]f an original invoice matched the CPR as far as dates of purchase, description of equipment, and costs but the number of units varied, it appears reasonable for the auditors to conclude that rescoring would be appropriate." *Id.* If, however,

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[24] *See, e.g.*, BA-North Rpt. ¶ 21 & App. C.

"the source documentation did not match the descriptions and costs listed in the CPR, it seems reasonable that the auditors would not rescore." *Id.* As the Staff properly determined, "documentation without authorizing signatures or dates of removal is not considered adequate documentation." *Id.* at 5.

Under these reasonable standards, the Staff rejected RBOC documentation that, for example, consisted of an "invoice[] demonstrating only that an item had been purchased" with no additional "proof that an interim removal or retirement had occurred." *Rescoring Report* at 3. In other cases, the Staff rejected evidence showing "that a retirement or removal had occurred, but "no further documentation or evidence . . . that reflected dates of removal or authorizing signatures." *Id.* The Staff's decision to reject such patently insufficient evidence was plainly reasonable, Loebbecke Reply Aff. ¶ 20, and neither the RBOCs nor their accounting firms provide any explanation as to why such evidence should have been deemed sufficient.

Professor James K. Loebbecke, a distinguished scholar and practitioner of auditing, has reviewed the Staff's scoring and recording procedures with respect to several sampled items that the Staff declined to rescore for Bell Atlantic, the one carrier to permit third-party review of a significant amount of source documentation. Professor Loebbecke's analysis confirms that the Staff's scoring decisions were entirely reasonable.

[BEGIN BELL ATLANTIC PROPRIETARY]

[END BELL ATLANTIC PROPRIETARY]

4. The Staff's Rescoring Standard Was Consistently Applied.

The RBOCs' claim that the Staff inconsistently applied its rescoring standard also fails to withstand scrutiny.[25] Professor Loebbecke has thoroughly examined the Staff's rescoring of the sampled items in the Bell Atlantic audit, and has found that the Staff's rescoring standards were consistently applied. Loebbecke Reply Aff. ¶ 22-25.

The Staff explanation for rejecting the rescoring of an item was detailed and specific. These explanations were consistent among those of like kind as well as with the audit staff's published rescoring procedures. In many cases, adequate documentation was simply missing. *Id.* at 24. In particular, documentation of the following types was missing. **[BEGIN BELL ATLANTIC PROPRIETARY]**

[25] *See, e.g.*, Ameritech Comments at 15, 18-19; Bell Atlantic Comments at 7; SBC Comments at 26 & Exh. B at 2.

[END BELL ATLANTIC PROPRIETARY]

Furthermore, and contrary to the RBOCs' assertions, the Staff did not engage in allegedly inappropriate "back-at-the-office" rescoring. As MCI WorldCom explains, the Staff rearranged certain scoring categories after the audits were performed to reflect better that certain categories included missing equipment, and that another category included equipment that likely existed. Notice of Inquiry, *MCI WorldCom Comments* at 22, CC Docket No. 99-117, ASD File No. 99-22 (Sept. 23, 1999) ("MCI WorldCom Comments"). Thus, the Staff's rescoring procedures simply reflected the Staff's commitment to make the audits fair, accurate, and consistent, and did not represent, as the RBOCs contend, a sinister attempt to inflate the number of items classified as missing.

5. The Staff's Rescoring Standard Did Not Violate The Administrative Procedure Act Or Otherwise Prejudice The RBOCs.

Some of the RBOCs contend that the Staff violated the Administrative Procedure Act ("APA") and otherwise prejudiced the RBOCs by allegedly failing to inform the RBOCs of the rescoring standard the Staff applied in reviewing the sufficiency of the RBOCs' post-audit

documentation. *See, e.g.*, Bell Atlantic Comments at 4-5; Ameritech Comments at 13, 17, Exh. B at 6; SBC Comments at 18-19 & n.53. This argument is unfounded for several reasons.

As an initial matter, the adjudicative standard applied by the Staff to assess the probative value of the RBOCs' evidence is neither a regulation nor a procedure subject to the APA, and the RBOCs' claims of retroactive rulemaking therefore are baseless. In any event, on June 27, July 8, and October 8, 1997, the Staff provided preliminary results to the RBOCs, and specifically asked them to provide *all* additional explanations and documentation they wanted the Staff to consider in potentially rescoring items initially scored as "not found." BA-North Rpt. ¶ 19 n.29. Moreover, as SBC concedes, the Staff had discussions with the RBOCs concerning the sufficiency of their evidence "early in the [rescoring] process," and thus the RBOCs were well aware from the very beginning of the rescoring process that the Staff considered much of the RBOC evidence to be insufficient. SBC Comments at 19 n.53. And, as BellSouth concedes, the Staff issued another request on March 11, 1998, asking for all "'the necessary documentation that [the RBOCs] believe will support [their] position by April 7, 1998.'" BellSouth Comments at 21 (quoting Letter from Kenneth Ackerman, Chief, Audits Branch to Mary L. Henze, BellSouth (Mar. 11, 1998) (attached as Exh. 4 to BellSouth's comments)). In these circumstances, the RBOCs' argument rests on an assumption -- that the RBOCs held pertinent information back because they allegedly were not aware of the Staff's rescoring standard – that is obviously false. The Staff asked for any documentation the RBOCs cared to submit, and the RBOCs had every incentive to submit whatever favorable information they could obtain. Thus, it is not surprising that, despite their claims of lack of notice, the RBOCs to date have failed to identify *any* additional information that they would have submitted had the *Rescoring Report* been issued at an earlier time.

D. The Audit Procedures Complied With GAAS And GAGAS.

The RBOCs also allege that the Staff's procedures failed to comply with GAAS, and that the Staff improperly relied on GAGAS. *See, e.g.,* Ameritech Comments at 13-14. This allegation should be rejected at the outset. Even Arthur Andersen concedes that the Staff's procedures were "similar in many respects" to the procedures followed by the RBOCs' own accounting firms. Ameritech Comments, Exh. A, at 13. In any event, as Mr. Loebbecke explains, the Staff was not required to comply with GAAS, but reasonably looked to the GAAS and GAGAS standards for guidance, and generally complied with them. Loebbecke Reply Aff. ¶ 27.

The audits conducted by the Staff were an entirely appropriate approach to the exercise at hand. To the limited extent that the procedures could, with hindsight, have been improved (which could be said of virtually any audit), that in no way undermines the Staff's ultimate conclusion that a significant amount of equipment listed in the CPRs is missing. As the Florida PSC and the New York State Attorney General both note, regardless of any minor deficiencies in the Staff's procedures, the sheer size of the problems identified through the Staff's audit indicate that corrective action is warranted. Florida Comments at 1-2, 5; New York Comments at 7-8.

This is confirmed by consideration of the nine "errors" that the RBOCs claim the Staff auditors made. First, the RBOCs contend that the Staff violated GAAS by failing to perform "corroborating testing of account balances or other financial statement accounts." *See, e.g.,* Ameritech Comments at 13. As Professor Loebbecke explains, however, the Staff audits were not intended or claimed to be general purpose audits of financial statements conducted in accordance with GAAS. The Staff audits were in fact special purpose audits of limited scope, conducted in accordance with GAGAS. Their scope was defined by the description of the

procedures performed. These included physical inspection and review of documented submitted by the RBOCs for rescoring. The conclusions of the audit Staff were based on the results of those procedures, as stated and described in the Staff reports and in Public Notice DA 99-668. Loebbecke Reply Aff. ¶ 29.

Second, the RBOCs contend that the Staff violated GAAS by failing to review "internal controls over the hardwired COE CPRs." *See, e.g.*, Ameritech Comments at 13. As Professor Loebbecke notes, the requirement to review internal controls under GAAS is contained in the second standard of fieldwork, as follows:

> There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

In a conventional audit of financial statements by an outside auditor, a central purpose of which is to check the adequacy of internal controls, this standard requires the auditor to understand the company's internal controls well enough to plan his tests, and to test those controls if the auditor intends to limit the scope of his procedures. The Staff specific purpose audit was designed to test the accuracy of the CPRs, not the adequacy of the RBOCs' internal controls. But, even if this GAAS standard applied to the Staff's limited scope GAGAS audit, the Staff's work will meet it. The Staff did have sufficient knowledge to adequately plan and conduct their selected procedures. Furthermore, the scope of the Staff's procedures was not limited; it was based on a 95 percent confidence level, an examination which is considered to be extensive under professional standards and practices. Bell Reply Aff. ¶ 29.

Third, the RBOCs contend that the Staff violated GAAS by failing "to communicate its [rescoring] standards" before the release of the *Rescoring Report*. *See, e.g.*, Ameritech Comments at 13. As demonstrated above, that contention is baseless. The audit Staff repeatedly

asked the RBOCs to provide *all* additional explanations and documentation they wanted the Staff to consider in potentially rescoring items initially scored as "not found," and the RBOCs did so. The RBOCs had every incentive to submit whatever favorable information they could obtain, and there is no evidence in the record that the RBOCs held pertinent information back.

Fourth, the RBOCs contend that the Staff violated GAAS by "[a] nearly exclusive reliance on physical inspection as the only competent evidential matter considered." *See, e.g.*, Ameritech Comments at 13. As demonstrated above, that contention also is baseless. The Staff fully considered all of the RBOCs' post-audit documentary submissions, its rescoring standard was eminently reasonable, and the Staff in fact performed a significant amount of rescoring based on that evidence and according to that standard.

Fifth, the RBOCs contend that the Staff violated GAAS by engaging in "limited communication with [RBOC] management as a source of audit evidence and to validate audit results." *See, e.g.*, Ameritech Comments at 13. The RBOCs fail to explain what additional information in the possession of RBOC senior management would have assisted the audit Staff in clearing up the scoring of specific items of HWCOE. The audit Staff repeatedly invited the RBOCs to provide further information. If the RBOC personnel involved in the audits failed to bring these requests to the attention of more senior management, the responsibility for this internal failure of communication lies with the RBOCs themselves.

Sixth, the RBOCs contend that the Staff violated GAAS by failing to account for the lapse of time "between the date of the sampled report and the physical verification." *See, e.g.*, Ameritech Comments at 13. As shown in MCI WorldCom's initial comments, however, interim retirements were scored as "found" to the extent the RBOCs were able to provide evidence

showing that such retirements had in fact occurred. MCI WorldCom Comments at 19-20. Accordingly, this criticism is entirely misguided.

Seventh, the RBOCs contend that the Staff violated GAAS by performing "limited and restrictive field audit procedures." *See, e.g.,* Ameritech Comments at 13. As described above, however, this allegation is false in numerous respects. The auditors remained at each central office location until the RBOCs' *own personnel* agreed that the missing items could not be found and that a exhaustive search for the sample items had been performed. Thus, the RBOCs were given a virtually unlimited opportunity to locate the sampled equipment, and simply failed to do so. In addition, the RBOCs' claim fails to recognize that the Staff's initial scoring during the on-site inspection was extremely generous to the RBOCs.

Eighth, the RBOCs contend that the Staff violated GAAS by failing to perform follow-up field visits. *See, e.g.,* Ameritech Comments at 13. In a perfect world of unlimited time and money, follow-up visits might be appropriate. In the real world in which the RBOCs were given ample advance notice of the initial field visits and every opportunity to locate audited items, the RBOCs have offered no compelling justification for the delays and expense of follow-up field visits. Certainly, the failure to conduct follow-up visits cannot change the fact that *all* of the information before the Commission, including the reports of the RBOCs' own accounting firms that performed such follow-up inspections, shows that a significant amount of equipment is missing. Accordingly, the Staff's inability to perform follow-up visits does not provide any basis to disparage the Staff's procedures or for the Commission to fail to mandate remedial action. *See* Loebbecke Reply Aff. ¶ 32.

Finally, the RBOCs contend that the Staff violated GAAS by "[t]he restrictive review afforded companies to comment on the draft audit findings." *See, e.g.,* Ameritech Comments at

13. As demonstrated above, that contention is completely false. On at least four separate occasions, the RBOCs were invited to provide the Staff with whatever documentation or other evidence they deemed relevant to show that missing items had in fact been found, and the RBOCs had every incentive on each of these occasions to submit all such evidence they had in their possession. AT&T Comments at 18.

E. Reports Of Accounting Firms Hired To Refute The Staff Report Are Devoid Of Probative Evidence.

In an after-the-fact effort to rehabilitate their CPR, the RBOCs hired several large accounting firms to review the Staff's audit. To this end, accounting firms purported to reenact their clients' audits by visiting the central offices and looking for equipment that the Staff was unable to find. Unsurprisingly, the accountants' reports assert that some—but, tellingly, not all—of the CPR scored by the audit staff as missing should have been scored as found.

The results of this reenactment are entitled to no weight for the simple reason that the audit reports are essentially black boxes. Almost none of the source documentation purportedly relied on by the accountants in reenacting the audits have been released to the public. Hence, the accountants' results can be neither tested nor replicated.[26]

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[26] Although Ameritech attached a small amount of documentation to its comments, the attachments are both incomplete and redacted to the point of illegibility. *See e.g.* Ameritech Comments Att. C to Att. B at 3 (two black squares and illegibly faded writing); *id.* at 11 (same); *id.* at 12-13 (same); *id.* Att. G to Att. B (mostly copies of illegible faxes).

Reliance on such analyses would violate the interested parties' right to test underlying data and assumptions.[27] The opinions of outside auditors, no matter how reputable, cannot be the last word for reporting entities whose financial reports and accounting practices are at issue in a regulatory proceeding.[28]

In addition, the portions of Ameritech's documents that can be deciphered indicate that its rescoring standards were overly lenient. For example, Ameritech's CPR report included a 1992 vintage piece of equipment. Ameritech Comments, Att. C to Att. B., App A-4 at 10. The Staff could not find that piece of equipment during the on-site office and, therefore, categorized it as "Not Found." Arthur Andersen also failed to find the equipment, but assumed that a different (and much older) piece of equipment that performs the same task as the item listed in the CPR was the same equipment listed in the CPR description.

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[27] *See Mail Order Ass'n of America v. United States Postal Service*, 2 F.3d. 408, 430 (D.C. Cir. 1993) (overturning agency cost findings because, *inter alia*, the parties were "afforded no opportunity . . . to test, or even examine, the methodology . . . or the figures and calculations used to attribute access costs").

[28] *See e.g. Review of Affiliate Transaction At Ameritech Services, Inc.*, 1995 FCC LEXIS 4555 (May 9, 1995) ("it is important to recognize that this audit report is not the first time an audit has arrived at different conclusions than outside auditors. The General Accounting Office 1992 Report to Congressional Requestors points out that the Federal Communications Commission has regularly arrived at materially different findings than outside auditors."); *Amerada Hess Pipeline Corp.*, 71 FERC ¶ 61,040 (1995) at 61,166 (rejecting accounting classification approved by carrier's outside auditor, and noting that where the "measurement and classification of items directly affect the amounts [regulated companies] . . . may charge . . . the carrier has the burden of proving . . . its accounting is just and reasonable. . . . That burden of proof carries with it an obligation to produce substantial evidence for the record sufficient to show the justness and reasonableness of its proposal"), *aff'd, Armada Hess Pipeline Corp. v. Federal Energy Regulatory Commission*, 114 F.3d 596 (D.C. Cir. 1997).

This assumption has two obvious flaws: (1) Arthur Andersen apparently did not search the CPR to verify whether the older piece of equipment was separately listed elsewhere in the CPR; and (2) even if the older piece of equipment was not listed elsewhere in the CPR, Ameritech's failure to specify the actual vintage for the item affects cost calculations. Newer items are more valuable and may depreciate faster. Both alternative scenarios would give Ameritech an illegitimate windfall at the expense of ratepayers. *See* Loebbecke Reply Aff. 37.

Similarly, Arthur Andersen counted items as "found" even when produced by a *different manufacturer* than listed in the CPR. *See, e.g.,* Ameritech Comments, Att. C to Att. B, App. A-4 at 17. There is no evidence that Arthur Andersen confirmed that these different items were not already listed in the CPR, nor is there evidence that the items made by different manufacturers were identically valued or that they depreciated at the same rate. Arthur Andersen also accepted as "found" items that were purchased in 1989, but included a price quote from a 1996 price list. Ameritech Comments, Att. E to Att. B. Likewise, Arthur Andersen removed items from the "not found" category because they saw some items of similar description in the basement of the central office, although the corresponding entries in the CPR recorded the items as upstairs, on an entirely separate floor. Ameritech Comments, Att. I to Att. B. The Staff properly counted these items as "not found" because there was no way to verify that the items in the basement were the ones listed in the CPR.

Nevertheless, even with all of these overly generous rescoring standards, these hired accountants still confirmed that most of the items found missing by the Staff were actually missing. For example, Staff found 96 of the sample HWCOE missing from BellSouth's central offices; PricewaterhouseCoopers notes that "only" 84 of the sample HWCOE are missing. *Compare BellSouth Rpt.* at 9, *with* BellSouth, Exh. 5, at 3. Similarly, Staff scored 104 of the

sampled HWCOE missing from Ameritech's central offices; Arthur Andersen scored 90 of the sampled HWCOE missing. *Compare Ameritech Rpt.* at 9, *with* Ameritech Comments, App. A-5, Att. 2 at 1 (Attachment to the Affidavit of Paul F. Charnetzski citing Arthur Andersen Study). Thus, even the RBOCS' own auditors confirm that the RBOCs were in significant non-compliance with the CPR requirements.

III. THE STATISTICAL PLAN WAS PROPERLY CARRIED OUT USING THE ACCURATE DATA COLLECTED BY THE AUDITORS.

The parties' initial comments confirm the illegitimacy of the RBOCs' efforts to hide their missing HWCOE through statistical manipulation—in particular, claims that: (1) the estimated value of the missing equipment should be based on the lower bound of the relevant confidence interval, (2) the relevant confidence interval is 99 percent, not 95 percent, and (3) the lower bound of the 99 percent confidence interval is zero (or even below zero). *Compare* BellSouth, Exh. 3 (Ernst & Young statement); Bell Atlantic Response at 12; *accord*, SBC Comments at 8-9; BellSouth Comments at 18 *with* AT&T Comments at 24-29.

There is no doubt that equipment recorded in the CPR is missing; the question is how much. Despite the best efforts of their own engineers and outside auditors, the RBOCs were unable to find a substantial amount of the HWCOE listed in the CPR. Thus, by definition, the value of missing equipment in the sample *must* exceed zero, and so must the value of missing equipment in the universe.

The purpose of the audit process is to estimate the amount of that overstatement, and the best estimate of the amount of overstatement is, by definition, the point estimate.[29] By choosing

[29] A confidence interval is a range of numbers that is, to some degree of confidence, likely to contain the true value. The one number that is the best estimate of the true value, however, is the

(continued . . .)

the point estimate, the statistician minimizes the overall risk of a large mistake in either direction.[30] Therefore, when a statistician must choose an estimate from within a confidence interval, the most logical choice is a number near the center, usually the point estimate. *See* AT&T Comments at 26-27.[31]

Moreover, the 99 percent confidence interval proposed by RBOCs is excessive even as a test of statistical significance. As AT&T explained in its initial comments, a 99 percent confidence level increases the range of numbers included in the confidence interval so greatly that the statistician generally cannot draw any useful conclusions from the sample. The confidence level commonly used by statisticians is the 95 percent level assumed by the audit Staff, and the Commission recently adopted a confidence interval of *90 percent* to evaluate compliance with its rules, on the ground that a higher confidence interval would prevent detection of rule violations. *Id.* at 28.

The absurdity of the RBOCs' position is exemplified by their claim that the lower bound of the relevant confidence interval is zero—or even negative. As noted above, this conclusion is impossible: the population of a group can never be less than zero, and existence of one or more

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(. . . continued)
point estimate. *See* Thomas H. Wonnacott & Ronald J. Wonnacott, *Introductory Statistics for Business and Economics* 254 (4th ed. 1990). Point estimates are designed to provide the researcher with most accurate estimate of the true value of the population. *Id.*

[30] Using the lower bound would increase the risk of greatly understating the actual mean value for the entire population; using the upper bound would increase the risk of overstating the actual mean.

[31] The basic methods of calculating confidence intervals ensure that the point estimate will be near the center of the confidence interval. *See* Wonnacott, *supra*, at 254.

missing items of HWCOE in the sample necessarily means that one or more items must be missing from the entire universe. Bell Aff. ¶ 33.[32]

Finally, the parties' initial comments confirm that the Staff's point estimates are sound. As AT&T noted in its comments, the formulas used by the Staff to calculate the point estimates are found in leading sampling theory textbooks. AT&T Comments at 27. Even the RBOCs concede that any resulting statistical bias "appears to be negligible." Bell Atlantic Response, Exh. 2, at 5; BellSouth Comments 3, at 4. It is thus unsurprising that the RBOCs have little to say about the methods employed by the Staff to calculate the point estimates.[33]

IV. THE ESTIMATED $2.9 BILLION OVERSTATEMENT OF THE RBOCS' HWCOE CPR PLAINLY WARRANTS CORRECTIVE ACTION.

The Commission's findings are consistent. The Staff found that all of the RBOCs were missing from their central offices at least 15 percent (and as much as 30 percent) of the HWCOE listed in their respective CPRs. The aggregate point estimate of missing equipment, based on the Staff's point estimates, is $2.88 billion.[34] *See* AT&T Comments at 30. Clearly, some corrective action is needed to remedy the RBOCs' massive overstatement of HWCOE.

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[32] Most of the RBOCs, like the audit Staff, have overlooked the fact that the relevant confidence intervals are unlikely to be symmetric: that is, the upper limit should be further from the point estimate than is the lower limit. While Bell Atlantic appears to have recognized the problem, its proposed cure exacerbates the problem. *See* Bell Reply Aff. ¶¶ 21-23.

[33] The Staff analyses closely follow the scientifically rigorous textbook method for calculating statistical error. *See generally*, Cochran, *supra*, Ch. 11. Indeed, even the RBOCs admit that, to the extent that the data collected are correct, "[t]he audit sampling plan was designed to produce a precise estimate of the proportion [of missing HWCOE]." Bell Atlantic Response, Exh. 2, at 3; BellSouth Comments, Exh. 3, at 4.

[34] Indeed, even this number appears to be too low, because recent revisions of the Staff's analysis of the HWCOE shortfall indicates that U S West's shortfall may have been underestimated by $125 million. See, "Corrections to Audit Reports of Bell Operating Companies' continuing Property Records," CC Docket No. 99-117, ASD File No. 99-22, *Federal Communications Commission Public Notice*, released 10/22/99.