PRICEWATERHOUSECOOPERS

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June 18, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Room TWB-204
Washington, D.C. 20554

Dear Ms. Salas:

Re: Ex Parte
In the Matter of – Implementation of the Telecommunications Act of 1996:
***Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150**

The enclosed materials are being filed pursuant to Verizon Communications Inc.'s ("Verizon") obligations under Section B.f., paragraph 184 of the above referenced docket to engage an independent accountant to perform an agreed-upon procedures engagement regarding Verizon's compliance with the requirements of Section 272 of the Telecommunications Act of 1996. The accompanying material includes:

- Report of Independent Accountants on Applying Agreed-Upon Procedures. This report is a supplement to the June 11, 2001 Report of Independent Accountants on Applying Agreed-Upon Procedures which was filed pursuant to the requirements of Section 272 of the Telecommunications Act of 1996.
- Observation of the Joint Federal/State Oversight Team.

Section 272(d)(2) of the Telecommunication Act of 1996 requires that this material be made publicly available. Therefore, its distribution is not limited. Please place a copy of the material in the Ex Parte file of the above referenced proceeding.

A separate confidential and proprietary version of this report is being filed under seal of confidentiality with the Office of the Secretary of the FCC.

Very truly yours,

PricewaterhouseCoopers LLP

By
PricewaterhouseCoopers LLP

Enclosures
cc: Ms. Carol Mattey
Mr. Ken Moran
Mr. Hugh Boyle
Mr. Anthony Dale

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Report of Independent Accountants on
Applying Agreed-Upon Procedures

To the Management of Verizon Communications Inc.
and the Joint Federal/State Oversight Team

We have performed the procedures enumerated in Appendices C, D and E, which supplement the procedures in our report dated June 11, 2001, which were agreed to by the management of Verizon Communications Inc. ("Verizon") and the Joint Federal/State Oversight Team (collectively, the "Specified Users"), solely to assist you in evaluating management's assertion that Verizon complied with the requirements of Section 272 of the Communications Act of 1934, as Amended ("Section 272 Requirements") during the period from July 1, 2000 through January 2, 2001 (the "Evaluation Period"). This engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the Specified Users of the report. Consequently, we make no representations regarding the sufficiency of the procedures described in Appendices C, D and E for the purpose for which this report has been requested or for any other purpose. Appendix C enumerates the procedures performed in connection with the GTE Operating Companies and certain of the former GTE Section 272 affiliates. Appendix D enumerates the procedures performed in connection with the Bell Operating Companies and the former GTE Section 272 affiliate, Verizon Select Services, Inc. Appendix E enumerates the procedures performed in connection with the GTE Operating Companies and the former Bell Atlantic Section 272 affiliates.

The procedures performed and the results obtained are documented in Appendices C, D and E. The procedures and the results of performing such procedures are not intended to be an interpretation of any legal or regulatory rules, regulations or requirements.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on Verizon's assertion regarding its compliance with the Section 272 Requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the management of Verizon and the Joint Federal/State Oversight Team, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

PricewaterhouseCoopers LLP

June 18, 2001

- For the two line items related to assets which had individual items both transferred from an affiliate and purchased directly from an unaffiliated entity, we obtained the Display Asset Accounting Documents or the related invoices.

We traced the transmission and switching facilities to the supporting documentation, as appropriate, without exception. We also inspected the company codes on the Display Asset Accounting Documents, and noted that the 15 line items related to transmission and switching facilities were recorded to VSSI's company code in the accounting system. Management indicated that the land and buildings where the VSSI transmission and switching facilities are located were not included on the VSSI detailed listing since the land and buildings were leased by VSSI from unaffiliated entities.

Management indicated that the operations, installation and maintenance services on the transmission and switching facilities were provided by Bell Atlantic Global Networks, Inc. (d/b/a Verizon Global Networks, Inc.), a non-regulated affiliate.

5. We obtained the functional organizational chart for VSSI as of December 31, 2000 and obtained from VSSI a list and description of services rendered to VSSI from October 1, 2000 through January 2, 2001 by the GTOCs and by other affiliates. We noted that this data identified and documented which entity performed OI&M functions over transmission and switching facilities either owned or leased by VSSI. We also noted that this data included the street address where these facilities are located and identified whether these facilities are owned or leased by VSSI, and if leased, from whom they are leased. We noted that OI&M functions were provided by Bell Atlantic Global Networks, Inc. (d/b/a Verizon Global Networks, Inc.), at three sites where the transmission and switching facilities were located.

6. We inquired of management as to the existence of any research and development activities of the GTOCs from October 1, 2000 through January 2, 2001 related to VSSI or unaffiliated entities. Management indicated the GTOCs did not perform any research and development on behalf of VSSI or unaffiliated entities.

7. We obtained the balance sheets and detailed fixed asset listings, which include capitalized software, as of December 31, 2000 for VSSI. VSSI was composed of three financial reporting divisions: VSSI - Long Distance ("VSSI-LD"), VSSI-Solutions, and Verizon Customer Network Solutions ("VSSI-CNS"). We compared the fixed asset balances from the totals listed in each VSSI financial reporting divisions' detailed fixed asset listings to the fixed asset balances in the respective VSSI financial reporting divisions' balance sheets. For VSSI-LD and VSSI Solutions, we noted no differences between the fixed asset balances from the detailed fixed asset listing to the fixed asset balances in the balance sheets. We noted that the fixed asset balance per the VSSI-CNS balance sheet was ****proprietary****, and the fixed asset balance per the VSSI-CNS detailed listing was ****proprietary****. The holding account that includes assets prior to being placed in service, totaling ****proprietary****, was included in VSSI-CNS's balance sheet and not in the detailed fixed asset listing.

   We noted that the detailed listings of fixed assets included the description of each item, including the location of the equipment/ software, date of purchase, price paid, price recorded, and a notation as to whether the asset was acquired from a GTOC, affiliate or an unaffiliated entity.

   VSSI's detailed listings of fixed assets included 15 line items related to transmission and switching facilities which had a cost value up to ****proprietary****. Management indicated that title documents do not exist for the assets selected. We obtained supporting documentation as follows:

   - For the 12 line items related to assets transferred from an affiliate, we obtained copies of the corresponding Display Asset Accounting Documents. These documents show a description of the asset, the amount for which the asset was booked, the affiliate from which the asset was transferred, and to which company the asset was transferred.

   - For the one line item related to asset purchased directly from an unaffiliated entity, we obtained the related invoices.

Routing and Rating Database Maintenance *(includes input and maintenance of VSSI in the Routing Database System and the Business Rating and Routing Input Database System)*
Sales Agency Services *(includes promotion and order taking for VSSI products where applicable)*
Joint Marketing *(See Sales Agency Services)*
Slamming/Liability Services *(investigation and resolution of activities relating to unauthorized carrier changes)*
Provision of Licensed Software (E. Solutions Software)
Technical Support for Licensed Software *(See Provision of Licensed Software)*
Warm Transfers *(VSSI calls received by Verizon West telephone companies are transferred to VSSI)*
Voice Messaging *(Purchase of residential and business voice messaging service)*
Conference Call Connection
Tariff Special Access Services
Tariff Switched Access Services
Tariff Telephone Services *(Includes but not limited to local service, centranet, directory assistance, intraLATA services, etc.)*
Interconnection Service (resale)

<u>Services Rendered by Other Non-Regulated Affiliates</u>
Major Materials
Minor Materials and Supplies
Contractor-Other Professional, Office, Support Services
Internal Telecommunications - Private Line
Lease – Real Property
Mailing Charges
Access Charges – Wireless
Internal Telecommunications – Cellular *(includes toll charges)*
Access Charges- Capacity
Corporate Operations Services
Customer Operations Services
General &Administrative Services
Network Operations Services
Network Support Services
Customer Billing Services
Billing and Collection Services
Executive Services
Accounting/Finance Services
Human Resources Services
Legal Services
Regulatory Services
Public Affair Services
Marketing Services
Engineering Services
Treasury Services
Real Estate Services
Access Charges

Objective I: Affiliate Shall Operate Independently from the GTOC

1. We obtained and inspected the certificates of incorporation and bylaws of Verizon Select Services Inc. and noted that VSSI was established as a Delaware corporation separate from the Verizon GTOCs. Management indicated that, in Delaware, articles of incorporation are known as certificates of incorporation.

2. We obtained and inspected the Verizon corporate entities' organizational charts as of December 31, 2000 and confirmed with legal representatives of the GTOCs and VSSI the legal, reporting, and operating corporate structures of VSSI. We documented the ownership of VSSI as well as the entities to which VSSI reports.

   We obtained a written confirmation from management noting that VSSI is 100% owned by GTE Corporation, which is owned by Verizon. VSSI reports to GTE Corporation.

3. We obtained the functional organizational chart for VSSI as of December 31, 2000 and a list of employees that documented the number of employees in each department, the street addresses where the employees were located, and a general description of functions performed at each work location. We noted by inspection of the VSSI functional organizational chart and the list of employees that VSSI employed ****proprietary**** employees as of December 31, 2000 who were classified in the following functional departments: Long Distance Operations – West, Sales and Services – West, Marketing – West, Performance Assurance – West, Card Services – West, Platform Services – West, Sales and Operations – West, Sales – West, Finance – West, Marketing Services – West, and Customer Services – West.

4. We obtained from VSSI a list and description of services offered to VSSI from October 1, 2001 through January 2, 2001 by the GTOCs and other affiliates. According to management, the services offered are as follows:

   <u>**Services Rendered by the GTOCs**</u>
   Billing and Collection Services
   Capacity (e.g., OC12)
   Technical Support for CPE Equipment
   General, Administrative, and Operating Services *(Includes but not limited to these services, Ancillary Bill Process, Care Repair Processing, Customer Treatment, Network Management Services, Offline Center Services, Order Removal, Post Order Fulfillment, Product Deployment, Return Mail Center, Service Fulfillment Support, Service Order Processing, Support Assets Services, etc.)*
   Inside Wire Installation & Repair Services
   Work Force Management Training
   Customer Premise Equipment (CPE) Maintenance
   Network Monitoring
   National Directory Assistance *(includes call completion and branding)*
   Communication Medium Services to allow VSSI to convey alarms.
   National Operator Assistance *(includes mechanized calling card calls, operator handled calls and call recording)*
   Acceptance of customer payments in telephone stores

Appendix C enumerates the procedures performed in connection with the GTE Operating Companies [1] ("GTOCs") and certain of the former GTE Section 272 affiliates.

With respect to transactions between the GTE Operating Companies and Verizon Select Services, Inc. ("VSSI"), we conducted the procedures agreed to by the Specified Users for the period from October 1, 2000 to January 2, 2001. As agreed to by the Specified Users, Verizon prepared a letter indicating the corrective actions they took in the period from July 1, 2000 to September 30, 2000 and the dates that the corrective actions were completed. This letter is included in Attachment I. Additionally, Verizon provided a letter indicating the corrective action they took related to an affiliate Telecommunications Service Inc. ("TSI"). This letter is included in Attachment II.

The procedures in Objectives V through IX were designed by the Specified Users to assess compliance with the transactional and nondiscriminatory requirements of Section 272. In order to avoid duplication between this Agreed-Upon Procedures engagement and the Separate Advanced Services Affiliates Agreed-Upon Procedures engagement, the Specified Users agreed to incorporate into this report the results of applying the procedures for Objectives V through IX that were performed under Separate Advanced Services Affiliates Agreed-Upon Procedures engagement as they relate to VSSI. This information is included in Appendix F. Results related exclusively to other Separate Advanced Services affiliates have not been incorporated into this report. As agreed by the Specified Users PricewaterhouseCoopers did not perform any procedures for Objectives V through XI for VSSI in the Section 272 affiliate Agreed-Upon Procedures.

[1] For the purposes of this document, GTE Operating Companies refer to Verizon California Inc.; Verizon Florida Inc.; Verizon Hawaii Inc; GTE Midwest Inc. (d/b/a Verizon Midwest); Verizon North Inc.; Verizon Northwest Inc.; Verizon South Inc.; GTE Southwest Inc. (d/b/a Verizon Southwest); and Contel of the South Inc. (d/b/a Verizon Mid-States).

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PUBLIC VERSION – REDACTED

Objective II: Affiliate Shall Maintain Records Separate from those of the GTOC

1. We requested the VSSI general ledger and management indicated that there was no consolidated general ledger for VSSI; however separate ledgers were maintained for the divisions of VSSI. We obtained the general ledgers of the three divisions. For VSSI, we noted the title on the certificate of incorporation was "Verizon Select Services, Inc." which did not specify the separate VSSI operating divisions. We noted no special codes that linked the separate Advanced Services affiliates' general ledgers to the ILECs' general ledgers.

2. We obtained VSSI's written accounting policies and procedures. We inquired of management and documented our understanding of the accounting systems, processes, transaction flows and control points impacting revenue, accounts receivable, cash receipts, purchasing, accounts payable, cash disbursements, payroll, leases and fixed assets related to the proper identification and recording of VSSI's transactions in their separate books of accounts and we summarized our understanding as follows:

   General Overview of Accounting System
   - VSSI-LD and VSSI-Solutions use SAP and separate company codes in the accounting system.
   - All accounting records for VSSI-CNS are recorded and maintained on a separate general ledger system, Dispatch-1 ("D1"). D1 is an integrated accounting/service/billing system that is uniquely dedicated to VSSI-CNS's activities and separate from the accounting system of the ILECs.
   - Both D1 and SAP systems require a unique user identification and password. Also, specific profiles are assigned for each user identification restricting access to areas commensurate with the Specified Users' responsibility.

   Revenue, Accounts Receivable, Cash Receipts
   - VSSI-LD and VSSI-Solutions have unique carrier identification codes to properly identify and route orders to the appropriate legal entity.
   - The VSSI divisions utilize billing systems that are separate from the ILEC billing systems. Revenue Billings and Accounts Receivable information is interfaced to the SAP and D1 accounting systems.

   Purchasing, Accounts Payable, Cash Disbursements
   - VSSI purchasing systems are password protected and are restricted to authorized VSSI employees.
   - VSSI-LD and VSSI-Solutions use separate company codes in SAP. When an invoice is received, the purchase order, and invoice are automatically matched in SAP.
   - VSSI-CNS uses D1, which is separate from the accounting system of the GTOCs. Transactions are controlled by a company code that affects processing of Purchase Orders, Material Receipts and Invoices.

   Payroll
   - VSSI utilizes the SAP payroll system which assigns a unique company code to each employee.
   - Only authorized VSSI personnel can enter time information into the payroll system.
   - All VSSI payroll disbursements are charged to a unique VSSI bank account based on the VSSI company code.

- An electronic fund transfer file is generated from the payroll systems containing the unique VSSI bank account and other bank routing information.

Fixed Assets

- VSSI-LD and VSSI-Solutions have separate company codes in SAP. Only Asset Accounting personnel with appropriate security clearance per their job function may record transactions to these separate company codes.
- VSSI-CNS uses D1, which is separate from the accounting systems used by the ILEC, to record fixed assets. Access to the D1 system is restricted to authorized VSSI personnel.

3. We obtained the cash receipts and cash disbursements journals and related ledgers for the month of December 2000. We randomly selected 10 cash receipt and 10 cash disbursement (including 5 payroll) transactions. We obtained from management a list of VSSI's bank accounts. We traced 11 of 20 transactions to VSSI's bank accounts and eight of the 20 transactions to the Intercompany Settlement Vouchers. For one cash receipt for ****proprietary****, we traced the transaction to a former GTE Corporation bank account which management indicated is used by several divisions of the Company. We traced the selected receipts and disbursements to the general ledger and noted no differences.

4. We obtained VSSI's financial statements and listings of lease agreements as of December 31, 2000. We identified leases for which the annual obligation was $500,000 or more. We randomly selected and obtained the lease agreements for five VSSI leases and noted the terms and conditions. We obtained and inspected the Company's lease accounting policies and the Statement of Financial Accounting Standards No. 13, *Accounting for Leases* assessment prepared by management indicating the accounting treatment determined by management for each lease. We noted such accounting policies were consistent with generally accepted accounting principles ("GAAP"). For the five VSSI selections, we requested from management but did not receive the fair market values of the properties or equipment necessary to assess conformity with GAAP. Consequently, we were unable to make a determination based upon the information provided.

Objective III: Affiliate Shall Have Officers, Directors, and Employees Separate from those of the GTOC

1. We obtained the policies and procedures from the GTOCs for transferring, sharing, and loaning employees among each other. We also obtained VSSI's policies and procedures for transferring employees. Management indicated that VSSI does not have written policies and procedures for sharing and loaning employees. Management indicated that employees were permitted to transfer between a GTOC and VSSI; however, since the loaning or sharing of employees was not permitted there was no need for written policies and procedures. Management indicated that no employees were loaned or shared between the GTOCs and VSSI between October 1, 2000 and January 2, 2001. Through inspection of the GTOC policies and procedures and inquiry of management, we noted and documented the types of internal controls in place that would prevent one from being an officer, director, or employee of both the GTOCs VSSI simultaneously.

   Based on our discussions with management and inspection of related documentation we noted the Verizon controls in place that would prevent an individual from simultaneously being an officer, director, or employee of both the GTOCs and VSSI are as follows:

   - Selection of Directors and Officers – Management indicated the Corporate Governance Group ("CGG") is responsible for managing the requirement for the GTOCs and VSSI to have separate officers and directors. Potential officer and director candidates are compared to the roster of current separate VSSI and GTOC director and officer listings by the CGG and reviewed by the legal department and the Affiliate Interest Compliance Office. If a match is found that is inconsistent with the Section 272 affiliate separation requirements, a request is put in for a new candidate.
   - Transfers of Employees - When an employee from a GTOC accepts a job offer at VSSI, or an employee from VSSI accepts an offer at a GTOC, the affiliate human resources representative issues an Employee Action Record to notify the payroll staff of the new employee, the employee's start date and other critical information. The payroll staff representative then notifies the regulated corporate payroll staff of the impending transaction and requests a Reassignment – Transfer Checklist and a Transfer Form, which are completed by the corporate payroll staff and forwarded to the non-regulated payroll and employee change records teams, to ensure the individual is not on the payroll of both VSSI and a GTOC at the same time.
   - Management indicated that in order to determine that employees are not simultaneously working for more than one entity, the payroll systems, although different for the GTOCs and VSSI, are reconciled by Verizon Communication's corporate payroll department records. The system will not allow more than one payment to a social security number in a given pay cycle.

2. We inquired of management and management indicated that VSSI and the GTOCs maintain separate boards of directors and separate officers.

   We obtained a list of officer and director names and corresponding dates of service to the GTOCs and VSSI from October 1, 2000 through January 2, 2001. We compared the list of officers and directors of the GTOCs to the list of officers and directors of VSSI and noted that no names appeared on both lists.

We obtained and inspected the minutes of the meetings of the boards of directors and/or written consents of the stockholders electing the boards of directors for the GTOCs and VSSI from October 1, 2000 through December 31, 2001 and compared and documented the names appearing on the minutes of the GTOCs and VSSI. We noted no instances where an individual simultaneously served as a director or officer of both a GTOC and VSSI.

3. We obtained and inspected the functional organizational charts for VSSI as of December 31, 2000 and noted that no departments reported either functionally or administratively (directly or indirectly) to an officer of the GTOCs.

4. We obtained the files containing the year-to-date payroll information for VSSI and the GTOCs that included the social security numbers of employees as of December 31, 2000. We inquired of management and management indicated that some officers and directors of the GTOCs and VSSI were employees of Network Services Inc. d/b/a Verizon Services Corp., Telesector Resource Group, d/b/a Verizon Services Group, or GTE Services d/b/a Verizon Services Group and, therefore, were not included in the payroll.

   We designed and executed a program that electronically compared social security numbers of employees on VSSI's lists to the GTOCs' listings. We noted that 160 employees appeared on both VSSI's and the GTOCs' listings. We selected a random sample of 25 employees appearing on both lists and obtained detailed payroll records and noted that none of the employees selected had been simultaneously on a GTOC and VSSI's payroll.

5. We obtained the list of officers and employees who transferred from the GTOCs, between October 1, 2000 and January 2, 2001, to VSSI. We selected the seven transferred employees to determine that the controls documented in Objective III, Procedure 1 were applied by inspecting employees' employment history from the Company's Employee Information System and noted no instances where an individual was concurrently employed by a GTOC and VSSI. We requested and received written confirmations from five of the seven transferred employees that they did not use any proprietary information (e.g., customer proprietary network information (CPNI), Network Planning Manuals, Plant Traffic Practices, and OI&M Practices) obtained while they were employees of the GTOCs and that no proprietary information was made available to them through friends and acquaintances still employed by the GTOCs.

6. We obtained a list of all employees who were hired by or transferred to VSSI between October 1, 2000 and January 2, 2001, and selected a statistically valid sample of 67 employees from the list and obtained their employment histories. We documented whether the selected employees were employees of the GTOCs or any of its affiliates at any time. We documented the number of employees, number of times, and dates each employee transferred between a GTOC and VSSI since October 1, 2000. We noted seven employees that transferred from a GTOC to VSSI. We noted no instances where any of the selected employees had transferred from VSSI to a GTOC.

7. We obtained the methodology used to calculate annual bonuses for officers and management employees of VSSI. We noted that the calculation of the annual bonuses is not tied to the exclusive performance of the GTOCs or VSSI, or the combined performance of the GTOCs and VSSI. Therefore, we did not obtain the related bonus calculation.

Objective IV: Affiliate May Not Obtain Credit with Recourse to the Assets of the GTOC

1. We documented VSSI's debt agreements, noting that these debt agreements were with related parties, Verizon Global Funding and GTE Corporation. Management indicated there was no credit arrangement with lenders and major suppliers of goods and services in effect from October 1, 2000 through January 2, 2001. Major suppliers are defined as those having $500,000 or more in annual sales to VSSI. Upon review of the debt agreements, we did not note any language indicating guarantees or recourse to the GTOCs' assets, either directly or indirectly through another affiliate.

2. We obtained the lease agreements (where the annual obligation was $500,000 or more) used in Objective II, Procedure 4 which documented the terms and conditions of VSSI's leases. We did not note any language in these agreements indicating recourse to the GTOCs' assets, either directly or indirectly through another affiliate.

3. We requested and received positive confirmation from Verizon Global Funding and the GTE Treasury Group confirming lack of recourse to the GTOCs' assets for the debt agreements with VSSI.

   We requested positive written confirmation for six VSSI leases with annual payment obligations in excess of $500,000 confirming lack of recourse to GTOC assets. We did not receive responses from the six lessors to which confirmation requests were sent, confirming they did not have recourse to the GTOCs' assets.

4. We obtained the general ledgers for VSSI and documented the balances of accounts payable to the GTOCs at December 31, 2000. We noted no balances for advances from the GTOCs in the general ledgers of VSSI. The balance of accounts payable to the GTOCs as of December 31, 2000 for VSSI – LD was ****proprietary**** to GTE Southwest, Inc. We noted no balance of accounts payable to the GTOCs at December 31, 2000 for VSSI-Solutions or VSSI-CNS.

Appendix D enumerates the procedures performed in connection with the Bell Operating Companies[2] and the Section 272 affiliate, VSSI.

With respect to the transactions between the Bell Operating Companies ("BOCs") and VSSI, we completed the following:

(a) We inquired of management of the BOCs and VSSI and management indicated the following:
- Local telephone exchange service was the only service purchased by VSSI from the BOCs during the period from October 1, 2000 to January 2, 2001.
- VSSI maintains separate books, records, and accounts from those of the BOCs, and all such books, records, and accounts are maintained in accordance with accounting principles generally accepted in the United States of America.
- VSSI had no officers, directors, or employees in common with a BOC during the period from October 1, 2000 to January 2, 2001.
- VSSI has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOCs during the period from October 1, 2000 to January 2, 2001.
- No assets were sold or transferred between a BOC and VSSI during the period from October 1, 2000 to January 2, 2001.
- VSSI operates independently from the BOC.
- The BOC does not own any facilities jointly with VSSI.
- The BOC does not provide any operations, installation and maintenance functions over the facilities owned by VSSI, or leased by VSSI from unaffiliated entities.

(b) We obtained the 20 invoices and the related Customer Service Records ("CSRs") issued by the BOCs to VSSI for local telephone exchange services in October 2000. We compared the rates appearing on the VSSI CSRs to the rates as determined by FCC and state public utility commission tariffs and noted no differences. Management indicated that the terms and conditions for local telephone exchange services are in accordance with the provisions of FCC and state public utility commission tariffs.

[2] For the purposes of this document, Bell Operating Companies Verizon PA, Verizon NJ, Verizon DE, Verizon MD, Verizon VA, Verizon Washington, DC, Verizon WV, Verizon New York and Verizon New England.

Appendix E enumerates the procedures performed in connection with the GTE Operating Companies and the former Bell Atlantic Section 272 affiliates.

We inquired of management of the GTOCs and former Bell Atlantic Section 272 affiliates as to whether any relationship in terms of structural, transactional and nondiscriminatory requirements exists between the GTOCs and the former Bell Atlantic Section 272 affiliates. Management indicated the following:

- During the period July 1, 2000 through December 31, 2000, Verizon Long Distance purchased Primary Interexchange Carrier Charge ("PICC") services from the GTE Operating Companies: Verizon North, Inc. and Verizon Northwest, Inc. amounting to approximately ****proprietary**** for July 1, 2000 through December 31, 2000.

Appendix F enumerates the results of applying the Agreed-Upon Procedures for Objective V through IX that were performed under the separate Advanced Services affiliate Agreed-Upon Procedures engagement.

The procedures in Objectives V through IX were designed by the Specified Users to assess compliance with the transactional and nondiscriminatory requirements of Section 272. In order to avoid duplication between this Agreed-Upon Procedures engagement and the Separate Advanced Services Affiliates Agreed-Upon Procedures engagement, the Specified Users agreed to incorporate into this report the results of applying the procedures for Objectives V through IX that were performed under Separate Advanced Services Affiliates Agreed-Upon Procedures engagement as they relate to VSSI. Results related exclusively to other Separate Advanced Services affiliates have not been incorporated into this report.

Objectives V & VI: Determine whether the separate Advanced Services affiliates conducted all transactions with the ILECs on an arm's length basis with the transactions reduced to writing and available for public inspection and determine whether the ILECs accounted for all transactions with the separate Advanced Services affiliates in accordance with the accounting principles and rules approved by the FCC.

1. We documented the procedures used by the ILECs and the Corporate Compliance Officer to identify, track, respond, and take corrective action to complaints relating to alleged noncompliance with the Advanced Services provisions of the BA/GTE Merger Conditions. Management indicated that the regulatory liaison department is responsible for monitoring the complaint process. When a complaint arises, a complaint manager is assigned, who, with the assistance of a representative from the line of business that is impacted by the complaint, is responsible for investigating the complaint. The complaint manager is responsible for compiling a formal response, including the corrective actions to be taken. A database is maintained by the regulatory liaison department to track the status of all complaints including the final resolutions thereto.

   We requested a list of all FCC formal complaints, as defined in 47 CFR 1.720; FCC informal complaints, as defined in 47 CFR 1.716; and any written complaints made to a state regulatory commission from competitors involving alleged noncompliance with the Advanced Services provisions of the BA/GTE Merger Conditions, including complaints submitted by competitors related to the provision or procurement of goods, services, facilities, and information, or in connection with the establishment of standards. Management indicated that no FCC formal or informal complaints or any written complaints made to state regulatory commissions from competitors involving alleged noncompliance with the Advanced Services associated with the provision or procurement of goods, services, facilities, and information, or in the establishment of standards have been received by Verizon up to the date of this report.

2. We obtained from the ILECs and VSSI current written procedures for transactions with affiliates and compared these procedures with the FCC Rules and Regulations, including: 32.27; 53. (203(e)); 64.901, and 64.902; paragraphs 122, 124, 183 and 265 of the *Report and Order* in CC Docket No. 96-150, issued December 1996, concerning Accounting Safeguards Under the Telecommunications Act of 1996 (11 FCC Rcd 17539 (1996)); paragraph 193 of the "First Report and Order and Further Notice of Proposed Rulemaking" in CC Docket 96-149, issued December 1996, concerning Non-Accounting Safeguards under Sections 271 and 272 of the Communications of the Communications Act of 1996; and paragraph 337 of the Memorandum Opinion and Order in CC Docket No. 98-121, issued October 13, 1998, concerning BellSouth's 271 application in Louisiana. We did not note any differences between the Company's written procedures and the FCC rules and regulations listed above.

3. We inquired and documented how the ILECs and VSSI disseminate the FCC Rules and Regulations and the conditions of the Merger Agreement and raise awareness among employees for compliance with the rules listed in Objective V & VI, Procedure 2. This documentation includes a description of the type and frequency of training, literature distributed, each Company's policy and the names of supervision employees responsible for ensuring compliance with these rules. The following activities have taken place among the ILECs and VSSI employees:

- On July 7, 2000, the Senior Vice President Regulatory Compliance, issued a letter to the top 300 senior executives of Verizon outlining the importance of complying with the various affiliate rules, including those associated with the merger conditions and requested this letter be cascaded broadly.
- During the fourth quarter of 2000, electronic mail was sent from the Affiliate Interest Compliance Office to various ILEC organizations outlining the availability of training materials related to "rules of engagement, i.e., as to how regulated telephone companies are to interact with Advanced Services Affiliates in accordance with the merger conditions."
- An electronic presentation for use in familiarizing employees with the rules of engagement and a list of questions to assist employees in determining if they need to participate in the training, were forwarded within Verizon's respective organizations. These organizations then began to schedule training sessions with the Affiliate Interest Compliance Office or to review the information on their own.
- A computer-based training package related to the separate Advanced Services affiliates, which includes a section on compliance with the regulatory rules, was developed with the "rules of engagement" input from the Affiliate Interest Compliance Office. This training package can be found at http://netlearn.verizon.com.
- A compliance office was established to help monitor all regulatory compliance-related activity.
- An internal website was developed by Verizon to post various compliance-related documents such as the Affiliate Transaction Policy Statement.
- A toll-free number was established to answer all employee affiliate transaction related questions.

We requested that employees responsible for the development and recording of transactions affected by these rules in the books or records of the carrier complete a questionnaire regarding their awareness of the FCC Rules and Regulations governing affiliate transactions. We interviewed these employees and documented their awareness of these rules. The following are the positions held by these employees:

- Specialist in Finance Operations, Special Purpose Billing-Verizon East
- Manager of Affiliate Billing in Corporate Books-Verizon East
- Manager of Affiliate Billing in Finance-Verizon East
- Senior Specialist in Enterprise Solutions Group-Verizon East
- Senior Specialist in B&C Account Management-Verizon East
- Manager of Performance Assurance in Real Estate-Verizon East and Verizon West
- Senior Market Manager of B&C in Wholesale Billing Operations-Verizon West
- Manager of Affiliate Transactions in Corporate Accounting-Verizon West
- Product Manager of Wireless and CLEC Wholesale Operator Services
- Assistant Market Manager of Wholesale Operator Services

4. We obtained the written agreements, including interconnection agreements, for services and for equipment/facilities between the ILECs and VSSI, which were in effect during the Engagement Period. We summarized these agreements and documented the names of parties, types of services, rates, terms, and conditions. We compared the services rendered by the ILECs to VSSI under these agreements with the list of services offered to VSSI in Objective I, Procedure 4 and noted the following difference for VSSI:

- Tariff Special Access Services, Tariff Switched Access Services, and Tariff Telephone Services are included in the Objective I, Procedure 4 list but are not included in written agreements obtained in Objective V/VI, Procedure 4. These services are purchased for VSSI's own use. They are purchased in accordance with the ILEC's publicly filed and approved state and federal tariffs.

We inquired of management and noted which agreements were still in effect as of December 31, 2000.

The VSSI agreements that were terminated as of December 31, 2000 are as follows:

Table 11

VSSI				
No.	**Party Providing Service**	**Party Receiving Service**	**Type of Service**	**Expiration Date**
1	Verizon-North	VSSI	Interconnection (Resale) Agreement – Wisconsin	Expired on 9/29/2000
2*	Verizon Midwest	VSSI	Interconnection Agreement – Iowa	Expired on 6/2000
3*	Verizon Minnesota	VSSI	Interconnection Agreement – Minnesota	Expired on 8/31/2000
*Management indicated that no services were provided under agreements 2 or 3.				

We inquired of management and management indicated that no agreements were terminated prematurely for VSSI. We inquired of management and management indicated that Verizon's policy is to provision services to VSSI only with written agreements.

5. We inquired of management and management indicated that interconnection agreements between VSSI and the ILECs have been publicly disclosed, including prices, discounts, terms and conditions.

   For VSSI, we inquired of management and management indicated that the process used to publicly disclose interconnection agreements was to post such agreements on VSSI's affiliate agreement website at http://www.gte.com/AboutGTE/272s/index.html. We inspected the website and noted that the interconnection agreements were posted.

6. For 12 VSSI affiliate agreements selected by the Specified Users, we compared the rates, terms and conditions of services on the web postings (at www.gte.com) to the written agreements. One of the selected agreements was not included on the website as management indicated that VSSI was not a party to the agreement during the Engagement Period and the agreement was erroneously included in the population of agreements for this procedure. This was the Advanced Services Agreement. We compared the remaining 11 agreements to the web postings and noted the following:
   - Rates, terms and conditions for 8 of the 11 web postings were agreed to the written agreements with no exceptions;
   - 3 of the 11 web postings contained discrepancies as compared to the written agreements. Management indicated the discrepancies occurred as a result of administrative errors. The

discrepancies between the web postings and the written agreements, which are included in the below table, are categorized as follows:

- services listed on the web postings were not included in the written agreements;
- difference between the effective date on the web posting and the effective date on the written agreement;

Table 15

No.	Affiliate	Contract	Difference
1	Verizon West to VSSI	Billing Services Agreement	Two services and their rates were listed on the web posting but were not noted in the written agreement. These services were "monthly minimum per CIC per GTE area" for $6,000 and "multiple CIC – start-up all GTE areas" for $36,000.
2	Verizon West to VSSI	Software License Agreement	The effective date is not listed on the written agreement, but is listed on the web posting as June 30, 1998.
3	Verizon West to VSSI	Wholesale Service Agreement	Two services and their rates were listed on the web posting but were not noted in the written agreement. These services were "single line ext. mailbox 1st" for $14.95 and "enhanced mailbox – 100 message cap" for $15.00.

We obtained a list of locations where the agreements are made publicly available. We physically inspected the 12 agreements to determine whether the same information was made available for public inspection at the principal place of business of the ILECs and noted the following:

- 11 of the 12 agreements were available for public inspection;
- As indicated above, the web posting for one agreement was not available. Management indicated that the agreement was incorrectly included in the population and that VSSI was not a party to the agreement during the Engagement Period.

The Company made no claims of confidentiality for nondisclosure.

We inquired of management and documented the procedures VSSI has in place for posting transactions on a timely basis. As indicated on the Company's websites, http://www.banetworkdata.com/process.html and http://www.gte.com/AboutGTE/272s/index.html, the Company has several employees, including the VSSI Web Posting Employee and the VSSI Contract Administrator, whose functions are to ensure that postings are made on a timely basis. Management indicated that the following is the process to ensure that postings are made on a timely basis:

- VSSI's lead negotiator prepares the web transactional page which describes the transaction.
- VSSI's contract administrator verifies the web transactional page to coordinate distribution of posting material.
- The web transactional page is posted by VSSI.
- To ensure process compliance and timely posting, the web transaction pages are reviewed by VSSI's contract administrator to ensure that no web transaction pages are missing. If any web transactional pages are noted missing, VSSI contract administrator notifies the lead negotiator, web posting employee, and the Affiliate Legal and Federal Regulatory team.

For the 12 selected agreements, we compared the posting dates listed on the website to the effective dates of the contracts and noted that three web postings were not posted within the required ten calendar days. Management indicated the web postings were not posted within the required period as the result of an administrative error. The postings are summarized in the table below:

Table 16

No.	Affiliate	ILECs	Contract	Timing Difference*
1	VSSI	All ILECs	National Transport Network Agreement	1 day
2	VSSI	All ILECs	Operator Assistance Agreement	32 days
3	VSSI	Verizon West	Sales Agency Agreement, Amendment No. 1	51 days

*Number of days beyond 10 calendar days when the web site was posted.

We inspected and noted that one web posting did not contain some of the required disclosures necessary for posting. Management indicated the omission of data occurred as a result of an administrative error and was corrected on June 6, 2001. The omission is included in the below table:

Table 17

No.	Affiliate	ILECs	Contract	Omission
1	VSSI	All ILECs	Sales Agency Agreement	The listing of services and rates, including number, type and level of personnel, was listed as "To Be Developed".

7. We inquired of management and management indicated that there were no transfers of any software or licenses from the ILECs to VSSI.

8. For nontariffed services and for services for which a prevailing market price ("PMP") has not been established, or which are not subject to agreements filed with a public service

commission, we documented the ILECs' and VSSI's process for developing fully distributed cost ("FDC"). Management indicated that the entity providing the service is responsible for gathering the information required to develop the FDC calculation. Examples of the types of information that an entity providing the service should provide include a detailed description of the product or service being provided, the job function code or titles of the employees involved, the number of employees in each job function or title, the building location and floor space used by these employees, any computer systems utilized, vendor or outside contractor costs, or any special equipment or supplies purchased. This information is forwarded to the Verizon Service Costs Department (a department of Verizon Service Corp. ("NSI") and Verizon Service Group "TRG"), which calculates FDC.

We inquired of management and identified and documented the types of costs included in FDC. These costs include direct costs, indirect costs, and overhead loadings.

For two services provided by the ILECs to VSSI, we obtained and documented the actual development of FDC. These services included Service Order Processing and Call Center Management.

FDC for Service Order Processing, provided to VSSI by Verizon Southwest, included the following types of costs:

- direct labor costs
- general and administrative overhead charge (including finance, legal, human resources, public affairs, treasury, accounting, regulatory, and data processing)
- shared asset charge (including return on investment)
- loading charge for insurance costs, pension costs, and taxes
- order processing charge (including return on investment)

FDC for Call Center Management, provided to VSSI by Verizon Southwest, included the following types of costs:

- average salary costs
- general and administrative overhead charge (including finance, legal, human resources, public affairs, treasury, accounting, regulatory, and data processing)
- shared asset charge (including return on investment)
- loading charge for insurance costs, pension costs, and taxes

For two services provided by VSSI to the ILECs, we obtained and documented the actual development of FDC. These services included Network Management and Marketing and Selling.

FDC for Network Management, provided by VSSI to Verizon North, included the following types of costs:

- Network Costs (including network purchases, management center charges, and access charges)
- Administrative Overhead (including return on investment)
- Manager/Contingency Costs

FDC for Marketing and Selling, provided by VSSI to the ILECs, included only direct costs. Management indicated that the only marketing and selling program in 2000 was toll optimization and the cost that VSSI charges the ILECs is the actual charge that VSSI pays the third party vendor. Management also indicated that VSSI's involvement is minimal, therefore, there are no indirect costs, overhead, or return on investment associated with this service.

9. For nontariffed services for which a PMP has not been established, or which are not subject to agreements filed with a public service commission, we inquired of management and documented the process the ILECs and VSSI follow to make good faith estimates of fair market value ("FMV"). Management indicated that a good faith determination of the fair market value requires the use of methods that are routinely used by the general business community. Examples of general business methods for obtaining fair market valuations include independent valuations such as appraisals, the use of catalogs listing similar items, competitive bids, the replacement cost of an asset, and the net realizable value of an asset. Additionally, the Company periodically engages unaffiliated entities to perform fair market valuations.

   The entity providing the good, service, or transferring the asset is responsible for obtaining a fair market value for all associated costs. The entity develops a detailed description of the goods, services or assets involved, and provides any additional information required by an independent firm to further assist in the valuation of the goods, services or assets being valued.

   For two services provided by the ILEC to VSSI, we obtained and documented the actual development of FMV. These services included Routing and Rating Database Maintenance and Voice Messaging. The FMV calculations are as follows:

   - The FMV for Routing and Rating Database Maintenance, provided to VSSI by Verizon West, was developed by benchmarking this service against a third party vendor. The specific transaction fee was benchmarked against this vendor's current rates, and an additional annual flow-through charge was added to arrive at the final transaction-specific rate.

   - The FMV for Voice Messaging, provided to VSSI by Verizon West, was developed using non-discounted retail rates obtained from the in-house retail group. The rates were used to construct discounted prices for various term and volume commitments. Management indicated that the ILECs' retail offering of voice messaging is the dominant offering of the product in the franchise area and, therefore, is representative of the retail market price.

   For the one service provided by VSSI to the ILEC at FMV, Prepaid Calling Cards, we obtained and documented the actual development of FMV. The FMV, provided by VSSI to GTE Services Corp. d/b/a Verizon Services Group on behalf of itself and its affiliates, which includes the former GTE ILECs, was developed by reference to actual sales to third party vendors.

10. We obtained a listing and amounts of all services rendered by month by each ILEC to VSSI. We identified services made available to VSSI that were not made available to third parties. For a sample of 6 transactions selected by the Specified Users, we obtained unit charges of FDC and FMV, as appropriate, and determined that the costs for these transactions were recorded in the books of the ILECs at the higher of FDC or FMV in accordance with the affiliate transactions standards. We documented the amounts VSSI recorded for the transactions in its books of record. We also documented the amounts VSSI paid for the

transactions to the ILECs. The amounts recorded were the same as the amounts paid for all transactions.

11. We obtained a listing of all services rendered by month to each ILEC by VSSI. For a sample of six transactions selected by the Specified Users, we obtained unit charges of PMP, FDC, or FMV, as appropriate, to determine that the costs for these transactions were recorded in the books of the ILECs in accordance with the affiliate transactions standards. We noted the following:

    - For one of the six transactions, we were unable to obtain the FMV unit charge; therefore, we were unable to determine whether the transaction was recorded in the books of the ILEC at the lower of FDC and FMV in accordance with the affiliate transactions standards. Management indicated that the FMV was not available because the service was a new offering within the industry. This service was PIC Management, provided to Verizon North, in the amount of $****proprietary**** for July 2000. We obtained the FDC calculation for this service and noted the amount on the FDC calculation was $****proprietary****.

    - For two of the six transactions, we were unable to obtain the FMV unit charges. Therefore, we were unable to determine whether the transaction was recorded in the books of the ILEC at the lower of FDC and FMV in accordance with the affiliate transactions standards. This service was Network Transport provided to Verizon California in the amount of $****proprietary**** for October 2000 and to Verizon South in the amount of $****proprietary**** for November 2000.

    - For two of the six transactions, we were unable to map the unit charge to the total billing amount; therefore, we were unable to determine whether the transaction was recorded in the books of the ILECs at the lower of FDC and FMV in accordance with the affiliate transactions standards. This service was for Official Company Long Distance provided to Verizon Southwest in the amount of $****proprietary**** for August 2000 and to Verizon Florida in the amount of $****proprietary**** for September 2000.

    We documented the amounts that each ILEC recorded and paid for the services noted above in its books of record. We noted the following:

    - For the Network Transport service, we were unable to trace the amount recorded and paid by the ILEC to the amount selected. Management indicated that the entry and payment included amounts in arrears and that the amount selected was included in this total amount. The amount recorded and paid by the ILEC was $****proprietary****.

12. We inquired of management and documented how and which company maintained VSSI's employee benefit plans. We noted that Verizon maintained the following employee benefit plans for its employees: medical, dental, life, long term disability, pension, and savings. The employee benefit plans were administered by the Verizon Human Resources – Benefits Planning Group, a department of Verizon Services Corp. The costs for these plans were allocated to the participating affiliates based on factors such as relative employment of the entities, relative payroll of the entities, and historical costs.

13. We obtained a listing and amounts charged for services by month by the two central services organizations, Verizon Services Corp. and Verizon Services Group, to VSSI from June 30,