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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 21, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW
Room TW-A325
Washington, D.C. 20554

Re: *Ex Parte* Presentation
CC Docket No. 00-199

Dear Ms. Salas:

In the above-referenced proceeding, the United States Telecom Association (USTA) has explained that the creation of new accounts and new reporting requirements as requested by some of the state regulatory commissions contradicts the purpose of the Section 11 biennial review. As discussed in USTA's comments the new accounts would be enormously and unnecessarily burdensome to implement. Some would require special studies that would require incumbent LECs to incur substantial new costs. The FCC should reject the creation of new accounts and complete the work it has started to streamline all of the accounting and reporting requirements.

The attached chart responds to a blanket ex parte filing made by the National Association of Regulatory Utility Commissioners (NARUC) on September 6, 2001. It addresses all of the issues raised by NARUC. It explains that states will continue to receive information that they require in order to carry out their responsibilities to set UNE prices and to certify the use of universal service funding without the new accounts. The system of accounts should not be used to accommodate fifty different sets of changing regulatory requirements.

In accordance with Section 1.1206(a)(1) of the Commission's rules, an original and a copy of this notice are being filed in the Office of the Secretary. Please include a copy of the letter in the above-referenced proceeding. If there are any questions regarding this submission, please contact the undersigned.

Respectfully submitted,

Linda L. Kent

Linda L. Kent
Associate General Counsel

Attachment

No. of Copies rec'd 0+1
List ABCDE

cc: Kyle Dixon
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NARUC ACCOUNTING/REPORTING PHASE 2 ISSUES
AND HOW THEY CAN BEST BE ADDRESSED
9/21/01

NARUC	SOLUTION
Some states, like Virginia, get information through interrogatories and cannot require creation of new workpapers to back up existing accounts. (Section I)	**States can continue to get information through interrogatories.** **Most states can require carriers to provide additional data or new reports, if necessary**. States with special problems can work with their carriers to resolve those specific problems. States have rules that are different from each other and the FCC's rules. If the FCC developed a Chart of Accounts (USOA) that satisfied the unique requirements of every state, the system of accounts would have to increase dramatically. This would not be prudent, nor feasible.
Existence of ARMIS allows states to determine if certain carriers are over recovering overheads via misallocations of the same costs to more than one state. (Section I)	**Phase II does not eliminate ARMIS reporting.** Furthermore, Generally Accepted Accounting Principles require that a cost be recorded once. The same cost cannot be recorded multiple times. For those carriers that have a legal entity that includes multiple states, many state regulators have their own overhead allocation requirements. **States can and do ask for data supporting how overhead costs are allocated. Any state-requested overhead amount can be compared to the total company overhead to see what percentage of total company was assigned to the state.**

NARUC	SOLUTION
Section 271 of the 1996 Act and the FCC gave states significant guidance on how rates and prices are established. State UNE proceedings rely heavily on data from the FCC's Part 32. (Section I)	**The Federal guidance given to states was for Unbundled Network Element Rates. Carriers perform, and will continue to perform, detailed studies for UNEs regardless of the chart of accounts used by the carrier.** The FCC's Local Competition Order, CC Docket 96-98, (released 8/6/96) establishes a standard for states to follow when carriers calculate UNE rates (prices). That standard is TELRIC (Total Element Long Run Incremental Cost), not the embedded or accounting costs. Par 690 states **"Only forward-looking, incremental costs shall be included in a TELRIC study." The standard also requires that the cost for the "most efficient technology available" be used.** A carrier's USOA books include the historical costs for all the different investment technologies in use, not just the most efficient technology available. Par 678 says that the ILEC offerings generally will be "network elements." Neither Class A, Class B nor the new technology accounts that are being proposed equal a network element or UNE rate. UNE pricing requires more detailed inputs than exist in the USOA. A UNE is an element (portion) of the most efficient technology. Charts of accounts reflect historical costs of entire assets. When costs of assets need to be allocated or separated, processes other than a chart of accounts are used. There are some cases where data that supports the USOA becomes a starting point for additional calculations. This support data can be obtained regardless of the chart of accounts used. Carriers provide and will continue to provide the states with detailed information needed to calculate UNE prices. These methods and procedures are well established. Furthermore, if a carrier did not provide the supporting data, the carrier would not get their prices approved.

NARUC	SOLUTION
States are charged with certifying carrier's use of universal service funds. (Section I)	**Changing the USOA will not impact in any way the ability of state commissions to certify the use of universal service funds.** The state is not certifying how much money a carrier receives and journalizes in it's books. The state commission is ensuring the carrier makes proper use of the funds it receives. In addition, Federal support is received only for the high cost areas within a state, not for the entire state. Carriers do not keep their books by high cost area. **If a state needs to know how much a carrier receives from the Federal Universal Service fund, the Universal Service Administrative Company (USAC) can provide that information.**

NARUC	SOLUTION
New technology accounts will enable FCC and states to ensure prices are reflective of actual costs (Section III)	**FCC prices are not set using actual costs.** For Class A carriers (the carriers who will need to implement the proposed new accounts), prices are subject to **price cap regulation which has severed the link between price and cost.** **UNE pricing is based on the most efficient network**, not the actual network deployed by the carriers. Furthermore, the process uses **forward-looking costs, not the embedded investment costs represented by a USOA account.** For example, carriers rely on engineering records, purchasing records, etc. **Studies can and will be performed whether or not a carrier is on Class A, Class B or it's own chart of accounts**. Where UNE pricing calculations begin with data that supports the USOA, this support data can be obtained regardless of the chart of accounts used. Supporting documentation for the studies will continue to be provided to state regulators and CLEC's in UNE proceedings. The models that carriers have developed to calculate UNE costs are well-established and documented, and are more detailed than the USOA. States are <u>not</u> uniform in how they regulate their carriers. **Methods used to develop state pricing vary by state.** Some states have price regulation, some have other types of incentive regulation and few still retain rate of return regulation. **States that are on rate of return regulation can continue to obtain the embedded cost data they need during the rate case proceedings under their state regulatory authority.** Individual state needs are met separately today and will continue to be met separately, especially since most states are basing prices on other than embedded costs. It would be inefficient and costly to expect the FCC to accommodate each state's individual regulatory requirements.

NARUC	SOLUTION
USOA Amounts are audited (Section III)	**Regardless of the number of accounts, all accounting dollars are subject to audit**. For Security and Exchange Commission Reporting (SEC reporting), carriers' external financial reports are audited by independent auditors. This audit is not dependent upon whether the carriers maintain an FCC prescribed USOA or whether carriers establish their own chart of accounts A second audit is conducted for Part 64 Cost Allocation. The principal purpose of this audit is to insure that the carrier's costs are allocated in accordance with the carriers' Cost Allocation Manual and related FCC rules. This requirement is unchanged and will continue for the large carriers.
USOA will enable the FCC and States to monitor issues such as deployment, collocation, and interconnection cooperation. (Section III)	**Other ways to monitor these types of issues exist.** Deployment is already monitored using state infrastructure reports. Collocation and interconnection are subject to substantial review as part of obtaining 271 relief. Also as a condition of 271 relief, the FCC has insisted on many service quality measures backed up by penalties of noncompliance. Another example is the Broadband and Local Competition Report which not only complies with the Congressional mandate in Section 706 of the Act to monitor advanced telecommunications deployment, but also provides for "collecting timely and reliable information about the pace and extent of competition for local telephone service in different geographic areas -- including rural areas" (See CC Docket 99-301, released March 30, 2000, paragraph 2) **The best information to satisfy these state concerns is unlikely to be historical accounting information**. For example, interconnection order processing statistics and plant performance statistics do not come from accounting records. Reports should be targeted to provide only the information necessary in today's changed environment.

NARUC	SOLUTION
Revenue the ILEC receives from UNE, Resale or Reciprocal Compensation trends will show whether the trend is upward or downward and if the ILECs are making money from the sale of UNEs. Trends in UNE/Resale revenues across states can inform specific state regulators if their UNE/resale rates are too low or too high to incent competitive entry. (Section III A)	**Revenue trending does not show whether an ILEC is making money from the sale of UNEs. A more appropriate measurement for whether there is incentive for competitive entry would be the type of measurement found in the Broadband and Local Competition Report**. For example, Part II: Wireline and Fixed Wireless Local Telecommunications. **This unit and percentage reporting by more than just ILECs is a better indicator of how competition is progressing.** The revenue account being proposed would not indicate how many units are sold, just the total booked dollars. Because states use different assumptions and develop prices differently, and because there are hundreds of different UNE prices within a given company, one total UNE revenue dollar amount in a new account would not be comparable among states. Trending this total revenue amount is also not an indication of how competition is progressing. A CLEC may stop purchasing a UNE because that CLEC has invested in it's own facilities. A decrease in a carrier's UNE revenue does not necessarily mean a decrease in competition. As discussed above, information about competition is more appropriately collected in a report targeted for measuring competition. Historical accounting information is not suited for this measurement. None of the above comparisons tell regulators if prices are too high or too low. The comparison merely shows that they are different. **The appropriate venue to determine whether UNE prices are too high or too low is the UNE pricing proceedings, since they allow all parties to present evidence as to the proper forward-looking cost for UNE prices.** To require a process in addition to this would merely add another layer of uneconomic costs onto the ILECs.
Carriers will use the FCC simplification (lack of USOA requirements) to make a burden argument at the state level. (Section III)	In addition to the Federal Commission**, State Commissions should be reviewing their processes in light of the changed competitive and regulatory environment.** State Commissions have their own rules and the authority to obtain necessary information from carriers for their particular situations regardless of what the Federal Commission does or does not do. The possibility that ILECs may also approach State Commissions for accounting and reporting relief is not adequate justification for the FCC to avoid simplification.

NARUC	SOLUTION
If ILECs purchase UNE's from CLECs, from time to time, and it is booked improperly, it will distort plant accounts. (Section III A)	**ILECs do not generally purchase UNEs**, ILECs provide facilities-based services. ILEC's that provide services out of their region, for the most part, operate using separate affiliates, so the associated costs would never be recorded in the ILEC's USOA. **For those carriers that do not have a separate affiliate for CLECs operating out-of-region, the cost of the purchased UNE is not journalized to the plant accounts because the UNE is not the purchaser's facility.** Because these costs are not journalized to the plant accounts, they cannot distort plant accounts. Furthermore, the cost that is paid for the UNE is also removed from the regulated accounts prior to being forwarded to the separations process. UNE rates have been established through exhaustive processes to obtain State Commission approval. Not only is further regulation redundant, but adding an account in which few, if any, dollars will be recorded is unnecessary.

<table>
<tr><th>NARUC</th><th>SOLUTION</th></tr>
<tr><td>If an ILEC pays to a State Universal Service Fund or the USAC, it goes in the expense account. If a carrier bills an end user for USF, it goes to revenue. With new USF accounts for revenue and expense, we can see if ILEC's are overrecovering or if there is a mismatch. (Section III B)</td><td>The FCC has set up a process to administer the federal universal service funds. The Universal Service Administrative Company (USAC)

1. Collects revenue data from all carriers required to support universal service.
2. Calculates contribution payments
3. Collects payments
4. Obtains information on revenues charged to customers, including charges levied by the reporting entity in order to recover contributions to state and federal universal service support mechanisms
5. Pays recipients of universal service
6. Approves, collects and distributes funds under the rural health care and schools and libraries programs

In other words USAC has all the information needed to monitor the universal service program, including information to determine overrecovery of costs.

All contributors to Universal Service complete FCC Form 499. Rather than require carriers to establish new accounts, USAC should be ordered to make the information it collects from carriers available to state regulators and still treat the information as proprietary to the extent that information is not otherwise publicly available.

To ask the ILEC's to modify their accounting systems for information that is already available from all carriers in a centralized place is not competitively neutral, especially when ILEC Customers represent only 16% of the contributions to Universal Service.[1]

Many states have a similar process to monitor state universal service programs.</td></tr>
</table>

[1] Table 1.8 of the Universal Service Monitoring Report (CC Docket 98-202, released September 2000) shows the following percentage breakdown of contributors to Universal Service.

Customers of Long Distance Carriers	76%
Customers of ILECs	16%
Customers of Wireless Carriers	6%
Customers of CLECs	2%

NARUC	SOLUTION
The addition of these new USF accounts to the USOA would also allow the end user revenue accounts to better reflect facilities based competition. (Section III B)	NARUC believes that separating the revenue a carrier receives from end users for USF surcharges from the revenue a carrier receives from facilities based services provides a better picture of facilities based competition because the USF revenue would not be comingled with the revenue from actual services. **It is the CLECs, not the ILECs, that provide the facilities based competition.** Creating a new USOA account will not accomplish this objective because: a. CLECs do not use USOA b. ILECs do not have in their books the CLEC facilities based revenue (competition includes more than just ILEC UNE revenue) c. Facilities Based Competition is already being measured In establishing the Broadband and Local Competition Report, "We require incumbent and competitive local exchange carriers (LECs) to report data about their provision of local exchange and exchange access services. This obligation applies without regard to the type of technology utilized by the LEC in delivering these services and without regard to the carrier's use of entry strategy." (Page 6, CC Docket 99-301, released 3/30/00). For example, the cover page of the report requires filers to indicate whether they are an incumbent Local Exchange Carrier or a non-incumbent Local Exchange Carrier. Part II, Column C provides for a percentage of the lines reported in Column A that are "provided over your own local loop facilities connecting to the end user's premise."

NARUC	SOLUTION
In the absence of federal accounting rules, if one state adopts accounting rules that expense costs while another state allows the same cost to be capitalized, excess Federal USF monies could flow to that state from other states. (Section III B)	**If state rules differ, these differences will not impact Federal USF monies.** Differences between state and federal rules are accounted for in a separate state set of books. Federal USF is not based on the state set of books. **Even if states implemented the Federal rules differently, the Federal USF is based on forward-looking investment costs, not embedded investment accounting costs**. Furthermore, ratios for overheads and maintenance have already been developed and input into the USF cost model. (The ratios used federal accounting data as a starting point. The data was then substantially adjusted and ratios were developed). **Phase II does not eliminate USOA** What USTA has requested in Phase II is an expense limit ceiling of $2,000 for all plant accounts. The only accounts that do not have a $2,000 limit today are central office tool and test equipment and computers. This USTA proposal allows carriers some flexibility between capital and expense on the federal books, but it still sets a limit on how much could be expensed. This will not cause monies to shift between states.
Plant accounts must recognize technologies being deployed by the industry today to avoid cross subsidy - for non-reg services provided via packet technologies. (Section III D)	**The ability to cross subsidize accounting costs can no longer exist when carriers no longer use the accounting costs on their books to set their rates.** Furthermore, even for those smaller carriers who are on rate of return regulation, **not all services that use packet technology are nonregulated.** **Where rate of return regulation is still in use, the Part 64 cost allocation rules protect against cross subsidization.** A new account is not necessary. The nonregulated activity must compensate the regulated side of the business by recording a tariff rate. If a tariff rate does not exist, the carrier then determines if this investment is used for nonregulated or is shared between regulated and nonregulated activities. If shared, it is allocated appropriately. What must be added to the rules is the nonregulated activity's ability to compensate the regulated side of the business using a UNE rate, the same rate that the carrier would record technology provided to a nonregulated affiliate. Carriers can identify what is needed to comply with not just the Part 64 rules, but with USF requirements and UNE requirements without new USOA technology accounts.

NARUC	SOLUTION
Packet vs. Circuit accounts are critical for UNE and USF cost models. The cost characteristics of the legacy circuit switching is different from packet. Shifting to packet switches could result in shifts from non-traffic sensitive costs to traffic sensitive costs and effectively move costs from the loop to transport. This should reduce loop expense and make the transitional UNE rollout strategy more cost effective to CLECs. (Section III D)	**Cost studies have been and will continue to identify inputs for the carriers' UNE models and the FCC's USF model**. As previously explained, **USF and UNE cost studies are performed using the most efficient network**, not the actual network deployed by the carriers. These processes use **forward-looking costs, not the embedded investment costs represented by a USOA account.** Even if the cost of the packet services was broken out separately, it would be of no use to forward-looking cost models. Older versions of ATM equipment, would be included in this account at their historical, not forward looking cost. Furthermore switches and loops are not the same investment. Purchasing a packet switch does not alter the cost of the loop that is already in place. What does decrease a per unit loop cost is the loop's handling of more demand. Demand can only increase when consumers purchase more services that go over the same loop.
It may happen that a circuit switch is added or modified to provide packet switching and carriers would not know how to account for this switch. Carriers should use the predominant use. (Section III D)	**For future switch technology, vendors have indicated that the packet and circuit technology will be combined. There will be no packet/circuit distinction to determine predominant use.** **For current technology, predominant use can be applied**; however carriers do not maintain unique accounts, subaccounts or field reporting codes for packet vs. circuit switches. Carriers that use Telecordia's PICS (Plug In Control System), have Equipment Category Numbers (ECN) numbers that identify packet vs. other units and dollars. Carriers that do not use Telecordia's PICS system use other methods. For example, some of Verizon's ILECs use the manufacturer's part number. Although this information does exist, it is not normally extracted or reported for business purposes. **To move these dollars into a unique investment account with associated depreciation reserve and maintenance would be costly.**[2] Furthermore, additional ongoing burdens would be placed on field personnel to time report to the new accounting codes. Field reporting personnel do not report time to Equipment Category Numbers or to a manufacturer's part number today.

[2] For example BellSouth, who uses Telecordia's PICS system, estimates from $1.0 million to $1.2 million to create subaccounts for both the asset and related expense accounts. (See BellSouth Comments, July 16, 2001).

NARUC	SOLUTION
Circuit vs. packet in accounts provide the most reliable audited information on the deployment of new technologies - something the FCC has been instructed by Congress to track. (Section III D)	**The FCC has met the Congressional tracking requirement with the Broadband and Local Competition Report (Form 477).** "Our Congressionally mandated efforts to assess the availability of advanced telecommunications capability to all Americans will be substantially aided by a regular and consistent survey of current broadband deployment. **This collection will allow us to monitor broadband deployment by a wide variety of entities** that might not otherwise participate in a Section 706 proceeding and should provide us with a more objective and comprehensive view of broadband deployment" (See par 13, CC Docket 99-301, released 3/30/00). For example, data is collected from "facilities-based providers of full broadband and one-way broadband services" (par 22). Data on number of lines and wireless channels is collected. Also provided are zip codes in which the customer services by broadband lines and wireless channels are located. (par 66 to 74) **Form 477 collects information from <u>all</u> facilities-based broadband providers, not just from ILECs.** The proposed new accounts are limited to the Class A ILECs. Historical costs are not a good measure of deployment of new technology because equipment costs change rapidly, and the same technology can have a substantially different cost depending on when it was purchased.
For the customer service accounts, if an ILEC is selling to a CLEC, book as wholesale - to residential/retail/business, book as retail. (Section III E)	**Carriers will continue to provide the necessary information in their UNE studies. UNE costs are forward-looking costs, not the costs on a carrier's accounting books. Furthermore, customer service accounts include more costs than sales costs.** Also included in Account 6620 (Services) are call completion services and number services. Number services include the preparation of white page listings. Carrier white pages contain CLEC as well as ILEC customers.

NARUC	SOLUTION
States are concerned that any changes do not effectively incent cross subsidy. Eventually, competition could reduce the need for such regulation, but significant changes are premature. (Section IV)	Changing the affiliate transaction rules will not "incent cross subsidization." **The ability to cross subsidize via misallocation of accounting costs disappeared with the adoption of price caps with no sharing.** In 1993, the FCC itself noted that "Since AT&T's price caps are unrelated to AT&T's current costs, attempts by AT&T to manipulate the costs it records for affiliate transactions will not increase AT&T's rates. " (93-251; NPRM). The changes proposed by the carriers cannot be classified as "significant." **The carriers are requesting only that the rules be modified to no longer require an estimated fair market value/fully distributed cost comparison for every transaction.** Carriers' have provided several specific and modest proposals which would reduce the burden without eliminating the rules. **Affiliate transaction rules and other accounting safeguards will still apply to the majority of transactions.** For example, Section 272 requires the RBOC may not discriminate between it's Section 272 affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards. These requirements would remain unchanged.

NARUC	SOLUTION
If the non-reg forecast methodology is no longer required, states are concerned that relying on current factors will necessarily dump more costs on states. For every extra dollar assigned to regulated operations, 75 cents would be assigned to the states. Price cap regulation may delay but will not eliminate the state impact - which is to inflate "regulated" costs and effectively subsidize the "non-reg" service. (Section V)	**The current rules do not require that all investment be forecast, only that which is shared. Investment can and has been directly assigned to nonregulated.** In the USTA March 29, 2001, exparte, Qwest and Verizon showed direct assignment of central office and cable and wire of 97% and 95%. On an industry basis, all companies that filed ARMIS 43-03 showed total nonregulated percentage (direct and forecasted) of 3/5 of a percent (0.59%). Clearly there is no room for cross subsidization. Furthermore, **the ability to cross subsidize accounting costs can no longer exist when carriers no longer use the accounting costs on their books to set their rates** **The industry is simply asking the FCC to implement the same standard in Part 64 that it has already implemented for affiliate transactions. Rather than forecast shared network investment for central office and cable and wire (as the current Part 64 rules require), the nonregulated activity could "purchase" the investment at the UNE rate.** This can be accomplished by eliminating the forecast requirement for the shared investment and by modifying the cost allocation hierarchy to include additional services at the top of the hierarchy. Along with tariff services, those services that are provided at a UNE rate should be included. This change merely puts the nonregulated operations of an ILEC in the exact same position as a CLEC when it purchases network services.
NARUC strongly opposes USTA's proposal to eliminate practically all current ARMIS reporting requirements for mid-sized carriers. (Section VII)	**Most smaller carriers do not file ARMIS reports, and states obtain the information needed from these carriers without relying on ARMIS.** Only New York, California Georgia, Ohio, Nebraska, North Carolina and Pennsylvania have 2% carriers that file ARMIS reports. For example, Citizens operates in 12 states, but is only required to file ARMIS in 1 state. **The FCC and State Commissions can continue to collect information needed to conduct oversight by making use of sources other than ARMIS.** For example FCC Form 499, tariff review plans, etc., are used for calculating the Federal Universal Service Fund. **Midsize carriers will still be subject to Part 32 accounting rules and existing cost allocation rules, even if ARMIS is not reported.**

NARUC ACCOUNTING/REPORTING PHASE 2 ISSUES
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NARUC	SOLUTION
NARUC believes USTA's proposal to eliminate state-by-state ARMIS information would undermine that state's ability to use any data provided in ARMIS. (Section VII)	NARUC believes that ARMIS helps states benchmark their individual state with other states. USTA recommended that the ARMIS 43-01 (Summary of ARMIS 01 through 04), select 43-02 schedules (USOAR), 43-03 (Reg/Nonreg), and 43-04 (Separations) reports be consolidated and reported at a Company level with a separate Table containing Separations statistics still provided at the state study area level. Although a state has access to it's own information, some NARUC members are concerned that there will be no access to another state's information if ARMIS is either eliminated or no longer produced at a state level. ILECs are only part of the LEC universe. **The precedent has already been set for targeted reporting that includes <u>all</u> carriers**. Examples of this are FCC Forms 477 and 499. **Not all state-by-state ILEC benchmarking is meaningful.** Carriers are no longer uniform. Some carriers have merged. All have formed their own unique strategies and business plans. Some carriers use affiliates to deploy certain products and services that other carriers' ILECs deploy. Not all carriers or states served by the same carrier have the same equipment mix. Not all states have the same demographics or geography. Not all carriers deploy the same plant or deploy plant in the same way in all states. **Benchmarking does not have to be performed using a state-by-state ARMIS report.** For example, the FCCs USOA Report (ARMIS 43-02) is <u>not</u> prepared on state-by-state level. It is prepared on a Operating Company level. In addition, there are other sources of a company's financial data. Companies file financial reports with the Securities and Exchange Commission (SEC). This information is publicly available on the SEC's EDGAR (Electronic Data Gathering, Analysis, and Retrieval) data base.