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Before the
Federal Communications Commission
Washington, D.C. 20554

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In the Matter of	)	
	)	
2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2	)	CC Docket No. 00-199
	)	
Amendments to the Uniform System of Accounts for Interconnection	)	CC Docket No. 97-212
	)	
Jurisdictional Separations Reform and Referral to the Federal-State Joint Board	)	CC Docket No. 80-286
	)	
Local Competition and Broadband Reporting	)	CC Docket No. 99-301

RECEIVED

REPORT AND ORDER IN CC DOCKET NOS. 00-199, 97-212, AND 80-286
FURTHER NOTICE OF PROPOSED RULEMAKING IN CC DOCKET NOS. 00-199, 99-301, AND 80-286

Adopted: October 11, 2001 Released: November 5, 2001

By the Commission: Chairman Powell, Commissioners Abernathy and Martin issuing separate statements; Commissioner Copps approving in part and dissenting in part and issuing a statement.

Comment Date (Issue A): Sixty days from date of publication in the Federal Register
Reply Comment Date (Issue A): Ninety days from date of publication in the Federal Register

Comment Date (Issue B): Thirty days from date of publication in the Federal Register
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Paragraph no.

APPENDIX H – Regulatory Flexibility Analyses

I. INTRODUCTION

1. In this order, we undertake the Commission's second comprehensive, biennial review of the accounting rules and the Automated Reporting Management Information System (ARMIS) reporting requirements that apply to incumbent local exchange carriers (LECs). In so doing, we expand on the deregulatory initiative that the Commission began two years ago in its first, statutorily mandated review and streamlining of these rules.[1] This effort is driven, most immediately, by section 11 of the Communications Act of 1934 (Communications Act), which requires that we review every two years those regulations that are "no longer necessary in the public interest as the result of meaningful economic competition between providers of" telecommunications service.[2]

2. We read section 11 to require a review of our regulations with an eye toward achieving Congress's goal, in the 1996 Act,[3] of a truly "pro-competitive, deregulatory" national policy framework for the telecommunications industry.[4] We recognize that any unnecessary regulation places a corresponding, unnecessary burden on the carriers that are subject to it. Furthermore, we have attempted, in this review, to be mindful that the national marketplace in which the regulated LECs operate continues to move toward a competitive model. Below, we attempt to strike an appropriate balance between the operations of the free market and a continuing need for some regulation. Accordingly, we do not flash cut to complete deregulation today. Rather, we endeavor to remove only those accounting and reporting regulations that are outdated or unnecessary.

3. Many of the regulations that we review in this order survive from the time of the government-sanctioned monopoly provider, when the Commission's main function was rate regulation, which required extensive accounting and reporting information. Under the direction of the 1996 Act, we are moving to an environment in which competition will be the main force that sets rates. Thus, we come to our statutory task with the approach that we will not retain a particular regulation unless it advances a valid regulatory interest. The focus of much of our policymaking has shifted to implementing the mandates of the 1996 Act in such areas as local competition, universal service, and the deployment of advanced services, particularly in rural areas.

4. Below, we adopt changes to our accounting rules that reflect a sharpened focus on ongoing regulatory needs in the areas of competition and universal service. Moreover, the changes we adopt today recognize the importance of changing technology with an eye toward

[1] *See* 1998 Biennial Regulatory Review – Review of ARMIS Reporting Requirements, CC Docket No. 98-117, *Report and Order*, 14 FCC Rcd 11443 (1999) (*ARMIS Reductions Report and Order*); 1998 Biennial Regulatory Review – Review of Accounting and Cost Allocation Requirements, CC Docket No. 98-81, *Report and Order*, 14 FCC Rcd 11396 (1999) (*Accounting Reductions Report and Order*).

[2] 47 U.S.C. §161.

[3] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act.

[4] Joint Statement of Committee of Conference, S. Conf. Rep. No. 230, 104th Cong. 2d Sess. 113 (1996).

identifying ways in which we can minimize the regulatory burdens and distortions that could undermine the development and deployment of such technology.

5. Our review leads us to four major accounting and reporting reforms. First, we substantially consolidate and streamline Class A accounting requirements. Second, we relax certain aspects of our affiliate transactions rules. Third, we significantly reduce the cost of regulatory compliance with our cost allocation rules for mid-sized carriers.[5] And finally, we reduce the ARMIS reporting requirements for both large and mid-sized LECs. More specifically, we:

- Reduce the number of Class A accounts in Part 32 of our rules by forty-five percent, maintaining only those currently used in ongoing regulatory activities under the Communications Act and the 1996 Act;
- In response to state requests, establish new subaccounts for circuit and packet under digital switching, electronic and optical subaccounts under circuit equipment, and wholesale and retail subaccounts under services;
- Reduce the current Class B accounts in Part 32 of our rules by 27 percent;
- Eliminate certain inventory requirements in our rules;
- Allow carriers to adopt Statement of Financial Accounting Standard (SFAS) 116 for federal accounting purposes;
- Revise the affiliate transactions rules so that carriers are not required to do a fair market comparison for asset transfers that total less than $500,000;
- Give carriers the flexibility to use the higher or lower of cost or market valuation as a ceiling or floor in valuing transactions with affiliates;
- Eliminate the need to do a fair market valuation in situations where third party sales amount to greater than 25 percent of total sales volume for that asset or service;
- Simplify how carriers record nonregulated revenues in the Uniform System of Accounts;
- Simplify deferred tax accounting;
- Modify our expense limit rules to include central office tools and test equipment in the $2000 expense limit;
- Simplify how carriers separate regulated from nonregulated costs by permitting carriers to treat as regulated revenues certain activities that are not regulated;
- Simplify the preparation of cost allocation manuals for Class A carriers by permitting them to allocate certain costs at the Class B level;

[5] A mid-sized incumbent LEC is a carrier whose operating revenue equals or exceeds the indexed revenue threshold and whose revenue when aggregated with the revenues of any LEC that it controls, is controlled by, or with which it is under common control is less than $7 billion.

- Permit carriers to treat rates in interconnection agreements as tariffed rates for purposes of our cost allocation rules;

- Eliminate the requirement to do a revenue study analyzing the effect of proposed accounting standards changes prior to implementing those changes;

- Amend our accounting rules to expressly limit them to incumbent LECs;

- Modify ARMIS reporting for the large incumbent LECs to eliminate obsolete reporting requirements and to capture technological changes;

- Significantly streamline ARMIS 43-04, the Separations and Access Report, by reducing the report from 64 to 7 pages;

- Eliminate the cost allocation manual (CAM) filing requirements and the biennial attestation requirement for mid-sized LECs; and

- Significantly simplify the reporting requirements for mid-sized incumbent LECs by eliminating the requirement that they file ARMIS 43-02, 43-03 and 43-04 Reports.

6. In adopting these rule changes, we have attempted to steer a course that avoids both deregulation simply for its own sake and the countervailing temptation to retain rules that may no longer be necessary. Thus, we decline to adopt the proposal of the USTA to move even the largest LECs to the less detailed, Class B system of accounting. As we describe below, this decision is motivated by our conclusion that the higher level of detail of Class A accounts is necessary for the Commission to continue meeting its statutory obligations with respect to universal service. For similar reasons, we have chosen not to fully collapse the Class A accounts to the extent that USTA has advocated.

7. In addition, we adopt a Further Notice of Proposed Rulemaking addressing certain issues. Specifically, we:

- Seek to further develop the record on the appropriate circumstances for elimination of accounting and reporting requirements for incumbent local exchange carriers, including whether some or all requirements should be eliminated by a date certain;

- Seek comment on whether certain ARMIS information would more appropriately be collected through other means such as ad hoc data requests or our Local Competition and Broadband Data Gathering Program; and

- Seek comment on conforming amendments to our separations rules, necessitated by our modifications to the Uniform System of Accounts.

II. BACKGROUND

A. Accounting Requirements

8. Under the Commission's Part 32 rules, incumbent LECs record their costs and revenues in the Uniform System of Accounts (USOA).[6] The USOA was intended to provide a financial-based system maintained in sufficient detail to facilitate recurrent regulatory decision making.[7] Part 32 originated at a time when regulators were required or inclined to organize telecommunications costs in a manner that allowed a logical mapping of these costs to telecommunications rate structures. The states historically have relied upon our Part 32 accounts, rather than imposing different accounting requirements that might serve similar purposes.

9. There have been two classes of incumbent LECs for accounting purposes: Class A and Class B.[8] Carriers with annual revenues from regulated telecommunications operations that are equal to or above the indexed revenue threshold, currently $117 million, are classified as Class A; those falling below that threshold are considered Class B.[9] Class A carriers – SBC, Qwest, Verizon, and BellSouth – have been required to maintain 296 Class A accounts,[10] which provide more detailed records of investment, expense, and revenue than the 113 Class B accounts that Class B carriers are required to maintain.[11] The more generalized level of accounting required under Class B was established to accommodate smaller carriers, which number over 1,300.[12]

10. The Commission has used Part 32 accounting data for various regulatory purposes. For example, these data are used to allocate costs between regulated and nonregulated

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[6] 47 C.F.R. Part 32. The Part 32 USOA replaced the former Part 31 USOA on January 1, 1988. The establishment of a uniform system of accounts is mandated by section 220(a)(2) of the Communications Act. 47 U.S.C. § 220(a)(2).

[7] *See* Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Parts 31, 33, 42, and 43 of the FCC's Rules), CC Docket No. 78-196, *Report and Order*, 60 Rad. Reg. 2d (P&F) 1111 (1986).

[8] 47 C.F.R. § 32.11.

[9] *See* "Annual Adjustment of Revenue Threshold," *Public Notice*, DA 01-903 (rel. April 11, 2001) (adjusting annual indexed revenue threshold to $117 million).

[10] Other Class A carriers include ALLTEL, Citizens Communications, Cincinnati Bell, C-TEC, Sprint, Roseville, and CenturyTel. We have already taken measures to reduce accounting requirements for mid-sized companies and allow them to maintain their accounts on a Class B level. *See ARMIS Reductions Report and Order*, 14 FCC Rcd at 11449, ¶ 11.

[11] The difference in the number of accounts is that many of the Class A accounts are aggregated into summary accounts under Class B.

[12] The Commission has recognized that small carriers often have limited resources and have financial transactions that are smaller and fewer in number than the larger incumbent LECs. For example, in the *Joint Cost Order*, the Commission applied cost allocation standards and affiliate transactions rules to all local exchange carriers, but exempted the smaller carriers from the potentially burdensome enforcement provisions, *e.g.*, CAM annual filing, an annual independent audit, and reporting requirements. *See* Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, *Report and Order*, CC Docket No. 86-111, 2 FCC Rcd 1298, 1330-31, ¶¶ 254-56 (1987) (*Joint Cost Order*), *recon.*, 2 FCC Rcd 6283 (1987), *further recon.*, 3 FCC Rcd 6701 (1988), *aff'd sub nom.* Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C.Cir. 1990).

activities under Part 64.[13] Part 32 accounting data are also used in jurisdictional separations under Part 36. The dual system of federal and state regulation reflected in the Communications Act requires the separation of common carrier costs and revenues between interstate and intrastate operations. USOA data are used to accomplish this jurisdictional allocation.

11. USOA data are currently used to calculate universal service support, which enables carriers serving high-cost and rural areas to provide local service at affordable rates.[14] Non-rural carriers receive support based on the forward-looking economic cost of providing the services eligible for support, as determined by the Commission's universal service cost model. The Commission used accounting data to develop many of the input values used in the model. Rural carriers currently receive support based on their embedded costs, as reflected in their accounts.[15]

12. Finally, the accounting data reported in Part 32 accounts are also currently used to determine interstate access charges. Prior to the adoption of price cap regulation in 1991, access charges for all incumbent LECs were governed by Part 69 access charge rules. The USOA continues to be used, even with the Commission's adoption of price cap regulation for many incumbent LECs.[16] For example, data recorded in uniform accounts are used to adjust price cap indices upward if a price cap carrier earns returns below a specified level in a given year. Price cap carriers may also seek exogenous adjustments based on actual cost changes.[17] For example,

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[13] The Commission's rules under Part 64 require that joint and common costs incurred in providing regulated and nonregulated services be allocated so that regulated services do not subsidize nonregulated services.

[14] The 1996 Act codified the Commission's historical commitment to promote universal service to ensure that all Americans have access to affordable, quality telecommunications services. In section 254 of the Communications Act, Congress directed the Commission, after consultation with the Joint Board, to preserve and advance universal service in the competitive environment that Congress envisioned by establishing specific, predictable, and sufficient support mechanisms. In the *Universal Service Order*, the Commission adopted a plan to replace the historical universal service support mechanisms with new support mechanisms that will be sustainable in an increasingly competitive marketplace. *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776 (1997) (*Universal Service Order*). Among other things, the Commission agreed with the Joint Board that federal universal service support should be based on the forward-looking cost of constructing and operating the network used to provide the supported services, rather than each carrier's embedded costs. *Universal Service Order*, 12 FCC Rcd at 8888, ¶ 199.

[15] Although the Commission has determined that all carriers will eventually receive universal service support based upon their forward-looking costs, it has delayed application of a forward-looking cost model to determine support for rural carriers to allow them ample time to adjust to changes in support calculations that would result from such a transition. In the meantime, the Commission has permitted rural carriers to continue to receive support based on their embedded costs. *See* Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256*, FCC 01-157 (rel. May 23, 2001)

[16] The Commission required price cap regulation for the Bell Operating Companies and GTE, and permitted other incumbent LECs to elect price cap regulation. *See* Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, *Second Report and Order*, 5 FCC Rcd 6786 (1990).

[17] An exogenous adjustment allows a carrier to increase its prices to recover costs imposed on it by governmental or administrative action beyond its control.

in their 2001 annual access tariff filing, several carriers sought exogenous adjustments.[18] Accounting costs are used to define claims for exogenous adjustments. In addition, a price cap LEC may petition the Commission to set its rates above the levels permitted by the price cap indices based on a showing that the authorized rate levels will produce earnings that are so low as to be confiscatory.[19]

B. Reporting Requirements

13. ARMIS is an automated reporting system developed by the Commission in 1987 for collecting financial, operating, service quality, and network infrastructure information from certain incumbent LECs.[20] ARMIS was designed to provide federal and state policymakers with a database for monitoring activities associated with the provision of telecommunications services and the development of the telecommunications infrastructure without having to rely on ad hoc information requests.

14. ARMIS contains ten separate reports. The following chart summarizes (1) the name of the ARMIS Report; (2) the level of reporting required; and (3) the incumbent LECs required to file each report.

ARMIS Report	43-01 Annual Summary	43-02 USOA Report	43-03 Joint Cost Report	43-04 Sep. & Access	43-05 Service Quality	43-06 Cust. Satisfaction	43-07 Infra-Struct.	43-08 Oper. Data	495A Forecast of Investment Usage	495B Actual Usage of Investment
Level of reporting	Study area	Operating co.	study area	study area	holding co./ study area	holding co./ study area	holding co./ study area	operating co.	study area/ consol. access tariff area/ oper. co.	study area/ consol. access tariff area/ oper. co.
LECs	All LECs at	All LECs at	All LECs at	All LECs at	All price cap	Mandatory	Mandatory	All LECs at	All LECs at	All LECs at

[18] *See, e.g.,* Ameritech Operating Companies 2001 Annual Filing, Transmittal No. 1270, Description and Justification, section 2; BellSouth 2001 Annual Access Charge Tariff Filing, Transmittal No. 592, Description and Justification, section 6; Pacific Bell Telephone Company 2001 Annual Filing, Transmittal No. 37, Description and Justification, section 2; Qwest Corporation 2001 Price Cap Revisions Tariff Filing, Transmittal No. 76, Description and Justification, section 2.2.

[19] All these cost recovery mechanisms remain in place even under recent access charge reform measures. *See* Access Charge Reform, CC Docket No. 96-262, *Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, and Eleventh Report and Order in CC Docket No. 96-45,* 15 FCC Rcd 12962 (2000) (*CALLS Report and Order*). The measures were proposed by the Coalition for Affordable Local and Long Distance Service (CALLS), a group that included AT&T, SBC, Bell Atlantic (now Verizon), BellSouth, GTE (now Verizon), and Sprint

[20] *See* Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies (Parts 31, 43, 67, and 69 of the FCC's Rules), CC Docket No. 86-182, *Order,* 2 FCC Rcd 5770 (1987), *modified on recon., Order on Reconsideration,* 3 FCC Rcd 6375 (1988). In 1990, the Commission added reporting categories for service quality and infrastructure development. *See* Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, *Second Report and Order,* 5 FCC Rcd 6786, 6827-30 (1990).

that file	or above thresh-old	or above thresh-old	or above thresh-old	or above thresh-old	LECs	price cap LECs	price cap LECs	or above thresh-old	or above thresh-old	or above thresh-old

15. Currently, only 52 out of over 1300 incumbent LECs are required to file ARMIS reports on an annual basis.[21] Class A carriers are required to file four ARMIS reports that collect financial information: ARMIS 43-01, which is a summary report, ARMIS 43-02, which collects basic accounting information, ARMIS 43-03, which collects information on how costs are allocated between regulated and nonregulated activities, and ARMIS 43-04, which collects information about how costs are allocated between the federal and state jurisdictions.[22] Supporting data for the ARMIS 43-03 Report are collected in two reports: Form 495A (Forecast of Investment Usage Report) and Form 495B (Actual Usage of Investment Report). The ARMIS 43-05 Service Quality report is filed by all price cap incumbent LECs.[23] The ARMIS 43-06 Customer Satisfaction Report and ARMIS 43-07 Infrastructure Report are filed by mandatory price cap incumbent LECs.[24] The ARMIS 43-08 Operating Data Report is filed by all Class A incumbent LECs.[25] These ARMIS filings provide information on incumbent LECs serving more than 90 percent of the nation's telephone customers.

C. History of this Proceeding

16. In Phase 1 of this comprehensive review of accounting and reporting requirements, the Commission streamlined the Part 32 accounting rules and ARMIS reporting requirements by, *inter alia*, reducing the total number of Class A accounts and subaccounts by over 50 percent.[26] The Commission also reduced the reporting requirements for the ARMIS 43-

[21] Specifically, 52 incumbent LECs have annual operating revenues exceeding the indexed revenue threshold and file financial ARMIS reports. These incumbent LECs include the operating companies of Verizon (19 operating companies); SBC (9 operating companies); BellSouth; and Qwest. The other 22 incumbent LECs are considered mid-sized carriers. They are Cincinnati Bell (1 operating company), C-TEC (1 operating company), Sprint (13 operating companies), ALLTEL (5 operating companies), and Citizens Communications (2 operating companies).

[22] The largest incumbent LECs file such reports using Class A accounting information, while the 22 mid-sized incumbent LECs report at the Class B level.

[23] There are 93 price cap LECs subject to service quality reporting requirements. They are Verizon (19 operating companies); SBC (9 operating companies); BellSouth (1 operating company); Qwest (1 operating company); Sprint (17 operating companies); Citizens Communications (45 operating companies); and Cincinnati Bell (1 operating company).

[24] There are 30 mandatory price cap incumbent LECs that are subject to customer satisfaction and infrastructure reporting requirements. They are Verizon (19 operating companies); SBC (9 operating companies); BellSouth (1 operating company); and Qwest (1 operating company).

[25] Specifically, the same 52 incumbent LECs that have annual operating revenues exceeding the indexed revenue threshold and file the financial reports.

[26] Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 1, CC Docket No. 99-253, *Report and Order*, 15 FCC Rcd 8690 (2000) (*Phase 1 Report and Order*). Specifically, in Phase 1, the Commission eliminated the expense matrix filing requirement; allowed carriers to reduce the CAM audit requirement from an annual financial statement audit to a biennial attestation engagement; relaxed the affiliate transactions rules for services; eliminated the 15-day pre-filing requirement for certain CAM changes; eliminated the 30-day notification

02 USOA Report by revising certain tables, eliminating several other tables, and establishing new threshold levels for certain reporting items.

17. In the Phase 2 *Notice*, the Commission sought comment on proposals to further revise the accounting rules and ARMIS reporting requirements in the near term by streamlining the chart of accounts, revising the affiliate transactions rules, modifying other accounting rules, and streamlining the ARMIS reporting requirements.[27]

18. Subsequent to the release of the *Notice*, the Commission adopted the recommendation of the Federal-State Joint Board on Separations to impose an interim freeze of Part 36 category relationships and jurisdictional allocation factors for price cap carriers and allocation factors for rate-of-return carriers.[28] As directed by the Commission, the Common Carrier Bureau sought comment on streamlining ARMIS 43-04, the Separations and Access Report.[29]

19. In the Phase 3 *Notice*, adopted concurrently with the Phase 2 *Notice*, the Commission undertook a broader examination of Part 32 and ARMIS reporting requirements to determine what additional deregulatory changes should be made as competition develops in the local exchange market. We will address Phase 3 issues in a subsequent order in this docket.

D. Ongoing State Role in Revisions to the Uniform System of Accounts

20. Under our system of dual regulation, the Commission and the states work together as partners.[30] Section 220 of the Communications Act provides states a unique partnership role in developing the uniform system of accounts.[31] Through this partnership, the

requirement for establishment of temporary or experimental accounts; allowed carriers to record contingent liabilities without Commission review; eliminated the reclassification requirement for certain property held for future use; and eliminated the reclassification requirement for certain plant under construction.

[27] 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2 and Phase 3, CC Docket No. 00-199, *Notice of Proposed Rulemaking*, FCC 00-364 (rel. Oct. 18, 2000) (*Notice*). Twenty-nine parties filed comments and 21 parties filed reply comments in Phase 2. Appendix A contains a list of the commenters and their abbreviated names. After reviewing the comments, the Commission sought further comment on streamlining Class A and Class B accounts. *See* "Commission Seeks Further Comment in Phase 2 of the Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers," *Public Notice*, DA 01-1403 (rel. June 8, 2001) (*June 8 Public Notice*). Twelve parties filed comments and six parties filed reply comments to the *June 8 Public Notice*. These comments are referred to herein as "PN Comments" and "PN Reply Comments."

[28] Jurisdictional Separations and Referral to the Federal-State Joint Board, CC Docket No. 80-286, *Report and Order*, FCC 01-162 (rel. May 22, 2001) (*Separations Freeze Order)*.

[29] *See* "Common Carrier Bureau Seeks Comment on Proposed Streamlined ARMIS 43-04 (Jurisdictional Separations) Report," CC Docket No. 80-286, *Public Notice*, DA 01-1496 (rel. June 22, 2001) (*ARMIS 43-04 Public Notice*).

[30] *See* GSA Reply Comments at 5.

[31] Section 220(i) of the Communications Act provides that "[t]he Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations." 47 U.S.C. § 220(i).

Commission has developed an accounting system that almost every state uses.[32] For example, the State of Alaska uses our USOA to determine local service rates as well as for evaluating unbundled network element (UNE) and interconnection rate proposals and arbitrations.[33] Alaska also uses the USOA to determine intrastate access charges, evaluate the allocation of the Alaska Universal Service Fund support, and evaluate proposed tariffs.[34]

21. Uniformity provides efficiency to the regulatory process for both federal and state regulators because regulators need only have expertise in one accounting system.[35] Uniformity among states allows regulators or other interested parties to compare and benchmark the costs and rates of incumbent carriers operating in various states.[36] A comparative analysis of these costs could be hindered, at least to some extent, if that data were too aggregated. At a reduced level of detail, data could mask important inter-company differences in the utilization of various technologies and deployment of various types of plant. One goal of our reform of accounting and reporting requirements is to determine whether those regulatory benefits are outweighed by the burdens imposed on carriers and ratepayers.

22. We recognize that our federal accounting system has a significant impact on state regulatory processes. The Commission has specifically sought the input of the states in this proceeding. Prior to the Phase 2 *Notice*, we held a series of teleconferences to seek input from the states in crafting proposals for the Phase 2 *Notice*. Subsequently, 24 state commissions[37] and the National Association of Regulatory Utility Commissioners (NARUC) filed comments, reply comments, or *ex parte* comments in Phase 2 of this proceeding. We have found the input of our state colleagues to be very valuable throughout this process. We are committed to soliciting further state input as we continue to streamline our accounting and reporting requirements.

III. DISCUSSION

23. In this order, we streamline many of our accounting rules and reporting requirements. As a preliminary matter, we note that several commenters observe that the record

[32] *See, e.g.*, Oregon Comments at 1; Wisconsin Comments at 4; ALTS Reply Comments at 10; Washington Comments at 2; Indiana Sept. 21, 2001 *ex parte* at 2. Wisconsin observes that many states have different levels of regulation and in some cases the incumbent LECs are still subject to rate-of-return regulation where the accounting needs may be greater. Wisconsin Comments at 4.

[33] Alaska Reply Comments at 3. The State of Alaska requires incumbent LECs with annual revenues of $5 million or more to maintain their accounting records using the USOA Class A accounts. *Id.* According to Alaska, the USOA structure serves as the most useful and efficient tool for overseeing the fair and efficient implementation of competition, as well as to evaluate local service rates in the absence of competition. *Id.*

[34] *Id.*

[35] *See, e.g.*, Oregon Comments at 2; Wisconsin Comments at 4; North Carolina Public Staff Comments at 3; Washington Comments at 2; Alaska Reply Comments at 4; Virginia Reply Comments at 1. Indiana observes that "requiring carriers to file the same form of report gives comparability between states that may not otherwise be possible." Indiana Sept. 21, 2001 *ex parte* at 2.

[36] *See* Applications of NYNEX Corporation, Transferor, and Bell Atlantic, Transferee, for Consent to Transfer Control of NYNEX Corporation and its Subsidiaries, File No. NSD-L-96-10, 12 FCC Rcd 19985, 19994, ¶ 16 (1997).

[37] The states of Alaska, California, Florida, Idaho, Illinois, Indiana, Kansas, Maryland, Michigan, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Oregon, South Dakota, Utah, Virginia, Washington, Wisconsin, and Wyoming.

fails to provide any evidence of meaningful economic competition for local exchange services.[38] We are not, however, limiting our analysis to whether meaningful economic competition exists and therefore rule changes may be justified under the standard in section 11. Instead, we are going beyond section 11 to determine whether our accounting rules should be revised and streamlined to serve the public interest and how we can revise these rules to have validity today. We note that most of the rule changes adopted herein, including the addition of new accounts, are listed as proposals in our *2000 Biennial Regulatory Review Report*.[39] In addition, we have the inherent authority to consider at any time whether our rules should be repealed or modified; thus, we need not make a finding in this proceeding that meaningful economic competition exists in order to make rule changes. Considering whether other factors, such as technological changes or changes in the law, may have made certain regulations appropriate for modification is an efficient use of our resources.[40]

24. Below, we discuss the streamlining that we accomplish in the chart of accounts first with respect to Class A accounts and then with respect to Class B accounts. Next, we detail the additional, substantial regulatory relief that we afford all of the carriers subject to our accounting rules. Following that, we review the changes we adopt for the ARMIS reporting system. Finally, we respond to the unique concerns of the smaller Class A, or mid-sized, carriers, providing these entities further relief in both their accounting and their reporting requirements.

A. Class A Accounts

25. Currently, there are 296 Class A accounts. In the *Notice*, the Commission proposed to eliminate one-fourth of the Class A accounts.[41] Specifically, the Commission proposed to retain the Class A account structure for network plant and related asset and expense accounts[42] and, for all other accounts, to consolidate the chart of accounts to Class B accounts. The Commission also sought comment on USTA's proposal to adopt Class B accounting for all

[38] *See, e.g.,* AT&T Comments at 1 & Reply Comments at 2-5; XO Communications Reply Comments at 3; NARUC Comments at 4; ALTS Reply Comments at 6-7; Ohio CC and NASUCA Joint Reply Comments at 2-3; Ohio CC PN Reply Comments at 2. Qwest, on the other hand, contends that competition in the provision of interstate access services is robust, and it is those services on which the Commission should focus. Qwest Reply Comments at 8-9. *See also* Verizon Reply Comments at 4-5 (Verizon-east has provided over 2 million unbundled loops and over 2 million interconnection trunks to competitors.)

[39] *See* 2000 Biennial Regulatory Review, CC Docket No. 00-175, *Report*, FCC 00-456 (rel. Jan. 14, 2001) at ¶ 21 & note 23 (*2000 Biennial Regulatory Review Report*).

[40] *See 2000 Biennial Regulatory Review Report* at ¶ 19.

[41] *See Notice* at ¶ 17.

[42] Network and related asset accounts consist of Accounts 2111-2682 and the related accumulated depreciation and amortization accounts in the 3000 series. Related expense accounts are all plant specific and plant non-specific accounts included in Accounts 6111-6565. The network and related asset accounts we proposed to retain, Accounts 2111-2682, include the Class A accounts for land, motor vehicles, aircraft, tools and other work equipment, buildings, furniture, office equipment, general purpose computers, analog electronic switching, digital electronic switching, electro-mechanical switching, operator systems, radio systems, circuit equipment, station apparatus, customer premises wiring, large private branch exchanges, public telephone terminal equipment, other terminal equipment, poles, aerial cable, underground cable, buried cable, submarine cable, deep sea cable, intrabuilding network cable, aerial wire, conduit systems, capital leases, and leasehold improvements.

carriers.[43] Commenters agreeing with USTA's proposal contend that Class A accounts are not needed for any regulatory purpose.[44] Many commenters, particularly state commissions, disagree with USTA's proposal to completely eliminate Class A accounting.[45] After reviewing the record, we sought further comment on additional consolidating, to reduce 296 Class A accounts to 178 Class A accounts.[46]

26. Based on our review of the current USOA and the comments received in this proceeding, we conclude that our existing Class A accounting system can be significantly streamlined. We conclude that we can reduce the number of Class A accounts by forty-five percent, from 296 to 164 accounts. In particular, we conclude that we can substantially streamline the number of financial accounts. We also consolidate a number of current plant expense accounts, while preserving those accounts that the Commission and the state commissions use for ongoing regulatory activities. We add several new subaccounts to meet new needs.

1. Class A Accounts Being Eliminated or Consolidated

27. After reviewing the record, we conclude that we can reduce the number of Class A accounts, as proposed in the *Notice* and *June 8 Public Notice*, with some modifications. We are consolidating many of the financial accounts as well as some of the plant accounts. At the same time, arguments raised by some of the commenters persuade us to retain some of the accounts we proposed to eliminate. We remain open to future additional consolidation of Class A accounts in the event that future proponents provide more persuasive support that such consolidation is acceptable or appropriate than exists on the record before us here.

28. *Telecommunications Plant in Service – Cable and wire facilities assets.* In the *June 8 Public Notice*, we proposed to consolidate Account 2423, Buried cable, Account 2424, Submarine cable, and Account 2425, Deep sea cable, as well as the corresponding expense accounts: Account 6423, Buried cable expense, Account 6424, Submarine cable expense, and Account 6425, Deep sea cable expense. Several commenters disagree with this proposal.[47] New

[43] *Notice* at ¶ 16.

[44] *See, e.g.*, BellSouth Comments at 4.

[45] *See, e.g.*, AT&T Comments at 2-3 & Reply Comments at 6-9; AT&T Aug. 29, 2001 *ex parte* at 2; Florida Comments at 4; GSA Comments at 3 & Reply Comments at 6; Idaho Comments at 4; Maryland Comments at 3; NARUC Comments at 4-5 & Reply Comments at 2-7; New York Comments at 1-2; North Carolina Public Staff Comments at 3; Ohio CC and NASUCA Joint Comments at 5 & Reply Comments at 3-5; Ohio CC PN Reply Comments at 3; Oregon Comments at 1-4; RUS Comments at 2; Sprint Comments at 8; Utah Comments at 2; Wisconsin Comments at 6; Alaska Reply Comments at 4-5; ALTS Reply Comments at 4-5; California Reply Comments at 2; Virginia Reply Comments at 1; WorldCom Reply Comments at 1-3; XO Communications Reply Comments at 9-14; North Carolina Sept. 4, 2001 *ex parte* at 1-2; New Mexico Aug. 30, 2001 *ex parte* at Appendix; Illinois Aug. 24, 2001 *ex parte* at 1-2; NARUC Sept. 6, 2001 *ex parte* at Appendix A; North Dakota Aug. 31, 2001 *ex parte* at 1; Utah Aug. 31, 2001 *ex parte* at Appendix, p.1; Indiana Sept. 21, 2001 *ex parte*; Michigan Sept. 14, 2001 *ex parte*; Maryland Sept. 7, 2001 *ex parte*; New Hampshire Sept. 7, 2001 *ex parte* at 1. Several states filed brief comments, concurring with the comments filed by NARUC. *See, e.g.*, Illinois Comments at 1-2; Montana Comments at 1; Nebraska Comments at 1; Washington Comments at 1-2.

[46] *See June 8 Public Notice.*

[47] *See, e.g.*, New York PN Comments at 2; Sprint PN Comments at 2-3; GSA PN Reply Comments at 7; Ohio CC PN Reply Comments at 4; AT&T Aug. 29, 2001 *ex parte* at 3; New Hampshire Sept. 7, 2001 *ex parte* at 2; CompTel Oct. 3, 2001 *ex parte;* NASUCA Oct. 4, 2001 *ex parte* at 4. Verizon, on the other

York contends that the elimination of the submarine cable account would jeopardize its ability to conduct depreciation studies and to evaluate depreciation reserves.[48] Sprint opposes incorporating the submarine and deep sea accounts into the underground or buried cable accounts, thereby "contaminating" the underground and buried cable accounts with these expenses, because the underground and buried cable accounts are important in determining loop costs.[49]

29. Based on these comments, we consolidate Account 2425, Deep sea cable into Account 2424, Submarine cable and consolidate Account 6425, Deep sea cable expense into Account 6424, Submarine cable expense. We note, however, that submarine and deep sea cables have plant characteristics dissimilar to buried cable. For example, the maintenance expenses can be much higher for deep sea cable than for buried cable.[50] Buried cable costs are used to develop inputs for the universal service high-cost model for non-rural carriers. The model does not include submarine or deep sea cable as an input value, so including buried cable in the same account would inflate maintenance expenses for buried cable. Accordingly, we have decided that the submarine and deep sea cable accounts should not be combined with buried cable because this could distort buried cable costs.

30. *Current liabilities.* In the *June 8 Public Notice*, we proposed consolidating Accounts 4010 and 4020 into one account -- Account 4000, Current accounts and notes payable. This proposal would eliminate Account 4040, Customers' deposits. Oregon and New Hampshire disagree with this proposal, contending that they require detailed information relating to the balance of customer deposits.[51] Illinois also opposes our proposal, arguing that Account 4030, Advance billing and payments, provides information that is useful in identifying and tracking unearned revenue.[52]

31. Based on our review of the record, we will consolidate Account 4010, Accounts payable and Account 4020, Notes payable into new Account 4000, Current accounts and notes payable. We also will consolidate Account 4030, Advance billing and payments; Account 4050, Current maturities-long-term debt; and Account 4060, Current maturities-capital leases; and Account 4120, Other accrued liabilities into Account 4130, Other current liabilities. We will retain Account 4040 as a separate account, as that account is a current Class B account. The net result of this action is that Class A carriers will record liabilities in an identical fashion to Class B carriers, which is the relief sought by USTA.

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hand, contends that there is no further need to break out these accounts because they share the same depreciation schedule as the other buried cable investment. Verizon PN Reply Comments at 4. Verizon also contends that eliminating this detail will have no practical impact, especially in light of the separations freeze under which the Class B accounts that combine all cable and wire will be assigned to categories based on frozen category relationships. *Id.* Notwithstanding depreciation or separations issues, we conclude that it is important to prevent including other expenses in the underground and buried cable accounts because such inclusion could distort loop costs of which underground and buried cable are important factors.

[48] New York PN Comments at 2.

[49] Sprint PN Comments at 2-3.

[50] When a maintenance problem develops in a deep-sea cable, the expense of locating and repairing the cable is much greater than for buried cable.

[51] Oregon PN Comments at 1; New Hampshire PN Reply Comments at 3; New Hampshire Sept. 7, 2001 *ex parte* at 2. *See also* AT&T Aug. 29, 2001 *ex parte* at 2.

[52] *See* Illinois Aug. 24, 2001 *ex parte* at 2.

32. *Local network services revenues.* In the *Notice*, the Commission proposed consolidating the Local network services revenue accounts (Accounts 5001 through 5069) into Account 5000, Basic local service revenue.[53] Several commenters disagree with our proposal to aggregate these revenue accounts.[54]

33. After consideration of these comments, we consolidate these accounts into three accounts as follows: Accounts 5001 through 5004 will be consolidated into Account 5001, Basic area revenue; Account 5040, Private line revenue will remain disaggregated; and Accounts 5050 through 5069 will be consolidated into Account 5060, Other basic area revenue.[55] We do not further consolidate these accounts at this time in deference to the states' concerns that a separate breakdown of basic revenue from private line revenue serves state regulatory needs.[56] We encourage states to consider, however, alternative means to gather such information.[57] Therefore, for the time being, we are retaining these accounts.

34. *Network access service revenues.* In the *June 8 Public Notice*, we proposed to eliminate Account 5084, State access revenue. Some commenters argue that if we eliminate Account 5084 (State access revenue) and require these revenues to be included in Accounts 5081-5083 (end user, switched, and special access revenues), we must modify the ARMIS 43-04 Report so that the state and interstate amounts are reported separately.[58] Otherwise, in the absence of alternative approaches, neither the federal nor state commissions will be able to track the respective jurisdictional revenues.

35. We agree that we can eliminate Account 5084 as long as we require the proper reporting of jurisdictional revenues in ARMIS. Therefore, we eliminate Account 5084,[59] and adopt conforming reporting changes in the ARMIS 43-04 report.[60]

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[53] These accounts are Account 5000, Basic local service revenue; Account 5001, Basic area revenue; Account 5002, Optional extended area revenue; Account 5003, Cellular mobile revenue; Account 5004, Other mobile services revenue; Account 5040, Local private line revenue; Account 5050, Customer premises revenue; Account 5060, Other local exchange revenue; Account 5069, Other local exchange revenue settlements.

[54] *See, e.g.*, AT&T Comments at 3 & Reply Comments at 9; New York Comments at 1 & PN Comments at 1; GSA Comments at 4; GSA PN Comments at 2-3 & PN Reply Comments at 6; WorldCom Comments at 2 & PN Comments at 3; Ohio CC PN Reply Comments at 4; New Hampshire Sept. 7, 2001 *ex parte* at 2-3.

[55] *See* WorldCom Comments at 2 & PN Comments at 3. *See also* Ohio CC PN Reply Comments at 4. The GSA also proposes that we consolidate these accounts: Account 5010, Area revenue; Account 5020, Mobile services revenue; Account 5040, Local private line revenue; and Account 5050, Other local services revenue. GSA Comments at 4 & PN Comments at 3.

[56] *See, e.g.*, AT&T Comments at 3 & Reply Comments at 9; New York Comments at 1 & PN Comments at 1; GSA Comments at 4; GSA PN Comments at 2-3 & PN Reply Comments at 6; WorldCom Comments at 2 & PN Comments at 3; Ohio CC PN Reply Comments at 4; New Hampshire Sept. 7, 2001 *ex parte* at 2-3.

[57] *See* Further Notice of Proposed Rulemaking at paragraph 207.

[58] GSA PN Comments at 3 & PN Reply Comments at 6; WorldCom PN Comments at 2; Sprint PN Reply Comments at 2. Illinois recommends retaining Account 5084, State access revenue, as the best method of tracking and reporting state revenues. Illinois Aug. 24, 2001 *ex parte* at 2.

[59] Because we are eliminating the state access revenue account, we decline to add subaccounts to the state access revenue account for switched access, special access, and subscriber line charge accounts, as

36. *Miscellaneous revenues.* In the *Notice*, the Commission proposed consolidating the miscellaneous revenue accounts (Accounts 5230 through 5270) into Account 5200, Miscellaneous revenue.[61] Commenters argue that Account 5230, Directory revenue should be retained because of outstanding proceedings at the state and federal levels.[62] We recognize that directory revenue is generally a separate line of business, not miscellaneous revenue. Nevertheless, we are not persuaded that there continues to be regulatory benefit from a federal perspective associated with maintaining directory revenue separately from miscellaneous revenue. State commenters have raised legitimate state concerns about retaining data on directory revenues separately. We note that nothing we decide today restricts state commissions from receiving these data from carriers when state-specific reasons require them to do so. Therefore, on balance, we are adopting the proposal in the *Notice* and consolidating Accounts 5230 through 5270 into Account 5200.

37. *Plant nonspecific operations expense.* In the *June 8 Public Notice*, we proposed consolidating the depreciation and amortization expense accounts (Accounts 6561 through 6565) into Account 6560, Depreciation and amortization expenses. Commenters oppose our proposal, contending that Account 6562, Depreciation expense-property held for future telecommunications use is important in state rate cases.[63]

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proposed by the states. Wisconsin proposes adding two subaccounts to Account 5081, End user revenue: Subscriber line charge (SLC) and Non-SLC. Wisconsin Comments at Attachment A, p. 9. Wisconsin also proposes adding two subaccounts to Account 5082, Switched access revenue: Flat-rate (PICC) and Usage-based. *Id.* In addition, Wisconsin proposes adding five subaccounts, to Account 5084, State access revenue: SLC (end user), Non-SLC, PICC, Usage-based switched access, and special access. *Id. See also* Wisconsin PN Comments at 3; New Hampshire PN Reply Comments at 4. Commenters argue that these new subaccounts would be useful in analytical studies, such as in determining whether there is movement toward recovering nontraffic-sensitive costs via fixed charges and traffic sensitive costs via usage-based charges. *See, e.g.,* GSA Comments at 5; Ohio CC and NASUCA Joint Comments at 6; Oregon Comments at 2; Wisconsin Comments at Attachment A, p.9; Ohio CC PN Comments at 5 & Reply Comments at 5. Verizon, however, argues that this would be difficult to administer due to the variety of rate structures in different states. Verizon Comments at 3. *See also* USTA Comments at 11.

[60] *See* Section III.D.5, *infra.*

[61] These accounts are Account 5230, Directory revenue; Account 5240, Rent revenue; Account 5250, Corporate operations revenue; Account 5260, Miscellaneous revenue; Account 5261, Special billing arrangements revenue; Account 5262, Customer operations revenue; Account 5263, Plant operations revenue; Account 5264, Other incidental regulated revenue; Account 5269, Carrier billing and collection revenue.

[62] *See* Ohio CC and NASUCA Joint Comments at 4 (*citing* Petition of US West Communications, Inc. for an Accounting Order, Washington Utilities and Transportation Commission Docket No. UT-980948, Fourteenth Supplemental Order and Order Denying Petition (2000) (holding that Yellow Pages publishing activity had not been transferred permanently to US West's affiliate for regulatory purposes and that the state commission could continue the practice of attributing – imputing – to US West a portion of the earnings of its affiliate from publishing the Yellow Pages); Ohio CC PN Comments at 4. *See also* Washington Aug. 16, 2001 *ex parte* at 1; New Hampshire Sept. 7, 2001 *ex parte* at 3. New York, Utah, and AT&T also argue that we should not consolidate these miscellaneous revenue accounts. New York PN Comments at 1-2; Utah Comments at 1; AT&T Aug. 29, 2001 *ex parte* at 2;

[63] New Hampshire PN Reply Comments at 3; Oregon PN Comments at 1. Illinois contends that we should retain Account 6562, Depreciation expense for property held for future use and Account 6563, Amortization expense-intangible. Illinois Aug. 24, 2001 *ex parte* at 2. Illinois explains that states, including Illinois, that use rate-of-return regulation would benefit from separate identification of amortization of intangible expense because these costs require special scrutiny. *Id.* Sprint also disagrees

38. We recognize that this account may be important to state regulators in cases where property held for future telecommunications use is excluded from the rate base. We note, however, that the amount in this account for year 2000, for all Bell Operating Companies (BOCs) combined, was $168,000, which is less than .001 percent of the depreciation expense.[64] Due to the *de minimis* nature of this account, we will adopt our proposal to consolidate these depreciation accounts. We expect, however, that companies will provide these records to the state commissions, if needed for state rate cases.

39. *Customer operations expense* and *corporate operations expense*. We proposed to consolidate the Class A level expense Accounts 6610 through 6790, into Accounts 6610, 6620, and 6720.[65] WorldCom objects to our proposal, contending that these accounts are used in the determination of wholesale and retail rates and are major components of the forward-looking cost model used in the Universal Service Program.[66] With two minor modifications, we adopt this proposal.

40. After reviewing the record, we conclude that Account 6790, Provision for uncollectible notes receivable is not properly included in general and administrative because it relates to bad debts, not general and administrative expenses. General and administrative expenses are used to develop inputs for the high cost model for universal service purposes and should not include any expenses related to bad debts. Therefore, we will retain Account 6790, Provision for uncollectible notes receivable. In addition, we agree with WorldCom that, for universal service modeling purposes, we should retain Account 6613, Product advertising. Section 214(e)(1)(B) requires that all eligible telecommunications carriers must "advertise the availability of [the universal-service supported] services and the charges therefor using media of general distribution."[67] Because these advertising costs are required costs to providing the

with our proposal, arguing that it is important to retain the detail accounts as potential tools for maintaining a check on the accuracy of RBOC cost studies. Sprint PN Comments at 3.

[64] *See* ARMIS 43-02 Report, Balance Sheet Tables.

[65] These accounts are Account 6611, Product management; Account 6612, Sales; Account 6613, Product advertising; Account 6620, Services; Account 6621, Call completion services; Account 6622, Number services; Account 6623, Customer services; Account 6710, Executive and planning; Account 6711, Executive; Account 6712, Planning; Account 6720, General and administrative; Account 6721, Accounting and finance; Account 6722, External relations; Account 6723, Human resources; Account 6724, Information management; Account 6725, Legal; Account 6726, Procurement; Account 6727, Research and development; Account 6728, Other general and administrative; and Account 6790, Provision for uncollectible notes receivable. In the *June 8 Public Notice*, we proposed to consolidate Account 6710, Executive and planning into Account 6620, Services.

[66] WorldCom Comments at 2 & PN Comments at 3-4. New York observes that consolidating the corporate operating expenses into one account would make regulatory audits more difficult and time consuming to conduct. New York PN Comments at 2. *See also* Utah Comments at 1; California Reply Comments at 2; Ohio CC PN Reply Comments at 4; New Hampshire Sept. 7, 2001 *ex parte* at 3. Illinois proposes retaining Account 6622, Number services, because a separate account would be useful in identifying directory related expenses. Illinois Aug. 24, 2001 *ex parte* at 2. Oregon suggests combining Accounts 6711 and 6710 and Accounts 6721 through 6728 into two accounts. Oregon PN Comments at 1. Illinois also opposed consolidating the 6700 accounts into one account because such a consolidation would make it difficult for state regulators to identify expenses that should not be borne by competitive carriers. Illinois Aug. 24, 2001 *ex parte* at 3. For example, Account 6722, External relations contains costs for non-product related corporate image advertising that Illinois does not allow to be recovered from ratepayers or carriers. *Id.*

[67] 47 U.S.C. § 214(e)(1)(B).

universal-service supported services, the expenses recorded in Account 6613 are required to develop inputs for the universal service model. If we eliminated this account as proposed in the *Notice,* all costs associated with marketing, product management, and sales would be recorded in the same account as product advertising expenses. This could inflate the forward-looking costs of the supported services. Maintaining product advertisement expenses separately will eliminate this problem and, thus, we do not eliminate Account 6613 as we proposed.

41. Other than Accounts 6790 and 6613, we adopt our proposals to consolidate the customer operations expense and corporate operations expense accounts, as set forth in the *June 8 Public Notice*. As a result, Accounts 6611 and 6612 will be consolidated into Account 6611, Product management and sales; Accounts 6621 through 6623 will be consolidated into Account 6620, Services, with subaccounts for wholesale and retail; Accounts 6710 through 6728 will be consolidated into Account 6720, General and administrative. Accounts 6613, Product advertising and Account 6790, Provision for uncollectible notes receivable will remain disaggregated.

42. Based on our review of the record, particularly the comments filed by state commissions, we conclude that the other Class A accounts that we proposed for elimination in the *Notice* and the *June 8 Public Notice* are not vital to our regulatory mission. We are therefore consolidating 296 Class A accounts into 164 Class A accounts because we no longer need the level of detail provided in those accounts. As technology and the regulatory environment changes, the need for accounting detail changes as well. Appendix B contains a list of the eliminated Class A accounts. Appendix C is the revised list of Class A accounts.

43. In the *Notice*, we also sought comment on USTA's proposal to eliminate the subaccounts in Account 2123, Office equipment. Based on our review, we conclude that the subaccounts can be eliminated. One of the subaccounts, Account 2123.2, is used to identify the investment in the telephone company's internal telecommunications system. The other subaccount, Account 2123.1, contains the other office support equipment. We agree with USTA that these subaccounts are no longer necessary. There are two subaccounts in Account 2231, Radio systems that identify distinct technologies: one includes the carrier's ownership interest in satellites and its investment in earth stations, the other records investment in other radio facilities. We conclude that these subaccounts are no longer needed in order to differentiate between these investments. In addition, we agree with USTA that the subaccounts in Account 2215, Electro-mechanical switching can be eliminated. These subaccounts distinguish between three types of electro-mechanical switches: step-by-step switching, crossbar switching, and other electro-mechanical switching. The investment in Account 2215 is minimal. We are combining this account with Account 2211, Analog switching and eliminating the subaccounts.

2. Class A Accounts Maintained

44. As noted above, the USOA has served various regulatory purposes over the years. We acknowledge that both our regulatory framework and the marketplace have changed significantly since the USOA was originally adopted.[68] Nonetheless, state and federal policymakers have an ongoing need for carriers to continue maintaining certain of the Class A accounts so that we may carry out our regulatory mission, as described below. We therefore reject USTA's proposal to adopt Class B accounting for all carriers.

45. First, we conclude that it is necessary to retain the Class A accounts relating to network plant and related asset and expense accounts to continue the Commission's

[68] The Part 32 USOA replaced the former Part 31 USOA on January 1, 1988.

administration of the universal service high-cost support mechanism. Currently, data collected in the Class A accounts and reported through ARMIS are critical to the calculation of high-cost support for non-rural carriers. In 1999, the Commission adopted a cost model to estimate non-rural carriers' forward-looking cost of providing the supported services, and concluded that support should be based on those cost estimates. At that time, the Commission used the USOA Class A accounting information to develop certain inputs used in the model. Aggregation of the Class A accounting information into consolidated Class B accounts would result in distortions in the cost estimates and could prevent the Commission from developing accurate inputs. For example, the high-cost model for non-rural carriers requires the development of expense factors for outside plant. Class A accounting requires that outside plant be accounted for by type of plant (*i.e.*, poles, aerial cable, underground cable, buried cable, etc.), whereas Class B consolidates all outside plant into a single account, cable and wire facilities. Because different outside plant types typically have different operating expense factors, aggregating outside plant into one Class B account would cause distortions in the outside plant cost estimates generated by the high-cost model.[69]

46. Second, we currently use certain of the Class A accounts in administering our price cap regulation regime. Access charges of price cap LECs were originally based on levels existing at the time they entered price caps; the prices, however, have been adjusted annually pursuant to formulae set forth in Part 61 of the Commission's rules. Price cap indices are adjusted upward if a price cap carrier earns returns below a specified level in a given year.[70] We recognize, however, that several incumbent LECs have obtained pricing flexibility and thus have waived low-end formula adjustments.[71] Price cap carriers may also seek exogenous adjustments

[69] We note, however, that the need for such Class A accounting information to develop inputs for the high-cost model may change as the model evolves. In the *10th Report & Order*, the Commission recognized that the model must evolve as technology and other conditions change. *See* Federal-State Joint Board on Universal Service, Forward-Looking Mechanism of High-Cost Support for Non-Rural LECs, CC Docket No. 97-160, *Tenth Report and Order*, 14 FCC Rcd 20156, 20170, ¶ 28 (1999) (*10th Report and Order*), *aff'd sub nom.* Qwest v. FCC (10th Cir.), file nos. 99-9546, 99-9547, 00-9505 (July 31, 2001). The Commission committed to initiating a proceeding to study, among other things, how often the inputs data should be updated and how the model itself should change to reflect changing circumstances. In addition, the Commission stated its intent to initiate a review, with the Federal-State Joint Board on Universal Service, of the operation of the high-cost support mechanism for non-rural carriers on or before January 1, 2003. We intend in the near future to initiate a proceeding to examine how often and to what extent the high-cost model inputs should be revised and updated. To the extent that we, in our review of the model and its cost inputs, conclude that certain inputs should be eliminated or modified, we intend to make corresponding modifications to the accounting requirements to continue our efforts to streamline the accounting and reporting requirements.

[70] *See, e.g.,* Southwestern Bell 1999 Annual Access Charge Tariff Filing, Transmittal No. 2763, Citizens Telephone Company, 1998 Annual Access Charge Tariff Filing, Transmittal No. 49; GTE-Kentucky Telephone Company, 1998 Annual Access Charge Tariff Filing, Transmittal No. 248.

[71] *See, e.g.*, Sprint Petition for Pricing Flexibility for Special Access and Dedicated Transport Services, CCB/CPD No. 01-04, *Memorandum Opinion and Order*, DA 01-1279 (rel. May 25, 2001); BellSouth Petition for Pricing Flexibility for Special Access and Dedicated Transport Services, CCB/CPD No. 00-20, *Memorandum Opinion and Order*, DA 00-2793 (rel. Dec. 15, 2000); Petition of Ameritech Illinois, *et al.* for Pricing Flexibility, CCB/CPD No. 00-26, Petition of Pacific Bell Telephone Company for Pricing Flexibility, CCB/CPD No. 00-23, Petition of Southwestern Bell Telephone Company for Pricing Flexibility, CCB/CPD No. 00-25, *Memorandum Opinion and Order*, DA 01-670, (rel. Mar. 14, 2001); Verizon Petitions for Pricing Flexibility for Special Access and Dedicated Transport Services, CCB/CPD No. 00-24, 00-28, *Memorandum Opinion and Order*, DA 01-663, (rel. Mar. 14, 2001).

based on actual cost changes.[72] The Commission typically uses Class A cost information from ARMIS in evaluating submissions from carriers seeking exogenous adjustments. Obtaining such information through ad hoc data requests would be very difficult in the compressed 15-day tariff review process. In addition, the Commission utilizes Class A cost information to evaluate proposed tariff revisions. For instance, the Commission utilized such information to evaluate a carrier's cost justification filed in support of a proposed increase in collocation rates after suspending that tariff.[73] Finally, the Commission has commenced a cost study to assess the need for increases in the subscriber line charge (SLC) above the five-dollar threshold that went into effect on July 1, 2001.[74] While we could use ad hoc data requests to obtain information to evaluate the submissions we receive from the incumbent LECs, this could impair our ability to perform meaningful trend analysis. As a result, even after the adoption of price cap regulation, Class A accounting data is utilized by the Commission in setting access rates, although we recognize that we could adopt alternative approaches in the future. For these reasons, we find that maintaining the disaggregated Class A level of detail for network plant and related asset and expense accounts in the Uniform System of Accounts is a useful tool, at least for the time being, to provide the cost data needed for analysis of these issues.[75]

47. Third, this Commission and the states currently use certain Class A information to update depreciation ranges. Price cap carriers may use the Commission's life and salvage factor ranges to compute their depreciation rates rather than file detailed depreciation studies. Ranges are updated periodically to keep them in line with technological, demand, and competitive changes.[76] Commenters observe that the lack of Class A plant account information would inhibit the Commission's ability to update depreciation ranges and the states' ability to assess the depreciation ranges because there would be no plant account information on which to base the update.[77] In addition, this lack of specific data for plant accounts could jeopardize the states' ability to conduct depreciation studies and evaluate depreciation reserves, unless

[72] An exogenous adjustment allows a carrier to increase its prices to recover costs imposed on it by governmental or administrative action beyond its control. It is typical for incumbent LEC annual access tariffs to include exogenous adjustments. *See, e.g.*, Ameritech Operating Companies 2001 Annual Filing, Transmittal No. 1270, Description and Justification, section 2; BellSouth 2001 Annual Access Charge Tariff Filing, Transmittal No. 592, Description and Justification, section 6; Pacific Bell Telephone Company 2001 Annual Filing, Transmittal No. 37, Description and Justification, section 2; Qwest Corporation 2001 Price Cap Revisions Tariff Filing, Transmittal No. 76, Description and Justification, section 2.2.

[73] *See* Bell Atlantic Telephone Companies Revisions in Tariff FCC Nos. 1 and 11, CC Docket No. 01-140, *Order Terminating Tariff Investigation*, FCC 01-278 (rel. Sept. 26, 2001).

[74] *See CALLS Report and Order*, 15 FCC Rcd at 12994, ¶ 83; "Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps," CC Docket Nos. 96-262, 94-1, *Public Notice*, DA 01-2163 (rel. Sept. 17, 2001).

[75] All of these cost recovery mechanisms remain in place even under recent access charge reform measures. *See CALLS Report and Order.*

[76] Price cap carriers may seek waivers from the Commission's depreciation requirements if they meet certain conditions. *See* 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket No. 98-137, *Report and Order and Memorandum Opinion and Order*, 15 FCC Rcd 242 (1999).

[77] *See, e.g.*, Florida Comments at 5; Idaho Comments at 4; Maryland Comments at 3-4; NARUC Comments at 5; Utah Comments at 2; XO Communications Reply Comments at 11-12; North Carolina Sept. 4, 2001 *ex parte* at 2; Maryland Sept. 7, 2001 *ex parte* at Appendix.

alternative approaches were developed.[78] New York, for example, uses our Class A plant accounts to set the intrastate depreciation rates for all carriers.[79]

48. Fourth, federal and state regulators currently use the information maintained in Class A Account 2411, Poles, to resolve disputes over maximum permitted rates for access to poles, ducts, conduits, and rights-of-way.[80] As the National Cable Television Association (NCTA) observes,[81] the current pole attachment formulae rely on Class A accounting data.[82] Pole rents are determined by the Class A Account 2411; under USTA's proposal to eliminate all Class A accounts, a discrete account for pole investment would no longer be publicly available.[83] Reliance on publicly available information has allowed pole owners and attaching parties to resolve rate issues without Commission involvement, which is a cost-savings benefit to utilities, cable operators, other attaching parties, and the Commission.[84]

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[78] *See, e.g.*, Idaho Comments at 4; Florida Comments at 5; Maryland Comments at 3; NARUC Comments at 5; New York Comments at 2; ALTS Reply Comments at 9; AT&T Reply Comments at 8; XO Communications Reply Comments at 11-12.

[79] New York Comments at 2.

[80] *See* 47 U.S.C. § 224; 47 C.F.R. § 1.1401-1.1418; Amendment of Rules and Policies Governing Pole Attachments, CS Docket No. 97-98, *Report and Order*, 15 FCC Rcd 6453 (2000), *aff'd in pertinent part* Consolidated Partial Order on Reconsideration, FCC 01-170, 16 FCC Rcd 12103 (2001). *See also* Florida Comments at note 2; Idaho Comments at 4; Maryland Comments at 3; NARUC Comments at 5 & Reply Comments at 3-4; ALTS Reply Comments at 8-9; AT&T Reply Comments at 7; North Carolina Sept. 4, 2001 *ex parte* at 2.

[81] *See* NCTA Reply Comments at 3-5.

[82] *See* Amendment of Rules and Policies Governing Pole Attachments, CS Docket No. 97-98, *Report and Order*, 15 FCC Rcd 6453 (2000).

[83] *See* NCTA Reply Comments at 4; XO Communications Reply Comments at 12. NCTA states that the following accounts are necessary for calculation of pole and conduit rental: Account 2001, Telecommunications plant in service; Account 2411, Poles; Account 2441, Conduit systems; Account 4100, Net current deferred operating income taxes; Account 4340, Net noncurrent deferred operating income taxes; Account 6411, Poles expense; Account 6441, Conduit systems expense; Account 6710, Executive and planning; Account 6720, General and administrative; Account 7200, Operating taxes. NCTA Aug. 31, 2001 *ex parte*.

[84] *See* NCTA Reply Comments at 5; XO Communications Reply Comments at 12. NCTA states that the following accounts are necessary for calculation of pole and conduit rental: Account 2001, Telecommunications plant in service; Account 2411, Poles; Account 2441, Conduit systems; Account 4100, Net current deferred operating income taxes; Account 4340, Net noncurrent deferred operating income taxes; Account 6411, Poles expense; Account 6441, Conduit systems expense; Account 6710, Executive and planning; Account 6720, General and administrative; Account 7200, Operating taxes. NCTA Aug. 31, 2001 *ex parte*. We agree that these accounts are necessary and must be maintained and reported in ARMIS. However, for purposes of the pole attachment formulas, because Account 6720 (General & Administrative) has been amended to include Account 6710, once this order is implemented, parties to pole attachment disputes may substitute Account 6720 for the sum of previous Accounts 6710 and 6720. Also, Account 7200, which has been eliminated may be substituted by using the individual Accounts 7210 to 7250 inclusive. Also, Class A carriers must report their pole rental expense, which reduces the pole owner's maintenance expense (Account 6411) in the pole attachment formula. (This would also apply to conduit if any conduit rental expense was included in Account 6441). Class A carriers must also continue to file the pole and conduit-specific information in current ARMIS Report 43-02, Tables B-5, for Account 3100, Lines 0490 (depreciation reserve for total plant in service), 0390 (depreciation reserve for pole plant, Account 2411), and 0470 (depreciation reserve for conduit, Account 2441) and

49. Fifth, state regulators use Class A account information relating to network plant to determine appropriate pricing for UNEs pursuant to section 251. Commenters argue that it is critical to have the account detail at the Class A level to establish proper rates for UNEs.[85] State commenters and other parties in this proceeding argue that without detailed cost data, regulators and other parties cannot develop cost models or evaluate cost studies provided by the carriers.[86]

50. Two of the essential market-opening provisions of the 1996 Act are sections 251(c)(3) and 251(c)(6) of the Communications Act, relating, respectively, to the provision of UNEs and physical collocation.[87] The Commission regards the appropriate pricing of UNEs to be particularly important in promoting efficient competition. The ability of a competing carrier to use UNEs, and combinations of UNEs, is essential to promote efficient competition in the local exchange market.[88] The states assert an ongoing regulatory need for more disaggregated cost information, at the Class A level, to assist their evaluation of incumbent LEC cost submissions when developing rates for UNEs and collocation. Moreover, Class A information from the USOA, will be used by the Commission itself in cases where the Commission preempts the state commission under section 252(e)(5) of the Communications Act.[89] In particular, state regulators,

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Table B-7 - depreciation rate for poles, Account 2411 and depreciation rate for Conduit, Account 2441 as well as the information contained in current ARMIS Report 43-08 Table 1.A, Equivalent Number of Poles; Conduit System Trench Km and Conduit System Duct Km. In addition, Class A carriers must maintain and report pole and conduit-specific information related to Accounts 4100 (net current deferred operating income taxes) and Account 4340 (net noncurrent deferred operating income taxes). Finally, we note that in certain cases, where a complaint is filed against a utility concerning the charges for non-traditional attachments, additional information may be required to calculate a maximum rate.

[85] *See, e.g.,* Florida Comments at 4; Idaho Comments at 4; Maryland Comments at 3; NARUC Comments at 4-5; Ohio CC and NASUCA Joint Comments at 5 & Reply Comments at 4; Utah Comments at 2; AT&T Comments at 4 & Reply Comments at 7; Alaska Reply Comments at 3; ALTS Reply Comments at 8; California Reply Comments at 2; GSA Reply Comments at 7; Virginia Reply Comments at 1; WorldCom Reply Comments at 3; XO Communications Reply Comments at 6, 10; Maryland Sept. 7, 2001 *ex parte* at Appendix.

[86] *See, e.g.,* Idaho Comments at 4; NARUC Comments at 5; North Carolina Public Staff Comments at 3; Utah Comments at 2; Sprint Comments at 2; ALTS Reply Comments at 9; XO Communications Reply Comments at 10.

[87] Section 251(c)(3) requires incumbent LECs to "provide nondiscriminatory access to network elements on an unbundled basis at any technically feasible point, on rates, terms, and conditions that are just, reasonable, and nondiscriminatory." 47 U.S.C. § 251(c)(3). Section 251(c)(6) requires incumbent LECs to "provide, on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, for physical collocation of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier." 47 U.S.C. § 251(c)(6). Section 252 of the Communications Act, 47 U.S.C. § 252, sets forth the procedures by which telecommunications carriers may request and obtain interconnection and unbundled network elements from an incumbent LEC.

[88] We note that pursuant to the section 251(c)(3) requirements, incumbent LECs are providing increasing numbers of unbundled network elements to competitive LECs (CLECs). They provided over 5.2 million UNE loops in the last six months of 2000, compared to over 3.2 million six months earlier. *See* Industry Analysis Division, *Local Telephone Competition: Status as of December 31, 2000,* (rel. May 2001).

[89] *See, e.g.,* Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Telecommunications Act of 1996 for Expedited Preemption of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon and Expedited Arbitration, CC Docket No. 00-218, filed Oct. 26, 2000; "Pleading Cycle Established for Comments on Section 252(e) Petition filed by WorldCom, Inc.," CC Docket No. 00-218, *Public Notice*, 15 FCC 20456 (2000).

or the Commission, may compare incumbent LEC cost submissions with USOA cost information obtained from other incumbent LECs or they may compare current cost information with recent ARMIS filings to determine whether there are any unusual increases or decreases in certain accounts.[90] Without such ready access to Class A accounting or some similar level of accounting detail, for plant-specific, customer, and corporate expense disaggregated accounts, regulators would be at a disadvantage in evaluating cost studies prepared by the incumbent LECs because the incumbent LECs would be the only parties with access to disaggregated cost data.[91] This could significantly compromise regulators' ability to implement the local competition mandates of the 1996 Act.[92]

51. Plant accounts are an important indicator of a company's investments.[93] As illustrated below, disaggregation of these accounts at the Class A level, or some similar level of accounting detail, enables regulators to determine a carrier's costs in different contexts. For example, without this level of detail, regulators would not have data readily available regarding construction of the various types of outside plant because all outside cable and wire investments for both fiber and copper cable located aerial, underground, or buried are aggregated into one account under Class B.[94] This distinction is important due to different costs associated with installation and maintenance of the three different types of outside cable.[95] If the three types of outside cable were aggregated into one Class B account, it would be difficult to analyze a company's outside plant costs. Outside plant costs are important for several reasons. For example, we have used outside plant costs in the development of inputs to the universal service high-cost model for non-rural carriers. Because of cost differences, we use six different sets of input values in the model for cable costs depending on whether the cable is aerial, underground, or buried and copper or fiber for each of the three types of plant. Moreover, certain outside plant costs, not presently available in Class B accounts, are required to compute just and reasonable pole attachment rates, a responsibility shared between the states and the Commission. We intend to develop a further record on whether alternative means of obtaining such information would be adequate to meet our ongoing federal regulatory needs. Based on that record and the

[90] *See, e.g.,* AT&T Comments at 3-4 & Reply Comments at 6-7; Florida Comments at 4; Idaho Comments at 4; Maryland Comments at 3; NARUC Comments at 4-5; North Carolina Public Staff Comments at 3; Ohio CC and NASUCA Joint Comments at 5; Sprint Comments at 8; Utah Comments at 1-2; California Reply Comments at 2; XO Communications Reply Comments at 10.

[91] *See, e.g.,* AT&T Comments at 3-4; Florida Comments at 5-6; Idaho Comments at 4; Maryland Comments at 4; NARUC Comments at 5; Sprint Comments at 8; Utah Comments at 1-2; ALTS Reply Comments at 9; XO Communications Reply Comments at 10; Illinois Aug. 24, 2001 *ex parte* at 1-2; North Carolina Sept. 4, 2001 *ex parte* at 1-2.

[92] In the accompanying Further Notice of Proposed Rulemaking, we seek comment on whether state commissions can develop alternative sources of such information in the future.

[93] *See* California Reply Comments at 2.

[94] *See, e.g.,* Florida Comments at 4-5; Idaho Comments at 4; Maryland Comments at 3; NARUC Comments at 5; RUS Comments at 2; Sprint Comments at 8, Utah Comments at 2; AT&T Reply Comments at 7; California Reply Comments at 2; Maryland Sept. 7, 2001 *ex parte* at Appendix.

[95] Aerial cable (Account 2421) is strung between poles above ground and has lower installation costs but higher maintenance costs. Underground cable (Account 2422) is placed underground within conduits, and buried cable (Account 2423) is placed underground without conduit. Underground and buried cable have higher installation costs than aerial cable, but may have lower maintenance costs. A carrier will determine whether to use aerial, underground, or buried cable based on factors such as the geographic distribution of the population and the terrain.

development of alternative mechanisms, the Commission could later determine that such aggregation is acceptable in the Uniform System of Accounts.[96]

52. The Class A or some similar level of detail is also needed to distinguish costs associated with metallic cable from fiber (nonmetallic cable). Otherwise, lower maintenance costs for fiber would be mixed in with higher maintenance costs for metallic cable, creating artificially high maintenance costs.[97] The universal service high-cost model for non-rural carriers uses expense factors for copper cables that are developed separately from those for fiber cables. These outside plant costs should therefore remain disaggregated at the Class A level, absent a determination that countervailing or other factors not addressed sufficiently here make such aggregation acceptable.

53. In addition, estimates of operating costs for digital switches can be derived from Class A accounts in Part 32, enabling the states or other parties to evaluate forward-looking switching costs when developing UNE rates without the distortion that would result if all types and vintages of switches were combined into one account.[98] We use digital switching costs in various contexts, including the development of inputs to the universal service high-cost model for non-rural carriers. Because the model estimates forward-looking costs, it includes only digital switches. We use investment and expense data for digital switches to develop input values. Use of aggregated Class B accounts would aggregate analog electronic switching (Account 2211), digital electronic switching (Account 2212), and electro-mechanical switching (Account 2215), thereby distorting input values in the high-cost model. Again, we may conclude in the future that this level of disaggregation in the USOA is no longer necessary, if we or the states develop alternative sources of such information to meet federal or state regulatory needs.

54. Thus, at least at present, the Commission and the states have an ongoing regulatory need to maintain the Class A accounts for network plant and related asset and expense accounts. We conclude that these regulatory needs outweigh the potential costs of maintaining the accounts at this level of detail. We are not convinced that maintaining Class A accounting for the network plant and related asset and expense accounts is unduly burdensome, particularly in light of the streamlining reforms adopted in this Order.[99] Incumbent LECs maintain many more than the Class A accounts in their own accounting systems and even the smallest incumbent

[96] *See* Further Notice of Proposed Rulemaking.

[97] *See* Sprint Comments at 8.

[98] *See* XO Communications Reply Comments at 11.

[99] *See, e.g.*, Florida Comments at 6; Idaho Comments at 4-5; Maryland Comments at 4; NARUC Comments at 5 & Reply Comments at 7; New York Comments at 2; North Carolina Public Staff Comments at 3 ("most of the small ILECs regulated by the NCUC use the Class A accounting system"); Utah Comments at 2; ALTS Reply Comments at 11; Ohio CC and NASUCA Reply Comments at 2; XO Communications Reply Comments at 8-9; New Hampshire PN Reply Comments at 2; Nebraska Aug. 27, 2001 *ex parte* at 1; North Carolina Sept. 4, 2001 *ex parte* at 2; Maryland Sept. 7, 2001 *ex parte* at Appendix. The State of Oregon observes that most of the complaints it receives about accounting burdens are related to confidentiality or nonregulated activities, and audits have shown that companies keep more details than they usually offer to regulators. Oregon Comments at 3. Even BellSouth admits that if it were "allowed to set up its own set of accounts it would still capture and record the information that it needs to effectively operate a business. This information would in all likelihood very much resemble the information that BellSouth currently captures today." BellSouth Reply Comments at 4.

LECs use Class A accounting which is required for Rural Utility Service (RUS) loans.[100] For the reasons discussed above, we therefore decline at this time to adopt USTA's proposal to eliminate Class A accounting in its entirety.

55. We also decline to adopt USTA's proposal to eliminate subaccounts 1220.1 and 1220.2.[101] USTA, Sprint, and Verizon contend that carriers should not be required to maintain subaccounts or subsidiary records that are not necessary to meet business requirements.[102] We find that these subaccounts continue to serve federal regulatory needs. The information recorded in subaccount 1220.1, Materials and supplies, is used by the Commission in almost all tariff proceedings and in investigations to calculate materials and supplies overhead factors.[103] If these subaccounts were eliminated, the Commission would lack the information to calculate such overheads, and would therefore be hampered in its ability to critically evaluate the submissions of the carrier. This information is also used in state UNE ratemaking proceedings.

56. We do, however, adopt USTA's proposal to eliminate the subaccounts under Account 1406, Nonregulated investments. At present, large incumbent LECs record very few transactions in Account 1406. Thus, we believe that requiring subaccounts for permanent investment, receivable/payable, and current net income or loss is unnecessary.

3. The States' Proposals for New Class A Accounts

57. Many commenters, particularly the state commissions, argue generally that the new accounts listed in the *Notice* and the *June 8 Public Notice* would be appropriate and necessary to maintain an up-to-date accounting system.[104] Commenters observe that changes in the industry and the ongoing implementation of local competition should be reflected in the chart of accounts through both additions and deletions.[105] Commenters propose adding new accounts to

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[100] The RUS provides financing and technical advice to about 825 rural local exchange carriers. *See* RUS PN Comments at 1.

[101] *See* USTA Letter at Attachment A.

[102] *See* Sprint Comments at 7; Verizon Comments at 6; USTA Comments at 8-9.

[103] Subaccount 1220.2, Property held for sale or lease, is not included in such calculations and therefore must be accounted for separately.

[104] *See, e.g.,* Florida Comments at 6; Oregon Comments at 2; Utah Comments at 4; Maryland Comments at 6-7; North Carolina Public Staff Comments at 3; NARUC Comments at 6 & Reply Comments at 4; Ohio CC and NASUCA Joint Comments at 5-6; Wisconsin Comments at 6; WorldCom Comments at 3-4; Idaho Comments at 5; California Reply Comments at 2; ALTS Reply Comments at 11-12; GSA Reply Comments at 9; Nebraska Aug. 27, 2001 *ex parte* at 1; Illinois Aug. 24, 2001 *ex parte* at 2; AT&T Aug. 29, 2001 *ex parte* at 1-2; NARUC Sept. 6, 2001 *ex parte* at Appendix A, pp.3-5; Washington Aug. 16, 2001 *ex parte* at 1; North Carolina Sept. 4, 2001 *ex parte* at 3-4; New Mexico Aug. 30, 2001 *ex parte* at Appendix, p.2; North Dakota Aug. 31, 2001 *ex parte* at 1; Indiana Sept. 21, 2001 *ex parte* at 1-3; Maryland Sept. 7, 2001 *ex parte* at Appendix; New Hampshire Sept. 7, 2001 *ex parte* at 1-2; Kansas Oct. 2, 2001 *ex parte*; South Dakota Aug. 27, 2001 *ex parte* (explaining that the accounts listed in the *June 8th Public Notice* reflected a compromise between accounting streamlining and the strong needs of state regulators for modest updating of new technologies and nascent competition-related accounts.)

[105] *See, e.g.,* Oregon Comments at 1; North Carolina Public Staff Comments at 3; Wisconsin Comments at 6; Indiana Sept. 21, 2001 *ex parte* at 1-3. Oregon explains that detariffing, deregulation, and new technologies have increased the need for some reporting requirements and account details and reduced the need for other information Oregon Comments at 1. Idaho also notes that rapid growth in Internet traffic, packet switching, digital subscriber line services, and UNEs has forced the industry to increasingly

recognize revenues and costs for items such as UNEs, collocated facilities, interconnection agreements, reciprocal compensation, universal service fund transactions, and to recognize meaningful subcategories of digital electronic switches and cable and wire facilities.[106] Ohio CC and NASUCA observe that the information in the proposed new accounts would be used by state commissions, state consumer advocates, and other stakeholders.[107] Incumbent LECs oppose adding these new accounts.[108] BellSouth, for example, contends that, despite the net reduction in accounts, the added burden created by the additional accounts and subaccounts will far outweigh any positive effects of the elimination of other accounts.[109] Verizon observes that state commissions should require carriers to report the data required to meet the state's regulatory needs, regardless of whether the Commission streamlines the Part 32 accounts.[110] After consideration of the record, we conclude that at this time we will only adopt new Class A subaccounts for circuit and packet digital electronic switching, electronic and optical circuit equipment, and wholesale and retail services.[111]

58. *Circuit and packet switching subaccounts*. In the *June 8 Public Notice*, we proposed to add two subaccounts, for circuit and packet switching, to the digital switching accounts.[112] We note that circuit and packet switching equipment has substantially different functions, designs, and cost structures. The addition of these subaccounts would assist federal and state regulators, as these subaccounts will be used to develop and assess forward-looking cost studies for UNE pricing as well as for developing inputs to the high-cost model for universal service support. Under our current rules, packet switches need not be unbundled except under

rely on the incumbent LEC's network; monitoring of the incumbent LECs' costs, investments, and cost allocation practices is important. Idaho Comments at 3.

[106] *See, e.g.,* Florida Comments at 6; GSA Comments at 5; MD Comments at 6-7; NC Public Staff Comments at 3; NARUC Comments at 6 & Reply Comments at 5; Ohio CC and NASUCA Joint Comments at 6; Utah Comments at 4-5; Wisconsin Comments at 6-7; ALTS Reply Comments at 11; WorldCom Reply Comments at 4-5; GSA PN Comments at 4-5; Ohio CC PN Comments at 5-6; WorldCom PN Comments at 2; New Hampshire PN Reply Comments at 3-4; Illinois Aug. 24, 2001 *ex parte* at 2; AT&T Aug. 29, 2001 *ex parte* at 1-2; NARUC Sept. 6, 2001 *ex parte* at Appendix A, pp. 3-5; Washington Aug. 16, 2001 *ex parte* at 1; North Carolina Sept. 4, 2001 *ex parte* at 3-4; New Mexico Aug. 30, 2001 *ex parte* at Appendix, p.2; North Dakota Aug. 31, 2001 *ex parte* at 1; Indiana Sept. 21, 2001 *ex parte* at 1-3; Maryland Sept. 7, 2001 *ex parte* at Appendix; New Hampshire Sept. 7, 2001 *ex parte* at 1-2.

[107] Ohio CC and NASUCA Joint Comments at 6; Ohio CC PN Comments at 7.

[108] *See, e.g.*, Verizon Comments at 3-4 & Reply Comments at 5-6; USTA Comments at 9-12 & Reply Comments at 10-11; BellSouth Comments at 5; Qwest Comments at 2-4.

[109] BellSouth PN Comments at 2.

[110] Verizon PN Reply Comments at 2.

[111] We note that we continue to look at all of these issues in Phase 3. States, of course, are free to revisit these issues in the course of that proceeding. Commenters urge us to create new accounts, or subaccounts, to better track costs associated with specific UNEs, such as loops and switching. *See, e.g.*, North Carolina Public Staff Comments at 3; OCC and NASUCA Joint Comments at 6; Wisconsin Comments at Attachment A, pp. 3, 11; GSA PN Comments at 4-5; & PN Reply Comments at 4-5; AT&T Aug. 29, 2001 *ex parte* at 1; NARUC Sept. 6, 2001 *ex parte* at Appendix A, p. 5; North Carolina Sept. 4, 2001 *ex parte* at 3; New Mexico Aug. 30, 2001 *ex parte* at Appendix, p.2.

[112] The digital switching accounts are: Account 2212, Digital electronic switching and Account 6212, Digital electronic expense. Several commenters supported this proposal. *See, e.g.*, GSA PN Comments at 5 & PN Reply Comments at 5; Utah Aug. 31, 2001 *ex parte* at Appendix, p.3; Maryland Sept. 7, 2001 *ex parte* at Appendix; New Hampshire Sept. 7, 2001 *ex parte* at 2; NASUCA Oct. 4, 2001 *ex parte* at 2-3.

limited circumstances. We are sensitive to the concerns of states that the accounts for digital electronic switching and digital electronic expense not be distorted by the inclusion of costs incurred to deploy packet-based switches. For example, new packet switching equipment may have substantially different maintenance expenses than the older circuit switches. If we do not disaggregate the plant and maintenance expenses in the digital switching accounts, the forward-looking cost factors will be based on combined data from circuit and packet technologies. This could lead to an overstatement of the forward-looking costs, and UNE rates for switching that are too high. As a result, we adopt our proposal to add two subaccounts for circuit and packet switching under Account 2212, Digital electronic switching and Account 6212, Digital electronic switching expense.

59. We are not persuaded that because a switch could have both packet and circuit elements, it would be difficult or costly to implement the new subaccounts.[113] As with the introduction of any new technology, there is a period of time in which the old technology coexists with the new. We are not requiring carriers to allocate the cost of a multi-functional switch between the two subaccounts. Rather, consistent with existing Commission precedent in other contexts, a switch that has both packet and circuit switching capabilities should be accounted for in the subaccount that reflects its predominant use.

60. *Optical switching,* In the *June 8 Public Notice*, we proposed to add Account 2213, Optical switching and Account 6213, Optical expense.[114] After reviewing the record, we agree with the incumbent LEC commenters that adding the optical switching account is premature because the technology has not yet developed to the point where widespread deployment is imminent.[115]

61. *Electronic and optical circuit equipment subaccounts*. In the *June 8 Public Notice*, we proposed adding subaccounts to segregate electronic and optical in the circuit equipment accounts.[116] As we discussed above, as new technologies are deployed, it is critical that cost models be updated to properly calculate the forward looking cost of the relevant facility. We understand that carriers are increasingly deploying fiber in their networks and deploying electronic circuitry that provides a conversion between electronic and optical transmission. For the same reasons we adopt circuit and packet switching subaccounts, we adopt subaccounts for electronic and optical circuit equipment under Account 2232, Circuit equipment and Account 6232, Circuit equipment expense. These new subaccounts will help prevent the distortion of operating expense factors. Optical technology equipment may have substantially lower maintenance expense than the electronic equipment. The addition of subaccounts to disaggregate optical from electronic circuit equipment would provide federal and state regulators more refined

[113] Verizon PN Comments at 7; USTA PN Comments at 4; USTA Sept. 28, 2001 *ex parte*. Carriers currently maintain accounts for packet and circuit switches, for their own purposes.

[114] Several commenters supported this proposal. *See, e.g.*, GSA PN Comments at 4-5; Utah Aug. 31, 2001 *ex parte* at Appendix, p.3; Maryland Sept. 7, 2001 *ex parte* at Appendix; New Hampshire Sept. 7, 2001 *ex parte* at 2; NASUCA Oct. 4, 2001 *ex parte* at 2-3.

[115] USTA PN Comments at 4; Verizon PN Comments at 7. BellSouth contends that it will cost between $1.0 and $1.2 million to implement this change. BellSouth PN Comments at 2. SBC also argues that this change would require additional costs. SBC PN Comments at 4.

[116] The Circuit equipment accounts are Account 2232, Circuit equipment and Account 6232, Circuit equipment expense. *See* New Hampshire Sept. 6, 2001 *ex parte* at 2-3 (stating that the addition of these subaccounts would recognize the evolution that is occurring in telecommunications today and will provide regulators with necessary information). *See also* NASUCA Oct. 4, 2001 *ex parte* at 2-3.

data to develop and assess forward-looking cost studies for UNE pricing as well as for developing inputs to the high-cost model for universal service support. This new optical account would be used, for instance, to record investments and expenses relating to optical splitters. Circuit equipment that converts electronic signals to optical signals or optical signals to electronic signals shall be categorized as electronic.

62. *Switching Software.* We decline to add a subaccount to the intangible asset account for switching software.[117] The intangible asset account currently has subsidiary record categories for general purpose computer software and network software.[118] We see no regulatory need at this time to separately track investment in switching software in a new subaccount.

63. *Loop and Interoffice Transport.* We decline to add subaccounts to central office transmission, cable and wire facilities, and information origination/termination accounts for loop and interoffice transport. We recognize that some commenters argue that these subaccounts would allow the refinement of cost models that estimate forward-looking costs of unbundled transport and loops.[119] While it may be useful to have this disaggregated information, we find that allocating these costs to separate subaccounts would be overly burdensome because, in some cases, both loop and interoffice transport would be carried on the same cable facility.[120]

64. *Wholesale and retail subaccounts.* In the *Notice*, the Commission sought comment on adding subaccounts for wholesale and retail.[121] We conclude that we should create new subaccounts to existing Account 6620, Services, to separately record expenses associated with retail and wholesale services. The wholesale versus retail distinction is important for customer service because the per-line expenditure for customer service is higher at the retail level.[122] Moreover, we anticipate that the wholesale/retail distinction will increase in importance as competition develops in the local exchange market. Adding these new subaccounts will assist

[117] Several commenters supported this proposal. *See, e.g.*, GSA PN Comments at 5. Incumbent LEC commenters opposed this. *See, e.g.*, Sprint Comments at 9.

[118] In the *Accounting Reductions Report and Order*, 14 FCC Rcd at 11419, ¶ 49, the Commission required carriers to establish and maintain subsidiary record categories for general purpose computer software and network software within the intangible asset account. The Commission noted that the cost of software upgrades and enhancements would continue to be expensed or capitalized in accordance with GAAP. *Id.* We will amend section 32.2690 to clarify this requirement.

[119] *See, e.g.*, WorldCom Comments at 3-4; GSA Comments at 4-5; North Carolina Public Staff Comments at 3; Wisconsin Comments at Attachment A, p.4 & PN Comments at 4; New Hampshire PN Reply Comments at 4.

[120] *See, e.g.*, CBT Comments at 5; Sprint Comments at 9-10; Verizon Comments at 3 & Reply Comments at 5; USTA Comments at 10-11 & Reply Comments at 10; USTA PN Reply Comments at 5. Verizon observes that cost studies are more than adequate to develop loop and interoffice transport costs. Verizon Comments at 3. Sprint observes that the recent freeze of Part 36 category relationships for price cap carriers stabilizes these investments and reduces the significance of analyzing loop and transport allocations. Sprint PN Reply Comments at 2.

[121] *See Notice* at Appendix 5. Several commenters supported this proposal. *See, e.g.*, GSA Comments at 5; Oregon Comments at 2; New York Comments at 1; Wisconsin Comments at Attachment A, pp. 14-15 & PN Comments at 4; GSA PN Comments at 5 & PN Reply Comments at 6; New Hampshire PN Reply Comments at 4; Washington Aug. 16, 2001 *ex parte* at 1; NARUC Sept. 6, 2001 *ex parte* at App. A, pp.5-6; AT&T Aug. 29, 2001 *ex parte* at 2.

[122] This is because CLECs (wholesale customers) do most of the customer service functions themselves.

the states in developing UNE rates that properly reflect the costs of providing a wholesale service. Therefore, we adopt the proposal in the *Notice* to add retail and wholesale subaccounts to Account 6620, Services. We are not persuaded by those commenters that argue that the burden of adding the subaccounts outweighs any potential benefits.[123] These commenters have not quantified this burden. Moreover, we anticipate that the wholesale/retail distinction will increase in importance as competition develops in the local exchange market.

65. *Interconnection-related Revenues and Expenses*. We decline to adopt new Class A accounts for UNEs, resale, reciprocal compensation, and other interconnection arrangements.[124] Commenters argue that these new accounts would allow policymakers to monitor technology deployment, collocation, interconnection, and resold services.[125]

66. The Form 477 already provides information on the extent of local competition.[126] In the *Local Competition and Broadband Data Gathering Program*, service providers file data on a Form 477, giving the Commission information on the status of local competition and the deployment and availability of broadband services to discrete geographic areas.[127] Service providers that meet the relevant reporting threshold file data on a state-by-state basis and also report a list of zip codes in which they have at least one customer for local exchange telephone

[123] *See, e.g.*, Sprint Comments at 9-10; USTA Comments at 11 & Reply Comments at 11; Verizon PN Reply Comments at 4; USTA PN Reply Comments at 5.

[124] On October 7, 1997, we released a Notice of Proposed Rulemaking in CC Docket No. 97-212, proposing, *inter alia*, new Part 32 accounts and subsidiary recordkeeping requirements to record the revenues and expenses related to providing and obtaining interconnection arrangements and access to unbundled network elements. *See* Amendments to Uniform System of Accounts for Interconnection, CC Docket No. 97-212, *Notice of Proposed Rulemaking*, 12 FCC Rcd 16577 (1997). GTE Service Corporation, MCI Telecommunications, Corp., Ameritech, Public Utilities Commission of Ohio, Cox Communications, Inc., BellSouth, and United States Telephone Association filed comments in that docket. Ameritech filed reply comments. The issues raised in that proceeding are resolved here; therefore, we are terminating CC Docket No. 97-212.

[125] *See, e.g.*, Florida Comments at 6; Maryland Comments at 6-7; New York Comments at 1; North Carolina Public Staff Comments at 3; NARUC Comments at 6 & Reply Comments at 5; Idaho Comments at 5; Wisconsin Comments at 6; Wisconsin PN Comments at 3; GSA Comments at 5; GSA PN Comments at 4; ALTS Reply Comments at 11; WorldCom Comments at 3 & Reply Comments at 4-5; WorldCom PN Comments at 2-3; Ohio CC and NASUCA Joint Comments at 6; Ohio CC PN Comments at 5 & Reply Comments at 5; New Hampshire PN Reply Comments at 3; North Dakota Aug. 31, 2001 *ex parte* at 1; Utah Aug. 31, 2001 *ex parte* at Appendix, p.2; Maryland Sept. 7, 2001 *ex parte* at Appendix; New Hampshire Sept. 7, 2001 *ex parte* at 2; Kansas Oct. 2, 2001 *ex parte*; CompTel Oct. 3, 2001 *ex parte*; NASUCA Oct. 4, 2001 *ex parte* at 4; California Oct. 2, 2001 *ex parte* at 1-2; Indiana Sept. 21, 2001 *ex parte* at 1-3. Indiana explains that currently resale revenues are classified by the incumbent LECs as "rent," which does nothing to assist the states and the Commission in monitoring the extent of local competition (in this case, through resale of bundled services). Indiana Sept. 21, 2001 *ex parte* at 1-2. NARUC explains that revenues the incumbent LEC receives from UNEs or resale would show trends in competition. NARUC Sept. 6, 2001 *ex parte* at Appendix A, pp. 3-4.

[126] Verizon PN Reply Comments at 3-4.

[127] *See* Local Competition and Broadband Reporting, CC Docket No. 99-301, *Report and Order*, 15 FCC Rcd 7717 (2000) (*Local Competition and Broadband Data Gathering Program*). This program seeks to develop the Commission's understanding of the deployment and availability of broadband services and the development of local telephone service competition in order to comply with section 706 of the 1996 Act. The *Local Competition and Broadband Data Gathering Program* was established for a five-year period, unless the Commission acts to extend it.

service. Although this program collects a more limited amount of information than the proposed Part 32 interconnection accounts, it covers a broader range of providers than the incumbent LECs. Based on the current record, we conclude that the information collected through the *Local Competition and Broadband Data Gathering Program* provides a way to monitor the extent of local competition, and we do not need at this time to add new USOA revenue accounts for UNE revenue, resale revenue, and reciprocal compensation in order to assess the status of local competition.

67. We note that incumbent LECs currently record UNE revenues in Account 5240, Rent revenue, which we now consolidate into Account 5200, Miscellaneous revenue.[128] Moreover, we understand that incumbent carriers currently record reciprocal compensation receipts in Account 5084, State access revenues, an account we eliminate today. Henceforth, revenues derived from both UNEs and reciprocal compensation should be recorded as part of Account 5200. Nothing in this order is intended to preclude states from requiring carriers to maintain subsidiary records or subaccounts for UNE revenues or reciprocal compensation revenues. We expect that carriers will provide disaggregated information regarding such revenues if states request such information.

68. We also decline to establish a new account to record resale revenues. Incumbent LECs currently record resale revenues in the various accounts where they record the revenues derived from various retail services.[129] We conclude, based on the record before us, that it could be unduly burdensome for incumbent LECs to segregate all of their resale revenues into a separate account. Moreover, we conclude that no compelling case has been made that the regulatory need for this new revenue account outweighs the burdens associated with its creation.

69. With respect to proposed new expense accounts, we note at the outset that our rules and the statute itself otherwise require that incumbent carriers document these costs pursuant to the mandates of sections 251 and 252 of the Communications Act. For example, the Communications Act clearly requires that incumbent LECs offer services for resale and access to unbundled network elements at cost-based rates. This "bottom-up" approach involves, in many cases, cost studies or other detailed examinations that use current cost information as the starting point for determining forward-looking costs. Thus, based on the record before us here, we find there is insufficient support to justify imposing new Class A accounts to record the expenses associated with UNEs, resale, reciprocal compensation, and other interconnection arrangements. Nevertheless, we expect to continue monitoring this issue closely.

70. We see no need to create a new account for UNE expenses. Commenters suggest that this account would record amounts incurred when an incumbent LEC purchases a UNE from another carrier, such as when the incumbent purchases UNEs from an adjacent LEC to expand into neighboring territories, or when an incumbent purchases UNEs to provide service out-of-region. This account also could record expenses incurred by an incumbent LEC in leasing facilities from a CLEC within the incumbent LEC's service area. The concern expressed by the states is that these expenses not be recorded in the incumbent LEC's current expense accounts, because that would distort forward-looking cost studies for UNE pricing by overstating the relationship of operating expenses to plant.[130]

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[128] USTA Sept. 6, 2001 *ex parte*

[129] *Id.*

[130] *See, e.g.*, NARUC Sept. 6, 2001 *ex parte* at Appendix A, p. 4.

71. Our sense is that, at present, incumbent LECs are not incurring a significant amount of these expenses. Moreover, incumbent LECs have asserted that they do not include these costs in their regulated costs at all,[131] which would appear to address the states' primary concern that these costs not distort the accounts used for regulated costs. Therefore, we see no need to establish these new accounts, and direct incumbent LECs not to record these costs in their regulated accounts.

72. Similar considerations pertain to expenses associated with an incumbent LEC's purchase of resold services from another incumbent LEC. Assuming that the incumbent LECs are not presently recording such expenses as regulated expenses, there is no danger that expense accounts used to develop UNE prices are being distorted. We direct carriers not to include these costs, if any, in their regulated expense accounts.

73. In addition to the above proposals listed in the *Notice*, two commenters suggest adding subaccounts to identify affiliated and nonaffiliated amounts in several accounts. Specifically, Wisconsin proposes to add subaccounts for affiliated and nonaffiliated amounts to the following accounts: Account 1120, Cash and equivalents; Account 1215, Other receivables – net (a proposed new account); Account 1408, Sinking funds; and Account 4025, Accounts and notes payable (a proposed new account).[132] Wisconsin contends that these subaccounts should be identified due to the section 272(b)(5) requirement for arm's length transactions with affiliates.[133] We note that several of the accounts being consolidated into these accounts currently require subsidiary record categories to be maintained so that carriers may separately report the amounts contained therein that relate to affiliates and nonaffiliates. We will continue to require subsidiary record categories for the consolidated accounts to the extent required in the past. We note that there has been no requirement for such subsidiary record categories for Account 1408, and none will be added.

74. *Universal service support*. We decline to amend Part 32 by adding new universal service expense and revenue accounts.[134] At the outset, we note that we already collect from all

[131] USTA Sept. 6, 2001 *ex parte*.

[132] Wisconsin Comments at Attachment A, pp. 1, 2, 5; Wisconsin PN Comments at 3 & Attachment A, pp. 1, 2, 5. *See also* New Hampshire PN Reply Comments at 3. USTA disagrees with this proposal. *See* USTA PN Reply Comments at 6.

[133] Wisconsin Comments at Attachment A, p. 1.

[134] We note that several commenters, primarily state commissions, contend that we should adopt a new account for universal service support revenues. *See, e.g.*, North Carolina Public Staff Comments at 3; Ohio CC and NASUCA Joint Comments at 6; Ohio CC PN Comments at 5 & Reply Comments at 5; Wisconsin Comments at 7 & PN Comments at 3; GSA Comments at 5; WorldCom Comments at 3; NARUC Reply Comments at 5; New Hampshire PN Reply Comments at 4; North Dakota Aug. 31, 2001 *ex parte* at 1; Utah Aug. 31, 2001 *ex parte* at Appendix, p.2; Indiana Sept. 21, 2001 *ex parte* at 1-3; Maryland Sept. 7, 2001 *ex parte* at Appendix; New Hampshire Sept. 7, 2001 *ex parte* at 2; Kansas Oct. 2, 2001 *ex parte*; California Oct. 2, 2001 *ex parte* at 2; NARUC Sept. 6, 2001 *ex parte* at Appendix A, pp. 4-5. NARUC states that expense and revenue accounts must be created for universal service programs to ensure that carriers' universal service billing rates reflect the needs of the programs. *Id.* NASUCA argues that this is the proceeding where the Commission should create a new revenue account for universal service, which would be preliminary to any final determinations in a separate universal service proceeding. *See* NASUCA Oct. 4, 2001 *ex parte* at 3. Based on a review of the record, it appears that some commenters had a different view of what information these accounts would capture than what we intended. Ohio CC and NASUCA observe that in Ohio, the recipient of the largest amount of federal high cost universal service support includes that amount in Account 5082, Switched access revenue, and this account is

carriers information on amounts recovered from end users for state or federal universal service contributions in FCC Form 499-A Telecommunications Reporting Worksheet.[135] We therefore see no need to separately track this information from a smaller universe of carriers through the USOA.

75. Moreover, we currently have a proceeding to reform how universal service contributions are assessed and how these costs are recovered from consumers.[136] One of the options that the Commission could adopt in that proceeding would be to limit the amount that carriers could recover from each end user to the amount they contribute to universal service. Although we decline to prejudge that option here, we note that a separate revenue account for universal service might not be necessary if that option were, after considering other options, adopted. In the meantime, we believe it makes little sense, and that it would be unduly burdensome, to add a new universal service revenue account that we might eliminate soon thereafter. Thus, we decline to amend Part 32 by adding such an account. We also note that there is no need to adopt a universal service expense account, as the amounts that carriers contribute to support universal service are readily available from the Universal Service Administrative Company (USAC).

B. Streamlining the Class B Accounts

76. When the Commission adopted Part 32, a two-tiered system was retained so that smaller carriers would have a less burdensome accounting system than the carriers with annual revenues in excess of the revenue threshold. Currently, we have 113 Class B accounts. In our *June 8 Public Notice*, we sought comment on reducing the number of Class B accounts to 89.[137] The proposed consolidation of Class B accounts corresponded to our proposal to consolidate

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allocated entirely to the interstate jurisdiction, despite the fact that the purpose of the support is to keep local rates low. *See* Ohio CC and NASUCA Joint Comments at 6 & note 9. This argument presumes that a USF revenue account would track revenue (support) received from USAC, rather than revenue received from end-users.

[135] NARUC observes that the FCC Form 499-A Telecommunications Reporting Worksheet is not audited. NARUC Sept. 6, 2001 *ex parte* at Appendix A, p. 4.

[136] *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Notice of Proposed Rulemaking*, FCC 01-145 (rel. May 8, 2001).

[137] Specifically, we proposed to eliminate the following Class B accounts: Account 1180, Telecommunications accounts receivable; Account 1181, Accounts receivable allowance – telecommunications; Account 1190, Other accounts receivable; Account 1191, Accounts receivable allowance – other; Account 1200, Notes receivable; Account 1201, Accounts receivable allowance; Account 1210, Interest and dividends receivable; Account 1401, Investment in affiliated companies; Account 1402, Investments in nonaffiliated companies; Account 1407, Unamortized debt issuance expense; Account 1408, Sinking funds; Account 1439, Deferred charges; Account 3400, Accumulated amortization – tangible; Account 3500, Accumulated amortization – intangible; Account 3600, Accumulated amortization – other; Account 4010, Accounts payable; Account 4020, Notes payable; Account 4030, Advance billing and payments; Account 4040, Customers deposits; Account 4050, Current maturities – long-term debt; Account 4060, Current maturities – capital leases; Account 4120, Other accrued liabilities; Account 4130, Other current liabilities; Account 4210, Funded debt; Account 4220, Premium on long-term debt; Account 4230, Discount on long-term debt; Account 4240, Reacquired debt; Account 4250, Obligations under capital leases; Account 4260, Advances from affiliated companies; Account 4270, Other long-term debt; Account 4310, Other long-term liabilities; Account 4360, Other deferred credits; Account 5084, State access revenue; Account 6710, Executive and planning; and Account 6790, Provision for uncollectible notes receivable.

Class A accounts. For example, we proposed to consolidate Accounts 1180 through 1210, which are both A and B accounts. The RUS urges us not to eliminate any of the Part 32 accounts below the existing Class B level of detail.[138] RUS argues that further streamlining at this time could result in insufficient information for the Commission, state regulators, and the RUS to make informed decisions that impact the telecommunications industry.[139] For example, the RUS loans funds to carriers and requires more disaggregated liability information to assess its risk exposure. In addition, some of the collapsed information could be relevant in state rate-of-return proceedings. Oregon also disagrees with our proposal in several respects, and notes that if we eliminate certain Class B accounts, it will require Class B carriers in Oregon to continue to report this information.[140]

77. After reviewing the record, we conclude that our Class B account consolidation should correspond with our Class A account consolidation. Permitting aggregation of our Class A accounts without similarly aggregating the corresponding Class B accounts would be contrary to our intent to adopt a less burdensome accounting system for the Class B carriers.[141] We remain open to further streamlining Class B accounts in the event future proponents can demonstrate that such streamlining is acceptable or appropriate more persuasively than we find on the record before us here.

78. In the *Notice*, the Commission sought comment on USTA's proposal to eliminate the Jurisdictional Difference Accounts (accounts 1500, 4370, and 7910) that Class B carriers currently must report.[142] After careful review, we agree with the states of Oregon and Wisconsin that the jurisdictional difference accounts should not be eliminated.[143] A number of states are required by state law to use the federal USOA.[144] If we were to eliminate these accounts at the federal level, those states would have no means to track any variances in ratemaking practices between the federal and state jurisdictions. For example, states use these accounts to record differences related to state-mandated depreciation rates and special state accounting requirements. These differences cannot be recorded to the plant accounts, because this would distort future state depreciation determinations. To the extent state practices vary, carriers must comply with those state rules, so there should be little incremental burden in determining the net difference in state and federal accounts. Accordingly, we will retain the jurisdictional difference accounts.

[138] RUS PN Comments at 1.

[139] *Id.* The RUS states that aggregation below the Class B level of detail will provide insufficient information to enable it to carry out its mission required by the Rural Electrification Act in an efficient and effective manner while maintaining its fiduciary duty to the taxpayer. *Id.*

[140] Oregon PN Comments at 2-3.

[141] Consistent with our actions with respect to Class A accounts, we are not consolidating some of the accounts we proposed to consolidate in the *Notice* or *June 8 Public Notice*; *e.g.*, Account 4040, Customers deposits. Such accounts, which are both Class A and Class B accounts, will not be consolidated for either class.

[142] *See* June 9, 2000 letter from Linda Kent, USTA to JoAnn Lucanik and Tim Peterson, Accounting Safeguards Division, Common Carrier Bureau, FCC ("USTA Letter") at Attachment A. *See also* USTA PN Comments at 3.

[143] *See, e.g.*, Oregon Comments at 4; Oregon PN Comments at 1; Wisconsin Comments at Attachment A, pp. 2, 7, 17. *See also* Ohio CC PN Reply Comments at 4.

[144] *See* Further Notice of Proposed Rulemaking at paragraph 207.

C. Other Regulatory Relief Applicable to All Carriers

79. In the *Notice*, we sought comment on a variety of additional, proposed measures to provide carriers, both Class A and Class B, with meaningful relief from many other accounting requirements. As set out in this section, we have adopted, in full or in large part, the great majority of these proposed changes to our rules.

1. Regulatory Relief Provided in Full

a. Inventories

80. Commission rule 32.1220(h), requires that inventories of material and supplies be taken during each calendar year and that adjustments to this account be charged or credited to Account 6512, Provisioning expense.[145] Section 32.2311(f) of the Commission's rules requires an annual inventory of all station apparatus in stock included in this account.[146] We sought comment on USTA's proposal to eliminate the detailed inventory requirements in the rules and instead permit companies to perform inventories based on risk assessment and on existing controls.[147] In the *Notice*, the Commission sought comment on whether to adopt USTA's proposal to eliminate these inventory requirements. Only one commenter disagreed with this proposal, observing that inventory records are often of low priority and may be significantly out-of-date.[148] Other commenters addressing this issue support eliminating these inventory requirements.[149]

81. We conclude that companies should have the latitude to determine the appropriate inventory validation methodology based on risk assessment.[150] In this case, considering the small percentage of the total physical assets involved, the level of effort and cost incurred to ensure the integrity of asset values should be commensurate with the level of financial risk involved.[151] Surrogate measures such as inventory cycle counts and statistical sampling measures may be more cost effective for a carrier than a complete physical inventory.[152] We therefore adopt USTA's proposal and revise sections 32.1220(h) and 32.2311(f) to eliminate the annual inventory requirement.

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[145] 47 C.F.R. § 32.1220(h).

[146] Section 32.2311(f), 47 C.F.R. § 32.2311(f), provides: An annual inventory shall be taken of all station apparatus in stock that are included in this account. The number of such station apparatus item as determined by this inventory, together with the number of all other station apparatus items included in this account, shall be compared with the corresponding number of station apparatus items as shown by the respective control records. The original cost of any unreconciled differences thereby disclosed shall be adjusted through Account 3100, Accumulated Depreciation. Appropriate verifications shall be made at suitable intervals and necessary adjustment between this account and Account 3100 shall be made for all station apparatus included in this account.

[147] *See Notice* at ¶ 37; USTA Petition for Rulemaking – 2000 Biennial Regulatory Review (filed August 11, 1999) ("USTA Petition") at 24 & Attachment at 2.

[148] Wyoming Comments at 2.

[149] Sprint Comments at 11; Verizon Comments at 6; USTA Comments at 12.

[150] Sprint Comments at 11.

[151] *Id.* Sprint notes that its material and supplies and station apparatus inventory balances stated as a percent of total physical assets are less than one quarter of one percent and one half of one percent, respectively. *Id.*

[152] *Id.*

b. Contributions

82. We adopt, for federal accounting purposes, Statement of Financial Accounting Standards No. 116 (SFAS-116), "Accounting for Contributions Received and Contributions Made." SFAS-116 requires companies to record in the current period a liability and related expense for unconditional pledges to make contributions in future years. Prior to adoption of SFAS-116, companies would record such pledges annually when the contributions were made. In 1994, shortly after FASB adopted SFAS-116, the Common Carrier Bureau (Bureau) informed carriers not to adopt SFAS-116 for federal accounting purposes.[153] In the *Notice*, the Commission sought comment on adopting SFAS-116 for federal accounting purposes.[154]

83. Our primary concern is the effect such a rule could have on the carriers' rates. As commenters note, our adoption of SFAS-116 would allow carriers to record increased expenses in a given year to reflect contributions pledged for future years. In turn, the Commission's exogenous cost rules, which allow carriers under price caps to increase their interstate rates to reflect cost increases caused by accounting changes, would allow carriers to recover the entire amount of the pledged contributions as an exogenous cost in the year the accounting change is adopted.[155] Adopting SFAS-116, however, would establish an accounting rule that would be consistent with GAAP. The Commission's rules require financial records to be kept in accordance with GAAP, to the extent permitted by our system of accounts.[156] Our goal is to bring our accounting rules into conformity with GAAP, to the extent consistent with our regulatory needs. Accordingly, we adopt SFAS-116 for federal accounting purposes and direct the Bureau to monitor the carriers' accounting treatment of contributions to determine whether implementation of SFAS-116 has a significant impact on rates.

c. Section 252(e) agreements

84. In the *Notice*, the Commission sought comment on USTA's proposal that the Commission clarify that section 252(e) agreements are treated the same as tariffed services in Part 64 cost allocation rules.[157] USTA's proposal was supported by incumbent LEC and state commenters.[158] Based on the record before us, we adopt USTA's proposal. Accordingly, to the extent a carrier provides a non-tariffed service to its nonregulated operations pursuant to a section 252(e) agreement, that service will be recorded to nonregulated operations at the amount of that

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[153] Notification of Intent to Adopt Statement of Financial Accounting Standards No. 116 (SFAS-116), "Accounting for Contributions Received and Contributions Made," AAD 94-156, *Order*, 10 FCC Rcd 1567 (Com.Car.Bur. 1994). Under our rules, carriers may implement changes in accounting standards after 90 days, unless directed otherwise by the Commission.

[154] *Notice* at ¶ 26.

[155] Utah Comments at 3; AT&T Comments at 5-6; WorldCom Reply Comments at 5-6. Sprint also observes that a carrier under price cap regulation could "bunch up" future years' contributions in one year and that allowing a "lumpy" expense would violate good regulatory policy by causing a price increase solely due to the timing of pledges. Sprint Comments at 12. Sprint suggests that we not allow a carrier to adopt SFAS-116 until that carrier elects pricing flexibility. *Id.* at 13.

[156] 47 C.F.R. § 32.12.

[157] *See Notice* at ¶ 27.

[158] *See, e.g.,* Oregon Comments at 5; Wisconsin Comments at 10; Sprint Comments at 14; Verizon Comments at 9.

service as set forth in an interconnection agreement approved by a state commission pursuant to section 252(e).

2. Regulatory Relief Provided in Part

a. Affiliate transactions rules

85. In 1987, the Commission adopted affiliate transactions rules to protect ratepayers of regulated telecommunications services from bearing the costs and risks associated with a carrier's nonregulated activities.[159] The affiliate transactions rules set forth the procedures that all incumbent LECs, other than average schedule companies, must use in recording transactions between regulated entities and nonregulated affiliates.[160] The underlying policy concern is that the risk of cost misallocation is increased when carriers engage in transactions with nonregulated affiliates. The affiliate transactions rules discourage such misallocation of costs by requiring carriers to follow appropriate valuation techniques in recording the transfer of assets and the provision of services between regulated entities and their nonregulated affiliates.

86. After Congress adopted the 1996 Act, the Commission revised its long-standing affiliate transactions rules in order to implement the statutory provisions prohibiting cross-subsidization. In the *Accounting Safeguards Order*, the Commission modified the affiliate transactions rules to provide greater protection against subsidization of competitive activities by subscribers to regulated telecommunication activities.[161] The Commission concluded that its revised affiliate transactions rules would promote competition by preventing LECs from using their market power in local exchange services to obtain an anti-competitive advantage in other markets, such as the market for in-region interLATA service.[162] The Commission amended the affiliate transactions rules for assets and services provided by a carrier to its affiliate and services received by a carrier from its affiliate. Under these rules, such transactions are to be valued at publicly available rates, if possible.[163] The publicly available rates, in order of precedence, are (1) an existing tariff rate, (2) (for services only) a publicly filed agreement or statements of generally available agreements, or (3) a qualified prevailing price valuation.[164] If there is no tariff price for the asset, and the transfer does not qualify for prevailing price treatment, the carrier must compare the asset's net book cost to its fair market value and value it at the higher of the two if the transfer is from the (regulated) carrier, and at the lower of the two if the transfer is to the (regulated) carrier.[165] Carriers must make a good faith determination of the asset's fair market

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[159] *See Joint Cost Order.*

[160] *See* 47 C.F.R. § 32.27.

[161] Accounting Safeguards under the Telecommunications Act of 1996, CC Docket No. 96-150, *Report and Order*, 11 FCC Rcd 17539 (1996) (*Accounting Safeguards Order*), *recon.*, *Order on Reconsideration in CC Docket No. 96-150*, 14 FCC Rcd 11396 (1999), *Second Order on Reconsideration*, 15 FCC Rcd 1161 (2000). A subsidy occurs when the reasonable costs associated with a service are not covered by the revenues generated by that service, but are instead covered by revenues generated by one or more other services. *See Accounting Safeguards Order*, 11 FCC Rcd at 17541-42 & n.4, ¶ 1.

[162] *See id.* at 17638-39, ¶ 218.

[163] An exception to this rule is that services received by a carrier from its affiliate that exists solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost. *See* 47 C.F.R. § 32.27(c).

[164] 47 C.F.R. § 32.27(c).

[165] 47 C.F.R. § 32.27(b).

value.[166] As discussed below, we take a number of steps to simplify our affiliate transactions rules so that carriers have greater flexibility in how they price transactions with affiliates.

(i) **Eliminate requirement for FMV comparison for asset transfers under $500,000**

87. We revise our affiliate transactions rules to eliminate the requirement that carriers make a fair market value comparison for assets when the total annual value of that asset is less than $500,000. As discussed above, our current affiliate transactions rules require all carriers to record the value of an asset according to a hierarchy. In the *Phase 1 Report and Order*, the Commission eliminated the requirement that carriers make a good faith determination of fair market value for services when the total annual value of that service is less than $500,000.[167] The Commission noted that below that threshold, the administrative cost and effort of making such a determination would outweigh the regulatory benefits of a good faith determination of fair market value. In such cases, the service should be recorded at fully distributed cost.

88. In the *Notice*, the Commission proposed a conforming exemption for assets.[168] Under the proposal, carriers would not be required to perform the net book cost/fair market value comparison for asset transfers totaling less than $500,000 per year. For assets within this exception, carriers would use net book cost instead of fair market value. This exception would be on a product-by-product basis similar to the services-by-services basis on which we base the services threshold. The exception would apply "going forward," so that the net book cost/fair market value comparison would be required once the total amount of transfers (*i.e.*, total net book cost) for a given product line in a given year exceeds $500,000.

89. Contrary to the assertions of some commenters,[169] we are not persuaded that we should adopt a $1 million threshold for making the net book cost/fair market value determinations. The purpose of this threshold is to avoid the situation where the cost of determining fair market value would outweigh the regulatory benefits of such a determination. Commenters advancing the $1 million threshold have not presented any persuasive arguments justifying that $1 million is the appropriate threshold. Furthermore, these commenters have not provided any evidence of the costs involved in conducting the net book cost/fair market value comparison.

90. We conclude that the threshold should be the same for both assets and services. In the *Phase 1 Report and Order*, the Commission adopted a $500,000 threshold for services, balancing the desire to provide accounting relief while not creating an exception so large that it would swallow the rule. We now adopt a similar rule for assets, which eliminates an incentive for companies to turn "assets" into "services." In both cases, the threshold should be applied to the aggregate transactions, for a given affiliate. Carriers, therefore, will not be required to perform the net book cost/fair market value comparison for the first $500,000 of asset transfers, on a product-by-product basis, per year, per affiliate. In such cases, the asset should be recorded at net book cost. The net book cost/fair market value comparison would be required on a

[166] *Id.*

[167] *Phase 1 Report and Order*, 15 FCC Rcd at 8701, ¶ 20.

[168] *See Notice* at ¶ 34.

[169] *See, e.g.*, Sprint Comments at 14-15; Verizon Comments at 9; USTA Comments at 17-18.

prospective basis once the total amount of asset transfers for a given product line in a given year exceeds $500,000.[170] Carriers (except average schedule companies) will reflect these transactions in their CAMs as well as ARMIS reports, if ARMIS filing is required. Adopting this $500,000 threshold exception for each affiliate will reduce the burden of performing the net book cost/fair market value comparison.

(ii) Establish floor and ceiling for recording transactions

91. In the *Notice*, the Commission sought comment on whether ratepayers would be harmed if carriers had flexibility to use the higher or lower of cost or market valuation as either a floor or ceiling. As discussed above, for certain transactions carriers must compare the cost of the service or asset to market value.[171] If the carrier is the recipient of the asset or service, it must be recorded on the carrier's books at the lower of cost or market. If the carrier is the provider, it must be recorded at the higher of cost or market. The Commission proposed giving carriers flexibility in valuing these transactions by allowing the higher or lower of cost or market valuation to operate as either a floor or ceiling, depending on the direction of the transaction.[172]

92. We agree with those commenters that argue that this proposal would not harm ratepayers because it would permit the regulated carrier to either pay less or charge more to the nonregulated affiliate for the service or asset.[173] We recognize that adopting a ceiling and floor for recording affiliate transactions could potentially have an anti-competitive effect.[174] It seems unlikely, however, that a transaction would have such an effect, particularly if the transaction is *de minimis* and is not priced below incremental cost.[175] We therefore adopt the proposal in the

[170] This is similar to how the threshold applies to services. If carriers were not allowed to look at asset or service transactions prospectively, all transactions would have to be analyzed for fully distributed cost and fair market value. The exception that we adopt here would then be illusory.

[171] 47 C.F.R. § 32.27(b) – (c).

[172] For example, if the transaction were from the carrier to the nonregulated affiliate, the higher of cost or market valuation would function as the floor amount, *i.e.*, the carrier could value the asset or service at that amount or higher. If the transaction were from the nonregulated affiliate to the carrier, the lower of cost or market valuation would function as the ceiling, *i.e.*, the incumbent carrier could value the asset or service at that amount or lower. Therefore, if a carrier purchased an asset from one of its nonregulated affiliates with a net book cost of $750,000 and a fair market value of $1,000,000 (and no tariff rate or prevailing price), our current rules would require the carrier to book the asset at $750,000, which is the lower of cost or market. The proposal in the *Notice*, on the other hand, would allow the carrier to record the asset at any price up to $750,000.

[173] *See, e.g.*, Sprint Comments at 15; GSA Comments at 6; USTA Comments at 18-19.

[174] *See* Wyoming Comments at 2-3; Wisconsin Comments at 13.

[175] For dominant carriers, Commission rules prohibit pricing below incremental cost to prevent predatory pricing. *See* Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, *Second Report and* Order, 5 FCC Rcd 6786, 6824, ¶ 310 (1990) (requiring price to exceed average variable cost, used as a surrogate for incremental cost). *Also see* Amendments to Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket No. 89-79, *Memorandum Opinion and Order on Second Further Reconsideration*, 7 FCC Rcd 5235, 5237, ¶ 12 (1992) (requiring price of a new service to exceed direct costs). The Commission has not extended those rules to non-dominant carriers. Economists explain that such carriers would have nothing to gain by pricing an entire product line below incremental cost because they could not recoup their losses. *See* F. M. Scherer, *Industrial Market Structure and Economic Performance, Second Edition* (Chicago: Rand McNally, 1980), 335-40.

Notice to give carriers flexibility by allowing the higher or lower of cost or market valuation to operate as either a floor or ceiling, depending on the direction of the transaction. Carriers can use the ceiling or floor in transactions with affiliates, as long as such transaction complies with the Communications Act, Commission rules and orders, and is not otherwise anti-competitive.[176]

(iii). Prevailing price treatment

93. In the *Notice*, the Commission sought comment on USTA's proposal to revise the prevailing price definition.[177] The prevailing price describes a price at which a company offers an asset or service to the general public. Under our current rules, to qualify for prevailing price treatment, greater than 50 percent of sales of the subject asset or service must be to third parties.[178] USTA proposes that the Commission revise section 32.27(d) to decrease the threshold from greater than 50 percent to 25 percent for use of prevailing price in valuing affiliate transactions.[179]

94. After reviewing the record, we adopt USTA's proposal.[180] The purpose of the Commission's threshold is to ensure that sufficient transactions occur with unaffiliated parties to produce a reasonable surrogate of a true market price. If the percentage of third-party business is *de minimis*, there can be no assurance that the price agreed upon by the carrier and its affiliates represents the true market price or that the amount of sales represents a significant influence on the carrier's pricing decisions.[181] Our general approach is to ask whether a particular company conducts a substantial portion of its transactions with unaffiliated third parties outside of the corporate family; if so, it is reasonable to presume that firm is indeed pricing those transactions in a marketplace environment and that this level of sales does significantly influence the carrier's pricing policy. We are skeptical that it is a sustainable strategy for a firm significantly to underprice transactions with 25 percent of its customers in order to be able to record transactions at that price with an affiliate. As USTA observes, a lower threshold would be consistent with a more competitive environment.[182] We will grant the relief requested by USTA and will monitor the situation to determine whether this modification has any unintended consequences.

(iv) Centralized services exception to estimated fair market value rule

95. In the *Notice*, the Commission sought comment on USTA's proposal to expand the current exception to the estimated fair market value rule to include "all services provided by a

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[176] We note that section 272(b)(5) of the Communications Act requires arm's length transactions between a BOC and its section 272 affiliate. 47 U.S.C. § 272(b)(5). Recording a transaction at the higher or lower of cost or market as a floor or ceiling may not meet our definition of "arm's length," and therefore may not be used in transactions where arm's length transactions are required under the Communications Act or otherwise required by Commission rule or order.

[177] *See Notice* at ¶ 29.

[178] 47 C.F.R. § 32.27(d). Under our current rules, if third party sales are less than 50 percent, there is no prevailing price and the asset or service must be valued based on a comparison of cost and fair market value.

[179] *See* USTA Letter at Attachment A.

[180] Sprint and BellSouth support USTA's proposal. *See* Sprint Comments at 14; BellSouth Sept. ?, *ex parte*.

[181] *Id.* at ¶ 134. *See* Wisconsin Comments at 11.

[182] USTA Comments at 16.

carrier or its affiliate(s) where the service is provided solely to members of the carrier's corporate family."[183] Under our current affiliate transactions rules, if a transaction cannot be valued at publicly available rates, it must be valued based on a comparison of cost and fair market value.[184] If a comparison is used, the carrier must make a good faith determination of fair market value.[185] If the regulated company purchases the asset or service from a nonregulated affiliate, the carrier must record the transaction at the lower of cost or market value.[186] On the other hand, if the carrier sells the asset or service to a nonregulated affiliate, the carrier must record the transaction at the higher of cost or market.[187] The Commission adopted this valuation rule in the *Accounting Safeguards Order* to ensure that the transactions between the carriers and their nonregulated affiliates take place on an "arm's length" basis, guarding against cross-subsidization of competitive services by subscribers to regulated services.[188] .

96. The exception USTA seeks to expand provides that when an incumbent carrier purchases services from an affiliate that exists solely to provide services to members of the carrier's corporate family, the carrier may record the services at fully distributed cost rather than applying the cost or market rule. When the Commission adopted this exception in the *Accounting Safeguards Order*, it explained that the narrow exception to the general rule was justified because an affiliate that provides services solely to the incumbent carrier's corporate family is established to take advantage of economies of scale and scope. The benefits of such economies of scale and scope are reflected in the affiliate's costs and are ultimately transferred to ratepayers through transactions with the incumbent carrier for such services valued at fully distributed costs.[189] Requiring incumbent carriers to perform fair market valuations for such transactions would increase the cost to ratepayers while providing limited benefit.[190]

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[183] *See* USTA Comments at 17.

[184] We use net book cost for assets and fully distributed cost for services. Net book cost is the original cost of an asset adjusted by the associated valuation reserves (*e.g.*, accumulated depreciation, deferred taxes). Fully distributed cost is the cost determined in a manner that complies with the standards and procedures for apportionment of joint and common costs between the regulated and nonregulated operations of the carrier. *See* 47 C.F.R. § 64.901(b).

[185] Carriers may make good faith determinations based on "appraisals, catalogs listing similar items, competitive bids, replacement cost of an asset, and net realizable value of an asset." *Accounting Safeguards Order*, 11 FCC Rcd at 17610, ¶ 154.

[186] 47 C.F.R. § 32.27(b) – (c).

[187] *Accounting Safeguards Order*, 11 FCC Rcd at 17607, ¶ 147.

[188] Prior to adopting the *Accounting Safeguards Order*, our valuation rules required a carrier to record services sold to a nonregulated affiliate at the carrier's fully distributed cost. This applied even when the fully distributed cost was less than the fair market value. Under such circumstances, the carrier would obtain a smaller profit from the transaction with the affiliate than it could receive from a third party for the same service. In addition, carriers were required to record services purchased from a nonregulated affiliate at the affiliate's fully distributed cost, even if the fully distributed cost was higher than the fair market value. As a result, ratepayers may have been harmed if a carrier's smaller profits or increased costs were reflected in the rates for telecommunications services. In addition, competitors for non-regulated services may have been harmed if the valuation methods for affiliate transactions induced carriers and their affiliates to use services that were not competitive to subsidize non-regulated services, thereby putting competitors to a disadvantage. The Commission concluded that such valuation rules might not be consistent with the section 272(b)(5) requirement that transactions be conducted "on an arm's length basis." *Id.*

[189] *Id.*

[190] *Id.*

97. USTA proposes that we expand the current exception to the estimated fair market value rule to include "all services provided by a carrier or its affiliate(s) where the service is provided solely to members of the carrier's corporate family."[191] Under USTA's proposal, an affiliate could have one service that is offered solely to the corporate family, which USTA proposes would be subject to the exception, and other services that are subject to market valuation studies because they are offered to third parties. USTA also suggests an alternative: "All services provided by an affiliate that exists primarily to serve members of the carriers' corporate family (provides over 50 percent) and individual services provided by an ILEC primarily to members of a carriers' corporate family (provides over 50 percent) shall be recorded at fully distributed cost."[192] Most commenters addressing this issue support USTA's proposal to expand the exception to the estimated fair market value rule.[193]

98. We are not persuaded at this time that we should expand the scope of the exception to the valuation rule. The Commission adopted the exception in order to relieve incumbent carriers from performing a fair market valuation in circumstances where the burdens outweighed the benefits. If, as USTA proposes, the exception is applied based on an individual service being offered solely to the corporate family, while other services of the affiliate are subject to market valuation studies because they are offered to third parties, the risk of improper cross-subsidization increases. For example, if an affiliate offers several services of which only one is provided solely within the corporate family and subject to the exception, the carrier would need to assign costs between the excepted service and the other services. Such allocations could shift costs between services offered outside the corporate family and services offered to the incumbent carrier. This increased risk of cost shifting applies equally to USTA's alternative proposal wherein the exception would apply to affiliates that exist primarily to serve members of the carrier's corporate family and to individual incumbent LEC services provided primarily to the carrier's corporate family. This risk of cost shifting between third party services and the incumbent carrier's services does not exist when the exception applies only to affiliates offering service within the corporate family.

99. There are several potential ramifications of cost misallocations arising out of affiliate transactions. First, the affiliate transactions rules apply to rate-of-return carriers as well as price caps carriers. Second, there are price caps carriers that can still avail themselves of low-end adjustments. Third, cost misallocations could impact the development of pricing for new services by price cap carriers. Fourth, even in the event that federal ratepayers are protected from cost misallocations by the imposition of price caps or CALLS, state ratepayers can be affected. Inappropriate shifting of costs from nonregulated activities to regulated activities would result in inflated regulated costs prior to separations. After the separations process, those inflated costs would flow to the state jurisdiction, and eventually would be recovered from state ratepayers. Although we do not adopt USTA's and BellSouth's proposal to broaden the centralized services exception, in an attached Further Notice of Proposed Rulemaking, we seek further comment on this rule and potential alternatives.

[191] *See* USTA Comments at 17.

[192] *See* USTA Reply Comments at 15.

[193] *See, e.g.,* CBT Comments at 6-7; ITTA Comments at 24; Verizon Comments at 9-10. *See also* BellSouth August 2, 2001 *ex parte.* NASUCA opposes weakening our affiliate transactions rules. *See* NASUCA Oct. 4, 2001 *ex parte* at 2.

(v) Exempt nonregulated to nonregulated transactions from the affiliate transactions rules

100. Our affiliate transactions rules apply to all transactions between carriers (except for average schedule companies) and their nonregulated affiliates that affect the carrier's regulated books of account.[194] Transactions involving nonregulated assets and services are subject to our affiliate transactions rules.[195] In the *Notice*, the Commission proposed that the affiliate transactions rules should not apply to nonregulated activities transferred from the carrier's nonregulated operations to its nonregulated affiliate.[196] We defer action on this proposal, as it raises broader issues that should be considered in a more comprehensive fashion.[197]

b. Section 32.5280(c) subsidiary record requirement

101. In the *Notice*, the Commission sought comment on USTA's proposal to eliminate the section 32.5280(c) subsidiary record requirement.[198] This rule requires carriers to maintain subsidiary record categories for each nonregulated revenue item recorded in Account 5280, Nonregulated operating revenue.[199] USTA contends that this subsidiary record requirement is unnecessary.

102. We conclude that we can simplify the manner in which incumbent LECs record their nonregulated revenues, but stop short of eliminating section 32.5280(c) altogether. Account 5280 may include revenues from services that are still regulated at the state level.[200] In addition, in the *Accounting Safeguards Order*, the Commission concluded that BOC-provided interLATA telecommunications services, although regulated services, should be treated like nonregulated activities for federal accounting purposes.[201] We conclude that we do not need incumbent LECs to break out each nonregulated revenue item. Rather, we modify section 32.5280(c) so that LECs may group their nonregulated revenues into two groups: one subsidiary record for all the revenues from regulated services treated as nonregulated for federal accounting purposes pursuant to Commission order and the second for all other nonregulated revenues. In the event further detail is required, we can request carriers to break out these nonregulated revenues by subsidiary.

[194] 47 C.F.R. § 32.27(a). Nonregulated activities are recorded in the regulated books of account when they involve use of assets and resources also used in regulated activities. 47 C.F.R. § 32.23(c).

[195] *See, e.g.*, Citizens Utilities Company Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, *Memorandum Opinion and Order*, 11 FCC Rcd 4676 (Com. Car. Bur. 1996).

[196] Carriers must list their nonregulated activities in Section II of their CAMs. *See* Responsible Accounting Officer Letter 19, 6 FCC Rcd 7536 (1991).

[197] We note, however, that commenters addressing this issue supported the proposal. *See, e.g.*, Sprint Comments at 15-16; GSA Comments at 6; Verizon Comments at 9; USTA Comments at 19.

[198] *Notice* at ¶ 27; 47 C.F.R. § 32.5280(c).

[199] Account 5280, Nonregulated operating revenue is an account maintained by Class A and Class B carriers.

[200] *See* Oregon Comments at 4; RUS Comments at 2.

[201] *Accounting Safeguards Order*, 11 FCC Rcd at 17572-73, 17652-55, ¶¶ 73-76, 251-57.

c. Accounts 1437 and 4361

103. In the *Notice*, the Commission sought comment on USTA's proposal to simplify deferred tax accounting by allowing carriers to book Account 1437, Deferred tax regulatory asset net of Account 4361, Deferred tax regulatory liability. USTA argues that carriers should be permitted to eliminate the requirement to calculate the gross up for the tax on tax effect.[202] Commenters addressing this issue contend, and we agree, that netting Accounts 1437 and 4361 would simplify deferred tax accounting.[203] We, therefore, revise sections 32.1437 and 32.4361 accordingly to reflect this change. We do not, however, agree with USTA that the requirement to gross-up for the tax on tax effect should be eliminated. The regulatory asset and liability accounts, as well as the tax gross up on the accounts, were incorporated into the USOA to allow carriers to adopt the GAAP method of accounting for income taxes without affecting rates or the IRS normalization requirements. We believe that eliminating the tax on tax gross up would cause us to possibly violate the IRS normalization rules with respect to investment tax credit and excess deferred tax amounts. Accordingly, we will retain the tax on tax gross up requirement in Part 32.

d. Expense limits

104. We revise the expense limit rules to include tools and test equipment located in the central office in the $2000 expense limit. Section 32.2000(a)(4) of the Commission's rules requires that the cost of individual items of equipment with a cost of $2000 or less or having a life of less than one year, classifiable in specified accounts, shall be charged to the applicable expense accounts rather than capitalized.[204] The expense limit reduces the cost of maintaining property records for the acquisition, depreciation, and retirement of a multitude of low-cost, high-volume assets. This expense limit applies to equipment classifiable in Account 2112, Motor vehicles; Account 2113, Aircraft; Account 2114, Tools and other work equipment; Account 2122, Furniture; Account 2123, Office equipment; and Account 2124, General purpose computers, except for personal computers falling within Account 2124. Personal computers classifiable to Account 2124, with a total cost for all components of $500 or less, are charged to the applicable Plant Specific Operations Expense accounts. We have periodically increased the expense limit due to the effects of inflation, technological changes, and changes in the telecommunications regulatory environment.[205] In addition, Responsible Accounting Officer Letter No. 6, increased

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[202] USTA Comments at 13.

[203] *See, e.g.*, Oregon Comments at 4; Wisconsin Comments at 8; Sprint Comments at 13; Verizon Comments at 8; USTA Comments at 13.

[204] 47 C.F.R. § 32.2000(a)(4).

[205] The limit was raised from $25 to $50 in 1974, *see* Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) to Increase the Monetary Limit Where Capitalization is Appropriate from $25 to $50, Docket No. 20110, *Report and Order*, 47 FCC 2d 1153 (1974), from $50 to $200 in 1981, *see* Amendment of the Uniform System of Accounts to Increase the Dollar Limit for Expensing Minor Items, CC Docket No. 81-273, *Report and Order*, 87 FCC 2d 1137 (1988), from $200 to $500 in 1988, *see* Revision to Amend Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies as it Relates to the Treatment of Certain Individual Items of Furniture and Equipment Costing $500 or Less, CC Docket No. 87-135, *Report and Order*, 3 FCC Rcd 4464 (1988), and from $500 to $2000, Revision to Amend Part 32, Uniform System of Accounts for Class A and Class B Telephone Companies to Raise the Expense Limit for Certain Items of Equipment from $500 to $2000, CC Docket No. 95-60, *Report and Order*, 12 FCC Rcd 7566 (1997) (*Expense Limit Order*). In the *Expense Limit Order*, we specifically excluded from the $2000 expense limit all personal computer components falling within Account 2124, General purpose computers. The cost of operating system software was

from $200 to $500 the limit for expensing the tools and test equipment included in the central office plant accounts.[206]

105. In the *Notice*, the Commission sought comment on whether the expense limit rules should be modified again. Specifically, the Commission sought comment on raising the expense limit from $500 to $2000 for both Account 2124, General support computers and the tools and test equipment included in the central office plant accounts.

106. We conclude that the tools and test equipment located in the central office should be included in the $2000 limit because these assets are virtually the same as the tools and test equipment located in the general support function.[207] Moreover, tools and test equipment are generally individual units rather than components of a larger unit. Therefore, we are revising our expense limit rules to include the central office tools and test equipment.

107. We conclude that we should not increase the expense limit to $2000 for personal computers. As several commenters observe, circumstances have not changed significantly since 1997, and an extension of the expense limit to all plant accounts is not warranted.[208] Moreover, commenters assert that personal computers and peripheral equipment generally cost less than $1000 and increasing the expense limit to $2000 would result in very little, if any, capitalization of these assets.[209] We conclude that personal computers should be subject to a special limit because of the nature of these assets. Individual personal computers are made up of relatively low cost components, such as the monitor, keyboard, and CPU, that should be looked at as a single unit for purposes of applying the expense limit. Moreover, although relatively low cost individually, personal computers are part of larger networks within each company and represent substantial investments. These investments should be capitalized. Accordingly, we do not revise the rules regarding personal computers.

e. Incidental activities

108. We adopt the proposal in the *Notice* to eliminate the "treated traditionally" requirement from incidental activities. Under section 32.4999(l) of the Commission's rules, revenues from minor nontariffed activities that are an outgrowth of the carrier's regulated activities may be recorded as regulated revenues under certain conditions.[210] These activities, known as "incidental activities," must: (1) be an outgrowth of regulated operations; (2) have been treated traditionally as regulated; (3) be a non-line-of business activity; and (4) result in

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excluded from the $500 expense limit for personal computers. *See Accounting Reductions Report and Order*, 14 FCC Rcd at 11420, ¶ 50.

[206] Responsible Accounting Officer Letter 6, Part 32, Uniform System of Accounts for Class A and Class B Carriers - Item Lists, 4 FCC Rcd 1965 (revised Feb. 13, 1989, rel. Feb 27, 1989).

[207] *See, e.g.*, Florida Comments at 9; NARUC Comments at 7; Idaho Comments at 6; Wisconsin Comments at 14; Sprint Comments at 17; GSA Comments at 7 & Reply Comments at 13; Verizon Comments at 10; USTA Comments at 20.

[208] *See, e.g.*, Florida Comments at 9; NARUC Comments at 7; Idaho Comments at 6.

[209] *See, e.g.*, Florida Comments at 9; NARUC Comments at 8; Idaho Comments at 6. *See also* GSA Reply Comments at 13.

[210] 47 C.F.R. § 32.4999(l).

revenues that, in the aggregate, represent less than one percent of total revenues for three consecutive years.[211]

109. Accounting for incidental activities as regulated revenues obviates the need to make detailed cost allocations to remove the costs of the nonregulated activity from regulated costs. Carriers must list their incidental activities in their CAM.[212] They may not add new incidental activities because of the "treated traditionally" criterion. In the *Notice*, the Commission proposed eliminating the "treated traditionally" criterion. This would permit carriers to add to their incidental activities, provided that the remaining three criteria were satisfied. We find that the three remaining criteria provide sufficient safeguards to prevent misuse of the incidental activities exception. This modification will result in a lessened regulatory burden as new incidental activities are identified.[213]

110. We are not persuaded that the one-percent revenue ceiling should be raised.[214] Incidental activity accounting allows carriers to avoid the burden of full nonregulated activity accounting for minor activities that are an outgrowth of their regulated activities. Incidental activity accounting has not been permitted for an activity that is a separate line of business. A separate line of business must be accounted for as a nonregulated activity regardless of its size. The one-percent ceiling recognizes that an activity that begins as an incidental activity may grow into a separate line of business that requires accounting as a nonregulated activity. For example, one percent of Verizon's total revenues exceeds $400 million. If Verizon had an incidental activity with revenue greater than that, it would raise a question of whether it should be accounted for as a separate line of business. Moreover, if the one-percent limit is reached and a carrier has several incidental activities, it would only be necessary to remove from incidental activity accounting the activity or activities that would drop the total incidental activities to less than one percent.

f. Allocation of costs at Class B level

111. Section 64.903 of the Commission's rules requires incumbent LECs with annual operating revenues from regulated telecommunications operations equal to or above a designated indexed revenue threshold,[215] to file cost allocation manuals annually setting forth the procedures that they use to allocate costs between regulated and nonregulated services.[216] In the *Notice*, we

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[211] *See* 47 C.F.R. § 32.4999(l); *Joint Cost Order*, 2 FCC Rcd at 1308, ¶ 78. For example, in its CAM filed on December 31, 1993, Citizens Utilities Company listed six activities that it treated as incidental: land and building space rental, pole contact and conduit space rental, incidental custom work, operator services not covered by tariff, customer list sales for equal access, and scrap material. *See* Citizens Utilities Company Permanent Cost Allocation Manual for the Separations of Regulated and Nonregulated Costs, AAD 94-6, *Memorandum Opinion and Order*, 10 FCC Rcd 16, 17, ¶ 9 (1994).

[212] 47 C.F.R. § 64.903(a).

[213] GSA Comments at 7 & Reply Comments at 12-13. Sprint, Verizon, and USTA also support the proposal. *See* Sprint Comments at 16; Verizon Comments at 10; USTA Comments at 19-20.

[214] *See* Sprint Comments at 16.

[215] *See* "Annual Adjustment of Revenue Threshold," *Public Notice*, DA 01-903 (rel. Apr.11, 2001) (adjusting annual indexed revenue threshold to $117 million).

[216] 47 C.F.R. § 64.903.

sought comment on USTA's proposal that the Commission allow all carriers the option to allocate Part 64 costs at a Class B level.[217]

112. We decline to adopt USTA's proposal to allow all carriers to allocate all part 64 costs at the Class B level. We conclude that it is necessary to continue to require Class A carriers to allocate costs at the Class A level for the limited number of Class A accounts needed for the administration of the universal service high-cost support mechanism as set forth in Appendix E.[218] As discussed above, the Commission uses Class A accounting information to develop certain input values used in the universal service model and, therefore, we retain certain Class A accounts relating to network plant and related asset and expense accounts. Universal service support for non-rural carriers is based on the forward-looking cost of providing the supported services. Input values are derived using a carrier's regulated costs. For example, a Class A carrier that uses fifty percent of its fiber facilities and eighty percent of its copper facilities to provide regulated services currently reports the allocation associated with each type of plant. Under USTA's proposal, however, carriers' would merely report an aggregate allocation amount for all outside plant in a single account, which would cause distortions in the model's outside plant cost estimates.

g. Section 32.16 requirement for implementing new accounting standards

113. In the *Notice*, the Commission sought comment on USTA's proposal to eliminate the section 32.16 requirement for notification and approval to implement new accounting standards prescribed by the Financial Accounting Standards Board (FASB). Section 32.16 of the Commission's rules requires carriers to revise their records and accounts to reflect new accounting standards prescribed by FASB. This section provides that Commission approval of a change in an accounting standard shall automatically take effect 90 days after a carrier notifies the Commission of its intention to follow a new standard and files a revenue requirement study for the current year analyzing the effects of the accounting standards changes.[219] USTA argues that incumbent LECs should be permitted to simply adopt new FASB standards, without Commission review and without performing any revenue requirement studies.[220]

114. We are not persuaded that we should eliminate our ability to determine whether it is appropriate for carriers to implement accounting changes. Accounting standard changes often raise questions regarding exogenous treatment under price cap rules and that when they do, cost data must be available to resolve such issues.[221] Several commenters disagree with USTA's position, observing that mere compliance with GAAP does not ensure compliance with the

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[217] *See Notice* at ¶ 43; USTA Letter at Attachment A.

[218] *See* Appendix E.

[219] In the *Accounting Reductions Report and Order*, the Commission liberalized this rule by requiring a revenue study only for the current year, rather than for three years into the future. In that proceeding, the Commission declined to adopt the suggestion that price cap incumbent LECs should be allowed to adopt new standards without notification. *See Accounting Reductions Report and Order*, 14 FCC Rcd at 11413, ¶ 35.

[220] USTA Comments at 14.

[221] The Commission's exogenous cost rules allow carriers under price caps to increase their interstate rates to reflect cost increases caused by accounting changes.

Commission's rules.[222] Commenters argue, and we agree, that the prior review period permits the Commission to ensure uniformity in LEC accounting practices and allows the Commission to assess the implications of GAAP changes for LEC revenue requirements.[223]

115. We agree with the RUS that GAAP standards frequently allow several options or alternatives to implement accounting changes.[224] We believe that the 90-day period is sufficient for the Commission's accounting staff to review GAAP changes to determine what guidance should be given to carriers. Sometimes this guidance can be done easily in the form of an RAO letter.[225] At other times, rulemakings are necessary to implement accounting changes.[226] It is, however, important for the Commission's staff to know how those changes are being implemented.

116. For these reasons, we retain the requirement for carriers to notify the Commission of their intentions to adopt a FASB change and how the carrier intends to implement this change. We eliminate, however, the requirement to provide a revenue requirement study. We agree with USTA that this requirement is burdensome and that there are alternative methods for assessing the revenue effects of these changes.

3. Current Rules Maintained

a. Charges to plant accounts

117. Section 32.2003(b) is an exception to the general rule that construction costs are recorded in Construction Work-in-Progress accounts until the construction project is completed. It allows carriers to charge directly to the appropriate plant accounts the cost of any construction project that is estimated to be completed and ready for service within two months from the date on which the project was begun.[227] In addition, this section allows carriers to charge directly to the plant accounts the cost of any construction project for which the gross additions to the plant are estimated to amount to less than $100,000. The purpose of this exception is to allow carriers to record short-term and small-cost construction projects directly to the plant accounts without having to first record these costs in the Construction Work-in-Progress accounts. This exception is acceptable for Commission purposes because it has no material affect on carrier cost or rates, and it is acceptable under GAAP because GAAP's definition of materiality is more lenient than the Commission's.

118. The *Notice* sought comments on USTA's proposal that carriers should be permitted to determine materiality for plant work-in-progress accounting.[228] In particular, USTA

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[222] *See, e.g.*, AT&T Comments at 4-5 & Reply Comments at 11; WorldCom Comments at 4-5; Sprint Comments at 13-14; RUS Comments at 3; GSA Reply Comments at 10-11.

[223] *See, e.g.*, WorldCom Comments at 4; Wisconsin Comments at 9.

[224] RUS Comments at 3.

[225] *See, e.g.*, Responsible Accounting Officer Letter 31, Cost Allocation Manual Audit Requirements for Large Incumbent Local Exchange Carriers, DA 00-2385, (rel. Dec. 21, 2000).

[226] *See, e.g.*, *Accounting Reductions Report and Order*, 14 FCC Rcd at 11416-420, ¶¶ 42-51 (adopting GAAP with respect to accounting for computer software costs).

[227] 47 C.F.R. § 32.2003(b).

[228] *Notice* at ¶ 24. *See also* USTA Petition, Attachment at 6.

sought additional flexibility to record construction projects in the relevant account rather than a work-in-progress account.

119. We decline to accept USTA's proposal because allowing carriers to set their own materiality levels for deciding when construction costs and assets should be capitalized would give carriers an incentive to capitalize large dollar amounts of uncompleted construction. Our current rules ensure that carriers have an opportunity to earn the authorized rate of return on the interstate portion of all investment they make in the telephone network, while reducing the amount recovered from ratepayers for assets under construction during the period in which they are under construction.[229] The revenue requirement offset method effectively limits the amount that current ratepayers pay for assets prior to their placement into service.[230] Moreover, allowing carriers to establish their own materiality level for capitalizing plant work in progress accounting, as proposed, would eliminate the uniformity and consistency in reporting that Part 32 strives to achieve. Consistency and uniformity in carriers' books of accounts should be maintained so that we can readily compare their regulatory operating results. We, therefore, decline to adopt USTA's proposal.

b. Continuing property records

120. In the *Notice*, the Commission sought comment on USTA's proposal to eliminate detailed requirements for property record additions, retirements, and recordkeeping. The property records consist of continuing property records (CPR) and all supplemental records necessary to provide the property record details required by the Commission.[231] Many commenters contend that the property records are necessary to ensure that the network plant accounts accurately reflect those assets in service.[232] We concur and decline to adopt USTA's proposal.

121. CPR records provide data for cost allocations studies used in state regulatory proceedings. In addition, these records provide material-only costs for accounting for transfers, reallocations, and adjustments of plant.[233] State regulators rely heavily on the CPR records in their

[229] *See* Utah Comments at 2.

[230] In 1995, the Commission adopted the revenue requirement offset method for construction projects to allow carriers to earn the authorized rate of return on all construction projects and to conform accounting for Allowance for Funds Used During Construction (AFUDC) to GAAP. Under the revenue requirement offset method, Telephone Plant Under Construction (TPUC) is included in the rate base during the construction period and the AFUDC is recognized as part of that cost of construction. To prevent double recovery, the current year's AFUDC is treated as a revenue amount for ratemaking purposes. For cost of service companies, this credit reduces the carrier's revenue requirement. *See* Accounting and Ratemaking Treatment for the Allowance for Funds Used During Construction (AFUDC), CC Docket No. 93-50, *Report and Order*, 10 FCC Rcd 2211, 2213, ¶ 10 (1995).

[231] 47 C.F.R. § 32.2000(e)(3).

[232] *See, e.g.*, Florida Comments at 7; Idaho Comments at 5; Maryland Comments at 4; NARUC Comments at 6; Oregon Comments at 4 (if proposal is adopted, OPUC will require carriers to maintain the information); ALTS Reply Comments at 12; AT&T Reply Comments at 10-11; XO Communications Reply Comments at 14-15; NASUCA Oct. 4, 2001 *ex parte* at 4. NASUCA observes that our CPR rule is consistent with the Foreign Corrupt Practices Act of 1977 that applies to any domestic firm engaged in business with a foreign entity. *Id.*

[233] *See, e.g.*, Florida Comments at 7; Maryland Comments at 4; NARUC Comments at 6; Idaho Comments at 5.

local ratemaking processes.[234] The attached Further Notice of Proposed Rulemaking seeks comment on whether there are alternative avenues for states to gather whatever information pertaining to property records they need for state regulatory proceedings, and whether there are any federal or state regulatory needs served by our CPR rules that cannot be met through alternative mechanisms. The Further Notice also seeks comment on eliminating the CPR rules in three years.

c. Cost allocation forecasts

122. The Commission's cost allocation rules require that costs be allocated between regulated and nonregulated activities. Carriers are required to assign costs directly to regulated and nonregulated activities, whenever possible. Costs that cannot be directly assigned are known as "shared" or "common costs" and are allocated between regulated and nonregulated use based on a hierarchy of principles. Section 64.901(b)(4) of the Commission's rules requires that carriers allocate the costs of central office equipment and outside plant investment between regulated and nonregulated activities based on a forecast of the relative regulated and nonregulated usage during a three calendar year period beginning with the current calendar year.[235] The policy consideration underlying this rule recognizes that investment decisions are made in anticipation of future use. In the *Notice*, the Commission sought comment on USTA's proposal to eliminate the forecast use rule.[236]

123. USTA argues that LECs should be allowed to allocate costs of common central office and outside plant investment on the basis of actual usage.[237] USTA states that actual usage cost allocations increase accuracy and avoid costly burdens.[238] USTA also argues that forecasting nonregulated usage of shared central office and outside plant is obsolete with the introduction of interconnection agreements.[239] The states and other commenters argue that USTA's proposal to eliminate the forecast use rule for allocating joint investments between the carrier's regulated operations and nonregulated "start up" operations would result in the over-allocation of nonregulated costs to the LECs' regulated activities.[240] GSA agrees and further states that unless a forward-looking allocation procedure is maintained, plant additions to provide nonregulated services will be consistently allocated incorrectly.[241]

124. We decline to adopt USTA's proposal to eliminate the forecast use rule for allocating joint investments between the carrier's regulated and nonregulated operations. We conclude that the forecast use rule remains a valuable tool in allocating the costs of shared

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[234] *See, e.g.*, Florida Comments at 7; NARUC Comments at 6; Idaho Comments at 5; California Reply Comments at 2-3; ALTS Reply Comments at 12; AT&T Reply Comments at 11.

[235] 47 C.F.R. § 64.901(b)(4).

[236] *Notice* at ¶ 45. USTA contends that this rule is burdensome, but has not quantified the burden.

[237] USTA Comments at 21.

[238] *Id.* at 22.

[239] USTA Sept. 28, 2001 ex parte at 8.

[240] *See, e.g.*, Florida Comments at 8; Utah Comments at 3-4; Maryland Comments at 5; North Carolina Public Staff Comments at 4; NARUC Comments at 7; Ohio CC and NASUCA Joint Comments at 7; Idaho Comments at 5; GSA Comments at 9 & Reply Comments at 14; NASUCA Oct. 4, 2001 *ex parte* at 2.

[241] GSA Comments at 9.

facilities fairly. Because investment in central office equipment and outside plant is made in anticipation of future usage, the allocation of such investment between regulated and nonregulated activities should be based on that anticipated usage.[242] If allocation were based on current usage instead, an underallocation of central office equipment and outside plant to nonregulated activities could result whenever the usage associated with those activities increases over a period of several years.[243] Moreover, to the extent there is an overallocation of costs to the regulated books, that overallocation will flow through to the states through separations. As a consequence, ratepayers would be bearing a portion of the costs of deploying networks used to provide nonregulated activities in the future. We therefore find that the three-year peak forecast method is a reasonable approach to allocating joint and common costs. As a result, we will continue to require that carriers allocate these costs based on forecasted usage.

125. Based on the record before us, it does not appear that it will be unduly burdensome to maintain the existing forecast rule. The current rules do not require a forecast of usage for all facilities; rather, only investment in facilities that are shared between regulated and nonregulated uses are subject to the forecast rule. The vast majority of central office and cable investment already is directly assigned (and therefore not subject to the forecast rule).[244] Moreover, other rule changes that we adopt today may affect what investment is subject to the forecast rule. As set forth above,[245] we are amending our cost allocation rules to provide that, to the extent a carrier provides a non-tariffed service to its nonregulated operations, that service will be recorded to nonregulated operations at the price set for that service or facility as set forth in an interconnection agreement approved by a state commission pursuant to section 252(e). As a result of this modification to our cost allocation rules, carriers may be able to directly assign costs to nonregulated activities in more instances, so that fewer costs will remain in the pool of common costs that must be allocated based on a three-year forecast of anticipated usage.

4. Classification of Companies

126. As we have discussed above, rule 32.11 divides companies into Class A and Class B for accounting purposes. This rule does not state that our accounting rules apply only to incumbent LECs. Rather, the rule merely speaks in terms of "companies." Currently, we apply these requirements to incumbent LECs only, because they are the dominant carriers in their markets.[246] In the *Notice*, the Commission sought comment on whether section 32.11 should be amended so that its requirements explicitly pertain only to incumbent LECs, as defined in section

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[242] *See* NARUC Aug. 17, 2001 *ex parte* at 9.

[243] For example, if an incumbent LEC deploys fiber and coaxial cable transmission facilities and equipment; signal generation, reception, and control equipment; broadband switching equipment; and operations support systems in anticipation of providing cable service in the future, but allocates costs based only on current usage, the costs of that equipment will be disproportionately allocated to the regulated local exchange service, rather than the nonregulated activity. *See* NARUC Sept. 6, 2001 *ex parte* at Appendix, p.6.

[244] Verizon and Qwest report direct assignment of central office and outside plant of 97 percent and 95 percent, respectively; therefore, only 3 percent and 5 percent of their investment is subject to the forecast rule. USTA March 29, 2001 *ex parte*. Our ARMIS data show that both Verizon and Qwest reported direct assignment of central office and outside plant of 95 percent for year 2000.

[245] *See* section III.C.1.(c).

[246] In Implementation of the Telecommunications Act of 1996, CC Docket No. 96-193, *Report and Order*, 12 FCC Rcd 8071, 8095, ¶ 53 (1997), we specifically excluded non-incumbent LECs from CAM and ARMIS filing requirements.

251(h) of the Communications Act, and any other companies that the Commission designates by order.[247] None of the commenters opposed the proposal to revise section 32.11 to apply to incumbent LECs.[248]

127. We adopt the proposal in the *Notice* to revise section 32.11 of the Commission's rules to specifically apply to incumbent LECs and any other companies that the Commission designates by order. Section 32.11 was adopted at a time when there were no competitive local exchange carriers; the language in the rule presumably was intended to refer to the carriers that existed at the time, which were the incumbent LECs. Now that new carriers have entered the local exchange market, we will conform our rules to today's marketplace and replace the term "companies" with "incumbent LEC."

D. ARMIS Reporting Requirements

1. Background

128. ARMIS is an automated reporting system developed by the Commission to collect financial, operating, service quality, and network infrastructure information that carriers are required to collect under Commission rules. As previously noted, ARMIS reports 43-01, 43-02, 43-03, and 43-04 contain financial information of carriers with annual operating revenues that are equal to or above the indexed revenue threshold, currently $117 million.[249] In particular, ARMIS 43-01 summarizes the carriers' accounting and cost allocation data prescribed in Parts 32, 36, 64, 65, and 69 of the Commission's rules, ARMIS 43-02 collects basic accounting information, ARMIS 43-03 collects information on how costs are allocated between regulated and nonregulated activities, and ARMIS 43-04 collects information on how costs are separated between the federal and state jurisdictions. Supporting data for the ARMIS 43-03 Report currently are collected in two reports: Form 495A (Forecast of Investment Usage Report) and Form 495B (Actual Usage of Investment Report). The remaining four ARMIS reports contain non-financial information. Of the four, two are at issue in this proceeding: ARMIS Report 43-07 (Infrastructure Report) and ARMIS Report 43-08 (Operating Data Report), which collect information about the physical and operating characteristics of the incumbent local exchange carriers.[250]

129. ARMIS provides policymakers with one mechanism for monitoring activities associated with the provision of telecommunications services and the development of the

[247] *Notice* at ¶ 44.

[248] *See, e.g.*, ALTS Reply Comments at 5; XO Communications Reply Comments at 16-17 (arguing that CLECs enter the local exchange and exchange access markets in competition with other providers and without control of bottleneck facilities).

[249] The 30 large incumbent LECs that file financial reports are Verizon (19 operating companies), SBC (9 operating companies), BellSouth (1 operating company), and Qwest (1 operating company).

[250] The ARMIS Report 43-07 is required for the 30 mandatory price cap incumbent LECs: SBC (9 operating companies), Verizon (19 operating companies), Qwest (1 operating company), and BellSouth (1 operating company). The ARMIS Report 43-08 is required by the same 52 incumbent LECs that file the financial reports: SBC (9 operating companies), Verizon (19 operating companies), Qwest (1 operating company), BellSouth (1 operating company), Cincinnati Bell (1 operating company), C-TEC (1 operating company), Sprint (13 operating companies), ALLTEL (5 operating companies), and Citizens Communications (2 operating companies). Roseville and CenturyTel have also passed the indexed revenue threshold and would be required to file ARMIS 43-08 this year, under the current rules.

telecommunications infrastructure. Moreover, it allows regulators to perform these functions without having to rely on ad hoc information requests. Government agencies, interexchange carriers, CLECs, state regulators,[251] and other parties currently rely on ARMIS data.[252]

130. In the *Phase 1 Report and Order*, the Commission reduced the reporting requirements of the ARMIS 43-02 USOA Report.[253] Specifically, the Commission revised Table C-3 of ARMIS 43-02 Report to include carrier's operating states; eliminated Tables C-1, C-2, and C-4 from the ARMIS 43-02 Report; eliminated nine of twelve reporting items from Table C-5 of ARMIS 43-02 Report and established new threshold levels for two reporting items; eliminated seven of fifteen reporting items from the Table B Series of ARMIS 43-02; and eliminated three of seven reporting items from the Table I Series of ARMIS 43-02, established new threshold reporting levels for items reported in Tables I-6 and I-7, and eliminated the Academia reporting requirements.

131. In the *Notice*, the Commission sought comment on eliminating several tables and line items from certain ARMIS Reports.[254] The Commission also sought comment on USTA's proposal to eliminate most of ARMIS reporting.[255] In particular, USTA proposed to combine the ARMIS 43-01, 43-02, 43-03, and 43-04 into one report, and have carriers report only at the aggregated operating company level.

132. USTA contends that consolidating the ARMIS reports would substantially reduce the volume and complexity of the current ARMIS financial reports and significantly minimize the reporting burden.[256] BellSouth supports USTA's proposal and contends that the Commission can monitor accounting costs through the revised report proposed by USTA, and that the Commission should eliminate ARMIS 43-07 and 43-08 because monitoring the network infrastructure is no longer needed in today's competitive environment.[257] According to BellSouth, if incumbent LECs do not provide the services demanded by their customers, those customers will "vote with their

[251] For a list of state proceedings in which ARMIS data were used from January 1997 to July 1998, *see ARMIS Reductions Report and Order*, 14 FCC Rcd at 11456-457, ¶ 24 & n. 56.

[252] *See, e.g.*, Florida Comments at 11 (stating that "the only publicly available source of accounting data and information is that reported in ARMIS"); Idaho Comments at 7; Maryland Comments at 6; NARUC Comments at 4, 9 & Reply Comments at 7; North Carolina Public Staff Comments at 5; Oregon Comments at 6; Utah Comments at 4; Wisconsin Comments at 16; Wyoming Comments at 3-4; ALTS Reply Comments at 10; AT&T Comments at 4, 8 & Reply Comments at 13; GSA Comments at 10 & Reply Comments at 16; RUS Comments at 2; WorldCom Comments at 8 & Reply Comments at 7-8; Alaska Reply Comments at 4; California Reply Comments at 3; NCTA Reply Comments at 5-7; Ohio CC and NASUCA Reply Comments at 9.

[253] *Phase 1 Report and Order* at ¶¶ 32-57.

[254] ARMIS Reports 43-05 and 43-06 are under examination in a separate proceeding. *See* 2000 Biennial Regulatory Review – Telecommunications Service Quality Reporting Requirements, CC Docket No. 00-229, *Notice of Proposed Rulemaking*, 15 FCC Rcd 22113 (2000). Through ARMIS Report 43-05, the Commission, state commissions, and the public monitor trends in the quality of service provided by price cap LECs. The ARMIS Report 43-06 contains the results of customer satisfaction surveys conducted by the price cap LECs.

[255] *See Notice* at Appendix 6.

[256] USTA Comments at 23.

[257] BellSouth Comments at 6.

feet" and obtain services from a competitor.[258] Verizon also argues that the Commission should adopt USTA's proposal and contends that ARMIS is an overly burdensome relic of regulation that is contrary to the de-regulatory goals of the 1996 Act.[259]

133. The states and other commenters oppose USTA's proposal, contending that the ARMIS reports are important to understand the incumbent LECs' local exchange and exchange access operations, both financially and technically.[260] Commenters observe that ARMIS data are collected in a uniform and standard format so that all states and the public have efficient and reliable access to data they use currently to establish UNE prices, interconnection rates, and universal service support.[261]

134. Although we recognize that there could be alternative federal or state mechanisms that would adequately address the most important of the Commission's regulatory activities, no such mechanisms are presently in place. In the absence of alternative federal or state mechanism(s),[262] USTA's proposal to eliminate state-by-state ARMIS information would destroy the utility of ARMIS to states that wish to compare cost information of the incumbent LEC in their state to that incumbent LEC's costs in other states.[263] For these reasons, we do not adopt USTA's proposal at this time. We do, however, streamline several ARMIS reports, as described below. We direct the Common Carrier Bureau to implement programming changes to effectuate the modifications adopted below.

2. ARMIS Report 43-01 (Annual Summary Report)

135. The ARMIS 43-01 Annual Summary Report summarizes the carriers' accounting and cost allocation data prescribed in Parts 32, 36, 64, 65, and 69 of the Commission's rules.[264] It consists of Table I, a highly aggregated and comprehensive view of the carriers' financial and cost allocation data and Table II, a summary of demand in minutes of use and billable access

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[258] *Id.*

[259] Verizon Comments at 11.

[260] *See, e.g.*, Florida Comments at 10-11; Idaho Comments at 7; Maryland Comments at 5-6; ALTS Reply Comments at 4; AT&T Reply Comments at 12-13; California Reply Comments at 3-4 ; AT&T Aug. 29, 2001 *ex parte* at 2; NARUC Sept. 6, 2001 *ex parte* at App. A, p.7; North Carolina Sept. 4, 2001 *ex parte* at 4; Utah Aug. 31, 2001 *ex parte* at Appendix, p.3; Maryland Sept. 7, 2001 *ex parte* at Appendix; Michigan Oct. 3, 2001 *ex parte* at 1-2.

[261] *See, e.g.*, Florida Comments at 11; Idaho Comments at 7; Maryland Comments at 6; Alaska Reply Comments at 4; California Reply Comments at 3-4; Ohio CC and NASUCA Reply Comments at 9; NASUCA Oct. 4, 2001 *ex parte* at 2. NASUCA observes that the overwhelming majority of all UNE inputs begin with Class A accounts which are then forecasted into a future time period that is used to determine forward looking costs. *Id.* Michigan observes that ARMIS data were used to defend its decisions on a claim that the Michigan Telecommunications Act is confiscatory before the US District Court for the Eastern District of Michigan in Civil Action No. 00-73207. Michigan Oct. 3, 2001 *ex parte* at 2.

[262] *See* Further Notice of Proposed Rulemaking.

[263] *See, e.g.*, Florida Comments at 11; Idaho Comments at 7; NARUC Comments at 11; Maryland Comments at 6; North Carolina Public Staff Comments at 5; Utah Comments at 4; WorldCom Reply Comments at 6; NARUC Sept. 6, 2001 *ex parte* at App. A, p.7; North Carolina Sept. 4, 2001 *ex parte* at 4; New Mexico Aug. 30, 2001 *ex parte* at Appendix, p.2; Utah Aug. 31, 2001 *ex parte* at Appendix, p.3; Michigan Oct. 3, 2001 *ex parte* at 2.

[264] 47 C.F.R. Parts 32, 36, 64, 65, and 69.

lines. All incumbent LECs with annual operating revenues for the preceding year equal to or above the indexed revenue threshold file the 43-01 Report[265] on a study area basis.[266]

136. Table I summarizes the carrier's costs and revenues as reported in the Part 32 accounts (43-02 USOA Report), and shows the allocation of costs between regulated and nonregulated activities (43-03 Joint Cost Report), the separation of regulated costs between state and interstate jurisdictions, and the interstate costs used to support access elements (43-04 Separations and Access Report). In the *Notice*, the Commission proposed eliminating the requirement to file Table I for all carriers filing at the Class A level. The Commission proposed to generate this table from information provided in other financial ARMIS reports and to post the report electronically with the carrier's annual ARMIS filing.

137. The Commission also proposed eliminating the requirement to file Table II. The Commission proposed to eliminate the reporting of all Common Line Demand Minutes of Use (*i.e.*, premium and non-premium) and retain the sections for Switched Traffic Sensitive Demand Minutes of Use and Common Line Demand Billable Access Lines, which would be added to the ARMIS 43-04 in conjunction with row 9010 (Total Billable Access Lines).

138. In the next section of this Report and Order, we adopt streamlined ARMIS reporting for mid-sized incumbent LECs, and no longer require them to file ARMIS 43-02, 43-03, and 43-04 Reports. If we were to eliminate Tables I and II from ARMIS 43-01, we would no longer have certain information from mid-sized carriers that we currently need for various regulatory purposes. Because we cannot generate the information for mid-sized incumbent LECs in any other manner, we do not adopt our proposal to eliminate filing Tables I and II.[267] Therefore, ARMIS 43-01 will continue to include Tables I and II. With respect to Table II, we adopt our proposal to eliminate the Common Line Minutes of Use (rows 2010, 2020, 2030, and 2040). The remaining eight rows (2050, 2060, 2090, 2100, 2110, 2120, 2140, and 2150) will remain in Table II. Rows 2100, Residence Lifeline Access Lines and 2110, Residence Non-Lifeline Access Lines are needed by the Commission to track support amounts USAC pays to qualifying companies. In addition, all of these eight rows are needed by the Commission to verify data received in tariff filings by the CALLS companies.

3. ARMIS Report 43-02 (USOA Report)

139. The ARMIS 43-02 Report provides the annual operating results of the carriers' telecommunications operations for every account in Part 32. All incumbent LECs with annual operating revenues for the preceding year equal to or above the indexed revenue threshold file the 43-02 Report on an operating company basis. The 43-02 Report collects information about the carrier's ownership (Table C Series), balance sheet (Table B Series), and income statement accounts (Table I Series). Information collected in Tables B and I provides data about the carrier's financial accounts, including overall investment and expense levels, affiliate

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265 Mid-sized incumbent LECs currently may file ARMIS reports at the Class B level, starting with the 1999 reporting year. *See ARMIS Reductions Report and Order*, 14 FCC Rcd at 11449, ¶ 11.

266 A study area is a geographic segment of an incumbent LEC's telephone operations. Generally, a study area corresponds to the LEC's service territory within a state.

267 USTA and Verizon contend that the proposal to generate Table I and eliminate Table II is hardly worth the effort and would provide no administrative relief. *See* USTA Comments at 23; Verizon Comments at 11.

transactions, property valuations, and depreciation rates. In the *Phase 1 Report and Order*, the Commission significantly reduced the reporting requirements for Tables C, B, and I.

140. In the *Notice*, the Commission proposed to eliminate the filing of ARMIS 43-02, Table I-1 (Income Statement Accounts) for all carriers filing at the Class A level. Table I-1 collects data on the carrier's revenues, expenses, and net income for the reporting period. The Commission proposed to generate this table from information provided in the other financial ARMIS reports. In order to implement the proposal to eliminate the requirement to file ARMIS 43-02, Table I-1 for the largest incumbent LECs, the Commission proposed to include in ARMIS 43-03: the collection of data for Account 1402 (Investment in Non-Affiliate Companies) and the account series (7410 through 7450) for Account 7400 (Non-operating Taxes).[268] In addition, the Commission proposed the addition of 4 rows for collecting information on the number of employees (rows 830, 840, 850, and 860).[269] These data are currently required in ARMIS 43-02, Table I-1, but not in any other ARMIS report. The Commission anticipated that this proposal would provide relief to carriers from reporting information that can otherwise be derived from other ARMIS reports. USTA and Verizon, however, contend that adopting the proposal would be unnecessarily complicated and not provide any administrative relief.[270] Because it would be administratively difficult for us to effectuate this proposal at this time, we do not adopt the proposal in the *Notice* to have the Commission generate Table I-1 of the ARMIS 43-02 Report.

141. In the *Notice,* the Commission also proposed to add rows to ARMIS 43-02 to allow for the reporting of metallic and non-metallic cable investment and expense information.[271] Carriers already maintain this information in subsidiary record categories for each of the cable investment and expense accounts. The subsidiary record categories are not reported to the Commission, but the data are used for various purposes, such as inputs to the Commission's universal service high cost model for non-rural carriers as well as other forward-looking cost studies.[272] Given our desire to explore whether there are alternative sources for this information other than annual ARMIS filings,[273] we do not think it makes sense at this time to add these rows to ARMIS. For these reasons, we do not adopt the proposal in the *Notice* and add rows to ARMIS Report 43-02, tables for the reporting of metallic and non-metallic cable investment and expense.

4. ARMIS Report 43-03 (Joint Cost Report)

142. The ARMIS 43-03 Report contains the allocation of the carriers' revenues, expenses, and investments between regulated and nonregulated activities. All incumbent LECs with annual operating revenues for the preceding year equal to or above the indexed revenue threshold file the 43-03 Report on a study area basis. In the *Notice*, the Commission proposed to reduce the number of columns currently reported on the 43-03 Report by eliminating the distinction between "SNFA and Intra-co. Adjustments" and "Other Adjustments" and combining

[268] *Notice* at ¶ 60.

[269] *Id.*

[270] USTA Comments at 24; Verizon Comments at 11. WorldCom does not support the elimination of Table I-1. WorldCom Comments at 5-6.

[271] Several commenters support this proposal. *See, e.g.,* WorldCom Comments at 6 & Reply Comments at 7; GSA Comments at 11 & Reply Comments at note 53; AT&T Reply Comments at 14.

[272] This information has been provided to the Commission pursuant to ad hoc data requests.

[273] *See* Further Notice of Proposed Rulemaking at paragraph 208.

these columns into one column entitled "Adjustments."[274] USTA and Verizon agree with this proposal.[275] Verizon observes that approximately 0.2 percent of all adjustments appeared in the "SNFA and Intra-co. Adjustments" column.[276] We find that there does not appear to be a significant regulatory need to retain the "SNFA and Intra-co. Adjustments" column. We therefore are adopting the proposal to combine the two columns into one for the 43-03 Report. We also make a conforming change to the 43-01 Report.

5. ARMIS Report 43-04 (Separations and Access Report)

143. We revise the ARMIS 43-04 (Separations and Access) Report[277] to reduce the data required to be reported during the interim freeze of certain jurisdictional cost categories and allocation factors prescribed in Part 36[278] of the Commission's rules.[279] Carriers will file this revised ARMIS 43-04 Report on April 1, 2002, and on an annual basis thereafter for the duration of the freeze.

144. Part 36 of the Commission's rules provides procedures for incumbent LECs to separate their regulated costs between the intrastate and interstate jurisdictions. In 1997, the Commission initiated a comprehensive reform of the jurisdictional separations procedures to ensure that they met the objectives of the 1996 Act, and to consider reforms needed due to changes in the law, technology, and the market structure of the telecommunications industry.[280] In May 2001, the Commission adopted the recommendation of the Federal-State Joint Board to impose an interim freeze of certain jurisdictional cost categories and allocation factors for price cap carriers and the allocation factors only for rate-of-return carriers.[281] The freeze will be in effect for five years (from July 1, 2001 to June 30, 2006) or until the Commission has completed comprehensive reform of the rules for jurisdictional separations, whichever comes first.

145. In the *Separations Freeze Order*, the Commission concluded that incumbent LECs should report results of jurisdictional separations in a streamlined ARMIS 43-04 Report.[282] Pursuant to instructions of the Commission, the Common Carrier Bureau released a Public Notice on June 22, 2001, seeking comment on a proposed streamlined ARMIS 43-04 Report.[283]

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[274] *Notice* at ¶ 59.

[275] USTA Comments at 24; Verizon Comments at 12.

[276] Verizon Comments at 12.

[277] FCC Report 43-04 Table I-Separations and Access Table is attached as Appendix G.

[278] 47 C.F.R. Part 36.

[279] On May 22, 2001, the Commission adopted the recommendation of the Federal-State Joint Board to impose an interim freeze. *See* Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, CC Docket No. 80-286, *Report and Order*, FCC 01-162 (rel. May 22, 2001) (*Separations Freeze Order*).

[280] *See* Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, CC Docket No. 80-286, *Notice of Proposed Rulemaking*, 12 FCC Rcd 22120 (1997).

[281] *See Separations Freeze Order* at ¶ 2.

[282] *Id.* at ¶¶ 45-46.

[283] *See* "Common Carrier Bureau Seeks Comment on Proposed Streamlined ARMIS 43-04 (Jurisdictional Separations) Report," CC Docket No. 80-286, *Public Notice*, DA 01-1496 (rel. June 22, 2001) (*ARMIS 43-04 Public Notice*). We received five comments and four reply comments. ALLTEL

146. Generally, commenters were supportive of the proposed streamlined report. They did, however, raise several specific issues discussed below.

147. Currently, the report contains cost and revenue data as well as allocation factors. The report is organized so that the cost and revenue data are followed by the corresponding allocation factors. The proposed, simplified report eliminates many of the allocation factor rows, thereby making it less clear which factors apply to which costs and revenues. SBC suggests placing the cost and revenue data in one table and the allocation factors in a second table. SBC and GSA argue that this would improve the report by making it clearer which allocation factors apply to which cost and revenue data.[284] We agree with the parties that the proposed, simplified report would be improved if the links between the cost, revenues, and allocation factors were clearer. We find, however, that SBC's suggestion would lead to a lengthier report, since many of the cost and revenue rows are also allocation factors and would therefore have to appear in both tables. We find that the links can be improved without lengthening the report by continuing the use of only one table, and revising the ARMIS software so that, when an ARMIS user selects a specific cost or revenue row, the program will show the row number of the corresponding allocation factors. Furthermore, this can be accomplished without requiring the ARMIS filers to segregate their cost, revenue, or allocation factors or by requiring that they submit certain of the data more than once. We therefore direct the Bureau to make the necessary ARMIS program changes.

148. AT&T proposes that we retain the separate identification of traffic sensitive services as local switching and local transport.[285] AT&T contends that access customers will be unable to conduct proper cost analysis of traffic sensitive rates without separate local switching and local transport data.[286] We agree with AT&T that these two categories for traffic sensitive plant and expenses should be retained. One reason for doing so is that this cost detail would be needed under a new approach to intercarrier compensation on which the Commission recently sought comment.[287] Under this compensation proposal, carriers would use a bill and keep arrangement that requires them to recover local switching costs from their own customers. Local transport costs, however, would continue to be recovered partly through intercarrier compensation. Accordingly, this plan calls for access charges to be retained for local transport but not for local switching. The Commission's ability to monitor and evaluate local transport access rates would be greatly hindered if it could not identify and track local transport costs separately from local switching costs.

149. A second reason for retaining these two cost categories is that this cost detail might be needed in any future reform of our access charge rules. We do not anticipate implementing major changes to our access charge rules for price cap carriers for several years because the CALLS plan established interstate access rate levels for the period July 1, 2000

Communications, Inc. (ALLTEL), General Services Administration (GSA), SBC Communications, Inc. (SBC), Sprint Corporation (Sprint), and United States Telecom Association (USTA) filed initial comments. AT&T Corporation (AT&T), GSA, SBC, and USTA filed reply comments.

[284] SBC Comments at 3; GSA Reply Comments at 6.

[285] AT&T Reply Comments at 1-2.

[286] *Id.* at 2.

[287] *See* Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, *Notice of Proposed Rulemaking*, FCC 01-132 (rel. Apr. 27, 2001) (*Intercarrier Compensation NPRM*).

through June 30, 2005.[288] As the Commission recently stated, however, one of our long-term goals is to develop a uniform regime for all forms of intercarrier compensation, including interstate access. For price cap incumbent LECs, this means that we will need to revisit access charge rules when the CALLS plan expires in four years. For all other incumbent LECs, the Commission has under consideration various issues relating to access reform and universal service.[289] We believe it would be premature to consolidate the local switching and local transport categories before these issues are resolved.

150. We also received comment regarding removing certain rows from the proposed report. SBC suggests removing all the equal access rows and instead requiring that the data be reported in the appropriate accounts.[290] Our separations rules require maintaining the equal access costs separate from the investment and expense accounts.[291] Several incumbent LECs still have costs in these equal access accounts. Removing these rows, as SBC proposes, would require revising our separations rules, which is outside the scope of this proceeding.

151. Sprint proposes that we delete row 1213 "% Interstate Category 3 COE-Allocation." Sprint argues, and we agree, that this row is duplicative of row 1216 "# Dial Equipment Minutes."[292] We adopt Sprint's suggestion, and delete row 1213.

152. USTA and Sprint argue that the data reported in the "OTHER DATA" section of the ARMIS 43-04 Report should be eliminated.[293] They contend that the data in this section are available from other sources or can be calculated from other available data. GSA argues for retention of this section, stating that ARMIS reports are published on a more timely basis than other sources and that ARMIS is supported by a user friendly data base program available through the Internet.[294] We have reviewed the data reported in this section and find that it can be obtained from other sources that will adequately serve our data needs. Accordingly, we eliminate the "OTHER DATA" section of the ARMIS 43-04 report.

153. We also received suggestions to make revisions based on the Part 32 rule changes proposed in the *Notice* in CC Docket No. 00-199.[295] GSA proposes that rows 4010, Network access service revenues-End user; 4011, Network access service revenues-Switched; 4012, Network access service revenues-Special; and 4013, Network access service revenues-State include state and interstate revenues.[296] We agree with the GSA that the elimination of Account 5084, State access revenue, as proposed in the *June 8 Public Notice*, require such a conforming change to ARMIS 43-04 Report. Because Account 5084, State access revenue is consolidated

[288] *See CALLS Report and Order.*

[289] *See* Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, *Notice of Proposed Rulemaking*, FCC 00-448 (rel. Jan. 5, 2001).

[290] SBC Comments at 2.

[291] 47 C.F.R. § 36.421.

[292] *Id.*

[293] USTA Comments at 3; Sprint Comments at 3-4.

[294] GSA Reply Comments at 5.

[295] Following the *Notice*, we sought further comment on Part 32 streamlining in a Public Notice. *See June 8 Public Notice.*

[296] GSA Comments at 3-4.

with Account 5081, End-user revenue; Account 5082, Switched access revenue; and Account 5083, Special access revenue, we will need disaggregated reporting of jurisdictional revenues in ARMIS. We note however, that the changes to Part 32 adopted in the Report and Order in CC Docket 00-199 will not be in effect until the April 1, 2003 ARMIS filing. Therefore, we are not making that change to the ARMIS 43-04 Report in this Report and Order. Additional revisions to the ARMIS 43-04, to reflect the Part 32 rule changes in CC Docket No. 00-199, will be adopted in the annual ARMIS Order for the April 1, 2003 ARMIS filings.

154. We received proposals to change the descriptions of various rows and column "c." Sprint recommends numerous changes to the rows, which we adopt, with some modifications.[297] USTA proposes that column "c" should be labeled "non-interstate" instead of "state" to avoid confusion.[298] We do not adopt this proposal. Jurisdictional separations is the process by which incumbent LECs apportion regulated costs between interstate and intrastate jurisdictions. Therefore, columns "c" and "d" are properly labeled "state" and "interstate." "State" and "intrastate" are interchangeable for these purposes, particularly when we are using abbreviations throughout for labeling rows and columns. We see no point in introducing "non-interstate," a lengthier label, to replace "state" in this instance.

155. We are also deleting rows 1523, 3251, 4065, 4110, 8012, and 8017 because they are redundant. Row 1523 is the same as row 1393; row 3251 is the same as row 2194; rows 4065, 8012, and 8017 are the same as row 2131; and row 4110 is the sum of rows 4066, 4076, 4080, and 4090, less 4100. We are adding row 3021, needed as an allocator for other rows; row 5042, needed to summarize "IOT-Other" expense; and row 5050, needed to report directly assigned "IOT-CPE" expense.

156. Finally, USTA indicates that as part of the process of identifying dial equipment minutes, as required for Part 36 separations and reported in the 43-04 Report, the carriers make special studies to calculate local call volumes that are required to be reported in the 43-08 Operating Data Report. They suggest that "as a result of the adoption of the separations freeze, these special studies will also be frozen," and, therefore, rather than report the same information on future reports, "local call" data should be eliminated from the 43-08 Report. We disagree with this conclusion. The *Separations Freeze Order* applies only to Part 36 category relationships and jurisdictional allocation factors. The Order does not apply to the local call volumes as reported on the 43-08 Report and/or their means of development.

157. We therefore adopt the streamlined ARMIS 43-04 Table I-Separations and Access Table, attached as Appendix G. This revised ARMIS 43-04 will be filed on April 1, 2002, and on an annual basis thereafter, for the duration of the separations freeze.

6. ARMIS 43-07 (Infrastructure Report)

158. The ARMIS 43-07 Report collects data about the carrier's switching and transmission equipment, call set up time, and cost of total plant in service. This report is prescribed for every mandatory price cap carrier.[299] The report is filed on a study area and holding company level. The report captures trends in telephone industry infrastructure development under price cap regulation. Policymakers at the federal and state levels use this information,

[297] Sprint Comments at 6-7. GSA supports Sprint's proposals. GSA Reply Comments at 6.

[298] USTA Comments at 3.

[299] Originally, the BOCs and GTE; now SBC, Verizon, Qwest, and BellSouth.

which is critical data not available through other public sources. The ARMIS 43-07 Report is a data source for a number of Commission publications. For example, on an annual basis, the Commission publishes the *Statistics of Communications Common Carriers* and *Infrastructure of Local Operating Companies*. The Commission also publishes on a biannual basis, *Monitoring Reports on Universal Service*. These reports are generated from publicly available data, including data reported in carriers' annual ARMIS 43-07 submissions.

159. USTA, Verizon, and BellSouth contend that we should eliminate the 43-07 Report because it is obsolete.[300] USTA argues that with increased competition and alternative networks providing telecommunications services, the 43-07 is irrelevant and no longer serves a useful purpose.[301] USTA contends that it would be more cost effective and efficient to use data requests should this information be needed.[302]

160. We agree that some of the current reporting requirements are redundant or outmoded, but we decline to eliminate the ARMIS 43-07 in its entirety at this time. The information collected in ARMIS 43-07 provides the Commission with information about the infrastructure -- capacity, and operating characteristics of the vast majority of the nation's wireline network -- basic infrastructure information on carriers that provide service to 93 percent of the Nation's customers.[303] While there may be no need to collect such data in the long term, there is continued utility in collecting such data through this mechanism in the short term to evaluate the effects of public policy choices on those carriers that play a critical role in our national economy and to calibrate our actions. We recognize that adequate information for regulatory purposes could be generated through state or regional activities or through our *Local Competition and Broadband Data Gathering Program*, and we intend to develop a record on whether this is a preferred approach.[304] Thus, at this time, we will limit our streamlining to those current reporting requirements that are redundant or that have clearly outlived their usefulness.

161. Table I - Switching Equipment. In the *Notice*, the Commission proposed to eliminate the collection of outdated information and to collect information on newer technologies. In Table I (Switching Equipment), the Commission proposed to eliminate all reporting requirements for electromechanical switches (rows 0130-0141).[305] Ohio CC and NASUCA oppose the elimination of information on electromechanical switches, and argue that until there are no electromechanical switches remaining in the public switched network, it remains an

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300 USTA Comments at 25-26; Verizon Comments at 12; BellSouth Comments at 6-7.

301 USTA Comments at 25.

302 *Id.*

303 The State members of the Joint Board on Separations urge the Commission to continue accounting mechanisms that support ARMIS Report 43-04 and to retain ARMIS Reports 43-07 and 43-08 because the information in those reports is necessary to evaluate separations reform measures. Joint Board Reply Comments at 2-3. They note that one option for separations reform would be to assign directly all facilities based upon the location of those facilities in the network; the state members say that it would be difficult to evaluate this alternative without information similar to the infrastructure report and the detailed Part 32 sub-account data. *Id.* at 3.

304 *See* Further Notice of Proposed Rulemaking. *But see* Michigan observes that information obtained on broadband deployment by the Michigan Economic Development Corporation from the Commission was either insufficient or restricted by non-disclosure agreements. Michigan Oct. 3, 2001 *ex parte* at 2.

305 *Notice* at ¶ 68.

important element of the network.[306] Other commenters, however, agree with our proposal to eliminate the collection of these data.[307] We note that for the year 2000, the total for all reporting companies of electromechanical switches was zero. We conclude that there is little value in requiring carriers to continue to report that they have no electromechanical switches. Therefore, we adopt the proposal in the *Notice* and eliminate all reporting requirements for electromechanical switches (rows 0130-0141).

162. The Commission also proposed to eliminate reporting requirements for analog stored-program-control (ASPC) and digital stored-program-control (DSPC) switches except for the total number of switches and lines served (retain rows 0150, 0160, 0170 and 0180; eliminate rows 0151-0155, 0161, 0171-0175, and 0181). We find that there is no regulatory need for carriers to report percentages, as the Commission or any interested party can easily calculate them. Therefore, we are eliminating rows 0151, 0153, 0155, 0161, 0171, 0173, 0175, and 0181. For the year 2000, the total reported in row 154 (ASPC Tandems) was two. We find that there is little value in requiring carriers to continue to report such a minimal quantity. Therefore, we are eliminating row 0154. There is also no need to require carriers to report row 0152 (ASPC Local Switches), which is substantially the same as the Total ASPC switches in row 0150; therefore, we are eliminating row 0152. Similarly, because row 0170 is substantially the sum of row 0172 plus row 0174, we are eliminating rows 0172 and 0174. In conclusion, we are adopting the proposal in the *Notice* to eliminate rows 0151-0155, 0161, 0171- 0175, and 0181.

163. Additionally, the Commission proposed to eliminate all reporting requirements related to equal access and touch-tone capabilities (rows 0190-0221).[308] Ohio CC and NASUCA oppose the elimination of information on equal access and touch-tone capabilities. They argue that, until equal access and touch-tone capability are universal, it will be important to know where in the public switched network they are unavailable.[309] We note that for the year 2000 virtually all the reporting carriers' access lines had equal access and touch-tone capability. We conclude that there is little value in continuing to require these carriers to report the data regarding touch-tone capability and equal access.[310] Therefore, we adopt the proposal in the *Notice* and eliminate all such reporting requirements (rows 0190-0221).

164. The Commission also proposed to eliminate reporting of information related to Signaling System 7 (SS7)[311] and integrated services digital network (ISDN)[312] capabilities except

[306] Ohio CC and NASUCA Joint Comments at 8.

[307] *See, e.g.,* WorldCom Comments at 7; GSA Comments at 11; NARUC Comments at 12; Idaho Comments at 7; Florida Comments at 11.

[308] In our *ARMIS Reductions Report and Order*, we eliminated 55 rows pertaining to equal access from ARMIS Report 43-04, because the nearly complete transition to equal access reduced our need to monitor its deployment. *See ARMIS Reductions Report and Order*, 14 FCC Rcd at 11450-451, ¶¶ 14-15.

[309] Ohio CC and NASUCA Joint Comments at note 11.

[310] BellSouth agrees that reporting information on the availability of touch-tone services is not useful. BellSouth Comments at 6.

[311] SS7 provides a means for networks and interoffice switches to communicate with each other using digital links outside the voice channel.

[312] ISDN technology provides the service protocols and channel designations for digital services to customers and can convey voice, data, or compressed video. Basic rate interface ISDN are provided as two 64-kilobit data channels and one 16-kilobit control channel associated with each basic rate access line.

to retain information concerning total switches, lines, local switches, and tandems equipped with SS7 and ISDN capabilities.[313] Commenters agree that this information is no longer needed for our current regulatory needs.[314] There is no need for carriers to report percentages, as the Commission or any interested party can easily calculate them. Therefore, we are eliminating rows 0231, 0233, 0235, 0237, 0241, 0247, 0251, 0257, 0271, 0281, 0291, and 0301.

165: In addition, we note that most switches equipped with SS7-394 capability are also equipped with SS7-317 capability; therefore, the data reported in the interLATA and intraLATA rows for switches and tandems in this section are almost identical. Having carriers report information in both the row for SS7-394 capability and the row for SS7-317 capability appears to be superfluous. Therefore, we are eliminating rows 0234, 0236, 0246, and 0256. We are renaming row 0230 "Total switches equipped with SS7." We are renaming row 0240 "Local switches equipped with SS7" and row 0250 "Tandems equipped with SS7." We conclude that there is no need to continue reporting the number of lines with SS7 service because that is essentially the same as row 0120. Therefore, we eliminate row 0232.

166. In the *Notice*, the Commission sought comment on whether its monitoring program should include information on new technologies that indicate how carriers are upgrading the public switched network.[315] The Commission sought comment on whether to include information for switches capable of transmitting the asynchronous transfer mode (ATM) protocol in Table I. The Commission also sought comment on including data on switched multi-megabit data service (SMDS), internet routers, and frame relay service[316] in Table I. These services, widely offered to business customers for high-volume usage, are high-speed data telecommunications services built upon packet-switching technology.

167. USTA contends that we should not add this information to the ARMIS 43-07, but that this should be collected from all providers through the *Local Competition and Broadband Data Gathering Program*.[317] USTA's arguments are far from trivial. The Communications Act mandates the creation and promotion of a multi-provider local service environment in which all providers will deploy newer technologies. To the extent the Commission is concerned with monitoring the deployment of such technologies, it may be more appropriate for the Commission to collect the appropriate information comprehensively, and we therefore seek comment on this possibility in the attached Further Notice of Proposed Rulemaking. We also acknowledge that such comprehensive efforts, such as the *Local Competition and Broadband Data Gathering Program* are more likely than ARMIS reporting to balance carefully the regulatory need for the information against the burdens that reporting requirements impose on carriers, particularly newer entrants. To date, we have not yet fully evaluated whether it is more appropriate to track these newer technologies through ARMIS or through the *Local Competition and Broadband Data*

Primary rate interface ISDN provides the capacity of twenty-three 64-kilobit data channels and one 64-kilobit control channel.

[313] *Notice* at ¶ 68.

[314] WorldCom Comments at 7; BellSouth Comments at 6.

[315] *Notice* at ¶ 69. Several commenters supported this proposal. *See, e.g.*, Utah Comments at 4; Ohio CC and NASUCA Joint Comments at 9; North Carolina Public Staff Comments at 5; NARUC Comments at 12; Idaho Comments at 7-8; Florida Comments at 11-12; Maryland Sept. 7, 2001 *ex parte* at Appendix.

[316] Frame relay service is a high-speed packet-switching technology used to communicate digital data between, among other things, geographically dispersed local area networks (LANs).

[317] USTA Comments at 26.