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Director - Regulatory Affairs



CC: 96-45/

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RECEIVED

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Ms. Magalie R. Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: Correspondence dated August 23, 2001 from Dorothy Attwood, Chief Common Carrier Bureau, to Irene Flannery, Universal Service Administrative Company - Interim Hold-Harmless Support

Dear Ms. Salas:

Attached is an analysis of hold harmless support for 2001 for various Verizon (former GTE) entities. This analysis was provided to the staff of the Accounting Policy Division of the Common Carrier Bureau on September 7, 2001 in response to concerns raised in the correspondence indicated above. At the request of the staff, we are filing an updated version the analysis as of December 7, 2001.

If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,

W. Scott Randolph

Attachment

cc: William Scher

No. of Copies rec'd 074
List A B C D E

FEDERAL HIGH COST FUNDS
ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

MEETING WITH THE FCC STAFF
SEPTEMBER 7, 2001

UPDATED DECEMBER 7, 2001

RICHARD C. LAVERY
DIRECTOR - REGULATORY SUPPORT

FEDERAL HIGH COST FUNDS ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- PROPOSED MEETING OBJECTIVES:
 - REVIEW SUPPORT CHANGES FROM 2ND TO 3RD QUARTER 2001 LEVELS (00-4 FILNG)

 - IDENTIFY DRIVERS OF CHANGE:
 - SALE OF EXCHANGES IN CONTEL - TEXAS AND GTE - MISSOURI STUDY AREAS
 - CORRECTION OF AN ACCOUNTING ENTRY WHICH HAD UNDERSTATED ACCOUNT 7250 OPERATING TAXES IN PRIOR PERIODS

 - SUMMARY AND NEXT STEPS

FEDERAL HIGH COST FUNDS

ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **REVIEW SUPPORT CHANGES FROM 2ND TO 3RD QUARTER 2001 LEVELS (00-4 FILING):**
 - TOTAL HCF SUPPORT IN VERIZON -WEST (FORMER GTE) STUDY AREAS INCREASED BY \$9.3 M (FROM \$7.3 M TO \$16.6 M) BETWEEN THE 2ND AND 3RD QUARTER OF 2001
 - 86% OF THIS INCREASE OCCURED IN THE FIVE STUDY AREAS FOR WHICH THE FCC HAS EXPRESSED CONCERN:
 - »

	<u>CHANGE / QTR.</u>
• CONTEL - TEXAS	\$ 5.8 M
• GTE NORTH - MISSOURI	\$ 1.1 M
• CONTEL OF NORTH CAROLINA	\$.7 M
• GTE - ALABAMA	\$.4 M
• CONTEL - ALABAMA	<u>\$.0 M</u>
• TOTAL	<u>\$ 8.0 M</u>
 - CONTEL - TEXAS AND GTE NORTH - MISSOURI ACCOUNT FOR:
 - 74% OF THE TOTAL QUARTER TO QUARTER INCREASE
 - 86% OF THE INCREASE FOR THE FIVE STUDY AREAS IN QUESTION

FEDERAL HIGH COST FUNDS

ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **IDENTIFYING DRIVERS OF CHANGE - SALE OF EXCHANGES IN CONTEL - TEXAS AND GTE NORTH - MISSOURI:**
 - FCC RULES REQUIRE LECS TO FILE EXPENSE, INVESTMENT AND LOOP COUNTS ON A ROLLING TWELVE MONTH BASIS (FCC PART 36 AT 36.612)
 - THE 00-4 FILING REPRESENTS THE TWELVE MONTH PERIOD ENDED SEPTEMBER 30, 2000
 - EXPENSES ARE TWELVE MONTHS TO DATE WHILE INVESTMENT AND LOOP COUNTS ARE END OF PERIOD (EOP) (FCC PART 36 AT 36.611)
 - VERIZON SOLD:

	<u>% OF STUDY AREA</u>
• 145K LOOPS IN CONTEL -TEXAS ON AUGUST 31, 2000	54 %
• 39K LOOPS IN GTE NORTH - MISSOURI TO ON JULY 31, 2000	27 %

FEDERAL HIGH COST FUNDS ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **IDENTIFYING DRIVERS OF CHANGE - SALE OF EXCHANGES CONTEL- TEXAS AND GTE - MISSOURI (CONTINUED):**
 - FEDERAL HCF DATA, THEREFORE, REFLECTS:
 - CONTEL - TEXAS - ELEVEN MONTHS OF EXPENSE (OCTOBER 1999 - AUGUST 2000) FOR 260K LOOPS AND EOP INVESTMENT AND LOOP COUNTS FOR 115K LOOPS
 - GTE NORTH - MISSOURI - TEN MONTHS OF EXPENSE (OCTOBER 1999 - JULY 2000) FOR 144K LOOPS AND EOP INVESTMENT AND LOOP COUNTS FOR 105K LOOPS
 - EFFECT IS TWO FOLD:
 - INCREASED THE STUDY AREA LOOPS COST (COST/LOOP) AND, THEREBY, LOOPS SUPPORT
 - DRIVES THE SUPPORT CALCULATION FROM THE LARGE TO SMALL COMPANY ALGORITHM FOR CONTEL TEXAS

FEDERAL HIGH COST FUNDS ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- IDENTIFYING DRIVERS OF CHANGE - SALE OF EXCHANGES CONTEL - TEXAS AND GTE - MISSOURI (CONTINUED):

– IMPACT OF SALE:

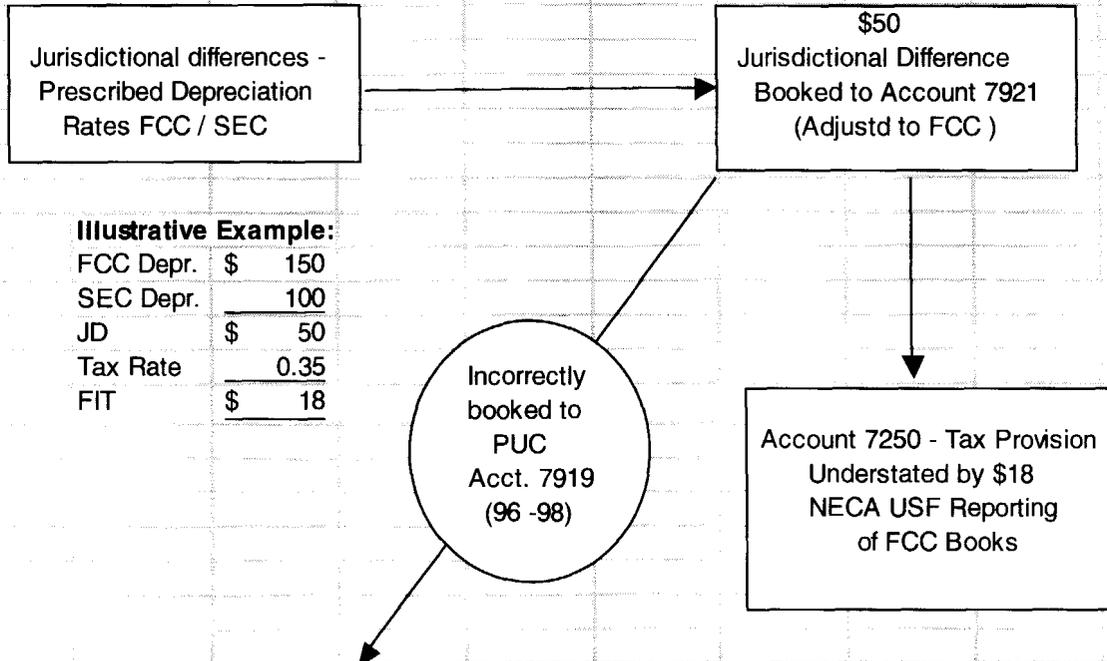
	<u>QUARTERLY SUPPORT</u>		
»	<u>COST W/O LOOPS</u>	<u>ALGORITHM</u>	<u>TOTAL</u>
»			
• CONTEL - TEXAS	\$ 2.2 M	\$ 2.2 M	\$ 4.4 M
• GTE NORTH - MISSOURI	\$ <u>1.1 M</u>	N/A	\$ <u>1.1 M</u>
– TOTAL	\$ <u>3.3 M</u>	\$ <u>2.2 M</u>	\$ <u>5.5 M</u>

FEDERAL HIGH COST FUNDS

ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **IDENTIFYING DRIVERS OF CHANGE - CORRECTION OF AN ACCOUNTING ENTRY WHICH HAD UNDERSTATED OPERATING TAXES IN PRIOR PERIODS**
 - DIFFERENCE IN DEPRECIATION LIVES BETWEEN FCC V. SEC AND FCC V. PUC BOOKS GIVE RISE TO DIFFERING LEVELS OF DEPRECIATION EXPENSE RESULTING IN AN FEDERAL INCOME TAX IMPACT
 - DUE TO AN ACCUMULATION ERROR, THE TAX EFFECT OF THE *FCC V. SEC* DEPRECIATION EXPENSE WAS INCORRECTELY RECORDED IN ACCOUNT 7919 - INCOME EFFECT JURISDICTIONAL DIFFERENCE - (*PUC*) TAX EFFECT
 - FCC V. SEC INCOME TAX EFFECT SHOULD HAVE BEEN RECORDED TO ACCOUNT 7250 - PROVISION FOR DEFERRED OPERATING TAXES
 - THE EFFECT OF THIS ERROR RESULTS IN AN UNDERSTATEMENT OF TAX EXPENSE RECORDED IN ACCOUNT 7250 AND REPORTED FOR HCF PURPOSES
 - A HYPOTHETICAL EXAMPLE IS SHOWN NEXT TO ILLUSTRATE THE ERROR

Jurisdictional Difference Correction of FIT/SIT Tax Provision



Illustrative Example:

FCC Depr.	\$	150
SEC Depr.		100
JD	\$	50
Tax Rate		0.35
FIT	\$	18

ISSUE: JD DEPRECIATION TRUE-UP

There are two types of book depreciation--SEC v. FCC and FCC v. PUC. Account 7911 should represent the book depreciation difference between FCC and PUC; whereas, account 7921 should be the book depreciation difference between FCC and SEC. Deferred taxes on Account 7911 should be recorded in tax account 7919 and deferred taxes on account 7921 should be recorded in tax account 7250.

For years 1996-1998, the source document used to distinguish the two accounts was incorrect; therefore, we booked deferred taxes on account 7921 to 7919 erroneously. As a result, a correcting entry was made in the 3rd quarter of 2000 for these years.

FEDERAL HIGH COST FUNDS

ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **IDENTIFYING DRIVERS OF CHANGE - CORRECTION OF AN ACCOUNTING ENTRY WHICH HAD UNDERSTATED OPERATING TAXES IN PRIOR PERIODS (CONTINUED)**
 - ERROR FOR YEARS 1996 THROUGH 1998 WAS REFLECTED IN THE HCF REPORTING OF ACCOUNT 7250 USED TO COMPUTE SUPPORT IN YEARS 1998 THROUGH 2000
 - THE BALANCE IN ACCOUNT 7250 WAS CORRECTED IN SEPTEMBER 2000 AND HAD THE EFFECT OF INCREASING THE OPERATING TAX REFLECTED IN THE 00-4 SUBMISSION WHICH DETERMINES SUPPORT FOR THE 3RD QUARTER OF 2001:

»	<u>CHANGE / QTR.</u>
• CONTEL - TEXAS	\$ 1.4 M
• GTE NORTH - MISSOURI	\$.0 M
• CONTEL OF NORTH CAROLINA	\$.7 M
• GTE - ALABAMA	\$.4 M
• CONTEL - ALABAMA	<u>\$.0 M</u>
• TOTAL	<u>\$ 2.5 M</u>

FEDERAL HIGH COST FUNDS

ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **IDENTIFYING DRIVERS OF CHANGE - CORRECTION OF AN ACCOUNTING ENTRY WHICH HAD UNDERSTATED OPERATING TAXES IN PRIOR PERIODS (CONTINUED)**
 - REPORTING OF HCF DATA REFLECTS FCC PART 32 FINANCIAL DATA AS RECORDED ON THE BOOKS OF THE COMPANY

 - BOOK TIMING DIFFERENCES ARE NOT “NORMALIZED”
 - NORMALIZATION OF ACCOUNT 7250 IN THE 00-4 FILING WOULD DECREASE TOTAL VERIZON HCF SUPPORT BY \$ 4.3 M PER QUARTER
 - 2ND HALF OF 2001 \$ 8.6 M
 - CALENDAR 2002 \$ 17.2 M
 - » TOTAL \$ 25.8 M

 - NORMALIZATION OF ACCOUNT 7250 IN YEARS 1996 THROUGH 1998 WOULD INCREASE HCF SUPPORT BY \$26.6 M FOR YEARS 1998 THROUGH 2000
 - DUE TO THE 24 MONTH RETROACTIVE CONVENTION FOR TRUE-UPS, ONLY \$12.8 M WOULD BE RECOVERABLE AT THE PRESENT TIME

FEDERAL HIGH COST FUNDS

ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **SUMMARY AND NEXT STEPS:**

- THE INCREASE IN HCF SUPPORT IS DRIVEN BY TWO EVENTS:

	»	»	<u>SALE OF EXCHANGES</u>	<u>ACCOUNT</u>		
			<u>COST/LOOP</u>	<u>ALGORITHM</u>	<u>7250 TAXES</u>	<u>TOTAL</u>
• CONTEL-TEXAS			\$ 2.2 M	\$ 2.2 M	\$ 1.4M	\$ 5.8 M
• GTE NORTH -MISSOURI			\$ 1.1 M			\$ 1.1 M
• CONTEL OF NORTH CAROLINA					\$.7 M	\$.7 M
• GTE - ALABAMA					\$.4 M	\$.4 M
• CONTEL - ALABAMA						<u>\$.0 M</u>
– TOTAL			<u>\$ 3.3 M</u>	<u>\$ 2.2 M</u>	<u>\$ 2.5 M</u>	<u>\$ 8.0 M</u>

NOTE: Contel Texas has 3 dependent variables changing simultaneously. Calculated independently, the algorithm change is \$3.6 M; however, it was assumed the residual in this illustration (total change – other changes = algorithm change).

- CORRECTION OF ACCOUNT 7250 HAS UNINTENTIONALLY IMPACTED THE TIMING OF HCF SUPPORT

- VERIZON’S HCF REPORTING IS COMPLIANT WITH FCC PART 36 REPORTIN RULES

FEDERAL HIGH COST FUNDS ANALYSIS OF VERIZON - WEST HOLD HARMLESS SUPPORT

- **SUMMARY AND NEXT STEPS (CONTINUED):**
 - VERIZON DOES NOT HAVE THE DISCRETION TO ALTER ITS HCF FILING FROM AN “AS BOOKED” VIEW
 - SHOULD THE FCC ACT TO COMPEL “NORMALIZATION” OF BOOK TIMING DIFFERENCES IN ACCOUNT 7250, THIS RULE EXCEPTION SHOULD ALSO PERMIT RETROACTIVE RECOVERY OF ALL PRIOR PERIODS
 - VERIZON STANDS READY TO ASSIST THE FCC WITH ANY FURTHER DISCUSSIONS AND/OR ANALYSIS IT DEEMS NECESSARY TO BETTER UNDERSTAND THE HCF FILING