

# PUBLIC NOTICE

FEDERAL COMMUNICATIONS COMMISSION  
445 12th Street, SW, TW-A325  
Washington, DC 20554

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**DA 01-605**

**BellSouth Corporation and BellSouth Telecommunications, Inc.  
File Application for Review of Responsible Accounting  
Officer Letter 31, Cost Allocation Manual Audit  
Requirements for Large Incumbent Local Exchange Carriers**

**File No. ASD 01-20**

**Released: March 13, 2001**

**Comment Date:** March 28, 2001  
**Reply Date:** April 9, 2001

On January 19, 2001, BellSouth Corporation and BellSouth Telecommunications, Inc. ("BellSouth") filed an Application for Review of Responsible Accounting Officer Letter 31, *Cost Allocation Manual Audit Requirements for Large Incumbent Local Exchange Carriers*, pursuant to Section 1.115 of the Commission's rules. 47 C.F.R. § 1.115. With this Public Notice, we seek comment on BellSouth's Application, which is attached. This Public Notice is issued pursuant to sections 4(i) and (j) of the Communications Act of 1934. 47 U.S.C §§ 154 (i) and (j).

Interested parties may file comments no later than **March 28, 2001**, with the Secretary, FCC, 445 12<sup>th</sup> Street, SW, TW-A325, Washington, DC 20554. Replies to these comments should be filed no later than **April 9, 2001**. Comments should reference File No. ASD 01-20. A copy of each pleading should also be sent to Ernestine Creech, Accounting Safeguards Division, Common Carrier Bureau, FCC, Room 6-C317, 445 12<sup>th</sup> Street, SW, TW-A325, Washington, DC 20554, and to the Commission's contractor for public services records duplication, International Transcription Services, Inc. (ITS), 1231 20<sup>th</sup> Street, NW, Washington, DC 20036.

This proceeding is being treated as a permit, but disclose proceeding for purposes of the Commission's *ex parte* rules. See generally 47 C.F.R. §§ 1.1200-1.1216. Parties making oral *ex parte* presentations are reminded that memoranda summarizing the presentation must contain a summary of the substance of the presentation and not merely a listing of the subjects discussed. More than a one or two sentence description of the views and arguments presented is generally required. See 47 C.F.R. § 1.1206(b)(2), as revised. Other rules pertaining to oral and written presentations are set forth in section 1.1206(b). Interested parties are to file with the Secretary, FCC, and serve Ernestine Creech and ITS,

with copies of any written *ex parte* presentations or summaries of oral *ex parte* presentations in these proceedings in the manner specified above.

For further information, please contact Mark Stone, at (202) 418-0816 (voice), (202) 418-0484 (TTY), e-mail [mstone@fcc.gov](mailto:mstone@fcc.gov).

Action by the Chief, Accounting Safeguards Division, Common Carrier Bureau, FCC.

**DA 01-605  
Attachment**

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

In the Matter of )  
 )  
RAO Letter 31 ) Reference 1600E  
RE: CAM Audit Requirements for Large )  
Incumbent Local Exchange Carriers )

**APPLICATION FOR REVIEW**

BellSouth Corporation and BellSouth Telecommunications, Inc. (“BellSouth”), pursuant to Section 1.115 of the Commission’s rules, 47 C.F.R. § 1.115, hereby apply to the Commission for review of the Common Carrier Bureau’s (“Bureau”) Responsible Accounting Officer Letter 31 (“RAO 31” or “RAO Letter”), released December 21, 2000 (DA 00-2385).

**I. Introduction and Background**

As part of the 1998 Biennial Review, the Commission adopted a report and order that changed the cost allocation manual (“CAM”) audit requirements for mid-sized local exchange carriers (“LEC”) by requiring attestation engagements instead of financial audits.<sup>1</sup> The *Accounting Review Order* also required that the attestation engagements be performed once every two years covering the previous two-year period instead of being performed every year. Subsequent to the *Accounting Review Order’s* release, the Accounting Safeguards Division (“ASD”) of the Bureau issued Responsible Accounting Officer Letter 29 (“RAO 29”) that established procedures that mid-sized LECs were to follow in order to meet the regulatory needs of the Commission.

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<sup>1</sup> *In the Matter of 1998 Biennial Regulatory Review – Review of Accounting and Cost Allocation Requirements*, CC Docket No. 98-81, *Report and Order*, FCC 99-106, released June 30, 1999 (“*Accounting Review Order*”).

The Commission subsequently issued its *Phase 1 Accounting Order*<sup>2</sup> in which it gave large ILECs the option of either continuing obtaining the financial audits on their CAM, which they have been required to obtain since 1990, or allowing them to opt for an attest examination on their CAM. The ASD followed up the *Phase 1 Accounting Order* with RAO 31 that states “[i]n the future, large ILECs shall follow the requirements established for mid-sized ILECs in RAO 29 when engaging auditors for *all* CAM examinations.”<sup>3</sup> Thus, RAO 31 requires that large ILECs apply the procedures in RAO 29 to CAM audits even if the large ILEC chooses to continue to obtain a financial audit. This results in additional regulatory burdens being added to the CAM financial audit process. The addition of such burdens makes absolutely no sense. Large ILECs have been obtaining financial audits for their CAMs for ten years without problem.

The procedures from RAO 29 that were applied to large ILECs through RAO 31 include: 1) 30 days prior to beginning the audit, the mid-sized LEC’s auditors must submit the attestation audit program to the ASD to review; 2) the establishment of the assertions that the mid-sized LECs must make to the Commission regarding their CAM, including the provision of a model assertion letter;<sup>4</sup> 3) the requirement that a separate assertion letter be provided by management regarding the establishment and maintenance of internal controls; and 4) the requirement that the auditors for any attestation engagement must follow ASD’s guidance in performing the engagements. Although RAO 29 established these four requirements, only the first listed item applies a new requirement to large ILECs that choose to obtain a financial audit. The second requirement relates only to an attestation engagement. Moreover, the third requirement is already performed in a financial audit. A requirement of a financial audit is that management must provide a representation letter to the auditors. This letter usually includes or can be expanded to include representations regarding internal controls. Additionally, in the course of performing a financial audit,

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<sup>2</sup> *In the Matter of Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase I*, CC Docket No. 99-253, *Report and Order*, FCC 00-78, released March 8, 2000 (“*Phase I Accounting Order*”).

<sup>3</sup> RAO 31 at 1(emphasis added).

auditors always tests internal controls for weaknesses and compliance. Finally, the auditors have always conducted a post-audit review with the ASD. The auditors implement any suggestions or guidance the ASD may have had for the audit on a prospective basis.

The first requirement, that auditors provide audit programs to the ASD 30 days prior to the commencement of the audit, however is a completely new and unnecessarily burdensome procedure. While the review itself may not appear particularly onerous, BellSouth does not believe that it would have been added by the ASD unless the ASD plans to add additional audit procedures to the audit program. As discussed more thoroughly herein, this will result in increased time and expense that large ILECs will have to expend to have the financial audit performed.<sup>5</sup>

One of the Commission's first steps in its odyssey of establishing rules to govern how an ILEC could provide non-regulated services was issuance of the *Computer II* order.<sup>6</sup> In *Computer II*, the Commission determined that if an ILEC provided any non-regulated services it would have to do so through a separate affiliate. This structural separation was deemed necessary, the Commission reasoned, in order to avoid cross-subsidization of the non-regulated services by the regulated services. The Commission later changed its policy regarding a complete structural separation and allowed ILECs to provide non-regulated services on an integrated basis in its *Computer III* proceeding.<sup>7</sup> In implementing this policy change the Commission reasoned that significant steps had been taken to reduce ILECs incentive and ability to cross-subsidize non-regulated services with regulated services. One such step was

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<sup>4</sup> In an attestation engagement the auditor expresses an opinion on whether management's assertions are fairly stated in all material respects.

<sup>5</sup> The remaining portion of the AFR focuses on this new 30-day pre-approval requirement. Because the other requirements are non-applicable or redundant, BellSouth asks that the Commission completely vacate RAO 31's application to financial audits.

<sup>6</sup> *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Docket No. 20828, *Final Decision*, 77 FCC 2d 384 (1980) ("*Computer II*").

<sup>7</sup> *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, CC Docket No. 85-229, *Report and Order*, 104 FCC 2d 958 (1986) ("*Computer III*").

the implementation of the *Joint Cost Order*<sup>8</sup> and the cost accounting safeguards that it provided including the prescription of rules controlling how costs were to be allocated between regulated and non-regulated services. The *Joint Cost Order* also established the CAM and required all ILECs subject to CAM filing requirements to obtain an annual attest audit by an independent auditor.

In the *Computer III Remand* proceeding, the Commission sought to further strengthen the cost accounting safeguards that it established in the *Joint Cost Order* by requiring ILECs subject to the CAM filing requirements to have the independent auditors to provide a financial audit of the underlying cost allocation data instead of the attest engagement.<sup>9</sup> The Commission stated:

An attest engagement results in an opinion by the auditor about the reliability of a written assertion that is the responsibility of another party. A financial statement audit engagement, by contrast, results in an opinion by the auditor whether the company's financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit must include an examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements, an assessment of the accounting principles used and of significant estimates made by management, and an evaluation of the overall financial statement presentation. The professional standards of field work for financial statement audit engagements specifically require auditors to obtain evidential matter through inspection, observation, inquiries, and confirmations to afford a reasonable basis for the statements under examination, and to evaluate internal controls when those controls are relied upon in determining the extent of auditing procedures.<sup>10</sup>

The Commission clearly recognized that a financial audit provides a substantial amount of assurance related to the financial statement being audited. This level of assurance is the result of significant testing performed by Certified Public Accountants (“CPA”) pursuant to the professional standards established by the governing body of the accounting industry. An audit by a CPA is universally accepted as adequate assurance that the management of the organization that was audited has fairly

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<sup>8</sup> *In the Matter of Separation of costs of regulated telephone service from costs of nonregulated activities, Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to provide for nonregulated activities and to provide for transactions between telephone companies and their affiliates*, CC Docket No. 86-111, *Report and Order*, 2 FCC Rcd 1298 (1987) (“*Joint Cost Order*”).

<sup>9</sup> *In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards; and Tier I Local Exchange Safeguards*, CC Docket No. 90-623, *Notice of Proposed Rulemaking and Order*, 6 FCC Rcd 174 (1990) (“*Computer III Remand*”).

presented the information that was tested. The most significant users of financial audits, the financial and investment communities, are fully satisfied that the audits will be conducted pursuant to uniform accounting and auditing standards. The audit report is sufficient. Indeed, the ASD has accepted every financial audit of cost allocation data filed with the Commission without requiring the review of the audit program prior to the audit. Nothing has changed between the filing all of those previous audits and the current audits. The ASD's requirements in RAO 31 should not be extended to financial audits.

## **II. The ASD Is Adding Requirements Without Justification**

Requiring ILECs that choose to continue having a financial audit to comply with the RAO Letter proposes burdensome new audit requirements on these ILECs without: 1) demonstrating that the proposed new requirements are necessary; 2) estimating the burden that the proposed new requirements would impose; and 3) demonstrating that the benefit of the proposed new requirements outweighs the burdens they would impose. These additional requirements are not in the public interest and should be eliminated.

The Commission must review the additional requirements imposed by RAO 31 with heightened scrutiny considering that the ASD chose to place these additional audit requirements on ILECs pursuant to a Commission order that was issued to reduce regulation. The *Phase 1 Accounting Order* was an effort by the Commission to fulfill its mandate by Congress to eliminate unnecessary regulation pursuant to Section 11 of the Telecommunications Act of 1996.<sup>11</sup> In fact, the *Phase 1 Accounting Order* specifically stated that the purpose of allowing ILECs to obtain an *attestation engagement* was to reduce the ILECs regulatory burden of the present financial audit.<sup>12</sup> In fact, the Commission specifically stated that it was “adopting the less burdensome attest audit requirement, as an option, because we are convinced that attest audits, with the Commission’s input on audit procedures, will adequately protect ratepayers.”<sup>13</sup> As part of this reduction, however, the Commission stated that it would require entities obtaining an attestation

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<sup>10</sup> *Computer III Remand* ¶ 28.

<sup>11</sup> 47 U.S.C. § 161.

<sup>12</sup> “We fully anticipate that this attestation procedure will be a reduction in burden from the present annual financial audit requirement.” *Phase 1 Accounting Order* ¶ 13.

<sup>13</sup> *Phase 1 Accounting Order* ¶ 14.

engagement to submit the audit program to the Commission 30 days prior to the commencement of the audit. This was to allow the Commission time to review the audit and add additional requirements. This additional step was presumably included because an attestation engagement is a change from the financial statement audit engagement in place for the last decade.

The Commission, however, allowed carriers the option of continuing the financial audits. In providing this option the *Phase I Accounting Order* never mentioned the possibility of adding the audit program review process to the existing financial audit requirements. All references to the audit program review process specifically address the attestation engagement. Thus, the ASD is adding requirements to the existing financial audit procedures that were never contemplated by the Commission. Moreover, these requirements are being added pursuant to a congressionally mandated de-regulatory proceeding without even a hint as to why they should be required.

Nothing in the RAO Letter even attempts to justify the increased burden of having the ASD review, with the ability to add requirements, the financial statement audit programs prior to the commencement of the audit. This is particularly egregious considering that the Commission did not seek comment on the matter, nor has there been any indication or discussion that such a requirement was in any way necessary. BellSouth asks why this requirement is necessary now when it was not necessary for the past ten years? Unfortunately, the ASD did not attempt to provide any justification. Accordingly, the requirement cannot stand.

Not only did the ASD not attempt to demonstrate the necessity of the new audit requirement, RAO 31 does not discuss or try to estimate the burden the new requirement will impose. While the ASD may contend that reviewing audit programs prior to the commencement of an audit does not impose any significant burden on the large ILECs, this is not the case. First, it will require a meeting between the ILEC's auditor and the ASD, which will increase the ILEC's expense. Second, BellSouth anticipates the ASD's review of the programs resulting in additional requirements. Indeed, the RAO Letter gives the ASD carte blanche to prescribe whatever additional procedures it may want. Any request, however, will be superfluous to the CPA's need to produce an audit opinion on the cost allocation data. CPAs plan



CAM audit engagements with adequate testing, as required by Generally Accepted Auditing Standards (“GAAS”) and supporting pronouncements, to render an opinion on whether the cost allocation information is presented fairly by management. The CPA has included, as required by the professional standards, all tests necessary to render such an opinion. Thus, any procedures required by the ASD will not be necessary for the CPA to provide an opinion but will merely be additional steps the CPA will have to perform to satisfy the ASD.

The burden imposed on the large ILECs is twofold. First, ILEC resources will be used to assist the CPA in performing the ASD mandated tests. This can be significant depending upon the test required. Second, the CPA will incur additional time in order to perform the additional tests. Thus, the ILEC’s audit expense will increase for no justifiable reason.

Because there is no stated, or plausible, reason for the additional audit requirement, the burdens it will cause far outweigh any benefit. It is unreasonable that the financial audits of the CAMs, performed by the largest CPA firms in the world who have partners with significant experience and intellect regarding cost allocation requirements, would not provide the ASD with sufficient assurance regarding the cost allocation data. Thus, the requirements of RAO 31 are unnecessary for a financial audit.

### **III. Conclusion**

In conclusion, BellSouth respectfully requests that the Commission review RAO 31 and vacate its application to financial audits of large ILECs cost data performed by independent auditors. As demonstrated above, the RAO Letter's requirements are an unnecessary and a costly burden that will serve no useful purpose in a financial audit. The Commission should therefore follow precedent and allow financial audits to be performed as they have for the past ten years.

Respectfully submitted,

BELLSOUTH CORPORATION and  
BELLSOUTH TELECOMMUNICATIONS, INC.

By:

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Richard M. Sbaratta  
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Their Attorneys

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Date: January 19, 2001

**CERTIFICATE OF SERVICE**

I do hereby certify that I have this 19<sup>th</sup> day of January 2001 served the following parties to this action with a copy of the foregoing APPLICATION FOR REVIEW by hand delivery, or by placing a copy of same in the United States Mail, addressed to the parties listed below.

\*Magalie Roman Salas  
Office of the Secretary  
Federal Communications Commission  
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TW-A325  
Washington, D. C. 20554

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Juanita H. Lee

**\* VIA HAND DELIVERY**