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

In the Matter of	)	
	)	DA 96-1434
ALLTEL TELEPHONE SYSTEMS'	)	AAD 94-147
Permanent Cost Allocation Manual	)	
for the Separation of Regulated	)	
and Nonregulated Costs	)	

ORDER

Adopted: August 23, 1996 Released: August 23, 1996

By the Chief, Accounting and Audits Division
Common Carrier Bureau:

I. INTRODUCTION

1. On October 31, 1994, Alltel Telephone Systems ("Alltel") filed a cost allocation manual ("CAM") pursuant to the Joint Cost Order.[1] Subsequently, Alltel filed revisions to this CAM.[2] On November 14, 1994, the Common Carrier Bureau ("Bureau") released a public notice seeking comments on Alltel's initial CAM.[3] MCI Telecommunications Corporation ("MCI") filed comments and Alltel filed a reply. On August 29, 1995, the Bureau released a public notice seeking comments on Alltel's revised CAM.[4] No comments were received pursuant to this notice. In this order we find that Alltel's revised CAM contains cost accounting procedures that are adequate to meet our requirements, except where additional information or clarification is required as discussed below. Moreover, we believe that Alltel's CAM will provide an adequate basis for Commission audits.

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[1] *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 ("Joint Cost Order") recon.,2 FCC Rcd 6283 (1987) ("Joint Cost Reconsideration Order"), further recon., 3 FCC Rcd 6701 (1988) ("Further Reconsideration Order"), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F. 2d 1378 (D.C. Cir.1990).

[2] *See* Alltel filings dated December 29,1994, March 31, 1995, and August 16, 1995.

[3] Comments Sought on Alltel Telephone System's Cost Allocation Manual, 9 FCC Rcd 6695 (1994).

[4] Comments Sought on Alltel Telephone System's Revised Cost Allocation Manual, 10 FCC Rcd 9358 (1995).

II. BACKGROUND

2. In the Joint Cost Order, the Commission established a mechanism for separating the costs of regulated telephone services from the costs of nonregulated services. The purpose of the Joint Cost Order was to assure that regulated operations do not improperly subsidize nonregulated activities. The Commission established two separate but complementary sets of rules, one which governs how carriers allocate their costs between regulated and nonregulated activities and the other which governs transactions between carriers and their affiliates. The Commission required that carriers file CAMs setting out in detail the manner in which they propose to implement those cost allocation and affiliate transaction rules.

3. The Joint Cost Order promulgated standards and guidelines for carriers to follow in developing their cost allocation practices. That Order established a hierarchy of cost apportionment methods with emphasis on the direct assignment of costs and the use of cost-causative allocation methods. First, whenever possible, costs in each Part 32[5] account must be directly assigned to either regulated or nonregulated activities. If costs in an account cannot be directly assigned, they are considered common costs and they must be placed in cost pools which are homogeneous categories designed to facilitate the allocation of costs. The costs in these pools must then be allocated between regulated and nonregulated activities using a factor or formula which is called an allocator. Although the Joint Cost Order did not prescribe specific allocators for each cost pool, it established guidelines for the use of cost-causative allocation methods. Whenever possible, common costs must be directly attributed based upon direct analysis of the origin of the costs themselves. Common costs that cannot be directly attributed must be indirectly attributed based on an indirect, cost-causative linkage to another cost pool or group of cost pools for which a direct assignment or attribution is available. If direct or indirect measures of cost-causation are not available, the cost pool must be allocated using a prescribed general allocator. The general allocator is the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.[6]

4. Section 64.903 of the Commission's rules, requires that a CAM include the following elements: (a) a description of each carrier's nonregulated activities; (b) a list of all incidental activities and the justification for treating each activity as incidental; (c) a chart showing all of the carrier's corporate affiliates; (d) a statement that identifies affiliates that engage in or will engage in transactions with the carrier and that describes the nature, terms, and frequency of such transactions; (e) for each Part 32 account, a detailed description of the cost pools to which amounts in the account will be assigned and the basis on which each cost pool will be allocated, and (f) a description of the carrier's time reporting procedures including the

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[5] 47 U.S.C. Part 32 - Uniform System of Accounts for Telecommunications Companies.

[6] 47 C.F.R. §64.901(b); see Joint Cost Order, 2 FCC Rcd at 1318-19.

methods used to allocate nonproductive time.[7] In addition, ten of the accounts must be assigned to cost pools and allocated using specific procedures prescribed by the Common Carrier Bureau in the CAM Uniformity Order.[8]

5. The Bureau established uniform filing requirements for the CAMs.[9] In accordance with these requirements, a CAM must include the following information: (a) a list of all nonregulated products and services that the carrier provides; this list must indicate the accounts that are associated with each product or service; (b) a list of each type of affiliate transaction in which the carrier engages; this list must indicate which affiliate is involved with each type of transaction; and (c) a list of each type of time reporting method which the carrier uses, this list must indicate which groups of employees use each type of reporting method. In addition, a CAM must describe the procedures used to train employees, monitor, and enforce accurate time reporting, as well as the methods for capturing and allocating the costs of nonproductive time.[10]

III. DISCUSSION

A. Nonregulated Activities.

6. Alltel's CAM includes a table that describes six nonregulated, revenue-producing activities. These activities are: direct sales of customer premise equipment and ancillary equipment; lease/purchase of customer premise equipment and ancillary equipment; lease of customer premise equipment and ancillary equipment; maintenance of customer premise equipment and ancillary equipment; inside wire installation and maintenance; and voice mail services. Alltel's CAM provides adequate descriptions of these nonregulated services and their accounting treatment.[11]

B. Incidental Activities.

7. Alltel's CAM contains a list of nonregulated activities that it proposes to categorize as incidental activities. In the Joint Cost Order, the Commission permitted carriers to account for incidental activities as regulated activities, provided the activities meet the following quantitative and qualitative tests: (a) each activity must be an outgrowth of the carrier's regulated operations; (b) the activities, individually or combined, cannot constitute separate lines of

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[7] 47 C.F.R. §64.903.

[8] Implementation of Further Cost Allocation Uniformity, Memorandum Opinion and Order, 8 FCC Rcd 4664 (1993) (CAM Uniformity Order).

[9] Responsible Accounting Officer Letter No. 19, 6 FCC Rcd 7536 (1991)(RAO Letter 19).

[10] Joint Cost Order at 1321-22.

[11] Alltel's Manual at Section II.

business; (c) each activity must have traditionally been treated as regulated for accounting purposes, and (d) the revenues from all of these activities must not exceed one percent of the carrier's total revenues.[13] Alltel's CAM lists several activities that it treats as incidental, but it provides no description of these activities. We direct Alltel to provide a description of each incidental activity listed in its CAM.

8. We believe that Alltel's mobile cellular sales agency activity, cable TV service, and Alltel long distance service activity do not meet the qualitative tests specified in the Joint Cost Order for inclusion as incidental activities because these activities constitute separate lines of business. Therefore, Alltel is directed to remove them from the Incidental Activities section of its CAM and include them in the Nonregulated Activities section of its CAM, or explain its failure to do so.

C. Affiliate Transactions.

9. The Joint Cost Order established rules that govern the provision of assets and services to and from affiliates. These rules were created to prevent carriers from circumventing the cost allocation rules and engaging in transactions in which they provide assets or services to affiliates, or obtain assets or services from affiliates, at prices that result in unfair rates being charged to ratepayers. Section 32.27 of the Commission's rules defines how carriers are to record affiliate transactions in their books of account.[14] These rules distinguish between transactions involving the transfer of assets and the provision of services. The transfer of assets between affiliates must be recorded at the prevailing prices established through third party arms-length transactions. If no prevailing price is available, asset transfers from an affiliate to the carrier must be recorded at the lower of net book cost or fair market value, and asset transfers to an affiliate from the carrier must be recorded at the higher of net book cost or fair market value. The provision of services must be recorded at the tariff rate, or prevailing price if one exists. Absent a prevailing price, the costs of the service must be recorded at costs that are determined in a manner consistent with the cost allocation requirements of Section 64.901 of the Commission's rules.[15]

10. We find three deficiencies in the Affiliate Transaction section of Alltel's CAM. First, it does not contain a narrative describing sales from its telephone companies to its other affiliates. To rectify this, Alltel must revise its CAM to include such a narrative. Second, it does not adequately describe the services provided to affiliates or specify to which affiliates

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[13] Joint Cost Order at 1308.

[14] 47 C.F.R. §32.27

[15] On October 20, 1993, the Commission released a *Notice of Proposed Rulemaking* to reevaluate its affiliate transaction rules. When a final rule is adopted, the Commission's affiliate transaction rules could be extensively modified. *See Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates,* CC Docket 93-251, 8 FCC Rcd 8071 (1993).

these services are provided. Alltel must revise its CAM to provide this information. Third, in some cases, it specifies terms of affiliate transactions that are apparently inconsistent with our rules. For example, the CAM specifies the use of lease rates, contract rates, and lowest sales prices while our rules specify the use of tariff rates, prevailing market prices, or fully distributed costs. Alltel must either revise its CAM to comply with the terms specified by our rules or clarify how the terms it uses in the CAM do comport with our rules.

D. Cost Allocation Tables

(1) Apportionment Methods

11. In its CAM, Alltel describes its apportionment methods and provides a table, organized by Part 32 account, that describes how it proposes to use its apportionment methods to isolate nonregulated costs. We have three concerns with respect to Alltel's definitions of its apportionment methods. First, it is unclear which apportionment procedures are used to divide costs into pools and which are used to allocate costs between regulated and nonregulated operations. Alltel must revise its "definition of apportionment basis" to clearly distinguish between apportionment methods used to divide costs into pools and allocators used to apportion costs between its regulated and nonregulated activities.

12. Second, Alltel has failed to provide the level of detail necessary to determine whether particular apportionment methods are sound. For example, Alltel uses a business office study as an apportionment method for costs incurred in establishing and serving customers, but does not include sufficient information for us to determine if this study is valid and reliable. Alltel must revise this description to include: the criteria it uses to determine whether it would perform time and motion studies or surveys of customer service representatives time reporting, and the criteria it would use for selecting a study period and what statistical sampling techniques it would employ. Also, Alltel's description of its business office study contains a reference to jurisdictional separations pools. We are unsure how the jurisdictional separations pools relate to the allocation between regulated and nonregulated activities. Alltel must either explain this relationship or eliminate the reference to jurisdictional separations. We direct Alltel to review its description of the business office activity study and all of the apportionment procedures in its CAM to ensure that the CAM provides a complete and accurate description of each of these apportionment procedures.

13. Third, in its "Definition of apportionment basis," Alltel describes how it allocates Headquarters/Regional Costs and Information Services Costs from its affiliates to its telephone operating companies. The description indicates that these activities involve affiliate transactions. Therefore, they should also be included in the Affiliate Transaction section. If Alltel's cost apportionment methods include specific allocators that apportion these costs between regulated and nonregulated activities, the allocators should also be included as part of its definition of allocators.

(2) Cost Apportionment Tables

14. Alltel lists several accounts, each of which are assigned to one cost pool. In the CAM these accounts are directly assigned. However, Alltel does not state whether these accounts are directly assigned to its regulated or its nonregulated operations. Alltel must revise its CAM to clarify the assignment for these accounts.

15. For some accounts in the Cost Allocation Tables, Alltel does not list the specific method it uses to allocate costs between its regulated and nonregulated activities. For example, Alltel lists indirect attribution as the allocator for Account 2115, Garage work equipment. However, indirect attribution is a type of allocation method, not a specific allocator. Alltel must revise the Cost Allocation Tables section of its CAM and specify an allocation method for each cost pool.

(3) Official Communications

16. The Commission's rules require that nonregulated activities be charged tariff rates for services that are offered under tariff.[16] Although the Affiliate Transaction section of the CAM states that Alltel provides services to its affiliates at tariff rates, it is unclear whether Alltel proposes to apply tariff rates to determine the "official communications"[17] costs of its nonregulated activities. Assuming that official communications services are identical to services offered under tariff, the Commission's rules require the application of the tariff rate. In amendments to its CAM, Alltel must explain its proposed treatment of official communications costs and how that treatment is consistent with the Commission's rules.

E. Time Reporting

17. The Joint Cost Order permits carriers to select from among several methods of recording employee time. The Commission reasoned that, since the use of wages and salaries would serve as an important allocator, it was imperative that carriers use accurate methods of recording employee time. The Commission found that no single time reporting system would provide accurate results in all situations. Carriers were, therefore, permitted to propose the use

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[16] 47 C.F.R. §64.901(a)(1).

[17] The term "official communications" applies to telephone service and other communications systems that the company uses for internal purposes.

of positive time reporting or exception time reporting[18], or to develop special studies of employee time.

18. We have several concerns regarding Alltel's description of its time reporting procedures. First, although the CAM identifies the reporting systems the various employee segments use to record their time, it does not describe these systems and it does not demonstrate how they are used to ensure a proper apportionment of labor costs between regulated and nonregulated activities. Alltel must revise its CAM to provide this information.

19. Our rules require that time be reported in increments of one hour or less.[19] For Alltel's positive time reporting system, the CAM states that time is recorded in increments of no less than quarter hours, but the CAM does not set a limit on how large the reporting increment can be. Thus, Alltel has not addressed our concern that reporting in increments of greater than one hour would be unacceptably inexact and result in the misallocation of labor cost. Alltel's CAM must be revised to state that time is reported in increments of one hour or less.

20. CAMs must describe the methods used to train employees, monitor, and enforce accurate time reporting, as well as the methods for capturing and allocating the costs of nonproductive time.[20] Alltel's CAM states that all employees are instructed on policies and procedures concerning time reporting at the time of hiring. This statement provides insufficient description of the training procedures. Alltel must provide more information. For example, it should state whether employees are provided with written time reporting instructions, whether training sessions are held and, if so, how often, and how changes in time reporting procedures are communicated to employees.

IV. PROCEDURAL ISSUES

21. In this Order, we have required Alltel to amend its CAM clarifying many of its cost pool apportionment and cost allocation procedures. We have also directed Alltel to submit additional information concerning its incidental activities, affiliate transactions, and time reporting mechanisms. Alltel must submit a revised CAM that incorporates the changes we have

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[18] In positive time reporting, an employee's day is parcelled into increments of time, typically six minutes to one hour in length. The employee then accounts for all or most of the time worked during a given day by dividing the total amount of hours worked among the specific jobs or functions performed. Under exception time reporting, an employee's time is assumed to be devoted entirely to one or more jobs or functions in which the employee is normally engaged. The employee actively reports only the time spent on activities that depart from the expected schedule.

[19] Joint Cost Order, 2 FCC Rcd at 1321.

[20] *See Supra* para. 7.

required. These revisions will be subject to notice and comment as required by the Joint Cost Order.[21] All revisions that are approved or ordered shall be made retroactive to January 1, 1996.

22. When filing CAM revisions, Alltel must adhere to RAO Letter 19 and Section 64.903 of the Commission's rules. RAO Letter 19 and the rules specify that CAM revisions be accompanied by a transmittal letter and a complete description of changes. Alltel must specify each change to the CAM and state the reasons for each change. The description must contain a sufficient level of detail for us to analyze Alltel's response to each issue raised in this Order. All revised language in the CAM must be in bold-faced type and must be indicated by a vertical line in the right margin. Alltel must file four copies of its revised CAM with the Office of the Secretary and one copy must be delivered to the Chief, Accounting and Audits Division, Common Carrier Bureau.

V. ORDERING CLAUSES

23. Accordingly, IT IS ORDERED, pursuant to Section 4(i) of the Communications Act of 1934, as amended, 47 U.S.C. Section 154(i), and Section 0.291 of the Commission's rules, 47 CFR Section 0.291, that the Cost Allocation Manual filed by Alltel Telephone Systems IS APPROVED, subject to the conditions noted in this Order.

24. IT IS FURTHER ORDERED, that revised copies of the Cost Allocation Manual shall be submitted within 60 days of the release date of this Order.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran

Kenneth P. Moran
Chief, Accounting and Audits Division
Common Carrier Bureau

[21] Joint Cost Order at 1327.