

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

In the Matter of
Ameritech Corporation
Telephone Operating Companies'
Continuing Property Records Audit
ASD File No. 99-22

ORDER

Adopted: February 24, 1999

Released: March 12, 1999

By the Commission: Commissioners Ness and Tristani issuing separate statements; Commissioners Furchtgott-Roth and Powell dissenting in part and issuing separate statements.

I. INTRODUCTION

1. By this Order, we release to the public certain information obtained during an audit of the Ameritech Corporation Telephone Operating Companies ("Ameritech"). The audit report to be released contains the Commission auditors' findings from an audit of Ameritech's continuing property records, conducted pursuant to sections 4(i), 4(j), 213, 217, 218, 220, 303(r), and 403 of the Communications Act of 1934, as amended ("Act"). In releasing the audit report or Ameritech's response attached thereto, we do not pass judgment on the accuracy of the audit report, its findings and conclusions, or the company's response. In the immediate future, we will initiate a proceeding seeking public comment on this matter.

II. BACKGROUND

2. Pursuant to its authority under the Act, the Accounting Safeguards Division (ASD) of the Commission's Common Carrier Bureau audited Ameritech's continuing property records in order to: (1) verify whether the costs on Ameritech's financial books accurately reflect telephone plant used for the provision of telephone service; and (2) determine whether Ameritech was in compliance with Part 32 of the Commission's accounting regulations. The carrier is required by Part 32 to maintain a detailed inventory and other records of its telecommunications plant in service so that the equipment may be readily spot-checked for proof of physical existence. Based upon this audit, ASD's auditors have prepared an audit report containing findings concerning Ameritech's compliance with the Part 32 rules.

1 47 C.F.R. Part 32.

2 47 C.F.R. §§ 32.2000(e) and (f).

3. The auditors provided a draft of their initial audit findings to Ameritech on July 27, 1998, and requested Ameritech to respond in writing by August 26, 1998. The auditors revised the findings as they deemed appropriate, based on Ameritech's response. On December 23, 1998, a final audit report was provided to Ameritech with a letter that offered Ameritech a further opportunity to provide a final response by January 11, 1999. The letter stated that both the final audit report and Ameritech's response would be released to the public. As a procedural courtesy to Ameritech, we will attach their response to the audit.

III. DISCUSSION

4. Section 220(f) of the Act prohibits Commission personnel from disclosing to the public facts and information obtained during an audit, absent Commission or court order. By letter of January 19, 1999, Ameritech has waived its rights to confidential treatment of information contained in the audit report and to information contained in its response to the audit report.

5. We find that release of this audit report to the public serves the public interest by providing interested state regulatory commissions and ratepayers with information gathered during the audit. The findings of the audit report relate to joint assets of the carrier that are used for both state and interstate ratemaking purposes; thus, state commissions and ratepayers have an obvious interest in this information. An additional compelling reason for disclosure is that the audit report provides the basis for further inquiry to safeguard the public interest. We believe that the public policy interests favor release of this audit report. In releasing the audit report or Ameritech's response attached thereto, we do not pass judgment on the accuracy of the audit report, its findings and conclusions, or the company's response.

6. Ameritech has waived claims of confidentiality concerning the audit report and its response. Upon finding it in the public interest, we direct the Common Carrier Bureau to release for public inspection the audit report of Ameritech's continuing property records as well as the company's January 11, 1999 response to the final audit report.³

³ Because Ameritech has waived confidentiality, we need not provide Ameritech five (5) working days in which to seek judicial stay of the Commission's ruling as would otherwise be required by section 0.459(g) of our rules. See 47 C.F.R. § 0.459(g).

IV. ORDERING CLAUSES

7. Accordingly, IT IS ORDERED, pursuant to section 220(f) of the Communications Act of 1934, as amended, 47 U.S.C. § 220(f), and Section 0.459(g) of the Commission's rules, 47 C.F.R. 0.459(g), that the audit report and Ameritech's January 11, 1999 response to the final audit report attached herewith shall be released for public inspection.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

**Separate Statement
of
Commissioner Susan Ness**

Re: Orders Releasing Continuing Property Records (CPR) Audit Reports of Ameritech; Bell Atlantic (North); Bell Atlantic (South); BellSouth; Pacific Bell; Southwestern Bell; U S West

I support releasing the results of the staff audits so that we can discuss their findings, extrapolations, and ramifications with *all* stakeholders -- including state public utility commissions, in particular, as well as purchasers of interstate services and incumbent local exchange carriers.

It is important, however, that our decision to release the results of the staff audits not be misunderstood. While it is plain that there are material discrepancies between the carriers' continuing property records and the physical plant actually found during site visits by the Common Carrier Bureau's audit teams, *the Commission has reached no decisions concerning these audit results*. The reasonableness of the audit methodology, findings, and extrapolations, the relevance of our continuing property rules to the current telecommunications environment, the ramifications of the audit results for interstate rates, the need for remedial measures, and similar issues are all open for discussion.

Until now, it has been appropriate for the discussions between the agency and the audited carriers to be bilateral and confidential. When reputations are at stake, due process requires an extra measure of fairness and opportunity to be heard. That's why release of these reports has been delayed, to allow for additional give-and-take between the Bureau and the audited carriers and inclusion of carrier responses to Bureau findings and conclusions. Now, however, the discussion needs to be broadened, so that *all* interested parties have an opportunity to participate.

I know, from discussions held already, that incumbent local exchange carriers believe the property record discrepancies have no significance for (1) the reasonableness of "going-in" price cap rates, (2) the computations under price caps of (a) low-end adjustments, (b) sharing, and (c) total factor productivity, (3) calculations under the Telecommunications Act of 1996 relating to (a) universal service support and (b) pricing of unbundled network elements, and (4) the merits of "takings" claims and "stranded cost" recovery issues. These arguments merit full discussion on the part of all stakeholders before I am willing to render a decision on the merits.

With today's decision, a full and open dialogue can begin.

Separate Statement of Commissioner Gloria Tristani

Re: Orders Releasing the Continuing Property Records Audits of Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Bell, Southwestern Bell, and US WEST Telephone Companies.

Today, the Commission is releasing to the public audit reports of the Bell Operating Companies' hard-wired central office equipment. This report concludes that the BOCs' book costs for this equipment are overstated by approximately \$5 billion. I fully support the release of the audit reports prepared by the Common Carrier Bureau. At the same time, I am concerned that the Commission is not proceeding expeditiously to the next logical step, *i.e.*, issuance of an order to show cause seeking to enforce our rules.

The costs of the capital investments of telephone companies, recorded in their continuing property records, account for more than half of the annual cost of operations. These costs are fundamental to calculating all financial information upon which this Commission and state commissions rely for decision making. If one-quarter of these records are in error, as the audit reports conclude, then there is a fundamental question of the soundness of financial information provided by the companies. This would be very troubling because we base many important decisions on this information. For instance, cost data is key to making informed decisions on jurisdictional separations, allocation of costs between regulated and non-regulated activities and between competitive and non-competitive services, the accuracy of reported earnings, setting of rates under price caps (including the initial price cap rates, which were set with direct reference to the BOCs' ratebases), legacy cost issues, and universal service support.

Over the past year, the BOCs have lobbied the Commission heavily on this matter. They have aggressively attacked the audits, the competence of the auditors, and the credibility of the audit design. I have reviewed the audit reports and met with Bureau staff several times to discuss the audit findings, the audit procedures, and the specific attacks leveled by the companies. I find the Bureau's audit staff has been very thorough and careful in performing these audits. The staff has years of experience and specialized knowledge in this area and I am confident that the audits were well designed and executed.

In addition, I would strongly disagree with the suggestion that state commissions could uniformly perform the kind of audit that was conducted by the FCC. Resource constraints are a reality of life for most state commissions, and it would be unreasonable to assume that all -- or even most -- states have the resources to conduct these types of audits.

While I fully support public release of these audit reports, I very much want to hear from other parties, such as consumers, purchasers of access service, state commissions, and competitors, all of whom may be significantly affected by misstated regulatory accounts. I

encourage the Commission to move swiftly toward developing a full public record and to initiate any enforcement action that may be necessary.

SEPARATE STATEMENT OF COMMISSIONER HAROLD FURCHTGOTT-ROTH DISSENTING IN PART

Re: Orders Releasing the Continuing Properties Records Audits of Ameritech; Bell Atlantic BellSouth; Pacific Bell; Southwestern Bell; and U.S. West Telephone Companies.

I support the public release of accurate information. I dissent in part from today's Order, however, and fear that the Commission's actions today are irresponsible. If the audit reports released today are methodologically sound and fully accurate, then the Commission is remiss in failing to take immediate action to address these accounting inaccuracies and protect consumers. Indeed, if that is the case, then the agency has been negligent in its regulatory oversight for at least the last two decades, as it has failed to perform such audits even when these companies were under rate of return type regulation. If there remain legitimate questions concerning the accuracy of these audits and the reasonableness of the audit process, however, then it is equally irresponsible of the Commission to release a report that recommends substantial write-offs and suggests that these are not mere technical violations of the bureau's strict interpretation of our rules but rather allegations of significant misconduct.

To the extent that these audit reports contained a mere recitation of the facts which occurred, along with the companies' responses, I would have supported their release. I cannot support, however, the Commission releasing a report that recommends millions of dollars in write-offs and that implies equipment may not have even existed while at the same time admitting that (i) the accuracy of the underlying factual conclusions remains in dispute, (ii) the reasonableness of the audit methodology is still in question, and (iii) the validity of the auditors' extrapolations and conclusions remains open for debate. Indeed, I believe that it is irresponsible for a public agency to release a report that concludes that millions of dollars of equipment may be missing and, in the same order, indicate that it has insufficient confidence in its own conclusions to actually take action. For those who support releasing the audit reports with these factual conclusions and recommended financial actions, I ask why the Commission does not go further and actually initiate some regulatory action? Because the Commission does not have sufficient confidence in its own methodology to propose any action. In the end, it is because the Commission is not sure that these reports are even right!

I, for one, have serious reservations with the audit process itself, the accuracy of its factual conclusions, and the merits of its statistical extrapolations. Thus, I cannot support the release of the entirety of these reports as they build upon these possible inaccuracies to recommend significant financial consequences. Instead, I had urged the Commission merely to release reports that describes the actual physical examinations that took place, and the subsequent information that was filed by the companies. At the same time, this Commission could and should have required the companies to undergo a complete, statistically valid audit by professional private auditors of all of its plant. As I understand it, several companies even made such an offer. In the alternative, the Commission could have referred the matter to another government agency with substantial expertise in actual physical audits. Indeed, I point out that in the entire history of this agency's existence, it has never performed a statistically valid audit

of a regulated entity's entire plant and equipment, whether it be inside plant, outside plant or so called plug-in equipment. This agency did not even find it necessary to perform such an audit when it more directly regulated these or any company's rate of return.

While this initial examination does not necessarily support the conclusions that are reached by the report, it does raise serious factual questions. As would any public official, I take these allegations seriously and if true significant remedies might be necessary to compensate the consumer. The problem arises, however, when this agency levels accusations at companies that it acknowledges may not be entirely accurate. As public officials we have a higher duty than to level accusations while at the same time acknowledging that the underlying facts may not be entirely true. We have a duty first to determine the underlying facts.

It is irresponsible, for example, to turn a blind eye to subsequently found items while endorsing the release of a report that concludes these items do not exist.

It is irresponsible to refuse to ensure even the reasonableness of the auditor's methodology before supporting the release of a report that concludes that millions of dollars of equipment does not exist and should be written off a company's books.

I went and visited such a central office and saw for myself examples of "missing equipment" that had merely been placed on the wrong shelf of a bin. I saw examples where the correct amount of equipment existed, but the exact piece could not be distinguished from other similar pieces and as such the companies were marked down. It is the equivalent of walking into the lobby of an office and asking to see the waiting room chair that was purchased in 1994. Well, the company responds, I can tell you that we are supposed to have 7 chairs and that exactly 7 chairs are in the room. But I cannot tell you for sure which chair was bought in 1994. Well then, conclude the auditors, your records are incomplete and the chair is unverified or missing.⁴ Before my colleagues were to endorse the release of a report that makes such conclusions, I would challenge them to at least visit one of these central offices and see the "missing" equipment for yourself. Either that, or remove such conclusions from the report that is released as endorsed by this Commission.

At core is the fundamental issue of what the bureau audits represent. There are many possibilities. If the bureau audits are accurate, they represent either missing plant and equipment, sloppy record-keeping by the telephone companies, or both. If the bureau audits are not accurate, they may reflect some lack of experience by the bureau in conducting this specific form of plant and equipment audit, this being the first such comprehensive physical audit that the Commission has ever conducted of a company's CPR records. In many if not most matters

⁴ Indeed, frequently such cross checks were not even performed by the Commission. See e.g., *Response To Audit Staff Draft report of Findings Related to Audit of Continuing Property Records of Bell Atlantic*, at 6 (described *infra* at nt. 5).

before the Commission, there are disagreements about how to interpret facts, but not always disagreements about underlying facts. We have in this matter substantial disagreements about basic facts. There is no convergence of opinion about the bureau audits. The bureau stands by its audits; the telephone companies and their auditors claim that they are hopelessly and irreparably inaccurate.

It is clear from my colleagues' comments that many, if not all of us, find it difficult to sort out what the underlying factual basis is. This is a matter with no Commission precedent or experience and with little prospect of Commission expertise in the future. If the local telephone companies have done something wrong, the Commission should take decisive action. I join with my colleagues, however, in a sense of unease that we do not yet have sufficient information to determine exactly what has happened.

Concern for Commission Staff

The FCC has an extraordinarily talented staff of auditors and accountants. They have decades of experience in many types of auditing and accounting. But no one in the FCC has experience with the type of reviews of continuing property records that the Commission staff recently performed. And there is no experience with the form of extrapolations from such unprecedented record reviews.

This entire exercise of reviewing continuing property records could be an opportunity for good purposes. It could demonstrate obsolete record-keeping requirements are no longer needed. It could demonstrate that plant and equipment audits make no sense in an era without rate of return regulation. It could demonstrate that record-keeping and auditing practices have long been inconsistent with contemporary business and regulatory practice.

But the opportunities for good purposes are overshadowed by other purposes. What emerges today is not an academic report on the archeological excavations of ancient accounting records, but a game of "Gotcha!" on the present and future accounting records of a handful of large telephone companies.

The FCC staff has been put in an untenable position. First, they were asked to conduct a comprehensive, massive audit of plant and equipment based on decades-old records that had never been reviewed, much less audited, before. As with any initial review of any type of record, judgments and interpretation had to be made, and these judgments were made as the review went along. Rather than comparing initial audits with other records or allowing parties to respond to initial reports or to comment on the initial judgments rendered in the review, the Commission staff was instructed to extrapolate from the initial reviews to determine a total amount of missing equipment, with little or no accounting for depreciation.

If the Commission had tried-and-true methods to review the continuing property records, and if the Commission had exercised these methods year after year, the results of a Commission

audit would have substantial weight and clear defensibility. We have no such basis for this review of the continuing property records. And we have no intellectually defensible basis to do these wild extrapolations to the total value of missing equipment, with little or incomplete regard for depreciation.

This entire process has placed the entire Commission in the position of publishing reckless reports that are injurious to specific parties. But the process is also unfair to the Commission staff, who are extraordinarily talented, and who should never be placed in a position of having to conduct and then defend work that is ultimately indefensible. The staff has enormous integrity. It should not suffer as a result of being placed in this position.

History & Background

One year ago this week, I expressed my concern with the Commission's ongoing micromanagement of LEC accounting rules in the release of the GTE CPR audit.⁵ I noted that state utility commissions frequently require and private auditors are regularly hired to examine a LEC's financial records. I pointed out that such comprehensive property records were only remnants of rate of return regulation, and encouraged the Commission to become more aggressive in eliminating these rate of return type regulatory backstops. Instead, I hoped and urged the Commission to focus its efforts on developing a more forward-looking blueprint to guide the transition from price-cap regulation to even more streamlined regulation for particular geographic or service markets in which competition occurs.

Unfortunately, little progress has been made in the past year. As demonstrated by the release of today's reports, my urgings have been for not. This Commission seems intent on remaining mired in regulatory details -- such as whether or not a piece of equipment that is found in the central office but is placed on the wrong shelf or in an incorrect bin violates our "regulations" -- unwilling to let go of the regulatory stranglehold that the 1996 Telecommunications Act was supposed to eliminate. How much has this focus of Commission resources cost the American public? The Common Carrier Bureau estimates that at least 4800 hours -- more than 2 man-years -- were spent on *each* of the seven Audits. That is at least 33,600 Commission hours not spent on other issues such as Section 251 enforcement, or completing its work on universal service for small rural carriers, or fulfilling its statutory mandate to review all of its regulations pursuant to Section 11, or approving the transfer of broadcast licenses that otherwise meet the Commission's written rules in a timely manner.

Indeed, today's audits are unprecedented in Commission history; the interpretations of our rules to require that locations be specified down to the shelf level are novel. Even during rate of

⁵ In response to recent press stories regarding the Commission's delay in releasing these audit reports, I feel compelled to state that I had finished my statement earlier and that the release of the audit report and my statement has been delayed by several days at the Common Carrier Bureau's request.

return regulation, the Commission never found it necessary to perform the type of sweeping audit that was conducted here. Nor had the Commission ever enforced its accounting rules in such an exacting manner. I find it ironic that the Commission takes these actions in today's price-cap regime where it can be argued that the capital investment is irrelevant to prices, but never found it necessary to do so under a rate of return regulatory environment where capital investment is directly correlated to the rates charged to consumers.

To the extent that accurate plant accounts play any continuing role in monitoring financial results, defining stranded investment or calculating low-end earnings adjustments, these mechanisms are mere relics of rate of service regulation and should be eliminated in today's increasingly competitive environment. Indeed, price-cap regulation is only designed, to the extent possible, to replicate a competitive marketplace. But any form of regulation is an imperfect surrogate for full-fledged competition. At a minimum, we should implement a system of pure price-cap regulation for the largest carriers, under which there would be little need for the Commission to continue to perform general plant account audits or dictate, even through revised or streamlined procedures, low-end adjustments and depreciation rates.⁶ In any event, the Commission should immediately stop any further auditing of outside plant or plug-ins until it is determined (i) whether this agency has the experience to perform a meaningful audit of continuing property records, and (ii) whether or not the benefits of these audits outweigh the costs in a price-cap regulatory environment.

Some Potential Flaws with the Audits' Process, Methodology, and Conclusions

Potential Problems With the Audits' Methodology. I am concerned that there are several flaws with the audit methodology that could severely undermine the credibility of the audit results. For example, the conclusions reached in the audit report are inappropriate given the statistical sampling methods used. The Commission staff designed an audit to test the compliance with CPR rules. In the audit report, the Commission extrapolates such results to make conclusions regarding the dollar value of the account balance errors. The audit methodology, however, was designed to determine the percentage of equipment in compliance, not to predict a fair dollar value of the company's account balances. I am concerned about the appropriateness of reaching any conclusions about the dollar value of account balances using this sampling methodology.

For example, to attempt to make such statements about the dollar value of the equipment in question, the audit would have been much more accurate if it had stratified the equipment based on its dollar value. In other words, if the Commission wants to say something about the potential overstatement of plant in a company's account records, it should be sampling for

⁶ Some may argue that, even under pure price-caps, some accounting rules would be necessary to determine expenses if a LEC filed a general rate case with the Commission. But only under those limited circumstances would the FCC have any need for a CPR audit.

expensive pieces of equipment. Instead, the Commission staff designed a test to assess compliance with FCC regulations, but not the accuracy of plant account balances. Thus, it is questionable whether these results can ever be used to say something meaningful about the plant account balances.

In addition, the Commission has failed to take depreciation even partly into account for its suggested write-offs. The Commission staff's extrapolated amounts ignore that the equipment may have been retired or significantly depreciated. Even if all other aspects of the report are accurate, the failure to account properly for retirement and depreciation systematically leads to exaggerations of the estimate of missing equipment.

For all of the pretense of statistical sampling, the estimates of missing equipment are painfully and impossibly precise. The Commission has no basis to know all of the possible sources of uncertainty, but at the very least they include the accuracy of the underlying audits, whether equipment was actually present or not, and whether retirement and depreciation were taken into account. The Commission's extrapolations present consistently the upper bound estimate of possible missing equipment. The lower bound is zero, a value defended by the companies' outside auditors. Based on the information available to the Commission, it is impossible to estimate the value of missing equipment with any precision. It would have added enormously to the credibility of the report to have acknowledged the wide range of possible values, including zero.

I am also concerned with the Commission's refusal to perform a two-way plant and equipment review. I fear that the audit report may be systematically biased in that the methodology is designed only to detect instances of overstatement in plant records. The Commission failed to perform a two-way audit or to perform any tests to determine the possible existence of assets that are not found on the accounting records, potentially undermining the reliability of the report.⁷

Finally, I am concerned that a cross-check of "missing" equipment was not systematically performed. When the auditors determined that a company was unable to identify a particular piece of equipment, they refused to ask how many of such pieces of equipment were supposed to be present and ask if such pieces were indeed there.⁸ To illustrate, if the auditors had

⁷ "The Failure to conduct a reverse or two-way audit means that any quantification of 'missing' investment systematically overstates any value and cannot be relied upon." *Joint Reply of SBC LECs to FCC December 22, 1998 Draft Report*, at 14. See also, *Response To Audit Staff Draft report of Findings Related to Audit of Continuing Property Records of Bell Atlantic*, at 9-10.

⁸ Frequently such cross checks were not performed by the Commission. See e.g., *Response To Audit Staff Draft report of Findings Related to Audit of Continuing Property Records of Bell Atlantic*, at 6:

"Indeed, the property reports themselves recognize that further investigation is warranted under these

determined that a company was unable to identify a particular waiting room chair that was purchased in 1994, the auditors refused to consider the fact that the records indicated that a total of 7 chairs should be present and that indeed 7 chairs were present. The inability to identify which chair was the one in question resulted in the company being marked down.

Potential Problems With the Audits' Process. I am also concerned with the audit process itself, and the apparent lack of communication. On numerous occasions, carriers requested the opportunity to discuss documentation submitted and provide explanations to audit staff, but were given no opportunity to do so. This refusal to discuss audit results alone would be troubling, but becomes more problematic when carriers raise legitimate factual discrepancies.

Generally accepted auditing standards require the auditors to consider all appropriate evidence. As described above, the Commission failed to conduct a two-way audit and consider that evidence in relation to possible overstatements in plant equipment. In addition, it appears that the staff did not consider all of the material documentation subsequently submitted by the companies as evidence of the existence of that equipment. For example, it appears that several items were classified as missing from some central offices in the Bell Atlantic territory because the equipment was retired between the time that the auditors selected the property records and the actual on-site visit. When notified of this error, the Commission staff seemed to accept the explanation with regards to some equipment and it reject it with respect to others.⁹ Even more important, the Commission staff would not discuss the discrepancies in their treatment of this issue with representatives of the company.

In general, such evidence appears to suggest that additional steps to verify the audit findings should have been taken. At the very least, the Commission staff should have been allowed to discuss the discrepancies in their treatment of such subsequently submitted material. It is my understanding, however, that there was little or no communication of the audit findings with the

circumstances to clarify that such items correspond to the item in the property records:

For some items, additional audit work allowed auditors to conclude that the item shown was the item listed on the CPR. This additional work consisted of the auditor conducting an office count of like items to account for all such items in the central office or on the floor where the item was expected to be found. . . .

Audit Staff Report, Appendix C at 1. While this procedure *rarely* was adhered to by the audit staff -- presumably because the audit staff only allowed six hours to physically inspect each office, or roughly ten minutes per item -- it was successfully adopted by Bell Atlantic in its post inspection review. Despite the endorsement of this procedure in the audit staff reports, however, *the reports do not yet reflect the fact that many items were found through precisely this type of cross check.*"

⁹ *Response To Audit Staff Draft report of Findings Related to Audit of Continuing Property Records of Bell Atlantic*, at 5.

companies until the report was prepared. Frequent communication seems a necessary part of any audit, and its dearth here leaves me questioning the audits fairness and impartiality.

With this lack of meaningful communication as a backdrop, I am troubled with the audit staff's own inconsistent treatment of subsequently filed material. My office was shown many examples of inconsistent scoring by the Commission staff in its report. Ameritech alone provided numerous examples of inconsistencies in which items with the same or similar explanations and documentation were submitted, but treated differently by the auditors. How can the exact same explanation for identifying a piece of a frame be accepted for some offices and rejected for others with no explanation?

Finally, I believe that the audit staff misinterpreted the Commission's rules and requirements. I do not believe that the Commission's regulations require that the auditors be able to "spot-check" the location of a company's entire equipment inventory down to a specific bay or shelf, with no meaningful opportunity for subsequent filings. Our rules do not require such a precise location be maintained for every piece of equipment. Indeed, if our rules require such detail, then the Commission has surely been negligent in failing to identify these rules for streamlining under the Section 11 biennial review process as the cost of such precise detailed record-keeping would surely outweigh the public benefit. Indeed, I think that an audit with such a precise location standard has been designed for companies to fail.

Potential Problems With the Audits' Conclusions. The issues described above with respect to the audit methodology and process alone would raise serious questions about the audits conclusions. I also note that these companies seemed to raise several important arguments regarding the significance and impact that any such plant account discrepancies would have on ratepayers.

In addition to these concerns, I note that many of the carriers engaged private accounting firms that have reduced the alleged overstatement significantly, sometimes by as much as 50%.¹⁰ Thus, I fear that the carriers may have "found" significant amounts of the equipment the Commission staff is classifying as "missing." At the request of one of the carriers, I even visited one of the central offices and was shown equipment that had been categorized as "missing" that was obviously found. In one example, there were supposed to be at least 8 pieces of equipment in one bin but it appeared that there were only 5 present. Indeed, three had been marked as missing by the auditors. But, as I was shown, the remaining equipment was merely out of sight -- hidden by the catwalk. If one stepped back, you could see the remaining equipment above the catwalk. I do not fault the auditors for missing this equipment on the first

¹⁰ Bell Atlantic, for example argues that it has "found fully 97% of the items included in the audit staff's sample, and the bulk of the remaining 3% either have been accounted for as retirements or otherwise cannot be fairly characterized as `missing.'" *Response To Audit Staff Draft report of Findings Related to Audit of Continuing Property Records of Bell Atlantic*, at 1.

round. I do however, fault a Commission process that turns a blind eye to subsequently found equipment while at the same time releasing a report that concludes such equipment *is* missing. In another example of excess that I was shown, the auditors had counted as unverifiable a battery that was being used in a piece of equipment because it could not be removed to display its serial number without taking the piece of equipment out-of-service, destroying its usefulness.

Let me make an important distinction. To the extent that we wanted to say that the equipment was not readily available on the day that Commission staff arrived, but make no conclusions about whether or not it truly exists, the audit report would be fine. But the report approved for release by the majority takes the next step of concluding that the equipment does not exist and making recommendations regarding write-offs and adjustments. As I have stated, to make such conclusions while ignoring facts is irresponsible.

Conclusion

I support the release of a report describing the review of continuing property records. I believe, however, that we Commissioners may not be very good auditors. The Commission staff's physical verification raises serious concerns with the company's record-keeping but also with this agency's capability of finding any meaningful results based on these continuing property records. The Commission should avoid wasting further government resources performing physical verification audits with these records. Instead, the Commission should have required that such a comprehensive audit be performed by private or other public auditing professionals based on standard accounting and auditing procedures, not necessarily limited to continuing property records. I believe that this agency and its Commissioners may never be capable of judging the accuracy and authenticity of the current set of audit results.

I spent several years in private economic consulting. I have seen good cases; I have seen weak cases; but rarely have I seen numbers as indefensible as the extrapolations of missing equipment contained in these orders. I could not possibly defend them, and I therefore must respectfully dissent from their release. Their release is unfair to the professional staff of the FCC who must defend these numbers, and ultimately loose. Their release is also unfair to companies whose reputations will suffer. Accusations that companies are bilking the American public of billions of dollars should not be made lightly by government agencies. Grave accusations must be substantiated by evidence that is unambiguous and rock solid. Ambiguity is only one frailty of our evidence.

**STATEMENT OF COMMISSIONER MICHAEL K. POWELL,
DISSENTING IN PART**

Re: Bell Atlantic (North) Telephone Companies' Continuing Property Records Audit et al.

In this combined statement, I write separately to explain the bases upon which I dissent in part from each of the referenced *Orders* releasing continuing property record (CPR) Audit Reports for the Bell Companies.

I fully agree that the information contained in the Audit Reports should have been released in some manner, primarily to ensure its factual accuracy, methodological validity and to determine whether, if the Reports' conclusions are valid, there has been a detrimental impact on ratepayers. Such an impact, if proven, would be serious. And I would willingly support addressing such an impact right now were I persuaded that we have enough information to prove it. Accordingly, I support these *Orders* to the extent they stand for the proposition that the kind of information in these Audit Reports should, as a general matter, find its way into the public domain so that its validity may be properly and thoroughly tested, and so that the Commission can take whatever actions are appropriate based on the conclusions it reaches in light of such thorough testing.

I am reluctant, however, to level accusations as grave as are implied by these Reports without first subjecting the underlying facts and analysis to outside scrutiny, which we have yet to do. The Reports' recommendations of writeoffs, accounting corrections and complete inventories strongly suggest that we have concluded that these are more than mere technical violations and that they must be remedied. Thus, I feel I must dissent in part from these *Orders*.

As the *Orders*' indication that we will initiate a proceeding appears to suggest, we simply do not have enough information to endorse fully and take action on the Reports' conclusions at this time. Specifically, the intention to start a future proceeding suggests we lack sufficient confidence in the Reports to proceed to enforcement without first subjecting their facts and analysis to public scrutiny. Yet today we push these Reports and their conclusions into the public domain without such scrutiny. This action might be troubling even if the Reports did not, in essence, allege misdeeds as potentially significant as these. But the allegations here are, indeed, very significant. By releasing the audit information as we do today, I fear we will subject the Companies to premature and prejudicial criticism and adverse market impact.

The *Orders* indicate that, by releasing the Reports in this manner, the Commission does not endorse the recommendations and conclusions of our Common Carrier Bureau's auditors. Such a distinction is too fine to my mind in light of the seriousness of the allegations and the fact that the *Commission* -- not the Bureau -- is ordering release of the Reports. I do not doubt the integrity of our auditors' work or even necessarily the

validity of their analyses and conclusions. I simply am unprepared to place what seems to be the Commission's imprimatur on those analyses and conclusions before they are tested in the fire of vigorous debate by other interested parties.

Under these exceptional circumstances,¹ I believe we should have erred on the side of giving the Companies more process than may normally be due *before* hinting at conclusions and implications. We had already begun to provide such extra process by, for example, sharing with the Companies the results of their respective audits and allowing them to comment on them. By releasing the Audit Reports in the manner we do today, however, I believe we have short-changed the process of gathering additional information in as neutral a manner as possible.²

In closing, I would underscore that my partial dissent from these *Orders* in no way reflects serious doubt on my part that the Commission's auditors worked diligently and carefully to perform these audits. I have every expectation that they endeavored to do so under the circumstances. My concern is primarily with the manner in which the information contained in the Reports is being released today, and with the manner in which we will build on that information to reach final conclusions. I thank our Common Carrier Bureau staff and my colleagues for their patience and hard work in this matter, and I look forward to working with everyone as we take the next step of seeking and considering outside comment on this important issue.

¹ It is my understanding, for example, that the Commission has never (even in a rate of return environment) enforced these long-standing rules in so sweeping a manner. The Companies also have apparently raised some important arguments regarding whether, even if the Reports are valid, the Companies' alleged misconduct would result in significant impact on ratepayers or other public policy detriments.

² I think the ideal approach would have been to release the Reports without specific recommendations and conclusions and neutrally solicit comments on both the statistical methodology and policy implications (e.g., ratepayer impact) of any plant deemed missing. I recognize that some are concerned that releasing the Reports without recommendations and conclusions would somehow interfere with Commission auditors' autonomy. I am unpersuaded by this concern, for I believe reserving judgment on the appropriate recommendations and remedies in no way undermines the integrity of auditors' findings or their work, nor would such an approach require substitution of the auditors' conclusions with those of other individuals. I should add, however, that I also would have been willing to issue these Reports *simultaneously* with a "neutral overlay" document, such as a Notice of Inquiry, that would have sought comment without interpreting the factual findings or making tentative conclusions as to the impact on ratepayers, etc. I think this could (and should) have been done in a way that would not impugn the performance and integrity of the Commission's auditors, but that would have merely reserved judgment until we have an opportunity to hear from other interested parties.