JOINT FEDERAL/STATE OVERSIGHT GROUP

GENERAL STANDARD PROCEDURES FOR BIENNIAL AUDITS REQUIRED UNDER SECTION 272 OF THE COMMUNICATIONS ACT OF 1934, AS AMENDED

As of December 16, 1998

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BIENNIAL ENGAGEMENT PROCEDURES

INTRODUCTION

Background

1. Section 272(a) of the Communications Act of 1934, as amended, requires that a Bell Operating Company (BOC) set up one or more separate affiliates before engaging in manufacturing activities, in-region interLATA services, and interLATA information services. Also, before engaging in the provision of in-region interLATA services, a BOC or an affiliate of the BOC must meet the requirements of Section 271 of the Communications Act of 1934 and must receive approval by the Federal Communications Commission (FCC). A BOC required to operate a separate affiliate under Section 272 must obtain and pay for a joint Federal/State audit every two years.[1]

2. After having considered all types of audits and engagements performed by certified public accountants (CPAs) and the FCC staff's past experience in the Cost Allocation Manual (CAM) audits, we believe that it would be in the best interest of all the parties concerned that this audit be an Agreed-Upon Procedures (AUP) Engagement. The American Institute of Certified Public Accountants (AICPA) defines an AUP engagement as, "one in which a practitioner is engaged by a client to issue a report of findings based on specific procedures performed on the subject matter of an assertion."[2] The objective of an AUP engagement is to present specific findings to assist users in evaluating an entity's compliance with specified requirements. The users include the federal and state regulators as well as the companies responsible for obtaining and paying for the biennial audits.

3. As the primary users of the joint Federal/State biennial audit, the Federal/State Biennial Oversight Group (Oversight Group), which is comprised of staff members from state regulatory agencies and the FCC, is responsible for the nature, timing and extent of the AUP. The Oversight Group will be subdivided into Regional Oversight Teams (Oversight Teams), one for each Regional Bell Operating Company (RBOC). Each team will be comprised of two members from the FCC and members of the State Commissions who have chosen to participate in this project and

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[1] 47 U.S.C. § 272(d)

[2] AT § 600.03 Codification of Statements on Standards for Attestation Engagements, published by the American Institute of Certified Public Accountants.

who have jurisdiction over that RBOC. Each team is responsible for reviewing the conduct of the engagement and, after discussion with the BOC and its Section 272 affiliate, for directing the practitioner to take such action as the team finds necessary to achieve each objective. The text below provides the requirements for the engagement as listed in Section 53.209(b) of the FCC Rules and indicates the nature, timing and extent of the AUP for each requirement. It should be noted that AUP engagements are not based on the concept of materiality; therefore, the practitioner must report all errors or discrepancies discovered while performing the AUP engagement.

COMPLIANCE REQUIREMENTS

4. The requirements for the biennial audits are contained in 47 U.S.C. Section 272(b), (c), and (e) of the Communications Act of 1934, as amended, and in 47 C.F.R. Section 53.209(b) of the FCC Rules and Regulations. Below is a listing of those requirements:

Structural Requirements

The separate affiliate required under Section 272 of the Act:

I. Shall operate independently from the Bell operating company;

II. Shall maintain books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the Bell operating company;

III. Shall have officers, directors, and employees that are separate from those of the Bell operating company;

IV. May not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company;

Accounting Requirements

The separate affiliate required under Section 272 of the Act:

V. Shall conduct all transactions with the Bell operating company on an arm's length basis with the transactions reduced to writing and available for public inspection.

The Bell operating company:

VI. Shall account for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

Nondiscriminatory Requirements

The Bell operating company:

VII. May not discriminate between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards;

VIII. Shall fulfill any requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates;

IX. Shall not provide any facilities, services, or information concerning its provision of exchange access to the Section 272 affiliate unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions;

X. Shall charge its separate affiliate under Section 272, or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service;

XI. May provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated.

Related FCC Dockets

5. These requirements have been clarified and expanded upon in several FCC proceedings. These proceedings are subject to further modification in subsequent FCC orders, or in orders on reconsideration. Below is a list of orders related to the above requirements issued by the FCC:

CC Docket No. 96-149, In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; *First Report and Order and Further Notice of Proposed Rulemaking*; Released December 24, 1996

CC Docket No. 96-150, In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996; *Report and Order*; Released December 24, 1996

CC Docket No. 96-98, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; *First Report and Order*; Released August 8, 1996 (<u>First Interconnection Order</u>); *Second Report and Order and Memorandum Opinion and Order*; Released August 8, 1996 (<u>Second Interconnection Order</u>)

CC Docket No. 96-115, In the Matter of Implementation of the Telecommunications Act of 1996: Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information; *Second Report and Order and Further Notice of Proposed Rulemaking*; Released February 26, 1998

6. In addition, the FCC has opened the following pending dockets which may, if applicable to the activities of the BOC, result in additional regulations surrounding the Nondiscriminatory Requirements:

CC Docket No. 96-254, In the Matter of Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996; *Notice of Proposed Rulemaking*; Released December 11, 1996 (to examine manufacturing by BOCs - "Manufacturing NPRM")

CC Docket No. 98-56, RM-9101, In the Matter of Performance Measurements and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance; *Notice of Proposed Rulemaking*; Released April 17, 1998 (to examine a proposed methodology by which access to incumbent LEC operations support systems is measured and reported to ensure nondiscriminatory, just, and reasonable treatment of new local telephone service providers - "OSS NPRM")

ENGAGEMENT PLAN

Engagement Period

7. In order to facilitate meaningful data collection, the AUP engagement shall cover the first 12 months of operations commencing on the date the first Section 271 approval is obtained to provide in-region interLATA services, or at such time a Bell operating company first commences manufacturing operations, or begins providing interLATA information services. The engagement will also cover all assets since the date of inception of the Section 272 affiliate, which shall be the date when it, or its predecessor, was incorporated or the date when it first had assets. In the case of in-region interLATA services, if Section 271 approval is obtained, for example, on May 1 and operations begin on June 10, the engagement will cover the 12-month period of operations beginning May 1 through April 30. The planning and preliminary work for the engagement may commence prior to the end of the 12-month period of operations. The first biennial audit will cover all services for which a separate affiliate is required under Section 272(a)(2) and includes all states in which Section 271 approval has been obtained.

Sampling

8. The sampling sizes and methodologies will be determined after the initial survey of the Section 272 affiliate. Where indicated and appropriate, the practitioner will select a statistically valid sample using random and stratified sampling techniques with the following parameters: a desired confidence level equal to 95% and a desired upper precision limit equal to 5% with an expected error rate of 1%. The Oversight Team will approve the sampling plan, after consulting with the BOC, when reviewing the detailed procedures written by the practitioner.

9. Generally, the practitioner should consider all data and information falling within the engagement period; however, unless otherwise stated in this document or accepted by the Oversight Team, the practitioner should obtain data and information as of the latest period available during the engagement period.

Definitions

10. Throughout this document the BOC is mentioned as being one of the entities being analyzed. If the BOC transfers or assigns to an affiliated entity ownership of any network elements that must be provided on an unbundled basis per Section 251(c)(3), such entity will be subject to all of the requirements of the BOC. For purposes of this audit, in the event that the BOC retails or wholesales any exchange and/or exchange access services exclusively through one or more of its subsidiaries or affiliates, or through one or more other subsidiaries, divisions,

etc., of the parent Regional Holding Company, and the same services cannot be purchased directly from the BOC, then these entities will also be subject to all of the relevant nondiscriminatory requirements of objectives VII through XI of this document. Affiliates that merely resell the BOC's exchange services and/or exchange access services or lease unbundled elements from the BOC, or engage in permissible joint marketing activities (see Section 272(g)(1) of the Act), are excluded from these requirements.

11. The term "affiliate" means a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For this purpose, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent. (Section 3 of the Communications Act of 1934, as amended)

Conditions of Engagement

12. The practitioner leading this engagement must be a licensed CPA. He/she and his/her team performing the engagement must be familiar with the guidelines established for agreed-upon procedures, the requirements for this engagement, and its objectives. The team performing the engagement should also be independent as defined in the Statements on Standards for Attestation Engagements at "AT §100.23, .24". All members of the team performing the engagement must have read, understood, and be familiar with all of the requirements contained in the following documents:

- Sections 271 and 272 of the Communications Act of 1934, as Amended;
- Section 32.27, Transactions with Affiliates, of the FCC's Uniform System of Accounts for Telecommunications Companies (USOA);
- The following FCC Dockets:

  a. CC Docket No. 86-111 dealing with the allocation of joint costs between the regulated and nonregulated activities of the telephone company;

  b. CC Docket No. 96-149 dealing with the implementation of the non-accounting safeguards of Sections 271 and 272 of the Act;

  c. CC Docket No. 96-150 dealing with the implementation of the accounting safeguards of Sections 271 and 272 of the Act;

d. CC Docket No. 96-98 dealing with the implementation of the local competition provisions of the Act (the interconnection orders);

e. CC Docket No. 96-115 dealing with the use of customer proprietary network information;

f. Pending and/or initiated proceedings, such as CC Docket No. 96-254 dealing with manufacturing operations; CC Docket No. 98-56 dealing with standards for measuring operations support systems (OSS);

- BOC's Section 271 application and related FCC approval;

- State Commissions' orders approving those interconnection agreements tested within the engagement;

- Petitions for arbitration with the BOC for those agreements tested within the engagement.

13. In addition, the practitioner has an affirmative obligation to first advise the Joint Federal/State Oversight Team, where he/she deems appropriate, of the need to expand the scope of the engagement and its procedures in order to provide to the users all of the information which they need to determine compliance or noncompliance with the various requirements, including any additional fees that will be charged the BOC for the expanded scope. However, after discussion with the BOC and its Section 272 affiliates, the Oversight Team will make the final decision where additional procedures are warranted.

14. The practitioner may use the services of a specialist for assistance in highly technical areas. The specialist must not be affiliated in any form with the BOC or any of its affiliates.

15. Use of internal auditors must be limited to the provision of general assistance and the preparation of schedules and gathering of data for use in the engagement. Under no circumstances shall the internal auditors perform any of the procedures contained in this document. All procedures contained in this document must be performed by the independent practitioner and his/her staff.

16. No part of the BOC cost allocation manual (CAM) annual audit can be used to satisfy any of these biennial audit requirements.

Representation Letters

17. The practitioner shall obtain three representation (assertion) letters. One representation letter should address

all items related to operations. Another representation letter should address all items of a financial nature. And another representation letter should address that all Section 272 affiliates have been disclosed. Below are details of each representation letter.

18. The representation letter related to operations issues shall be signed by the Chief Operating Officer of the BOC and each Section 272 affiliate and shall include the following:

a. acknowledgement of management responsibility for complying with specified requirements;

b. acknowledgement of management responsibility for establishing and maintaining an effective internal control structure over compliance;

c. statement that management has disclosed or will disclose to the practitioner all known noncompliance up to the date of the draft report;

d. statement that management has made available all documentation related to compliance and noncompliance with the specified requirements;

e. statement that management has disclosed any communications from regulatory agencies, internal auditors, external auditors, external parties (including competitors), and other practitioners concerning possible noncompliance with the specified requirements, including communications received between the end of the period addressed in management's assertion and the date of the practitioner's report;

f. statement that each Section 272 affiliate operates independently from the BOC, that the BOC does not own any facilities jointly with the affiliates, that the BOC does not provide any operations, installation, and maintenance functions over the facilities owned by the affiliates, or leased by the affiliates from unaffiliated entities and that it is not providing and did not provide any research and development activities on behalf of the affiliates;

g. statement that each Section 272 affiliate has separate officers, directors, and employees from those of the BOC;

h. statement that the BOC has not discriminated between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards; (On the BOC's representation letter only)

i. statement that the BOC subject to Section 271(c) of the Act has fulfilled requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates; and (On the BOC's representation letter only)

j. statement that the BOC subject to Section 251(c) of the Act has made available facilities, services, or information concerning its provision of exchange access to other providers of interLATA services on the same terms and conditions as it has made available to its Section 272 affiliates that operate in the same market. (On the BOC's representation letter only)

19. The representation letter related to financial issues shall be signed by the Chief Financial Officer of the BOC and each Section 272 affiliate and shall include the following:

a. statement that each Section 272 affiliate maintains separate books, separate records, and separate accounts from those of the BOC and that all such books, records, and accounts are maintained in accordance with GAAP;

b. statement that each Section 272 affiliate has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC;

c. statement that management has identified to the practitioner all assets transferred or sold and services rendered, (i) by the BOC to each Section 272 affiliate, (ii) by all central services organizations to each Section 272 affiliate, and (iii) by each Section 272 affiliate to the BOC; and that these transactions have been accounted for in the required manner;

d. statement that the BOC subject to Section 251(c) of the Act has charged its Section 272 affiliates, or imputed to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; (On the BOC's representation letter only)

e. statement that, if the BOC and an affiliate subject to Section 251(c) of the Act make available and/or have provided any interLATA facilities or services to its interLATA affiliate, such facilities or services are made available to all carriers at the same rates and on the same terms and conditions, and the associated costs are appropriately allocated; (On the BOC's representation letter only)

f. statement that management has not changed any of the BOC processes or procedures (as they relate to transactions of any kind with the Section 272 affiliate), since the execution of these agreed-upon procedures without apprising the practitioner, before the date of the draft report. (On the BOC's representation letter only)

20. The representation letter related to the disclosure of all Section 272 affiliates shall be signed by the Chief Financial Officer of the BOC’s corporate holding company and shall state that each Section 272 affiliate has been identified, accounted for in the required manner, and disclosed in the required manner.

Engagement Process

21. The general standard procedures contained in this document are intended to provide general areas of audit work coverage and uniformity of audit work among all regions, to the extent possible considering state regulatory and corporate differences. They will be used by the BOCs as a guide for drafting the preliminary audit requirements, including the proposed scope of the audit, as prescribed in Section 53.211(a) and (b) of the FCC's Rules and Regulations. Under these rules, the BOCs subject to these audits must submit the preliminary audit requirements, including the proposed scope and extent of testing to the Oversight Team before engaging an independent accounting firm to conduct the biennial audit. The Oversight Team then has 30 days to review the preliminary requirements to determine whether they are adequate to meet the audit requirements in Section 53.209. We expect the preliminary requirements and scope of the audit to be similar to this document and to cover all of the areas described in this model. The BOC shall not engage any practitioner who has been instrumental during the past two years in designing any of the systems under review in the biennial audit. After the BOC has engaged a practitioner to perform the biennial audit, the process for drafting detailed procedures is as follows:

- The Oversight Team and the practitioner will perform a joint survey of the affiliate. The purpose of this survey is to become acquainted with the company's structure, procedures, recordkeeping process, extent of affiliate transactions, and process followed by the BOC to process orders for services received from affiliates, nonaffiliates, and its own end-user customers. This survey will be conducted between four to six months after the affiliate has received approval to begin operations, or four to six months after the affiliate has begun operations where approval is not necessary.

- The practitioner will draft detailed procedures following the guidelines set forth by these general standard procedures and will submit them for review concurrently to all users.

- The Oversight Team will review the detailed procedures for consistency and adequacy of audit coverage and will approve them within a period of 30 days.

22. Access to companies' proprietary data and discussions of findings and facts related to the biennial audit is restricted to: (a) FCC staff members, (b) state staff members who by statute protect companies' proprietary data, (c) state staff members who have signed a protective agreement with the companies over which they have jurisdiction, (d) all state staff members of any participating state that has confidentiality procedures in effect covering all staff and that has the Chairman or designee sign the protective agreement on behalf of the entire Commission including Commission staff, and, (e) state staff members who have not signed the protective agreement, but that the company does not object to provide verbal information or written data, provided that they do not take possession of such data. Section 272(d)(3)(C) of the Communications Act of 1934, as amended, requires that State Commissions implement appropriate procedures to ensure the protection of any proprietary information obtained in connection with these biennial audits.

23. The detailed examination of the transactions may begin at such time as the practitioner deems appropriate to complete the engagement in accordance with the time schedule set forth in the FCC Rules and Regulations of Section 53.211 and Section 53.213.

24. During the course of the biennial audit, the practitioner will inform the Oversight Team well in advance, but not less than 10 days, of plans to meet with the representatives of the BOC and the affiliate to discuss plans and procedures for the engagement, to survey the companies' operations, to overview the companies' procedures for maintaining books and records, and to discuss problems and findings encountered during the engagement. It is not necessary to inform the Oversight Team of meetings with the client to ask for clarification and explanation of certain items and/or to explore what other records exist and for requests of data. The practitioner shall also inform the Oversight Team and explain any deviation and or revisions necessary to the final detailed procedures immediately after having done so. The practitioner shall also submit to the Chief, Common Carrier Bureau, and shall copy the Oversight Team, any accounting or rule interpretations necessary to complete the engagement. The practitioner shall advise the Oversight Team of the need for more time to complete the engagement in the event additional procedures are requested by the Oversight Team (see 25c. below).

Timetables

25. In order to complete this engagement in a timely manner, below are time schedules to complete certain tasks:

a. Within 60 days after the end of the engagement period, but prior to discussing the findings with the BOC or the affiliate, the practitioner shall submit a draft of the report to the Oversight Team.

b. The Oversight Team shall have 45 days to review the findings and working papers and offer its recommendations, comments, and exceptions concerning the conduct of the engagement to the practitioner.

c. If additional procedures are recommended by the Oversight Team, the practitioner will advise the Oversight Team of any need for additional time to perform such procedures. Otherwise, after receiving the Oversight Team's recommendations, the practitioner has 15 days to make the appropriate revisions to the report and submit the report to the BOC for its comments on the findings, and to the Oversight Team.

d. The BOC shall have 30 days after receipt of the report to comment on the findings and send a copy of its comments to both the practitioner and the Oversight Team. At this time, the BOC will also indicate what information in the report it deems proprietary and why it should not be released to the public.

e. The Oversight Team will negotiate with the BOC and delete from the final report information deemed proprietary. The BOC will provide the Oversight Team a statement where it makes no proprietary or confidential claim with regard to any information contained in the final biennial engagement report or to any comments or reply comments included therein. This statement should be signed by the Chief Operating Officers of both the Section 272 affiliate and the BOC.

f. The practitioner shall have 10 days to respond to the BOC's comments. The report which contains the procedures employed with the related findings, the Oversight Team's comments, the BOC's comments, and the practitioner's reply comments will comprise the final report.

g. The report is then filed by the practitioner with the FCC and the State Regulatory Agencies participating in the joint AUP engagement for concurrent public release.

h. Interested parties have 60 days from the date the report is made available for public inspection to file comments with the Commission and/or any State Regulatory Agency.

Report Structure

26. The practitioner's report shall present all procedures and all findings encountered for each procedure performed, regardless of materiality, under each engagement objective. It should also contain the following elements:

a. A statement indicating that the practitioner is independent.

b. Identification of the specified users.

c. Reference to management assertions and the character of the engagement.

d. A statement that the procedures performed were those agreed to by the specified users identified in the report.

e. Reference to standards established by the American Institute of Certified Public Accountants.

f. A statement that the sufficiency of the procedures is solely the responsibility of the specified users and a disclaimer of responsibility for the sufficiency of those procedures.

g. A statement that the practitioner was not engaged to, and did not, perform an examination of the assertion, a disclaimer of opinion on the assertion, and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported.

h. This report becomes a matter of public record via the practitioner's filing the final report with the FCC and the state regulatory agencies participating in the audit for the region.

i. A description of any limitations imposed on the practitioner by the BOC or any other affiliate, or other circumstances that might affect the practitioner's findings.

j. A description of the nature of the assistance provided by specialists and internal auditors.

PROCEDURES

Procedures for Structural Requirements

<u>OBJECTIVE I.</u> Determine whether the separate affiliate required under Section 272 of the Act has operated independently of the Bell operating company.

<u>STANDARDS</u>

The FCC has issued rules and regulations in CC No. Docket 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended. Some of those rules require that,

- A BOC and its Section 272 affiliate cannot jointly own transmission and switching facilities, broadly defined as local exchange and exchange access facilities, or the land and buildings where those facilities are located. (47 C.F.R. Section 53.203(a)(1) and First Report and Order, para. 15, 158, 160)

- A Section 272 affiliate shall not perform operating, installation or maintenance functions associated with the BOC's facilities. Likewise, a BOC or any BOC affiliate, other than the Section 272 affiliate itself, shall not perform operating, installation or maintenance functions associated with the facilities that each Section 272 affiliate owns or leases from a provider other than the BOC with which it is affiliated. (47 C.F.R. Section 53.203(a)(2), (3) and First Report and Order, para. 15, 158, 163)

- To the extent that research and development is a part of manufacturing, it must be conducted through a Section 272 affiliate. If a BOC seeks to develop services for or with its Section 272 affiliate, the BOC must develop services on a nondiscriminatory basis for or with other entities pursuant to Section 272(c)(1). (First Report and Order, para. 169)

<u>PROCEDURES</u>

1. Inspect the certificate of incorporation, bylaws, and articles of incorporation of each Section 272 affiliate to determine whether the affiliates were established as corporations separate from the BOC. Note the results of this procedure.

2. Obtain and inspect corporate entities' organizational chart(s) and confirm with legal representatives of the BOC and Section 272 affiliates the legal, reporting, and operational corporate structure of the Section 272 affiliates. Document who owns the Section 272 affiliates and to whom do they report to determine the independence of the affiliate.

3. Obtain functional organizational chart for each Section 272 affiliate as of the end of the ninth month of the engagement period and document for each department,

   - Number of employees

   - Street address(es) where employees are located

   - Description of functions performed by location.

4. Obtain from each Section 272 affiliate a list and description of services rendered to each Section 272 affiliate,

   - By the BOC (all services)

   - By other affiliates (all services)

   - By unaffiliated companies (operations, installation and maintenance only).

   This list should include the location of both the providing and receiving entity for all services involving operations, installation and maintenance.

5. From the data obtained in Procedures 3 and 4, identify and document which entity performs operations, installation, and maintenance functions over transmission and switching facilities either owned or leased by each Section 272 affiliate. Also, identify the street address location where these facilities are located and identify whether these facilities are owned or leased by each Section 272 affiliate, and, if leased, from whom they are leased.

6. Obtain descriptions of research and development (R&D) activities of the BOC for the first nine months of the engagement period and note any R&D related to the activities of each Section 272 affiliate. For R&D related to activities of each Section 272 affiliate ask BOC personnel for more details, such as extent of R&D provided, progress reports, cost, and whether the Section 272 affiliate has been billed and has paid for this service. Inquire, and provide details, as to whether R&D service is offered and/or

has been performed when requested by unaffiliated entities.

7. Obtain as of the end of the ninth month of the engagement period the balance sheet of each Section 272 affiliate and a detailed listing of all fixed assets which agrees with the amount shown in the balance sheet. If the list does not agree, inquire and document why. This detailed listing should include a full description of each item, date of purchase, price paid and recorded, and from whom purchased or transferred. Inspect title and other documents, which reveal ownership, of a statistically valid sample of transmission and switching facilities and the land and buildings where those facilities are located. Look for and make a note of any facilities which are owned jointly with the BOC. The balance sheet information obtained in this procedure should also be used to perform Procedure 13 under Objectives V and VI.

OBJECTIVE II. Determine whether the separate affiliate required under Section 272 of the Act has maintained books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the Bell operating company.

STANDARDS

In CC Docket No. 96-150, Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996, the FCC requires that each Section 272 affiliate maintain books, records, and accounts, in accordance with generally accepted accounting principles (GAAP), and separate from those of the BOC. (Report and Order, para. 170)

PROCEDURES

1. Obtain the general ledger (G/L) of each Section 272 affiliate and match the title on the G/L with the name of the affiliate on the certificate of incorporation to determine that a separate G/L is maintained. Look for special codes, if any, which may link this G/L to the G/L of the BOC and provide documentation. Note: Linkage at corporate headquarters for consolidations is an accepted practice.

2. Obtain each Section 272 affiliate's written accounting procedures and policies and identify the process for recording financial transactions of the Section 272 affiliate in the G/L; document such transaction flows along with key control points. In addition, identify the controls related to the proper identification and recording of Section 272 affiliate transactions in its separate books of account.

3. Obtain the cash receipts and cash disbursement journals and related ledgers for the ninth month of the engagement period. By random selection trace ten (10) cash receipt and ten (10) cash disbursement (including at least 5 payroll) transactions to the Section 272 affiliate bank account(s). Note name of affiliate on the bank account and whether these transactions cleared through this bank account. Compare account numbers indicated in the journals to those in the general ledger and note any differences.

4. Obtain each Section 272 affiliate's financial statements and lease agreements, as of the end of the ninth month of the engagement period. Identify leases for which the annual obligation is $500,000 or more. Determine whether these leases have been accounted for in accordance with GAAP.

Determine whether client lease accounting policies are in accordance with GAAP.

OBJECTIVE III. Determine whether the separate affiliate required under Section 272 of the Act has officers, directors, and employees that are separate from those of the Bell operating company.

STANDARDS

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended, interprets the above requirement further by stating the following:

- Separate officers, directors, and employees simply dictates that the same person may not simultaneously serve as an officer, director, or employee of both a BOC and its Section 272 affiliate. (First Report and Order, para. 178).

PROCEDURES

1. Obtain the BOC's and Section 272 affiliates' policies and procedures for transfers, sharing, and loan of employees between each other. Identify and document the types of internal controls that are in place that would prevent one from being an officer, or director, or employee of both the BOC and Section 272 affiliate at the same time.

2. Inquire and document as to whether each Section 272 affiliate and the BOC maintain separate boards of directors and separate officers. Obtain list of officers and of board of directors' names of the BOC and Section 272 affiliate(s) for the engagement period and compare and document the names appearing on both lists, respectively. Obtain the minutes of the meetings of the board of directors for both the BOC and Section 272 affiliate(s) for the engagement period and compare and document the names appearing on the minutes of the BOC and each Section 272 affiliate.

3. Obtain the functional organizational chart of each Section 272 affiliate as of the end of the ninth month of the engagement period (see Objective I, Procedure 3) and inspect it to determine whether any departments report either functionally or administratively (directly or indirectly) to an officer of the BOC.

4. Obtain payroll registers for the BOC and each Section 272 affiliate that include the social security numbers of all the directors, officers and employees for the ninth month of the engagement period. Compare social security numbers of directors, officers, and employees appearing on both lists; document those names and/or social security numbers

appearing on both lists, and inquire and document why.

5. Obtain a list of officers and employees who transferred from the BOC at any time to each Section 272 affiliate, and by the use of a statistically valid sample, determine whether the company's internal controls inspected in Procedure 1 have been implemented. Also, interview these employees to determine whether they used any proprietary information (e.g., customer proprietary network information (CPNI), Network Planning Manuals, Plant Traffic Practices, Operation, Installation and Maintenance (OI&M) Practices) obtained while they were employees of the BOC or whether any of the above information is made available to them through friends and acquaintances still employed by the BOC.

6. Obtain a list of all employees of each Section 272 affiliate since February 8, 1996, the date of the Act. By the use of a statistically valid sample, inspect company's files which indicate employees' employment history within the BOC family of companies and document whether they were employees of the BOC or any of its affiliates at any time. Also, document number of employees, number of times, and dates each employee transferred back and forth between the BOC or any other affiliate and the Section 272 affiliate since February 8, 1996.

<u>OBJECTIVE IV</u>. Determine that the separate affiliate required under Section 272 of the Act has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company.

<u>STANDARDS</u>

The FCC in 47 C.F.R. Section 53.203(d) indicates that a Section 272 affiliate shall not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC of which it is an affiliate.

The FCC also expands on this premise in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended. In this docket the Commission states that,

- A BOC cannot co-sign a contract or any other instrument with a Section 272 affiliate that would allow each Section 272 affiliate to obtain credit granting recourse to the BOC's assets. (First Report and Order, para. 189)

- The BOC parent, or any other non-272 affiliate, cannot sign or co-sign a contract or any arrangement with a Section 272 affiliate that would allow the creditor to have recourse to the BOC assets. (First Report and Order, para. 189)

- A Section 272 affiliate cannot enter any arrangement with any party that would permit the lender to have recourse to the BOC in the event of a default. (First Report and Order, para. 189)

<u>PROCEDURES</u>

1. Document each Section 272 affiliate's debt agreements/instruments and credit arrangements with lenders and major suppliers of goods and services; look for guarantees of recourse to the BOC's assets, either directly or indirectly through another affiliate, and document those instances. Major suppliers are those having $500,000 or more in annual sales to the Section 272 affiliate.

2. Using the lease agreements obtained in Objective II, Procedure 4, document any instances in which each Section 272 affiliate's lease agreements (where the annual obligation is $500,000 or more) have recourse to the BOC's assets, either directly, or indirectly through another affiliate.

3. For all debt instruments, leases, and credit arrangements maintained by each Section 272 affiliate, obtain (positive) confirmations from loan institutions, major suppliers, and lessors (as defined in Procedures 1 and 2 above) to attest lack of recourse to the BOC assets.

4. Document from each Section 272 affiliate the balance of the accounts payable to and/or advances from the BOC as of the end of the ninth month of the engagement period.

Procedures for Accounting Requirements

OBJECTIVE V. Determine whether the separate affiliate required under Section 272 of the Act has conducted all transactions with the Bell operating company on an arm's length basis with the transactions reduced to writing and available for public inspection.

OBJECTIVE VI. Determine whether or not the Bell operating company has accounted for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

STANDARDS

The FCC in CC Docket 96-150, Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996, interprets the above requirements further by stating:

- A Section 272 affiliate shall conduct all transactions with the BOC of which it is an affiliate on an arm's length basis, pursuant to the accounting rules described in 47 C.F.R. Section 32.27, Transactions with Affiliates, of the FCC Rules and Regulations, with any such transactions reduced to writing and available for public inspection. (47 C.F.R. Section 53.203(e)). Section 32.27 requires the following:

  For transactions involving the sale or transfer of assets or products between the carrier and affiliates:

  a. assets sold to or by the carrier under tariff must be recorded at tariffed rate in the books of the carrier;

  b. nontariffed assets sold to or by the carrier that qualify for prevailing price must be recorded at prevailing price in the books of the carrier. In order to qualify for prevailing price valuation, sales of a particular asset must encompass greater than 50 percent of the total quantity of such product sold by an entity; 50% threshold is applied on an asset by asset basis rather than on a product line basis;

  c. all other assets sold by or transferred from a carrier to affiliates must be recorded in the books of the carrier at the higher of fair market value or net book cost; (Note: carriers are required to make a good faith estimate of fair market value.)

d. all other assets purchased by or transferred to a carrier from affiliates must be recorded in the books of the carrier at the lower of fair market value or net book cost; (Note: carriers are required to make a good faith estimate of fair market value.)

For transactions involving the provision of services between the carrier and affiliates:

a. services provided to or by the carrier at tariff must be recorded at tariffed rate in the books of the carrier;

b. nontariffed services provided to or by the carrier pursuant to publicly filed agreements submitted to a state commission must be recorded in the books of the carrier at the rate appearing in publicly filed agreements;

c. nontariffed services provided to or by the carrier that qualify for prevailing price must be recorded in the books of the carrier at prevailing price. In order to qualify for prevailing price valuation, sales of a particular service must encompass greater than 50 percent of the total quantity of such service sold by an entity; 50% threshold is applied on a service by service basis rather than on a service line basis;

d. all other services provided to a carrier by an affiliate must be recorded in the books of the carrier at the lower of fair market value or fully distributed cost. (Note: carriers are required to make a good faith estimate of fair market value.) *Exception* -- services received by a carrier from an affiliate that exists *solely* to provide services to members of the carrier's corporate family must be recorded in the books of the carrier at fully distributed cost.

e. all other services provided by the carrier to an affiliate must be recorded in the books of the carrier at the higher of fair market value or fully distributed cost; (Note: carriers are required to make a good faith estimate of fair market value.)

f. Fully distributed cost is determined by following the standards contained in 47 C.F.R. Section 64.901, Allocation of Costs, of the FCC Rules and Regulations. These rules emphasize direct assignment and cost causation. First, costs are to be directly assigned either to regulated or nonregulated activities to the maximum extent possible. Then, costs which cannot be directly assigned are to be grouped into homogeneous cost pools and allocated in accordance with direct or indirect measures of cost causation. Residual costs which cannot be apportioned on any cost-causative basis will be apportioned using the general allocator. The general allocator is the ratio of all expenses directly assigned or attributed to nonregulated activities, to the total of all (regulated and nonregulated) directly assigned or attributed expenses.

- A BOC and a Section 272 affiliate may provide in-house services to one another, except for operating, installation, or maintenance services. These in-house services, however, must be provided on an arm's length basis, and must be in writing. (CC Docket No. 96-149, First Report and Order, para 180)

- Provision of exchange and exchange access services and unbundled network elements constitute transactions requiring disclosure (CC Docket No. 96-150, Report and Order, para. 124). These transactions include the provision of transmission and switching facilities by the BOC and its affiliate to one another. (CC Docket No. 96-149, First Report and Order, para. 193)

- The separate affiliate must provide a detailed written description of the asset or service transferred, together with the specific price and the terms and conditions of the transaction on the Internet within 10 days of the transaction through the company's home page. These descriptions should be sufficiently detailed to allow evaluation of compliance with accounting rules. This information must also be made available for public inspection at the principal place of business of the BOC and must contain a certification statement identical to that included in the ARMIS Reports. This certification statement declares that an officer of the BOC has represented that to the best of his knowledge all statements of fact contained in the submission are true and the submission is an accurate statement of the affairs of the BOC for the relevant period. (Report and Order, para. 122)

- Affiliate transaction rules apply to transactions between the BOC and each Section 272 affiliate; between each Section 272 affiliate and a nonregulated affiliate, that ultimately result in an asset or service being provided to the BOC, i.e., chained transactions. (Report and Order, para. 183)

- Products and services made available to the Section 272 affiliate and to unaffiliated companies need not meet the 50 percent threshold in order for a BOC to record the transaction involving such products and services at prevailing price. (Report and Order, para. 137)

- Nondiscrimination requirements extend to any good, service, facility, or information that a BOC provides to its Section 272 affiliate(s) with the exception of joint marketing, which is covered in Section 272(g)(1) and (2) of the Act. Unaffiliated entities must have equal opportunity to acquire any such good, service, facility, or information. In particular, if a BOC were to decide to transfer ownership of a unique facility, such as its Official Services network, to a Section 272 affiliate, it must ensure that the Section 272 affiliate and unaffiliated entities have an equal opportunity to obtain ownership of this facility. (CC Docket 96-149, First Report and Order, para. 218)

- Interstate rate base, revenue requirements, and price cap indices of the BOC must be reduced by the costs related to any regulated facilities transferred to each Section 272 affiliate. (CC Docket No. 96-150, Report and Order, para. 265)

PROCEDURES

1. Obtain from the BOC a list of all complaints from competitors related to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the first nine months of the engagement period. This list should group the complaints in the following categories:

   - allegations of cross-subsidies (for Objectives V and VI);

   - allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

   - allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

   - allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible. For those complaints that had been resolved, document how those allegations were concluded and, if the complaint was upheld, inquire and document what steps the company has taken to prevent those practices from recurring.

2. Obtain from the BOC and each Section 272 affiliate current written procedures for transactions with affiliates. Compare these procedures with the FCC Rules and Regulations indicated as "standards" above. Note and describe any differences.

3. Inquire and describe how the BOC and each Section 272 affiliate disseminate the FCC Rules and Regulations and raise awareness among employees for compliance with the affiliate transactions rules. For this purpose, describe type and frequency of training, if any, literature distributed, company's policy, and document the supervision employees responsible for affiliate transactions received. Interview employees responsible for the development and recording of affiliate transactions costs in the books of record of the carrier to determine awareness of these rules.

4. Inquire and describe the process that a Section 272 affiliate must follow to request any type of service from the BOC. Describe the approval process within the BOC to fulfill a request for service from a Section 272 affiliate. Does the Section 272 affiliate request services directly from the department that provides the service?

5. Obtain all written agreements for services and for interLATA and exchange access facilities between the BOC and each Section 272 affiliate which were in effect during the first nine months of the engagement period. Summarize these agreements, if feasible, otherwise include copies of relevant pages, and note names of parties, type of service, price, terms, and conditions. Compare these agreements with the list of services provided by the BOC to the Section 272 affiliate in Objective I, Procedure 4 and note any discrepancies. In addition, note which agreements are still in effect. For those agreements no longer in effect, indicate termination date; identify agreements terminated

prematurely and document why. Inquire and document the provisioning of any service without a written agreement.

6. At the end of the ninth month of the engagement period, view each company's home page on the Internet and compare the prices and terms and conditions of services and assets shown on this site to the agreements provided in Procedure 5 above. By physical inspection, determine whether the same information is made available for public inspection at the principal place of business of the BOC. Describe any differences and inquire why such differences exist. If the company makes any claim of confidentiality for nondisclosure, obtain details. It should be noted that these transactions should be posted for public inspection within 10 days of their occurrence. Document the procedures that the company has in place for posting these transactions on a timely basis. The information provided on the Internet should be in sufficient detail to allow evaluation for compliance with accounting rules (see Docket No. 96-150, Report and Order, para. 122). Obtain copies of these public postings and include in the working papers.

7. For nontariffed services and for services for which a prevailing market price (PMP) has not been established, or are not subject to publicly filed agreements, document the BOC's and the Section 272 affiliate's process for developing fully distributed cost (FDC). Document and identify the type of costs included in FDC. Document the actual development of FDC for two services, at each company, to be identified by the Oversight Team after the survey of the affiliate.

8. For nontariffed services for which a PMP has not been established, or are not subject to publicly filed agreements, document the process the BOC and the Section 272 affiliate follow to make a good faith estimate of fair market value (FMV). Document the actual development of a good faith estimate of FMV for two services, at each company, to be identified by the Oversight Team after the survey of the affiliate.

9. Obtain a listing and amounts of all services rendered by month by the BOC to each Section 272 affiliate during the first nine months of the engagement period (see Objective I, Procedure 4). For those services made available to the Section 272 affiliate that are not made available to third parties, using a statistically valid sample, compare unit charges to PMP, or FDC, or FMV, as appropriate, to determine whether these amounts were recorded in the books of the BOC in accordance with the affiliate transactions standards. When differences exist, note the number of instances and the amounts involved. Inquire and make a note of reasons for

these occurrences. Document the amount the Section 272 affiliate has recorded for the service in its books of record. Also, document the amount the Section 272 affiliate has paid for the service to the BOC.

10. Obtain a listing and amounts of all services rendered by month to the BOC by each Section 272 affiliate during the first nine months of the engagement period. Using a statistically valid sample, compare unit charges to tariff rates, or PMP, or FDC, or FMV, as appropriate, to determine whether these services were recorded in the books of the BOC in accordance with the affiliate transactions standards. When differences exist, note the number of instances and the amounts involved. Inquire and make a note of reasons for these occurrences. Document the amount the BOC has recorded for the service in its books of record. Also, document the amount the BOC has paid for the service to the Section 272 affiliate.

11. Inquire and note how and who maintains each Section 272 affiliate's employee benefits plans (such as life insurance, health insurance, retirements plans). Determine by inquiry who pays or funds these benefits plans and whether the costs for administering these plans are allocated or assigned to the Section 272 affiliates.

12. Inquire whether any central services organization (such as the services company, the parent company, the data processing company, etc.) of the BOC renders services to each Section 272 affiliate. If so, obtain a listing (see Objective I, Procedure 4) and amounts of services rendered by month by each central services organization to each Section 272 affiliate during the first nine months of the engagement period. Note the methodology used to identify and cost these services and, for a statistically valid sample, obtain evidence that services are being billed to each Section 272 affiliate and that such affiliates are paying for these services. If not, identify and document the process these organizations have to ensure that these costs are not recovered from the BOC.

13. Obtain as of the end of the ninth month of the engagement period the balance sheet of each Section 272 affiliate and a detailed listing of all fixed assets which agrees with the amount shown in the balance sheet. If the list does not agree, inquire and document why. This detailed listing should include a full description of each item, date of purchase, price paid and recorded, and from whom purchased or transferred. The balance sheet information obtained in this procedure should also be used to perform Procedure 7 under Objective I. Other specific steps to be performed follow:

a. For those items purchased or transferred from the BOC, obtain net book cost and fair market value. Inquire and document how the fair market value was determined. Inspect these transactions to determine whether they were recorded in the books of the BOC at the higher of FMV or net book cost, as required.

b. For those items purchased or transferred from another affiliate, identify and document whether they were originally transferred from the BOC to other affiliates.

c. For those items purchased or transferred from the BOC, either directly or through another affiliate, since February 8, 1996, also inquire and obtain details as to how the BOC made an equal opportunity available to unaffiliated entities to obtain ownership of the facilities. Describe how and upon what basis the BOC decided to transfer/sell the facilities to a Section 272 affiliate instead of an unaffiliated entity.

14. Where assets are priced pursuant to Section 252(e) (i.e., as approved by the regulatory commissions) or statements of generally available terms pursuant to Section 252(f), compare such charges to the publicly-filed agreements or statements and document any differences.

15. Inquire and obtain details as to whether any part of the BOC's Official Services network was transferred or sold to a Section 272 affiliate at any time. In addition to the requirements for Procedure 13, for any transfer or sale of assets on or after February 8, 1996, inquire and obtain details as to how the BOC made an equal opportunity available to unaffiliated entities to obtain ownership of the facilities. Describe how and upon what basis the BOC decided to transfer/sell the facilities to a Section 272 affiliate instead of an unaffiliated entity.

16. If any facilities were either sold or transferred to a Section 272 affiliate, obtain the interstate price cap indices to determine whether, (i) the rate base had been reduced by the net book cost of the assets sold or transferred, (ii) the revenue requirement had been adjusted to reflect the gain from the sale or transfer of the assets and, (iii) the revenue requirement had been adjusted permanently to reflect the reduced operating costs related to the assets sold or transferred. Document this procedure. If the BOC had not made these adjustments, inquire and explain.

17. Inquire and obtain details on construction to reconfigure the telephone network of the BOC to connect to that of the

Section 272 affiliate. Describe the extent of the reconfiguration construction, who was the contractor, when did it take place, how much did it cost, who paid for it, and on which books and accounts was it recorded.

Procedures for Nondiscriminatory Requirements

OBJECTIVE VII. Determine whether or not the Bell operating company has discriminated between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards.

STANDARDS

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended, establishes some non-discriminatory rules and regulations. These rules and regulations do not permit a Bell operating company (BOC) to discriminate in the following manner:

- by giving preference to a Section 272 affiliate's equipment in the procurement process. (First Report and Order, para. 16)
- in awarding contracts for telecommunications equipment directly to their affiliate. (First Report and Order, para. 234)
- by failing to provide advance information about network changes to its competitors. (First Report and Order, para. 16)
- by not offering third parties the same goods, services, facilities and information (excludes customer proprietary network information (CPNI) and joint marketing) that it provides to its Section 272 affiliate at the same rates, terms, and conditions. (First Report and Order, para. 202)

  NOTES:
  (i) BOCs are not required under the nondiscrimination rules and regulations to provide to third parties Customer Proprietary Network Information (CPNI) that is shared with affiliates (see *Second Report and Order*, CC Docket No. 96-115, Released February 26, 1998, para. 169). The provision of "information" referenced in the nondiscriminatory rules and regulations excludes CPNI. CPNI is defined in Section 222(f)(1) of the Act and includes information that is personal to customers as well as commercially valuable to carriers, such as to whom, where and when a customer places a call, as well as the types of service offerings to which the customer subscribes and the extent the service is used.

(ii) BOCs are allowed to jointly market and sell affiliate-provided interLATA services without offering comparable joint marketing opportunities to other providers of interLATA services (see Section 272(g)(2) of the Act, and CC Docket No. 96-149, First Report and Order, Paragraphs 291-292). However, if BOCs market or sell their telephone exchange services through joint marketing conducted by the Section 272 affiliate, then the BOCs must also permit third parties to market and sell its telephone exchange services (see Section 272(g)(1) of the Act).

- in establishing or adopting any standards that favor its Section 272 affiliate over third parties. (First Report and Order, para. 208 and 229)

- in developing new services solely for its Section 272 affiliate. (First Report and Order, para. 210)

- in purposely delaying the implementation of an innovative new service by denying a competitor's reasonable request for interstate exchange access until its Section 272 affiliate was ready to provide competing service. (First Report and Order, para. 211)

- in marketing its affiliate's interLATA services to inbound callers without informing them of their right to select the interLATA carrier of their choice. (First Report and Order, para. 292)

In addition, a Section 272 affiliate may not market or sell information services and BOC telephone exchange services together, unless the BOC permits other information service providers to market and sell telephone exchange services. (First Report and Order, para. 287)

Another FCC Docket, in which orders have not yet been released, which may impact this objective is CC Docket No. 96-254 dealing with manufacturing activities.

PROCEDURES

1. Obtain from the BOC a list of all complaints from competitors related to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the first nine months of the engagement period. This list should group the complaints in the following categories:

    - allegations of cross-subsidies (for Objectives V and

VI);

- allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

- allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

- allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible. For those complaints that had been resolved, document how those allegations were concluded and, if the complaint was upheld, inquire and document what steps the company has taken to prevent those practices from recurring.

2. Obtain the BOC's written procurement procedures, practices, and policies for services and goods provided by each Section 272 affiliate. Make a note of any stated purchasing preferences contained in the BOC's procedures, if any, and provide details of the BOC's bidding process, the selection process, and how the BOC disseminates requests for proposals (RFPs) to affiliates and third parties.

3. Obtain and inspect the BOC's procurement awards to each Section 272 affiliate during the first nine months of the engagement period and inspect bids submitted by each Section 272 affiliate and third party, note terms, and discuss with BOC representatives how the selection was made. Compare this practice with the BOC written procurement procedures and note any differences.

4. Obtain a list of all goods (including software), services, facilities, and customer network services information, excluding CPNI, other than those related to exchange access services and facilities inspected in Objective IX, made available to each Section 272 affiliate by the BOC. For a

statistically valid sample, inquire and obtain copies of the media used by the BOC to inform unaffiliated entities of the availability of the same goods, services, facilities, and information at the same price, terms, and conditions.

5. Obtain a list from the BOC of all unaffiliated entities who have purchased the same goods (including software), services, facilities, and customer network services information (excludes CPNI) from the BOC. If any, describe what goods, services, facilities, and customer network services information and the extent of purchases made. Select a statistically valid sample and compare the rates, terms and conditions of the sampled items to the rates, terms and conditions offered to each Section 272 affiliate. Note any differences. Document the amount each Section 272 affiliate has paid for the same items purchased from the BOC.

6. Document how the BOC disseminates information about network changes, the establishment or adoption of new network standards, and the availability of new network services to each Section 272 affiliate and to unaffiliated entities. Note any differences.

7. Obtain and inspect customer service representatives' scripts for inbound calls establishing new service, adding a second line, moving to a new location, changing selected interLATA service provider, or any other situation where the BOC or BOC affiliated sales agents attempt to market its Section 272 affiliate's interLATA service. These marketing attempts may either be related to interLATA service only or following the sale of a BOC product or service.

8. Observe (listen in, for one half hour each, to at least five) customer service representatives, as defined in Procedure 7, responding to inbound callers to whom the sales representatives attempt to market the Section 272 affiliate's interLATA service. Labor union concurrence may be needed for this procedure. Note messages conveyed during observation. Make a note of any instances where the caller was referred to the Section 272 affiliate and was not informed of other providers of interLATA services and was not informed of his right to make the selection.

9. Interview 10 sales managers of each Section 272 affiliate and inspect any available printed materials to determine whether any Section 272 affiliates market information services and exchange services, as an agent of the BOC or as a reseller. If yes, interview 10 sales managers of the BOC and inspect printed materials of the BOC to determine whether unaffiliated entities have the same opportunity.

<u>OBJECTIVE VIII</u>. Determine whether or not the Bell operating company and an affiliate subject to Section 251(c) of the Act have fulfilled requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates.

<u>STANDARDS</u>

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended, provides some preliminary rules and regulations. A further proceeding in this matter, currently underway, will provide additional guidelines. We will revise these procedures to conform to the new guidelines when available. Current FCC rules and regulations require that,

- for equivalent requests the response time a BOC provides to unaffiliated entities should be no greater than the response time it provides to itself or its affiliate. (First Report and Order, para 240)

- a BOC must make available to unaffiliated entities information regarding the service intervals in which the BOC provides service to itself or its affiliates. (First Report and Order, para. 242)

- a BOC must not provide a lower quality service to competing interLATA service providers than the service it provides to its Section 272 affiliate at a given price. (First Report and Order, para. 16)

<u>PROCEDURES</u>

1. Obtain from the BOC a list of all complaints from competitors related to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the first nine months of the engagement period. This list should group the complaints in the following categories:

    - allegations of cross-subsidies (for Objectives V and VI);

    - allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

- allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

- allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible. For those complaints that had been resolved, document how those allegations were concluded and, if the complaint was upheld, inquire and document what steps the company has taken to prevent those practices from recurring.

2. Obtain BOC's reports during the first nine months of the engagement period, if available, indicating time intervals for processing orders, provisioning of service, performing repair and maintenance services **for end user customers** of the BOC, affiliate, and nonaffiliates for the following services:

   - Exchange telephone services

   - Exchange access services

   - Unbundled network elements

   Make a note of differences in time in fulfilling each type of request for the same services from end user customers of the BOC, affiliates, nonaffiliates.

3. Obtain BOC's reports during the first nine months of the engagement period, if available, indicating time intervals for processing orders, provisioning of service, and performing repair and maintenance services **for the affiliate and for nonaffiliates, as customers,** for the following services:

   - Exchange access services

   - Unbundled network elements

Make a note of differences in time in fulfilling each type of request for the same services from the affiliate and nonaffiliates.

4. Inspect a statistically valid sample of the underlying data used to prepare the reports obtained in Procedure 2 and 3 above and determine agreement with data in the report and document any differences.

5. If no reports are available, obtain from the BOC a statistically valid sample of all orders requesting exchange telephone services, exchange access services, and/or unbundled network services for end user customers for the period of one month and for one state (to be selected by the Oversight Team). Prepare worksheet indicating the date of the order, the address, the type of services ordered, the date when the order was executed and the service was provided and note the time interval to process requests for end user customers of the BOC, affiliates, nonaffiliates.

6. Repeat Procedure 5 for services requested by the affiliate and nonaffiliates as the users of those services (see Procedure 3 above).

7. Determine by inquiry, first, and then by inspection how and where the BOC makes available to unaffiliated entities information regarding service intervals in providing any service to end user customers of itself, of the affiliates, and of unaffiliated entities. Document the results.

<u>OBJECTIVE IX</u>. Determine whether or not the Bell operating company and an affiliate subject to Section 251(c) of the Act have made available facilities, services, or information concerning its provision of exchange access to other providers of interLATA services on the same terms and conditions as it has to its affiliate required under Section 272 that operates in the same market.

<u>STANDARDS</u>

The FCC in CC Docket No 96-149, Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended, indicates that a BOC may not discriminate in favor of its Section 272 affiliate in the following manner:

- by providing exchange access services to competing interLATA service providers at a higher rate than the rate offered to its Section 272 affiliate. (First Report and Order, para. 16)

- by not making available facilities and services to others on the same terms, conditions and prices that it provides to its Section 272 affiliate. (First Report and Order, para. 316)

<u>PROCEDURES</u>: This objective is closely related to Objective XI which contains procedures for the provision by the BOC of interLATA facilities and services. Therefore, these procedures may be performed in conjunction with the procedures for Objective XI.

1. Obtain from the BOC a list of all complaints from competitors related to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the first nine months of the engagement period. This list should group the complaints in the following categories:

   - allegations of cross-subsidies (for Objectives V and VI);

   - allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

   - allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

- allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible. For those complaints that had been resolved, document how those allegations were concluded and, if the complaint was upheld, inquire and document what steps the company has taken to prevent those practices from recurring.

2. Obtain list of exchange access services and facilities with their related rates offered to each Section 272 affiliate and inspect to determine whether the BOC makes these services and facilities available at the same rates, terms, and conditions to all carriers. For this purpose, inspect brochures, advertisements of any kind, bill inserts, correspondence, or any other media used to inform carriers of the availability of these services. Using a statistically valid sample of the informational media identified above, compare rates, terms, and conditions offered each Section 272 affiliate with those offered unaffiliated carriers.

3. Obtain invoices for exchange access services and facilities for one month (to be determined by the Oversight Team) rendered by the BOC to the Section 272 affiliate, and other interexchange carriers (IXCs). Using a statistically valid sample of billed items, inspect underlying details of invoice and compare rates, terms, and conditions charged each Section 272 affiliate with those charged IXCs for the same services and note any differences. If differences are noted, pursue the matter further through inquiry of appropriate personnel and note why they occurred.

4. Using the invoices obtained in Procedure 3 above, trace the amount invoiced for exchange access services to each Section 272 affiliate and determine whether the amount invoiced was the amount recorded by the BOC and paid by each Section 272 affiliate. For this purpose, identify and inspect method of payment such as cancelled checks, wire transfers, and, if needed, summaries of invoiced amounts corresponding to the

amount paid. Note any differences and inquire as to why they occurred.

<u>OBJECTIVE X</u>. Determine whether or not the Bell operating company and an affiliate subject to Section 251(c) of the Act have charged its separate affiliate under Section 272, or imputed to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service.

<u>STANDARDS</u>

The FCC has issued rules and regulations in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended. These rules require that,

- A BOC may not discriminate in favor of its Section 272 affiliate by providing exchange access services to competing interLATA service providers at a higher rate than the rate offered to its Section 272 affiliate (First Report and Order, para. 16). This requirement is met,

  - If the affiliate purchases exchange service and exchange access service at tariffed rates. (First Report and Order, para. 256)

  - If the affiliate acquires services or unbundled elements from a BOC at prices that are available on a nondiscriminatory basis under Section 251. (First Report and Order, para. 256)

  - If the BOC files with the State Commission a statement of generally available terms pursuant to Section 271(c)(1)(B) which would include prices that are available on a nondiscriminatory basis in a manner similar to tariffing, and a BOC's Section 272 affiliate obtains access or interconnection at a price set forth in the statement. (First Report and Order, para. 256)

  - If a BOC makes volume and term discounts available on a nondiscriminatory basis to all unaffiliated interexchange carriers. (First Report and Order, para. 257)

- BOCs are required to charge nondiscriminatory prices, and to allocate properly the costs of exchange access according to the affiliate transactions and joint cost rules. (First Report and Order, para. 258)

- For integrated operations (for operations performed within the company and not under a separate affiliate), a BOC must impute to itself an amount for access to its telephone exchange service and exchange access that represents tariffed rates (First Report and Order, para. 256). This tariffed rate must be the highest rate paid for access by unaffiliated carriers. The BOC may consider the comparability of the service provided. (CC Docket No. 96-150 Report and Order, para. 87)

PROCEDURES

1. Obtain agreements that each Section 272 affiliate and other interexchange carriers (IXCs) have with the BOC for exchange access services.

2. Determine and fully document in which LATAs the BOC has access price flexibility for interLATA interstate and interLATA intrastate access services.

3. From the agreements obtained in Procedure 1, use a statistically valid sample to compare volumes, discounts, and rates negotiated with each Section 272 affiliate with those negotiated by other IXCs for the same services. Note and discuss any differences with management.

4. Obtain list of interLATA services offered by the BOC and discuss list with appropriate BOC employees to determine whether the list is comprehensive. Compare services appearing on the list with interLATA services disclosed in the BOC's Cost Allocation Manual (CAM) and note any differences. Compare the nonregulated interLATA services listed in the BOC's CAM with those defined as incidental in Section 271(g) of the Act and those interLATA services allowed under FCC order (for example E911) and note any differences.

5. Obtain a statement of revenue, by month, from interLATA services provided by the BOC itself, for the first nine months of the engagement period, and perform a trend analysis. If increases of more than 10% are noted from month to month, inquire and note reasons for such increase.

6. From the list of services obtained in Procedure 4 above, by using a statistically valid sample of interLATA services offered by the BOC and not through an affiliate, determine whether the BOC is imputing (charging) to itself an amount for access, switching, and transport. Obtain usage details and tariffed rates for each of the above elements. Match rates used in calculations with the tariffed rates or those rates charged other interexchange carriers (IXCs) and note any differences. Trace amount to the journal entry and to the general ledger of the BOC. The entry should be a debit

to nonregulated operating revenues (decrease) and a credit to regulated revenues (increase). If the process followed by the BOC is different from the one described above, please describe it in detail and obtain full documentation.

7. For each of the following categories of services, viz., exchange access services, local exchange services, and unbundled network elements, provided by the BOC to the Section 272 affiliate during the first nine months of operations, document the total amount the affiliate has recorded for those services in its books and reconcile with the amount the affiliate paid to the BOC and the amount of revenue reflected in the BOC's books for those services.

<u>OBJECTIVE XI</u>. Determine whether or not the Bell operating company and an affiliate subject to Section 251(c) of the Act have provided any interLATA facilities or services to its interLATA affiliate and made available such services or facilities to all carriers at the same rates and on the same terms and conditions, and allocated the associated costs appropriately.

<u>STANDARDS</u>

Valuation and recording procedures for sales or transfers of any interLATA or intraLATA facilities to each Section 272 affiliate, leasing of any unbundled network elements, or provision of any service by the BOC to each Section 272 affiliate are covered in Objectives V and VI of this program, under the affiliate transactions rules.

BOC network services and unbundled network elements made available under Section 251 to each Section 272 affiliate must also be made available at the same price to unaffiliated companies. (CC Docket No. 96-149, First Report and Order, para. 256)

<u>PROCEDURES</u>: This objective is closely related to Objective IX which contains procedures for the provision by the BOC of exchange access services. Therefore, these procedures may be performed in conjunction with the procedures for Objective IX.

1. Obtain from the BOC a list of all complaints from competitors related to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the first nine months of the engagement period. This list should group the complaints in the following categories:

    - allegations of cross-subsidies (for Objectives V and VI);

    - allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

    - allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

    - allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible. For those complaints that had been resolved, document how those allegations were concluded and, if the complaint was upheld, inquire and document what steps the company has taken to prevent those practices from recurring.

2. Obtain list of interLATA network services and facilities with their related rates offered by the BOC to each Section 272 affiliate to determine whether the BOC makes these services and facilities available at the same rates, terms, and conditions to all carriers. For this purpose, inspect brochures, advertisements of any kind, bill inserts, correspondence, or any other media used to inform carriers of the availability of these services. Using a statistically valid sample compare rates, terms, and conditions offered each Section 272 affiliate with the rates offered unaffiliated carriers.

3. Obtain invoices for interLATA network services and facilities for one month (to be determined by the Oversight Team) rendered by the BOC to the Section 272 affiliate and other interexchange carriers (IXCs) that receive these services from the BOC. Using a statistically valid sample of billed items, inspect underlying details of invoice and compare rates, terms, and conditions charged each Section 272 affiliate with those charged other IXCs for the same services and note any differences. If differences are noted, pursue the matter further through inquiry of appropriate personnel and note why they occurred.

4. Using the invoices obtained in Procedure 3 above, trace the amount invoiced to each Section 272 affiliate for interLATA facilities and services and determine whether the amount invoiced was the amount recorded by the BOC and paid by each Section 272 affiliate. For this purpose, identify and inspect method of payment such as cancelled checks, wire transfers, and, if needed, summaries of invoiced amounts corresponding to the amount paid. Note any differences and inquire as to why they occurred.