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BY THE COMPTROLLER GENERAL 110841

Report To The Congress

OF THE UNITED STATES

Outlook Dim For Revised Accounting System Needed For Changing Telephone Industry

About 4 years ago, the Federal Communications Commission began to develop a new regulatory accounting system for the telephone industry. The existing system does not serve the information needs of the regulators or the industry, particularly with the trend toward competition. Progress on the new system has been slow and the outlook for its early implementation is dim. A myriad of problems remains to be solved.

The Congress is considering amending the Communications Act of 1934 to allow less regulation and more competition for the telephone industry. Such legislation would increase the need to expeditiously develop a revised accounting system for the industry.

This report recommends several ways to speed up progress, including formally appointing an overall coordinator, providing adequate resources, identifying specific user needs, and planning effectively. The Commission considered this report constructive and advised GAO of corrective actions it plans to take.

UNITED STATES GENERAL ACCOUNTING OFFICE

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

A revised Federal regulatory accounting system for the telephone industry is needed so that companies can file lawful rates promptly with adequate cost support. This report summarizes our review of the Federal Communications Commission's approach to revising its existing system. The report also contains recommendations to the Commission for improving its planned implementation and use of the revised system.

Our review was initiated because the Congress, which for some time has recognized the trend toward competition in the communications industry, is currently considering legislation which would reduce regulation and encourage competition. And, the Congress is looking to the Commission for prescribing an accounting system that would aid in achieving this goal.

Copies of this report are being sent to the Director, Office of Management and Budget and to the Chairman, Federal Communications Commission.

Elmer B. Staats
Comptroller General
of the United States

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

OUTLOOK DIM FOR REVISED
ACCOUNTING SYSTEM NEEDED FOR
CHANGING TELEPHONE INDUSTRY

D I G E S T

Historically, the telephone industry has been regulated on the premise that it is a "natural monopoly." Over the past several years, however, the Federal Communications Commission has allowed competition in some areas of the industry, notably for terminal equipment and intercity communication.

A more competitive industry will require a new regulatory approach. About 4 years ago the Commission began to develop a revised Uniform System of Accounts for the industry to provide better current information to Federal and State regulators, industry management, and other users. In particular, the new system is intended to make it possible to determine the cost of specific telephone services--to improve regulatory rate review and detect anticompetitive pricing practices.

GAO believes that unless a myriad of problems is solved, the outlook is dim for early implementation--and effective use--of the new system as proposed by the Commission. Our outlook is based on

--weaknesses in the Commission's approach to developing the system and planning for its implementation,

--concerns raised by State regulatory commissions about some aspects of the proposed system, and

--criticisms voiced to the Commission by industry representatives and other interested parties.

The Commission's approach to developing a revised system has been characterized by

--a lack of continuous overall direction and coordination by a high-level official,

--limited involvement of the Commission's accounting staff even though it has formal responsibility for system revision,

--assignment of various staff members on a sporadic and fragmented basis,

--lack of involvement in system conceptualization by many of the system's ultimate users within the Commission, and

--minimal contact with representatives of State regulatory commissions, the telephone industry, and other interested parties during systems conceptualization.

While any one of these weaknesses has some adverse effect on system revision, their collective impact will likely be severe. If not corrected, they will inhibit timely and effective revision of the system.

Even after the system design is complete, the Commission will need to be in a position to use it. For example,

--a systematic way of assuring that reported data is consistent and reliable is needed,

--necessary resources should be available to effectively and efficiently process the data reported, and

--system outputs need to be specified for the intended users within the Commission.

At the time of GAO's review, the Commission had done only minimal planning for these needs.

In response to a GAO questionnaire, State regulatory commissions identified several major problems that could arise if they use the revised system. The Commission must work more closely with State regulatory commissions to avoid imposing duplicate reporting burdens on the telephone industry.

Respondents to the Commission's initial proposal for a revised system expressed concerns about the complexity and cost of and time frames for revising the system. Other concerns expressed included a need to consider the impact of the revised system on (1) the existing separations procedures whereby telephone property costs are apportioned between interstate and intrastate operations and (2) methods of allocating cost to various telephone services. Also, respondents cited the need to identify the reporting requirements to be placed on the industry.

RECOMMENDATIONS TO CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

GAO recommends that the Chairman:

--Formally appoint a sufficiently high-level official to provide continuing and consistent direction and to monitor progress being achieved.

--Assign responsibility within the Commission for all phases of development and implementation.

--Define the specific needs of intended users of the revised system within the Commission.

--Improve the mechanism and procedures for coordination with State regulatory commissions to avoid imposing duplicate accounting and reporting burdens on the industry.

--Assess the resource needs of the Commission to provide an appropriate level of monitoring and to effectively and efficiently use reported information after system development.

--Explain how system development will be coordinated with other major actions which may be required, such as revising separations procedures and determining appropriate cost allocation methodologies.

--Identify the reporting requirements that the industry will need to follow.

COMMISSION COMMENTS

The Commission stated that GAO's report was critical, but very constructive. Therefore, the Commission believed GAO's report would be useful in the future development of the Uniform System of Accounts.

The Commission said it would take several managerial steps to alleviate many of the deficiencies discussed in this report, including establishing a task force, headed by a senior staff member and composed of individuals with appropriate backgrounds and expertise, to design the revised system.

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ABBREVIATIONS

AT&T	American Telephone and Telegraph Company
FCC	Federal Communications Commission
GAO	General Accounting Office

CHAPTER 1

INTRODUCTION

The advantages and disadvantages of lessening or even eliminating longstanding Federal regulation of certain major industries is an "in" topic--capturing the attention of the Congress, the executive branch, the private sector, and the public. Deregulation of the airline industry has been viewed positively by many, if not most, observers, and now legislation has been introduced to deregulate other major industries, including the railroad, trucking, and telecommunications industries.

For over 40 years, the Federal Communications Commission has regulated the telecommunications industry under the Communications Act of 1934. The Commission's regulatory policies and practices have been influenced by various factors, including technological changes and the political climate. Recently a major thrust has been to push for more competition in the industry, which historically has been dominated by one giant corporation--the American Telephone and Telegraph Company (AT&T).

In the 96th Congress, three bills have been introduced to rewrite or amend the Communications Act. While each bill varies from the other, they all aim at encouraging a more competitive environment, and each would lessen the degree of Federal regulation. Also, each would authorize the Federal Government to continue to prescribe accounting practices for the telephone industry; in Senate and House hearings on these bills in 1979, the accounting requirements were the subject of much debate.

Why? Because adequate and accurate accounting information can be crucial to determining whether anticompetitive pricing practices exist. In an industry where one dominant corporation offers both monopoly and competitive services, the advantages of competition could be greatly diminished if profits from monopoly services are subsidizing, or cross-subsidizing, the competitive services. An accounting system that adequately and accurately captures cost information by type of service can help detect whether such practices occur.

The Uniform System of Accounts, which the Commission now requires telephone companies to follow, does not provide cost information by type of service. However, in June 1978 the Commission adopted a formal rulemaking to develop a revised system which is intended to provide this information. (During congressional hearings on the proposed rewrite of the Communications Act, AT&T officials testified that they too lacked an internal system to identify cost by type of service.)

Since an appropriate accounting system is integral to implementing the Nation's future telecommunications policy, we looked into the progress and problems the Commission faces in developing a new system. Because the Commission's proposed system had not been finalized, we limited our review to evaluating the Commission's approach to developing and planning the implementation of the new system.

SCOPE OF REVIEW

We made our review primarily at the Commission's Washington, D.C. headquarters. We reviewed current and proposed legislation, congressional testimony, and agency documents and reports. We also interviewed Commission officials. We reviewed written comments of industry representatives and other interested parties in response to the Commission's proposed system and interviewed selected representatives. In addition, by using questionnaires, we obtained the views of State regulatory commissions.

CHAPTER 2

A PERSPECTIVE:

THE INDUSTRY AND ITS REGULATION

To appreciate the environment in which Federal regulatory policy for the telephone industry is formulated, the nature and structure of the industry must be understood. Major factors which shape the environment are:

--AT&T's domination of the industry.

--The relationship between AT&T and about 1,500 independent telephone companies.

--The rationale and nature of Federal and State regulation over the years.

--The growing significance of competition in an industry historically considered a natural monopoly.

THE TELEPHONE INDUSTRY

In 1978, the telephone industry generated about $50 billion in operating revenues and employed over 1 million individuals--roughly 1 out of every 200 Americans. The industry is dominated by AT&T, also known as the Bell System, which includes:

--23 wholly- or partially-owned telephone operating companies.

--Its Long Lines Department, the interstate and overseas operating unit.

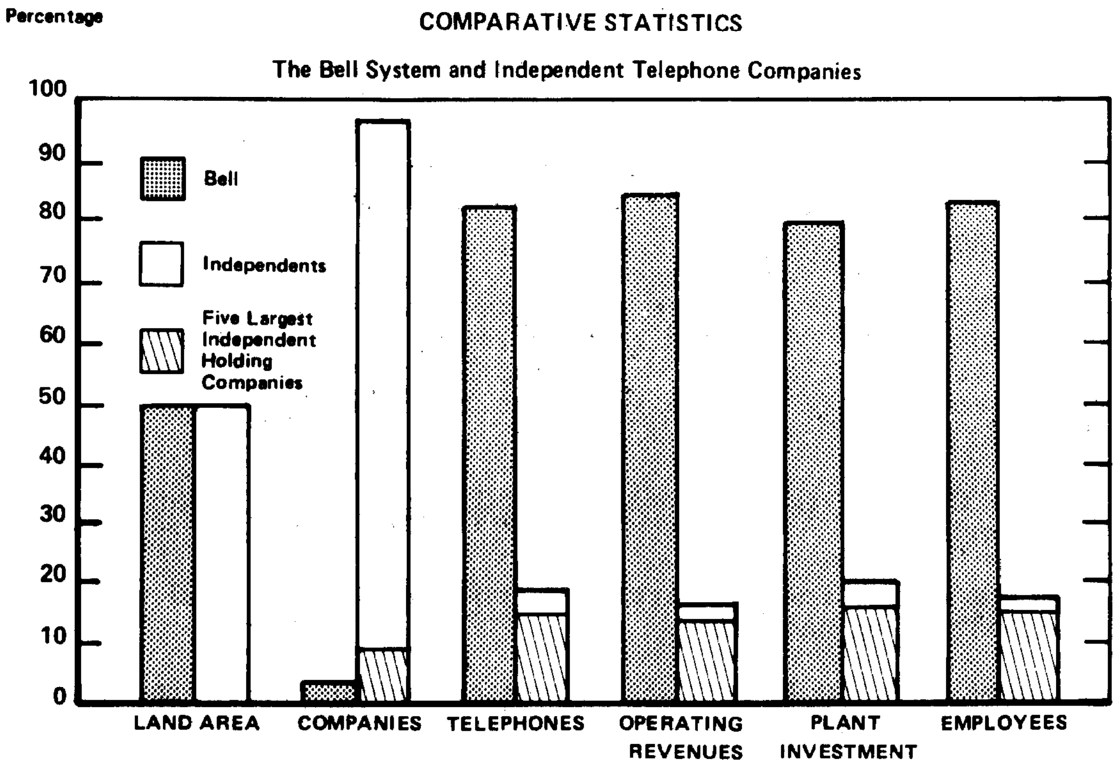
--The Western Electric Company, the manufacturing arm and supplier.

--Bell Laboratories, the research and development arm.

The Bell System's operating revenues in 1978 were about $42 billion. AT&T provides about 81 percent of the telephone service in the United States, as measured by the number of telephones, and accounts for about 84 percent of domestic telephone operating revenues.

Over 1,500 other telephone companies, known as independents, serve about half the geographic area of the United States--mainly rural and suburban areas and small towns. The independents, which include cooperatives financed by the Rural Electrification Administration, account for about 19 percent of the telephones in use and employ about 180,000 persons. Five holding companies account for about three-fourths of the independents' share of the market.

Most nationwide telephone service is provided by the Bell System and by the independents interconnecting any two of the Nation's almost 170 million telephones. The Bell System's operating companies provide both local and long-distance service. The independents operate separately from the Bell System in providing local service, but usually they must tie into the Bell System for long-distance service.



RATIONALE FOR AND NATURE OF REGULATION

The Communications Act of 1934 accomplished two things--(1) it consolidated the regulatory powers formerly exercised by various Federal agencies and turned them over to the Federal Communications Commission and (2) considerably broadened the scope of such regulation. A major purpose of the act was to make available, as far as possible, to all the people of the United States a rapid, efficient, nationwide, and worldwide wire and radio communication service with adequate facilities at reasonable charges.

The Commission regulates interstate and foreign communication, which includes the telephone industry. Purely intrastate telephone service is not, in general, subject to Commission jurisdiction but comes under the authority of State regulatory commissions.

The Communications Act requires every subject company to furnish service at reasonable charges upon reasonable request. Companies may not construct, acquire, or operate lines for interstate or foreign communication without Commission approval. Likewise, they cannot discontinue or curtail service without Commission approval. All their charges, practices, classifications, and regulations must be just, reasonable, and not unduly discriminatory. Telephone companies must file proposed rates with the Commission.

The Commission has authority to prescribe the forms of records and accounts to be kept by telephone companies and under this authority has prescribed a Uniform System of Accounts. Under that system, companies file monthly and annual reports with the Commission giving specified financial and operating information. The Rural Electrification Administration requires the telephone cooperatives it finances to follow the same system, as do most State regulatory commissions.

Natural monopoly--the rationale for regulation

Historically, the Commission has regulated the industry on the premise that it is a natural monopoly with certain attendant benefits. A key attribute of a natural monopoly is that a single firm can supply the entire market more cheaply than any combination of firms. To retain the benefits of the natural monopolist's low-cost production while preventing the exploitation of its position, regulation is imposed. Unregulated monopolists may, for example, produce too little, charge prices too high when compared with a competitive situation, engage in discriminatory pricing, and reap monopoly profits.

TREND TOWARD COMPETITION

Both technological innovation and increased demand for communications, including telephone services, are generating controversy over whether a natural monopoly continues to exist in various sectors of the industry. The telecommunications industry--which is dominated by the telephone industry--can be divided into three sectors:

1. Local services sector--primarily the telephone industry and firms which enable users to originate calls to a defined local calling area and to receive incoming calls, and which provide access to and from the long-distance network.

2. Terminal equipment sector--firms which produce equipment capable of sending and/or receiving information over a communications channel through which users gain access to the telecommunications network. For residential users, terminal equipment is often the basic telephone handset. For business users, it may be more sophisticated and provide more services.

3. Intercity transmission sector--firms which transmit voice and record communications between cities. This long-distance transmission may use wire, microwave relay stations, or satellite facilities.

The local services sector generally continues to be regulated as a natural monopoly. For the other two markets, the Commission has decided over the last several years to allow competition.

We discussed the trend toward competition in the telecommunications industry in more detail in an earlier report. ("Developing a Domestic Common Carrier Telecommunications Policy: What are the Issues?" Jan. 24, 1979, CED-79-18.)

CHAPTER 3

A NEW ACCOUNTING SYSTEM BEING DEVELOPED FOR A NEW ENVIRONMENT

To meet new information demands of the changing regulatory environment, the Federal Communications Commission has recently undertaken an effort to revise the existing Uniform System of Accounts for telephone companies. The impetus for restructuring the existing system has come from several fronts--Federal and State regulatory bodies, industry managers, and other interested parties. Legislation has been proposed recently which would alter the nature of Federal regulation and increase the significance of a new accounting system to fulfill new regulatory goals.

ORIGIN AND NATURE OF THE PRESENT SYSTEM

In 1913, the Nation's telephone companies first became subject to a uniform system of financial accounts established by the Interstate Commerce Commission, whose regulatory control then included telephone and telegraph companies. The Communications Act of 1934 established the Federal Communications Commission, and in 1935 the Communications Commission adopted the existing Uniform System of Accounts, which was based on an earlier system. Although the system has been modified occasionally, its basic structure has remained essentially the same since 1935.

The Commission has used the system to review the operations of the telephone companies subject to its jurisdiction. The existing system encompasses both balance sheet and income statement accounts, both of which focus on companywide financial and operating data. Historically, the system has been used by the Commission to review matters such as overall investment and expense levels, property valuation, and depreciation rates. It has also provided a basis for the Commission's review of _overall_ revenue requirements, including a determination of a fair rate of return. 1/

The existing system was established in an era when telephone companies offered only two basic types of service--

---

1/In judicial review of rate cases, the guideline generally followed has been that return must be (1) commensurate with returns in nonregulated enterprises with corresponding risk and (2) sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit standing and to attract capital.

local and long distance. Today, a large variety of services is available, including local exchange service, long-distance message telecommunications service (MTS), wide area telephone service (WATS), digital data service (DDS), and various private line and specialized services.

IMPETUS FOR REVISING THE EXISTING SYSTEM

Tremendous technological changes along with regulatory policy shifts have allowed competition to be introduced into some sections of the telephone industry. The industry now comprises companies offering both monopoly and competitive services, as well as companies that provide only competitive services. Because of that composition, both the Commission and the Congress recognize a need to establish procedures to ensure that a company offering both monopoly and competitive services does not cross-subsidize its competitive services with revenues from its monopoly services.

In recent years, the Commission's rate cases have dealt increasingly with rate levels and rate structures of specific services, and less with overall, companywide rate of return and revenue requirements. The primary ratemaking criterion has become cost by specific service, 1/ which the existing Uniform System of Accounts does not provide. In support of proposed rates filed, Bell has been forced to rely on special cost studies to supplement the system's data.

The Commission has not, however, been satisfied with these special studies, believing they were

> "incomplete, arbitrary, speculative, inaccurate, superficial, unauditable or otherwise flawed, largely because the information necessary to perform an adequate study is not available to Bell (or other carriers)."

The Commission believes that

> "the adoption of an improved accounting system would permit the Bell System to file lawful rates in a timely manner with adequate cost support."

1/"Cost of service" usually includes all expenses necessary to provide the required service, including operation and maintenance, depreciation, amortization expenses, taxes, and an allowance for the use of capital. Specific services in the telecommunications industry include local exchange service, long-distance message telecommunications service, etc.

According to a Commission official, with some exceptions, AT&T has been unable to present adequate cost support for its tariffed services for over 20 years.

The Commission is in the midst of system revision

In addition to the Commission's own statements regarding inadequacies of the existing Uniform System of Accounts, two consulting firms reviewed and commented on it in the mid-1970s. Under a Federal contract, a national public accounting firm assessed the system's effectiveness and, in March 1974, concluded that the current system could not determine and assess the costs of separate telephone services. The firm identified the need for a computerized, fully integrated uniform data system capable of providing several matrices of revenues and costs by such bases as cost of service categories, class of customers, function, product, and others.

Also, in June 1975 the Commission awarded another contract to study the information requirements of the Common Carrier Bureau. In its August 1976 report, the contractor recommended a data base approach to changing the system; costs would be traced to a service or group of services and assigned to accounts representing specific technical or business functions. The contractor also proposed that existing expense and telephone plant accounts be redefined to more closely match a functional type of organization.

In June 1978, the Commission adopted a Notice of Proposed Rulemaking entitled "Revision of Accounts and Financial Reporting for Telephone Companies." The notice outlined a proposal 1/ for extensively revising the Uniform System of Accounts, the data collection, and recordkeeping and reporting requirements for telephone companies. The Commission set forth several objectives for a new system:

--"It will form the basis for financial reports, including both balance sheet and income statement reporting."

1/The notice consisted of a portion narrating the origin, nature, and deficiencies of the existing system and the goals of the revision; it discussed many related issues on which comment was invited. Attached appendixes were: (A) Existing Chart of Accounts for Class A and B Telephone Companies; (B) Fully Distributed Cost Implementation Manual; (C) Separations Manual; (D) Proposed Revised Uniform System of Accounts--Revenue Accounts; (E) Primary Allocation Records--Revenues and Traffic Items; and (F) Allocation Procedures for a Cost Accounting System.

--"It will serve as a data base and a foundation for managerial decisionmaking and internal management reports by the carriers.

--"It will provide sufficiently detailed disaggregated cost and revenue information for derivation of costs and revenues of individual services and rate elements, for pricing decisions and other managerial decision-making by the carriers.

--"It similarly will provide detailed disaggregated cost and revenue information for derivation of costs and revenues of individual services and rate elements for rate review and continuing surveillance purposes of this Commission (and other regulatory bodies which adopt the revisions) and provide a basis for rate prescriptions, where appropriate.

--"It will facilitate the breakdown of costs between interstate and intrastate jurisdictions ('jurisdictional separations').

--"It will permit analysis of facility and plant utilization, including studies of the causes for each category of expenditure and review of service quality and service efficiency.

--"It will be structured so as to allow for regulatory and independent auditing and tracing of questioned entries." (Underscoring added.)

Initial and reply comments were due on January 15, 1979, and March 15, 1979, respectively. As of June 1979, more than 70 parties had filed written comments. In addition, a number of interested parties participated in a Commission-sponsored September 1978 public meeting.

After analyzing the comments, Commission staff prepared a draft Supplemental Notice of Proposed Rulemaking to further clarify issues and request additional comments on the proposed system. The Commission adopted the supplemental notice on August 1, 1979.

Although the Commission has begun to revise the Uniform System of Accounts, the road ahead is still quite long. Commission staff members have stated it must have a final system adopted by June 30, 1980, to fulfill a promise made to the Congress in 1978 to begin implementing the new system on January 1, 1981. Installation of the new system, as currently envisioned, will take 3 years.

AT&T is also developing a new system

In its notice, the Commission recognized that AT&T had been working for some years on a large, complex Functional Accounting System. The Commission, however, noted that AT&T's new system was intended to provide cost information along functional lines, but not by specific service--at least in the initial stages. The Commission asked for comments on how its proposed revised system would fit with the system being developed by AT&T.

THE CONGRESS IS ALSO INTERESTED IN AN IMPROVED SYSTEM

Congressional interest, beginning in 1976 with a general inquiry into the effect of competition on the telecommunications industry, has evolved into the introduction of major legislation in both the Senate and House to restructure the Communications Act of 1934. While the proposed legislation and hearings addressed many facets of telecommunications policy issues, considerable inquiry and testimony focused on the possible need for a cost accounting system to accomplish the goals of increased competition.

Proposals for statutory change appear as H.R.3333, S.611, and S.622. While somewhat different approaches are presented, commonalities exist between the bills' goals regarding lessening of Federal regulation and increased reliance upon market forces. The general intent, which is supported by the industry, is to maintain universal service while seeking diversification of telephone and information service markets. Two of the bills would mandate a new accounting system specifically designed to identify the cost by specific service, distinguishing between competitive and noncompetitive services. (See app. I.)

Perhaps the most often expressed congressional concern is the potential for cross-subsidizing competitive services by monopoly services and predatory pricing by dominant carriers. Remedies were proposed in the form of

--physical separation of ownership, operation, or management of companies offering both competitive and monopoly services, either by use of separate subsidiaries (S.611) or arms-length relationships (H.R.3333) and

--financial separation of costs by means of an innovative revised accounting system.

During hearings on the proposed legislation, considerable debate was heard over which approach would be better, or whether a combination of both would be required. The following excerpts from congressional testimony discuss these two approaches:

> "We understand the purpose of that requirement--that is, to preclude cross subsidy--and we recognize an obligation to demonstrate that our monopoly services do not subsidize our competitive services. But rigorous, closely supervised accounting systems would seem to me sufficient to this end."
>
> (Chairman, AT&T)

> "The creation of separate corporate entities with distinct facilities and distinct personnel aids regulation by making it easier to identify costs that are allocable to distinct services and to detect and remedy discrimination among competing carriers. Such reorganizations, however, may result in significant costs. In certain cases rigorous accounting measures might serve as an adequate substitute for maximum separation. In other cases accounting requirements might complement a requirement of maximum separation."
>
> (Chairman of the Commission)

> "* * *separate subsidiaries cannot solve the problem without rigorous accounting procedures, and may be unnecessary with such procedures."
>
> (Interested party)

CHAPTER 4

OUTLOOK FOR IMPLEMENTATION AND USE OF THE NEW SYSTEM

Agreement on the need for a revised Uniform System of Accounts for the telephone industry is widespread, and new legislation may greatly increase the system's importance. Yet, unless a myriad of problems is solved, we believe that the outlook is dim for early implementation--or effective use--of the new system as proposed by the Federal Communications Commission. Our outlook is based on

--weaknesses in the Commission's approach to developing the system and planning for its implementation,

--concerns raised by State regulatory commissions about some aspects of the proposed system, and

--criticisms voiced to the Commission by industry representatives and other interested parties.

THE COMMISSION NEEDS TO IMPROVE ITS APPROACH TO DEVELOPING AND IMPLEMENTING THE REVISED SYSTEM

Although the initial effort to develop a revised Uniform System of Accounts began about 4 years ago, it is evident from reactions to the initial proposal that much remains to be done. Because of weaknesses in the Commission's approach to developing the revised system and gaps in its planning for future needs, finalization of the revised system is languishing and the Commission is not in a good position to effectively use it--if and when it is implemented.

Weaknesses in the Commission's approach to development

The Commission's approach to developing a revised Uniform System of Accounts for the telephone industry has been characterized by

--a lack of continuous overall direction and coordination of system development by a high-level official;

--limited involvement of the Commission's accounting staff even though it has formal responsibility for system revision;

--assignment of various staff members on a sporadic and fragmented basis;

--lack of involvement during system conceptualization by many of the system's ultimate users within the Commission; and

--minimal contact with representatives of State regulatory commissions, the regulated industry, and other interested parties during system conceptualization.

While any one of these characteristics has some adverse effect on system revision, their collective impact will likely be severe and if not corrected, will militate against timely and effective development of the revised system.

Commission individuals from various offices and disciplines have been involved in developing the revised system. In October 1976, a cost analysis task force was formed within the Commission to begin work on three areas--the Uniform System of Accounts, implementing newly adopted cost allocation principles, and recommending changes in the depreciation rules. During 1977, the task force prepared several products, including a rough draft of a proposed new system of accounts.

Over time, some original task force members continued to be involved with the effort, others dropped out, and some new members became involved. At the time of our review, responsibility for developing the revised system had been assumed by a few key individuals, but no one individual had been formally designated as having overall responsibility.

In a formal mission statement, responsibility for revising or updating the telephone Uniform System of Accounts is assigned to the Commission's accounting staff (within the Common Carrier Bureau). To date, however, the Bureau's economists and lawyers have played the biggest role in system development, while accountants have played a very minor role. We estimated that the economics staff had accounted for about two-thirds of the personnel resources to date, whereas the accounting staff had accounted for only about 10 percent. While we recognize the value of involving various disciplines in system development, we believe that the Commission's accountants, because of their important perspective, should be more heavily involved in developing a revised accounting system.

In general, staff involvement appeared sporadic and fragmented. We identified 34 individuals who represented six offices within the Commission who have been involved in developing the revised system. Some were assigned to the effort as early as October 1976, while others were not involved until as late as May 1979; most were involved for a few months or less.

In developing the revised system, the major investments have been for the Commission's personnel resources and for contractual services. The Commission did not have formal records of personnel costs but we estimated such costs at about $220,000. That figure was based on typical salary costs for the time Commission staff spent on the project through June 1979. We did not attempt to estimate other costs, such as fringe benefits or overhead. In addition, a contractor's study cost about $130,000.

Eventual users of the system within the Commission were involved only minimally in conceptualizing the system as proposed in the Commission's initial notice. Although some users were involved in system conceptualization, many--including some with rate review responsibilities--were not. Without precisely defining user needs, a costly and complex system may be established without meeting the needs of users of the system within the Commission for rate review and other regulatory responsibilities.

Another factor which may have impeded progress in developing the revised system was the lack of opportunity at the system conceptualization stage for involvement by State regulatory commissions, industry representatives, and others. Earlier involvement by the regulated industry and other interested parties could have given the Commission a better idea of potential issues that might be faced as the system design evolved.

We recognize that in its regulatory role, the Commission already had general knowledge of the industry's accounting practices. Moreover, in the early stages of system conceptualization, Commission officials made brief visits to selected offices of AT&T and one major independent to further their understanding of existing accounting practices. However, the system as proposed in the initial notice was conceptualized largely in isolation from the State commissions and industry. (See pp. 17-19.)

<u>Gaps in planning for implementation and use of revised system</u>

Even after the final system design is complete, if it is to be of value, the Commission will need to be in a position to implement and use it. For example,

--a systematic way of assuring that reported data is consistent and reliable is needed,

--necessary resources should be available to effectively and efficiently process the data reported, and

--system outputs need to be specified for the system's users within the Commission.

At the time of our review, the Commission had done only minimal planning for these needs.

The Commission has only limited resources for auditing the reliability and consistency of data to be reported under the revised system. With a total current audit staff of only 16, Commission officials complain that they are not now in a position to audit data reported in the detail they prefer. Audits of major companies have been performed less than once every 10 years and are usually of limited scope. The new system will presumably be much more complex and require more extensive audit capabilities.

Considering its relatively limited audit capability to review the new system, the Commission may need to look to other viable means, such as computerized audit techniques, to monitor the system's implementation and operation. The Commission recognizes the importance of being able to audit the system and has asked for comments on additional measures that should be built into the system to further enhance auditing and entry verification in this age of computer-maintained accounts. Yet the Commission had not decided what approach to follow, nor had it begun to plan for the resources that would be needed to assure that the data to be reported is consistent and reliable.

Since it will be a new system, telephone companies using it will not necessarily interpret the specified accounts nor necessarily implement the system uniformly. Assuring that the resulting data is consistent and reliable under these conditions requires that more audit attention be given to a new system than one that has been in use for many years.

Since the proposed system is based extensively on computerized concepts and envisions computer-oriented inputs, the Commission must have the necessary computer capabilities to process the reported data. While it may not be possible to determine exactly the new computer requirements until final design, the concepts proposed envision rather massive computer resources. For example, additional personnel may be needed to develop the necessary computer software, and if computer hardware is needed, the leadtime to develop specifications and procure the hardware can require several years.

Although the Commission's 5-year plan for information processing listed a very general project regarding the proposed new system, neither those officials involved in system revision nor those with data processing responsibilities had done any substantive planning as to the computer-related aspects of the new system.

Although some of the ultimate system users within the Commission were involved in conceptualization, the users had not been asked to design outputs to meet specific needs. If adequate and timely attention is not given to the probable outputs, the new system may not be designed to produce the type of reports needed.

STATE REGULATORY COMMISSIONS IDENTIFIED PROBLEMS

Currently, most State regulatory commissions require the same Uniform System of Accounts as the Federal Communications Commission prescribes. If they are unable or unwilling to use the revised system, the regulated companies may be forced to maintain and report under more than one system. Moreover, since four-fifths of telephone business is subject to State rate regulation, and since the Federal Communication's proposed system would develop costs of services for that portion of the business, State views are extremely important.

During system conceptualization, the Commission did not hold any special meetings or workshops with State representatives to assure that accounting and reporting requirements would be coordinated. But the National Association of Regulatory Utility Commissioners, which represented State commissions, and eight individual commissions commented to the Federal Communications Commission on the proposed revision of the system.

In its response, the National Association of Regulatory Utility Commissioners pointed out that it would not be "reasonably possible" to have a single telephone company subject to two or more conflicting Uniform Systems of Accounts and, therefore, the current Federal system was now essentially prescribed by every State. Accordingly, the Association believed it was of the utmost importance that the current system at the Federal level be revised in cooperation with the States. To satisfactorily resolve problems which the Association believed were evident in the initial proposal, it suggested that a series of working sessions be held for representatives of the Federal Communications Commission and State staffs.

In addition to reviewing State comments, we sent a questionnaire to 53 regulatory commissions representing the 50 States, the District of Columbia, Puerto Rico, and the Virgin Islands, to obtain more specific reactions to aspects of the proposed revision as described in the Notice of Proposed Rulemaking. We received replies from 40 commissions, but some did not answer all the questions.

In responses to the questionnaire, these commissions endorsed the need for system revision; 29 of 40 responding agreed that some need existed to revise the current system. On the other hand, the responding commissions also identified potentially major problems. These included inadequate participation in system development by State commissions, reservations about the extent to which they may adopt the revised system, and possible difficulties in handling the computer implications of the new system.

The State and other regulatory commissions expressed concern over their level of participation. Of 22 answering the question, only 3 were satisfied with their participation, 8 termed their participation borderline, and 11 were either dissatisfied or very dissatisfied.

Even when they do participate, State and other commissions have reservations about what their impact was or will be eventually. Of 22 answering the question, only 3 believed their participation would have any impact, while 12 believed their impact would be minor, very minor, or nil. The remaining seven said it was too early to judge.

At the time of our survey, the State and other regulatory commissions expressed doubt about the extent to which they expected to adopt the revised system. Only 7 of the 40 said they expected to adopt the system totally and another 12 said they expected to adopt most aspects of the system; but 7 said they would make only limited use of the system or none at all. The remaining 14 commissions said they would decide later.

Because the revised system as proposed is based on computer concepts and envisions computerized input, we asked the State and regulatory commissions whether they would prefer to receive input from industry in this format. Of 38 who answered the question, 33 said they preferred manually prepared rather than computerized input, which indicates that the States may not agree with one major feature of the proposed system.

The responses concerning the State commissions' overall perception of the revised system in cost-benefit terms indicate perhaps the most serious problem. A total of 38 responded to the question, 11 of which said they had no basis for making a judgment. Of the other 27 expressing an opinion, 19 believed the total costs of the new system would probably outweigh the benefits to some degree.

The composite results of the questionnaire are included as appendix III of this report. We believe that the questionnaire results, coupled with comments filed with the Federal Communications Commission, clearly indicate a need for more meaningful Federal-State communication as the system revision proceeds. If not, State and other regulatory commissions which have the power to regulate rates for four-fifths of the industry may be faced with a Federal system that they cannot or do not understand or want. Or if the Federal system is not considered workable at the State level, the industry may be required to maintain and report under more than one system.

COMMENTS SUBMITTED TO THE COMMISSION IDENTIFIED OTHER PROBLEMS

In response to its Notice of Proposed Rulemaking, the Commission received over 1,600 pages of comments from more than 70 parties. Very few respondents questioned the need for a revised system or quarreled with its objectives; however, the proposal was heavily criticized.

The fact that a proposal for such a major change in a longstanding regulatory system elicited strong reactions from the industry and other affected parties is not surprising. Overall, the comments indicate that the Commission must deal with a large number of issues before the final version of the revised system can be effectively put in place. In this regard, the Commission's August 1, 1979, supplemental notice addressed many of the issues raised by those who commented on the initial notice; the Commission had not yet received comments on the supplemental notice at the close of our review.

Some major criticisms of the Commission's proposed system as described in the initial notice are discussed below. Selected excerpts from the comments received by the Commission are included in appendix II. We did not attempt to assess the validity of all comments received.

Based on the initial notice, two major criticisms related to

--the excessive complexity and attendant cost of the proposed system and

--time frames for implementation, which were considered to be much too optimistic.

Other criticisms included the lack of defined reporting requirements and the need to better define the relationship between the proposed new system and other unresolved issues.

Proposed system could be complex and costly

The proposed system would increase the number of the industry's accounts from 240 to an estimated several thousand. One small firm interpreted the system as possibly requiring a much larger number--perhaps millions--of sub-accounts. Most respondents considered this level of detail excessive, particularly for smaller firms.

The proposed system was also criticized because non-accounting--that is, statistical--records would be required to be part of it. While respondents generally agreed that such nonaccounting records were an integral part of the informational data base system, many argued that all nonfinancial data should be maintained in a separate record to protect the historical, fixed, and verifiable nature of the financial accounts. The concern was that the integrity of the financial accounting system not be destroyed.

The proposed system would also rely heavily on computerized techniques, possibly requiring regulated firms and State commissions which adopt the revised system to acquire new or more sophisticated computer systems. For example, information would have to be reported on computer-oriented media. Many companies, particularly smaller independents, said they did not have the necessary computer capabilities to implement the proposed system. Even AT&T and some of the larger independents had serious reservations about the data processing implications of the proposed system.

In the opinions of many respondents, the huge increase in the number of accounts, the inclusion of nonaccounting records, and more sophisticated data processing concepts would significantly increase costs. Because the system was not completely described, well-formulated estimates were not provided but various cost estimates were made by both large and small independents. Estimates ranged from general terms, such as "very substantial," to specific estimates as high as $25 million. Concern was also expressed that these costs would ultimately be borne by consumers.

While AT&T did not provide an estimate of the costs that might be associated with implementing the proposed system, it did say the cost incurred to date for developing and implementing its Functional Accounting System was over $400 million. Moreover, AT&T officials have stated that the total cost to implement the Functional Accounting System would eventually exceed $800 million. While these figures undoubtedly include some costs which may have been incurred even without developing a new system, AT&T is of the opinion that the Commission's proposed system is much more detailed and complex than the system it already has under development.

We did not attempt to verify the estimates by independents or the costs incurred by AT&T for its Functional Accounting System. In its notice, the Commission did recognize that its proposed new system might appear burdensome, but no estimates of anticipated costs to the industry were made. In deciding on final system design, the Commission will need to weigh the important goals being sought against the costs that will be associated with the system's implementation.

Time frames for industry implementation may be too optimistic

As stated in the previous chapter, the Federal Communications Commission has a goal of 1981 for beginning a 3-year implementation of the revised system. Several respondents from the regulated industry said they would have difficulty implementing the revised system in their company within this period. While some simply stated that the time frame was generally too short, others made specific projections which ranged up to 15 years.

Again AT&T did not specifically comment on the time that would be required for implementation, but it did express general concern. In other statements, AT&T officials have discussed the extended time frames for implementing the Functional Accounting System which is now being developed. Work on that system was initiated in 1973, but the Commission believes that it will not be able to produce information by cost of specific service until the late 1980s.

Many factors, some controllable and others not, will enter into the actual time frame for implementing a revised system. However, the comments concerning the possible difficulties in proposed time frames should be noted by the Congress and others who may be relying on early implementation of a revised system.

Other issues need to be resolved

Respondents to the Commission's Notice of Proposed Rulemaking on the Uniform System of Accounts expressed concern about various other issues, some of which also relate to the complexity, cost, and time frames to implement a revised system. Other major issues raised by respondents related to a need to:

--Define reasonable reporting requirements for industry.

--Arrive at acceptable methods for allocating costs to various services. Currently, a draft manual describing a method exists, but it has not yet been officially approved by the Commission and is subject to revision.

--Determine how the revised Uniform System of Accounts will affect the "separations" procedures. According to those procedures, telephone property costs are apportioned among interstate operations, subject to the jurisdiction of the Federal Communications Commission, and among the intrastate operations, subject to the jurisdiction of several State regulatory bodies. The separations process is carried out following standard procedures which make specific reference to the existing system and therefore, might need to be revised.

While briefly stated above, each of these issues, individually, is complex and involved, and the Commission has addressed each to some extent in both its initial and supplemental notice regarding the proposed new system. But the Commission will need to continue to address these issues as it revises the system.

COMMISSION'S MANAGEMENT PROBLEMS WERE POINTED OUT IN A PREVIOUS REPORT

In this report, we discuss the lack of continuous overall direction and coordination of system development by a high level official. The problems we noted in that regard are similar to those described in our July 30, 1979, report to the Chairman, Subcommittee on Communications, Senate Committee on Commerce, Science, and Transportation 1/ in which we stated:

> "As is the case with FCC's Chairman, most bureau and office chiefs at FCC find themselves unable to devote the close attention required to ensure effective management. These officials need to provide for alternative organizational arrangements to ensure that important management functions are not neglected. This is particularly true because the Commission has traditionally looked to the heads of operating bureaus and major offices for expertise, counsel, and leadership in the formulation of substantive policy. This expert adviser role of the bureau and office heads continues to be emphasized under the present Chairman and Commission."

1/"Organizing the Federal Communications Commission for Greater Management and Regulatory Effectiveness," CED-79-107.

The previous report found that coordination and communication between bureau and division chiefs and among division chiefs was lacking and, in general, firm, unified, and effective direction was absent. We believe that this situation is comparable to our current findings that involvement by many of the ultimate users within the Commission during the systems conceptualization stage was lacking.

This review found that the Commission had not yet addressed how it can assure consistent and reliable data in view of its limited audit capability nor what computer resources--people, computer hardware, and computer software--the revised system may require. Here again, similar problems were pointed out in the previous report.

> "Effective management through central, explicit control of FCC's staff by the Commission and bureau management is weakened by the absence of a planning process. Without setting goals and objectives or setting priorities, the Commission has little assurance that organizational directions and performance are or will be congruent with its desires."
>
> * * * * *
>
> "To ensure that an agency's ADP activities are consistent with its overall objectives, it is important for high level officials to take a comprehensive view of ADP management. Specifically, it is important for top agency management to be involved in setting ADP objectives, strategy, and priorities and in controlling and reviewing program performance.
>
> "We found, however, that the Commission does not set objectives and priorities for the data automation program nor does it review program performance except through the budget process. This review of FCC's budget does not, however, provide the Commission with an effective means for ensuring that ADP resources are being used to best achieve FCC's overall objectives."

CHAPTER 5

CONCLUSIONS, RECOMMENDATIONS, AND

COMMISSION COMMENTS

CONCLUSIONS

Over the past several years, Federal regulatory policy for the domestic telecommunications industry has placed increasing emphasis on achieving a more competitive environment. Now some members of the Congress are pushing for some deregulation of the industry--possibly in stages over the next few years. Although policy on the future extent, nature, and duration of Federal regulation has yet to be decided, in the near future the industry will continue to include both monopolistic and competitive segments. In such an environment, the accounting system the Federal Government prescribes for the telephone industry will likely be a key aspect of any new or modified regulatory mechanism.

The Uniform System of Accounts being revised by the Federal Communications Commission has as a primary goal an ability to determine the cost of specific services offered by the industry. Interested parties--including the regulators, the regulated, and others--agree that, in the current environment, this ability is greatly needed. Theoretically, this ability would permit the Commission and others to review the reasonableness of rates charged for the specific services. It would also allow them to determine whether rates for monopolistic services are set higher than related costs and allowed return as a means of cross-subsidizing rates charged for competitive services.

In fact, many of the benefits being sought in revising the system have considerable merit. In addition, the Commission's objective of developing a system capable of identifying cost by specific service is in line with pertinent sections of bills introduced in the Congress to amend or rewrite the Commissions Act of 1934. We do not take exception to the Commission's goals or the intended benefits of revising the system.

We have not attempted to reach final conclusions on the technical substance of the proposed system since it was still subject to modification. We do believe the Commission's approach to system development has been weakened by the absence of effective direction and coordination. Also, despite its laudable goals, and regardless of the form the new system takes, the Commission needs to pay close attention early to important practical considerations which will bear heavily on the system's implementation and the use and value of the information the system produces.

Without this attention to practical considerations, misconceptions may arise about the time, cost, and problems that will be associated with the system's implementation and use. We question whether adequate attention has yet been given to the following considerations:

--The specific needs of the revised system's intended users within the Commission.

--The Commission's plans and capabilities to monitor information that will be reported to assure its reliability and consistency.

--The level of resources, particularly for data processing, that the Commission will need to efficiently and effectively process reported information.

--The potential problems faced by State regulatory commissions if they are to adopt the revised system.

--The reporting requirements that the industry will need to follow.

--The impact of the new system on other related issues, such as existing separations procedures whereby telephone property costs are apportioned between interstate and intrastate operations, and methods of allocating cost to various telephone services.

While these matters have been addressed to some extent, the amount of attention given them needs to be increased if desired goals are to be achieved within expected time frames.

Just what are the current expectations regarding the time for implementing a revised system? The Commission has stated that the system's implementation could be expected to begin by early 1981. However, if appropriate and timely action is not taken regarding the practical matters discussed above, the Commission's planned time frame for implementation and use of the revised Uniform System of Accounts will prove to be overly optimistic.

These important matters must be resolved at the same time the system itself is finalized. If early implementation of this system remains an important goal of the Congress and the Commission in forming Federal regulatory policy, a well-coordinated development and implementation approach will be essential.

RECOMMENDATIONS TO CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

We recommend that the Chairman:

--Formally appoint a sufficiently high-level official to provide continuing and consistent direction and to monitor progress being achieved.

--Assign responsibility within the Commission for all phases of development and implementation.

--Define the specific needs of intended users of the revised system within the Commission.

--Improve the mechanism and procedures for coordination with State regulatory commissions to avoid imposing duplicate accounting and reporting burdens on the industry.

--Assess the resource needs of the Commission to provide an appropriate level of monitoring and to effectively and efficiently use reported information after system development.

--Explain how system development will be coordinated with other major actions which may be required, such as revising separations procedures and determining appropriate cost allocation methodologies.

--Identify the reporting requirements that the industry will need to follow.

COMMISSION COMMENTS

The Commission stated that our report was critical, but very constructive. Therefore, the Commission believed our report would be useful in the future development of the Uniform System of Accounts.

To alleviate many of the deficiencies discussed in this report, the Commission said it would take the following managerial steps:

--Establish a task force, headed by a senior staff member and composed of individuals with appropriate background and expertise, to design the revised system.

--Make development of an appropriate implementation schedule a priority assignment of the task force.

--Require regular progress reports to division chiefs and the deputy chief for policy to ensure that the Commission's overall goals are accommodated and that appropriate coordination is maintained among related major actions.

--Direct the task force to develop, as soon as possible, a management paper defining the output that the various users of the accounting system require, keeping in mind the priority to be accorded each of these needs.

--Direct the task force to evaluate the procedural options and outline steps that will ensure that appropriate input from the industry and State regulators will be obtained.

The Commission's response to our draft report is included in its entirety as appendix IV.

EXCERPTS FROM BILLS INTRODUCED* TO AMEND OR REWRITE THE COMMUNICATIONS ACT OF 1934 DURING 96th CONGRESS, 1st SESSION

SUBJECT	HR 3333	S 611	S 622
SPONSORS	Rep. Lionel Van Deerlin (D-Cal.) Rep. James M. Collins (R-Texas) Rep. James T. Broyhill (R-N.C.)	Sen. Ernest F. Hollings (D-S.C.) Sen. Howard Cannon (D-Nev.) Sen. Theodore Stevens (R-Alaska)	Sen. Barry Goldwater (R-Ariz.) Sen. Harrison Schmitt (R-N.M.) Sen. Larry Pressler (R-S.D.)
TITLE	Communications Act of 1979	Communications Act Amendments of 1979	Telecommunications Competition and Deregulation Act of 1979
FINDINGS AND PURPOSE OF BILL	"SEC. 101. (a) The Congress hereby finds that the regulation of interstate and foreign telecommunications is necessary, to the extent marketplace forces are deficient, in order to — (1) make available to the people of the United States nationwide and worldwide telecommunications services which are diverse, reliable, and efficient, and which are universally available at	"SEC. 102. To amend section 101 of the 1934 Act as follows: "For the purpose of making available, so far as possible, to all the people of the United States, rapid, efficient, nationwide and worldwide telecommunications services with adequate facilities at reasonable charges; for the purpose of the national defense; for the purpose of promoting safety of life	"SEC. 2. (a) The Congress finds that — (1) recent advances in technology are making possible diverse telecommunications services which were previously unavailable to the public; (2) marketplace competition can be the most efficient regulator of the provision of telecommunications services; and (3) judicial interpretations of certain decisions of the Federal

*Excerpts are from bills as originally introduced. The Congress had not taken final action on the bills at the close of our review.

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SUBJECT	HR 3333	S 611	S 622
FINDINGS AND PURPOSE OF BILL (Con't.)	affordable rates; and (2) meet the needs of United States foreign policy, the national defense, and the safety of life and property (b) It is the purpose of this Act to establish certain requirements relating to the regulation of interstate and foreign telecommunications, which shall apply to the extent that marketplace forces fail to protect the public interest."	and property through the use of telecommunication; for the purpose of encouraging diversity of ownership and control of telecommunications media and competition among telecommunications media in the provision of telecommunications and other media services; and for the purpose of promoting interstate and foreign commerce in telecommunications equipment and services***" SEC. 103. To amend section 102 of the 1934 Act as follows: "The Congress finds and declares that, whereas modern efficient interexchange telecommunications services and facilities are essential to interstate and foreign commerce and whereas technological advances have led to a convergence of interexchange telecommunications services and facilities, such that it is no longer possible to distinguish between interstate interexchange and intrastate	Communications Commission have created uncertainty and instability in the telecommunications industry. (b) It is the purpose of this Act to — (1) clarify telecommunications policy in light of changing technologies; and (2) eliminate and reduce certain forms of regulation which may hinder the future advancement of technology, inhibit its availability to the American people, or which are otherwise no longer necessary."

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SUBJECT	HR 3333	S 611	S 622
FINDINGS AND PURPOSE OF BILL (Con't.)		interexchange telecommunications simply on the basis of State boundaries without creating artificial and irrational barriers, which are a burden on interstate and foreign commerce and which will reduce the benefits otherwise accruing to the public, the provisions of this Act shall apply to and the Commission [Federal Communications Commission] shall exercise jurisdiction with respect to: all interexchange and international telecommunications ***; all commerce in telecommunications and electronics equipment and services, information software, and information services;*** and all persons engaged within the United States in such telecommunications***."	

APPENDIX I

SUBJECT	HR 3333	S 611	S 622
SPECIFIC TITLE OF TELECOMMUNICATIONS ISSUES	TITLE III-TELECOMMUNICATIONS CARRIER REGULATION	TITLE II-DOMESTIC AND INTERNATIONAL TELECOMMUNICATIONS: RURAL TELECOMMUNICATIONS DEVELOPMENT	TITLE II-AMENDMENTS TO TITLE II — PROMOTION OF COMPETITION IN AND DEREGULATION OF TELECOMMUNICATIONS SERVICES
FINDINGS AND PURPOSE	"SEC. 311. (a) The Congress hereby declares that it is the purpose of this title to assure that the people of the United States have available, at reasonable rates, domestic and international telecommunications services which are reliable, efficient, and diverse, and to assure that the economy, general welfare, and security of the Nation will benefit from the continuing improvements in telecommunications technology. In achieving such purpose, competition and the private sector shall be relied upon to the maximum extent possible to determine the variety, quality, and cost of telecommunications services and facilities.	"SEC. 201. (a) The Congress hereby finds and declares that— (1) the basic goals of the Communications Act of 1934—a rapid, efficient, nationwide, and worldwide communication service with adequate facilities at reasonable charges—are as valid today as they were in 1934, and that it is in the public interest to continue efforts to attain these goals, as the concepts of national and global communications needs and services continue to evolve; * * * * *	SEC. 201. To amend Title II of the 1934 Act by adding Section 225: "(a) The purposes of this section are— (1) to provide as soon as practicable for marketplace competition in all telecommunications services and deregulation of such services after a transition period implemented by the Commission; (2) to ensure that the minimum universal transmission capability necessary to provide basic voice-grade telephone service at reasonable rates continues to be available to all the people of the United States; (3) to maximize the availability of

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SUBJECT	HR 3333	S 611	S 622
FINDINGS AND PURPOSE (Con't.)	(b) Regulation of telecommunications services provided by carriers in the interexchange telecommunications service market shall be carried out by the Commission, *** only to the extent necessary to protect the consumers of telecommunications services provided by dominant carriers. The Commission shall refrain from exercising the authority established in this title when the Commission finds that the purposes of regulation are no longer served."	(4) current and projected technological developments and opportunities promise a wide range of alternative telecommunications and information services and equipment capable of being tailored to satisfy these increasingly diverse and specialized consumer needs; (5) the highly integrated structure and overall concentration of control which characterized the United States telecommunications industry during the development of essentially universal, standardized public message telephone service do not adequately provide for the creativity, technological and service innovation, responsiveness to consumer needs, operating efficiencies, and related factors required to exploit fully current	telecommunications services, *** and to promote the provision of such services with maximum efficiency, flexibility, and versatility; (4) to prevent predatory or anti competative practices in the provision of telecommunications services that may frustrate marketplace competition in the provision of such services; and (5) to promote the national defense, the domestic economy, United States foreign policy, and the safety of life and property. (b)*** (T)he Congress declares that the policy of the United States is - (1) to allow basic voice-grade telephone service to be offered and provided as a regulated monopoly service in local telephone exchanges until

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SUBJECT	HR 3333	S 611	S 622
FINDINGS AND PURPOSE (Con't.)		and projected technological opportunities ***; (6) selective deregulation of many industries leading to increased competition *** has already produced significant benefits ***; (7) further progress in this direction promises increased benefits *** and should be explicitly encouraged through appropriate statutory policies and guidelines; and (8) basic, universal, low-cost public telecommunications services must and can be maintained in an environment of increased competition, through appropriate financial, regulatory, and procedural safeguards incorporated in both statutory policies and industry relationships." SEC. 203. To amend Section 201 of the 1934 Act as follows: "In order to further the rapid and continuing	appropriate State commissions determine that competition will (i) maintain reasonable rates for basic voice-grade telephone service; and (ii) promote improved service through new technologies; (2) to assert Federal jurisdiction over all interexchange telecommunications services provided by common carriers; (3) to allow common carriers to provide both the monopoly service and other telecommunications services while ensuring that the revenues from the monopoly service are not used to subsidize the provision of other telecommunications services or other business activities, and the costs of other telecommunications services or other business activities are not applied to the monopoly service;" *****

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SUBJECT	HR 3333	S 611	S 622
FINDINGS AND PURPOSE (Con't.)		development of a wide range of telecommunications and information services and equipment that are responsive to evolving public needs and to enhance opportunities for technological innovation and operating efficiencies, it is declared to be the policy of the United States that such services and equipment be provided under conditions of full and fair competition, to the maximum extent feasible ***. Moreover, where effective and publicly beneficial competition is capable of being developed, but does not presently exist, *** such competition /shall/ be encouraged. Where a telecommunications carrier provides any telecommunications service on a regulated, noncompetitive basis, the consumers of such service shall not bear the burden of the costs of any competitive venture undertaken by such carrier***. It shall be presumed ***	

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SUBJECT	HR 3333	S 611	S 622
FINDINGS AND PURPOSE (Con't.)		that there are no basic technological, operational, or economic factors which would preclude the provision of any interexchange telecommunications service under conditions of effective competition."	
ACCOUNTING REQUIREMENTS	"SEC. 328. The Commission shall prescribe the forms of accounts and records to be filed with the Commission by dominant carriers and shall specify when the forms shall be filed. It shall be unlawful for such carriers to file forms other than those prescribed by the Commission."	SEC. 221. To amend Section 220 (a) of the 1934 Act as follows: "(1) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. (2) Not later than 360 days from the date of enactment of the Communications Act Amendments of 1979, the Commission shall prescribe guidelines of general applicability	SEC. 201. To amend the 1934 Act by adding Section 225(d) as follows: "(1) *** (T)he Commission shall prescribe such regulations for the transition period as may be necessary to accomplish, not later than 6 years after the date of enactment of this section, the purposes and policies stated in this section. *** (2) *** Such regulations shall — ***** (B) establish and implement an accounting system that will allocate costs of services provided in order to -

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SUBJECT	HR 3333	S 611	S 622
ACCOUNTING REQUIREMENTS (Con't.)		relating to accounts, records, and memoranda for separate services or separate products which shall be designed to assure a complete allocation of all costs including joint and common costs between non-competitive services and competitive services or products offered by any carrier. Such guidelines shall be designed to accomplish a complete accounting divestiture of competitive services or products from the non-competitive services of such carrier. ***"	(i) ensure that in any case where telecommunications products or services are provided by a carrier which also provides the monopoly service, revenues and costs attributable to the provision of the monopoly service and all other services, may be separately identified; (ii) furnish information necessary to determine the appropriate access charge for interconnection with the local telephone exchange; and (iii) provide such other information as the Commission deems necessary to carry out the purposes and policies stated in this section."

APPENDIX I

EXCERPTS FROM THE COMMISSION'S NOTICE OF PROPOSED RULEMAKING, COMMENTS FILED IN RESPONSE, AND SUPPLEMENTAL NOTICE OF PROPOSED RULEMAKING

This appendix provides excerpts from the Federal Communications Commission's (FCC's) rulemaking to revise the system of accounts and financial reporting for telephone companies. The appendix includes three sections:

A. FCC's Notice of Proposed Rulemaking (adopted June 1978)

B. Comments and reply comments filed in response to the Notice (filed January 1979 and March 1979, respectively), and

C. FCC's draft First Supplemental Notice of Proposed Rulemaking (adopted August 1979).

The purpose of these excerpts is to provide more specific detail on FCC's initial proposal; concerns raised by the industry, States, and other affected parties; and FCC's response to those concerns.

A. EXCERPTS FROM FCC'S NOTICE OF PROPOSED RULEMAKING

FEDERAL COMMUNICATIONS COMMISSION

(47 CFR Parts 31, 33, 42 and 43)

(Docket No. 78-196; FCC 78-453)

REVISION OF ACCOUNTS AND FINANCIAL
REPORTING FOR TELEPHONE COMPANIES

AGENCY: Federal Communications Commission

ACTION: Notice of proposed rulemaking

SUMMARY: This notice proposes revision of system of accounts kept by largest telephone companies, because recent experience has shown that existing accounts do not provide a basis for setting rates of particular services. The effects include eliminating many expensive special studies, simplifying determining whether rates are just and reasonable, facilitating the prescription of rates by the FCC, and making it possible to measure carrier efficiency.

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Adopted: June 28, 1978

Released: July 21, 1978

INTRODUCTION

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4. After reviewing all the various accounts and subaccounts in the USOA, it is apparent that the USOA in its present form focuses on company-wide financial and operating data, rather than information useful for modern regulation or effective managerial control and planning. Historically the USOA has been useful to the Commission in reviewing such matters as overall investment and expense levels, property valuation and depreciation rates. Furthermore, the USOA has provided a basis for Commission review of overall revenue requirements, including a determination of a fair rate of return computed on an appropriate rate base.

5. However, in recent years, it has become apparent that the USOA does not provide the industry with an effective tool for managing its resources in the current multi-service environment, or the Commission with the type of information that is necessary to regulate an increasingly complex telecommunications industry. When the USOA was first established, telephone companies offered only two basic types of services--local and long distance. Today, on the other hand, a large variety of services is available including: local exchange service, long distance message telecommunications service (MTS), wide area telephone service (WATS), digital data service (DDS), private line telegraph, private line telephone, audio/radio, television and various other private

line and specialized services. Furthermore, almost all of these services are offered on both an intrastate and interstate basis.

6. In recent years, our rate cases have dealt increasingly with rate levels and rate structures of specific services, and less with overall company-wide rate of return and revenue requirements.

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Because the focus of the USOA is on company-wide results, it has proven to be of little, if any, help in resolving issues concerning the appropriate rate levels and rate structures of the various services.

*****

8. In addition to our own statements regarding the USOA, two consulting firms have also recently reviewed and commented upon the USOA.***

*****

11. As a consequence of the introduction of competition in the specialized services and terminal equipment areas of telecommunications, and the development and use of technology available in some cases only to specialized users of telecommunications and not users of monopoly services, more specific service-related (and sub-service related) cost and revenue information is required than previously was the case. ***

12. ***It is our intention that the revised accounting system which will result from this proceeding will constitute a single data base serving the following functions: (1) It will form the basis for financial reports, including both balance sheet and income statement reporting. (2) It will serve as a data base and a foundation for managerial decisionmaking and internal management reports by the carriers. (3) It will provide sufficiently detailed disaggregated cost and revenue information for derivation of costs and revenues of individual services and rate elements, for pricing decisions and other managerial decision making by the carriers. (4) It similarly will provide detailed disaggregated cost and revenue information for derivation of costs and revenues of individual services and rate elements, for rate review and continuing surveillance purposes of this Commission (and other regulatory bodies which adopt the revisions) and provide a basis for rate prescription, where appropriate. (5) It will facilitate the breakdown of costs between interstate and intrastate jurisdictions ("jurisdictional separations"). (6) It will permit analysis of facility

and plant utilization, including studies of the causes for each category of expenditure and review of service quality and service efficiency. And (7) it will be structured so as to allow for regulatory and independent auditing and tracing of questioned entries.

*****

18. In summary, our goal in proposing a revised and expanded USOA is to develop a single data base which will serve multiple purposes and be used by both internal management and State and Federal authorities. It is our intention that the proposed modifications will be both broad enough and flexible enough to accomplish this goal.

ITEMS OF INQUIRY

19. ***Indeed, since we are placing in issue the industry's basic informational requirements (cost of service, jurisdictional separations, financial and tax data, and management decision making), we welcome comments from the regulated industry, the academic community, the accounting profession, and other interested parties. Furthermore, we invite comments, not only on the specific matters discussed below, but also on any other relevant matters directly related to the proposed USOA modifications.

DEFINITIONS

*****

22. ***Therefore, we invite comments as to how the accounts, subaccounts, primary allocation records and supporting records can be structured so as to provide maximum flexibility in the assignment and allocation of the appropriate costs to individual services.

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JURISDICTIONAL SEPARATIONS

39. Another important factor which must be taken into account is the "separations" process. Much telephone plant (perhaps a third or more of the total) is used in common to provide both interstate and intrastate telephone services. ***Basically, the process involves the assignment or allocation of amounts appearing in the uniform system of accounts (costs of plant and other related items) to the two jurisdictional categories. The directly assignable amounts are handled with relative ease but the "common" items must be allocated in accordance with the principle of relative use.***

40. It is important to recognize here that all allocations (where direct assignment is not possible) are made on a "relative use" basis. This is in contrast to the "cost causation" approach of FDC method 7 which has been prescribed by the Commission for allocating costs to each interstate service. Thus in order to arrive at cost of service, two allocations must be made. First, costs must be allocated to the various services in accordance with FDC method 7 methodology, and second the interstate service costs must be determined through the separations procedures. The fact that the two allocations are accomplished by different mechanisms may lead to certain inconsistancies which will have to be accounted for in any revised USOA.

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MORE DETAILED BREAKDOWN OF CERTAIN ACCOUNTS

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46. ***In budget hearings before the Senate Appropriations Committee on May 8, 1978 the following dialog took place:

Senator HOLLINGS. What do you project now***?

Mr. FERRIS.* I would say it would be 1980, 1981 before we could get the full system developed***.

Senator HOLLINGS. Three years before we can intelligently look at the problem? *** Can't we do that before everybody's term expires?

Mr. FERRIS. I think we can do it in 12 months if we have the resources***.

Senator HOLLINGS. It seems like you could design a system within a three-month period and they could comply in the next fiscal year, then by the end of 1979 we could have an answer.

Mr. FERRIS. I think we can if you will give us the resources***.

In view of the urgency expressed, we request comments on the following implementation schedule for our proposal, and any alternatives.

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*-Chairman, Federal Communications Commission, October 1977 - Current.

1. Revenue accounts - adopted and used as the basis for reports for the year in which the new system is adopted. (These are presently fully computerized.)

2. Expense accounts - adopted and used as the basis for reports beginning 1 year after the new system is adopted.

3. Plant accounts - adopted and used as the basis for reports beginning 2 years after the system is adopted.

4. Primary allocation records - adopted and used as the basis for reports at the same time as their associated accounts. ***

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REPORTING REQUIREMENTS

56. A further limitation of the USOA for analytical purposes is its design as a paper accounting system rather than a computerized one. ***(A)ny proposed changes should be geared toward a computerized data base USOA.

57. We invite comments on what reporting requirements we should establish once the basic USOA revisions are accomplished. *** At a minimum, we would expect each carrier to submit a complete report containing every financial account and all required non-financial information (including primary allocation records) at least once a year. Certain summary reports containing less detail could be filed on a more frequent basis. For purposes of auditing and making analysis of carrier performance, we propose that a detailed computer tape of specified information be submitted annually.***

AUDITABILITY AND ACCOUNTING ISSUES

58. ***We believe that our proposed revisions will readily facilitate audits, for we have created a direct link between the economic event (expenditure or receipt) and the final recordation in an account. We have further strengthened this relationship by defining "cost centers" (usually wire centers and transmission spans) as the loci of much primary accounting data, and this will ease the task of the auditor in ascertaining the basis of recorded accounts. We also believe that the details of the expense record and specific estimating systems for recording data enhance the auditor's capabilities, and promote the auditor's role in verifying the proper assignment of economic events to accounts. Nevertheless, we invite comment on additional structural safeguards which should be built into a revised USOA to further enhance

auditing and entry verification in this age of computer-maintained accounts.

*****

IMPACT ON CARRIERS-GENERALLY

60. *** When a new system reflecting 65 years of accounting progress is set side-by-side with the old one, the changeover may appear burdensome. ***

IMPACT ON SMALL CARRIERS; NEEDS OF STATE COMMISSIONS

61. ***We are aware that the changes we are proposing are extensive and that concern may exist among many of the smaller independent telephone companies as to how they can reasonably meet our new requirements. Further, to the extent that State regulatory agencies routinely adopt our accounting rules as their own, intrastate companies not directly subject to our jurisdiction may be affected. ***

62. ***We request comments on a specific proposal that the new system of accounts apply only to carriers with over $1,000,000 in operating revenues. ***

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B. EXCERPTS FROM COMMENTS FILED WITH FCC IN RESPONSE TO ITS NOTICE OF PROPOSED RULEMAKING

GAO note: The following represents excerpts from comments and reply comments (filed January 15, 1979, and March 15, 1979, respectively) in response to FCC's Notice of Proposed Rulemaking for the Revision of Accounts and Financial Reporting for Telephone Companies (adopted June 28, 1978). The excerpts are not necessarily representative of all comments filed, but rather provide indications of perceived problems with FCC's approach in revising the system of accounts. In addition, the selection of these excerpts does not necessarily imply GAO's agreement or disagreement with the stated opinions.

Managerial Approach

"A usual approach to the development of any major management information system involves the following sequence:

"1. assessment of the information required (a definition of the output reports)

2. project justification and overall cost analysis

3. identification of the data needed to produce the reports and

4. definition of data accumulation and procedural requirements of the system.

"It appears the Commission is proposing a reverse sequence involving an initial assumption that a complex data base system should be developed which presumably would contain enough detailed data to produce output sufficient to provide management and regulators with information found useful in the past or thought potentially to be useful in the future. In our view this approach to system development is imprudent. A system designed to capture any information which may ever be required is, in our view, a practical impossibility. We question whether the costs of developing and maintaining such a complex system would be reasonable in relation to the benefits which would be derived by its users or the ratepayers." (American Institute of Certified Public Accountants.)

Cost and Complexity of Proposed System

"(D)ue to prohibitive costs compliance with the Commission's proposal might be impossible for the vast majority of independent companies. The proposal assumes that all carriers have sophisticated data processing systems that can easily implement the Commission's revised USOA. This is simply not the case. Millions of dollars will have to be spent, even by companies that already have computer capabilities, in order to comply with the complex accounting and data reporting requirements. ***Despite its present data processing capabilities, Continental estimates that it could cost as much as $25 million to convert to an integrated data base system as proposed by the Commission." (Continental Telephone Corporation.)

"The outcome of this rulemaking may have grave consequences for small telephone companies***. The new USOA is obviously directed at the problems of regulating large telephone companies on a cost of service basis. Yet the small companies may be devastated if the FCC makes dramatic changes in the USOA without accomodating small telephone companies' limited resources and special circumstances. Small telephone companies with annual gross revenues of less than $50 million don't have the resources to create and maintain the massive, excruciatingly detailed USOA proposed in this docket. A multi-million account USOA will destroy many small telephone companies and increase costs to the customers of the survivors if it is applied inflexibly to them and AT&T without distinction. ***

"Southland Telephone *** has analyzed the impact of the proposed USOA on its operations. Southland had calendar 1977 operating revenues of $2.9 million and total maintenance expense of $630,000. It believes the proposed USOA would require it to maintain 2 million maintenance subaccounts, each averaging a balance of 30 cents per year per subaccount. Since the accounting would be monthly, Southland would allocate an average of 2.5 cents each month to each account." (Organization for the Protection and Advancement of Small Telephone Companies)

"In actuality, only a few Independents have the computer capabilities and sophisticated systems necessary to attempt to meet the requirements of the Commission's proposal. Even these companies are faced with the fact that they will have to expend millions of dollars and years of time in developing new systems or modifying existing systems in order to implement the Commission's proposal. Most Independents do not realistically have such capabilities. *** From a representative sample of the 600 Independents with 1,000 stations or less, USITA estimates that the additional cost of providing the proposed data would be $2 to $5 per customer per month." (United States Independent Telephone Association)

"The Federal Register setting forth the proposed Uniform System of Accounts weighs approximately one pound. It is our opinion that implementing the requirements of this change will be the equivalent of a death sentence for small independent telephone companies." (Haviland Telephone Co., Inc.)

Affected Carriers

"(W)e suggest that all companies be required to maintain 'standard' general ledger accounts and continuing property records. Only the 'larger' companies (for example, those with revenues in excess of $50,000,000) should be required to maintain the 'non-financial' data.*** (W)e do not feel that the $1,000,000 figure *** is realistic. If the Commission does not adopt our suggestion of 'splitting' its requirements*** between 'general ledger' and 'cost-of-service' categories, we believe that a revenue amount of not less than $50,000,000 would be more appropriate." (National Association of Regulatory Utility Commissioners.)

"A 'small' company should be defined as a company with annual revenues less than $50 million. The $1 million figure proposed in the Notice is inadequate. $50 million and above includes 97% of the total operating revenues of the telephone industry." (Organization for the Protection and Advancement of Small Telephone Companies.)

"It is *** NTCA's recommendation that the Commission develop three additional simplified systems of accounting that will correlate with the new proposed system, i.e., if the proposed system were designated Class AA Accounting, the simplified versions would fall within the capabilities of the smaller independent telephone systems:

"Class AA	$30,000,000 total annual revenues and up
Class A	$30,000,000 down to $1,000,000
Class B	$ 1,000,000 down to $100,000
Class C	below $100,000

(National Telephone Cooperative Association)

Implementation Timeframes

"We believe many of the carriers do not have the level of systems sophistication required to implement the rudiments of this new USOA. Even for companies with sophisticated systems the accounting records and feeder systems conversion efforts required will be substantial. The Commission's proposed implementation timetable therefore appears impractical." (Coopers & Lybrand.)

"The Commission's time schedule for implementing its proposal *** fails to reflect the complexity of the revised USOA. Implementation of the Commission's proposal, or any new comprehensive accounting and information system, could take as long as 10 to 15 years." (Continental Telephone Corporation.)

Financial vs. Statistical Data

"***FCC should not establish cost of service parameters within the chart of accounts. *** (T)he detailed financial and non-financial data prescribed by the proposal goes beyond that which is required for managerial decision making and regulatory purposes." (Central Telephone & Utilities Corporation.)

"The cost of service data should not be in the records of accounts. The PAR, which would be separate from the accounting system, should be the vehicle used to associate costs to services. *** Recognition must be given to the difference between a data base and a Chart of Accounts." (GTE Service Corporation.)

Reporting Requirements

"We are overwhelmed, as may be many of the telephone companies, by the Commission's anticipated reporting requirements***. ***The companies, and ultimately their ratepayers, should not bear the costs of developing 'useful information' for which the Commission has shown no need and which it may never get around to using." (Iowa State Commerce Commission.)

"***(A) more workable alternative to the one data base concept would be for the FCC to identify data elements it would require for surveillance and prescribe a format this information must be in so that on demand telephone companies could provide this information to the FCC.***By using this approach, it would allow telephone companies to use whatever level of technology that is available in their data processing departments to comply with the requirements of the FCC and would not put an undue burden on them, nor on their rate payers." (United Telecom Service, Inc.)

"The need for each type of information that will be gathered should be explained and referenced to the form in which it will be reported." (National Association of Regulatory Utility Commissioners.)

"As to identifying the requirements for specific reports in terms of recipient, content and frequency, such matters can only be determined subsequent to the development of the specific requirements of the system." (American Telephone and Telegraph Company.)

C. EXCERPTS FROM FCC's SUPPLEMENTAL NOTICE OF PROPOSED RULEMAKING

Before the

Federal Communications Commission

In the Matter of)
)
Revision of the Uniform System) CC Docket No. 78-196
of Accounts and Financial)
Reporting Requirements for)
Telephone Companies (Parts 31,)
33, 42, and 43 of the FCC's)
Rules))

FIRST SUPPLEMENTAL NOTICE OF PROPOSED RULEMAKING

Adopted: August 1, 1979 Released: August 9, 1979

By the Commission: Commissioner Lee absent.

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1. On June 28, 1978, the Commission adopted a Notice of PROPOSED RULEMAKING in CC Docket No. 78-196 (Notice) on the Revision of the Uniform System of Accounts and Financial Reporting Requirements for Telephone Companies (Parts 31, 33, 42, and 43 of the FCC's Rules), 70 FCC 2d 719 (1978), 43 FR 33560 (July 31, 1978). In that Notice, the Commission outlined a proposal for extensively revising the Uniform System of Accounts for Telephone Companies (USOA), the data collection, record keeping requirements and reporting for the telephone companies, and the reporting requirements the telephone companies are to meet. The Uniform System of Accounts contained in Parts 31 and 33 have remained unchanged in large part since their adoption in 1935. Since 1935, tremendous technological changes have occurred in the telecommunications industry. Along with some regulatory policy shifts, these changes have made possible the introduction of competition into some services in the telecommunications industry. Because the industry is composed of companies offering both monopoly and competitive services, as well as companies that provide only competitive services, we have perceived a need to adopt accounting and reporting procedures that will ensure that a company offering both monopoly and competitive services does not cross-subsidize its competitive services with revenues from its monopoly services. Thus, our need is for a cost accounting system that will develop cost of service directly in the accounts themselves.***

2. Initial and reply comments were due on January 15, 1979, and March 15, 1979, respectively. More than seventy parties have participated in the proceeding to date through the submission of questions for the September 22, 1978, public meeting at which the staff answered questions submitted in advance by persons interested in the revision of the USOA; by filing initial comments; or by filing reply comments.***

*****

4. Analysis of the comments and reply comments helped us focus on several key issues in the proceeding. Some of these were unanticipated by our original Notice. Others elicited no response at the time. Furthermore, some comments present alternative approaches that, while of some apparent interest, are set forth in insufficient detail to be evaluated. Since it is important that every reasonable effort be made to acquire all pertinent information, we are in this Supplemental Notice providing an opportunity for all parties to comment on any of the aforementioned types of issues.

<u>The Objectives of This Proceeding</u>

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6. The primary purpose of this proceeding is to develop a system of accounts which will constitute, with the Primary Allocation Records, a <u>Regulatory Information System</u> that will meet all the ordinary needs of the Commission for the regulation of common carriers. *** We see the reliance upon special studies for ordinary and frequent events, such as rate cases, as evidence of the inadequacy of the existing accounting system. Any system that cannot yield the information needed to resolve common regulatory questions is of limited value, however well it may meet some other goals. While accuracy of the basic system is an important desideratum, the information so carefully and accurately recorded must be useful for regulatory purposes. When an otherwise accurate accounting system forces us to rely upon special studies for many of the ordinary and necessary regulatory decisions, such system does not fulfill its functions. Accordingly, we have set as a major goal of our effort the achievement of a situation wherein no special study will be required to obtain any information used in the normal, recurring process of regulation. ***

7. Regulatory accounting differs from normal accounting in many ways because of regulators' urgent need for accurate and consistent information on used and useful investment, and the appropriateness of expenses. In this respect it has developed regulatory accounting concepts consistent with its needs that have gone beyond the requirements of traditional accounting. *** However, regulation has not, in the past, been preoccupied with cost of individual products (services), so regulatory accounting systems have not, until recently, included detailed cost accounting systems. The FPC (now FERC), the CAB, the ICC and now we, the FCC, have been forced to draw upon and then go beyond the experience of the accounting profession to develop costing methods that are consistent with regulatory practice.***

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Carriers Affected

12. In our July 31, 1978 Notice of Proposed Rulemaking we called for comment on a proposal that the new system of accounts apply only to carriers with over $1,000,000 in operating revenues. This created a great deal of concern as to which carriers would actually be required to implement the new system of accounts, particularly among the smaller independents. *** It is not the Commission's intention to burden any carrier with unreasonable demands of accountability. It is the Commission's intention to include only those carriers likely to have cost of service rate cases under the full scale version of the new USOA. Our proposal was intended to apply to companies so large that most of their accounting is already computerized. Assuming the states do not impose our accounting system on carriers from which cost of service information is not often required, those affected will be the Bell companies and some of the larger independents.

13. It may be necessary to modify the existing accounts for some smaller carriers to assist them in making settlement cost studies that are sufficiently comparable to those of the larger carriers. We expect that such comparability will require nothing more than some intermediate-type set of accounts (e.g., the proposed USOA at a slightly more aggregated level or a modified version of the present USOA). We leave the development of such a system to a later stage of this proceeding, at which time we may request the parties to develop with us a joint proposal. We wish to avoid a situation in which smaller carriers are forced to adopt an elaborate accounting system designed to develop information which they would rarely have to provide (that is, costs of services), where the only regulatory need is to perform cost studies for settlement purposes.

14. In addition to the respondents' almost universal recommendation of a higher threshhold level, another frequent recommendation was the use of a multi-tier carrier classification and corresponding account structure. One such possibility might be the following:

Size in Classification	Account Structure Operating Revenues	Required
AAA	over $30m	proposed USOA
AA	$10m to $30m	intermediate USOA

Size in Classification	Account Structure Operating Revenues	Required
A	Less than $10m	level of detail equivalent to existing accounts or separations categories
B		
C		
D		

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Account Structure

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62. ***The Commission did not propose a revision to the Separations Manual in the Notice. It did however, recognize that a revised USOA will have to account for the inconsistencies that result from the different mechanisms used to perform the allocations. Again, as in the case of the USOA, the problem of revising the existing Separations Manual is complex. It is generally maintained by the parties addressing this issue that a revision to the USOA will have an impact on the Separations Manual. While this may ultimately be true, there is not necessarily a causal relationship. We see improvements in the accounting system as permitting but not necessarily requiring changes in the separations process. ***

Reports

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64. The Commission proposes that carriers submit reports which would include the balance sheet and income statement items, the costs of individual services, and results for profit centers. *** The monthly report would have a greater degree of aggregation than the annual report.

65. It is appropriate at this time to specify the data that would be reported in an annual paper or computer format report replacing Form M, and a monthly report replacing Form 901, since these are the reports that would be used by most of the public, and for much regulatory surveillance. Indeed, such reports might after appropriate modifications, be the basis for the reports required of carriers not subject to the full rigor of the new accounting system. Finally, it is necessary to provide for reports during the transition period to the new system of accounts.

66. Accordingly, we ask respondents to provide lists of the data elements that should be included in the annual report replacing Form M and the monthly report replacing Form 901. We also ask respondents to discuss in detail reporting requirements in the transition period. Respondents should base their comments on our proposal, their own, and any other they care to comment upon.

*****

Features for Auditability

70. What features do the new Uniform System of Accounts and the primary allocation records require to make them thoroughly and efficiently auditable for regulatory purposes?***

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81. ***(W)e will require that the accounts constitute a fully integrated, fully merged data base, so that reconciliation is possible. We anticipate that, in addition to traditional types of compliance audits on the part of regulatory commissions, there will be systems audits to determine whether the internal controls are functioning properly, and that reconciliation will be performed, although in auditing a computerized system some of the procedures of a comprehensive audit may vary from those used in the past.

82. We call for comments upon the systems approach that should be followed to achieve a fully integrated accounting system that is completely reconciliable. We are concerned that the proposals of some of the carriers to have separate feeder systems leading to non-integrated financial and cost accounting systems will be unauditable because it will be impossible to establish internal controls or to reconcile the cost and financial results. While we are willing to entertain further argument on the subject, we have tentatively concluded that only a fully integrated cost and financial accounting system forming a Regulatory Information System will meet the regulatory needs of this Commission with respect to the telephone industry in the modern competitive era, in which cost of service has become the paramount regulatory issue.

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Data Base As A Goal

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99. The only way to effectively accomplish the above goal is with a Data Base Management System (DBMS). Data must be stored so that it can be used for a wide variety of applications and in such a way that both the data and the programs utilizing the data can be modified without disruption. A necessary characteristic of the USOA will be sufficient adaptability to accomodate expansion and change. The process of restructuring the data base must be simple and efficient to allow for new types of data as well as new applications. ***

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101. A broadly applicable computerized USOA will not come about immediately. It will have to expand one step at a time. Both the software and logical structure must be capable of orderly growth with minimal if any disruption. Commission employees must have the capability to utilize the data in creative and productive ways without having to wait for programmers to incorporate these thoughts into applications programs. To do this they should be able to both query and manipulate the data base in the easiest possible manner.

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103. ***Respondents are asked to provide a specific implementation schedule for a Data Base Management System.

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Disposal of Motions

105. ***AT&T, GTE, NARUC, as well as several other parties, have suggested the Commission should establish working committees to assist the Commission in developing a revised USOA. At this point in the proceedings we are not in a position to commit ourselves to a procedural framework for subsequent steps in the proceeding. This supplemental notice as well as the original notice have been designed to attempt to define issues that must be addressed, to develop alternative approaches to resolving these issues, and to determine whether there may be some commonality of viewpoints on certain issues. Accordingly, we encourage parties in filing their comments to consider various procedural approaches the Commission might use in evolving the next generation of its chart of accounts, account definition, item list, and accounting rules. ***

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COMPOSITE RESULTS OF GAO QUESTIONNAIRE

SENT TO STATE REGULATORY COMMISSIONS

U.S. GENERAL ACCOUNTING OFFICE
SURVEY OF STATE
REGULATORY COMMISSIONS

SECTION I: TELEPHONE INDUSTRY

INSTRUCTIONS

Please answer each of the following questions as frankly and completely as possible. There is space at the end of each segment for any comments you may wish to make concerning the questionnaire, or any other related topics. Responding to the questionnaire should not require research and each segment should take about 30 minutes or less of your time.

Throughout this questionnaire, there are numbers printed within parentheses to assist our keypunchers in coding responses for computer analysis. Please disregard these numbers.

We would appreciate the completion and return of the questionnaire in the enclosed envelope by May 15, 1979. If you have any questions, please call Mr. Thomas F. O'Connor or Ms. Janet Ferrell on (202) 275-5293.

UNITED STATES GENERAL ACCOUNTING OFFICE

/ / / /
(1-3)

SECTION I: TELEPHONE INDUSTRY

INTRODUCTION

The Federal Communications Commission (FCC) published a Notice of Proposed Rulemaking on July 31, 1978 (43 FR 33560), to revise the uniform system of accounts (USOA) for telephone companies. FCC's goal is to develop a single data base which will serve multiple purposes and be used by both internal management and State and Federal regulatory authorities.

1. Approximately how many regulated telephone companies in your State fall into each of the annual revenue categories specified below? (Please fill in the blanks--enter "0" where applicable.)

Companies' Annual Revenues	Number of Regulated Companies	
Up to $50,000 (Class D)	*	(5-7)
$50,001 to $100,000 (Class C)	*	(8-10)
$100,001 to $250,000 (Class B)	*	(11-13)
$250,001 to $1,000,000 (Class A)	*	(14-16)
$1,000,001 to $10,000,000 " "	*	(17-19)
$10,000,001 to $15,000,000 " "	*	(20-22)
Over $15,000,000 " "	*	(23-25)

2. How do your commission's accounting requirements compare to FCC's existing uniform system of accounts (USOA) and financial reporting requirements for telephone companies (parts 31, 33, 42, and 43 of the FCC rules)? (Check one.)

(26)

1. /   / No basis to judge
2. /21/ Exactly the same
3. /14/ Slightly different
4. /2/ Moderately different
5. /2/ Significantly different
6. /1/ No comparison at all

3. Please provide your best estimate of your commission's approximate annual operating costs (e.g., personnel, equipment, supplies, etc.) for your current accounting requirements for the telephone industry. (Check one.)

(27)

1. /13/ $50,000 or less
2. /17/ $50,001 - $250,000
3. /5/ $250,001 - $500,000
4. /2/ $500,001 - $750,000
5. /1/ $750,001 - $1,000,000
6. /2/ Over $1,000,000

4. In your opinion, how do your commission's costs of your existing regulatory accounting system compare to its benefits? (Check one.)

(28)

1. /4/ Costs significantly outweigh benefits
2. /3/ Costs somewhat outweigh benefits
3. /12/ Benefits and costs about equal
4. /6/ Benefits somewhat outweigh costs
5. /14/ Benefits significantly outweigh costs

1 missing

5. How do you rate the quantity, quality and timeliness of the accounting information your commission is currently receiving from telephone companies? (Check one box for each row.)

	Very good 1	Good 2	Fair (O.K.) 3	Poor 4	Very Poor 5	
1. Quantity (comprehensiveness of cost information)	7	21	8	4		(29)
2. Quality (accuracy of cost information)	7	24	6	3		(30)
3. Timeliness	8	21	9	1	1	(31)

6. Does your commission also make special studies or audits to supplement the accounting information regularly reported by telephone companies? (Check one.)

(32)

1. /35/ Yes
2. /5/ No

*Because companies' areas of service can include more than one State, composite answer not considered meaningful.

7. Do you believe there is a need to revise the existing USOA for telephone companies? (Check one.) (33)

1. /17/ Definitely yes
2. /12/ Probably yes
3. /6/ Undecided
4. /4/ Probably no
5. /1/ Definitely no

8. In general, has your commission supported or opposed FCC's July 31, 1978 proposed USOA revision? (Check one.) (34)

1. / / Strongly supported
2. /11/ Supported somewhat
3. /15/ Neutral
4. /8/ Opposed somewhat
5. /6/ Strongly opposed

9. How has your commission participated with FCC in the development of the proposed USOA revision? (Check all that apply.)

1. /17/ Not at all (Skip to question 12) (35)
2. /1/ Asked to participate but did not do so (Skip to question 12) (36)
3. /14/ Commented on proposed rulemaking thru NARUC (37)
4. /8/ Commented on proposed rulemaking independent of NARUC (38)
5. /6/ Attended seminars * (39)
6. /6/ Participated in informal discussions ** (40)
7. /1/ Other (please specify) (41)

____

____

*-Follow-up contacts with respondents indicated reference is not to FCC-sponsored seminars, but as part of meetings with broader purposes sponsored by National Association of Regulatory Utility Commissioners (NARUC)

**-Follow-up contacts with respondents indicated reference is primarily to discussions internally in State commissions with NARUC or others, rather than FCC.

10. What impact do you believe your commission's participation will ultimately have on the development of FCC's USOA revision? (Check one.) (42)

1. /2/ Major impact
2. /1/ Moderate impact
3. /6/ Minor impact
4. /4/ Very minor impact
5. /2/ No impact
6. /7/ Too early to judge

18 missing

11. So far, how satisfied or dissatisfied has your commission been with its participation in the development of FCC's USOA revision? (Check one.) (43)

1. / / Very satisfied
2. /3/ Satisfied
3. /8/ Borderline
4. /8/ Dissatisfied
5. /3/ Very dissatisfied

18 missing

12. What is your current expectation regarding the extent to which your commission will probably adopt the FCC's proposed USOA revision? (Check one.) (44)

1. /7/ Totally
2. /12/ Major extent
3. /2/ Moderate extent
4. /3/ Minor extent
5. /2/ Not at all (Skip to question 25.)
6. /14/ Will decide later

13. To what extent will FCC's proposed revision to the USOA facilitate or hinder your commission's reporting requirements? (Check one.) (45)

1. /1/ Greatly facilitate
2. /4/ Facilitate somewhat
3. /10/ Little or no impact either way
4. /5/ Hinder somewhat
5. /4/ Greatly hinder
6. /14/ Too early to judge

2 missing

14. In what media does your commission now receive telephone companies' annual reports? (Check as many as apply.)

1. /38/ Hard copy (reports) (46)
2. /1/ Computer print out (47)
3. / / Magnetic tapes (48)
4. / / Micro film/microfiche (49)
5. /2/ Other (please specify) (50)

____

____

15. If the FCC's proposed USOA revision is adopted, in what primary medium would your commission prefer to receive companies' annual reports? (Check one.) (51)

1. /33/ Hard copy (reports)
2. /1/ Computer print out
3. /3/ Magnetic tapes
4. / / Micro film/microfiche
5. /1/ Other (please specify) ______
2 missing

____

____

16. In your State, approximately what percent of all companies, with annual revenues exceeding $1 million, could feasibly submit data in magnetic tape format? (Check one.) (52)

1. /15/ Less than 20%
2. /5/ 20 to 40%
3. /9/ 41 to 60%
4. /4/ 61 to 80%
5. /5/ More than 80%

2 missing

17. FCC is also proposing that companies' annual reports be submitted on magnetic tapes. If this is required, to what extent would it facilitate your commission's regulatory responsibilities? (Check one.) (53)

1. /2/ Facilitate greatly
2. /6/ Facilitate somewhat
3. /3/ Facilitate little
4. /4/ Facilitate very little
5. /23/ Facilitate not at all

2 missing

18. At approximately what annual revenue level would it be feasible for telephone companies in your state to fully comply with FCC's proposed USOA revision? (Check one.) (54)

1. / / less than $1 million
2. /4/ $1 - $10 million
3. /6/ $11 - $15 million
4. /5/ $16 - $50 million
5. /19/ more than $50 million

6 missing

19. Please provide your best approximation of the magnitude of start-up costs, (e.g., acquisition of equipment and training of personnel) your commission would incur in connection with the new USOA. (Check one.) (55)

1. / / $0
2. /8/ $1 - $50,000
3. /5/ $50,001 - $100,000
4. /4/ $100,001 - $500,000
5. /2/ $500,001 - $1,000,000
6. / / Over $1,000,000
7. /19/ No basis to judge

2 missing

20. Do you expect your commission's annual operating costs to increase, decrease, or remain about the same under the new USOA? (Check one.) (56)

1. /27/ Increase
2. /9/ Remain about the same (If checked, please skip to question 22.)
3. / / Decrease

4 missing

21. Please provide your best approximation of the magnitude of likely change in annual commission operating costs expected under the new USOA. (Check one.) (57)

1. /__/ $0
2. /7/ $1 - $50,000
3. /5/ $50,001 - $100,000
4. /2/ $100,001 - $500,000
5. /__/ $500,001 - $1,000,000
6. /__/ Over $1,000,000
7. /13/ No basis to judge

13 missing

22. In terms of types of resources, what significant additions, if any, would you expect to be required for your commission as a result of the USOA revision? (Check as many as apply.)

1. /6/ None (58)
2. /25/ Additional staff (59)
3. /25/ Additional computer software (60)
4. /20/ Additional computer hardware (61)
5. /4/ Other (please specify) (62)

____

____

23. How would the total costs (start-up and additional operating, if any) compare to anticipated benefits, for:

(a) Your commission? (Check one.) (63)

1. /12/ Costs would probably significantly outweigh benefits
2. /7/ Costs would probably somewhat outweigh benefits
3. /5/ Costs and benefits about equal
4. /2/ Benefits would probably somewhat outweigh costs
5. /1/ Benefits would probably significantly outweigh costs
6. /11/ No basis to judge

2 missing

(b) Telephone companies in your State? (Check one.) (64)

1. /14/ Costs would probably significantly outweigh benefits
2. /8/ Costs would probably somewhat outweigh benefits
3. /__/ Costs and benefits about equal
4. /4/ Benefits would probably somewhat outweigh costs
5. /__/ Benefits would probably significantly outweigh costs
6. /11/ No basis to judge

3 missing

24. FCC's proposed revision to the telephone USOA did not define specific reporting requirements. To what extent would a definition of reporting requirements prior to completion of revision facilitate or hinder the development of the revised USOA? (Check one.) (65)

1. /18/ Greatly facilitate
2. /6/ Facilitate somewhat
3. /1/ Little or no impact either way
4. /2/ Hinder somewhat
5. /__/ Greatly hinder
6. /11/ No basis to judge

2 missing

25. There is considerable discussion concerning how the revised USOA will relate to major issues such as the jurisdictional separations process and a cost allocation methodology. For example, some believe the revised USOA will make the separations process, as it exists, much easier; others believe two sets of books must be maintained if the existing separations procedures are not revised along with the USOA. Some believe that the cost allocation methodology (fully-distributed cost method 7, historical cost causation) should be finalized before establishing the system of accounts. Please provide your opinions to the questions below. (Check all that apply.)

(a) Do you believe the revision to the USOA will necessitate major revisions to the jurisdictional separations process? (66)

1. /17/ Yes
2. /5/ No (Skip to question 25c.)
3. /18/ No opinion

APPENDIX III

(b) In your opinion, when should the jurisdictional separations process be revised?

(67)

1. /5/ Before revision of the USOA

2. /3/ After revision of the USOA

3. /9/ Simultaneously with revision of the USOA

4. /1/ Timing does not matter

22 missing

(c) Do you believe the revision to the USOA will necessitate major revisions to the current cost allocation methodology?

(68)

1. /17/ Yes

2. /6/ No (Skip to question 26)

3. /16/ No opinion

1 missing

(d) In your opinion, when should the cost allocation methodology be revised?

(69)

1. /8/ Before revision of the USOA

2. /1/ After revision of the USOA

3. /6/ Simultaneously with revision of the USOA

4. /1/ Timing does not matter

24 missing

26. Please provide any other comments regarding the FCC's development of a new Uniform System of Accounts and reporting requirements for the telephone industry in the space below. Use additional space as necessary.

(70-76)

27. Please provide name(s), title(s), and phone number(s) below of the individual(s) who responded for your State. (77)

Name

Title

Telephone Number

State

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

October 18, 1979

IN REPLY REFER TO

9700

Donald Scantlebury
Director, Financial and General Management
Studies Division
Room 6001
General Accounting Office Building
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Scantlebury:

On October 1, 1979, the Commission received draft copies of a General Accounting Office (GAO) report entitled "Outlook Dim For Revised Accounting System Needed For Changing Telephone Industry." Based on an on-site review by a GAO audit team, the report is critical of the Commission's management of CC Docket No. 78-196 relating to the Revision of the Uniform System of Accounts and Financial Reporting Requirements for Telephone Companies (Parts 31, 33, 42 and 43 of the FCC's Rules), 70 FCC 2d 719 (1978), First Supplemental Notice of Proposed Rulemaking, FCC 79-479 (released August 9, 1979). Furthermore, the report identifies several specific areas that it believes have received inadequate attention to date. At the direction of the Commission, I am providing its initial response to the GAO report.

While the GAO report is critical, it is also very constructive. It points out several areas in which the Commission has not fully solidified its planning processes. Therefore, the Commission believes that the GAO report will prove to be useful in the future development of a revised uniform system of accounts (USOA). We would like to set forth some observations regarding the nature of the project and the managerial steps anticipated that should alleviate many of the deficiencies raised by the GAO report.

The existing USOA dates back to its adoption by the FCC in 1935. Since that date, significant changes in the technology employed, as well as the competitive structure of the industry, have occurred. The evolving competitive structure raises questions of fair competition, cost causation, and cross-subsidization, issues on which the existing USOA was not producing relevant information. Accordingly, a proceeding to look into the revision of the USOA was instituted. As the GAO report notes, there is near unanimity among the commenting parties on the need for a revised USOA.

An accounting system provides important information for use in the regulatory process. However, accounting systems have their limitations and may not be the most effective regulatory tool for each of the diverse issues facing regulators, consumers and regulated firms in the present dynamic but contentious telecommunications environment. The use of additional options in combination with an accounting system may be appropriate to effectuate regulatory policies that promote the public interest. Among the options under review in this and other proceedings are the use of service structuring and separate subsidiaries; e.g., the Notice of Inquiry and Proposed Rulemaking In the Matter of American Telephone & Telegraph Company Private Line Rate Structure and Volume Discount Practices (CC Docket No. 79-246), FCC 79-565 (released October 17, 1979), and the Tentative Decision In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 72 FCC 2d 358 (1979). We would also note that the Congress in considering the pending legislation to amend the Communications Act of 1934, as amended, 47 USC 151 et seq, has received and considered extensive comments on the interrelationships between separate subsidiaries and accounting systems.

A revised USOA has an impact on each of the divisions of the Common Carrier Bureau. The task of developing a revised USOA also requires use of the disciplines contained ~~in~~ more than one division. In order to provide for effective managerial control, the Commission proposes to establish a task force composed of individuals with the appropriate background and expertise in the disciplines necessary to design a revised USOA. These disciplines include accounting, economics, and data processing, among others. These individuals will be assigned to the task force until the revision is completed. The task force will be headed by a senior staff member responsible for day-to-day operations. Regular progress reports will be provided to Division Chiefs with involvement in the project as well as to the Deputy Bureau Chief for Policy, who has been assigned overall responsibility for the progress of the project, in order to ensure that the overall goals of the Commission are being accommodated and that appropriate coordination between related dockets is occurring. The task force will be directed to develop as soon as possible a management paper delineating the output requirements of the various users of the accounting system, with an appropriate reflection of the priority to be accorded each of these needs. (The proposed restructuring of the Common Carrier Bureau, which the Commission approved on October 10, 1979, will facilitate these actions. While not conceived as a direct response to the GAO report, the reorganization of the Bureau stresses adequate and timely management.)

While the above-mentioned matter should serve to expedite the revision of the USOA, the GAO report, by highlighting the deficiencies in the planning process to date and the comments indicating that the implementation schedule was too optimistic, leads us to the conclusion that implementation of the revised USOA will not occur at the beginning of 1981. We take no position at this time on when implementation may be expected. The development of an appropriate implementation schedule will be a priority assignment for the task force.

Finally, the Commission has long recognized the need for any revised USOA to be compatible with the needs of the states, 70 FCC 2d 747. The First Supplemental Notice requested comments on future procedural options that the Commission might utilize to complete the docket. After receipt of these comments, the task force will expeditiously evaluate the procedural options and outline steps that will ensure that appropriate input from the industry and state regulators will be obtained.

Sincerely,

Charles D. Ferris
Chairman

(914501)

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