Joint Statement and

Exhibit Reflecting Resolved Issues

BEFORE THE CALIFORNIA PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.	Rulemaking 01-09-001
Order Instituting Investigation on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.	Investigation 01-09-002

JOINT STATEMENT AND EXHIBIT REFLECTING RESOLVED ISSUES

In compliance with the Assigned Commissioner's Ruling Determining the category, Scope, Schedule, Need for Hearing, and the Principal Hearing Officer for the Proceeding issued December 27, 2001 (Scoping Memo), active parties to Phase 1 of this proceeding, Commission Office of Ratepayer Advocates (ORA) and The Utility Ratepayer Advocates (TURN), are required to submit a Joint Exhibit reflecting the status of all audit recommendations including those which have been resolved and those which remain disputed. With respect to the proposed resolution of each resolved issue, the parties must demonstrate that the resolution is reasonable in light of the whole record, consistent with the law, and in the public interest. The parties must also identify what Commission action, if any, is required to implement the proposed resolution.

This statement provides an overview of the reasons why the Commission should accept the parties' agreed-upon resolution of many of the issues identified by ORA in its audit. In addition to this overview, the parties have provided explanations specific to each resolved issue identified in the Joint Exhibit.

The standard applied by the Scoping Memo to consideration of the issues presented for resolution is embodied in Rule 51.1(e) of the Commission's Rules of Practice and Procedure. Rule 51.1(e) provides that the Commission "will not approve stipulations or settlements, whether contested or uncontested, unless the stipulation or settlement is reasonable in light of the whole record, consistent with the law, and in the public interest." Verizon, ORA and TURN believe that the resolution of each issue identified in the Joint Exhibit satisfies these criteria and should be approved. In addition to the specific points identified in the Joint Exhibit, the following summary applies in general to the process of issue resolution and to each resolved issue.

A. Background

In compliance with Commission decisions D.94-06-011, D.96-05-036, and D.98-10-019, ORA conducted an audit of Verizon California Inc.'s affiliate transactions, cost allocations and monitoring reports covering the period 1996-1998. This effort began in mid-1999 and culminated in ORA's submission of its audit report on April 30, 2001. During the course of the audit, a team of Verizon subject matter experts worked cooperatively with the ORA's outside auditors, responded to more than 1000 data requests, hosted site visits to multiple locations, and participated in more than 30 employee interviews. In addition, in preparation for Phase 1 proceedings, a Verizon team of subject matter experts met or spoke on numerous occasions with representatives from ORA, their auditors, and TURN and provided substantial additional information and documentation as part of discussions intended to address recommendations raised in the audit report and to resolve outstanding issues. All of this laid the factual groundwork for ORA, its auditors and Verizon to reach substantial consensus on many of the recommendations contained in the audit report.

Description of the Joint Exhibit

For each issue, the Joint Exhibit contains the following information:

- Issue: Each issue is labeled as to topic, assigned one or more Reference Numbers for purposes of identification, and sourced to a chapter and page reference in the audit report.
- Audit Recommendation: (NOTE: This portion of the Joint Exhibit is the audit report statement only and does not reflect Verizon's views.) Language from the audit report is included here to summarize the auditors' recommendation. Separate but related recommendations are assigned individual reference numbers, and the auditors' calculated

financial impact of implementing the recommendation for each of the three audit years is assigned a separate Reference Number.

- Verizon Position: (NOTE: This portion of the Joint Exhibit is Verizon's statement only and does not reflect any other party's views.) With respect to reach resolved issue, this summarizes Verizon's position on the audit recommendation. With respect to contested issues, Verizon's position will be set forth in greater detail in testimony.
- Status: There are two categories of issues: contested and resolved. As stated above, contested issues will be addressed in evidentiary hearings and resolved in that forum. Resolved issues are of two kinds - with and without an associated financial impact. Resolved issues with no financial impact include instances in which either no impact was identified in the report or the parties agreed that the impact was zero. Such issues will not be addressed in evidentiary hearings and reflect an agreement among the parties that the identified resolution satisfies the criteria in Commission rule 51.1(a). The parties agree that each resolution is entered into without any admission by any party that the factual allegations and recommendations contained in the audit report regarding the issue resolved are justified or not justified. Resolved issues with no financial impact are completely resolved. Resolved issues with a financial impact are resolved as described above, except that the ratemaking treatment of any financial impact remains subject to dispute. Finally, in the case of all resolved issues, this section contains a summary of the agreed upon resolution and why it should be adopted.

Commission Implementation Action

At the most general level, the only action required by the Commission in implementing the proposed resolution of issues is to review the Joint Exhibit and supporting documentation and formally adopt them as part of Phase 1. In addition, the resolution of specific issues may require further action, such as implementation of agreed-upon financial adjustments to historic earnings reports by Verizon or review and approval of documentation or procedures by ORA and/or TURN. These actions will be addressed on an issue-by-issue basis in the Joint Exhibit.

Unresolved audit issues are identified but not addressed in the Joint Exhibit, and will be addressed separately in each party’s direct testimony. In addition, the parties disagree whether ratemaking treatment is appropriate for any of the financial adjustments, both resolved and unresolved issues. The issue of ratemaking treatment for all financial adjustments will be addressed in evidentiary hearings, and will be subject to any further Commission action ordered as a result of such hearings.

Reasonable in Light of the Record

Based on the record as a whole, including the comprehensive and detailed audit report itself, as well as substantial in-depth discovery conducted both during the approximately eighteen month audit process and during subsequent discussions, ORA, TURN and Verizon believe that the proposed resolution of each resolved issue is reasonable and should be approved.

The parties engaged in collaborative discussions have in-depth knowledge of the issues and are extremely well-positioned to evaluate the reasonableness of each proposed issue resolution in light of the information submitted by Verizon. ORA's independent auditors, who performed the audit and were intimately familiar with their audit report's recommendations and the information underlying it, participated actively in the discussions and resolution of issues. This depth of knowledge allowed an informed and reasonable compromise of competing interests and a balancing of the trade-offs relating to satisfaction of the audit report's recommendations and the risk, complexity, likely duration, and expected benefit of further litigation. The auditors' concurrence in the resolution of issues, after substantial discovery and investigation, supports a finding of reasonableness. Also, the agreement of two highly respected customer and public interest representatives, ORA and TURN, further supports a finding that the proposed resolution of issues is reasonable.

Consistency with Law

The parties expended considerable effort ensuring that the resolution of each issue comports with statute and Commission precedent. The parties do not believe that any of the terms or provisions contained in the Joint Exhibit contravene any statute or prior Commission decision. Rather, the issue resolution process focused on correction of any areas of alleged non-compliance with Commission rules and implementation of procedures and processes for ongoing compliance with such rules. Where particular issues relate to Commission statutes or decisions, those authorities are addressed in greater detail in the Joint Exhibit.

In particular, the resolution of issues is designed to meet the Commission’s criteria for conduct of the audit, i.e., to ensure against cross-subsidization or anti-competitive behavior, determine compliance with the Commission's affiliate transaction rules, determine whether Verizon is properly tracking and allocating costs related to non-regulated activities, and to determine whether ratepayer and competitor interests are adequately protected by current non-structural safeguards. (OII, App. A, p. A-1) The parties believe that the resolution of issues contained in the Joint Exhibit furthers the goals of the audit.

Many of the issues identified in the audit report related to documentation or procedures relating to cost allocation or compliance with affiliate rules, retention of such documents, and submission of monitoring reports designed to monitor compliance with Commission rules. In some instances, existing action addressing the audit recommendation was implemented by Verizon during or after the audit period; in others, further responsive action or modification of policies and procedures have been agreed to by the parties and documented. Those documents, attached to the Joint Exhibit as referenced in Issues 1 and 53, will become part of the record in this proceeding and, more importantly, will become part of a "living document" for use by Verizon and subject to review by ORA. These agreements will satisfy the goals of the audit on an ongoing basis. Where audit recommendations are no longer applicable due to process or structural changes within Verizon, those recommendations have been resolved with a financial adjustment covering the audit period, if appropriate.

In addition, the resolution of issues is consistent with law in that it provides the Commission with sufficient information to permit it to fulfill its regulatory obligations with respect to the parties and their interests.1 In this case, the Commission's regulatory obligations are to insure compliance with rules regarding affiliate transactions, cost allocations, and rules preventing cross-subsidization and anticompetitive behavior. The parties are confident that the Joint Exhibit and supporting documentation will provide sufficient information to the Commission to permit it to discharge its regulatory obligations and determine that the proposed resolution of issues satisfies the criteria set forth in the Scoping Memo.

Finally, as with any resolution of disputed issues in Commission practice, the parties do not intend the resolution of any issue here to be precedential as to the determination of any other

[1] D.92-12-019, mimeo, p. 2, fn. 2. While this case established criteria for all-party settlements, the need for sufficient information is the same whether an agreement is one entered into by all parties or less than all parties.

issue in this proceeding or in other proceedings. This is consistent with long-standing Commission precedent and rules.

Public Interest

The resolution of issues proposed in the Joint Exhibit satisfies the public interest for all of the reasons set forth above. In addition, it allows parties and the Commission to focus their resources on developing agreed-upon means of insuring and documenting compliance with Commission rules, rather than on litigation of disputed factual issues which, once resolved, would have little or no ongoing significance and hence no public benefit. As a result, the parties have reached resolution on certain issues rather than engaging in protracted factual disputes regarding the audit recommendation. Certain issues have thus been resolved without a determination of the factual disputes underlying those issues, and parties have agreed instead to the implementation of measures to address the audit concerns on an ongoing basis. Such an approach serves the public interest by devoting regulatory resources towards satisfaction of consumer protection goals rather than unnecessary litigation.

DATED: January 22, 2002

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By: ____________________

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VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES
R.01-09-001/L.01-09-002

JOINT EXHIBIT OF
VERIZON CALIFORNIA INC., OFFICE OF RATEPAYER ADVOCATES AND
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Ref No.	**Issue: Documentation for Cost Allocation Process and Results** **Page Reference: (6-1 t o 6-8, 25-5 to 25-8)**
1	**Audit Recommendation:** Verizon should be required to develop a detailed reference manual and check-off system to assure that the process and procedures are documented and the documented procedures have been completed and followed.

Verizon Position:

In October 2001,Verizon developed a detailed reference binder that contains necessary information to assure processes and procedures are documented and completed. It contains the following information:

a. Overview of the Operating Telephone Company (OTC) allocation process
b. Vrizon West Factor Development
c. Service Corporation Time Survey Process
d. Monthly processing check off list
e. Time Survey and Compliance Report Web Site Development
f. System Overview

Since 1999, Verizon has implemented a number of formal reports and controls to ensure that the processes and procedures are followed. These reports and controls, which have been incorporated into the reference document, include:

<u>1999:</u>

1. Process checklist implemented.
2. Manual off-line allocation process refined for unallocated expenses.
3. Pre-calculation process implemented.
4. Compliance Reports and Time Survey forms were improved and revised to: a) include a list of all jurisdictions to assist in completing the process; b) business units required to provide a positive indication of all jurisdictions supported; and c) improved detailed instructions on how to fill out the forms.
5. The Common Cost Allocation group assigns the cost pool based on the jurisdictions indicated.

<u>2000:</u>

1. Service Corp time survey process simplified by using the percentages reported on time survey instead of producing a weighted average by FCC account.
2. Compliance Reports, Time Surveys and instructions revised to meet business changes.
3. Bi-weekly Interdepartmental Work Center discussions implemented.

<u>2001:</u>

1. Additional reports by jurisdiction and cost pool are being developed.
2. A Time Survey and Compliance Report Web site is being developed.

Status: Resolved

This documentation as described above by Verizon was reviewed and modified in response to comments by ORA's auditors.

This resolution should be adopted because Verizon has complied with the audit recommendations and agrees to utilize the documentation as a reference in applying the processes and procedures addressed in the documentation. Verizon also agrees to update this documentation on a regular basis and provide, when requested, such updates to ORA for purposes of review and monitoring. This will insure that the cost allocation procedures set forth in the document will be followed. No further Commission action is required.

Resolved Financial Impact: 1996 – $0.0; 1997 – $0.0; 1998 - $0.0.

Ref No.	**Issue: Service Corp Factor Development** **Page Reference: (6-9 to 6-12, 6-25 to 6-32)**
2 **3**	**Audit Recommendation:** Verizon needs to establish policies and procedures for developing allocation factors for GTE Service Corp that will be adhered to. The policies should define what a time survey is, indicate how often it will be performed and what is necessary to modify a previous study that is carried over from a prior period. Procedures should explain how the time study is to be performed and how the factor is developed. The payroll dollars that are included in the factor calculation should be changed each year and the period should be consistent from year to year. Any changes and/or modifications to policy and procedures should be documented and retained with the study material. Financial Impact (Z Factors): 1996 – NA; 1997 – NA; 1998 - $5.5M

Verizon Position:

Verizon believes this finding contains a factual misunderstanding. Verizon always performs service corporation time surveys in the fall of each year to determine appropriate factors for the upcoming year. Verizon did this for all audit years reviewed. The misunderstanding appears to revolve around an "extra" time survey that was performed in April 1998 to take into account significant changes in corporate structure that could affect allocations. This "above and beyond" the normal time survey was performed to capture the creation of Service Corp II and BDI as well as other corporate changes and was necessary for accuracy. The additional survey was designed to only survey the work centers in the six significant FCC accounts most related to the corporate changes and update the factors for those six accounts. During the audit work papers were provided that included references to other factors that were not part of the partial mid year survey update. Unfortunately, the inclusion of these work papers in the updated documentation created the appearance and misunderstanding that all factors had been updated but not implemented. This is not the case. Indeed, the audit finding concludes there was an error when in fact Verizon was going outside its normal procedures to accurately reflect this significant change.

Annual time surveys are always performed. Time survey procedures are outlined in the documentation binder. The use of a time survey and its definition is based on the Service Corporation Prorate contract, which was effective April 1, 1959. The contract specifically states in paragraph 15 "The total expenses of the Service Corporation are allocated between (a) telephone companies and (b) the other General System companies upon the **basis of time spent in rendering services** to such companies."

The concern that payroll dollars should be changed each year for the calculation of the factors is no longer an issue since the development of factors based on payroll data has been discontinued. Verizon now uses percentages reported by the work center owner for each business unit.

Time surveys are maintained for at least 5 years. The company's retention policy does not specifically state a time period for common cost allocations, however, for non-tax items the retention periods run between 1 – 6 years. For Labor Distributions the time period is 3 years per the policy and the Common Cost Allocation department has determined that the records should be maintained for at least 5 years.

Status: Resolved.

The genesis of this issue lay in an "extra" time survey performed in April 1998 to take into account significant changes in corporate structure that could affect allocations, and whether this survey was necessary to insure accuracy or was an error in procedure. To resolve the factual dispute, Verizon acknowledged that Verizon California's ZW allocated expenses were overstated by $2.296 million in 1998, and the parties reached consensus that a $2.296 million adjustment would be made in lieu of the $5.5 million adjustment recommended in the audit report. Verizon agrees to restate the annual 1998 earnings filing to reflect this adjustment. In order to avoid future disputes, Verizon included the requested documentation regarding its time survey process in the reference documentation described under Ref. No. 1.

The concern that payroll dollars should be changed each year for the calculation of the factors is no longer an issue since the development of factors based on payroll data has been discontinued. Verizon now uses percentages reported by the work center owner for each business unit.

This resolution should be adopted because Verizon has complied with the audit recommendations. No further Commission action is required.

Resolved Financial Impact: 1996 – $0.0; 1997 – $0.0; 1998 - $2.296M

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Ref No.	Issue: Historical Use of Factors Page Reference: (6-12 to 6-25, 9-1 to 9-2, 9-4 to 9-18, 25-8 to 25-9)
4 **5** **6**	**Audit Recommendation:** Verizon should use consistent data and time periods for the calculation of Network Services factors. Financial Impact (C and F Factors): 1996 - \$.2 M; 1997 - \$.2 M; 1998 - \$.8 M (related to the use of net plant vs. gross plant) Financial Impact (I Factor) 1996 – \$4.0 M; 1997 - \$10.0 M; 1998 - \$10.0 M

Verizon Position:

During the audit period, Verizon utilized the following factors:
B – Big Three Expenses – Non-regulated
C – Net Plant in Service
F – Central Office Equipment, Information Originating/Terminating Equipment and Cable and Wire Facilities Investment
G – Current Billings (Regulated Current Billings)
GG – Modified Billings (Regulated/Non-regulated Current Billings)
H – Big Three Expenses – Regulated (Plant Specific, Plant Non Specific and Customer Expenses)
Q – Big Three Expenses – Regulated/Non-regulated
I – Weighted Actual Work Seconds
S – Access Lines
T – Coin Collection

For factors C and F, the auditors suggested that net plant was more representative of the plant investment than gross plant. Verizon's position is that either gross or net plant provides a reasonable allocation of the accounts to which it is applied if it is used consistently between the jurisdictions but supports the continued use of gross plant for F allocations. Verizon disagrees with the financial adjustments for the F factor.

Verizon agrees that Factor I – Weighted Work Seconds documentation was not available for review. The I factor was developed based on a time study of Operator work seconds. Unfortunately, due to the lack of documentation as to how the factor had been originally developed, the Common Cost Allocations group was unable to reproduce the study. The I factor continued to be used as it had been originally calculated through 1999. Larkin and Associates recommended that the I factor be replaced with the S Factor – Access lines. At the beginning of 2000, all Network Services factors were aligned with the Bell Atlantic factors. In this particular instance the accounts assigned to the I factor were assigned to Factor MC - Access Lines.

Larkin and Associates also raised concerns about the inconsistent application of base year data affecting the results of the calculated allocation factor. Verizon used different base year data for factor development due to changes in when the base information was developed and available. However, what is important for factor development is that the same periods are used for all jurisdictions in the study. As long as the same periods are used for all jurisdictions in the study, the factor calculations cannot be manipulated, as the relative size among the jurisdictions does not materially fluctuate from period to period.

Due to the merger with Bell Atlantic, Verizon's factors were revised in 2000 in order to start aligning allocations across the regulated telephone companies. (Please refer to the Factor Development in the Verizon West Documentation Binder).

Verizon accepts the adjustments related to the I factor.

Status: Resolved.

(4) This recommendation was based on a number of issues identified with regard to factor development during the audit period. Due to the merger with Bell Atlantic, Verizon's factors were revised in 2000 in order to start aligning allocations across the regulated telephone companies. As of 2000, the new set of factors is based on data obtained from the company's financial statements, not normalized separated data. The reference document provided in response to Ref. No. 1 explains that annual factors are developed using October twelve months to date data of the prior year. Verizon's documentation also provides that in the future, the time period may be adjusted due to unforeseen business requirements. The parties agree that this position is reasonable.

(5) Verizon uses gross plant rather than net plant as the basis for the F allocations; the auditors agree that this method is reasonable as long as the allocated difference between methods remains de minimis. The parties agree that no adjustments will be made.

(6) Verizon agrees to restate each of the annual 1996 – 1999 earnings filings to reflect the recommended audit adjustments for 1996 – 1998 (cumulative $23.902 million) and an $8.152 million adjustment for 1999. These adjustments resulted because Verizon could not locate historical documentation supporting the development of the "I" factor and therefore, had not verified or updated this factor since 1994. Beginning in 2000, Verizon replaced the "I" factor with the "S" factor consistent with the audit recommendation.

This resolution should be adopted because Verizon has complied with the audit recommendations and agrees to utilize processes and procedures that are consistent with the audit recommendations. No further Commission action is required.

Resolved Financial Impact: 1996 – $3.988 M; 1997 - $9.890 M; 1998 - $10.024 M; 1999 - $8.152 M.

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Ref No.	**Issue: Budget Center Testing** **Page Reference: (6-32 to 6-39, 9-2 to 9-4, 9-19 to 9-60)**
 7 **7a** **8**	**Audit Recommendation:** Oral interviews and review of work centers result in conflicting responses between the interview and actual allocations. Systems should be implemented to track incoming calls to the centers. This information should be used to allocate costs properly. Financial Impact: 1996 – \$1.6 M; 1997 – (\$2.7) M; 1998 – (\$3.0) M
Verizon Position: Verizon acknowledges there were differences between the compliance reports and the interviews that were conducted several years after the fact. Without agreeing the interviews were correct, in order to resolve this issue, Verizon will adopt the results of the findings provided in the interview process and make updates as appropriate. Since the inception of SAP in 1998 (as discussed in the documentation binder) the Common Cost Allocation staff has continually been adding and improving controls such as: 1) Revising the Network Services Compliance Report and Service Corporations Time Survey, including the associated instructions; 2) implementing bi-weekly interdepartmental work center meetings for the SAP production team; 3) implementing a monthly process check list; 4) refining the pre calculation process to identify work centers that should be set up to allocate; and 5) developing monthly reports by company, jurisdiction and cost pool to ensure the results reflect what has been submitted by the work center owners in either a Network Services Compliance Report or a Service Corporation Time Survey. Also, a web site is under development that will house both the Network Services Compliance Reports and the Service Corporation Time Survey. The CCA staff continues to review the process and add additional controls when needed on an ongoing basis.	

Status: Resolved.

(7) Verizon acknowledges there were differences between the compliance reports and the interviews that were conducted several years after the fact. Upon further discussion with the auditors and additional analysis, Verizon agrees to restate the annual 1996 – 1998 earnings filings to reflect the recommended audit adjustments for 1996 – 1998. The parties agree that these adjustments are reasonable.

Since the conversion of the general ledger system from OPARS to SAP in 1998 (as discussed in the Ref. No.1 documentation) the Common Cost Allocation staff has continually been adding and improving controls such as: 1) Revising the Network Services Compliance Report and Service Corporations Time Survey, including the associated instructions; 2) implementing bi-weekly interdepartmental work center meetings for the SAP production team; 3) implementing a monthly process check list; 4) refining the pre calculation process to identify work centers that should be set up to allocate; and 5) developing monthly reports by company, jurisdiction and cost pool to ensure the results reflect what has been submitted by the work center owners in either a Network Services Compliance Report or a Service Corporation Time Survey. Also, a web site is under development that will house both the Network Services Compliance Reports and the Service Corporation Time Survey. Verizon continues to review the process and add additional controls when needed on an ongoing basis.
In addition and in conjunction with Ref. No. 105, Verizon agrees to conduct internal audits on selected budget centers every three years with the first audit to be conducted in 2002.

By April 30, 2002, Verizon agrees to complete an analysis and provide workpapers supporting the allocations of the Multilingual Service Solutions Center (MSSC) and the Language Assistance Center (LAC) for 1999, 2000 and 2001 to the ORA. Based on its analysis, Verizon agrees to restate the annual earnings filings for 1999, 2000 and 2001 for any resulting adjustments.

By April 30, 2002, for 2002 and on a prospective basis, Verizon will document its remedy for determining work center allocations for the Customer Service Solution Center (CSSC), the MSSC and the CARE centers and will provide a summary of that remedy to the ORA.

(7a) Verizon is currently reviewing a system that will track calls to the centers by originating location. If a decision is made to proceed to implement the system, Verizon will provide more information on the system and the date the system becomes operational to the ORA. Verizon will also provide a copy of initial reports from the system to ORA when they become available.

This resolution should be adopted because Verizon agrees to review work center allocations for the CSSC, the MSSC and the CARE centers and document its remedy for determining, on a prospective basis, the allocations for these centers. No further Commission action is required.

Resolved Financial Impact: 1996 – $1.604 M; 1997 – ($2.734) M; 1998 – ($2.997) M; (1999 – 2001) – TBD.

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Ref No.	**Issue: Manual Allocation** **Page Reference: (9-65 to 9-68)**
 9 10 11	**Audit Recommendation:** Verizon should analyze the 1998 unallocated expenses. Verizon should investigate changing manual/PC process to allocate unallocable B accounts using the B factor rather than the Q factor on a going –forward basis. Financial Impact (B Factors): 1996 – NA; 1997 – NA; 1998 – ($.2) M

Verizon Position:

With the conversion of the general ledger system from OPARS to SAP, a system design error was discovered that allowed expenses to journalize as allocable, but then did not allocate during the month end processing. From April through September 1998, these unallocated costs remained in the incurred jurisdiction. Larkin and Associates voiced concern that GTE had neither analyzed nor reallocated the September YTD unallocated expenses. In November 1998 Verizon analyzed April through October's unallocated dollars and performed a manual allocation of expenses to the jurisdictions, including California. An off-line mechanical process was designed to match work centers with cost pools. If a work center matched with an allocable cost pool then it was allocated accordingly to the appropriate jurisdictions. If a work center did not match with an allocable cost pool there was no basis upon which to allocate the cost and the expenses were allocated back to the host legal entity that incurred the expense. This is the same manual process that Verizon began using in November 1998 for October 1998 YTD data which Larkin and Associates found reasonable (Chapter 9-68, paragraph 1).

The manual off-line allocation process to clear SAP of unallocated expenses each month uses only one factor because of the time limitation of the month end closing schedule and the continuing reduction in the amount of the unallocated dollars. As Larkin & Associates stated, the increased expense to Verizon CA was insignificant.

Status: Resolved.

(9) With the conversion of the general ledger system from OPARS to SAP, a system design error was discovered that allowed expenses to journalize as allocable, but then did not allocate during the month end processing. From April through September 1998, these unallocated costs remained in the incurred jurisdiction. In response to auditor concerns, Verizon analyzed April through October's unallocated dollars and performed a manual allocation of expenses to the jurisdictions, including California. An off-line mechanical process was designed to match work centers with cost pools. If a work center matched with an allocable cost pool then it was allocated accordingly to the appropriate jurisdictions. If a work center did not match with an allocable cost pool there was no basis upon which to allocate the cost and the expenses were allocated back to the host legal entity that incurred the expense. This is the same manual process that Verizon began using in November 1998 for October 1998 YTD data. As a result of the follow-up analysis and the downward trend in unallocated dollars, the parties agree that no adjustments are required.

(10) and (11) Only one factor (the Q factor) is used for the manual process because of the time limitation of the month end closing schedule and the continuing reduction in the amount of the unallocated dollars. Due to the amount of this finding and the downward trend of unallocated dollars, the parties agree that no adjustments are required.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Impact: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0

Ref No.	**Issue: GTEDS ROR** **Page Reference: (10-4)**
12 13	**Audit Recommendation:** In 1996, GTEDS earned in excess of the Commission's authorized ROR of 10.5%. Financial Impact: 1996 - $1.8M; 1997 – N/A; 1998 – N/A

Verizon Position:

Verizon disagrees with the adjustment. First, in reaching its conclusion, the audit used amounts that included GTEDS' transactions with third parties and with affiliates other than the regulated telephone operating company. CPUC pricing rules are not applicable to such transactions. The pricing adjustment should use only the amounts associated with the transactions between GTEDS and the regulated entity. Second, imputing earnings of non-regulated affiliates to Verizon CA income is inconsistent with NRF. Third, as discussed in response to Ref. No. 15, GTEDS affiliate pricing should be calculated using an 11.50% ROR.

Status: Resolved.

Verizon proposed an 11.50% ROR for affiliate pricing in its 1996 CCAM filing that was submitted for Commission approval in September 1995. However, Resolution T-15950, which approved the CCAM and adopted the 11.50% ROR proposed by Verizon, was not issued until December 6, 1996. Therefore, the parties agree that a 10.5% ROR will not apply to 1996. Based on recalculating the adjustment using actuals and applying 11.5% ROR to 1996, Verizon agrees to restate the annual 1996 earnings filing to reflect a $10.6 million expense reduction.

Resolved Financial Adjustment: 1996 – $10.600 M; 1997 – $0.0; 1998 – $0.0

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Ref No.	**Issue: GTEDS ROR** **Page Reference: (10-2 to 10-4)**
 14 15 16	Audit Recommendation: When pricing services to affiliates and when affiliates are pricing services to GTEC at fully distributed cost, 11.50% should be used as the return on investment for 1997 and 1998. Because there was not a CAM in effect during 1996, the rate of return for charging affiliates should be 10.50%. Financial Impact (ROR): 1996 - N/A; 1997 - $3.4M; 1998 – ($0.07)M

Verizon Position:

1) Although Verizon agrees with the audit report's recommendation to utilize an 11.50% ROR for 1997 and 1998, the adjustments of ($11,684) for 1997 and ($73,270) for 1998 are de minimis. Verizon is willing to forego these two adjustments because the amount is small.

2) Verizon does not agree that a 10.5% ROR is appropriate for 1996 and the appropriate ROR is 11.50%. Verizon proposed an 11.50% ROR for affiliate pricing in its 1996 CCAM filing that was submitted for Commission approval in September 1995. However, the Division of Ratepayer Advocates protested other issues related to the Company's CCAM filing that resulted in Resolution T-15950 not being issued until December 6, 1996. The Resolution ultimately adopted the 11.50% ROR proposed by Verizon.

3) Verizon agrees that 15.50 % ROR was used in error in this specific instance in 1997. However, the auditors' calculation is incorrect because it used a 1996 estimate of 1997 actuals. Using actual 1997 amounts and an 11.5% ROR, GTEDS over-billed GTE CA by approximately $1.7M and therefore, GTE CA should have reduced its expenses for Jan-July 1997 by that amount. The adjustment that the company filed on its CPUC report was a $2.9M decrease to cost. Consequently, GTE CA should increase its expense by $1.3M.

Status: Resolved.

Verizon proposed an 11.50% ROR for affiliate pricing in its 1996 CCAM filing that was submitted for Commission approval in September 1995. However, Resolution T-15950, which approved the CCAM and adopted the 11.50% ROR proposed by Verizon, was not issued until December 6, 1996. Therefore, the parties agree that a 10.5% ROR will not apply to 1996. In addition, based on a recalculation using 1997 actuals, Verizon agrees to restate the annual 1997 and 1998 earnings filings to reflect a $1.31 million expense increase and a 1998 expense increase of $.07 million to CA.

Verizon also agrees with the auditors' recommendation to note on its monitoring reports that Verizon may apply the FCC return (11.25%) as long as the FCC return does not exceed the CPUC return (11.5%).

This resolution should be adopted because it benefits the California ratepayers to not reflect the difference in the two returns as long as the FCC's return is less than the CPUC's return. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – ($1.310) M; 1998 – ($0.070) M

VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES
R.01-09-001/L.01-09-002

JOINT EXHIBIT OF
VERIZON CALIFORNIA INC., OFFICE OF RATEPAYER ADVOCATES AND
THE UTILITY REFORM NETWORK

Ref No.	**Issue: GTEDS Pricing** **Page Reference: (10-2 to 10-4)**
17 17a	**Audit Recommendation:** The CPUC pricing methodology for affiliate transactions should be used. Financial Impact (Pricing): 1996 – N/A; 1997 – N/A; 1998 – $2.5M

Verizon Position:

Verizon disagrees with the auditor's recommendation that an adjustment of $2.5 million is required for 1998 due to an overstatement of GTEDs' charges. This recommendation mistakenly concludes Verizon CA is out of compliance with the affiliate pricing rules. An adjustment is not warranted because the company complied with the Commission's pricing methodology and GAAP.

Each year affiliate prices are based upon both estimated and actual costs for the year due to availability of data. To the extent actual costs and units for the year are available, they were incorporated into the pricing prior to year-end. However, some estimates are needed (as they are every year), because actual costs are not known or finalized for December until after year-end when GTEDS' financial statements are prepared and audited. This is a required accounting practice per GAAP(accrual basis accounting).

In 1998, GTEDS billed Verizon CA amounts based, in part, on estimated cost. After year-end financial statements were available, GTEDS determined that the amount billed exceeded the actual cost by $2.5 million. Consistent with accrual basis accounting, GTEDS reduced its billing to Verizon CA in the following year, 1999, by the same amount. This accounting practice is no different than that followed for any other type of expense, such as salaries and wages, where accruals are commonly booked using estimates and reversed in the following period concurrently with the recording of actual cost. An adjustment of ($2.5) million was made in 1999 to adjust the overstated GTEDs billing in 1998. Therefore, any additional adjustment for this issue is not appropriate.

Status: Resolved.

The audit recommends that an adjustment of $2.5 million is required for 1998 due to an overstatement of GTEDs' charges. Verizon demonstrated that it had already made a $2.5 million adjustment in 1999, consistent with the Commission's pricing methodology and GAAP, to adjust the overstated GTEDs billing in 1998.

Each year affiliate prices are based upon both estimated and actual costs for the year due to availability of data. To the extent actual costs and units for the year are available, they were incorporated into the pricing prior to year-end. However, some estimates are needed (as they are every year), because actual costs are not known or finalized for December until after year-end when GTEDS' financial statements are prepared and audited. This is a required accounting practice per GAAP(accrual basis accounting).

In 1998, GTEDS billed Verizon CA amounts based, in part, on estimated cost. After year-end financial statements were available, GTEDS determined that the amount billed exceeded the actual cost by $2.5 million. Consistent with accrual basis accounting, GTEDS reduced its billing to Verizon CA in the following year, 1999, by the same amount. This accounting practice is no different than that followed for any other type of expense, such as salaries and wages, where accruals are commonly booked using estimates and reversed in the following period concurrently with the recording of actual cost. An adjustment of ($2.5) million was made in 1999 to adjust the overstated GTEDs billing in 1998. The parties agree that no further action is required.

This resolution should be adopted because the concern raised by the audit recommendation was limited to the audit period and has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0

Ref No.	**Issue: GTEDS Cost and Market Studies** **Page Reference: (10-2 to 10-4)**
18 19	**Audit Recommendation:** GTEC should continue to have GTEDS prepare studies which demonstrate that the prices charged GTEC are the lower of cost or market. Financial Impact: None identified

Verizon Position:

This recommendation is no longer applicable. Effective June 2001, Verizon Data Services (formerly GTEDS) no longer provides third party business and meets the FCC 96-150 description of a Corporate Services Company. This change eliminates the requirement for any further pricing studies per FCC rules. Consequently, all services are provided at fully distributed cost without any FCC requirement to make a lower of cost or market determination.

Status: Contested.

Ref. No.	Issue: GTEDS Royalty Fees Page Reference: (10-7 to 10-8)
20 21	**Audit Recommendation:** GTEDS should track the costs incurred to market and distribute software licensed on behalf of the GTE Telcos. The revenue to GTEC should then be determined by taking its allocated share of the total revenue less the costs incurred by GTEDS to market and distribute the software. Financial Impact: 1996 – \$1.3M; 1997 - \$0.6M; 1998 - \$0.2M Note: Audit Schedule 10-8 reflects the 1996 royalty fee adjustment of \$1.3 million as being incorporated in the ROR adjustment of \$1.8 million (Ref. No. 13).

Verizon Position:

This recommendation is no longer applicable. Effective January 1999, SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" was implemented. SOP 98-1 negates any discussion of royalties on a prospective basis. Under SOP-98, all license fees for internal use software developed after 1998 must be applied against the capital value of the software. Any license fees received through an amortization must be applied against the capital value currently recorded on Verizon Data Services Inc. books. The benefit of the license fee flows to the entity that uses the systems through reduced costs because of the reduction in the amortization.

Under the method utilized by the Company during the audit period, Verizon CA received 25% of the gross license fee revenue and was not allocated any marketing and distribution costs incurred by GTEDS to complete the sale. Conversely, the methodology proposed in the audit would increase costs to the ratepayers. If the marketing effort did not result in any sales, Verizon CA would be allocated its proportionate share of costs, but not receive any offsetting revenue.

Verizon does not agree with the audit recommendation to adjust royalty fees by \$1.3 million, \$.6 million and \$.2 million in 1996, 1997 and 1998, respectively. The issue of the reasonableness of the royalty rate was addressed at the time the marketing agreement was implemented in 1985 and 1986. A study was presented at that time which demonstrated the 25% royalty rate was at the high end of the market range for similar marketing agreements in the data processing area. This study was provided in response to data request ORA 0013-23. Prior to January 1999, Verizon monitored market industry royalty information that demonstrates during the audit period that the 25% rate was at the high end of the market range. For instance, the February 1995 Licensing Economic review contained an article entitled, "Royalty Rates in General and on Average" by Russell L. Parr in which he stated that in his study "95% of the licenses involved royalty rates of 12% or less". He reported in his summary that he reviewed 95 licenses involving telecommunications, semiconductors, and computers.

Status: Resolved.

The parties agree that no explicit adjustments will be made for the audit period. On an ongoing basis, the issue raised in the audit is moot. Effective January 1999, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" (SOP 98-1) was adopted. Under SOP 98-1, all license fees for internal use software developed after 1998 must be applied against the capital value of the software. The benefit of the license fee flows to the entity that uses the systems through reduced costs because of the reduction in the amortization. SOP 98-1 negates any discussion of royalties on a prospective basis.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed both during the audit period and prospectively. No further Commission action is required.

Resolved Financial Adjustment: 1996 – \$0.0; 1997 – \$0.0; 1998 – \$0.0.

Ref No.	Issue: Capitalization of Software & Development Costs Page Reference: (10-8)
 22 23	Audit Recommendation: A change in the ownership of intellectual property rights should cause GTEC to file an 851 Application with the Commission. Financial Impact: None Identified

Verizon Position:

The finding is in error. There is no violation of FCC Docket 86-111 regarding the transfer of property rights to non-regulated affiliates because there was no transfer of assets. There is no requirement to file an 851 Application with the California Public Utilities Commission.

In 1999, as a result of the implementation of AICPA SOP 98-1, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,” GTEDS began capitalizing the costs of software development and enhancement (D&E) rather than seek reimbursement for these expenses from the former GTE Telephone Operating Companies (fGTOCS). Thus, the cost for the software development and enhancement was not borne by the fGTOCS. As such, when SOP 98-1 was implemented, GTEDs owned the software and systems that GTEDS funded.

Status: Resolved.

Verizon provided the auditors documents showing capitalized D&E related to Verizon CA and the D&E amortization billed to Verizon CA by system/software application for 1996 – 2001. On a prospective basis, Verizon CA agrees to provide to ORA, the capitalized D&E related to Verizon CA and D&E amortization billed to Verizon CA by system/software application, on an annual basis. The parties agree that no adjustments are appropriate.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0.

Ref No.	Issue: LABs Beneficiary Analysis Page Reference: (11-3 to 11-19)
24 25	**Audit Recommendation:** The CPUC should reallocate the amounts charged to GTEC in 1997 such that GTECC-Other and Internetworking are allocated the same percentages they were in 1998. In the alternative, the Commission could evaluate each project and determine which ones benefit the regulated telephone operations and the remainder of the costs should be allocated below the line. Financial Impact: 1996 – N/A; 1997 – \$5.9M; 1998 – N/A

Verizon Position:

The finding is in error. Verizon does not agree with the audit recommendation to reallocate the amounts charged to Verizon CA in 1997 so that GTECC-Other and Internetworking will be allocated the same percentages of research and development expenses they were in 1998. The reallocation of the R&D amounts for Verizon CA between 1998 and 1997 is illogical and inappropriate because of the timetable applicable to the GTE Labs Research and Development program. The time table for the determination of business group research needs and preparation of the R&D program is as follows:

a) By July of each year, GTE Labs solicits the business units for research requests for the following year. The types of efforts requested range from urgent demands for critical near-term assistance in specific technology to general requests for strategic research. These research requests are submitted by the end of August each year.

b) At the end of August, these business unit requests are distributed to the GTE Labs personnel who are responsible for constructing the program.

c) The first step in the formulation of the research program for the following year is the development of a set of research proposals by the GTE Labs department managers. Specific priorities are a result of various internal technical drivers as well as a need to be responsive to the requests of the business units.

d) The proposed research program is sent out in October/November to the SBUs. The process normally culminates in a finalized research program by the end of December.

Based on this process, the 1997 program could not have included business units, such as GTE Internetworking, that came into existence in August of 1997. The reorganization of 1997 could not be reflected in the GTE Labs' research program until the research requests for the 1998 cycle. The 1997 research provided support to the business unit customers that had requested such research within the normal cycle (1996). By 1998, the research program reflected the new organization and the requests of the new business units were in many cases incorporated into existing projects, changing the scope and direction of the project and changing the allocation of the expenses. Therefore, the adjustment is not appropriate.

Status: Resolved.

The audit recommendation relates solely to application of research and development costs during 1997 and relates to entities such as GTE Internetworking which came into existence in August 1997. Verizon agrees to restate the annual 1997 earnings filing to reflect a \$2.46 million expense reduction adjustment to reflect the five months of 1997 that GTE Internetworking was in existence. The parties agree that this adjustment is reasonable.

This resolution should be adopted because the dispute was limited to the audit period, and was corrected to the parties' mutual satisfaction so that the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 – \$0.0; 1997 – \$2.460 M; 1998 – \$0.0.

Ref No.	Issue: LABs Affiliates Pricing Page Reference: (11-20)
26 27	**Audit Recommendation:** For the period 1996-98, GTE was not in compliance with the Commission's affiliate pricing requirements. There are no cost or market studies for GTE Labs showing that fully distributed cost is lower than market. Financial Impact: None identified

Verizon Position:

Verizon disagrees. During the audit period, 1996-1998, GTE Labs was a part of the GTE Service Corp. and its services were billed at fully distributed cost (FDC) pursuant to the service corporation exemption in 96-150. However, the FCC staff ruled that because GTE Labs had a small amount of third party business, Labs was not eligible for the 96-150 exemption allowed for Corporate Services entities. To comply with the FCC ruling and FCC 96-150, Frost & Sullivan completed a market study for the services provided by GTE Labs in October 2000. This study indicates that GTE Labs' pricing at FDC is at the lower end of the range of market prices.

In 2001, the functions GTE Labs performed were transferred to Consolidated Services Inc. (CSI) which, under 96-150, is exempt from having to perform market studies because CSI only provides services to the domestic telecom group. The functions that remain in GTE Labs legal entity will be provided under contract to Verizon entities or non-affiliate third parties.

Status: Resolved.

Verizon provided an independent market study conducted after the audit period to be used as a basis for reasonableness. Based on a comparison of the audit period information to that study, the audit period rates were found to be within the range of market prices and therefore within a range of reasonableness. The parties agree that no further action is required.

This resolution should be adopted because the dispute was limited to the audit period, and was corrected to the parties' mutual satisfaction so that the concern raised by the audit recommendation has been fully addressed. On an ongoing basis, affiliate pricing is addressed in other issues. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0.

Ref No.	Issue: LABs Overhead Rates Page Reference: (11-20)
28 29 30	**Audit Recommendation:** GTE Labs should begin employing lab-specific overhead rates when performing the beneficiary analysis. A square footage analysis should be performed for use in the allocation of period expenses in calculating the lab-specific overhead rates. Any exceptions or modifications to the percentages resulting from the square footage analysis should be documented. Financial Impact: 1996 – ($.06) M; 1997 - $.02 M; 1998 – ($.09) M

Verizon Position:

Verizon disagrees. The methodology used is consistent with the audit recommendation. In 1995, GTE Labs used a lab specific rate at the request of Arthur Andersen. However, this approach proved to be very onerous because GTE Labs' accounting systems were not designed to handle multiple rates. GTE Labs subsequently requested that it be allowed to return to a single average rate because the difference was immaterial. Arthur Andersen agreed with the assessment and found that the use of an average rate was compliant. The financial implications of any variance in methodology are immaterial as the audit report notes.

As a result of the GTE Labs restructure in 2001, the audit recommendation is no longer applicable because GTE Labs no longer performs the R&D function for Verizon's regulated entities.

Status: Resolved.

Verizon provided additional correspondence between an independent auditor, Arthur Andersen, and GTE Labs which supported the reasonableness of a single average lab overhead rate. Arthur Andersen showed that the difference between a single average lab overhead rate during the audit period was immaterial. The parties agree that no adjustments are appropriate.

In addition, Verizon Labs was restructured in 2001. As such, the audit recommendation is no longer applicable because Verizon Labs no longer performs the R&D function for Verizon's regulated entities.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed, and is not applicable on an ongoing basis. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0.

Ref No.	Issue: LABs Third Party & Special Contract Losses Page Reference: (11-20 to 11-21)
31 32 33	**Audit Recommendation:** GTE Labs or its parent company should absorb losses incurred in projects undertaken for government and other independent parties. Losses from projects undertaken for affiliated companies should be directly assigned to those companies. Financial Impact: None explicitly identified <u>(Modified 1/4/02: 1996 - $.203 M; 1997 - $.114M; 1998 - $.199M)</u>

Verizon Position:

Verizon disagrees. GTE Labs allocated third-party losses and losses from projects undertaken for affiliated companies to <u>all</u> the applicable former GTE entities through the Beneficiary Analysis methodology, not just the fGTOCs. In addition, GTE Labs also allocated the third party gains to <u>all</u> the applicable GTE entities through the Beneficiary Analysis methodology. Subsequent to 1997, GTE Labs generated third-party gains that were passed on to the affiliated companies. Profits of $587,254 and $4,271,527 were distributed in 1999 and 2000, respectively.

Beginning in 2001, GTE Labs was restructured. GTE Labs retained the third party business and all services previously provided to Verizon CA were moved to CSI, a 96-150 service corporation entity. Any GTE Labs' third party revenue gains or losses will no longer be allocated to other Verizon entities, including Verizon CA.

Status: Resolved.

The auditors reviewed the 1998 Arthur Anderson CAM audit workpapers related to Labs January 2002 to complete its analysis. The auditors recommend that Verizon reflect cumulative losses of $.516 million on Verizon CA's books for the audit period. Verizon agrees to restate each of the annual 1996 – 1998 earnings filings to reflect annual expense reductions of 1996 - $.0.203 M; 1997 - $0.114 M; and 1998 - $0.199 M. The parties agree that these adjustments are reasonable.

Beginning in 2001, Verizon Labs was restructured and no longer provides services to Verizon CA. As a result, on a prospective basis, any Labs' third party revenue gains or losses are no longer allocated to other Verizon entities.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed, and is not applicable on an ongoing basis. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $.0.203 M; 1997 – $0.114 M; 1998 – $0.199 M

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Ref No.	Issue: AGCS Payment and Billing Terms Page Reference: (12-8)
34	**Audit Recommendation:** GTEC should make AGCS' contract pricing with other customers available to complete the audit review of these expenses.

Verizon Position:

Verizon requested the AGCS contract pricing information requested by Larkin & Associates to complete the audit review of these expenses, but AGCS rejected the request. AT&T owned more than 80% of AGCS during the audit period. Today, Verizon owns less than 10%. Verizon has no control over AGCS and therefore, is not able to fill this request.

Both California and Federal law provide that a party may be required to produce in discovery only such records as are in the party's "possession, custody, or control." *See, e.g.,* Cal. Code Civ. Proc. §2031(a); Fed. Rule Civ. Proc. 34(a).

Status: Resolved.

The parties agree that Verizon made a good faith effort to obtain the requested third party prices or some demonstration that it paid AGCS the lower of cost or market. Verizon provided correspondence from AGCS that "under comparable conditions, charges for network switching products by AGCS to Verizon telephone operating companies are made at or below charges made to non-affiliated carrier customers." Because Verizon was unable to obtain the data, the auditors could not determine whether Verizon paid AGCS the lower of cost or market. The parties agree that the adjustments that Verizon agrees to reflect in its annual earnings filings (Issue 35) reflect AGCS costs. The parties agree that no further action is required.

This resolution should be adopted because the dispute was corrected to the parties' mutual satisfaction so that the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $.0.0 ; 1997 – $0.0; 1998 – $0.0

Ref No.	**Issue: AGCS Earnings** **Page Reference: (12-9)**
35 36	**Audit Recommendation:** ACGS return on investment was in excess of the Commission's authorized return for GTEC. The costs charged to GTEC by ACGS should be reduced by these excess charges. Financial Impact: 1996 – \$3.9M; 1997 – \$4.2M; 1998 – \$9.9M (Modified 1/4/02: 1996 - \$3.2M)

Verizon Position:

Verizon disagrees. First, the audit calculation used amounts that included transactions with third parties. CPUC pricing rules are not applicable to such transactions. Second, imputing earnings of non-regulated affiliates to Verizon CA income is inconsistent with NRF. Third, Verizon does not agree that 10.5% ROR should be used for 1996.

Status: Resolved.

Parties agree that 10.5% ROR will not be used in 1996. Because Verizon does not have a controlling interest in AGCS, Verizon was unable to obtain third party prices or some demonstration that it paid AGCS the lower of cost or market in conjunction with Issue (34). Verizon agrees to restate the annual earnings filings for 1996 – 2000 to reflect AGCS costs.

1) Verizon agrees to restate the annual 1996 – 2000 earnings filings to reflect annual expense overcharges (including depreciation expense) to Verizon CA of: 1996 - $.0.318 M; 1997 - $0.324 M; 1998 - $1.010 M; 1999 - $0.415 M; 2000 - $0.594 M; and
2) Verizon agrees to reflect cumulative rate base overcharges: 1996 - $0.184 M; 1997 - $0.631 M; 1998 - $1.390 M; 1999 - $2.318 M; and 2000 - $2.746 M.
3) Verizon agrees to make comparable earnings adjustments for 2001, 2002 and 2003 or until Verizon's ownership in AGCS drops below 5%. The parties agree that the historic adjustments and prospective application of this adjustment for AGCS are reasonable.

This resolution should be adopted because the dispute was corrected to the parties' mutual satisfaction so that the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment:

Expense: 1996 - $.0.318 M; 1997 - $0.324 M; 1998 - $1.010 M; 1999 - $0.415 M; 2000 - $0.594 M; (2001 – 2003) – TBD.

Rate Base: 1996 - $0.184 M; 1997 - $0.631 M; 1998 - $1.390 M; 1999 - $2.318 M; 2000 - $2.746 M; (2001 – 2003) – TBD.

Ref No.	**Issue: AGCS External Audit Workpapers** **Page Reference: (12-10)**
37 38 39	**Audit Recommendation:** GTEC should provide any information on any gains on the sale associated with AGCS as well as the Joint Venture Agreement between GTECS and AT&T. The Commission should order GTEC to provide the requested Coopers & Lybrand audit workpapers for AGCS. Financial Impact: None identified

Verizon Position:

AGCS is partly owned by GTE Communications Systems Corporation. Verizon California does not nor has it ever held an ownership interest in AGCS. Therefore, there is no reporting obligation on any gain from reducing the ownership interest in AGCS from 19.9% to 9.9% on June 30, 2000. Also, since Verizon-CA has no ownership interest in or control of AGCS, Verizon California has no authority to provide the requested Coopers & Lybrand audit workpapers.

Both California and Federal law provide that a party may be required to produce in discovery only such records as are in the party's "possession, custody, or control." *See, e.g.,* Cal. Code Civ. Proc. §2031(a); Fed. Rule Civ. Proc. 34(a).

Status: Resolved.

AGCS is partly owned by GTE Communications Systems Corporation, which reduced its ownership from 19.9% to 9.9% in June 2000. Verizon California does not have nor has it ever had an ownership interest in AGCS.

The parties agree that: 1) the auditors did not receive the requested workpapers; 2) Verizon made a reasonable effort to obtain the workpapers from AGCS but was unable to do so; and 3) in the future, Verizon will comply with FCC instructions regarding audit workpapers and provide internal memorialization in the event subcontract auditors are employed (Ref. No. 108).

This resolution should be adopted because the dispute was limited to the audit period, and was corrected to the parties' mutual satisfaction so that the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0.

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Ref No.	**Issue: GTE Leasing Corp. Cost/Market Studies** **Page Reference: (15-1 to 15-3)**
40 41	**Audit Recommendation:** GTEC should conduct market/cost studies to determine if fully distributed cost or market (in this instance prevailing price) is lower. GTEC should then be charged the lower of cost or market. Financial Impact: None identified

Verizon Position:

This recommendation is no longer applicable. GTE Leasing Corporation, now known as Verizon Credit Inc. ("VCI"), complied with Commission rules that required it to charge Verizon CA the lower of cost or market.

In September 1998, Verizon Finance began performing a semi-annual study that compared VCI rates with PHH Vehicle Management Services Corporation rates to determine that VCI monthly rates were lower. PHH is very competitive in the market and is the second largest company in the fleet leasing and administration business.

Attachment S to Verizon's response to NRF 17-2c demonstrated that over an 18-month period (9/98 to 2/00), VCI's lease rate was 27 to 55.5 basis points lower than PHH. As shown in Attachment S of NRF 17-2c, VCI's lease rate (i.e., cost of funds) was between 4.625% and 7.0% for that 18-month period. The fully distributed cost ("FDC") of a lease, based on the CPUC allowed ROR of 11.5% was considerably higher. Using the example provided in NRF 17-2c, the monthly payment to Verizon CA would have been $332.98 as compared to the $270.02 charge based on VCI's prevailing market rate.

Verizon continued to monitor VCI's rates against the market and FDC until February 2001, when Verizon CA ceased acquiring vehicles through lease arrangements. Prior to February 2001, there were no instances where an adjustment was required to meet the lower of FDC and market test. If VCI's rates had exceeded the market rate or FDC, Verizon would have adjusted its costs accordingly.

No new leases are being executed under this agreement and none are contemplated in the future. Therefore, no further market studies are necessary.

Status: Resolved.

This issue involves vehicle lease rates paid by Verizon California to its affiliate. Verizon provided information comparing rates charged by Verizon Credit Inc. (VCI, formerly GTE Leasing Corporation) to market rates and demonstrated that the rates charged during the audit period were reasonable. In September 1998, Verizon Finance began performing a semi-annual study that compared VCI rates with PHH Vehicle Management Services Corporation rates to determine that VCI monthly rates were lower. PHH is very competitive in the market and is the second largest company in the fleet leasing and administration business.

Verizon provided additional information that demonstrated that GTE Leasing's rates were lower than PHH's during the entire test period of 1996 –1998. Verizon also demonstrated that subsequent to the audit period, (9/98 to 2/00), VCI's lease rate was 27 to 55.5 basis points lower than PHH. VCI's lease rate (i.e., cost of funds) was between 4.625% and 7.0% for that 18-month period. The fully distributed cost ("FDC") of a lease, based on the CPUC allowed ROR of 11.5% was considerably higher. Using the example provided in NRF 17-2c, the monthly charge to Verizon CA would have been $332.98 as compared to the $270.02 charge based on VCI's prevailing market rate**.**

Verizon continued to monitor VCI's rates against the market and FDC until February 2001, when Verizon CA ceased acquiring vehicles through lease arrangements. Prior to February 2001, there were no instances where an adjustment was required to meet the lower of FDC and market test. If VCI's rates had exceeded the market rate or FDC, Verizon would have adjusted its costs accordingly.

Beginning February 2001, Verizon CA ceased acquiring vehicles through lease arrangements. No new leases are being executed under this agreement and none are contemplated in the future. The parties agree that no further action is required.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed, and is not applicable on an ongoing basis. No further Commission action is required.

Resolved Financial Adjustment: 1996 – $0.0; 1997 – $0.0; 1998 – $0.0.

Ref No.	Issue: GTEITS Cost/Market Studies Page Reference: (16-1 to 16-2)
42 43 44	**Audit Recommendation:** GTEC should conduct a market study comparing the prices GTEITS charges to those available from other IXCs at least once every two years. This formal study should demonstrate that the prices charged GTEC are set at the lower of cost or market. GTEC and GTEITS should develop a method for crediting GTEC for the recovery of GTEITS' expenses. Financial Impact: 1996 - ($.06) (audit report recommended no adj.); 1997 –$0.3M; 1998 – $0.01M

Verizon Position:

1) This recommendation is no longer applicable. Effective September 2001, The National Transport Network "NTN" Agreement was transferred to Verizon Data Services Inc (VDSI). VDSI meets the FCC 96-150 description of a corporate services company. This change in FCC 96-150 status eliminates the requirement for any further pricing studies. Consequently, all services are provided at FDC without any FCC requirement to make a lower of cost or market determination.

2) VDSI will issue a credit to all NTN customers, including Verizon CA for its pro rata share of the cumulative amount of over-recovered expenses.

Status: (42) Contested; (43) and (44) Resolved.

(42) Contested.

(43, 44) Verizon agrees to restate each of its annual 1996 – 2001 earnings filings by the following: 1996 – ($.063)M; 1997 - $.338M; 1998 - $.052M; 1999 - ($.009)M; 2000 - $.667M; 2001 - $.190M resulting in a cumulative $1.2 million expense reduction.

This recommendation should be adopted because the concern raised by the audit recommendation has been fully addressed, and is not applicable on an ongoing basis. No further Commission action is required.

Resolved Financial Adjustment: 1996- ($0.063)M; 1997 - $0.338M; 1998 - $0.052M; 1999 - ($0.009)M;
2000 - $0.667M; 2001 - $0.190M

VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES R.01-09-001/L.01-09-002

JOINT EXHIBIT OF VERIZON CALIFORNIA INC., OFFICE OF RATEPAYER ADVOCATES AND THE UTILITY REFORM NETWORK

Ref No.	**Issue: GTE Govt. Systems Gain on Sale** **Page Reference: (17-9)**
45 46 47	**Audit Recommendation:** GTE Government Systems Corporation was sold in 1999. Often commissions attribute gains on sales of assets to the regulated companies. The sale resulted in an after-tax gain of $514 million. Our estimate is based upon GTE Operating Companies accounting for between 1.5% and 2.7% of GTE Government Systems Corporation revenue (NRF 22-23). GTEC was approximately 0.34%. Financial Impact: None identified.

Verizon Position:

Verizon disagrees with the audit proposal to adjust Verizon CA's regulated books for the after- tax gain of $514 million for the sale of GTE Government Systems Corporation (GTEGS) in 1999. GTEGS was operated independently of Verizon CA and was not created to provide services to the fGTOCs. Furthermore, Verizon CA does not nor has it ever held an ownership interest in GTEGS.

The percentages in the recommendation are incorrect. The revenue percentages applied to sales to all fGTE affiliates – not just fGTOCs. The .34% represented all fGTOCs – not just Verizon CA. Furthermore, only $2K, $11K and $8K of Verizon CA's affiliate expense with GTEGS for 1996-98 were attributable to regulated operations. This represents .0008% or less of GTEGS revenues – a de minimis percentage. Thus, assuming an adjustment is appropriate, which it is not, applying that percentage to the gain would result in attributing only $4K of the $514M gain to Verizon CA's regulated telephone operations

Status: Resolved.

GTE Government Systems Corporation was an affiliate of GTE Corporation. It operated independently of Verizon California, which had no ownership interest in it. Verizon provided corrected information which demonstrated that, even if this recommendation were adopted, it would have even a smaller financial impact on California than the identified potential adjustment. The parties agree that no further action is required.

This resolution should be adopted because the dispute was limited solely to the sale of an affiliate which took place in 1999. Due to the very minimal impact of the recommended adjustment, resolution of this issue through litigation would divert resources from other issues and would serve no public interest. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0 M; 1997 - $0.0 M; 1998 - $0.0 M.

<table>
<tr><td>Ref No.</td><td>Issue: GTEDC Earnings
Page Reference: (18-3 to 18-6)</td></tr>
<tr><td>48
49
50</td><td>Audit Recommendation:
The amount of excess revenues earned by GTEDC associated with publishing activities for GTEC and Contel of California, Inc. should be used to increase the revenues of GTEC.
GTEC should conduct the necessary studies to demonstrate the price charged GTEC is the lower of market or fully distributed cost. Such studies should be conducted at least bi-annually.
Financial Impact: 1996 – $22.7M; 1997 – $ 6.2M; 1998 – $35.6M (Modified 1/4/02: 1996- $20.5 M)</td></tr>
<tr><td colspan="2">Verizon Position:

1) Verizon disagrees. Imputing non-regulated affiliate earnings to the Verizon CA regulated earnings is inconsistent with NRF.
2) The audit recommendation that studies be conducted twice a year to demonstrate the price charged Verizon CA is the lower of market or fully distributed cost would be administratively burdensome to implement and is unnecessary. First, the pricing of services provided by Verizon Directories Corp. (VDC) (formerly GTEDC) to Verizon CA in connection with the publishing agreement are reviewed by Verizon CA’s independent auditors periodically in connection with the FCC Cost Allocation Manual (“CAM”) audit. Currently, Verizon CA is required to obtain an attest examination or financial audit every two years, covering the prior two-year period of the CAM. Since these services are already reviewed for FCC purposes, no further study requirements are necessary. Second, Verizon CA’s financial reports are adjusted to account for FCC and CA affiliate pricing differences.</td></tr>
<tr><td colspan="2">Status: Contested.

This is a contested issue; however, the parties agree that, should the Commission adopt an earnings adjustment for 1996, an 11.5% ROR will be used in 1996. The adjustment in the audit report used 10.5% in 1996.</td></tr>
</table>

<table>
<tr><td>Ref No.</td><td>Issue: GTEDC Directory Contracts – New Technologies
Page Reference: (18-5 – 18-6)</td></tr>
<tr><td>51
52</td><td>Audit Recommendation:
GTEC should study alternative ways to construct the directories contract such that the impact of new technologies is considered.
Financial Impact: None identified</td></tr>
<tr><td colspan="2">Verizon Position:

Verizon disagrees. Verizon CA did not and does not provide human resources or financial resources to develop, produce, or publish the electronic directories developed and provided by Verizon Information Services Inc. (VIS), (formerly GTE Information Services). Verizon CA faces no risk related to the electronic directories product and has no obligation to reimburse VIS if the product loses money (as is the case for the years under study). In short, Verizon CA is not involved with this product in any way and is not entitled to participate in revenues, if any are generated.</td></tr>
<tr><td colspan="2">Status: Contested.</td></tr>
</table>

Ref No.	Issue: GTECC Market/Cost Studies Page Reference: (19-1 to 19-3)
 53 54 55 56	**Audit Recommendation:** We recommend that the Commission order GTEC to have such a study conducted at least once every two years. We recommend that the contract be updated to reflect the fully loaded labor rate charged, until such time that a study is prepared to determine which is lower, fully distributed cost or market. After the study is conducted, the agreement should reflect the lower of the two costs. Financial Impact: None identified

Verizon Position:

At the time of contract execution, there was no vendor in the market that performed PIC management services based on industry standards. Therefore, a comparison of Verizon Select Services Inc.'s (VSSI) (formerly GTECC) fully distributed cost to a market rate could not be completed and fully distributed cost was used. Subsequently in 2000, NeuStar, Inc. announced its comprehensive solution for managing Customer Account Record Exchange transactions, which created a market rate for comparison purposes. Now that a market rate is available Verizon is in the process of amending the contract, which will reflect the lower of fully distributed cost or market value. Future pricing compliance will be addressed at contract term expiration.

Status: Resolved.

At the time of contract execution, there was no vendor in the market that performed PIC management services based on industry standards. Therefore, a comparison of Verizon Select Services Inc.'s (VSSI) (formerly GTECC) fully distributed cost to a market rate could not be completed and fully distributed cost was used. Subsequently in 2000, NeuStar, Inc. announced its comprehensive solution for managing Customer Account Record Exchange transactions which created a market rate for comparison purposes. Now that a market rate is available Verizon is in the process of amending the contract, which will reflect the lower of fully distributed cost or market value. Future pricing compliance will be addressed at contract term expiration.

Verizon commits to completing a study and updating the contract by the end of 1Q02. Verizon also agrees to provide ORA with a copy of the study and amended contract when they become available.

A Verizon produced document titled "Affiliate Transaction Pricing Guideline for Transactions Between Verizon Incumbent Local Exchange Carriers and Verizon Non-Regulated Affiliates" provides guidance in determining permissible transactions between Verizon ILECs and non-regulated affiliates and sets forth the FCC and State pricing requirements for these transactions. The Guideline also provides direction on determining the applicable transaction price and identifies responsibility ensuring requirements are met. In producing this document, Verizon incorporated input from ORA's auditors. The parties reached a mutually agreeable position regarding the study frequency to be used on a prospective basis and incorporated it into the document.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. Completion of the required work and submission of the requested information will demonstrate compliance with affiliate pricing rules on an ongoing basis. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Wholesale Service Agreement – Voice Messaging** **Page Reference: (21-3)**
57 58 59	**Audit Recommendation:** We question the reasonableness of the rate charged due to the lack of documentation. The rate offered to other CLECs is a national offering and may not have been a negotiated rate. The Commission should order GTEC to reconstruct wholesale voice messaging rates for 1996- 1998 since supporting documentation could not be located. Financial Impact: None identified

Verizon Position:

Verizon disagrees with the recommendation to reconstruct wholesale voice messaging rates for 1996 – 1998 for the following reasons:

1) The rates for 1996-1998 are no longer applicable.
2) During the audit period the Commission issued D.98-10-020 (R.95-04-043/I.95-04-044) on 10/08/98 which found that resale of voicemail at a discounted rate is not mandated.
3) No wholesale voice mail tariff should exist.
4) The Commission found that Verizon CA offered "wholesale" voice mail a) via contract to CLCs at retail tariff rates, and b) as a residual service directly to CLC end users via tariff where the CLC provides lines via resale.

Status: Resolved.

Verizon provided the auditors with copies of affiliate and non-affiliate CLEC contracts that demonstrated that the same discount plans were offered in a non-discriminatory manner during the audit period. The parties agree that no further action is required.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. The documentation is consistent with D.98-10-020 which found that resale of voice messaging at discounted rates is not mandated. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Remittance Processing** **Page Reference: (21-4 – 21-7)**
60 **61**	**Audit Recommendation:** The amount charged to GTECC is understated for the difference between 11.25% and 11.5% allowed by the CPUC. Pricing is not adequately supported by a study showing that FDC is higher than market value.

Verizon Position:

Verizon disagrees. These recommendations are no longer applicable because remittance processing has not been provided by Verizon CA since April 1999.

1) The amount charged to GTECC included an ROI component of 11.50% in the shared asset cost, not 11.25% as the audit report notes. The 11.50% return included in the shared asset loading for all three years was documented in response to NRF 4-30, Attachment U, Tabs 9 and 10.

2) Verizon did provide adequate support. Remittance processing services were not provided to GTECC until late December 1997. No adjustment was necessary on the 1997 books of account for December 1997 transactions, as billing did not occur until 1998. GTECC was billed $56.17 in January 1998 for December 1997 transactions, using a preliminary rate. The preliminary 1997 rate was also used in billing GTECC early in 1998, and an adjustment was made before year-end 1998 to reflect the final rate. This is appropriate under accrual basis accounting. The 1998 FDC calculation of the final rate was provided in response to NRF 6-7, Attachment AC, and NRF 16-3. 274 transactions were processed in December 1997 for GTECC. Using the $.3067 recalculated unit price, the bill totaled $84.04, an immaterial difference of $27.87 for the 1997 activity. The fully distributed cost for remittance processing services provided to GTECC in 1998 was provided in response to NRF 6-7, Attachment AC, and supplemented by back-up documentation for the calculation in response to NRF 16-3.

   In addition, a 1997 market study provided by Frost & Sullivan, a leader in market research and consulting in the telecommunications industry, included a market analysis of the remittance processing service. Two of the vendors surveyed by Frost & Sullivan provided rates for this service. Exhibit 21-6, Page 19, of the Larkin & Associates report contains an excerpt of this market study, which includes the market rates for this service. The first vendor's price range of $.0095-$.0065 per payment was far below the $.3067 price charged to GTECC by GTEC. The second vendor's price range was $25 to $28 per hour. Converting the $.3067 per payment rate to an hourly rate, using the previously provided supporting data, resulted in an FDC hourly rate of $27.42, which is within the vendor's hourly price range.

Status: Resolved.

The issue relates to the amount charged to GTECC for remittance processing services provided by Verizon California. Verizon produced a study which demonstrated that the amount charged to GTECC used an 11.5% ROR as required.

Also, Verizon provided support that the rates charged to GTECC were the higher of cost or market. A 1997 market study provided by Frost & Sullivan, included a market analysis of the remittance processing service. Two of the vendors surveyed by Frost & Sullivan provided rates for this service. The first vendor's price range of $.0095-$.0065 per payment was far below the $.3067 FDC price charged to GTECC by GTEC. The second vendor's price range was $25 to $28 per hour. Converting the $.3067 per payment rate to an hourly rate, using the previously provided supporting data, resulted in an FDC hourly rate of $27.42, which is at the high end of the vendor's hourly price range.

Verizon California ceased providing remittance processing to GTECC in April 1999.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: Remittance Processing - Service Bureau Page Reference: (21-7)
62 63	**Audit Recommendation:** Supporting documentation for the allocation factor used to remove these costs from GTEC to the Service Bureau is unsupported. Financial Impact: 1996 – NA; 1997 - $0.4 M (allocation); 1998 - $0.02 M (allocation)

Verizon Position:

Verizon disagrees with the proposed adjustments related to costs removed from GTEC's books because sufficient expenses were allocated from Verizon CA to cover the billings. Workpapers supporting billed amounts were provided to the auditors in response to NRF 6-18(d), NRF 6-18(f), NRF 12-47 and NRF 15-19. Workpapers supporting allocated amounts were also provided in response to NRF 15-23. The FDC calculation and market study were provided to the auditors. Verizon's analysis shows the FDC to be higher than fair market value. The amounts GTEC allocated to Service Bureau for this service for 1997 and 1998 exceeded the billed amounts to the affiliated and nonaffiliated companies for these years. As such, Verizon does not agree that the 1997 adjustment of $0.4 million and the 1998 adjustment of $0.02 million are appropriate.

Status: Resolved.

Verizon demonstrated through workpapers provided to the auditors that the amounts Verizon CA allocated to Service Bureau for this service in 1997 and 1998 exceeded the billed amounts to the affiliated and non-affiliated companies for these years. The parties agree that no adjustments are appropriate.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: CATV Pole and Conduit Agreements** **Page Reference: (21-8 – 21-9)**
64 65 66	**Audit Recommendation:** We find that during 1996 and 1997, GTEC did not conform to the Commission's affiliate pricing standards. The prices charged GTEMV appear to be lower than market price based upon the price charged CLECs in 1998. We recommend that the Commission require GTEC to charge GTEMV the same price that it charges unaffiliated CLECs. The price negotiated between GTEC and unaffiliated CLECs should represent the fair market value for these services. Financial Impact: 1996 - \$.1 M; 1997 - \$1.2 M; 1998 – NA

Verizon Position:

Verizon disagrees with the recommendation that higher poles/conduit rates be charged to its affiliate, Media Ventures. Media Ventures is a wholly owned subsidiary of Verizon Communications which is in the business of providing cable TV service. It does not provide telecommunications service and does not hold an operating certificate from the Commission to do so.

The pole attachment rate charged to Media Ventures is the tariffed pole attachment rate of $2.92 per attachment per year which is the applicable rate charged to all other cable television companies. This rate was established exclusively for cable television companies pursuant to Public Utilities Code section 767.5 and was approved by the Commission. Since Media Ventures provides cable service, not telecommunications service, this rate is proper both historically and currently.

The audit's recommendation on applying the higher rate of $3.70 per attachment per year to Media Ventures is inappropriate and is in violation of Verizon's tariff. The $3.70 rate was a negotiated rate between Verizon California and the CLCs pursuant to the authority provided in the 1996 Telecommunications Act and this Commission's right-of-way decision, D.98-10-058. This rate is contained in interconnection agreements entered into pursuant to section 251 of the Act and is available for adoption by any CLC. Since Media Venture is not a CLC, they should not be charged a CLC rate.

With respect to the issue of the charges for conduit space, during 1996 and 1997, Media Ventures was appropriately charged rates that were identical to those charged other cable companies. The rate of $0.40 per linear foot of duct space was the market rate for the cable companies at that time, hence, the same rate was charged to Media Ventures. Beginning in 1998, CATV companies who entered into new conduit agreements were charged the $1.40 for sub-duct space and $3.50 for conduit space and Media Ventures was charged accordingly.

The rates charged to Media Ventures during 1996 and 1997 for poles/conduit space were appropriate and were in compliance with the tariff and/or consistent with the treatment of all other cable companies. Therefore, no adjustment should be made for this issue.

Status: Resolved

Verizon's affiliate, Media Ventures, is a wholly owned subsidiary of Verizon Communications which is in the business of providing cable TV service (CATV). It does not provide telecommunications service and does not hold an operating certificate from the Commission to do so.

The pole attachment rate charged to Media Ventures is the tariffed pole attachment rate of $2.92 per attachment per year which is the applicable rate charged to all other CATV companies. This rate was established exclusively for CATV companies pursuant to Public Utilities Code section 767.5 and was approved by the Commission in Resolution T-15603.

The higher rate recommended in the audit report is a negotiated rate between Verizon California and the CLCs pursuant to the authority provided in the 1996 Telecommunications Act and this Commission's rights-of-way decision, D.98-10-058, which holds that rates negotiated by CLCs may differ from the tariffed rates charged to CATV companies under PU Code sections 767 et. seq.

With respect to the issue of the charges for conduit space, during 1996 and 1997, Media Ventures was charged rates that were identical to those charged other CATV companies. The rate of $0.40 per linear foot of duct space was the market rate for the cable companies at that time, hence, the same rate was charged to Media Ventures. Beginning in 1998, CATV companies who entered into new conduit agreements were charged the $1.40 for sub-duct space and $3.50 for conduit space and Media Ventures was charged accordingly. In addition, beginning 2001, all companies using conduit space were charged the same prices that CLECs are charged.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. The rates charged Media Ventures conform with the tariffs, Commission decisions and statutes cited above. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES
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JOINT EXHIBIT OF
VERIZON CALIFORNIA INC., OFFICE OF RATEPAYER ADVOCATES AND
THE UTILITY REFORM NETWORK

<table>
<tr><td>Ref No.</td><td>Issue: Bill Distribution
Page Reference: (21-10 – 21-12)</td></tr>
<tr><td>
67
68
69</td><td>Audit Recommendation:
During 1997, GTE CLEC and Media Ventures were undercharged. This resulted from a preferential rate that did not include overhead loadings. GTEC did not provide sufficient workpapers showing how the per-unit prices were developed and could not locate documentation showing that it had allocated off the books of GTEC costs related to bill distribution services for GTE CLEC and GTE Media Ventures.
While these amounts are small, the Commission must keep in mind that the volumes for both of these affiliates should increase considerably.
Financial Impact: 1996 – NA; 1997 - $0.1 M; 1998 - $0.05 M</td></tr>
<tr><td colspan="2">Verizon Position:

The audit found that the amounts were de minimis but should be reviewed by the Commission because of possible future volume growth. Since bill distribution ceased to be provided after April 1999, volume growth will not be experienced.</td></tr>
<tr><td colspan="2">Status: Resolved.

The audit report found the amount of undercharging was de minimus but should be reviewed due to the possibility of volume growth. Because Verizon no longer provided bill distribution after April 1999, the recommendation is no longer applicable and the parties agree that no adjustments will be made.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed, and is not applicable on an ongoing basis. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.</td></tr>
</table>

VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES
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JOINT EXHIBIT OF
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Ref No.	Issue: Affiliate Pricing Compliance, Work Paper Retention and FDC/Market Rate Comparison Page Reference: (21-12, 21-36)
	Audit Recommendation: The auditors recommend that the Commission instruct GTEC to:
70	Retain all workpapers associated with pricing services to its non-regulated affiliates;
71	Develop written policies and procedures for pricing services to its non-regulated affiliates;
72	Where applicable, develop a consistent approach to pricing services to its affiliates; and
73	Conduct extensive market studies for each service provided to an affiliate at least once every two years. The studies should contain a detailed explanation of how the prices were determined and should compare them to the prices charged GTEC's affiliates.
74	Use actual times for work tasks, not estimates. This could be accomplished through time and motion studies.

Verizon Position:

Verizon disagrees in part with this Finding. Verizon maintains the core documentation supporting its affiliate pricing transactions consistent with its retention policy. Core documentation is defined as the first level of backup.

1) Verizon is in the process of reviewing and revising its record management policy which will standardize the current practices and procedures of the former Bell Atlantic and GTE companies. Consistent with its records management policy and retention schedule, Verizon retains all core workpapers associated with affiliate services. Verizon's retention policy during the audit period provides guidelines to retain back-up for journal entries and other general ledger transactions. This would include the entries to bill non-regulated affiliates for services provided and to remove the expenses from the regulated books. The policy is to retain such documentation permanently.
2) A thorough review of and analysis of Verizon's current practices and procedures for pricing affiliate transactions is underway. Verizon is developing affiliate transaction pricing guidelines which will standardize the current practices and procedures of the former Bell Atlantic and GTE companies.
3) Verizon uses a consistent approach to pricing services to its affiliates, with some exceptions. It is sometimes necessary to base the pricing of new services on estimates of handling time and forecasted costs and units. As units are tracked and costs and handling times measured, the pricing can be further refined to include actual handling time and costs. For this reason, calculations may vary from year to year as pricing models are improved and costs are more accurately refined. And while Verizon's consistent approach is to price affiliate services at the higher of FDC and fair market value, pricing models may vary by service to accurately reflect the activity, processes and costs of each.
4) As noted, Verizon is developing affiliate transaction pricing guidelines and intends to follow them with regard to the frequency of conducting market studies and the comparison of FDC to market prices. Verizon agrees that the FDC of services should be compared to fair market value to determine which is higher. Generally, company personnel conduct the FDC to FMV comparison. Some examples of alternative available resources for market information include the Internet (e.g. Salary.com, Loopnet.com), published reports (e.g. Black's Guide), and commercial surveys. Some services may require more frequent studies and some services may be studied less frequently to coincide with regulatory reviews such as FCC CAM audits. External market research companies are a more costly alternative. If external market research firms are hired to conduct market studies in the future, Verizon will not provide the FDC costs to the research firm in advance of the independent market study being completed in order to avoid compromising the independent results of the analysis.
5) Verizon conducts time studies for affiliate services whenever handling time is the primary basis of prices charged. Time studies are conducted in phone marts, CCCs and Branch offices. Affiliate Billing requests the channels to perform these studies and surveys on an annual basis for major affiliate billings.

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Status: Resolved.

Verizon provided a copy of its affiliate transaction policy and affiliate pricing guidelines to the parties and agrees to incorporate all of the audit report's recommended changes including the definition of "workpapers" to be retained that the parties agreed to.

A Verizon document titled "Affiliate Transaction Pricing Guideline for Transactions Between Verizon Incumbent Local Exchange Carriers and Verizon Non-Regulated Affiliates" provides guidance in determining permissible transactions between Verizon ILECs and non-regulated affiliates and sets forth the FCC and State pricing requirements for these transactions. The Guideline also provides direction on determining the applicable transaction price and identifies responsibility ensuring requirements are met. In producing this document, Verizon incorporated input from ORA's auditors. The parties reached a mutually agreeable position regarding the study frequency to be used on a prospective basis and incorporated it into the document.

This resolution should be adopted because Verizon has complied with the audit recommendations and agrees to utilize the documentation as a reference in applying the affiliate transaction policies and pricing addressed in the documentation. This will insure that the affiliate pricing and policies are clearly stated, easily monitored, and in compliance with California requirements. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: GTE Wireless Service Agreemen Page Reference: (21-13)
75 **76** 77	**Audit Recommendation:** We recommend that the Commission order GTEC to conduct a study containing a detailed explanation of how the prices were determined and should also compare them to the prices charged GTE Mobilnet. The price charged GTEMN should be the $.335 per call for the three-year term, not the $0.325 for the five-year term. GTEC has not provided any rationale for charging its affiliate less than the rates set forth in the contract. Financial Impact: 1996 – NA; 1997 - $0.1 M; 1998 - $0.1 M

Verizon Position:

The recommendation is no longer applicable because the Star Information Service Agreement has been terminated.

1) Verizon CA outsourced this service from Excel in 1997-1998. Information from a study conducted by Phillips InfoTec (July 30, 1999) shows that the rates charged to Verizon Wireless (VZW) (formerly GTE Mobilnet) were fair market rates. Verizon also noted that the rates charged VZW were higher than the rates Verizon CA would have been charged by Excel in 1999.

2) In January 1997, the three-year term of the contract had expired. An amendment was added to the agreement increasing the calling area, extending the contract term, and applying the five-year term rates which were lower than the original three-year term rates.

3) The adjustments are not appropriate.

Status: Resolved.

Verizon provided the auditor with a copy of a non-affiliate contract that demonstrates that prices charged GTE Wireless are in line with prices charged non-affiliates. The parties agree that no further action is required.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Other Services Provided by GTEC** **Page Reference: (21-14)**
78	**Audit Recommendation:** When asked to provide market studies and fully distributed cost studies, GTEC provided a description of how its labor rates were loaded (NRF 6-5, Attachment AJ-5).
Verizon Position: This finding relates to NRF 6-12, not 6-5. The company's response to NRF 6-12 indicated that fully distributed cost for this service was based on actual costs incurred in dedicated work centers, not on a cost study. Each month the actual costs were extracted from the books of record and loadings were applied. Attachment AJ-5 described the loading calculations. Attachment AI-5 was an excerpt from the Frost & Sullivan Market Study, which gave market rates for the services.	
Status: Resolved. Verizon demonstrated that Technician Services are provided under the terms of the union contract, thus no cost or market study was required. The parties agree that no further action is required. This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.	

Ref No.	**Issue: Advertising and Telemarketing Charges to GTELD** **Page Reference: (21-34)**
79 80	**Audit Recommendation:** The auditors could not locate any documentation on how GTELD was charged for advertising and telemarketing during 1996 and 1997. A combined $2.5 million adjustment incorporated a 20% overhead rate and a 10% mark-up because GTEC did not demonstrate that FDC was higher than FMV. Financial Impact: 1996 - $1.6 M; 1997 - $.9 M; 1998 – NA

Verizon Position:

Advertising and Telemarketing are no longer provided to GTELD by Verizon.

These services were included in the services provided under the Sales and Marketing Agreement, and the method of charging was described in response to NRF 17-1.

With regard to this specific application of the 10% mark-up, these services were performed by outside vendors, for which Verizon CA paid a market rate that it, in turn, billed to GTELD for its portion. Verizon CA's cost was the same as the market rate and no market study was required to prove this.

Status: Resolved.

Verizon provided documentation that demonstrated that it used outside professional agencies for these services. The fully distributed cost of a vendor-paid expense is the amount of payment. Overhead loadings are not applicable in this case. The parties agree that Verizon did comply with the Commission's pricing standards, that a 10% markup is not applicable, and that no adjustments are appropriate.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: General Marketing Services Provided to Affiliates Page Reference: (21-36)
81 82 83	**Audit Recommendation:** The audit report found that the prices charged GTELD are inconsistent with the prices set forth in the signed agreement for the marketing functions performed by GTEC on GTELD's behalf. The Commission should require GTEC to modify its agreement with GTELD and file a new agreement (including all attachments) with the Commission. Financial Impact: None identified.

Verizon Position:

1) The agreement signed in April 1996 for the marketing functions performed by fGTOCs on GTELD's behalf were based on a rate to be charged per minute of use (MOU). There was an additional MOU rate for incremental growth over the MOU base for Year One of the Agreement. In Year One, the total compensation was to be the higher of the compensation calculated under this method or $20,000,000. In 1996 the services were primarily advertising services provided by vendors and paid by fGTE North, which allocated each fGTOC its share of the expense. In addition, there were telemarketing services provided by outside vendors, who were paid by fGTEC, and a small number of services provided in CCCs and Phone Marts.

During 1996, as costs were tracked to provide the services above, the rate initially agreed upon was found to be lower than fully distributed cost. An adjustment was made in December 1996 to true up the amount charged year-to-date, by recording an accrual for the unbilled fully distributed cost. The accrued amount of $44 million for total fGTOCs was billed to GTELD in January 1997. Total billed to GTELD for 1996 services was $57 million, of which $8.8 million was the fGTEC's portion. Thereafter, rates were established for each marketing function based on the higher of fully distributed cost or fair market value of that service. This was explained in response to NRF 17-1.

2) Verizon modified its agreement with GTELD in 1999 and continues to update the statements of work and related pricing on an annual basis, whenever possible, to ensure compliance with CPUC and FCC affiliate pricing standards. There is currently no requirement to file affiliate agreements with the Commission and Verizon does not recommend that the Commission adopt such a requirement.

Status: Resolved.

The agreement with GTELD signed in April 1996 for the marketing functions performed by fGTOCs on GTELD's behalf were based on a rate to be charged per minute of use (MOU). During 1996, as costs were tracked to provide the services above, the rate initially agreed upon was found to be lower than fully distributed cost. An adjustment was made in December 1996 to true up the amount charged year-to-date, by recording an accrual for the unbilled fully distributed cost. Thereafter, rates were established for each marketing function based on the higher of fully distributed cost or fair market value of that service.

Verizon modified its agreement with GTELD in 1999 and continues to update the statements of work and related pricing when appropriate to ensure compliance with CPUC and FCC affiliate pricing standards. Verizon provided a copy of 1999 agreement to the auditors.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

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Ref No.	**Issue: 20% General and Administrative Overhead Rate** **Page Reference: (21-5, 21-15, 21-19, 21-24, 21-25, 21-27,21-31 – 21-34)**
 84 85	**Audit Recommendation:** We recommend using a 20% overhead rate in calculating charges to affiliates. Financial Impact: This specific recommendation was not explicitly quantified for 1996, 1997 or 1998. (Modified 1/4/02: 1996 - $.014M; 1997 - $.417M; 1998 - $.266M)

Verizon Position:

As noted in the documentation provided in response to NRF 12-45, Verizon re-calculated its G&A overhead rate and applied 20% in 1999 and 2000 affiliate billings. G&A overhead rates will be calculated at least biennially on an ongoing basis.

Verizon accepts the corrections related to using a 20% G&A overhead rate to affiliate billings through 2000 except that it is not applicable in the case of advertising and marketing expenses charged to GTELD during 1996 and 1997 because these were vendor costs (i.e., no incurred labor was involved).

Status: Resolved.

Verizon agrees to restate each of the annual 1996 – 1998 earnings filings to reflect the annual adjustments of 1996 - $.014M; 1997 - $.417M; 1998 - $.266M. Verizon re-calculated its G&A overhead rate and applied 20% in 1999 and 2000 affiliate billings. G&A overhead rates will be calculated at least biennially on an ongoing basis.

The parties agree that use of a 20% G&A overhead rate is not applicable in the case of advertising and marketing expenses charged to GTELD during 1996 and 1997 because these were vendor costs (i.e., no incurred labor was involved).

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.014 M; 1997 - $0.417 M; 1998 - $0.266 M.

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Ref No.	**Issue: IPT Rate** **Page Reference: (21-19, 21-24, 21-31, 21-32)**
 86 87	**Audit Recommendation:** Use an IPT rate of 17.75% in 1997 instead of 22.81%. Financial Impact: This specific recommendation wasnot explicitly quantified for 1996, 1997 or 1998. (1/4/02 modified impact is contained in Ref. No. 85)

Verizon Position:

Verizon disagrees. Verizon has consistently applied an IPT rate that was calculated using prior year's actual financial results for current year analysis. The audit recommendation proposed to use the rate of 17.75% which was calculated early in 1998, using 1997 actual financial results, for 1997 affiliate billing. From a practical and prospective basis, the audit recommendation is not even feasible because each year's factor cannot be calculated and applied until after the current year's financial records are closed.

Status: Resolved.

Verizon provided supporting documentation for its use of a 22.81% IPT rate. The parties agree that no adjustment is appropriate.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: 10% Mark-up** **Page Reference: (21-19, 21-24, 21-25, 21-27,21-31 – 21-34)**
88 89	**Audit Recommendation:** Where the auditors could not find information showing that the price charged GTEC's affiliates was at the higher of fully distributed cost or market, the auditors recommend that a 10% mark-up be added to the price. Financial Impact: This specific recommendation was not explicitly quantified for 1996, 1997 or 1998, but was part of several recommendations to marketing services provided to affiliates. The financial impact of this issue only was subsequently calculated to be: (Modified 1/4/02: 1996 - $.007M; 1997 - $.208M; 1998 - $.186M)

Verizon Position:

Verizon disagrees. Verizon CA has consistently made a good faith effort to comply with the Commission's affiliate pricing guidelines and to price services provided to non-regulated affiliates at the higher of fully distributed cost or fair market value. Application of a penalty is not appropriate.

For some examples identified in the audit, Verizon did demonstrate that studies had been conducted and that fair market value/FDC comparisons could be determined. In some cases, Verizon had accepted its independent consultant's conclusion that, at the time a study was attempted, no comparable market existed upon which to base a market rate comparison. In other instances, Verizon made reasonable conclusions based on prior analysis and did not conduct consecutive studies.

FCC 96-150 set a baseline for a "good faith" determination of fair market value by requiring carriers to use methods that are routinely used by the general business community. Depending on the type of transaction, examples of methods for determining fair market values for both assets and services include independent valuation methods, appraisals, catalogs listing similar items, competitive bids, replacement cost of an asset and sales to third parties. Consistent with this regulatory guidance, Verizon makes a good faith determination of fair market value either by requesting outside market studies or commercial surveys or by conducting internal research using the Internet (e.g. Salary.com, Loopnet.com) and published reports (e.g. Black's Guide).

The 10% mark-up is particularly not applicable in the case of advertising and marketing charged to GTELD during 1996 and 1997 (Ref. No. 79).

Status: Resolved.

To resolve auditor concerns about the adequacy of pricing studies for certain transactions, Verizon agrees to restate each of the annual 1996 – 1998 earnings filings to reflect annual adjustments of 1996 - $.004M; 1997 - $.104 M; 1998 - $.093 M.

In addition, the parties reached a mutually agreeable position regarding the study frequency to be used on a prospective basis and incorporated it into a Verizon document titled "Affiliate Transaction Pricing Guideline for Transactions Between Verizon Incumbent Local Exchange Carriers and Verizon Non-Regulated Affiliates."

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.004 M; 1997 - $0.104 M; 1998 - $0.093 M.

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Ref No.	**Issue: Affiliate Pricing Compliance** **Page Reference: (21-36)**
90 91	**Audit Recommendation:** We find that GTEC did not conduct adequate studies to determine if the price it charged affiliates was at the higher of fully distributed cost or market. While it did commission Frost & Sullivan to examine some services in 1997 and 1998, not all services provided to non-regulated affiliates were examined. In addition, no studies were undertaken for 1996.

Verizon Position:

Verizon disagrees.

FCC 96-150 set a baseline for a “good faith” determination of fair market value by requiring carriers to use methods that are routinely used by the general business community. Depending on the type of transaction, examples of methods for determining fair market values for both assets and services include independent valuation methods, appraisals, catalogs listing similar items, competitive bids, replacement cost of an asset and sales to third parties. Consistent with this regulatory guidance, Verizon makes a good faith determination of fair market value either by requesting outside market studies or commercial surveys or by conducting internal research using the Internet (e.g. Salary.com, Loopnet.com) and published reports (e.g. Black’s Guide).

In 1996 all affiliate services were billed at FDC under FCC 86-111. The affiliate contracts were with fGTE Southwest, and the services were billed by fGTE Southwest, not by Verizon CA. The costs for those services performed in Verizon CA were moved or allocated under terms of the Operating Agreement to fGTE Southwest at FDC.

In 1997 and 1998, Frost & Sullivan, an independent market research company, was commissioned to conduct market studies. Frost & Sullivan based their determination on 1) a description of the service provided by Jurisdictional Accounting Compliance and 2) the results of their survey of the marketplace. The participating companies in their surveys are listed in their reports. For certain unique or comprehensive services, Frost & Sullivan attempted a market study but could not find a comparable market for the service. Frost & Sullivan concluded in such instances that a market rate was not available.

Status: Resolved.

A Verizon document titled “Affiliate Transaction Pricing Guideline for Transactions Between Verizon Incumbent Local Exchange Carriers and Verizon Non-Regulated Affiliates” provides guidance in determining permissible transactions between Verizon ILECs and non-regulated affiliates and sets forth the FCC and State pricing requirements for these transactions. The Guideline also provides direction on determining the applicable transaction price and identifies responsibility ensuring requirements are met. In producing this document, Verizon incorporated input from ORA’s auditors. The parties reached a mutually agreeable position regarding the study frequency to be used on a prospective basis and incorporated it into the document.

This resolution should be adopted because Verizon has complied with the audit recommendations and agrees to utilize the documentation as a reference in applying the affiliate transaction policies and pricing addressed in the documentation. This will insure that the affiliate pricing and policies are clearly stated, easily monitored, and in compliance with California requirements. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: Asset Transfers Page Reference: (21-38)
92 93 94 95	**Audit Recommendation:** GTEC undertook no independent study to assess the market value of the assets sold to its unregulated affiliates at the higher of cost (net book value) or market. We recommend that the Commission require GTEC to transfer assets to its unregulated affiliates at the higher of cost or market. We recommend that the Commission require that the unregulated affiliates transfer assets to GTEC at the lower of cost or market. Financial Impact: None identified

Verizon Position:

Verizon agrees with the recommendations to the point that market based pricing studies should be conducted for unregulated affiliates whose aggregated billing exceed $100,000 per year or as requested by the California Public Utilities Commission.

The audit report did not identify any circumstances in which Verizon CA failed to properly price those non-tariffed goods and services received from unregulated affiliates. Verizon acknowledges the California Public Utilities Commission requires unregulated affiliates transfer assets to Verizon CA at the lower of cost or market.

The following policies were updated in 2000 to address these concerns:

1) GTE Service Corporation Financial Policies and Standards (FPSP) number H-517 on Transfer of Supporting Assets was updated March 13, 2000.

2) GTE Service Corporation Financial Policies and Standards (FPSP) number H-504 on Transfer and Removal of Capital Equipment was updated March 6, 2000.

Status: Resolved.

Verizon provided two policies which reflect the audit recommendation: 1) GTE Service Corporation Financial Policies and Standards (FPSP) number H-517 on Transfer of Supporting Assets, dated March 13, 2000; and 2) FPSP number H-504 on Transfer and Removal of Capital Equipment dated March 6, 2000. The parties agree that no further action is required.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

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Ref No.	**Issue: Leases to Affiliates** **Page Reference: (23-1)**
96 97 98 99	**Audit Recommendation:** The audit found that leases of office space to affiliates of GTEC are required to be accomplished through 851 filings. It was discovered that GTEC was leasing office space to GTEDS and GTECC without a lease agreement in place. If GTECC was not being charged, GTEC will take corrective action and keep the Commission informed (NRF 19-88). Because of this oversight, GTEC must amend its 851 Application to take into consideration these two situations, which were not initially addressed in A.99-10-010. Financial Impact: None identified.

Verizon Position:

Verizon concurs. The audit identified two affiliate arrangements which were not documented by leases – one with GTE Communications Corporation and one with GTE Data Services.

> Regarding the GTECC employees at 2801 Townsgate, Verizon CA could not locate a lease or proof of payment for the office space. Therefore, GTE executed a retroactive sublease with GTECC for the space. The payment has been paid in full and the GTECC employees are no longer occupying the space.

> Regarding the GTEDS employees, Verizon CA determined that there was no lease or payment arrangement in place for the GTEDS employees at One GTE Place. Verizon CA has discussed including GTEDS employees in the shared asset methodology with the Commission, and they have agreed that it would be a reasonable approach.

Verizon has a pending application (A. 99-10-010) seeking approval of a number of existing leases pursuant to Public Utilities Code section 851, and also seeking approval of its shared asset methodology. This matter, filed October 6, 1999, has been pending since December 1999 to await the results of this audit with respect to the shared asset methodology. Verizon proposes to amend the application to include these arrangements in January 2002.

Status: Resolved.

Verizon provided copies of its booked entries demonstrating that the lease was paid in December 2001. In addition, Verizon agrees to amend its pending 851 application.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. Verizon has a pending application (A. 99-10-010) seeking approval of a number of existing leases pursuant to Public Utilities Code section 851, and also seeking approval of its shared asset methodology. This matter, filed October 6, 1999, has been pending since December 1999 to await the results of this audit with respect to the shared asset methodology. Verizon proposes to amend the application to include these arrangements in January 2002. Any outstanding issues which may exist should be addressed in that proceeding. No further Commission action is required here.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

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Ref No.	Issue: Cost Allocation Manuals Page Reference: (24-6)
100 101 102	**Audit Recommendation:** The auditors did not understand why the ICAM is considered a confidential document. The auditors' concluded that it is reasonable that the allocation factor study be conducted biannually <u>except</u> if a significant new non-regulated offering is added or an existing service deregulated, a study should be prepared in the intervening year to ensure that costs are properly allocated. The audit recommended that the ICAM should be filed with the Commission along with the CAM as part of the monitoring report program.

Verizon Position:

1) The recommendations related to the ICAM will no longer be applicable because a business decision was made to eliminate production of the ICAM effective January 1, 2002. The Verizon-wide CAM was filed with the FCC in November 2001 and became effective January 1, 2002.

2) Study update frequencies (biennial) were agreed to between the Company and the FCC. The update frequency considered changes that could occur, including changes in product and service offerings, both regulated and non-regulated, and other operational changes which affect activity in both regulated and non-regulated accounts. Study update frequencies were selected which gave weight to the materiality of the potential non-regulated allocation as well as to the sensitivity of each particular study to product line changes. Verizon believes that the current update frequencies adequately accommodate these changes.

3) Verizon does not agree that the internal CAM (ICAM) should be filed along with the CAM as part of the monitoring report program. Unlike the CAM, the ICAM was essentially a study procedures document that mirrored the CAM in structure but contained significantly more detail. Its purpose was to provide guidance to Verizon employees who prepare the CAM cost studies. The ICAM was very detailed, contained terminology used internally, identified sources for various pieces of information including names and phone numbers, listed data file names and locations and many other kinds of information that were not only proprietary in nature, but also would not be readily understandable to a non-employee. Furthermore, the ICAM could be changed at any time by the individual performing the studies to reflect changes in business practices, source documents, etc. Finally, the document as a whole was not updated on a routine basis. For these reasons, Verizon does not believe that the ICAM would be a useful document to file with a commission staff on a scheduled basis. The company believes the currently filed CAM is the more useful document to track changes in allocation methodologies and business activities as part of an ongoing reporting process.

Status: Resolved

Unlike the CAM, the internal CAM (ICAM) was essentially a study procedures document that mirrored the CAM in structure but contained significantly more detail. Its purpose was to provide guidance to Verizon employees who prepare the CAM cost studies. The ICAM was very detailed, contained terminology used internally, identified sources for various pieces of information including names and phone numbers, listed data file names and locations and many other kinds of information that were not only proprietary in nature, but also would not be readily understandable to a non-employee. Furthermore, the ICAM could be changed at any time by the individual performing the studies to reflect changes in business practices, source documents, etc. Finally, the document as a whole was not updated on a routine basis. Verizon eliminated production of the ICAM effective January 1, 2002. Verizon is currently negotiating with the FCC regarding a Verizon-wide CAM to become effective January 1, 2002.

Study update frequencies (biennial) were agreed to between the Company and the FCC. The update frequency considered changes that could occur, including changes in product and service offerings, both regulated and non-regulated, and other operational changes which affect activity in both regulated and non-regulated accounts. Study update frequencies were selected which gave weight to the materiality of the potential non-regulated allocation as well as to the sensitivity of each particular study to product line changes.

Verizon provided an example of the study documentation prepared in conjunction with the CAM that it does maintain in lieu of the ICAM and also maintains an index of the manual and mechanical studies available.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: Accounts Receivable/Payable Write-Off/On Page Reference: (25-1 to 25-2)
 103 104	**Audit Recommendation:** GTEC should establish a policy and procedure for tracking and monitoring of affiliate write-off/on. Financial Impact: None identified

Verizon Position:

Verizon has a corporate policy requiring the reconciliation of balance sheets accounts on a semi-annual basis. As part of the related administrative guidelines, old amounts must be investigated and corrected or written-off if necessary.

Status: Resolved.

The parties agree that: 1) Verizon made a reasonable effort to review the audit issue; 2) based on the review, there was no significant activity that warrants the recommendation be adopted and it would be administratively burdensome to implement; and 3) Verizon is in the process of standardizing payment processing for affiliates so that no write-offs will occur on a prospective basis.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Internal Audit** **Page Reference: (25-2 to 25-3)**
105 106 107	**Audit Recommendation:** Verizon's Internal Audit Department should perform annual audits of selected budget centers verifying the cost being allocated, the factors used and the allocation process. Audits should be performed from time to time on the monitoring reports to provide a level of comfort to management and the CPUC that the information contained within the audited monitoring reports are free from material errors and/or misstatements. Financial Impact: None identified

Verizon Position:

1) Verizon does not agree. The work conducted by external auditors described below provides the appropriate audit review. In addition, enhanced controls have been deployed since this audit was conducted and additional controls are being put in place (discussed in more detail in Chapter 6 – Ref. No. 1 and 7).
a) Annual audits of Verizon CA's financial statements are performed by an independent accounting firm in connection with the applicable rules and regulations of the FCC and SEC. Tests included in these audits verify (i) the pricing of transactions between Verizon CA and its affiliates and (ii) the process used to allocate corporate and common costs to Verizon CA.
b) The percentage of error identified in the report related to Network Services cost pool assignments is only .1% on a base of total allocated Network Services dollars of approximately $2 to $3 billion a year. This minor error rate combined with the controls in place does not justify a recommendation of annual audits of selected budget centers.
c) Any additional requirements would be at additional cost to Verizon and allocated 100% to California.

2) Verizon does not agree.
a) Controls have been enhanced in this area with two California Regulatory employees assigned the primary responsibility of ensuring the monitoring reports are timely received and submitted. The monitoring report checklist has been updated to include all reports and the departmental calendar has added the filing dates as "ticklers" to ensure timely filing. See Verizon's response to Chapter 26: Monitoring Reports, Internal Controls (Ref. No. 120-122).
b) Because of the broad scope of California specific monitoring report requirements, individual audits would be costly to implement. These additional costs would be allocated 100% to California.

Status: Resolved.

(105) Verizon agrees to conduct internal audits on select budget centers every three years with the first audit to be conducted in 2002. Copies of the internal audit reports will be provided to ORA upon request.

(106) Resolved in conjunction with (115 - 117) and (120 - 123).

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: External Audits Page Reference: (25-4 to 25-5)
108 109	**Audit Recommendation:** GTEC should establish specific policy and/or guidelines, which would require companies to advise CPAs that as part of the engagement, the workpapers and the workpapers of subcontractors are subject to review and access by the Commission and/or its contractors. Financial Impact: None identified
Verizon Position: Verizon does not agree to the specific recommendation. However, in general, auditors (e.g., CAM auditors) will make their workpapers available to the Commission for review at the auditors' premises.	
Status: Resolved. Verizon agrees to follow FCC input on the workpapers of other auditors and to provide future internal memorialization that subcontractors' workpapers will be made available. This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required. **Resolved Financial Adjustment:** 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.	

Ref No.	Issue: Clearing Account Studies Page Reference: (25-9 to 25-11)
110 111 112	**Audit Recommendation:** We recommend that studies for the distribution of costs in clearing accounts be performed every year or updated annually. In addition, the Company should comply with its record retention policy and maintain a copy of the study while it is current and transfer it to inactive storage for the prescribed retention period. Financial Impact: None identified
Verizon Position: Verizon concurs with the audit recommendations.	
Status: Resolved. A study was initiated during 2001. Verizon agrees to provide a copy of the completed study to ORA for its review. This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required. **Resolved Financial Adjustment:** 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.	

Ref No.	Issue: Individual Case Basis Activities (ICBs) Page Reference: (25-11 to 25-12)
113 114	**Audit Recommendation:** There is a concern regarding ratepayer subsidization of specific individual case basis (ICB) activities to the extent these costs were recorded above the line. Financial Impact: None identified

Verizon Position:

The audit report expressed concern about refusing a request for a copy of the Arthur Andersen audit report concerning instances of non-compliance with the Commission's contracting rules, and Verizon's correction of these matters. Verizon believes that this information is not relevant to ORA's inquiry for the following reasons.

First, the Arthur Andersen report was previously presented to the Commission as ordered in Resolution T-16218, approved December 3, 1998. In the body of the resolution, it explains,

"GTEC informs TD that it has contracted with an accounting firm to conduct an audit of all of its governmental agency contracts to ensure compliance with D. 91-07-010 and GO 96-A filing requirements. TD recommends that GTEC be directed to advise in writing the Director of TD by no later than March 1, 1999 the results of its outside auditor's review."

Ordering Paragraph 7 implements this by imposing the following requirement:

"GTEC is directed to advise in writing the Director of TD by no later than March 1, 1999 the results of its outside auditor's review of GTEC's compliance with D. 91-07-010 and GO 96-A filing requirements for its governmental agency contracts."

In conformance with this requirement, Verizon CA retained both Arthur Andersen and the law firm of O'Melveny & Myers to audit and thoroughly investigate the circumstances surrounding compliance with the Commission's contracting rules. Initial and supplemental audit reports were submitted to the Commission and the Consumer Service Division (CDS) pursuant to Public Utilities Code section 583 during May and June 1999. In addition, Verizon and O'Melveny & Myers have kept the Commission and CSD apprised of subsequent actions taken and supplemental reports. All of this information is currently under review by the CSD. Therefore, further review of Verizon's ICB contracts and compliance with the Commission's rules in this NRF audit would be unnecessarily duplicative of the above efforts and would yield no incremental benefit. More importantly, Verizon has been and will continue to be extremely forthcoming in its disclosures to the Commission on these issues. By declining to provide the Arthur Andersen report again here, Verizon is in no way withholding information from the Commission.

Secondly, issues concerning the cost centers and costs involved in the contracting activities are not relevant to this inquiry because Verizon's ICB contract issues do not affect the company's rates. The vast majority, if not all, of the contracts at issue in the Arthur Andersen audit were executed and effective well after January 1, 1990, the date Verizon's rates were regulated under the incentive-based framework of NRF, not a cost-of-service or rate of return mechanism. Under NRF, rates have been changed based only on application of the indexing formula and Commission-approved exogenous factors. Therefore, issues surrounding compliance with contracting rules had no impact on rates charged to other customers.

Status: Resolved.

The parties agree that Verizon provided a summary of corrective action that has been undertaken in response to the issue identified in the recommendation. Verizon's position is that it has cooperated fully with the Commission and submitted voluminous detailed information to the Consumer Services Division (CSD) pursuant to Resolution T-16218, dated December 3, 1998, and subject to PU Code section 583. The existing Commission oversight and investigation provided by the Telecommunications Division and CSD is ongoing and should not be duplicated here. ORA's position is that it was not provided access to documentation and therefore, could not make an assessment of the financial implications during the audit period. The parties agree that the Commission should make a final determination regarding whether it impacts the audit period.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. Any further Commission action should await resolution of the matters pending before CSD and not in this proceeding. No further Commission action is required here.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Accuracy of Amounts in Monitoring Reports** **Page Reference: (26-5)**
 115 116 117	**Audit Recommendation:** GTEC should file a schedule summarizing all known errors in existing reports. GTEC should file a schedule with the monitoring report recipients identifying the corrections to each monitoring report. Such schedules should be filed whenever GTEC identifies errors in previously filed monitoring reports. The schedule should include a description of the error and the impact on the respective monitoring reports. Financial Impact: None identified

Verizon Position:

Verizon does not agree. Verizon CA will continue to resubmit monitoring reports where errors have been identified. Verizon's standard procedure when submitting amended reports is to clearly identify any corrections being made in the report per 12/5/01 agreement with ORA. Regulatory will notify the departments who are responsible for generating the monitoring reports that revised reports should include a note stating, at a very general and high level, why the revision was necessitated and identifying where in the revised report the impact of the revision is reflected. It was also agreed that the Company is NOT required to identify every change in the report, e.g., a revenue change that will impact all of the numbers in a financial report.

Specifically, the 1998 Report No. GD-07-00 noted in the Audit Report was filed July 13, 2001. A copy of the cover sheet of the report transmittal has been submitted to ORA for its files.

Status: Resolved.

Verizon agrees to notify those departments responsible for generating the monitoring reports that revised reports should (1) include a very general and high level statement why the revision is necessary; and (2) clearly identify where the revised report reflects the impact of the revision. Verizon is not required to identify every change in a revised report e.g., a revenue change that will impact all of the numbers in a financial report. This will clarify the nature and purpose of revisions to monitoring reports without creating undue administrative burden for either Verizon or the staff.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	Issue: Failure to File Certain Monitoring Reports Page Reference: (26-5 to 26-7)
118 119	**Audit Recommendation:** GTEC should seek permission to discontinue specific reports rather than discontinuing them without specific Commission approval. Financial Impact: None identified

Verizon Position:

Verizon concurs. With the discovery that Verizon had not filed all of the monitoring reports, Verizon has reviewed its procedures and has filed any outstanding reports, if possible. The 1998 Report No. G.A.-XX-01 and the 1996 Report No. G.A.-07-00 were both timely filed. Verizon has filed missing reports for Report Nos. G.B.-02-00, G.C.-01-00, G.C.-XX-01, G.C.-XX-02, G.D.-03-00, and G.D.-XX-11 since the issuance of the Audit Report. Verizon has submitted the report cover sheets of the missing reports identified in Section C-2 of the audit, titled "Failure of GTEC to File Certain Monitoring Reports" to ORA for their files. Report GC-01-01 is not available and has not been filed. Reports GD-02-00 and GD-02-01 are the subject of Reference Number 129 and Verizon believed in good faith that there was no requirement to file such reports on a prospective basis but subsequently identified such a requirement to file GD-02-00 and GD-02-01 (see Reference Number 129 update).

A decision was made during the audit to defer determination of which monitoring reports should be requested to be discontinued until the conclusion of the audit. An internal review of the monitoring reports has now begun and Verizon anticipates that it will formally request the discontinuation of some monitoring reports.

Status: Resolved.

In response to the audit recommendation, Verizon has reviewed its procedures and filed any outstanding reports, if possible. The 1998 Report No. G.A.-XX-08 and the 1996 Report No. G.A.-07-00 were both timely filed. Since the issuance of the audit report, Verizon has identified and filed missing reports which were inadvertently not filed for Report Nos. G.B.-02-00, G.C.-01-00, G.C.-XX-01, G.C.-XX-02, G.D.-03-00, and G.D.-XX-11, and has provided this information to the auditors. After discussion with the parties on 12/05/01, Verizon identified the requirement to file GD-02-00 and GD-02-01.

Based on an internal review of the monitoring reports, Verizon anticipates that it will formally request the discontinuation of some monitoring reports in the near future.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required pending Verizon's request to eliminate monitoring reports

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Monitoring Reports - Internal Controls** **Page Reference: (26-8 to 26-9)**
120 121 122 123	**Audit Recommendation:** Formal, well-defined internal control process should be established, with an individual or a small group of individuals assigned overall responsibility to ensure that all monitoring report req. are met. Monitoring report checklist should be updated to reflect the current reporting requirements and changes in monitoring report req. Responsibilities should include: a) proper methods are followed to request report elimination; b) GTEC is not eliminating or not filing required monitoring reports on its own volition; c) the reports continue to be filed until requirements are officially revised; and d) the information included in the reports is complete and accurate. Financial Impact: None identified

Verizon Position:

Verizon has implemented internal controls.

1) Two California Regulatory employees have been assigned the primary responsibility of ensuring that monitoring reports are timely received and submitted to the Commission.

2) The monitoring report checklist has been updated to include all current monitoring report requirements including the missing reports. The checklist will be changed to reflect additions and deletions to the monitoring report requirements.

3) In addition, the monitoring report filing dates have been added to the California Regulatory departmental calendar as a "tickler" to ensure timely filing and individuals responsible for generating individual monitoring reports and their supervisors have been instructed to enter the monitoring report deadlines on their individual and departmental calendars. Regulatory will oversee the mechanism used to request that specific monitoring reports are eliminated. While Regulatory will ensure timely filing, individual organizations responsible for generating each report will be responsible for ensuring that the information included in the reports is complete and accurate. Per 12/5/01 discussion, Regulatory will remind the groups responsible for developing the monitoring reports of the requirement for accurate and timely information and the new requirements agreed to with the submission of revised reports (see Reference No. 115).

Status: Resolved.

Verizon has implemented internal controls described above which the parties agree are acceptable.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES R.01-09-001/L.01-09-002

JOINT EXHIBIT OF VERIZON CALIFORNIA INC., OFFICE OF RATEPAYER ADVOCATES AND THE UTILITY REFORM NETWORK

Ref No.	Issue: Streamlining of Monitoring Reporting Requirements Page Reference: (26-11 to 26-17)
124 125 126 127 128 129 130 131	**Audit Recommendation:** Reports that can be eliminated from the monitoring report requirements. Reports that can be consolidated from the monitoring report requirements. Reports required under General Orders should continue to be provided under the monitoring report requirements. If the Company wants to change the requirements, then it should file a formal petition to the Commission to modify the language contained in the General Orders. ORA prefers that GTEC continue to provide information when available or upon request including The Quality Improvement and Cost Reduction Program, the FCC Joint Board Monitoring Report (GA-06-00), and the US Telephone Subscribership Report (GA-06-01) even though the latter two are available directly from the FCC internet website. Begin submitting Financial News Releases (GD-XX-11) again, as currently required. GTEC should resume submitting the Total Revision of Computer Model Catalog – GD-02-00 and Updates of Computer Model Catalog Report GD-02-01, as required under the monitoring program and Assembly Bill 475 [and possibly PU Code Section 1822] GTEC should provide an updated Telephone Service Affordability Study triennially as part of the NRF review process. The report has not been filed since March 1994. Interested parties should have input into the development of the studies. Financial Impact: None identified

Verizon Position:

(124) Verizon concurs with the audit recommendation to eliminate certain existing monitoring reports.

Miscellaneous Information of Rand Corporation and Long Run Incremental Costs – GB-04-00;
Notice of Tax and Accounting Changes – GD-03-00;
Decision Data File, Sample; and
Voice Messaging – GF-01-NS03.

The company anticipates formally requesting that this recommendation be implemented.

(125) Verizon concurs with the audit recommendation to consolidate certain existing monitoring reports.

Summary of Category II Rate Change Report – GA-05-00 and Revenue Data for Categories II and II Report – GD-07-00;
Central Office Equipment Deployment and Utilization Reports – GE-01-00 and GE-01-01;
Outside Plant Annual View Deployment and Utilization Report – GE-01-04 and the Outside Plant Quarterly View – GE-01-5.

The company anticipates formally requesting that this recommendation be implemented.

Verizon Position (cont.):

(126) Verizon does not concur with the audit recommendation that continues to require reports under General Orders to be provided under the monitoring report requirements. This proposed requirement is redundant since the reports are already filed in compliance with General Orders. There is no added benefit to filing these same reports as monitoring reports. Such duplicative activity is not within the Commission's goal of achieving low cost efficient regulation. The proposal to file formal petitions to modify the language in individual general orders would also be administratively burdensome to undertake. It would be easier to file in compliance with the General Order and simply refer to each of those filings in the monitoring report compliance. If the Commission establishes a process to electronically file monitoring reports as the audit recommends (see Electronic Filing of Monitoring Reports) and further establishes an electronic library, any Commission staff person regardless of organizational classification would have access to these reports. Per 11/30/01 discussion with ORA, Verizon will continue to provide the reports required by the General Orders as monitoring reports. However, Verizon reserves the right to seek elimination of these reports in the future.

(127) The Quality Improvement and Cost Reduction Program "report" was never a monitoring report (D.91-07-056). No information has ever been provided as a monitoring report since the order was issued July 24, 1991. Therefore, Verizon objects to submitting this information as a monitoring report but will provide information upon request. The audit recommendation to continue filing the FCC Joint Board Monitoring Report and FCC US Telephone Subscription Report as Verizon specific monitoring reports is unnecessary and redundant. These reports are readily available to any Commission staff member including ORA and to the public on the FCC Web site. Verizon will provide the websites where these reports can be downloaded in electronic format for ease of use. Verizon will propose that these should be eliminated as Verizon specific monitoring reports Per 12/5/01 discussion, Verizon will continue to provide copies of the FCC reports but reserves the right to seek elimination of these reports in the future.

(128) Verizon agrees to continue submitting Financial News Releases (GD-XX-11) as a monitoring report. Verizon has submitted the Financial News Releases as required. Verizon has filed reports for 1996 through 2000. (see copies of cover sheets submitted for Reference No. 118.)

(129) Verizon disagrees with the audit recommendation to resume submitting the Total Revision of Computer Model Catalog and Updates of Computer Model Catalog Reports. Verizon did not believe that PU Code Section 1822 and Assembly Bill 475 required that these two reports be submitted on a routine, monitoring basis. Given the change in the regulatory environment since this report was last filed in 1993 and that it was apparently not missed during the last decade, Verizon originally proposed to eliminate this monitoring requirement. Based on further discussion with the parties, Verizon has identified the requirement to submit both reports as monitoring reports.

(130) The audit finding incorrectly states that the Telephone Service Affordability Study has not been filed since March 1994. Reports were filed on July 30, 1996, October 30, 1996 and May 30, 2001. Verizon has provided copies of the coversheets of the transmittals for the submission of these reports.

Status: Resolved.

(124) Verizon concurs with the audit recommendation to eliminate the identified monitoring reports and will take appropriate action to initiate this recommendation.

(125) Verizon concurs with the audit recommendation to consolidate specified monitoring reports.

(126 and 127) Verizon will continue to provide the reports required by the General Orders and the FCC reports identified above but reserves its rights to seek elimination of these reports in the future. The Quality Improvement and Cost Reduction Program is not a monitoring report but Verizon agrees to provide it on a request basis.

(128) Verizon has filed reports for 1996 – 2000 (Ref. No. 118).

(129) Verizon believes that the last report was submitted in 1993 and is in the process of locating the submission. Verizon is also in the process of implementing a procedure for the generation of these reports and will submit GD-02-00 as soon is it is available.

(130) Verizon provided documentation demonstrating that these reports were timely filed on July 30, 1996, October 30, 1996 and May 30, 2001.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required pending any Verizon request for elimination of monitoring reports.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: Potential Additions to Monitoring Reports** **Page Reference: (26-17 to 26-20)**
132 133 134 135 136 137	**Audit Recommendation:** Additional information regarding the level of local competition GTEC is subject to and GTEC's market share would be helpful in the monitoring process. Either informal meetings or workshops should be conducted between ORA, Telecommunications Division, GTEC and the other California LECs to discuss the addition of monitoring reports regarding competition levels and market share. All of the affected parties should participate in setting up the reporting requirements. Seven reports from the merger address quality of service issues and should be added to the monitoring report req. A CD copy would suffice. It would be helpful in the monitoring efforts if GTEC provided a copy of its current customer notification and education plan and provided updates to the plan when modified or revised. It would greatly aid in the monitoring process if copies of the Company's organizational charts and detailed descriptions of any organization changes were provided whenever a significant change occurs in the organization. The chart should include not only employee positions, but also employee names. Financial Impact: None identified

Verizon Position:

(132) Verizon disagrees. The audit report does not provide sufficient explanation on how Verizon specific information would benefit ORA when no other carriers are obligated to provide comparable information. Also, absent a consistent methodology for reporting data, any comparison of data among carriers would be suspect. If there is a need for market and competitive information to aid the monitoring process, this information must also be collected from all carriers, not just Verizon. Per 11/30/01 discussion, this issue is deferred to Phase III.

(133) Verizon believes that the appropriate venue to identify and recommend the adoption of additional monitoring report requirements is in the context of a rulemaking to determine the applicability and scope of such a requirement. Verizon's position is that an industry-wide workshop is required since many other LECs with market data would be impacted by any proposed requirement to provide the Commission with better information regarding the level of local competition. Per 11/30/01 discussion, this issue is deferred to Phase III.

(134) Verizon does not agree with the audit recommendation that it should provide seven additional service quality reports, which are submitted as a condition of the Bell Atlantic/GTE merger, as monitoring reports. As reflected in Attachment D of D. 00-03-021, ORA and Verizon agreed that these reports would be submitted for the limited period of only four (4) years. The audit has not identified any reason why these reports should become part of the permanent monitoring report list. As stated previously, the appropriate forum for discussing the need for and establishment of monitoring reports should be a rulemaking. The ORA had the opportunity to propose the Commission adopt additional service quality standards and reporting requirements in the recent proceeding to review General Order (GO) 133, Rules Governing Telephone Service. In its most recent decision (D. 00-03-052 issued on March 16, 2000), rather than finding that additional service quality standards were required, the Commission determined that two of the then-existing standards could be eliminated. There appears to be no need for additional service quality reporting at this time. Per 11/30/01 discussion, this issue is deferred to Phase II.

Verizon Position (cont.):

(135) Verizon already provides all Commission-required customer notification notices to the Commission in monitoring report G.A.-XX-01. These notices include customer education on Caller ID services and privacy issues. In addition, Verizon already works with the Commission's Public Advisor's office who reviews annual customer notifications and significant ad hoc customer notifications. This issue would be better addressed in the context of a rulemaking, for example, R.00-02-004, Rulemaking to establish Consumer Rights and Consumer Protection Rules, applicable to all telecommunications utilities. Requiring redundant reporting requirements is administratively burdensome and wasteful for the Commission, Verizon and its customers.

(136) Verizon disagrees with the audit recommendation to provide organizational charts with detailed descriptions of any organization changes, employee positions, and employee names. The Audit Report offers no support as to how the submission of organizational charts, including employees' positions and names, would assist the monitoring process or provide any benefit to staff. Also, given the number of changes in organizational structures and employee turnover that occur to meet the rapidly changing market and technological environment, such reports would become outdated and irrelevant quickly, resulting in little informational benefit to the ORA. However, Verizon agrees to submit high level organizational charts for the corporate structure, Verizon Communications, and for Verizon California, Inc. on an annual basis every March 31st

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Status: Resolved for Phase I.

The parties agree that (132) and (133) should be deferred to Phase III and (134) should be deferred to Phase II.

(135) Verizon agrees to provide Public Advisor approved customer notices to ORA.

(136) Verizon is in the process of implementing a procedure to provide high level organizational charts.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required at this time.

Resolved Financial Adjustment: 1996 - $0.0; 1997 - $0.0; 1998 - $0.0.

Ref No.	**Issue: ORA Administrative Processes for Improving Efficiency & Accessibility** **Page Reference: (26-20 to 26-21)**
138 139 140 141	**Audit Recommendation:** ORA should notify the Telecom Division when required reports are not filed by GTEC. The Telecom Division should then pursue the matter to determine why the reports were not filed by GTEC. A training program should be implemented at the ORA and the Telecom Division to go over the monitoring reports and the usefulness of the information contained in the reports. The Telecom Division and the ORA should place more emphasis on the actual monitoring program. Financial Impact: None identified

Verizon Position:

Although the implementation of these recommendations is not in its purview, Verizon believes that the Commission Staff did not miss many of the reports because the information contained in the reports ceased to be relevant or of interest. For one-time interest issues that do not have a recurring relevance or significance to the Commission, ORA and the Telecom Division staff should submit a written information request detailing the scope of the report and its purpose.

The advantages of responding to ad hoc requests as is done today is that Verizon does not have to expend limited resources to gather data and file recurring monitoring reports containing data that ceases to be relevant or of interest to the Commission. Specific information requests allow the requesting party to specify a user-friendly format.

Status: Resolved.

Verizon has no action or input on this issue.

Resolved Financial Impact: 1996 – $0.0; 1997 – $0.0; 1998 - $0.0.

VERIZON CALIFORNIA INC.

REGULATORY AUDIT OF VERIZON CALIFORNIA AND ITS CORPORATE AFFILIATES
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JOINT EXHIBIT OF
VERIZON CALIFORNIA INC., OFFICE OF RATEPAYER ADVOCATES AND
THE UTILITY REFORM NETWORK

<table>
<tr><td>Ref No.</td><td>Issue: Electronic Filing of Monitoring Reports
Page Reference: (26-21)</td></tr>
<tr><td>142
143
144</td><td>Audit Recommendation:
It would be useful to the monitoring process if some of the reports could be provided electronically. This could aid in using the information contained in the reports for various analysis and comparisons.
An employee at the Telecommunications Division and an employee at the ORA could be assigned the responsibility for ensuring that electronic reports are received and printed out in hard copy form upon receipt. This way the information could still be available in hard copy for filing in the monitoring report library, yet an electronic version would be available for use by employees.
Financial Impact: None identified</td></tr>
<tr><td colspan="2">Verizon Position:

Verizon concurs with the audit recommendation that would allow it to file its monitoring reports (except for Customer Information Notices) electronically with the Commission.

Electronic filings would eliminate the need for Verizon to make duplicate copies of the monitoring reports for various Commission personnel as it does today. The Commission would be able to establish and maintain an electronic library from which the Telecom Division, ORA or any other interested party including the general public, could access monitoring reports.</td></tr>
<tr><td colspan="2">Status: Resolved.

The parties agree to meet to formalize requirements for filing monitoring reports electronically with the Commission.

This resolution should be adopted because the concern raised by the audit recommendation has been fully addressed. No further Commission action is required.

Resolved Financial Impact: 1996 – $0.0; 1997 – $0.0; 1998 - $0.0.</td></tr>
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