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BELLSOUTH CORPORATION

EXECUTIVE INSTRUCTIONS

CONCERNING

COST ALLOCATION PRINCIPLES AND

REGULATORY COMPLIANCE

BELLSOUTH HEADQUARTERS COST APPORTIONMENT

Executive Instructions No. 10 is revised in its entirety. It has been divided into three sections that document BellSouth policy in regards to the FCC Joint Cost Order. The sections are:

Section 1 - BellSouth Headquarters Cost Apportionment

Section 2 - Corporate Functions Cost Assignment

Section 3 - Project Billing

In addition, detailed procedures to carry out the policy have been removed from the Executive Instructions and documented in BellSouth Administrative Practices.

The major changes include:

(1) Departmental Overheads are established to allocate costs that cannot be directly associated with one function but are in support of all functions.

(2) All Corporate Function Codes are assigned CX as the first two characters of the code.

(3) The annual review of the Cost Assignment Forms is changed from the fourth quarter to the second quarter.

Questions regarding this revision should be referred to Harry Babbit 404-249-2945) or Mary Fitzgerald (404-249-3005).

RECOMMENDED: Patrick 16 C
Vice President and Comptroller

APPROVED:

N L Harding
Vice Chairman

Date: 5-28-91

Filing Instructions:	Remove the following:	Insert the attached:
E.I. No. 10, Section 1	Pages 1-17	Pages 1-4
E.I. No. !0, Section 2	NA	Pages 1-4
E.I. No. 10, Section 3	NA	Pages 1-3

BELLSOUTH HEADQUARTERS COST APPORTIONMENT

CONTENTS

1. GENERAL

1.01 This Instruction defines the policies regarding the identification, collection, allocation and billing of costs incurred by BellSouth Headquarters to the subsidiaries of BellSouth Corporation specified in Executive Instructions No. 1, Exhibit B. The purpose of each section in this Instruction is as follows:

a. Section 1 - To specify the methodology employed to apportion BellSouth's costs in a fully distributed manner, consistent with the joint costing and affiliated transactions requirements of Parts 32 and 64 of the Federal Communications Commission's (FCC) rules and regulations.

b. Section 2 - To define corporate functions costs and describe the process used to bill these costs.

c. Section 3 - To define projects and the process used to bill project costs.

1.02 BellSouth Headquarters (BellSouth) incurs costs on its own behalf and on behalf of its subsidiaries as a result of performing its ownership responsibilities. Executive Instructions No. 1 defines the BellSouth Headquarters entity and details its various functions and duties. Additionally, BellSouth provides non-affiliated entities limited access to certain internal, but shared services provided to its affiliates. Costs incurred by BellSouth result from a variety of activities such as, engaging in corporate oversight responsibilities, performing general support functions for subsidiaries, performing incidental contracted work for non-affiliated entities, or performing specific services, on a discretionary basis for the subsidiaries. Based on the nature of the expense, costs incurred at BellSouth will either be retained at BellSouth or billed to the subsidiaries through the Corporate Functions Cost Assignment and/or Project Billing Systems.

1.03 The BellSouth Headquarters cost apportionment process has been developed to collect, allocate and bill costs which result from BellSouth's operations. These procedures were developed considering generally accepted accounting principles (GAAP), regulatory accounting practices, management information needs, and budgeting control requirements. The Corporate Functions Cost Assignment System was developed to properly separate, assign and bill to the subsidiaries those costs associated with the support of their general work functions. Likewise, the Project Billing System was developed to properly

2.05 In discussing this methodology, the Order characterizes the costs of resources as being either directly assignable or common costs. "Directly assignable" costs are the costs of those resources that are used exclusively for a specific activity (e.g. regulated or nonregulated activity in a regulated carrier). "Common costs" are the costs of resources which cannot be directly assigned to a specific activity.

2.06 The methodology used to assign BellSouth's common costs to the proper subsidiary depends on whether the cost can be directly or indirectly attributed to a specific activity, or is unattributable, as defined below.

a. Costs of resources are directly attributable if direct measures of cost causation exist. An example of direct attribution is the wages of time reporting employees performing work for two or more subsidiaries. Since the time reports provide us with the ability to tell how much of the employee's time was spent working on each subsidiary, we consider this a direct measure of cost causation.

b. Costs of resources are indirectly attributable if an indirect measure of cost causation must be used because a direct measure does not exist. An example of indirect attribution is the apportionment of a non-time reporting supervisor's salary to two or more subsidiaries based on the wages of employees supervised. Since the supervisory function does not lend itself to time reporting, we have no direct means for determining how its costs should be billed to each subsidiary. We can indirectly determine the amount by using the wages of the people that are supervised as a basis for allocating the cost of the supervisory function.

c. Costs of shared assets and resources are unattributable when no direct or indirect measures of cost causation exist. The salary of the Chief Executive Officer would be an example of an unattributable cost. Unattributable marketing costs will be allocated to the subsidiaries on the basis of each subsidiary's total marketing expenses as a percent of the total of all subsidiaries' marketing expenses. The proper allocation of these costs necessitates that the subsidiaries identify and report all marketing expenses on a consistent basis, as defined by the FCC. Unattributable non-marketing costs will be apportioned based on appropriate allocators as defined in BellSouth Administrative Practice 010-002-001.

2.07 In assigning costs to the subsidiaries, the following hierarchy must be adhered to:

a. Whenever possible, costs should be directly assigned to the subsidiary.

b. Common costs should be allocated as follows:

1.) Common costs are to be allocated based upon direct attribution, whenever possible.

2.) When direct attribution is not possible, common costs shall be allocated based upon indirect attribution.

3.) When neither direct nor indirect measures of cost causation can be

CORPORATE SERVICES COST ASSIGNMENT

CONTENTS

EXHIBITS

1. DEFINITIONS

1.01 Corporate services are defined as those responsibilities specifically identified in the Cost Allocation Agreements between BellSouth Headquarters and the subsidiaries. Included are both "natural" holding company functions (oversight) and those designated as such by policy or Corporate management. Corporate services not specifically identified in the Cost Allocation Agreement must be accounted for as project services (see Paragraph 4) until the Cost Allocation Agreement is amended to include the function.

1.02 Other definitions which will be helpful in understanding the Corporate Services Cost Assignment System are:

a. Corporate Services Manager: The district employee responsible for timely and accurate completion of the Cost Assignment Forms (Exhibit A) within his/her respective district. Specific responsibilities of the Corporate Services Manager are to:

1.) prepare, obtain approval of and submit Cost Assignment Forms on a timely basis,

2.) monitor the work activities of the employees within the group to ensure the accuracy of allocation methodologies, and

3.) ensure time and expense reporting activities, e.g., use of Corporate Function Codes (CX), are followed to ensure the proper assignment of costs.

b. Corporate Services Administrator: The BSHQ Corporate Accounting district's employee responsible for administration of the Corporate Functions Cost Assignment System. This employee will:

1.) ensure that the Corporate Services Cost Assignment System is properly configured based on the detailed methodology information prepared by the Corporate Accounting Standards District, and

2.) assign Corporate Function Codes (CX), after approval by the Corporate Accounting Standards District.

accomplished by assigning a Corporate Function Code (CX) to the non-homogeneous function and instructing the appropriate employees to use this code in conjunction with their responsibility code when reporting their time and expenses. This CX code may be used to permanently assign a fixed percentage of an employee's time to the function (via a payroll change report) or it may be used on an exception basis. For employee and sundry expenses, the code should be reported in the "PROJECT" column in the Classification Detail section of the voucher. If the entity is above the district level, a unique "administrative" responsibility code will be assigned to facilitate allocation.

3.03 The information reported on the Cost Assignment Form will be used as the basis for establishing the corporate functions allocation methodology associated with each administrative entity on the Corporate Services Cost Assignment System. A separate form is required for each unique responsibility code.

3.04 Annually, at a minimum, BellSouth Comptrollers will request a review of the cost allocation methodology by the departments and a review of the percentage of the department's time allocated to administrative time. At this time, new Cost Assignment Forms must be approved and submitted to the Corporate Accounting Standards District. This will generally be done during the second quarter of the year. In addition, whenever a new responsibility code is established, a Cost Assignment Form will be required so that the proper allocation methodology can be established within the Corporate Services Cost Assignment System. See BAP 010-002-001 for details. If at any time during the year, a significant change occurs within an administrative unit that affects the subsidiary allocation methodology being used, immediate submission of an updated Cost Assignment Form will be required.

3.05 Corporate service costs are billed to the subsidiaries one month in arrears. The necessary detail of services provided will be reflected on the subsidiary bill to allow the proper classification and journalization of these costs by the subsidiary in accordance with Part 32 and in order to facilitate the assignment of costs under Part 64.

PROJECT BILLING

CONTENTS

1. PROJECT BILLING

1.01 Projects are services which are performed by the BellSouth departments either at the direction of a subsidiary, the direction of BellSouth Corporate Management or in conjunction with a service provided to a non-affiliate; and, due to the nature of the task, require special cost identification and billing considerations. Generally, projects are associated with services that are not identified in the Cost Allocation Agreement. Depending on the manner in which a project originates, it will be classified as:

a. Subsidiary Funded (PS): Services performed by BellSouth at the request of subsidiary management which produce specific benefits for the subsidiary requesting the service.

b. BellSouth Funded Projects (PB): Services performed by BellSouth where assignment of costs to an affiliated entity would not be appropriate. A BellSouth Funded Project, as an example, would be used to identify research and pre-incorporated operational expenses of a new venture. BellSouth Funded Projects which ultimately produce benefits for one or more subsidiaries may be reclassified to the benefiting entity through the Corporate Functions Cost Assignment System by assigning a Corporate Function Code to these costs.

c. Cost Identification (PC): Projects designed to perform a specific cost identification purpose. Cost Identification projects are not true billing projects as defined in Paragraph 1.01, but are actually Company costs for which detailed tracking is desired e.g., Employee Security Partnership costs that are not project billed but need to be identified. Assigning a project number to these costs is simply a means of facilitating the tracking process. For cost assignment purposes, these costs are allocated to the subsidiaries based on the corporate function cost assignment methodology.

d. Non-Affiliated Billing (PN): Costs which result from the contracting by BellSouth with non-affiliated parties to perform specific services on behalf of the non-affliate for which full reimbursement is to be obtained. A contract must always be present between BellSouth and the benefiting party for a PN Project to be established. The provisions of Executive Instructions No. 2 must be adhered to prior to the establishment of this project.

1.03 Each department is responsible for establishing projects, selecting Project Managers, and negotiating, when necessary, with both affiliated and non-affiliated entities for all projects planned.

1.04 Costs accumulated under a new venture's BellSouth Funded project number must be approved by the CPC before billing to the subsidiary can take place.

1.05 Project billing is the only means of collecting cost for billing to BellSouth entities not parties to the Cost Allocation Agreement and non-affiliated entities.

1.06 All projects require either approval papers or a Memo Authorization Form. Procedures and forms for establishing a project are found in BellSouth Administrative Procedures (BAP) 010-003-001.

RL 89-02-008BS

BELLSOUTH

Subject: Accounting Policy Letter

Type: Strong Recommendation

Date: March 28, 1989

Distribution Lists: Attached

File No. Related Letters: N/A

Other: N/A

To: Vice President and Comptroller-Southern Bell and South Central Bell
Assistant Vice President and Comptroller-BellSouth Enterprises
Comptroller-BellSouth Services

Entities: BSC, SB, SCB, BSE, BSS

From: Vice President and Comptroller - BellSouth Corporation

Description: Transmits Accounting Policy Letter 610-03 which provides the policy and methodologies for allocation of BellSouth Corporation Headquarters and BellSouth D.C. costs to subsidiaries.

* * *

Attached is Accounting Policy Letter 610-03 which provides the BellSouth Headquarters policy and methodologies for cost allocations and presents the BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide. The Guide is a formal, centralized, and ongoing source of information and authority to promote the compliance of BSC and D.C. with the FCC rules which govern affiliated company transactions with regulated companies.

The two volume Guide will be provided to those who work with the material as well as others who may request it. It will be issued on a numbered basis to permit periodic updating.

Questions by your staff regarding this APL should be directed to Ken Mory (404) 249-3026 or Don Akridge (404) 249-3005.

Patrick H. Casey

Patrick H. Casey
Vice President and Comptroller

Attached

Distribution List

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SUBJECT: BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

STATUS: New Issue

ORIGINATOR: Kenneth J. Mory (404) 249-3026

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• • *

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J. Michael Hostinsky
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Approved:

Patrick H. Casey
Patrick H. Casey
Vice President and Comptroller

BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

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BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

1. INTRODUCTION

On February 6, 1987, the Federal Communications Commission (FCC) released the Report and Order on Joint and Common Costs (JCO), CC Docket No. 86-111, previously referred to as Part X. In general, the JCO, as amended with the Order on Reconsideration released October 16, 1987, prescribes cost allocation standards that a regulated carrier must use to separate costs between regulated and nonregulated activities when its resources are jointly used to provide nonregulated products or services. The JCO also prescribes certain affiliated transaction requirements for the regulated carrier in dealing with its nonregulated affiliates. As such, the requirements of the JCO apply to Southern Bell (SB), South Central Bell (SCB), BellSouth Services and other SB and SCB subsidiaries, BellSouth Corporation Headquarters (BSC), other BSC subsidiaries (i.e., Capital Funding and BellSouth D.C.), BellSouth Enterprises (BSE), and BSE subsidiaries involved in asset transfers or receiving products and services from or providing products and services to SB or SCB.

In September 1988, the JCO requirements for BSC Headquarters and D.C. were retroactively implemented effective with January 1, 1988 business. The costs of these two organizations are assigned to other BellSouth companies, or retained, based on the principles of cost causation consistent with the allocation hierarchy set forth in Section 64.901 and with the transfer pricing principles set forth in Section 32.27 of the Commission's Rules and Regulations. The policies and methodologies for allocating these costs are contained in the BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide ("Guide").

2. PURPOSE

This Guide is prepared and maintained by the Regulated Accounting Policy and Research district of BSC-Comptrollers for compliance and administrative purposes. It is a formal, centralized, and ongoing source of information and authority to promote the compliance of BSC and D.C. with the rules which govern transactions with affiliated companies. The Guide contains relevant policy statements, affiliated company contracts for discretionary and nondiscretionary costs, cost allocation principles and methodologies used for the assignment of nondiscretionary corporate functions costs to the subsidiaries, and the detailed methods and procedures used by BSC - Accounting Services to convert the methodologies derived in this Guide to allocated and billed costs. It provides a permanent record of principles and allocation methodologies effective January 1, 1988. Its primary beneficiaries are those who administer the

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affiliated transactions rules for BSC and D.C., the subsidiaries for understanding the basis for billings received from BSC, the Affiliated Witness, and the various audit groups in performing their compliance reviews. The Guide will be issued on a numbered basis to permit periodic updating. It will be provided to those who work with the material as well as to others who may request it.

3. SCOPE

This Guide governs only those transactions of BSC and D.C. with affiliated companies. Because the transfer of assets between BSC/D.C. and the other affiliates is minimal, its primary emphasis is in the billing of corporate functions and services to affiliates, and, accordingly, is primarily oriented toward Section 64.901. (See BellSouth Accounting Policy Letter No. 610-01: Joint Cost Allocations, for guidance on the joint costing requirements.) The pricing of these services and the Section 32.27 guidelines for establishing transfer prices on assets are also contained herein.

4. REVISIONS

This Guide will be continuously and promptly updated so that it reflects all changes resulting from revised regulations, revised BSC Policy, and revisions to methodologies resulting from changes in cost causation. In accordance with Executive Instructions No. 10, cost allocations for BSC and D.C. will be formally reviewed and revised as necessary at least annually. On a monthly basis, known changes will be made effective as they occur, incorporated into the Monthly Control Sheets, and Allocation Methodology Forms will be obtained to substantiate the changes. BSC-Accounting Services will implement these changes in accordance with the Monthly Control Sheets. The Regulated Accounting Policy and Research district of BSC-Comptrollers will maintain the Guide and administer its distribution.

5. POLICY STATEMENTS

To provide a comprehensive Policy framework for complying with the JCO, various BSC policy documents are included in this Guide for technical reference and historical perspective. These policies reflect the affiliated transaction rules which are the basis for assigning BSC and D.C. costs to subsidiaries. The policy documents included herein are:

BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

- Accounting Policy Letter No. 610-01: Joint Cost Allocations
- Accounting Policy Letter No. 610-02: Comptrollers' Responsibilities for Matters Pertaining to the Joint and Common Cost Order
- Accounting Policy Letter No. 620-01: Affiliated Transactions with Regulated Entities
- Accounting Policy Letter No. 660-01: Accounting for Overhead Costs
- Executive Instructions No. 10, Section 1: BellSouth Headquarters Cost Apportionment
- BellSouth Accounting and Financial Instructions, Part 5, Section 17: Corporate Functions Billing

6. BILLINGS TO SUBSIDIARIES

BSC-Accounting Services will incorporate the methodologies derived in this Guide into the cost allocation system and provide detailed monthly billings to the subsidiaries for corporate functions costs. The detailed methods and procedures for allocating these costs in accordance with the Guide are developed and maintained by BellSouth Enterprises-Methods and Procedures. This document: BellSouth Accounting and Financial Instructions, Part 5, Section 17: Corporate Functions Billing, is included in Section G of this Guide.

7. GENERAL ALLOCATOR

The General Allocator as specified by the FCC is the methodology used by BSC and D.C. for the allocation of its unattributable costs as developed in accordance with the principles set forth in Section 64.901.

Whereas the General Allocator for Southern Bell and South Central Bell allocates their costs to regulated and nonregulated cost objectives, BSC-HQ costs are generally not distinguishable to products and services but are distinguishable to regulated and nonregulated BellSouth companies. For allocating unattributable costs, BellSouth Corporation and its subsidiaries are theoretically one entity. Therefore, the subsidiaries' operating expenses, less costs of goods sold and BSC unattributable costs, represent the direct costs of BSC for General Allocator purposes. For example, the costs of the President of Southern Bell are unattributable for Southern Bell but are direct regulated company costs for BSC.

Accordingly, this conceptually sound approach appropriately allocates BSC unattributable costs to the subsidiaries in accordance with FCC requirements. These BSC unattributable costs received by the regulated companies then get recorded in their cost pools and allocated to regulated and unregulated cost objectives.

An example of the conceptual calculation of the General Allocator follows:

	SB	SCB	BSE
Operating Expenses (Income Statement)	$XXX	$XXX	$XXX
Less: Cost of Goods Sold*	-X	-X	-X
Less: BSC Unattributable Costs**	-X	-X	-X
Adjusted Operating Expenses***	$ A	$ B	$ C

Allocation factors:

$$\text{SB} \quad \frac{A}{A+B+C} = .XXXX$$

$$\text{SCB} \quad \frac{B}{A+B+C} = .XXXX$$

$$\text{BSE} \quad \frac{C}{A+B+C} = .XXXX$$

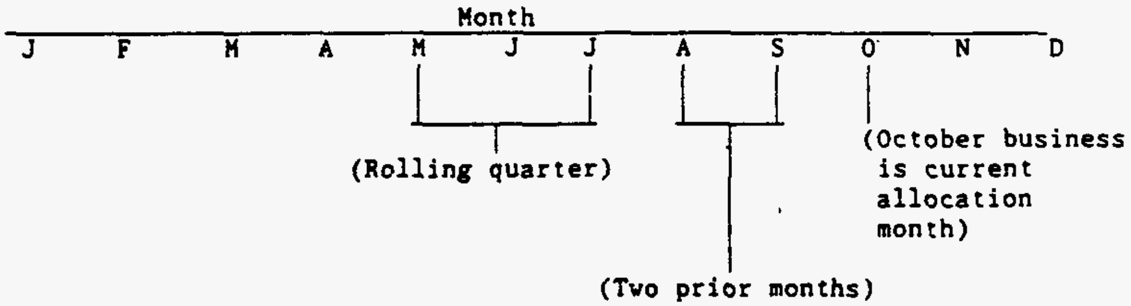
$$1.0000$$

* Non-operating interest if any, would also need to be deducted.

** BSC unattributable costs must be deducted to convert to direct costs.

*** Operating expenses are computed using rolling quarterly data collected during the three month period ending two months prior to the current allocation month. See the following example on page 7:

BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide



8. MARKETING GENERAL ALLOCATOR

Headquarters marketing costs, which are not directly assignable, will be allocated to the subsidiaries on the basis of each subsidiaries' total marketing costs as a percent of the total of all subsidiaries marketing costs. The proper allocation of these costs necessitates that the subsidiaries identify and report all marketing costs on a consistent basis and as defined by the FCC.

The FCC has defined marketing costs as certain costs incurred in support of the marketing of products and services. Specifically, these costs are functionally identified as follows:

A. Product Management - Costs incurred in performing administrative activities related to marketing products and services. This includes, but is not limited to, competitive analysis, product and service identification and specification, test marketing planning, demand forecasting, product life cycle analysis, pricing analysis, and identification and establishment of distribution channels.

B. Sales - Costs incurred in selling products and services. This includes, but is not limited to, determination of individual customer needs, development and presentation of the customer proposals, sales order presentation and handling, and preparation of sales records.

C. Customer Services - Costs incurred in establishing new accounts and adding new services to existing accounts. This also includes costs of instructing customers in the use of products and services to the extent that such service constitutes an inducement to purchase or is offered as part of a pre-purchase demonstration.

BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

D. Product Advertising - Costs incurred in developing and implementing promotional strategies to stimulate the purchase of products and services.

E. Non-Product, Image Advertising - Costs incurred to foster public awareness of the firm's name, reputation, or activities.

F. Public Relations - Costs incurred to foster public awareness of the firm's name, reputation, or activities.

Additionally, the FCC has further identified these costs by expense category within these functional groupings as follows:

A. Salaries and wages - Includes compensation to employees, such as wages, salaries, commissions, bonuses, incentive awards, and termination payments.

B. Benefits - Includes payroll related benefits of employees, such as:

- Pensions
- Savings plan contributions (company portion)
- Worker's compensation required by law
- Life, hospital, medical, dental, and vision plan insurance
- Social security, and other payroll taxes.

C. Other - Other marketing costs not included in the above categories. These include material and supplies, provisioning, contracted services, accident and damage payments, insurance premiums, traveling expenses, incidental rents (less than 30 days), and other miscellaneous costs.

Stated simply, all marketing related costs as defined by the FCC, must be identified and reported to BellSouth Corporation for the proper allocation of Headquarters marketing costs to its subsidiaries.

Southern and South Central Comptrollers should ensure that their marketing costs are classified at all times in accordance with the FCC requirements and the most recent version of the BellSouth Corporation Accounts and Subsidiary Record Categories for Operating Telephone Companies. (NOTE: This document is maintained by BellSouth Services - Accounting Classifications and is the basis from which Classification Letter 10-03 is developed.) Any existing or future deviations from these requirements should be promptly reported to BellSouth Services Comptrollers - Classifications.

For BellSouth Enterprises, similar requirements for reporting marketing costs apply. In those companies where cost classification does not fully identify the marketing related costs, a reasonable estimate must be provided and classifications established to accurately identify and report marketing costs.

9. TIME REPORTING

BSC utilizes the exception time reporting process when employees work on tasks not chargeable to their normal functions. This ensures that salary and wage costs incurred for a specific activity that is not included in the individual's corporate functions allocation basis gets properly assigned based on cost causation. Exception Time Reports must be provided to BSC-Payroll by noon of the first work day of each month for the prior month's business in order to be properly matched with the cost allocation methodologies in effect for that period. Time records must be maintained for one year following the end of the year for which the time was reported.

Detailed time reporting instructions are contained in BellSouth Administrative Procedures No. 003-006-001 and in BellSouth Executive Instructions No. 3, Section 6. These documents are incorporated into this Guide by reference only.

10. VALUATION OF SERVICES

The costs billed to the subsidiaries by BSC are fully distributed costs. This is in accordance with Section 32.27(d) which states in part: "When a carrier provides substantially all of a service to or receives substantially all of a service from an affiliate which are not also provided to unaffiliated persons or entities, the services shall be recorded at cost which shall be determined in a manner that complies with the standards and procedures for the apportionment of joint and common costs between the regulated and nonregulated operations of the carrier entity."

These rules are incorporated into Accounting Policy Letter No. 620-01, Section 8 which is included in Section C of this Guide.

BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

11. VALUATION OF ASSETS TRANSFERRED

Sections 32.27 (b) and (c) provide specific guidelines for valuing asset related transactions with affiliates. These guidelines are different depending on whether the transfer is into or out of regulation.

These rules are incorporated into Accounting Policy Letter No. 620-01, Section 5 which is included in Section C of this Guide.

12. OVERHEADS

At SB and SCB, their costs, whether classified as overhead or as attributable, are all in support of that entity. Accordingly, the net assignment of those costs among their products and services should be the same, whether classified as attributable or overhead. BSC activities are in support of the subsidiaries as well as BSC. Therefore, it is essential that BSC's costs be classified as attributable whenever possible. Only those costs that have no reasonable linkage to cost causation within BSC, e.g., depreciation, should be classified as overhead. At BSC, if attributable costs were misclassified as overhead, the allocation of these costs would become skewed toward the higher salary and wage units and subsequently get allocated to the subsidiaries using the methodology of the group receiving the excess overhead rather than the methodology of the group incurring the cost.

The overheads at BSC will consist of: Depreciation, Occupancy Expense, Property Taxes, Corporate Support, Employee Concessions - Retirees, Group Insurance - Retirees, Pension and Death, Accident and Sickness, Savings Plan, Disability, Medicare, Other Benefits, Compensated Absences, and Other Local Taxes. Though some of these items are not traditional overheads, they are causally linked to salaries and wages which is the basis for assigning overheads. In these cases, e.g., compensated absences, it is more cost effective to treat them as an overhead. The end result is the same as it would be if the item were attributed.

There should be no items included in BSC overhead except for those which are not reasonably attributable, e.g., depreciation, or which have no causal linkage to BSC salaries and wages.

For additional information on overheads, refer to Accounting Policy Letter No. 660-01 which is included in Section C of this Guide.

BellSouth Corporation - Corporate Functions Cost Allocations Policy Guide

13. RETAINED COSTS

All costs will flow through the Cost Allocation System or the Project Billing System and be billed or retained as appropriate. There will be no unallocated accounts representing retained costs for BSC and D.C. Any BSC retained costs will be controlled through the Project Billing System by the Operations Manager - Accounting Services to ensure that those costs are properly approved and monitored in accordance with Executive Instructions No. 10.

Confidential

SET F

TRANSCRIPT OF NOVEMBER 5, 1991

INTERVIEW WITH

MIKE HOSTINSKY AND GARY GRACE

4'11'' ext

INTERVIEW OF

GARY GRACE AND MIKE HOSTINSKY

INTERVIEW OF GARY GRACE AND MIKE HOSTINSKY, Southern Bell Telephone, Atlanta, Georgia, taken on the 5th day of November, 1991.

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REPORTED BY:

MARY VIRGINIA HUGHES
Certified Shorthand Reporter
In and for the State of Louisiana
...oOo...

MR. GRACE:

My name is Gary Grace. I am in BellSouth headquarters controllers. I am the BellSouth affiliated interest and transactions manager, and my responsibilities include looking at both BellSouth headquarters affiliate transactions, primarily with the telephone companies, to a certain extent also with nonregulated subsidiaries, and providing support, both regulatory and executive support to the telephone companies and their need for information concerning affiliate transactions.

MR. HOSTINSKY:

I am Mike Hostinsky. I am the assistant controller at Bell South Corporation.

My responsibilities include managing, directing the controllers' function at the corporation, and my primary responsibilities are financial reporting, accounting policy and the efforts BellSouth undertakes to interact in the external accounting environment with the SEC, the FASBE and other standard FASBE bodies.

MR. KOLLEN:

When you say BellSouth headquarters, BellSouth Corp.

MR. GRACE:

Yes.

BY MR. KOLLEN:

Q. One of the charts that we have been provided in response to data request is the cost allocation manual for BellSouth; and included in there is the BellSouth Corporate structuring. You are probably somewhat familiar with that chart.

I will just hand you a copy. That has some notes of mine on it. It's dated September 30, 1991. Is that still current?

MR. GRACE:

If this is September 30th. This one looks like it may be, 6/30.

MR. ZIMMERING:

I think it's 9/30.

MR. HOSTINSKY:

We do quarterly updates in the CAM. And there may be some changes that have taken place since 9/30.

I notice you have got the Chile Cellular deal, which has closed. There has been some domestic cellular deals that have closed, Graphic Scanning and some McCall properties in Wisconsin on the cellular side.

It's probably not perfect, but it's the latest issue in the CAM. We will be updating that at the end of the year in the normal quarterly file.

BY MR. KOLLEN:

Q. Who is it that makes the call as to how the company already structured, in terms of equity and in terms of where it's placed within the organization, for example if it's under BellSouth Enterprises, or whether it's under South Central Bell. Who makes those calls, those decisions.

MR. HOSTINSKY:

I can give you an overall picture. Those kinds of things are really a joint process between subsidiaries and the parent corporation.

There are lots of factors that go into it, and I don't know all of them, but certainly the business plan, the external operating environment, just the whole state of financial conditions, and those decisions are basically handled up through a subsidiary.

They come up to corporate, and I can tell you, you know, how we get involved. And basically, what happens is once the decision is made for debt and equity, then the equity flows down from the corporation, either to the regulated side or the unregulated side, based on the results of the joint process.

If it is debt, then if it is on the regulated side, they finance their own debt and do their own debt deals.

But if it is on the unregulated side, we have a subsidiary called BellSouth Cap Funding, and they issue unregulated debt.

What they do in issuing it, all their debt instruments have covenants that protect the regulated side so that the unregulated debt holders do not have any access to regulated assets.

So there is a very clear distinction in how we finance on the debt side.

The equity side, BellSouth is the only equity issuer.

Q. Let's talk --

MR. ZIMMERING:

I want to just back up.

MR. KOLLEN:

I was going to back up, too. I asked a very, very broad question. I wanted to refocus it towards the corporate structure. Is that consistent --

MR. ZIMMERING:

You skipped the biggest step. Once the debt and equity is decided on, how is the decision made what the capitalization of South Central Bell is going to be, any of these subsidiaries.

MR. HOSTINSKY:

Within subsidiaries, there is someone responsible from the treasury standpoint. And that person, within a subsidiary, from treasury, is responsible for that sort of decision and initiating the process as to how that entity is financed.

So what happens is it's generated internally, down at the subsidiary, and it bubbles up through the finance structure.

If you have seen organizational charts, you note that in the finance area, not only controllers but intraLATA team, tax, let's see, what else have we got? Treasury -- we have got four and I can't recall the big four.

But intraauditing, tax, controller, treasury, I guess are the main four and legal I guess was somewhat, too, have reporting functions in addition to their -- the decision starts down at subsidiary and bubbles up through the functional organization, within the treasury organization and they, like I say, they looked at a combination of things.

I am not all that familiar with everything, but I know certainly the external debt and equity markets, the relative costs, the business plans of the operation, all those kind of things.

MR. ZIMMERING:

Before -- well -- I will give this back to Lane in a second.

You are not that familiar with how the determination is made as to who at South Central Bell and Bell South Corporation makes the ultimate decision to what the capital structure of that entity is going to be. Who is? Who is the person we need to talk to.

MR. HOSTINSKY:

You need to talk to treasury people, if that's the case.

MR. ZIMMERING:

Who at BellSouth.

MR. HOSTINSKY:

Arlen Yokely is the treasurer of BellSouth. I am not that familiar exactly with his organization.

Jim Simpson is the treasurer of BST. So, you know, you would have to find out who on their staffs. We get involved, once those decisions are made, we get involved in the transaction flow, obviously.

BY MR. KOLLEN:

Q. I would like to start, now that we have kind of an overview which I think is very good, and my question was very broad to start out with, with respect to the organization of entities within the BellSouth Corp. umbrella, now, the placement of the entities, the location, I think that's maybe the best way to describe it, who is making the determination of where, for example, Dataserv Inc. is going to be located.

Is it going to be located in BellSouth Enterprises, or will it be located under BellSouth

Telecommunications.

Who is making that determination as to the placement of a business under the BellSouth Corp. umbrella?

MR. HOSTINSKY:

It would be whoever is doing the business planning.

I don't know exactly who that would be. I would think that as these decisions are made, what you have is you have some sort of business planning arrangement, you know, feeding off the strategic plan as to whether it's the appropriate thing to do or not.

You know, they -- certainly do things different ways.

I know frequently, they use task forces. I know Mr. Gunner is asked to handle the task force to look at BST.

MR. KOLLEN:

So, for example, if you acquire a company, it's not -- you don't know who at Bell South Corporation is determining where that company will be placed, will it be placed in one of the regulated operations or one of the nonreg operations; whether, for example, it will be placed in the Mobile Systems group or whether it will be in the marketing and international development group.

MR. HOSTINSKY:

Some are logical. But there is not necessarily a person at Bell South Corporation that is making those decisions.

I think they evolve through the acquisition process as part of the acquisition planning. They look at various models and -- the basic thing they look at is the business and the nature of the business and what makes sense to put things where.

I mean it's basically, the business operations that drives the, where you determine where to put a subsidiary.

But, you know, I don't know that there is necessarily a person that sits in a room and makes a call, we have got this one that needs to go here, needs to go there.

On the acquisitions, it's certainly done in the planning process for the acquisition and the modeling and the acquisition team.

Q. Where would that process be done, as far as the acquisition team is concerned, and when an acquisition is evaluated, and you said before that a task force would be assembled to evaluate it, perhaps, and, let's say that there was some planning involved with that, and there will be some determination at a point, if I understand you correctly, where it should be most appropriately placed within the Bell South organization.

At what levels is planning done? I am a little bit unclear.

MR. HOSTINSKY:

The overall planning, there is an acquisition team that's in place in Enterprises, and they basically handle the corporate development function for the corporation.

Q. There is an acquisition team at BellSouth Enterprises?

MR. HOSTINSKY:

Right.

MR. GRACE:

Let me make a statement here.

If you look at the chart in front of you there, what you will notice is that the companies are grouped in what we think is a pretty logical fashion.

Up in the upper right-hand corner, Southern Bell, South Central Bell, BellSouth Services and those are principally the companies that handle the regulated part of the business, the local telephone service, the access to the long distance network, those types of activities.

The bottom portion of that chart contains the companies that are engaged in, primarily, competitive, nonregulated types of businesses. Cellular is in there, paging is in there, various activities of a competitive nature now, I can only think of one instance where we have acquired a company that has been incorporated into the regulated side of the business, and that was the purchase of the Hughes Telephone System in Mississippi, and it was subsequently incorporated into South Central Bell.

All of our acquisitions and most of our start-ups have been in the competitive area, and, therefore, they have been naturally put in the group of companies that deal with those types of businesses and in that environment.

So just the nature of the business pretty well dictates where the structural location of it turns out to be.

BY MR. KOLLEN:

Q. For example, in BellSouth Business Systems, there are some unregulated companies within that corporation, and --

MR. GRACE:

That is correct.

BY MR. KOLLEN:

Q. On that basis, you expect those nonregulated businesses to be down in --

(Brief interruption.)

BY MR. KOLLEN:

Q. When we took the break, we talked to Guy Cochran, and he was able to help us determine a little bit more clearly where decisions were made and how they were made with respect to the placement of acquisitions by BellSouth Corp.

With respect to the organizational structure of acquisitions, or on an ongoing basis of corporate entities under the BellSouth Corp. structure, who makes the determination of what form of business that organizational entity will take, whether it's a joint venture, whether it's a partnership, whether it's a minority interest, whether it's a majority interest, whether it's a corporate form?

Who makes that decision, what business form the new entity will take, or, for that matter, on an ongoing basis whether the organizational form will change.

MR. HOSTINSKY:

That's basically, you know, part of the corporate development process.

When they examine all these deals, they look at various deal structures to see if they make sense for the corporation.

As part of that arrangement, they basically look at the various alternatives without eliminating any, and try to figure out what makes sense.

Q. Who is they?

A. The corporate development.

Q. Under BSC?

A. Right.

For example, the foreign subsidiaries generally require some sort of insight to work with the foreign government, and, for that reason, we frequently partner overseas. And have minority interests.

In terms of cellular, generally, what drives the marketplace there is the way the FCC awarded the nonwaterline licenses; and they were awarded, basically one for the wireline and one for the nonwireline, and the nonwireline pieces were formulated under partnerships at the time of the lottery.

So a lot of it is basically dictated by --

MR. GRACE:

It's hard to generalize because every acquisition, every deal is unique. Depending upon the particular deal that is under consideration, you may have a situation where the former owners want to sell completely out.

You may have another situation where they want to maintain part of the business, but they need capital or expertise to carry on an ongoing business. A lot of time we have different interests into getting into some of these businesses.

So depending upon the particular acquisition, a lot of times, and the participants in the acquisition, will determine what the structure turns out to be.

MR. KOLLEN:

Obviously the structure itself has an accounting impact in terms of how the results of your affiliation are recorded.

MR. HOSTINSKY:

Sure.

MR. KOLLEN:

Are you involved or the BellSouth Corporate staff, are they involved along with this corporate development group under BellSouth Enterprises in evaluating the effect, then, of the aggregate financial results of this affiliated entity, on BellSouth Corp.'s financial statements?

MR. HOSTINSKY:

Essentially, what we do is each acquisition is consummated, the ownership description, I guess, you know, basically flowing through the secretary's offices, come to finance, we know what the deal structures are and we follow the accounting rules, be it cost, equity, or fully consolidated, based on the accounting rules.

MR. KOLLEN:

I understand that. I am asking about a decision-making process as to the organizational form. Are you at all involved, or the BellSouth Corporate headquarters controllers office, are you involved in evaluating different organizational forms on the effect of the BSC's financial statements, as part of the decision-making process, before a deal is done?

MR. HOSTINSKY:

No. There are controllers' people on the corporate development team that are specialists in that area, that have special expertise in accounting, particularly the areas that you would normally expect, purchase accounting, pooling, those are -- those accounting expertises are part of the corporate development team; and that's done as a part of a unified effort.

And there is no fragmentation in the process.

MR. KOLLEN:

Essentially what you are telling me is the corporate development group under BSC is self-contained, in terms of all their analytical work?

MR. HOSTINSKY:

That is true. They do coordinate with us, once a deal structure has been determined, so we can help them on the SEC side.

We are the contact with the SEC. The corporate development team, you know, has no access to the SEC, except through us.

We perform that role for the corporation.

So while they have the specialist down there, they will come up with a specific deal structure, they will discuss it with us, and we will go ahead and start making the plans to change the corporate financial architecture to make sure that the financial reporting is properly handled and that we comply with the applicable accounting literature relative to the structure that's been chosen.

MR. KOLLEN:

You get involved more or less after the fact, after the decision has been made, either to acquire or not acquire, and after the decision has been made with respect to the corporate form, or the organizational form, I should say, whether it's corporate partnership, joint venture.

MR. HOSTINSKY:

As a general rule, that's pretty much correct. Although we do have input, along the way, because a lot of these things get to be very complex.

The pooling rules are constantly changing because the merging issues task force at FASBE, the SEC is very active in some of those areas.

So from a financial reporting standpoint, we have to make sure that the integrity of the financial statements is protected.

So we are involved to whatever extent we think is necessary to make sure that takes place, that the proper accounting is being done.

For the most part, that is done on a review or oversight type of arrangement, and not a partnership type arrangement.

MR. KOLLEN:

So, for example, if there is an acquisition candidate that BellSouth Enterprises, that is identified to the corporate development group, and they have an option of whether to account for this, to organize it as a joint venture or a wholly owned corporation, they would not come to you and say what is best for BellSouth Corp. in terms of presenting financial results. They would do that analysis themselves?

MR. HOSTINSKY:

That is correct.

MR. GRACE:

The one group at BellSouth headquarters that gets involved in the process that you are talking about is the tax organization.

As you can imagine, there are, a lot of these acquisitions have pretty large tax consequences that evolve from the corporate structure and how the deal is structured. So I think they get involved earlier in the process than financial reporting does.

MR. HOSTINSKY:

We get involved -- you have to keep in mind, from the disclosure process, too, that the SEC side, we have, you know, those responsibilities.

And, certainly, we are aware of every impact prior to the, any deal being executed, and that information is known and the implications on the, etched on the financial statements is part of the input that goes into the decision-making process.

MR. ZIMMERING:

It's not your group that makes the call.

MR. HOSTINSKY:

That is correct.

MR. KOLLEN:

You do assist in that analysis or not. The analysis of the effect on your external financial statements of the parent company.

MR. HOSTINSKY:

Except for review and oversight, interface with the SEC if there needs to be one, no.

MR. KOLLEN:

So, for example, it would be my expectation that if BellSouth Enterprises, or BSC were considering purchasing or, in some other form, affiliating with another entity, one of the pieces of information you would want to see is what would the effect be on BSC's external financial statements.

You don't get involved in that,

except for purposes of disclosure?

MR. HOSTINSKY:

Right.

MR. ZIMMERING:

Just to wrap this up, in the kind of transaction Lane is talking about, is it the function of your group simply to report what went on to the appropriate government agencies and to make sure you are accounting for it properly, according to FASBE rules and things like that?

MR. HOSTINSKY:

Right.

MR. ZIMMERING:

Is there any other function you serve in that kind of transaction.

MR. HOSTINSKY:

Basically, policy oversight, to make sure we get the expected level of consistency.

MR. ZIMMERING:

By policy oversight, it's not policy, is this a good or bad idea to acquire the company.

MR. HOSTINSKY:

That is right. Accounting policy.

MR. KOLLEN:

The next set of questions, they may not be very extensive, because they follow from this.

Where within the Bell South Corporation, organization, a new entity might fit, or on a continuing basis where you might want to move one.

The second thing we talked about was the ownership structure or the organization structure of that entity.

The third thing is the financing of that entity which is in part dependent on the organization structure.

Let's say, for example, it's a wholly-owned subsidiary, and now you are faced with the decision whether to issue debt in connection with the equity financing or how much financing to infuse into that entity.

Who makes that determination,

is that made by the treasurer of BSC, BSE, or is it made by the treasurer of BST, or does it depend on where that new entity is located on this chart?

MR. HOSTINSKY:

Well, what you have got -- remember, you have got a functional organization as well as a legal entity organization. So all of these legal entities have treasurers. Whoever functions as treasurer is responsible for initiating that process.

But it would be the BST treasurer would certainly have responsibility for all those subsidiaries on the BST side, treasurer for the BSE side, and the corporate treasurer, you know, has responsibility for both.

So it's a functional relationship.

It's discussed vertically through the organizational chart up this way when you have those kinds of decisions.

MR. ZIMMERING:

A company is purchased and its current capitalization, the day before it's purchased its capitalization is 75 percent equity and 25 percent debt.

It's purchased and it's an unregulated entity, it's not going into BST. Is there any kind of series of guidelines that exist as to what the capitalization of that company should be, once it becomes part of the BellSouth family?

What kind of criteria are applied to make that determination?

MR. HOSTINSKY:

That's the sort of question you have to ask the treasury folks. I don't have any knowledge.

MR. ZIMMERING:

Do you believe that such a set of guidelines exists for nonregulated companies and regulated companies?

MR. HOSTINSKY:

I don't have any idea.

MR. ZIMMERING:

So let me ask you this:

Is it a fair statement that companies change their capitalization after they are acquired by BellSouth?

MR. HOSTINSKY:

I would think so. Certainly we see transactions that indicate that.

MR. ZIMMERING:

[redacted]

MR. HOSTINSKY:

Right.

MR. KOLLEN:

With respect to this chart, then, out of the CAM, which is the BellSouth corporate structure, could you point us to where in the CAM it describes the equity ownership of each one of these organizational entities or the organizational structure of that entity; or if it doesn't, can we go through each one and have you briefly describe that to us.

MR. GRACE:

I don't think any of that

is in the CAM. The CAM basically tells how BST apportions costs between regulated and nonregulated. It also tells for the affiliates that do business with BST, what the transactions, what the nature of the transactions are, and how those transactions comply with the joint -- the FCC's joint cost order rules.

But I don't think there is any place in the CAM that describes whether a particular company is a partnership or a wholly owned subsidiary or anything like that.

MR. KOLLEN:

I think that's generally true. I think there are some references in some cases to some of these organizational entities that this is a one hundred percent-owned affiliate of such and such an affiliate.

So, then, I guess we are back to the chart, then. And we would like to have somebody walk us through this chart and tell us, essentially, what the organizational form is, first of all, for each one of the entities; and then, secondly, how it's financed.

MR. HOSTINSKY:

Before you do that, it might be helpful to understand, too, that in the CAM there is a section in here of affiliated transactions. And that section of affiliated transactions would have those entities that have transactions with BST and would be the only ones that affect the BST Louisiana operations.

A great many of these on here really don't have any effect at all.

We can certainly go through that. But I want to make sure you understand that.

MR. KOLLEN:

I don't really want to argue the point, but it's, I guess, our opinion that because the BellSouth Corporation's a publicly traded stock, that that is quite often what is the basis, then, for utilization as a cause of capital in a regulatory proceeding, and things like that.

Obviously, then, the capital structure throughout the organization has an effect on the total parent company capitalization, as well as its cost of equity.

So that's why we are interested.

MR. HOSTINSKY:

Sure. It's no problem. I just wanted to make sure you understood.

MR. KOLLEN:

Right. We do understand that.

I will leave it open to you as to how we can best walk through this.

I guess I was thinking maybe we could just start from the left upper corner and move from the right and then down.

MR. GRACE:

We can start through it. From memory, I can't go through each of the companies on here and tell you exactly what the --

MR. LLEWELLYN:

Why don't you do what you can. He just asked for a brief explanation. Start right here and tell them about what the company is and how it's owned and capitalized.

MR. KOLLEN:

Excuse me, I think we have a fairly good description of what the company is from the CAM. But basically, what we are looking for is how is it structured, in the form of a business form, and, secondly, is its capitalization, if it's a corporation or whatever of that nature.

MR. GRACE:

I will go through the ones of these that I can.

BellSouth Capital Funding is a subsidiary directly of Bell South Corporation. A wholly owned subsidiary.

MR. KOLLEN:

It has no debt of its own?

MR. GRACE:

It is the organization that acquires debt on the open capital market. Specifically to relay that debt in support of nonregulated companies within the BellSouth system.

As far as its own operations, it doesn't use it to support its own operations.

MR. KOLLEN:

It's essentially a pass-through on debt, is essentially what you are saying? Does it preacquire funds through the issuance of debt and in turn release those to other subsidiaries of BSC, for example?

MR. GRACE:

By and large it does a shelf registration. It if does a shelf registration for an amount of debt, it doesn't go out and acquire those dollars on day one automatically.

It makes those funds available, and as the companies need debt within their own organization, it makes provisions for that debt to be available.

MR. KOLLEN:

In some instances, it prefinances, or not, or don't you know?

MR. GRACE:

As I said, it acquires what is a shelf registration, which means it's preapproved for certain level of dollars and as the companies need that debt, it then issues the specific debentures and the amounts required at any given time.

It doesn't generally go out and acquire a large amount of debt and then try to find a place to put it. It only actually gets the debt from the debt markets as it's needed.

MR. ZIMMERING:

Only for nonregulated acquisitions.

MR. GRACE:

Only for nonregulated, that's it. No financing of Southern Bell, BellSouth Services, through that organization.

MR. HOSTINSKY:

This debt has special covenants to prevent the bondholders from having access at the regulated assets of BST.

MR. BARON:

Is the debt in the name of Bell South Corporation?

MR. GRACE:

BellSouth Capital Funding Corporation.

MR. BARON:

Not the entity that ultimately uses the proceeds.

MR. GRACE:

That is correct.

MR. KOLLEN:

That's carried on the books of BellSouth Funding Corporation. It's not carried on BellSouth Enterprises, Inc. or any of its subsidiaries.

MR. GRACE:

BellSouth Capital Funding would initiate a note to BellSouth

Enterprises.

You would see, on BellSouth Enterprises' books, the effect of the debt. But I think the question --

MR. BARON:

Externally with bondholders, it's Capital Funding.

MR. GRACE:

Yes.

MR. BARON:

They issue proceeds and --

MR. HOSTINSKY:

It's effectively a push down from the accounting standpoint.

MR. ZIMMERING:

Its payments guaranteed by Bell South Corporation on the debt?

MR. GRACE:

By Bell South Corporation, yes. Not by Southern Bell or South Central Bell --

MR. ZIMMERING:

I understand. But by Bell South Corporation?

MR. GRACE:

Yes.

MR. ZIMMERING:

Okay.

MR. BARON:

Are these debentures placed to specific holders, or is this traded in the open market?

MR. GRACE:

It's traded. They are handled through an underwriter. I am not sure who the -- Morgan Stanley, or one of those.

But generally we don't, we as a corporation, don't place debt with individual debt holders.

MR. KOLLEN:

As far as the, in essence, the intercompany or interaffiliate debt transfers, then, through this note process that you described, would BellSouth Enterprises, then, be responsible back to Bell South Capital Funding Corporation for that debt, or would some other of these affiliates, under BellSouth Enterprises, be directly responsible for the debt back to the Capital Funding Corporation?

MR. GRACE:

It works both ways. There are a few issues placed directly between BellSouth Capital Funding and an individual subsidiary, but for the most part, the flow of the money goes from BellSouth Capital Funding to BellSouth Enterprises; and then from BellSouth Enterprises to its subsidiaries.

MR. BARON:

Are there any debentures that are issued, other than by Capital Funding, to fund any of the nonregulated businesses?

In other words, are there any occasions when one of these entities may issue its own debt, directly into the marketplace?

MR. GRACE:

I don't know of any instance where that's happened. As far as I know, there is no policy that says it couldn't happen.

Some of the acquired companies may have had debt at the time of acquisition, and that debt may still be active.

So they still could have, you know, some debt to the open market on their own.

MR. HOSTINSKY:

I think we have called the debt if there was any acquired debt. I know, for example, that we plan to go ahead and call the debentures that Graphic Scanning has, which is one of our most recent acquisitions that just closed a matter of weeks ago.

So there may be for periods of time, but, as a general rule, no, the individual entities don't issue debt on their own. They all issue through Capital Funding.

MR. BARON:

What is the rating of the debentures.

MR. GRACE:

Cap Funding debentures?

MR. BARON:

Yes.

MR. HOSTINSKY:

I don't know.

MR. GRACE:

I don't know specifically.

MR. KOLLEN:

BellSouth Human Resources, Inc., it's our understanding that will be dissolved at the beginning of the year if the BST organization is approved.

MR. GRACE:

That's my understanding.

MR. HOSTINSKY:

Yes.

MR. KOLLEN:

BellSouth Enterprises, Inc. is --

MR. GRACE:

It's a holding company.

MR. KOLLEN:

The equity is held wholly by BellSouth Corp.

MR. GRACE:

Yes.

MR. KOLLEN:

None that is publicly traded directly for BSC?

MR. GRACE:

Equity or debt?

MR. KOLLEN:

Equity.

MR. GRACE:

No there is no equity.

MR. KOLLEN:

The only way BellSouth Enterprises raises debt is through Capital Funding Corporation. It does not raise any on its own.

MR. GRACE:

That is correct. BellSouth Enterprises does not go directly to the markets.

MR. KOLLEN:

Do you know what the capital structure is between equity and debt?

MR. GRACE:

I don't know precisely.
No, I don't.

MR. HOSTINSKY:

I don't, either. It's certainly available information.

MR. KOLLEN:

With respect, then, to the different groups and the companies within the groups that are part of the BellSouth Enterprises organization, do you know anything about the capitalization or the business form of any of those? Starting with the advertising and publishing group.

MR. GRACE:

The advertising and publishing group, I don't know specifically what it is today. Originally it was pretty much one hundred percent equity when it was formed.

They may have acquired a small amount of long-term debt. They certainly had some short-term working capital bank loans and that type thing, but -- it's mostly an equity company.

MR. KOLLEN:

All of these companies under the advertising and publishing group, to the best of your knowledge?

MR. GRACE:

Yes.

MR. KOLLEN:

Is that also the case with the companies under the Communication Systems Group?

MR. GRACE:

Generally, yes. Those are primarily equity.

Now, Dataserv Financial Services probably has a little more debt in its structure because it handles lèasing, some leases, which would be carried, I think, as debt.

MR. HOSTINSKY:

Yes, I think the Dataserv International is where the leasing operations are. It would probably be some debt there.

MR. BARON:

Isn't that going to be

terminated?

MR. LLEWELLYN:

Yes. That's the computer leasing you are talking about?

MR. HOSTINSKY:

That's the overseas leasing in the U. K.

MR. LLEWELLYN:

Yes.

MR. HOSTINSKY:

We had some domestic leasing that has been terminated. But I think internationally, there are still some leasing operations overseas.

MR. KOLLEN:

Does BellSouth Corp. hold any debt on its own, or have a subsidiary, other than the ones that are listed on this chart that issues debt?

MR. HOSTINSKY:

No.

MR. KOLLEN:

So, essentially, any equity investment by Bell South Corporation, into any one of these subsidiaries directly indicated on this chart, would be one hundred percent equity. It wouldn't be financed by a combination of equity and debt?

MR. HOSTINSKY:

That is correct.

MR. GRACE:

That is correct.

MR. BARON:

I will ask you a question.

Is BellCore owned by BST, or will be owned by BST or Bell South Corporation?

MR. GRACE:

Well, we only own one seventh share of BellCore, but it will be owned by BST.

MR. GRACE:

It's Bell Communications Research, 14.3 percent.

MR. BARON:

Are you familiar with how the transactions work between BellCore and BST.

MR. GRACE:

In general, I am.
Specific transactions, I am not.

MR. KOLLEN:

Then with respect to the Mobile Systems Group, there is a number of companies that are listed there. Are those also mostly common equity, to the best of your knowledge? In terms of --

MR. GRACE:

On an ongoing basis, they are mostly equity. They do, in the construction phase, when there are heavy capitalization requirements for constructing systems, they do some bank loan type and lines of credit, but on an ongoing basis, they are primarily equity-based.

A lot of those are under construction and emerging today.

I am not sure exactly what the ongoing -- I mean the long-term capital structure of those will be. The development of the business will, more than likely, dictate what that capital structure turns out to be over long-term.

MR. KOLLEN:

Going back to the left again, Corporate Enterprises Group. How are these financed, this group of companies?

MR. GRACE:

Those we would have to go individually.

BellSouth Financial Services, does have significant debt in its capital structure because it began, it engages in long-term leases of customer premises equipment, and those leases would be carried as debt.

BellSouth Resources, I believe, is one hundred percent equity. BellSouth Information Systems is one hundred percent equity, I think.

MR. KOLLEN:

Sunlink?

MR. GRACE:

Sunlink may have some debt associated with real estate development activity.

As a corporation, Sunlink wouldn't carry debt; but some of its partnerships would have debt. It's in partnership with Carter and Associates to develop some real estate activities. And those partnerships would have debt.

MR. KOLLEN:

You wouldn't show that debt on your books, ultimately, by the time you get to BellSouth Corporate set of external financial statements because of your minority holdings in some of these organizations; or would you show that as debt?

For example, if the partnership that's Sunlink Corporation is involved with has debt, that would roll all the way up to being reflected, ultimately, on the BSC's external financial statements, would it?

MR. HOSTINSKY:

That would not be. The literature now does not provide for the consolidation of partnership debts on up to the parent.

So that is off balance sheet.

MR. BARON:

Is there a threshold as to what percentage, if you own 90 percent of the partnership, would it make a difference?

MR. HOSTINSKY:

No, I think it's basically the partnership structure that does it. FASBE has an active project in that area now, that may lead to further consolidation.

But the consolidation rules have changed pretty dramatically over the last several years, and they have already addressed it for control corporations; but the literature, really has not been addressed for unconsolidated partnerships.

MR. KOLLEN:

Then the final box is Marketing International Corporate Development Group.

And these companies, how are these financed?

MR. GRACE:

I think for the most part, our interest in those companies would be all equity.

MR. KOLLEN:

So, for example, your purchase of Chile Cellular would have been financed all through equity?

MR. GRACE:

We don't own a hundred percent of that.

MR. KOLLEN:

Your ownership share.

MR. GRACE:

Our ownership share would be all equity. I think the company is SIDCOM.

MR. KOLLEN:

It wouldn't carry its own debt as such, but if there would be any debt supporting your ownership in those companies, it would be carried by BellSouth Enterprises or BellSouth Capital Funding Corporation?

MR. GRACE:

If we provide debt to that company, we being BellSouth Corporate, it would be through the Bell South Capital Funding Corporation and not directly from BellSouth.

MR. KOLLEN:

Just so that we make sure that we understand what it is, when you say that these companies are all financed, all equity, that means on their own balance sheets, they are all equity. But they may, in fact, be supported by debt on the part of BellSouth Enterprises?

MR. GRACE:

I don't think that's the case. I think if BellSouth Enterprises supplies debt capital originating through BellSouth Capital Funding, that it would show up as debt on the books of your subsidiaries, in the form of a note from BellSouth Enterprises, Inc., to that subsidiary.

MR. ZIMMERING:

Is BellSouth Corp. --

MR. KOLLEN:

That's a general rule, that if BellSouth Enterprises utilizes debt financing to purchase a position, let's say, in an affiliate, or an ownership interest in another organization, if they use debt financing, then that debt would be then carried on the books of the new affiliate? Through the form of a note between the --

MR. GRACE:

That's my understanding, yes.

MR. HOSTINSKY:

Yes, I believe that's the general rule that you follow. We subscribe to push-down accounting.

MR. ZIMMERING:

Does Bell South Corporation, other than short-term debt, have any debt?

MR. HOSTINSKY:

You mean as a corporation itself? No. I cannot think --

MR. GRACE:

Not to my knowledge.

MR. HOSTINSKY:

Not the corporation itself.

MR. ZIMMERING:

The only debt that exists, then, is the debt which is obtained through Bell South Capital Funding Corporation, which is utilized to either acquire or cause some of the capital structure of some of these nonregulated affiliates to have debt in it, plus the debt that is issued by Southern Bell and South Central Bell today? And that's it?

MR. HOSTINSKY:

I think that's the general rule. That's not to say you can't go through there and pick out an exception. Graphic Scanning --

MR. ZIMMERING:

95 percent of what I said is true.

MR. HOSTINSKY:

That's the general rule.

MR. COCHRAN:

When we acquire, when I was at Corp., we acquired L. M. Berry, Stevens Graphics and Dataserv. Those were all acquired with stock.

We didn't pay cash for any of them. They were actually new issue stock or some type of transaction.

They were a hundred percent equity type transactions.

Now, I think Stevens Graphics had some debt with it when it came. And I think it was in the form of, I don't believe it was public debt, or registered debt. It was more like big long-term bank loans and that type stuff.

MR. ZIMMERING:

Did you acquire it?

MR. COCHRAN:

I thought we kept some of it and actually pushed it down on to the Stevens Graphics books. We may have acquired it since I left. It seems like I left yesterday, but I have been gone five or six years.

MR. HOSTINSKY:

That's why I tried to clarify, that's the general rule.

MR. COCHRAN:

We were using push-down accounting to push the debt down to the subsidiaries' books all along.

If you say they are a hundred percent equity owned but Enterprise is sitting with 50/50 debt on their books, you can say the subsidiaries are 50/50 debt financed. Mike is saying it wouldn't have any debt on its books. The debt would be on the books of all subsidiaries under Enterprise.

MR. HOSTINSKY:

It would be a wash on their books. They are kind of a pass-through.

MR. KOLLEN:

If you had a stand-alone set of financial statements for each one of these companies, you would have pushed down the debt to the lowest level company. That's what you are telling me?

MR. HOSTINSKY:

Yes.

MR. ZIMMERING:

Do you have stand-alone financial statements on every individual subsidiary?

MR. HOSTINSKY:

No. Not on every individual one. It's very commonplace in the cellular area where there are partnerships with minority interests, and, you know, several of the other places we have it, BAPCO, Dataserv -- I have to look at --

MR. ZIMMERING:

Why do you have a separate financial statement for BAPCO?

MR. HOSTINSKY:

Why?

MR. ZIMMERING:

Why.

MR. GRACE:

It's --

MR. HOSTINSKY:

It's a separate company.

MR. ZIMMERING:

You don't have one for every other separate company.

MR. HOSTINSKY:

That's true.

I don't know exactly why that [redacted]

I can speculate. I guess as long as this is informal, I think there is just a lot of interest in BAPCO. It's been a hot topic of public debate with regulators and industry; and that's just, I believe, an outspring of that.

MR. ZIMMERING:

So you just started doing separate financial statements for BAPCO.

MR. HOSTINSKY:

I think we have done them all along.

MR. GRACE:

They were incorporated in 1984.

MR. ZIMMERING:

Yes. Have you done them since this?

MR. HOSTINSKY:

I think so. I can't recall not having them.

MR. GRACE:

Most of the companies in the Enterprises group there are, not necessarily in the name that's on here.

For instance, Graphics Holding Company, the primary operative subsidiary in there is Stevens Graphics, as Guy mentioned a minute ago, and Stevens Graphics has their own financials.

I don't know there is a Graphics Holding Company set of financials.

MR. HOSTINSKY:

The minority interests drive it as much as anything else.

Then, too, as part of our oversight responsibilities in representing the controller, I know he has very strong opinions about what he would like additional comfort from, from entities?

MR. GRACE:

Or between two BSE entities that would directly affect a BST activity.

MR. ZIMMERING:

If you are working on a [redacted]

MR. GRACE:

Because my purpose there is to insure that the regulated entity is not disadvantaged or that that transaction is in compliance with the joint cost order.

MR. ZIMMERING:

So your goal, or function, or loyalty -- or however you want to describe it -- is to the integrity, maybe could be used, of the regulated entities? They are not paying more than their fair share of what they should be paying; is that a fair statement?

MR. GRACE:

That is my primary responsibility, yes.

MR. HOSTINSKY:

Perhaps I could clarify from a conceptual framework.

Basically, the cost system that we have that was prescribed in the joint [redacted]

In Gary's case, the cost causer is the regulated side. All of his costs would be driven that way.

I have other subordinates that the regulated side is not the cost causer. For example, some of the SEC filings that we do, some of them are corporate in nature. So those get allocated down both ways.

There are other SEC filings, for example, Cap Funding type filings, that would be driven down the nonregulated side.

So that the joint cost order requirements that we have to comply with

Tab

is basically to have a cost causative accounting system. And it, corporate headquarters, we have to conform with that because we have costs that chain in the regulation.

So not only is there a CAM, or the regulated companies, but when we do our cost accounting at BellSouth Corporate, we also have to have a cost causative type account cost accounting system to comport with that.

So that's how it works from a big picture standpoint.

MR. ZIMMERING:

Mr. Grace, how will your allocation of time, expenses, et cetera, change if BST becomes a legal entity, from the way it was last February 27th?

MR. GRACE:

I think the only change would be, rather than being split 50/50 between Southern and South Central, it would be a hundred percent to BST, unless I exception report for some unusual circumstance.

MR. ZIMMERING:

Will the allocations, as among the states that are utilized currently in Southern Bell and South Central Bell, change, once there is a BST; do you know?

MR. GRACE:

I don't know that.

MR. ZIMMERING:

Let's talk just for a minute about BellCore.

Can you briefly, either of you, briefly describe for me the nature of the research that is done at BellCore, or the nature of the services performed by BellCore?

MR. GRACE:

I am not -- I don't primarily get involved with BellCore. That is a BST subsidiary, and BST has various people that deal with the BellCore organization.

MR. ZIMMERING:

Are transactions between BellCore and South Central Bell considered affiliated transactions by Bell South Corporation?

MR. HOSTINSKY:

Yes. I think so. Sure.

MR. ZIMMERING:

Can either of you talk to those affiliated transactions?

MR. HOSTINSKY:

In terms of the structure, now, you know, getting into the detail of the individual transactions, that's done by subject matter experts in BST.

MR. ZIMMERING:

Who is the highest person in BST who could tell me how transactions between BellCore and either individual states or South Central Bell and Southern Bell are handled?

MR. GRACE:

I don't know the individual's name particularly, but I know it falls currently within Mr. Teel's organization.

MR. BARON:

We are speaking to him

this afternoon.

MR. ZIMMERING:

I want to make sure.

Does BellCore perform, can you tell me, generally, the kinds of functions BellCore performs?

MR. HOSTINSKY:

Applied research systems support to, you know, the major central systems.

MR. ZIMMERING:

Does BellCore perform any services, research, et cetera, that are utilizable by the nonregulated portions of Bell South Corporation?

MR. HOSTINSKY:

I wouldn't have any idea. I am not that familiar with their individual projects.

MR. ZIMMERING:

Do you know how much of the costs associated with BellCore's operations are assigned or allocated to the regulated entity?

MR. HOSTINSKY:

I would say substantially all. I don't know of any exceptions.

I think that kind of detail you, again, have to ask somebody in Mr. Teel's organization.

MR. ZIMMERING:

We can ask those questions of Mr. Teel this afternoon.

MR. KOLLEN:

You had said that your title was manager of affiliated and-or affiliated and transactions manager; is that correct?

MR. GRACE:

Operations manager.

MR. KOLLEN:

Okay, operations manager.

You have an organization that reports to you?

MR. GRACE:

Well, currently I don't have directly reporting subordinates.

MR. KOLLEN:

Could you explain your situation with respect to the support that you do have, organizationally?

MR. GRACE:

I utilize, as I need, resources, the activities of those in other BellSouth organizations, such as the accounting services organization.

MR. KOLLEN:

BellSouth Corp.

MR. GRACE:

BellSouth headquarters. That's the organization that actually runs the systems, the cost allocation system and the project billing system and does the BellSouth headquarters' financial books.

I also have access into the other departments as the need arises for information from those departments to satisfy regulatory inquiries and that type.

MR. KOLLEN:

Your function is to make sure the affiliated transactions are recorded properly?

MR. GRACE:

Yes. Although I am not in direct accounting responsibility for the recording of those transactions.

MR. KOLLEN:

I understand.

MR. HOSTINSKY:

Our control function assures a lot more than to assure we have cost order compliance.

MR. KOLLEN:

What about under BST, is there, or either that or under the South Central Bell or the Southern Bell organizational structures, is there a group or is there a manager or somebody responsible for affiliated transactions under their organizational structure that you are aware of?

MR. GRACE:

There certainly is.

MR. KOLLEN:

Who is that?

MR. GRACE:

Well, there is a pretty big organization, I guess Mr. Cochran is one person who is responsible.

MR. HOSTINSKY:

I think it's more than --

MR. BARON:

He is ubiquitous.

MR. HOSTINSKY:

It's more than one person. If you look at the basic internal control structure on how we try to deal with these things, and you look at the internal controls, it's not just Gary. There are folks in my organization that do some pretty important things.

Probably the foremost things we do is issue a comprehensive set of policies and guidance to all subsidiaries, both the BST and the BSE, in terms of what the company's expectations and intent is.

MR. KOLLEN:

Are these executive orders?

MR. HOSTINSKY:

There are some executive

directives that do it at the very highest level, but then beyond that, there are a series of accounting policy letters that do it very, in a very definitive manner.

And one of those assigns responsibilities to the various controllers' organizations as to what their responsibility is.

And I would guess y'all would have probably been supplied a document, it's a compendium document.

MR. KOLLEN:

We heard it was at least five rooms.

MR. COCHRAN:

You have the policy letter. I think you asked for those after --

MR. HOSTINSKY:

We are in the process of taking those policy letters now and converting them from Southern and South Central and looking at them from the new operating management structure with BST and making sure that the, that everything is still in sync with the new management structure.

The responsibility for compliance is more than one person or organization. The transactions are too numerous and too complex to have a very simple control structure.

There are just too important to us.

MRS. HALPERN:

What kinds of directives are in these policy letters?

MR. HOSTINSKY:

To give you an example, the highest level, there is an executive directive that basically says that the only sorts of affiliated transactions that BellSouth wants to enter into are those that are significant from a financial or strategic standpoint.

We are not interested in small, insignificant transactions, because we know that all those things do are create regulatory noise. And that noise is more detrimental to us than the value of the transactions.

So, first of all, we have an up-front intent that unless they are financially significant, unless they are strategically significant, then we don't want to fool with them.

Any new classes of transactions require the approval of the controllers in BST, BSE, and BSC, depending on how the transactions are proposed to flow.

So that's the starting point.

Then beyond that, we have some very specific safeguards that we have in place to try to make sure that the transactions flow.

We have got the policies and procedures documented in the accounting policy letters to include the specific assignments of the responsibilities and the subsidiaries.

We have the cost accounting manual that's a basic control, whereby we are required to put all the affiliated transactions in there, and we have to keep them current.

So we have the policies, the practices, we have the cost accounting manual; and then beyond that, as those policies are put in place, the systems are designed to assure that this cross subsidy issue is not a problem for us. And we undertake lots of different activities to do that.

Probably the one that comes to mind -- since y'all brought the subject of BellCore up -- for subsidiaries of the regulated carriers, we require that the investment and the dividends from those subsidiaries be included in the rate-making process in the intrastate jurisdictions.

And that way, there can be no cross subsidy, and there can't be any siphoning off of any excess profits over to the unregulated side.

MR. ZIMMERING:

Say that again.

MR. HOSTINSKY:

That side.

MR. ZIMMERING:

The last thing you just described, protecting rate payers.

MR. HOSTINSKY:

On the intrastate rate-making models that we have, we include the dividends and the investment for BellSouth Services, and also that would include BellCore, because BellCore is owned by BellSouth Services.

We include those in the rate-making process. And, therefore, there cannot be any over-earnings, or excessive profits in those entities, and there can be no harm to the intrastate rate payers.

MR. BARON:

Are you familiar with the audit that was done, talked about last week, that NARUC did of BellCore?

A. Yes

MR. HOSTINSKY:

Yes.

BY MR. BARON:

Q. I think I read BellSouth's response was what you just said. Even if it's true, it doesn't matter.

MR. HOSTINSKY:

Yes. Unfortunately, we may be unfairly painted with some of the other companies that have not taken that approach.

MR. BARON:

Even if there were over earnings, it wouldn't make any difference because of the way the transactions occur; is that what you are saying?

MR. HOSTINSKY:

That is correct.

MR. ZIMMERING:

Let me get this straight. The inclusion of dividends, investment, and I assume cost and expenses associated with BellSouth Services, in what I would call the traditional rate-making process, is deemed to be appropriate by BellSouth, by Southern Bell, and South Central Bell.

MR. HOSTINSKY:

We even filed that way and suggested it be adopted at the federal level at the time the joint cost order was put into place.

MR. ZIMMERING:

This is because those entities believe that it is necessary to insure, on the one hand, that BellSouth Services and BellCore as part of it, is receiving an appropriate payment for the services it provides, while at the same time protecting rate payers from over paying for that service.

MR. HOSTINSKY:

The procedures were basically adopted as a safeguard.

MR. ZIMMERING:

For the reasons I described, to insure that BellSouth Services is paid adequately, but no more than adequately, and to insure that rate payers are protected from over paying for a service.

MR. HOSTINSKY:

I don't think the procedure itself necessarily assures that the transactions are perfect between the two. But what it does assure is that if there are any problems, or if there are any inadvertent benefits that accrue on the other side, that those amounts are automatically put back into the regulatory model.

MR. ZIMMERING:

Okay, good.

Tell me why that exact same process is not appropriate for Yellow Pages operations.

MR. HOSTINSKY:

I don't have any idea. The BAPCO contracts existed long before the cost order.

MR. ZIMMERING:

This whole thing is driven by the joint cost order, or the whole thing is driven by the fact --

MR. HOSTINSKY:

Well, divestiture drove a lot of that. A lot of the safeguards we are talking about in our compliance is aimed at complying with the joint cost order.

MR. ZIMMERING:

Is it inappropriate to have safeguards from the company overearning on its BAPCO and Yellow Pages operations? Is it inappropriate to have those safeguards?

MR. HOSTINSKY:

Well, it's not inappropriate to have safeguards anywhere, if there is a cross subsidy issue and something can be done to assure that there are no cross subsidies within the corporation.

MR. ZIMMERING:

You would agree that in the area of affiliated transactions, there is a larger danger -- let me restate that -- there is a greater need for protection of rate payers than there would be, for example, in a situation -- let me ask it a better way.

Would you agree with affiliated transactions there is a larger possibility that there might be abuse of the system than there would be if whatever the transaction is were occurring in the open market with numerous bidders to provide the same service?

MR. HOSTINSKY:

I think I would agree with that. I think that's basically the conclusion that came [redacted] the joint cost order [redacted] basically, they [redacted] accounting safeguards.

MR. BARON:

I just want to ask a question about BellCore. Do you know whether BellCore retains any earnings or is it a hundred percent payout, through dividends?

MR. HOSTINSKY:

I am not positive on that.

I think for the most part, they pay a hundred percent dividends.

MR. GRACE:

I think that is right.

MR. HOSTINSKY:

I am not aware of any

holdbacks.

MRS. HALPERN:

Is the company preparing a response to the BellCore audit just released?

MR. HOSTINSKY:

There was no BellCore audit released to my knowledge. I understand there is a draft of a joint NARUC FCC staff audit that came out in the discussion last week, and that's going to be discussed at the NARUC meeting in San Antonio in a week or two.

To my knowledge, the information that's been leaked only deals with a staff level draft audit that has not been given any standing, official, by NARUC, and/or the FCC.

MR. COCHRAN:

It was a leak. One of the auditors, or somebody that had access to that audit, leaked it to the press.

MR. KOLLEN:

Let me ask you a question with respect to the BellCore dividends.

Those don't come back to BellSouth in the form of revenue. They come back in the form of what? Cash. But it's a reduction of your equity investment, right?

MR. GRACE:

They come back to BellSouth Services. And they --

MR. KOLLEN:

Right.

MR. GRACE:

They go into BellSouth Services, and that becomes part six in BellSouth Services, that possibly result in dividends going back to the telephone companies. They don't come back to BellSouth directly.

MR. KOLLEN:

What is the accounting form the dividends come back to BellSouth Services in. Does it come back and is recorded as revenues or a reduction in your equity investment in BellCore?

Is it treated as a normal common stock dividend?

MR. HOSTINSKY:

Right, normally, as income. Their investment remains the same.

MR. KOLLEN:

So that essentially by the time it factors all the way through the whole process, through the whole Bell South Corporation and comes back down over here into Louisiana retail rate making, basically what we are talking about is moving the common equity of that Louisiana interstate operation, either up or down, depending on the level of dividends that you receive back from BellCore that was filtered all the way through the different entities of BellSouth Corp.

MR. HOSTINSKY:

Yes. I don't know how they do the jurisdictional allocation, but from a Louisiana standpoint, there would be some additional increase in investment that would be attributed to the BellCore investment. And there would be a corresponding increase in income in the revenue requirements level to reflect the earnings level.

MR. KOLLEN:

Maybe I could direct this to Guy.

My problem is this, if in Louisiana re -- if there is a capital structure, and, in fact, the dividends from BellCore are being reflected through the capital structure, as opposed to revenues or expenses or operating income, then where do the Louisiana retail rate payers receive the direct effect of any over earnings or under earnings at BellCore?

MR. COCHRAN:

We don't, we account for the BellCore as a direct dividend. They pay that dividend to BellSouth Services.

It goes into other income.

MR. KOLLEN:

It goes into other income?

MR. COCHRAN:

Other income, of BellSouth Services. Other income of BellSouth Services.

Then the total earnings of BellSouth Services is accounted for on the equity basis in South Central Bell.

I put it in dividend. I increase the investment in BellSouth Services.

So I got the dividend and the inquiries. Once a quarter BellSouth Services pays me those dividends and that's when I reduce the dividends back.

I use standard accounting method between BellSouth Services and the telephone companies. When it gets on my books, BellSouth Services earnings come to my books, we call it the BellSouth Services dividends; but it's the absolute level of earnings in Bell. Or 50 percent. I get 50 percent of the earnings.

I take that and I move it above the line into rate making. It's just a --

MR. KOLLEN:

Into operating income.

MR. COCHRAN:

Operating income. We move it above the line in operating income.

And then we add the average, whatever the average investment is to the rate base. And that average investment, you are right, it does slightly go up and down, as the dividends are accrued and paid.

But that, the bulk, BellSouth Services has about a 200 million dollar investment, I think, 200, 250 million dollars, and the dividend is not a great deal of money.

MR. HOSTINSKY:

In our financial report, and we consolidate, so that's why Guy does the mechanics the way he does.

MR. ZIMMERING:

Let's take what today might be a typical affiliated transaction, which might be -- well, you tell me if this is one.

The performance of certain computer work by BellSouth Services for South Central Bell, in connection with, I don't know, a rate case, let's say.

Does BellSouth Services perform those kinds of functions for South Central Bell in connection with the rate case, or a tariff redesign regarding private line tariffs.

MR. HOSTINSKY:

They have got information systems, so that's likely.

MR. ZIMMERING:

That would be a typical kind of transaction?

MR. HOSTINSKY:

Yes, it would.

MR. ZIMMERING:

How are the rates for that, for the time, the computer time and the services performed by the BellSouth Services employees associated?

MR. GRACE:

Well, first of all, you are talking about a BellSouth Services transaction with South Central Bell?

MR. ZIMMERING:

Yes.

MR. GRACE:

There are organizations within BellSouth Services that handle that.

We are -- we are better able to talk to you about other types of affiliate transactions, say between Bell South Corporation and Southern Bell.

MR. ZIMMERING:

Give me a typical one between Bell South Corporation and South Central Bell.

MR. BARON:

I have got one I am interested in, so maybe you can use this as an example.

I think we were told by someone in a prior meeting about the method for accounting, or charging off the office building, the BellSouth Corporate headquarters down the street and how those costs, a share of those costs might an external reporting standpoint, and he uses his judgment in determining where he would like to have certified financial statements.

I guess another area that enters into it, if there gets to be a situation where you think you may be in a disposal mode or if you are protecting some of the taxes bases for acquisitions, then you certainly want it in those particular cases, too. It just makes that process flow.

MR. COCHRAN:

Mike is talking, I think, you are talking certified financials?

MR. HOSTINSKY:

Right, certified financials.

MR. COCHRAN:

When you talk about standing alone financials, he is talking about audited certified.

I think there are some additional financials for some of those companies that aren't audited and certified. Is that right?

MR. ZIMMERING:

If you mean to say you keep track of the expenses and the cost and revenues associated with all the company, I don't think he did.

MR. COCHRAN:

No, but I think there is a -- maybe not a financial statement, but a trial balance to consolidate.

You have got to have all the numbers to consolidate.

MR. HOSTINSKY:

Right.

MR. KOLLEN:

Otherwise, you wouldn't have financial results for each one of these legal entities.

MR. HOSTINSKY:

Oh, right.

We have a corporate chart of accounts, and there is the trial balance on a corporate consolidated chart of accounts for all the entities.

MR. KOLLEN:

Is there some place, some reference that you have that describes the corporate, or the organizational form and the ownership interests and the financial or capital structures of each one of these entities?

In other words, you must have to know some of this information in order to do your work.

Do you have a reference source that you rely upon?

MR. HOSTINSKY:

Yes, we have a master listing that's compiled from the secretaries' offices that keeps track of the financial architecture.

MR. KOLLEN:

What's it called?

MR. HOSTINSKY:

I don't know that it has a name. Gary, are you aware of any name?

MR. ZIMMERING:

If we preproduce this page of this interview and hand it to your lawyers, they would know what to go look for to produce this list for us? They will know exactly what we are after when they come to it?

MR. HOSTINSKY:

Right. Call it a legal structure chart.

MR. KOLLEN:

Even though you used the term previously the financial architecture, do you see that there is a difference between the two?

MR. HOSTINSKY:

No. It is basically what drives the financial architecture.

MR. KOLLEN:

What kind of information does that listing have on it?

MR. HOSTINSKY:

Company name and percentage ownership. Gary, does that sound right? I am trying to --

MR. ZIMMERING:

Debt financing? It doesn't show equity and debt?

MR. HOSTINSKY:

No.

MR. KOLLEN:

Certainly it must have an organizational form on it?

MR. HOSTINSKY:

Yes, right. You can tell that from Inc., or limited partnerships in the percent.

MR. KOLLEN:

That comes from the BSC secretary's office?

MR. HOSTINSKY:

Well, it generally, the way it flows is Gary gets information from the BSE secretary, and I guess the BST secretary, and any changes for mail for headquarters, for Corp.

Essentially, the three secretaries, BST, BSE and BSC.

MR. KOLLEN:

How frequently do you obtain this listing; once a month?

MR. GRACE:

I obtain the listing from BellSouth Enterprises once a month.

BellSouth, BST side, generally, is not changing quite as quickly, so that's on an as-needed basis.

MR. KOLLEN:

Then you probably get BSC monthly?

MR. GRACE:

I have access to that whenever I need it.

MR. HOSTINSKY:

Generally it's so small and so few, we know about the changes in that area. It's not like there is a long list. We wish the BSE was the same length as the BSC. But the corporate covenants and tax rules, both overseas and here, pretty much drive how many entities you have.

From a controller's standpoint, I would like to see half of what we have got, but the tax and legal folks say no way, Jose.

(Brief recess.)

MR. ZIMMERING:

I think maybe, which one

of you gentlemen knows more about the affiliated transactions, how they are billed, booked, and things like that?

MR. GRACE:

Probably I would.

MR. ZIMMERING:

Let's start with an easy one.

When you go back to work this afternoon, what are you going to do about the time you spent talking with us today?

MR. GRACE:

What I will do -- I am not sure how many hours we are talking about here --

MR. ZIMMERING:

Whatever it is.

MR. GRACE:

In the BellSouth headquarters accounting system, we have provisions for billing in about three or four different ways, one is a general allocation process, one is a specific project process, and I guess the third major one is I guess what we call the flow-through process.

To answer your question, within the general allocation process, there is a sub provision that allows me to specifically identify time that carries with it my salary and expenses and loadings, that I can directly attribute that amount of time to South Central Bell.

And so what I will do, when I fill out my exception time report at the end of this reporting time period, is that I will identify a certain number of hours specifically to South Central Bell.

Our accounting system will then attribute that amount of time and associated expenses to South Central Bell, as apart from the normal occasion of my time between the companies.

MR. ZIMMBRING:

That's why it's called an exception in time reporting?

MR. GRACE:

That is correct.

MR. ZIMMERING:
Because this is, essentially, out of the norm?
MR. GRACE:
Normally my time is split between Southern and South Central Bell because of my regulatory support function between, that's equally applicable to those two companies.
While I am supporting one of those companies in the, in this case supporting a particular rate case activity or a particular audit activity, then I charge that time directly to them.
Similarly, if I am preparing some type of pleading or responding to data request from a Southern Bell state, I would charge that time directly to them.
But a part of my time that I can't identify to a particular proceeding or particular state is allocated equally between the two companies.
MR. ZIMMERING:
Normally, it's a 50/50

split, unless you are working on a particular project that you can do a direct allocation or direct assignments.

MR. GRACE:

That is correct.

MR. BARON:

Will it be, once the merger take place, or perhaps even now, will it go a ninth to each state, or be to BST.

Do you have any knowledge how that will work?

MR. GRACE:

From Bell South Corporation, I will attribute it to BST.

MR. BARON:

And they will allocate it.

MR. GRACE:

They have a number of ways they allocate expenses between states, BST.

MR. BARON:

You would not designate specifically that it is

Louisiana-related?

MR. GRACE:

I can do that. At times I do report that this particular expense was Louisiana-related, especially on voucher type expenses, that part of the purpose would identify the location.

MR. BARON:

All right.

MR. ZIMMERING:

Is any part of your job not regulatory support function? That is do you spend any time working for BSE?

MR. GRACE:

Only to the extent that I am working with BSE on some regulatory inquiry.

To answer your question, all of my time, in some form or fashion, is directly tied to a regulatory activity.

MR. ZIMMERING:

So if you are working for BSE, it would be in a context where there was a, for example, transaction between a BSE entity and one of the regulated be allocated to South Central Bell, or BST, as the case may be.

MR. GRACE:

Okay.

MR. BARON:

There is an example.

MR. ZIMMERING:

How is that negotiated?

MR. GRACE:

As far as negotiated, it's -- the formal negotiations, I think, are not there, as one person sitting across the table.

This cost accounting manual here identifies those types of transactions must take place, based on the hierarchy.

And in the case of the rent at the BellSouth headquarters building, it would be in accordance with either market value or fully distributed costs.

In the case of BellSouth headquarters, we bill our subsidiaries based on a market base for leases of office space, which we then look at and

determine that that is below what we
would charge if it was for the
distributed cost basis.

MR. BARON:

To make sure I understand.

I understand that you actually pay a lease payment to a subsidiary of BellSouth Corp., which has a lease for whatever price it has; but you are saying that the charge you make to South Central Bell and Southern Bell is not based on that cost; it's something less than or equal to that, based on the market assessment?

MR. GRACE:

Let me go into it just a little bit more.

The owner of the BellSouth headquarters building is a company called 155 Peachtree Associates.

It's a partnership between BellSouth and Carter and Associates, or some organization of Carter and Associates.

BellSouth rents space, leases

space within that building.

There are other tenants that lease space within that building.

On a market basis analysis, we have determined that the market base, in other words, a comparable between the BellSouth lease and an outside tenant lease in that building, is less than the fully distributed lease rate would be; and so we bill, through an overhead process, the amount for the BellSouth rental payment for the square feet that we occupy in that building, is billed at the lease rate of what the outside tenant is paying in the same, in that building.

MR. BARON:

Which is less than your actual cost?

MR. GRACE:

Less than the fully distributed cost.

MR. BARON:

When you say fully distributed, you mean the payment that the company actually makes to the partnership? What do you mean by the --

MR. GRACE:

There are a lot of other things that go into fully distributed costing analysis, other than just a direct write the check payment. There are all kinds of loadings that go on in a, if BellSouth, under the joint cost order, could pass on through as an expense of occupancy.

MR. ZIMMERING:

Is the fully distributed cost applied to what would have to be paid for the owners of the 1155 Corporation for them to fully recover their investment? Is that what fully distributed cost means in this situation?

MR. GRACE:

Well, the owners of 1155 Peachtree, of course they recover cost through the, their normal leasing process, both from internal and from external tenants; and, of course, their external tenants are *not* subject to joint cost rules.

Maybe I have misunderstood your question --

MR. ZIMMERING:

We are still looking for a definition of whose fully distributed costs.

MR. BARON:

In general we understand what fully distributed cost is. I thought we were just talking about the rental, the space, the rental payment component.

In other words, you have other overhead costs -- and I wasn't, I thought those would be passed on independently of a lease payment. That's what I am having some confusion.

You were talking about loading additional costs on to what your actual lease payment would be, or your rental payment?

MR. GRACE:

What I am saying is we

only pass on, in the form of overhead loadings for billing, the amount of the BellSouth lease expense that is comparable to leases of outside, unaffiliated tenants within our building.

If our lease payment requires a larger payment, then those are retained. We don't bill those through.

MR. BARON:

When you say fully distributed costs, you mean the total costs that you pass on to the --

MR. GRACE:

If that is greater than our comparable outside lease, then we don't bill the fully distributed cost. We only bill the "market rate" that is being paid by outside tenants.

MR. BARON:

Whatever is less is the rule?

MR. GRACE:

Yes.

MR. HOSTINSKY:

The general rule for

affiliated transactions for products and services is first tariff, if there is one. If there isn't one, it's market.

If there is neither tariff nor market, then the rule says you bill fully distributed cost.

The fully distributed cost would apply to that nonregulated affiliate's cost, and can include a return, but it can't exceed the interstate authorized rate of return, 11.25.

MRS. HALPERN:

This is all, this oversees all affiliated transactions, those rules you just said?

MR. HOSTINSKY:

That's the rule.

MRS. HALPERN:

Where is that written, the cost allocation --

MR. HOSTINSKY:

Basically that's Part 64 dot 901.

If you want to deal with

affiliated transactions that involve the transfer of assets, that's Part 32 dot 27.

There is a very definitive set of rules, and you would find all of these concepts in those policy documents. We go to great length to get at the very issues you seem to be wanting to know more about.

MR. ZIMMERING:

32 point 27 in Commission language.

Who is the --

MR. BARON:

Guy, did you have something --

MR. COCHRAN:

I think what Gary, if you look at numbers -- I am going to make up some numbers -- the fully distributed cost of that building, and that's basically maintenance and depreciation, return on investment, is 90 percent of what makes up the FDC, would be about $30 or $40 a square foot.

The lease rate that the outside tenants are paying is like, I don't know, this is somewhere in the ballpark, $18 a square foot. What they are billing us is $18 a square feet. They may be paying Camp and Neal, 1155, 19, 19 and a half.

Because when you set the lease rate that the company was going to pay for Camp and Neal, there were no external tenants.

The FCC came out with clarifications after all this was done. The lease was set up prior to the hierarchy and all of that.

So there was -- but basically, the FCC said that market has to be based on what you are selling it for. You can't go out and do a survey of buildings in this area and say that's market.

Even though, to me, that's a pretty good indication that's a market rate, the FCC said no, if you are not selling it, you don't have a market. If we don't have any tenants in that building, I would tell you that's better than FDC, because FDC on a building is substantially higher than a per square foot.

MR. BARON:

That's what I was confused about. You have a contract for lease, and fully distributed cost is basically if you incorporated the asset and calculated your true cost, which is a lot higher. And you are saying that the rules were moved, if there is no market based price it would move to fully distributed cost as opposed to this transaction that you have got called a lease.

MR. COCHRAN:

According to a literal reading of the FCC rules and their interpretation, if you don't sell it outside, you charge FDC.

In the case of like a building, if you don't have any other tenants, that makes no sense. Because you can look around.

MR. HOSTINSKY:

If you have market, you must charge market. It's not an option.

MR. ZIMMERING:

Market, as you perceive it, is defined by the FCC as a market for identical space in the identical building, not market for office space downtown Atlanta.

MR. HOSTINSKY:

Third-party transactions by the nonregulated affiliate.

MR. ZIMMERING:

Let me give you this hypothetical and see how this works.

Bell South Corporation goes out and builds 1155 Platinum. At 1155 Platinum at fully distributed cost would be $150 a square foot, okay?

It enters into a lease. It does the same thing that it does right now, okay? It has a partner, and a lease is entered into between Bell South Corporation and 1155 Platinum for a hundred bucks a square foot.

There are no other tenants.

According to the way you read the rules, $150 is what must be charged, because that would be fully distributed costs, correct?

MR. HOSTINSKY:

Yes.

MR. ZIMMERING:

Or if the Rockefeller Foundation wanted to pay $125 for that space, $125 would be what was used. Correct?

MR. HOSTINSKY:

That is correct.

MR. ZIMMERING:

However, the 1151 building has only gold space available for $50.00 a square foot -- are you with me -- and that can't be used as a market or comparable.

MR. HOSTINSKY:

That is correct.

MR. ZIMMERING:

That helps me understand how this works.

MR. BARON:

Are there other transactions similar to this in the corporation where you have to make an assessment as to market or fully distributed costs?

MR. HOSTINSKY:

You have to make the assessment on every transaction.

MR. BARON:

Every transaction.

MR. HOSTINSKY:

That's what the policies and practices do is essentially give you that guidance and assign responsibility for making those assessments.

MR. GRACE:

As an example, if an employee transfers, say, from BST to BellSouth headquarters, and his furniture and personal computer follow along, literally to make that asset transfer from BST to Bell South Corporation, an analysis has to be done on those assets, to determine what their netbook value is versus their fair market value. And then these rules determine whether the higher or lower would be charged.

MR. HOSTINSKY:

Then, of course, we have to engage an external auditor to audit this entire process on an annual basis, that's also a joint cost.

MRS. HALPERN:

Who is the major outside tenant in Camp and Neal.

MR. HOSTINSKY:

Coopers and Lybrand is probably --

MRS. HALPERN:

That's your external auditor?

MR. HOSTINSKY:

Yes. Procedures and processes were put in place, actually take place, and it deems both with affiliated transaction side, as well as the internal cost allocation side.

64901, 32 dot 27, as well as the one itself.

MR. BARON:
This is Coopers and Lybrand's audit?
MR. HOSTINSKY:
Yes. It was upgraded from a test in '89 to a financial audit for '90.
MR. KOLLEN:
Do they issue a report annually, then?
MR. HOSTINSKY:
Yes, they do.
MR. COCHRAN:
One more thing, the FCC takes their work papers to Washington and goes through their work papers.
It's not a, it's something the FCC -- I think ultimately, when they become satisfied that they are -- that the firms understand what the FCC wants, they will probably stop doing that.
But the first three years of this, they have, the FCC has reviewed all the work papers of all the firms of all the LECs, including GTE, Cincinnati.

MR. HOSTINSKY:

They give us both individual and industry feedback.

The industry feedback, from the 1989 round, has been made a part of the CI-3 docket, and it has to do with some consistency issues that they want; also there are some issues about, when we make changes to the CAM, as to what the magnitude of the change is.

And they have asked us to quantify those or at least try to break them into proper categories.

So that process of public debate is in process, and we expect to final order and will implement that as quick as we can.

And, in fact, have implemented most of the recommendations already.

MR. KOLLEN:

You get the feedback, who from, the FCC?

MR. HOSTINSKY:

Yes, the FCC staff. The audit staff.

MRS. HALPERN:

Are you saying that the audit, this external audit would extend to all of these transactions in the cost allocations --

MR. HOSTINSKY:

Yes, ma'am.

MR. LLEWELLYN:

One thing, too, to avoid confusion, in the hierarchy of things he mentioned the word tariff being the highest level of it.

A lot of transactions may only be selling of telephone service between South Central Bell and a company that happens to be affiliated and operating in our area.

MR. HOSTINSKY:

Your cellular phone in New Orleans, may buy from --

MR. LLEWELLYN:

We provide telephone service to everybody, but that everybody, one of them may be an affiliated company, that will show up in the affiliated transaction chart.

MR. BARON:

I was just wondering, on an order of magnitude basis, the total charges, if you know, from BellSouth Corp. to BST, let's say, on an annual basis.

This order of magnitude is all I am looking for.

MR. GRACE:

From -- well, of course, we haven't done a BST --

MR. BARON:

If you have South Central Bell and Southern Bell separate.

MR. GRACE:

-- from the general allocation process, and these are real broad numbers --

MR. BARON:

That's fine.

MR. GRACE:

I would think in the magnitude of 40 million dollars, from BellSouth headquarters to South Central

Bell.

From the project billing process, that goes pretty small, to South Central Bell, two to three million.

The other category that I mentioned was flow-through billing.

That's largely because BellSouth headquarters actually makes, writes the checks to all the taxing authorities, all of the property taxes, state income taxes, the license taxes and everything; and then out of our consolidated tax organization at BellSouth headquarters, and then directly passes those to the company.

So there is several hundred millions of dollars, as you can imagine, of payment.

Now, those don't appear as actual expenses on the BellSouth headquarters books. They are merely paid and then reimbursed by the company.

MR. BARON:

The general allocator is 50/50. So presumably, there was 40 million to Southern Bell as well?

MR. GRACE:

No.

MR. BARON:

It's not 50/50?

MR. GRACE:

There are a number of allocators that allocate various expenses from various functions within BellSouth headquarters.

Historically, the general split between Southern and South Central of the total BellSouth allocated charges was about 36 percent, I believe, 37; something like that, to South Central Bell and about 51 to 52 percent to Southern Bell, with the remainder to BellSouth Enterprise.

MR. HOSTINSKY:

We have our own cost accounting manual at BellSouth Corporate that's based on the cost causative doctrine. Just as the CAM in the BST folks have to comply with, we have a similar type of cost accounting manual

-- not precisely, but in concept.

MR. BARON:

Do you remember what the project charges, roughly, would be to Southern Bell? You had given two to three million to South Central Bell.

MR. GRACE:

What they were before?

MR. BARON:

No. The order of magnitude to Southern Bell. Is it about the same?

MR. GRACE:

About the same. Probably a little bit more to Southern Bell, but not significantly more.

MR. KOLLEN:

Percentages you had given before, roughly 38 percent to South Central, was it 52 to Southern Bell?

MR. GRACE:

51 to 52.

MR. BARON:

I think it was 35.

MR. GRACE:

It moves over time. We recalculate the percentages every month. That's affiliates. Just to take an aggregate of some 70 or so differential ratios and put them together into an overall average.

MR. ABBOTT:

The figure you stated was 36 --

MR. GRACE:

36 to 37.

MR. BARON:

For South Central Bell and 52 for Southern Bell and the remainder was nontelephone.

MR. ZIMMERING:

Would you take a look again at the chart -- okay, I need one to look at -- can you tell me which of these companies are profit centers? And which ones are cost centers, for want of a better word.

MR. GRACE:

Well, on the top row of boxes, Southern Bell and South Central

Bell would be profit centers.

MR. ZIMMERING:

All the rest are cost centers?

MR. HOSTINSKY:

Yes.

MR. GRACE:

In the BellSouth Enterprises group, I think pretty much all of those would be profit centers.

MR. ZIMMERING:

Were they all profit centers two years ago? Did some just turn the corner?

MR. GRACE:

Well, maybe not following your definition of profit center. Do they stand on their own on a profit and loss, not whether in fact there was a profit or loss.

MR. ZIMMERING:

Oh, no, I want to know whether in fact there was a profit or loss. My fault with not defining profit center properly.

I want to know if they, in fact, make money.

MR. GRACE:

I can't tell you for any individual company.

MR. ZIMMERING:

What would I have to ask for the company from 1984, 1989, 1988, to find out which of these companies, in fact, made money.

MR. LLEWELLYN:

Some of these companies weren't owned --

MR. ZIMMERING:

I understand.

What pieces of paper would I have to ask for? An income statement?

MR. HOSTINSKY:

That's the way you find out.

MR. ZIMMERING:

An income statement on each of these companies and that will tell me whether, in fact, they were profitable year to year.

MR. HOSTINSKY:

Or just year, if you have interest in the magnitude.

MR. ZIMMERING:

What corporate goals exist regarding capitalization of unregulated and regulated subsidiaries?

MR. HOSTINSKY:

You have to repeat that. I am not sure I understand.

MR. ZIMMERING:

What corporate goals exist regarding capitalization, percent equity, percent debt, of unregulated and regulated subsidiaries.

MR. HOSTINSKY:

I am not aware of any.

MR. GRACE:

Not any specific ones.

MR. ZIMMERING:

To the extent that a company was acquired, and it had debt when it was acquired, and that debt has been eliminated in one form or another, okay? So that the company is now a one hundred percent equity, the subsidiary is, where did that money come from to eliminate the debt?

MR. HOSTINSKY:

It would either have come from current operations or it would have come from the pool of funds at the corporate level.

I cannot think of any other sources.

MR. ZIMMERING:

We know it didn't come from debt, because you told us that Bell South Corporation -- unless we may be missing some little thing -- doesn't have any long-term, any long-term debt, and not a substantial amount of short-term debt.

MR. HOSTINSKY:

Right.

MR. ZIMMERING:

Do all of the unregulated subsidiaries of Bell South Corporation have equal risk?

MR. HOSTINSKY:

I -- I wouldn't have any idea. I am certainly not involved in anything that would give me any feel for which ones would have how much risk.

MR. ZIMMERING:

Are you aware of a show-cause order that was issued -- and I don't know if it's actually, it was called a show-cause order -- but an order that was issued, I believe, by the Alabama Commission regarding certain dollars associated with BAPCO and the way the company was accounting for them?

MR. HOSTINSKY:

I am not.

MR. GRACE:

I am generally aware there was a proceeding. I am not familiar with whatever information you have referenced.

MR. ZIMMERING:

Do you know -- well, when BST was formed, there were certain BBS companies that were moved in to BST; are you aware of that?

MR. HOSTINSKY:
Yes.
MR. ZIMMERING:
Do you know why those companies were moved into BST?
MR. HOSTINSKY:
I guess we made the transactions, and I know what's been happening. They formed a BBS company in Enterprises, and they assigned BCI to that company.
They then dividended that up to corporate and we made an equity infusion down to BST.
The primary motivation we were given for making that transaction was primarily corporate governments and tax reasons.
MR. ZIMMERING:
What is corporate governments?
MR. HOSTINSKY:
Legal reasons as to how you can move legal entities around within different holding companies.

The plans are that we will form another holding company with which we are calling BBS-II, and we will put BellSouth Communications, let's see, it's BCS.

I guess I would have to go with the acronym, BellSouth Communications System, in Dataserv and we will follow the same process.

When BBS-I and BBS-II meet on the other side, those two will be merged.

The reason for that, again, corporate governments and the tax reason of protecting the tax bases for those acquired acquisitions on BCS and on Dataserv.

MR. ZIMMERING:

So other than the tax reasons, do you know of any other substantive reason why they meshed properly in BST and elsewhere, why those companies were moved?

MR. HOSTINSKY:

No.

MR. ZIMMERING:

Do you know any reason why

Bell South Advertising and Publishing, L. M. Berry and Company, tech staff were not moved into BST?

MR. HOSTINSKY:

No.

MR. KOLLEN:

Do you know who made the decision to move those companies, Dataserv and BellSouth Communication Systems, into BST in the manner in which you described?

MR. HOSTINSKY:

No, except for the legal and tax context it is. But in terms of who made the decision, I don't know how that decision was made.

MR. KOLLEN:

How is it communicated to you to do this type of transaction? Who tells you that this is going to happen; we want you to record the effect of it.

MR. HOSTINSKY:

Primarily, it comes through the legal people who are involved in corporate governments. Frequently a tax attorney that gives us guidance in terms of structure.

MR. ZIMMERING:

Where does that person fall within the organization?

MR. HOSTINSKY:

BSC legal.

Usually there is a series of meetings, once you have a proposed transfer in which all disciplines are invited to give discipline; and in this case, multi-company, multi-discipline had some sessions, and usually, unless there are any unusual situations, the tax and the legal considerations pretty much drive the accounting.

MRS. HALPERN:

Why is 1155 Peachtree, and Carter and Associates, why are those entities listed on here? Or are they? I am referring to the BellSouth Corporate structure chart, in section four of the cost allocation.

MR. GRACE:

It's a nonconsolidated

partnership.

MRS. HALPERN:

Is that one of the guidelines you follow in listing the equity ownership, whether it's a nonconsolidated partnership?

MR. ZIMMERING:

This is what you are talking about earlier?

MR. HOSTINSKY:

These are corporations as opposed to partnerships, right.

MR. ZIMMERING:

Any venture that BellSouth, or any of the affiliated companies might be involved in that takes the form of a partnership or limited partnership, would not appear on this structural sheet?

MR. HOSTINSKY:

Right.

MR. KOLLEN:

That explains why these are all corporations. Thank you very much.

MRS. HALPERN:

Can you tell us what the partnerships are that you would have an equity interest in?

MR. HOSTINSKY:

I assume you are going to ask for that list. That list will have all of them.

MR. KOLLEN:

You will be sure to know what we are asking for.

MR. COCHRAN:

Aren't most of them, though, cellular. You have 1155, and that's almost an exception.

Everything else is a corporation except for those massive numbers of cellular.

MR. ZIMMERING:

Those are the ones in partnership with other companies to provide the cellular service.

MR. COCHRAN:

Yes.

MR. HOSTINSKY:

Those are the ones that came about as a result of the lottery process, the manner in which the FCC issued the nonwireline licenses. That's why you have so many.

Plus on the foreign side, I think there may be some partnerships there, but all those things are tied up, basically, in our efforts to partner up with people that have ties and influence in particular countries.

MR. LLEWELLYN:

You may want to clarify the lottery.

MR. BARON:

Did the partnerships tend to report up through the corporate structure, based on function, cellular, then it would be through --

MR. GRACE:

Within the mobile systems group.

MR. HOSTINSKY:

Right. And you have got, of course, the partnership at 1155, and you have a few real estate partnerships in Sunlink.

MR. KOLLEN:

1155 partnership is under Sunlink?

MR. HOSTINSKY:

No.

MR. KOLLEN:

Where on this chart would that flow through, even though it's not shown on the chart. Would it be under BSE?

MR. GRACE:

Which one?

MR. KOLLEN:

1155 Peachtree.

MR. GRACE:

Straight to Bell South Corporation.

MR. HOSTINSKY:

Right.

MRS. HALPERN:

Are there entities other than joint partnerships that we should be looking for?

MR. ZIMMERING:

That are not on here?

MR. HOSTINSKY:

There may be some down in the Enterprises area. If there are, they will show up on that other.

I cannot think of any significant.

MR. ABBOTT:

I think we operate like Louisiana law, but there is no difference between a joint venture and a partnership.

MR. COCHRAN:

On Mobility, the Mobility corporate, all those partnerships would be consolidated up through there. For their financial -- when I say consolidated -- the earnings of all those partnerships would be reflected in the Mobility's earnings.

MR. HOSTINSKY:

That is correct.

MR. BARON:

Yes. That's what I

understand you to say.

MR. HOSTINSKY:

We have a couple of cellular properties that we don't have control of that aren't consolidated.

But they flow up, too, -- they throw up through Enterprises, I believe.

MR. BARON:

I have got a question.

I think early on, you had made a reference to the strategic plan.

Is there, to your knowledge, is there a BellSouth Corporate strategic plan?

MR. HOSTINSKY:

Well, you know, I am not that familiar with the document itself, but we have a strategic planning group; and whether it's quoted in one, embodied in one document or lots of different documents, I am not that familiar with.

We have a departmental strategic plan that goes at input to the strategic planning process.

MR. ZIMMERING:

Do most departments have such a strategic plan?

MR. HOSTINSKY:

At BellSouth Corp., they do. I am not that familiar with how all the other functions do their planning.

MR. BARON:

I have an organization chart dated 12/90. There is a group called corporate planning and budget and under it is director financial management, director corporate planning. Is that where strategic planning is located?

MR. HOSTINSKY:

Yes. Clem Patton is the officer that has authority, both --

MRS. HALPERN:

That would extend to Enterprises, unregulated entities, as well as the telephone companies?

MR. HOSTINSKY:

Again, I think it's more set up where they have their own functions over there. This is one of those functions that is also not only found within legal entities, but is a function that transcends the corporation, just like auditing taxes, controls treasury.

All those things have to mesh. So they have horizontal and vertical linkage.

MR. BARON:

Have you ever seen a so-called strategic plan, or planning document for BellSouth Corp.

MR. HOSTINSKY:

No, I haven't.

MRS. HALPERN:

Have you?

MR. GRACE:

Not except for the one that Mike referenced for our particular part. I have never seen a document that was titled BellSouth strategic plan that incorporated everything.

MR. KOLLEN:

What time horizon do you

prepare, what time horizon do you operate under when you prepare your strategic plan for your department?

MR. HOSTINSKY:

Prior to the financial plan, so I think usually like late summer.

MR. KOLLEN:

For how many years into the future.

MR. HOSTINSKY:

Once a year. I think ours is more qualitative. The primary focus is into the next year, in terms of specific.

And then, you know, when you start your financial plan, then you try to make sure that you are addressing the things in there and assigning resources and so forth.

MR. BARON:

These are the broad-based goals, so to speak?

MR. HOSTINSKY:

Right, yes.

MR. BARON:

Did you have any involvement in the process that the corporation went through in deciding to restructure and then, ultimately, merge?

Were you involved in that in any way?

MR. HOSTINSKY:

I was. I was interviewed by John Gunner from the management structuring side; and then after that process and the decision was made that we were going to go to a different management structuring, that we were going to manage the nine states, as one, I was asked to provide input to him a couple of times on the question of whether we should collapse legal entities or not.

Basically, gave him the, what I think is the, pretty much the controller's viewpoint of that.

And that, basically, that when you made the decision we did on the management restructuring, that the collapsing of the legal entities was just a logical extension of that. And that it was probably the most humane thing you could do to control those people.

And, basically, straightforward as that.

The logic is pretty simple. The logic is the transactions are the root of all evil. And if you look at these affiliated transactions, between Services and Southern and South Central, you think about what those transactions generate, essentially you have got, first of all you have got a cost allocation in the company that initially incurs the cost.

So you have to go through this exercise of putting it in a cost pool, maybe keeping part of it, maybe getting the other part of it ready to bill; then you have got a billing transaction, such that you send it out.

And then, when it goes over to the other affiliate, you have got somebody that's got to receive it. And since you have got receiving and sending, generally you have to have somebody to track it to referee the receivers and senders.

Then you have to have another cost allocation process to go down within the receiving company, such that it goes through the reg, nonreg, jurisdictional allocations and finally gets down to the bottom line.

So, basically, the management structure they had chosen, from a controllers' standpoint, was a nightmare.

That's not to say we couldn't do it, because, I mean given enough computers and given enough accountants, we would be able to generate some systems.

But for a while, if the poor guy out in, I guess I should use Louisiana -- although I have served my tour in a couple of other jurisdictions -- the poor guy in Louisiana down there, if he happens to have responsibilities for three or four states, when he goes to open his mail, he is going to find he gets lots of letters from Birmingham, Jackson, Louisville, as well as his own local controllers people.

Then he is going to have to take all those things and pull them all together and figure out the cost information he needs to run the business.

MR. BARON:

When you first became aware a decision to restructure had been made, was there any question in your mind there would be a legal merger that followed?

MR. HOSTINSKY:

I guess I wasn't sure. I had been interviewed early on. Of course the external environment and the business needs always prevail. That's the overriding consideration, because you can make the accounting work.

I guess what I started hoping for was once that decision was made, and departments start understanding what it was going to take for them to get the information they need to run the business, that there would be a ground swell for collapsing legal entities.

And, you know, I was delighted to see that Mr. Gunner was asked again to review the issue of what you should do about the legal entity.

And, of course, I have some friends in other companies, because I have external responsibilities; and the U. S. West people had been warning me, and had actually sympathized with me, once they found out we were going to management restructuring without collapsing the legal entities.

And I had hoped at that time it would happen.

Eventually the issue came up, and, of course, we gave a lot of input, basically along the same lines I just gave you. It's a lot easier to do one set of internal cost allocations than it is to do multiple transactions.

And that, basically, by

collapsing into one legal structure, you eliminate tons of intramural transactions that don't add value to the business.

Fortunately, the decision was made to seek approval to collapse the legal entities.

MRS. HALPERN:

I was asking you before about the policy matters that seem to have, getting general guidance as to what was in these policy letters when we went off on a tangent.

So can you kind of go back to that area? We were talking about affiliated transactions and guidelines related to that.

You said something about there being a certain level at which you wouldn't enter into an affiliated transaction; is that right? If it's too low?

MR. HOSTINSKY:

Well, the, I guess the executive director that we had that governs the affiliated transactions in general says if it's not financially or strategically important, that we would not enter into those sorts of transactions.

Those are basically judgment calls made by officer level, the vice president, controllers, and BST, BSE, and BellSouth Corp.

MR. ZIMMERING:

Is that something you would look at current affiliated transactions and try to eliminate some, or would it be more in the context of, when we are looking at new affiliated transactions, let's apply these guidelines?

MR. HOSTINSKY:

That was designed, when we put it in, primarily as a prospective type arrangement, once we found we needed it.

But at the same time, we have this annual audit process, so we get feedback every year; and as a result of that feedback, we take whatever steps we feel are necessary to alter or change existing relationships.

MR. ZIMMERING:

Are you affirmatively trying to cut down, I mean every year, do you look and say let me pare down affiliated transactions, so this year there will be X minus 2000?

MR. HOSTINSKY:

Yes. I give you a perfect example. Last year the FCC Ultra came in. He did not like a company called TeleSensor.

I don't know a whole lot about this company except they did computerized controls for heating and air conditioning systems in large buildings.

And there were some transactions between BSE and the regulated companies, I think perhaps for column A, or some other buildings within the regulated side.

And what he disliked was not so much that the costs were different, because we use the same elements of cost, but what he didn't like was the fact that these were all custom projects and there was really no assurance as to how many units of labor that it would take, or units of material.

And he raised the issue, and was concerned about the appearance or the inability of the regulatory safeguard to address that concern.

So it didn't take us too many months after that before we decided that the regulatory noise was not worth it. And Enterprises disposed of that particular line of business.

And, you know, I don't know exactly how the decision was made on their side, but certainly when the findings came out, and the discussions that were held, it was agreed with the BellSouth Corporate and BellSouth Enterprises people, that that was not the kind of transaction we wanted to continue.

It just wasn't worth the regulatory noise. So kaput.

MRS. HALPERN:

How often does the FCC do audits of affiliated -- like what you just described?

MR. HOSTINSKY:

Periodically.

They did one last year.

I have heard rumors that NARUC is pushing for a joint NARUC FCC audit, that would take place next year

MR. ZIMMERING:

When was the last one prior to last year?

MR. HOSTINSKY:

I think that was the first on the FCC side.

MR. GRACE:

FCC staff audit. We had a station audit.

MR. KOLLEN:

Was that every affiliated transaction, or was that selected, in selected areas, or just an overview?

What was the scope of that FCC transaction audit?

MR. HOSTINSKY:

Well, I know they came and spent a week with the regulated carriers in looking at BellSouth Services, and then they planned one week on some of the Corporate and Enterprises subsidiaries; and then they expanded right at the end to include an additional listing of companies.

So I don't know. I don't believe I can say they got every single affiliated transaction, but it appeared to me, as an ex-auditor, perhaps they went through and used the initial review they made when they came in to expand their scope to satisfy whatever risk elements they placed on the whole subject matter.

MR. KOLLEN:

Is there a report?

MR. HOSTINSKY:

No report has been issued so far.

MR. ZIMMERING:

Give me an order of

magnitude. In 1990, how many affiliated transactions there were in Bell South Corporation. Are we talking 10,000, a hundred thousand?

MR. HOSTINSKY:

I am not sure. You are talking about individual transactions?

MR. ZIMMERING:

I don't know. However you guys define them.

MR. HOSTINSKY:

The easiest way to look is look at CAM and look at the affiliated transaction section and see how long the listing is.

You can compare length of listing.

MR. ZIMMERING:

I do not understand what you are talking about. Do you want me to go down the affiliated rules description of services?

MR. HOSTINSKY:

That's the complete listing at any given time of the affiliated transactions.

MR. ZIMMERING:

If we include telephone service, for example, and you included each line or each call separately, we would be talking about millions and millions of affiliated transactions, or billing done by one entity for another, we are talking millions and millions of transactions.

MR. HOSTINSKY:

I don't know about billing.

MR. ZIMMERING:

Not by itself. Telecommunications services, aggregated with that, telecommunications services daily, okay?

MR. HOSTINSKY:

Right, sure.

MR. ZIMMERING:

Legal and medical services on request; public affairs involving federal regulatory and federal legislative activities.

Anything I look at that says daily might be billed as a separate item, providing financial services such as securing capital -- that's a bad one --

MR. GRACE:

They are accumulated daily and billed on a monthly basis.

MR. ZIMMERING:

In your mind, it wouldn't be fruitful to say on an order of magnitude there were X number of affiliated transactions.

MR. HOSTINSKY:

Right. We look at it from a classes of transactions standpoint.

Part of the discussion, when I gave input in terms of my speech, transactions were the root of all evil, was essentially that if you played what-if, and you collapsed the legal entities, you can probably shorten that section of the cost accounting manual by a considerable number of pages.

MR. ZIMMERING:

But the transactions themselves wouldn't change.

MR. HOSTINSKY:

The transactions would go away.

MR. ZIMMERING:

The services provided would not change?

MR. HOSTINSKY:

That is correct.

MRS. HALPERN:

The company gets to decide the classes of transactions? The FCC doesn't have rules which say --

MR. HOSTINSKY:

Right.

MRS. HALPERN:

-- you can do this and this. The company decides that, right?

MR. HOSTINSKY:

Right. There are some legal requirements, I understand, on certain types of transactions, I know particularly when you get into cellular.

MRS. HALPERN:

What is something that would be a financially, of enough financial importance to be an affiliated transaction?

MR. HOSTINSKY:

Well, you know, I think the ones we have got listed.

MRS. HALPERN:

Is there a general dollar --

MR. HOSTINSKY:

No.

MRS. HALPERN:

-- guideline.

MR. HOSTINSKY:

Strictly from a judgment standpoint.

MRS. HALPERN:

What is the strategic importance; what are some of those guidelines that the officers would follow?

MR. HOSTINSKY:

I think, you know, my boss looks at it, but basically, you know, does it make sense, is it likely to be a major contributor at some point in the future; or is it absolutely necessary, such that it cannot be provided from an external source or another more appropriate internal source.

MR. ZIMMERING:

Is that a guideline that y'all try to apply, that is is it so necessary to be provided internally because it can't be provided by an external source, economically?

MR. HOSTINSKY:

I think it could be; I can't recall when it's ever been used along those terms since it went into place.

MR. ZIMMERING:

Maybe I didn't say that.

Is that a criterion against which you try to back up your affiliated transaction? That is do we need to do it internally, because we can't do it economically from a third-party?

MR. HOSTINSKY:

Oh, yes, I am sure.

MRS. HALPERN:

You referred to an external audit conducted by Coopers and Lybrand, regarding affiliated transactions.

How often is that done?

MR. HOSTINSKY:

It's done annually.

MRS. HALPERN:

To what degree do they look at each transaction?

MR. HOSTINSKY:

They do enough to be able to render a financial statement opinion on the level of unregulated services and nonregulated services.

I don't know how else I would characterize it. They issue an opinion that we have compliance.

MR. GRACE:

Can I give you an example?

MR. ZIMMERING:

Compliance with what,

before you start, I am sorry.

MR. HOSTINSKY:

Joint cost order compliance.

MRS. HALPERN:

With the FCC's joint cost order compliance?

MR. HOSTINSKY:

Yes.

MR. GRACE:

As an example, BellSouth Mobility provides, sells, cellular service to Southern Bell executives, or South Central Bell executives.

They would go in and look at the rate that BellSouth Mobility is charging Southern Bell for the provision of those services; they would then go and look at external transactions that BellSouth Mobility has with unaffiliated parties, and make sure that the charges for the same type of services that's being provided are the same to both of those parties.

Now, they don't go and look at

every individual cellular line that BellSouth Mobility charges; they just make sure it's being charged according to the price list and the, to the general public.

MR. ZIMMERING:

They wouldn't go look at Radiofone's cost of providing that service to see how it stacks up against BellSouth Mobility.

MR. GRACE:

That is right. Specifically, the FCC does not allow that to happen.

MR. ZIMMERING:

That was a conversation we had before about the Platinum building. I wanted to make sure that's where we were.

MRS. HALPERN:

Are there affiliated transactions excluded from the joint cost audit?

MR. GRACE:

Not to my knowledge.

MRS. HALPERN:

Do they audit the transactions in a way that would determine whether each state's particular regulatory requirements associated with affiliated transactions are being met?

Does it go to that level of detail?

MR. HOSTINSKY:

I don't believe it gets down to the individual state allocation, although we frequently, you know, have states that want to look at the work papers.

But in terms of their testing, you know, they are not testing down to that level. They are primarily interested in making sure that there is an absence of cross subsidy issues and that the reg and nonreg amounts that we issue in the financial statements that we provide the FCC are proper.

MRS. HALPERN:

Who negotiates the affiliated transactions?

MR. HOSTINSKY:

Well, there is an approval process that approves a class, and then, you know, once they are approved by the level of approval we require, which is the vice president controller level, the negotiation is over.

MRS. HALPERN:

That's vice president, controller in Corp., corporate?

MR. HOSTINSKY:

BST.

MRS. HALPERN:

BST?

MR. HOSTINSKY:

BST Corp. and BSE.

MR. ZIMMERING:

Could you describe that approval process in a little more detail?

MR. HOSTINSKY:

Well, I guess it's the initiating company who is providing the service would be the initial person to make a proposal.

That would go up within that particular entity, it would be documented and then that documentation would be provided to any other vice president controller that was affected by those transactions; and then there is a third requirement that BellSouth Corporate look at it from a compliance standpoint from the joint cost order.

Because my staff has the, a lot of the joint cost order expertise and the, and is plugged into the latest standard setting processes; and three of those gentlemen sign off and that's how the transaction is approved.

MR. ZIMMERING:

Is it often that the terms of the transaction change from the original proposal?

MR. HOSTINSKY:

Well ---

MR. ZIMMERING:

Five percent of the time, ten percent of the time?

MR. HOSTINSKY:

The feedback I have gotten, particularly from the BellSouth Enterprises staff, is that a lot more transactions are being squelched early on, and are never making it up to the approval process.

They never get into the documentation standpoint, primarily because they have trouble overcoming that hurdle of financial and strategic importance.

So I would say since we put the procedure in place, the number of transactions that you hear discussed for potential affiliated transactions has decreased.

MR. ZIMMERING:

Do transactions have to come up -- I think we are close to done -- periodically for review? Or can an arrangement which was entered into four years ago still be in effect?

Do most of them have terms?

MR. HOSTINSKY:

No. They are set up,

generally, as ongoing. But what happens is that the specific transaction testing takes place in the annual financial compliance audit.

And so you have the initial approval and then we rely on the annual audit process to capture any problems with them.

MR. BARON:

Are you the liaison between Coopers and Lybrand on the affiliated transaction audits?

MR. HOSTINSKY:

Yes, I am.

MR. BARON:

You mentioned some states requested the work papers. Do you recall which states those were?

MR. HOSTINSKY:

Florida.

MR. GRACE:

I can name some of them. I know the Florida staff has reviewed, in the past -- now -- Tennessee has, South Carolina and North Carolina -- I don't recall whether the Georgia staff has looked at them or not.

MR. HOSTINSKY:

I don't know.

MR. GRACE:

Those are the ones I recall.

MR. BARON:

All right.

MRS. HALPERN:

Did either of you have responsibility in negotiating L. M. Berry, BAPCO contract?

MR. HOSTINSKY:

No.

MR. GRACE:

No.

MRS. HALPERN:

Do you know who did?

MR. HOSTINSKY:

I don't.

MR. GRACE:

It would have been negotiated between those two companies.

MRS. HALPERN:

But approval of that contract would have gone through your organization?

MR. HOSTINSKY:

That was probably done before we put this process in place. So -- I don't know when that contract was negotiated, but this process has been in place roughly a year, maybe a year and a half.

MRS. HALPERN:

Prior to then, the two companies would have approval of the contracts they negotiated, the buyer and the purchaser?

MR. HOSTINSKY:

I don't know.

MRS. HALPERN:

You don't know what process was in place?

MR. HOSTINSKY:

Right.

MRS. HALPERN:

I understood you to say that your group now would look at all

affiliated transactions, or all
categories of it; is that right?

MR. HOSTINSKY:

Right.

MRS. HALPERN:

And have the ultimate approval; is that right?

MR. HOSTINSKY:

We don't have the ultimate approval. The controllers organization has approval on new classes of transactions. That's not just a corporate function. That's a function of both BST controller and the BSE vice president of finance over there.

Because the controller is not at officer level, but then, you know, the ongoing compliance audits generally take care of anything that has taken place since then, but they also capture the transactions that were created before we put in this approval process.

MR. ZIMMERING:

What you were telling Mrs. Halpern is you don't know what approval process was necessary one year and one day ago.

MR. HOSTINSKY:

Right.

MR. ZIMMERING:

Do you have any idea what approval process was necessary one year and one day ago for affiliated transactions?

MR. GRACE:

I don't think there was a formal approval process. That was the purpose of putting this structure into place.

But any contracts between companies, at least significant contracts, would have been signed by officers of each one of the companies involved.

MRS. HALPERN:

Let us have a minute or two.

(Brief recess.)

MR. ZIMMERING:

Let me get one thing

clear.

You indicated an officer from the buying company and an officer from the selling company had to sign off on whatever the affiliated transaction is, and then it came up through your organization.

Your organization's role was to make sure that the transaction complied with the manual in one of the necessary respects, but that is the only reason you would look at it.

Is that a fair statement, if it wasn't your affiliated transaction?

MR. HOSTINSKY:

Right. It really doesn't go to them separately and then come up to us; it goes all at the same time.

MR. ZIMMERING:

You don't look at it for reasonableness, would I enter into it, anything else, you see if it complies with the manual, that's the last you deal with it, if the guys from BSE and South Central Bell are happy, that's it, boom.

MR. HOSTINSKY:
Yes. I think the vice controller has the sufficient knowledge and expertise to make his own independent judgment as to whether it's financially and strategically important, he can give input to that decision.

MR. ZIMMERING:
That's the guy at Bell or Enterprises, not you.

MR. HOSTINSKY:
All three of them.

MR. ZIMMERING:
Are you telling me you do have substantive inputs as to whether or not the transaction should be entered into.

MR. HOSTINSKY:
Sure.

MR. ZIMMERING:
You do it for every transaction you check for compliance.

MR. HOSTINSKY:
Yes.

MR. ZIMMERING:

What criteria do you apply?

MR. HOSTINSKY:

That's where the controller makes a personal judgment based on his background, knowledge, understanding of the proposed transaction, and he frequently may have discussions with the vice president finance and Enterprises, and the vice president controller in BST, and they collectively put their judgment to it and buy off on it. It's all done.

MR. ZIMMERING:

Is one of the criteria whether or not the company as a whole will be better off profitwise, Bell South Corporation, if the transaction is entered into?

MR. HOSTINSKY:

You know, there is no written list, but I would suspect so. That's the standard they agreed to is financially and strategically significant.

MR. ZIMMERING:

What criteria would you apply if you were having to judge whether or not, from your position, a transaction should be entered into?

We already established one. Whether the company as a whole would be more profitable with or without the transaction. What else?

MR. HOSTINSKY:

From my position? What I do is I guess I give the vice president controller at corporate counsel on whether I think the transaction structure complies with the joint cost order and then he takes my input and he makes his own independent assessment, collectively with the other three, as to the appropriateness of the financial and strategic implications.

MR. ZIMMERING:

What does he look at. What criteria does he apply to see whether it's appropriate?

MR. HOSTINSKY:

He doesn't have to look at anything.

MR. ZIMMERING:

Does he apply no criteria.

MR. HOSTINSKY:

No. There is documentation that's been prepared, remember, that describes the categories of transactions, why they are important, what they are intending to do, what the proposed relationships are, you know, how -- how those particular transactions may grow over time.

But he doesn't have to have a punchlist with his background experience.

MR. ZIMMERING:

All I am asking is other than is the company more profitable with or without this transaction, and does it comply with the joint cost manual, you can't, today, identify any other criterion which should be applied in general by your boss when deciding whether to sign off on this transaction?

MR. HOSTINSKY:

Again, only the financial and strategic implications of it. If it is strategically important, it doesn't have to necessarily, you know, produce financial windfall.

MR. ZIMMERING:

That's all I have. It may very well be that we will ask either to talk to you guys again, or actually maybe even someone else on these transactions after we take a look at maybe the last audit done, or an example of a Coopers audit, or the FCC comes down with something in writing.

I think now we could go for a long time asking a lot of individual questions we might be able to avoid if we looked at the pieces of paper first.

MRS. HALPERN:

Up to the point that the decision is made to enter into the transaction, there is no external consultants or auditors or anyone who is consulted on this, it is purely an intercompany decision?

MR. HOSTINSKY:

We will frequently ask the counsel of Coopers and Lybrand did, simply, but because they operate in the, the industry group that generally does those kinds of audits, and they share amongst themselves particular findings, and they may be able to get inputs and insight into exactly what the latest standards are in these particular areas; because you are going to be, I think, somewhat amazed when you go back and look at sections 64901 and 32 dot 27, because these are not great lengthy codification of rules. They are very general guidelines.

You probably could get the entire set of rules on probably the front and back of a single sheet of notebook paper.

So those rules form the nucleus of the standards, and those standards are evolving and are continuing to evolve as to the, exactly what the requirements are.

And so it takes considerable judgment on behalf of the company before it chooses to enter into those transactions. And that's why the approval level on those transactions is so high.

MRS. HALPERN:

These reports would be written?

MR. HOSTINSKY:

Yes.

MR. BARON:

Does Coopers and Lybrand just order compliance with the Part 64 accounting, as opposed to examining the reasonableness of an affiliated transaction?

In other words, if it meets the criteria of, that's tariff or fully distributed cost or market, that's what they evaluate it, that's their role, not to look at the reasonableness.

In other words, in the example,

the office building, if it ended up because there were no tenants that you went to fully distributed cost and you paid $30 a square foot and the market price was 18, they don't assess situations like that?

MR. HOSTINSKY:

There is no approval there.

MR. COCHRAN:

Part 64 was built on top of the current framework and prudency was issued before Part 64 was built. The prudency issue has always been out there. Part 64 was not set up to enhance that.

It was set up to -- the presumption is on a Part 64 transaction, that the prudency is decided up front. I think that's where you were trying to head a minute ago.

The 64 rules were set up on top of the presumption that the transaction was prudent, but even if it's prudent, there are certain rules we want you to live with on top of the prudency issue, as far as what you charge an affiliate and how those dollars flow.

MR. BARON:

Has the FCC assessed issues like prudency in their audits?

MR. ZIMMERING:

Give me an example of FCC approved expenditure.

MR. COCHRAN:

Not that I can think of. Not that I can think of.

MR. ZIMMERING:

Thank you very much, Gentlemen. I am sorry we took as much time as we did.

(Whereupon the taking of the testimony of the witnesses was concluded.)

REPORTER'S CERTIFICATE

I, Mary Virginia Hughes, Certified Shorthand Reporter, in and for the State of Louisiana, do hereby certificate that the within witness, after being first duly sworn to testify to the truth, the whole truth, and nothing but the truth, did testify as hereinbefore set forth, in the foregoing pages;

That the testimony was reported by me in shorthand and transcribed under my personal direction and supervision, and is a true and correct transcript, to the best of my ability and understanding;

That I am not of counsel, and in no way interested in the outcome of this event.

MARY VIRGINIA HUGHES

CONFIDENTIAL

SET J

TRANSCRIPT OF OCTOBER 6, 1993 INTERVIEW OF

MIKE HOSTINSKY AND MIKE DEANS

DRAFT

Meeting Minutes Transcription

For: Kennedy & Associates
Meeting Date: October 6, 1993
Attendees: Mike Hostinsky and Mike Deans, Gail Barber, Wayne Hutchens, Lane Kollen

Wayne Hutchens: October 6, 1993, Interview of Mike Hostinsky & Mike Deans

Mike Hostinsky: I wanted to, I guess, wrap up some things from the last session that we had, some questions had come up, and I've researched some of those questions, and confirmed some of the original thoughts. First item was the allocations of administrative costs for the Bell South Foundation. The answer to that question is "Yes", they are allocated, complete details have been provided in response to interrogatories #6-059. Second item: I want to confirm that leveraged ESOP is in the overhead calculation. We've determined in checking, that it is part of account 721.311, savings plan match is in the overheads. The third item I want to confirm, and I had given the belief that the reason that the PV projects and Bell South's Headquarters decrease '91 versus '92 was because the merger and acquisitions budget was transferred to Bell South Enterprises and so those projects were now BSE projects. I want to confirm that that is the case. There were also questions about some of the detail coding, with respect to certain codes, code PD relates to Enterprises' projects, this is primarily MNA activities now, PF relates to conduit billing, or flow-through. PN relates to non-affiliated billings to third parties such as trust funds or where we have third parties use the accessment center, that sort of thing. Code PS relates to general project, or a subsidiary. One additional item is the relationship of the item #6-032 to 6-065 Attachment 1, 6-032 is in, fact a summary of 6-065. The other thing that was requested, and we have available today, are the July and December 1992 Cops (?) binders and data as requested.

Lane Kollen: Okay, very good. Thank you. My name is Lane Kollen, and let's see the other two people here are Wayne Hutchens and Gail Barber, just for record purposes. I'd like to spend quite a bit of time today, going over the details of the allocation process from Bell South Corporation. And to start that out, I'd like to first talk about the departments at Bell South Corp. Obviously the allocation process is done at the RC level according to what you told us last time, but yet there's this department determination. We have apparently some discrepancy in some of the data request responses as to what the departments actually are. In response to question #6-024, which is to provide a summary of the primary functions and activities for each of the following BSE's Headquarters' entities: the first entities is departments. We have 11 departments listed, and this is contained in a document called 1993 Corp. Services Work Program. Then, in question #6-030, which requests a copy of the 1991 & 1992 calendar year billings from Bell South Corporation Headquarters to each of its subsidiaries, it shows a total of, I believe, eighteen departments. First of all, I would like to try to reconcile these department determinations, if we at all could. First, do you have a copy of the response to 6-030?

Mike Hostinsky: Yes.

Lane Kollen: Okay. And 6-024?

Mike Hostinsky: I can't find them.

Mike Deans: That was a copy of the Work Programs?

Lane Kollen: 1993 Work Programs.

Mike Hostinsky: Yeah.

Lane Kollen: Okay. And do you probably have with you a copy of 6-032?.. which is a summary of the Cost Allocation Methodologies by department and Responsibility Code. Yes, you do.

Mike Hostinsky: Yes.

Lane Kollen: Okay. Looking at the response to number 30, and we'll look at the billing detail for the calendar year 1991, I believe there are eighteen departments listed there. This is page #1328, as part of the attachment to 6-030. The first department is Executive. Then looking at the 1993 Corporate Services Work Program, there is no executive dept on that list. Is Executive considered to be a department?

Mike Hostinsky: Well, it is a grouping for billing entities. But it has a rather obvious function in terms of providing overall direction to the corporation. So it is not listed in the Corporate Services Work Program for '93. But it is part of the billing process.

Lane Kollen: Okay. O.K. And then the next two departments on 6-030 are Corporate Secretary and Treasury. And, I presume that corresponds into Section 1 in the Work Program, Treasury/Secretary?

Mike Hostinsky : Yes.

Lane Kollen: O.K. And then the next item is Security, the response to 6-030. Where does that..?

Mike Hostinsky: That would fall under Corporate Responsibility and Compliance.

Lane Kollen: Okay. And then Comptroller's, going again down the list in response to #30, is consistent with Section 2 in the Work Program "Comptroller's."

Mike Hostinsky: That's correct.

Lane Kollen: And Tax, would be consistent with #3, Section 3, in the Work Program.

Mike Hostinsky: Correct.

Lane Kollen: Okay. Internal Auditing?

Mike Hostinsky: Internal Auditing would be part of section 4, Corporate Responsibility and Compliance.

Lane Kollen: By the way, do you actually bill Southern Bell and South Central Bell? Or, I guess at this point it's Bell South Telecommunications and the other subsidiaries. Do you actually bill by department?

Mike Hostinsky: We, We,,

Lane Kollen: Or is this just a summary type thing in response to our request?

Mike Hostinsky: We render a summary bill that has multiple line items on it, and provide just backup for their accounting and classification purposes.

Lane Kollen: Okay. The next one is Corporate Planning, and that would comport with Section #5? Financial Management would comport with section #5. Marketing? Where would that go?

Mike Hostinsky: There is no Marketing at Bell South Corporate Headquarters. There was in some of the earlier years, but I don't believe we've had any Marketing, at least since 1990. At one point, we had a small Marketing organization, that was transferred, I believe at that point to Bell South Services prior to the merger.

Lane Kollen: Okay, and of course, there are no dollars associated with this, as far as billings from the marketing department and such, from Fork to Telecommunications or any of the other entities for 1991, so. Bell South Human Resources Inc.?

Mike Hostinsky: That entity no longer exists.

Lane Kollen: Um-huh.

Mike Hostinsky: I guess that entity...

Lane Kollen: ...part of the transition?

Mike Hostinsky: ... was effective in 1991, but was I guess, that was discontinued at the same time that Southern and South Central and BellSouth Services were all put together.

Lane Kollen: Okay. There appears to be a residual amount on the next page in response to question #30. But that probably is just a carry over. That would be my guess.

Mike Hostinsky: Yeah, one month in arrears billing is more than likely what that would be.

Lane Kollen: Then Human Resources, is the next one, Bell South Human Res.., I'm sorry, Human Resources is the next department listed on 6-030. And presumably that would encompass Section 6,7 & 8?

Mike Deans: Right. Correct.

Lane Kollen: In the Work Program? Okay. Assistant Secretary/Corporate Counsel? In response to 30? How does that compare to the Sections listed in the Work Program?

Mike Hostinsky: That would be part of Legal.

Mike Deans: That's right, that would be part of Legal.

Lane Kollen: Federal Relations?

Mike Hostinsky: Part of Government Affairs.

Lane Kollen: Advertising?

Mike Hostinsky: Part of Public Relations?

Mike Deans: Right. The rest of those would all be part of Public Relations.

Lane Kollen: Do you have a copy with you in response to question #64? 6-64 which is a document entitled "Cost Assignment Methodology by Response Code" I think that was also provided in response to question 32. It may be the identical, something similar to it.

Mike Hostinsky: May I look at this document to see if I say this is part of 6-032?

Mike Deans: It's a different month.

Lane Kollen: It's a different month. Let me see if I have 32 with me. Yes, I have 32 with me. Could you describe for me what the response to question #32 provides us? In terms of the allocation process?

Mike Deans: This report is a summary of the Cost Allocation Forms. Like in 6-065, the individual forms are taken and summarized on this form, for, you know, that way they're all in one place.

Lane Kollen: Is this primarily for a summary documentation purposes? Or is it directly used for some reason?

Mike Deans: Well, I know I use it, as, in preparing the billing, as a reference, not having to go back to the individual Cost Assignment forms. The policy people provide that to me as a summary and a tool, to build allocations from.

Lane Kollen: I see. But the Cost Assignment Forms, are they raw material, are they not, to go into the PC, spreadsheet, or the program that does the allocations?

Mike Deans: Well, the methodology is derived, you know, the background and everything, derived to build a Cost Assignment Methodology, you know, with all detailed on the Cost Assignment Form. And then using that, then the methodology itself is transferred to this form, for my use, and for informational use.

Lane Kollen: Okay. One thing, that I forgot to do, and I guess I should have done it right up front, is I should have asked you to explain you what your responsibilities are.

Mike Deans: Well, I'm the one that actually presses the buttons, you might say that, and you know, I take the program that takes the raw data and creates the bill, for the Cost assignment.., you know, Cost Allocation bill for Bell South Corp. , to you know considering...

Lane Kollen: Okay. In what you do, is there any judgement involved? In terms of selection of the allocation basis or the data that is used, or is that already out of your hands?

Mike Deans: Well, I may have input in deciding, but that decision is not mine to make. You know, alone, it's the um,.. there's a policy group that does,.. decides what is, you know, what we allocate and they're the ones who provide me the methodology. I'm more on the mechanic's side.

Mike Hostinsky: Lane, we hold a cost accountant's in the policy group resp. for the allocation in working with the departments, Mike's held responsible for the execution system and the integrity of the calculations.

Lane Kollen: Okay. So, for example if, one of the responsibility codes is allocated across capitalization of subsidiaries, is it the policy group that will tell you which subsidiaries?

Mike Deans: Right.

Lane Kollen: Okay. So by the time it gets to you, the policy group has determined what the allocation basis are, what the source of the data will be.. Okay?

Mike Deans: Um-huh.

Lane Kollen: Is that how it...?

Mike Deans: That's right.

Mike Hostinsky: I think it's more than the policy group, though, because I think we talked in the first interview, that the Cost Assignment forms are prepared by the departments and its a joint process the cost of some...

Lane Kollen: Right. I didn't mean to imply that is just a group of accountant's operating in isolation from the rest of the company..

Mike Hostinsky: Sure. I just wanted to clarify that.

Lane Kollen: Now, as far as the data, that's used for the allocations, once the basis are determined, do you collect that data or is that provided to you by someone else, someone else in the accounting group.

Mike Deans: Which data?

Lane Kollen: Raw data for example of all of the subsidiaries capitalization.

Mike Deans: Well, um, depending on what, as far as building the methodology, I mean for actually building the factors that we allocate cost with, that um, I either am provided with reports, from the subsidiaries that they send me, or, you know, financial reports that are generated internally.

Lane Kollen: So basically, you are responsible for acquiring the data and that you be in accordance with the directives given by the policy group.

Mike Deans: Right.

Lane Kollen: Okay. Now, does the policy group tell you, for example, that certain subsidiaries are to be included in the allocation base, and certain ones are to be excluded. That is a determination by the policy group.

Mike Deans: Right.

Lane Kollen: Do you sit in on any discussions with the policy group as to what is to be the appropriate basis, or what the data should be,

Mike Deans: Uh..

Lane Kollen: Or do they communicate that to you in some manner.

Mike Deans: Well, the formal communications is the methodology summaries, Um, I'm not, you know, they interview the departments. and have their, you know, add their feedback from the departments., in building cost assignment forms, and so I'm not usually in on those conversations, No. But, you know, I'm... their..., we're.., always talking, you know about, Cost Allocations, so that's a part of it. That's the reason why I say that I have input, but I'm not the one who's going to determine..

Lane Kollen: Okay. Well then in addition to the allocation of the derived salaries and wages, then you're also responsible for accumulating the overhead costs and then the allocation of those overhead costs over the direct labor dollars.

Mike Deans: Right, the dollars that are in the general ledger, that right.

Lane Kollen: Okay, Then your PC program that you're responsible for actually generates a bill? for the subsidiary, or what does it actually generate?

Mike Deans: It generates the backup, consistent with I guess, it's uh, 6-030 that gives the detail, it's either department level or below department level. Do you want me to show him an example of the backup?

Mike Hostinsky: I think you can just describe it. they'll get it.

Mike Deans: Well, its just the backup, its just like the 6-030 in November, that had that breakdown, you know, to each subsidiary..

Lane Kollen: Okay, and then the bills, do you ever see the bills that are actually rendered to the subsidiaries?

Mike Deans: Uh, well I pass off that information to the people who generate the invoice, I do to see them sometimes, but normally that's, they're creating a mechanical invoice, at that point, it's pretty mechanical at that point.

Lane Kollen: What information specifically do you provide to billing people at Corp., you provide them the summary here, by department, that we've looked at in response to 6-030, do you provide them any account level detail, any department level detail, do you provide them any specific accounting issue type of detail?

Mike Deans: No, as far as, how they'd journaliz.. how the subsidiary would journalize the bill, once they receive it, no, I don't,no.. I don't provide that detail, no..

Lane Kollen: What about Bell South Corporation?

Mike Deans: Well, of course we record a receivable and revenue , but it's not really not in real detail, there..

Lane Kollen: Right. What I was wondering, I guess more specifically, is that with respect to, let's just pick one of these costs here, Internal Auditing, that has a certain acct. that Bell South Corporation charges with those costs, as Bell South Corporation incurs them, And I guess my question is the bill that goes to the various subsidiaries, and of course my interest is Telecommunications primarily, do you then bill them according to a comparable account number so that Telecommunications knows that it needs to be booked to an account that would receive internal auditing charges, or just is . . .

Mike Deans: Well, uh, the detail, this detail, the breakdown by department, or lower that we provide is, you know, that goes along with the bill, so they have that information and so they know what cost were internal audit costs and what costs were treasury costs.

Lane Kollen: Okay.

Mike Hostinsky: We, it would let it help to note at this point, that the corporation does not keep its books on a part 32 basis. So there is no correspondence, so all the subsidiaries that we bill down to get the information of what the costs were such that they can make the appropriate classifications in accordance with their own systems of account. I think that the other thing you have to be careful of too, is conceptually when you get into internal cost transfers, its just like a manufacturing example, and the one I always use is the department that makes the wheel assemblies, has wheels, tires, and nuts, and once they, you know, their accounting and their management is along those lines, but they ship out wheel assemblies and they may ship them on to another department within the plant, but that other department gets theirs, then they end up accounting for wheel assemblies, not for tires, wheels and nuts, they don't account for on a component basis. And so, a lot of the value that the corporation renders sometimes to a subsidiary is packaged in the cost of multiple organizations.

Lane Kollen: Okay. Well, I'm glad you brought that up, because that's really kind of is kind of where I was going here. And that is to what extent do you break out any components that are necessary for separate accounting treatment, by, for example Telecommunications? Let's, again, let's look at legal, let's just use that as an example, maybe some of those costs may be associated with lobbying. Is that something that you would break out in the allocation process, and separately provide that information to the billing people at Corp?

Mike Deans: Um, well the, at Corp? No, not.., what you mean included in the bill to the subsidiary?

Lane Kollen: Right.

Mike Deans: Well,..

Lane Kollen: I have a better way, let's talk more specifically about the precise information you provide your billing people, out of this allocation process. You provide them something comparable to what we have in response to 6-030,

Mike Deans: Right.

Lane Kollen: Okay. And that's a departmental listing and the bill for each one of the departments.

Mike Deans: Well, this section here, in my billing binder, has what I provide to the group...

Lane Kollen: Okay.

Mike Deans: It has a cover letter to the subsidiary saying that this is a corporate bill for this month. And any, *you know, any, anything unusual that* they may want to know, that might be on the bill. And reclassification that make a line look different from one month to another, or something that, you know, when they're large enough to.. make it, make it the bill look different from one month to the next. What I also provide...,

Mike Hostinsky: The only thing I was going to say, Mike, the one you're looking at is an example, for example, goes the Telecommunications and tells them the amounts included in the Fedpack, the administrative cost and also speaks to were there any prior period costs in the bill of significance, and so that's included in the details that goes to the *billing people*.

Lane Kollen: Okay, FedPack is what?

Mike Hostinsky: That's the uh, uh..

Mike Deans: The Administration of the Fedpak, Federal.

Lane Kollen: Oh, Okay, so that's something that you do breakout for the purposes of Telecommunications.

Mike Deans: Right.

Lane Kollen: They can separately identify.

Mike Deans: Right. As a backup to the bill, um, they receive it, a supplemental page that say what line includes how much of Federal Administration cost.

Lane Kollen: Are those the only two areas, FedPak and, that you routinely provide?

Mike Deans: For 1992.. uh...

Lane Kollen: What are Admin costs? For BellSouth Foundation, and what

Mike Hostinsky: No, for the Fedpak, that's the political action committee.

Mike Deans: To administer the FedPak

Lane Kollen: The administrative costs for the Fedpak,

Mike Deans: Right.

Lane Kollen: Okay. I see.

Mike Deans: There would be no Fedpak except on this books, but the administration costs of the employees.

Lane Kollen: Now, do you ever get requests from Telecommunications to provide you with individual detail on certain costs? Certain accounting costs, for example, pension costs, or things other than pensions?

Mike Deans: How much was included on a bill?

Lane Kollen: Yes.

Mike Deans: From the BST, as opposed not in response to a data request?

Lane Kollen: From BST and for this reason. In some of the states, Bell South Telecommunications is not afforded the regulatory treatment that's reflected on your books of account.

Mike Deans: Okay, .. so, what do they call it?

Lane Kollen: *Jurisdictional differences.*

Mike Deans: Jurisdictional differences. Yeah, but I do provide a report on a periodic basis for, well they also get a copy of this FedPAk administration, and they get some, you know, do you want to know which/what reports they get?

Lane Kollen: Well, first of all, do they get that type of information? DO they request or do you routinely provide it?

Mike Deans: Right.

Lane Kollen: For these, what I'll call and describe it as Jurisdictional differences.

Mike Deans: Okay.

Lane Kollen: The answer's Yes?

Mike Deans: Yeah.

Lane Kollen: And what is that?

Mike Deans: Uh, let's see. Routinely I give them the FedPak Administration cost. cause that goes to a different group, than the bill itself goes to. There's also, there would be a report on the BS Golf Classic costs.

Lane Kollen: Is that included in this Jurisdiction Differences Report.

Mike Deans: I don't really know what they use it for...

Lane Kollen: It doesn't really have a name, Okay.

Mike Deans: That, they ask for the breakdown of the FedPak Administration costs, the Bell South Golf Classic, and there one on memberships, social and service memberships.

Lane Kollen: There's nothing that you're aware of that deals with lobbying,um...?

Mike Deans: Well, there is one where we break down Fed. relations, or governmental affairs, whichever is on, the description on the line in this, between Federal Regulatory and Federal Relations. That organization is the two groups.

Lane Kollen: And what's the purpose of that?

Mike Deans: I don't know what they use it for.

Lane Kollen: But that's for the purposes of Telecommunications, as far as you know?

Mike Deans: Right, well yeah, it goes to how much of the governmental affairs line of the bill is split between Federal Relations and Federal Regulatory.

Lane Kollen: And these again, are just the direct costs incurred by Bell South Corporation and Headquarters. It doesn't include anything that may have been, well, probably would, include those costs that have flowed through from Bell South DC.

Mike Deans: Well, that's what Governmental Affairs is.

Lane Kollen: Right. Okay. Okay.

Mike Hostinsky: I think we talked in the first interview that Bell South DC while technically it is a legal entity for tax purposes, it's afforded a departmental treatment for cost allocation purposes at Headquarters.

Lane Kollen: Okay. Do you report, other than the Bell South Golf Classic, and Social and Service Memberships, any other type of community involvement costs? Or charitable contributions?

Mike Deans: I know I've been asked about contributions, I don't remember if this is something.., I can't remember, I'd have to check to see if this was something that I get regularly.

Lane Kollen: Is that report in here?

Mike Deans: No. It's not, it's a supplemental report.

Lane Kollen: Is there a name for the report, or are there a series, these are various reports that you just provide periodically?.

Mike Deans: Right, Yeah..

Lane Kollen: They're separate reports.

Mike Deans: They're separate reports.

Lane Kollen: And do you provide those monthly, or quarterly, or annually, or what?

Mike Deans: Well, it turns out to be about quarterly.

Lane Kollen: Okay, so there really isn't a single report that you would call Jurisdictional Differences report, it's just that some reports have been developed over time, generally provided on a quarterly basis, that identify these costs in these areas.

Mike Deans: Right.

Lane Kollen: Okay. All right. With respect to this group of type of costs, which may be treated differently by the different state regulatory commissions. Where would charitable contributions show up in terms of a departmental cost? Would that show up in Executive, would that show up in Public Relations? I couldn't find that in the material.

Mike Hostinsky: Did you bring your chart of accounts, Mike?

Mike Deans: No. I didn't think of bringing it. Wel, it would be in the Public Relations area, specifically on which of these four that are included in Public Relations, I don't know.

Lane Kollen: That's Okay. I just wanted to know whether it was in Public Relations or Executive..

Mike Hostinsky: Public Relations.

Lane Kollen: Ok. Would you have employee benefit costs, such as *pensions, or post-retirement* benefits, or healthcare benefits, or whatever we're talking about you know in terms of benefits, in addition to direct labor dollars. As I understand it those dollars are computed by the Comptroller's Department?

Mike Hostinsky: Um..

Lane Kollen: Statement 106.

Mike Hostinsky: Yes.

Lane Kollen: Do the costs get attributed to the Comptroller's Department, or are they attributed to Human Resources..? Or are they considered to be corporate overhead, and then spread over the dollars, the labor dollars associated with *each one of the direct departments*

Mike Deans: The last one that you said.

Mike Hostinsky: The last one.

Lane Kollen: Okay. Alright. Okay what I'd like to do then, is go on to the response to 6-32, which is the summary, um, it has a date of Dec. 10, 1992, of the Cost Assignment Methodology by Responsibility Code.

Mike Deans: Okay.

Lane Kollen: And then we also have, response to question #43, 6-043, which asks to provide the Factor of *Reference Numbers, and a brief description of each* simple non-composite factor and, do you have a copy of that with you?

Mike Hostinsky: I don't have that.

Lane Kollen: *I'm going to hand you..*

Mike Deans: I'm familiar with that report, I produce it, so..!

Lane Kollen: Okay. Let me hand you then a copy of the response to #6-043. *I'll just ask you to describe that* to me, each one of the columns if you would. I'm having difficulty in following it.

Mike Deans: Okay. The first column there, is the RC, that was assigned to that, to you know, each level, each supervisory level of whoever is assigned an RC, a Responsibility Code because of court they're given a number and that's what the first column is, that's their Responsibility Code and then, if there is a person, or if its administrative Responsibility Code or whatever, then that's noted in the second column. The third column is,.. and the *fourth column are primarily why I use this report.* The third column is the FRN, the Factor of Reference Number, which assigns a certain methodology, a three character number to a certain methodology, so that the system can associate, you know, this Responsibility Code with this methodology. An example here, the first one being H11001 with an FRN 100, that associates Factor Reference Number 100 with that RC, which in that case FRN100 is the general allocator.

Lane Kollen: Would you describe this document as a matrix?

Mike Deans: It's a matrix.

Lane Kollen: It's the relationships of the RC's and the FRN's

Mike Deans: Right. and also it tells it what line on the bill, which departmental or subgroup in the department to put it on in its assembly on the bill, which is the *third line called bill code.*

Lane Kollen: I see.

Mike Deans: Then, the following columns are really just informational for, you know, my use and in building, what is called composite factors. What group of RC's report to who, so that we're making sure that we're billing composite factors correctly. So that's what all the rest of these columns are for, reporting structure.

Mike Hostinsky: Another way to think about it from a broad system standpoint, may be that the first two columns, the Responsibility coding, and name are indicative of a cost pool. And that the Factor Reference Number is, distinguishes an allocation methodology. So this report essentially provides the linkage and association from a conceptual standpoint of cost pools and allocation factors.

Lane Kollen: That's what I thought it did. Okay. Thank you. *I did have one more question.* With respect to, again, the, this organizational report, the Responsibility Code report status, that we had just been talking about, the response to 6-043, there are to the right, in some instances it says, more than one Responsibility Code.

Mike Deans: Right.

Lane Kollen: What does that indicate?

Mike Deans: Well I've just said, the system does not use those columns per se. It's informational in the sense that what Responsibility Code's report to that RC, you know that in the first column there is an RC and then it would show what type of referring to, what cost bills, what cost bills report to that,, Lane Kollen: So in other words, if we were to locke at the RC 12, H12100, Patterson, with an FRN of 230 and a bill code of H112, it would not necessarily apply to the FRN of 230, to each one of these RC's that are listed out to the right.

Mike Deans: No.

Lane Kollen: Okay. That's as you said, for informational purposes only, just to let you know which RC's are out there.

Mike Deans: Right.

Lane Kollen: Okay. And that's why in fact, as we go down this list, we see 1210, 1220, 1240 each with its own supervisor and each with its own FRN.

Mike Deans: That's correct.

Lane Kollen: Okay. That's what had me confused. I thought that, there was a, I couldn't really figure out how the FRN was going to be RC'd, if there were nested RC's.

Mike Deans: So, there would be a separate line on that report for each pool or each RC which needed allocation methodology.

Lane Kollen: Okay. Now what I'd like to do, is I'd like to go over the response, still keep in hand the response to 32, and I'd like to start with 65, the response to question # 65 to provide all of the Bell South Corporation Headquarter's Cost Assignment Forms for 1992. I'd like to start going through this material in detail.

Mike Deans: Okay.

Lane Kollen: Alright, why don't we start with 32, that would be Bates(?) #1348, and as we go down, I see that the Chairman is allocation on the basis of a general allocator.

Mike Deans: Right.

Lane Kollen: First question is: Why the general allocator, and not a composite of direct reports.

Mike Hostinsky: Everybody just feels that general allocator is more appropriate. I mean certainly you can make arguments either way. I think that generally the Chairman is viewed at more that a supervisor of his direct reports, and is providing leadership to the corporation. He has a lot of outside activities, other boards and boards he sits on. And just basically general allocator is thought to be more appropriate.

Lane Kollen: As a general principle, and I think this is something we didn't talk about in the first interview, that we had about two weeks ago. The general allocator as I appreciate it, is used where you've made a determination that there is no cost causation basis for allocation. Is that right?

Mike Hostinsky: Well, it's sort of a default in the hierarchy of direct assignment attribution process.

Lane Kollen: So it's kind of at the end of the line, so to speak.

Mike Hostinsky: Right.

Mike Deans: Right.

Mike Hostinsky: And of course part of the joint cost order group, it was the whole line, cause that's basically the form of allocation that we had historically.

Lane Kollen: Is there a Cost Assignment form in here for, or any Cost Assignment Forms for the Executive function? By here, I mean in response to question # 65.

Mike Hostinsky: No, I don't think we bothered them to do that. I'm not aware of any that are ever done. We pretty much do those directly. Are you aware of any Mike?

Mike Deans: It was my understanding, though I never read it myself, but I thought that the joint cost order itself dictated what the Chairman's methodology would be. That it would be general allocator. I thought that that was dictated in the rules from the beginning.

Lane Kollen: Your recollection is that's a JCL?

Mike Deans: Right, like I said I never read it but just in conversation I thought that's what they implied.

(Side 2 Tape#1)

Lane Kollen: The next, Vice Chairman or Vice Chairman is Holding, and that's a general allocator and then a Vice Chairman which is vacant, is a general allocator. And then there's a number of people; the VP's Secretary and Treasurer, the Comptroller, the VP of Planning and Budget, and skipping to VP of Corporate Responsibility and Compliance, and the VP of Human Resource and a VP of Public Relations. It looks like almost everybody is a composite of direct reports, except for the Vice, I'm sorry except for the Vice Chairman, which is a general allocator. What is the reason for that distinction?

Mike Hostinsky: I think that the general reason for that is that the officers that are composite of direct reports, directly supervise major functions and activities. And they are the initial officer that supervises a function. Whereas you get the people above that, the Vice Chairman and the Chairman, their responsibilities entail much more than supervising basic functions. So, that's why you see the general allocator there. You'll note that the VP of Corporate Responsibility and Compliance, John Dunner, are a little different. And that's because he also serves personally as the ombudsman for the corporation and has an employee hotline, and therefore his does not exactly follow the composite of direct reports because of that function.

Lane Kollen: When we get down to Gunter, VP of Corporate Responsibility & Compliance, and the Cost Assignment Methodologies, employee head- count, by that you mean employees at Bell South Corp Headquarters or you mean throughout the entire Bell South..

Mike Deans: Right. Total employees of all Bell South are figured in.

Lane Kollen: Okay. Would that include the employees in International and Domestic Cellular operations?

Mike Deans: Yes.

Lane Kollen: It does. When we talk about a general allocator, you have more than one General Allocator. As I understand it, you have the general allocator which is more or less an overall general allocator, and you also have the Marketing General Allocator? Is that right?

Mike Hostinsky: Um-huh. Right.

Lane Kollen: Do you have any other General Allocators, that are department of activity specific?

Mike Hostinsky: Those are the only ones specified in the general ?.

Lane Kollen: Let's turn to the next page in response to question #32. The VP of Secretary & Treasurer, and I think that's consistent with the first page, the composite of direct reports would be the Cost Assignment Methodology for that RC. Then we go down, there's a Manager of Board Matters that apparently reports to the VP of Secretary & Treasurer? Thomas?

Mike Deans: Right.

Lane Kollen: And the Cost Assignment Methodology is general allocator again. What is the rationale for someone who reports to someone, the top person has a composite of direct reports, but the person beneath him is a general allocator. What is the rationale to that?

Mike Hostinsky: There is a Cost assignment form in 6-065, Attachment 1. It appears to be about seven pages down.

Lane Kollen: Okay I've got it.

Mike Hostinsky: The rationale is that the services support all entities, and no other method there was identified, that would more accurately identify the services provided. There's also a PV project indicated in Section 6, which is a retained cost for certain director's fees and expenses.

Mike Deans: General allocator is applied to the specific functions, and where like in this case where the rationale supporting methodology, you know, where no other method identified can more accurately identify the services provided. So that is done at any functional level.

Lane Kollen: Going on down the list, going beyond the individuals or the RC's that are allocated on the basis of the general allocator and the composite direct report. The first different Cost Assignment Methodology is for the Manager of Shareholder Relations. Name is Kellet. And the Cost Assignment Methodology is the Equity of Subsidiaries. Do you see that?

Mike Deans: Yeah.

Lane Kollen: Now, Equity of Subsidiaries consists of what?

Mike Deans: As far as what? How would you build that..?

Lane Kollen: Which entities.

Mike Deans: Oh, it would be of the subsidiaries that we bill, Bell South enterprises, Bell South Telecommunications, and the separate piece that we breakout for Bell South.. Systems.

Lane Kollen: So that the Equity of the Subsidiaries is effectively, if I'm not mistaken, then the consolidated equity of the direct subsidiaries of Bell South Corporation? Let me explain what I mean by that. The sum of the equity in the subsidiaries in the subsidiaries under enterprises for example, perhaps might not be the same number as the amount shown as equity on Enterprises' books.

Mike Deans: You mean a validated number versus a, if you took those individual subs separately?

Lane Kollen: Yes. So my question is do you take a consolidated equity for the subsidiaries or do you take individual equity for all or, each one of the subsidiaries. And then add a total, unconsolidated total..

Mike Deans: No, we use the legal consolidation.

Lane Kollen: Okay.

Mike Hostinsky: There would be sum for enterprises, a consolidated basis.

Mike Deans: There'd be a consolidated summary of enterprises, right.

Lane Kollen: Let's look at the Cost Assignment Form for the Manager of Shareholder Relations, and then for the next one as well, the Assistant Manager Investor and Shareholder Relations. And that would be under what? Can you tell me where I might find that?

Mike Hostinsky: Yeah, that's about ten or twelve sheets back. Pretty close to the top.

Lane Kollen: Okay. I have it, and this is Bates(?) #1502. The description on this form, says under Section 3, for Investor and Shareholder Relations, Mary Jane Kellet; RC H11311. Cost Causative Corporate Functions Assignment Methodology a subsidiary equity. How does that cause the cost?

Mike Hostinsky: Shareholder activities you know, basically arise out of the equity ownership and, equity just seems to be the logical way to allocate it. Or I should say a logical way to allocate it. I guess it's a basically shareholder related function, and therefore it's the shareholders' equity interest that gives rise to it, so that's the cost causative linkage.

Lane Kollen: The next person is Betty Ferrell and apparently she's in charge of Investor & Shareholder Relations, and this is RC H11312, the next one, and the allocation of that department's or that RC's costs is over the capitol of the subsidiaries. And why is it, that, with respect to the 1311RC, the one we just talked about, that the subsidiary equity is the cost causative factor, and then in RC11312, the subsidiary's capitol is the cost causative factor?

Mike Hostinsky: I think the relationship here is probably identified in Section 4 the best, the rationale is that this job primarily supports financial community interface, and deals not only with the interest of shareholders but also bond holders, and therefore this one is more appropriate on capitol as opposed to equity. Betty;s function, Section 2, talks about administration of the Investor Relations, research analysis, program development, implementation and that relates to the entire financial community.

Lane Kollen: Going on down the list, going back to the 6-32 response, you see the capitol funding line item, the name is Administration. You don't really have someone by that name do you? It would be RC1422

Mike Hostinsky: That's correct.

Mike Deans: No, there's not somebody name Administration, right, that's what I was saying, its a functional RC.

Lane Kollen: Okay. That's a Functional RC. How do costs get into there? Given the fact that there is apparently not a live person, as the supervisor of the Responsibilities Code. Are they simply charged to that RC by somebody, somewhere? Or does the system do it?

Mike Deans: No, it would be whatever kind of charges, I don't know, if there is a live body in that RC or not, that's a good question. But the expenses associated with that function are charged to it. I don't know the method.

Mike Hostinsky: Funding is also a separate legal entity. And the cost associated with Capped funding, and Mike, I'm not sure either if there is actually a person on that RC, my guess is that there is not, and that is used to capture any costs that result from that Capped funding transaction because that's strictly a BSE funding vehicle. So they're legal fees are outside investment banker fees, or those kinds of things. That would be the administrative RC for the legal entity that would capture those costs. If you had somebody internally that was not on that RC, they would have to section time report, to get cost in that way.

Lane Kollen: The next item on the list is CM - Financial Planning. What is CM?

Mike Deans: Corporate Manager, that's right.

Lane Kollen: The allocation again is similar to the Assistant Manager Investor and Shareholder Relations is capitol of subsidiaries, with some exception reporting.

Mike Deans?: This one is Greenfeld, is that the one you're looking at.

Lane Kollen: Yes, Greenfeld, RC1423, is that the same capital of subsidiaries as 1312RC, is that right?

Mike Deans?: Yes.

Lane Kollen: And again the capital of subsidiaries is on a consolidated basis for those subsidiaries that are owned, wholly owned by Bell South Corporation directly. Is that right?

Mike Deans: Well it would be for BS Enterprises. For BST since we provide a separate breakout for BBS, we would take BBS's consolidated equity, and that would be BBS's equity, and we would have for BST a separate #, and we'd have not a consolidated number, an unconsolidated number.

Lane Kollen: But with respect to BSE, you use a consolidated capitalization.

Mike Deans: Right.

Lane Kollen: Okay. Because I'm sure as you're aware you'd come up with a much different answer because the unconsolidated capitalization of each of the subsidiaries under enterprises, because of accounting conventions. For example, Enterprises may recognize its ownership in some of its subsidiaries as an investment, as an asset.

Mike Hostinsky: I think you, you'd certainly come up different. But I'm trying to think through what that would look like, they would obviously have an investment on the balance sheet, but they would also be in Enterprises equity number also.

Lane Kollen: And, Enterprises has only equity in its capitalization, is that right?

Mike Hostinsky: Ah, I don't believe so.

Mike Deans: As far as, as opposed to what else?

Lane Kollen: Debt.

Mike Hostinsky: They'd have some debt in the consolidated statement, we'd have to check and see, but that why Capped Funding as a financing vehicle was created, to make sure that when Enterprises had a debt issues, that the plant assets, or really the equity of the total companies was not jeopardized by that. We're very careful to try to separate the two.

Lane Kollen: As I appreciate it, the Capped Funding is not a subsidiary of Enterprises, rather is a subsidiary of Corp. Is that right?

Mike Hostinsky: That's right.

Lane Kollen: And when we allocate across the equity of the subsidiaries, or the capitol of the subsidiaries, so far anyway we've talked about Enterprises, Telecommunications and BPS. What about Capped Funding? Is that included in the allocation base? When we're talking about allocating costs over equity or over capitalization?

Mike Hostinsky: Capped Funding is just an funding vehicle, it wouldn't have any effect on the capitalization.

Lane Kollen: But they're the ones that have the hold the debt on their balance sheet, are they not? That's used by the different Enterprise entities?

Mike Hostinsky: No. I don't believe that's right. I don't believe they hold the debt.

Lane Kollen: Okay. Would you check that at break, that really is important to my understanding of this allocation process over capitalization, and equity to pull capitalization, and if the costs are being allocated to Enterprises, Telecommunications, and BDS and yet if Capped Funding is up there holding debt that would be an important thing to know. So I do need to know.

Lane Kollen: I have one, Gail, but this is going to be perhaps a little bit drier than, I can tell that this has been an exciting discussion.. Okay. Going on to the next page in response to Question 6-032. Somebody there, that's an Assistant Comptroller, with the name of Hostinsky, you wouldn't happen to know that person, would you? RC3100,?.. Anyway, let's go on, but the next one is the Corporate Consolidation/External Reporting, and presumably is that Operations Manager?

Voice G: Yes.

Lane Kollen: We have their equity of all subs. as the cost assignment methodology, is that correct?

Mike Hostinsky: That's correct.

Lane Kollen: Let's take a look at the Cost Assignment Form, and maybe if you find it, you can tell me where it is.

Mike Deans: I guess it would be in thirteen.

Mike Deans: Continuing down the Corporate Services Manual listing, is Patrick Smith, at the top. He's on the same order.

Lane Kollen: Is it on the same..

Mike Hostinsky: Yes.

Mike Deans: The second or third one in Comptrollers

Lane Kollen: Oh, I seem to be missing a good part of mine, I go from 1518 to 1534, so let me ..

Mike Deans: This would be in 13...

Lane Kollen: As far as the dates page,...

Mike Deans: Oh,oh...

Lane Kollen: This might be a good point to take a short break.

Mike Hostinsky: Which ones do you think you're missing?

Lane Kollen: It's 1519 to 15...

Mike Deans: Aren't they in some kind of order?

Mike Hostinsky: It is to us, it just goes right down the sheet, I've..

Lane Kollen: What have you got for capture Smith?

Mike Hostinsky: I've got Stephanie Pulliam.

Lane Kollen: Okay. Is that what? H3130? 3120?

Mike Deans: Um-huh.

Lane Kollen: Then it probably goes 3130, 3140,

Mike Hostinsky: It just keeps on going down, 30...

Lane Kollen: I think I'm missing the rest of the accounting. Is there any chance that we can get that?

Mike Hostinsky: I'm pretty sure I can get them faxed. Just to be sure that we have the right pages.

Lane Kollen: Okay. Alright, why don't we do that, and we'll just take a little break.

(Break)

Lane Kollen: We're back now. We're talking about some of the Responsibility Codes reporting to the Assistant Comptroller. Before the break I did not have a copy of my response to question #65 of the Cost Assignment Form. So I'm going to ask Mr. Hostinsky to hand over pages, 1519-33, and maybe we can locate at those jointly.

Mike Hostinsky: Mikes' copies doesn't have the Bates numbers on them, so we'll have to go by RC's..

Lane Kollen: That's fine. Why don't we start with RC1312, which is Corporate Consolidation External Reporting, and the Cost Assignment Methodology is equity of all subs.

Mike Hostinsky: That's correct. But I think its also important to note, that if you look at the Cost Assignment Form in Section five, that there are a considerable number of special project billings that take place in this group. Some of them, the primary ones are the PF 2200 and 2100 that are the used for the debt registrations of Southern and South Central Bell . There's also one that deals with filing registrations statements of Enterprises, those costs are direct assigned subsidiaries. There's one also for the preparation of debt registration for Bell South Capital Funding. We talked about that RC earlier, and this project code with would direct costs in that direction. And there is also a PN Project which would be used to build a Methods and Procedures cost for the savings plans to the trustee, Bankers Trust. And so after taking all those functions out of that group the rationale is that the remaining services support all the subsidiaries and basically are attributable based on the interest that Bell South has in each, and therefore the equity of all the subsidiaries has been used.

Lane Kollen: Okay. Any why is it that the equity of all subsidiaries is the cost causation base, as opposed to total capitalization or as opposed to some composite of total capitalization and total expenses or whatever..

Mike Hostinsky: I think that the key here is, if you look at the overall cost pool, once you take out the cost of the debt registrations, that are being project billed out, that the remaining activities all relating to SEC financial reporting are all generally directed at shareholders and producing press releases and external financial reports. And therefore the equity has been chosen.

Lane Kollen: With respect to the Corporate Consolidation/External Reporting function at Bell South Corp., Do they also prepare, and we also have, I think it was the 1993 Work Program, is that Responsibility Code responsible for SEC reporting of Telecommunications, or is the Comptroller's group in Telecommunications responsible for its own SEC reporting,

Mike Hostinsky: My group is responsible for the SEC reporting for Telecommunications.

Lane Kollen: As well as Corp?

Mike Hostinsky: Right. We do both. The Bell South Telecommunications sends us the information necessary to fill out our file, their report with information in it, primarily deregulatory information and some of the analytical information. But we actually do the compilation and the filing.

Lane Kollen: The next item on the list.. Can I briefly look at the 13130, the Corporate Accounting Standards? Responsibility Code Cost Assignment Form. Thank you. When there's a designation on this Response to 6-032 that states Headquarters allocation, is that the equivalent of the General Allocator or is that some other allocation?

Mike Deans: It's another allocation, its not general allocator.

Lane Kollen: Okay. And what is the definition of that allocation? Headquarters' allocation.

Mike Deans: We would take the billing methodology bill factors based upon our total billings of our subsidiaries. The total expense based billing projects and cost allocation billing to our subsidiaries, and build a factor based on that.

Lane Kollen: So this is kind of a final computation, after everything else, including the allocations and billings based on the general allocated.

Mike Deans: Well, we would use prior month to bill it, so it's not ...

Lane Kollen: Conceptually, that's the concept. Okay.

Mike Deans: Yes.

Lane Kollen: Now with respect to the Corporate Accounting Standards and the Responsibility Code 13-130, there is an Allocation Methodology that says 82% to BST, 9% to BSE and 9% Headquarters allocation. Was that based upon actual time studies, prepared for that Responsibility Code? Or where does that, it seems to me to be fairly specific allocations come from?

Mike Hostinsky: That was based on the specific analyses of the work in that group. Its not a particularly homogenous group, there are also, you'll note on the 6-032 Form an indication that CX Codes are on an exception basis..

Lane Kollen: Yes.

Mike Hostinsky: That simply means that periodically things come up that don't fit that Allocation Methodology and therefore we have to end up using a special allocation process, such that there's a need to override, if you will, the normal allocation methodology, and specifically utilize another allocation. Frequently 100% direct assigned cost that might be incurred in that group. I think that one of the examples at that point, in the Organization Structure, we were doing the Cost Allocation Manual back there, and the outside audit bill for that was paid through that group and directly billed down to BST.

Lane Kollen: So is it true then, that in order to come up with these allocation percentages, that the Corporate Accounting Standards group actually did a time survey?

Mike Hostinsky: Yes. They actually did an analysis for a period of time.

Lane Kollen: Is it also true, that costs are not maintained at a level lower, or at a more detailed level than the RC, as a general manner of course?

Mike Hostinsky: That's correct.

Lane Kollen: I'm talking about cost assignment or allocation purposes?

Mike Hostinsky: Right. The system's predicated on cost pools no lower that the RC level.

Lane Kollen: Okay. The next one, Operations Manager - Affiliated Interest, witness the name is Grace, the RC is 13140, Cost Assignment Methodology is 100 % DST. Why is it that that is 100% BST and why not 100% BSE? Is it not true that, you know, I know that I'm stringing a couple of questions together here, but just to give you a different perspective perhaps, is it not true that the affiliate interests issue is driven really by a non-regulatory side of the business? And therefore could be considered a cost causing?

Mike Hostinsky: Well, you could consider it that way. But I think what we consider is the fact that its the regulatory process at BST that drives the cost. And were it not for that regulatory process there'd be no need for an affiliated witness.

Lane Kollen: Could another perspective be that were it not for affiliate interests on the non-regulated side, there'd be no need for an affiliated interest witness.

Mike Hostinsky: You could certainly take that position, but I guess, we choose not to subscribe to that. We believe that it's the regulatory process that drives it and not the business activities of the Corporation.

Lane Kollen: The next item, Operations Manager - Compensation and Benefits, the name is Griffin, the RC is 13160, the Cost Assignment Methodology is the number of employees in each company participating in Bell South pension and benefit plans. And so I'm presuming then that the only activities that occur in this RC are those that relate to the Bell South pension and benefit plans. I guess we can look at the 1993 Work Activity Program..

Mike Hostinsky: Well, we have a Cost Assignment Form that has the functions on there also, you know, in the allocation. The basic description is development of corporate wide accounting policy, methods, procedures, all compensation plans and benefits plans, including pension, savings plans, ESOP, insurance, Executive/Key Management compensation plans. Depending, I guess, this one is one that is somewhat lacking in homogeneity too, because there are a number of CX projects, particularly relating to Executive payroll, that from a cost causative standpoint while the residual is billed on the number of employees in each company participating in the pension plans, on exception basis, there is reporting to try to deal with the issue of non-homogeneity. But in general, the services provided relate to the subsidiaries that participate in the pension and benefit plans. There's also a special project to bill some of the cost to the savings plans to the trustee, Bankers Trust.

Lane Kollen: Thank you. And this is where, the Griffin, is Greg Griffin. And this is the person you told us about last time that was responsible for the ESOP account. Alright, I have some detailed questions about this, but I think I'll save them for him, because I need to talk to him.

Mike Hostinsky: All right, that's fine.

Lane Kollen: Going on down the line, we've got O&M Risk Management, with a name of Hughes, with an RC of 13050. This appears to be 1/3 to Bell South Enterprises, 1/3 to BST, 1/3 to BBS. Do we have a Cost Assignment?

Mike Hostinsky: I'm looking for it.

Lane Kollen: We've got a page number of 1513.

Mike Hostinsky: Yeah, I think that's the one.

Lane Kollen: Okay. What I have here, a Cost Assignment Form, do you have that, or do you have the SQ's

Mike Deans: There were two of them, one for '91 and probably behind it is the one for '92.

Mike Hostinsky: The 1/3:1/3:1/3.

Mike Deans: That was the one with the methodology you're looking at.

Lane Kollen: I have an earlier one then, Bates #1513 and 14, and a later one with #1515 and 1516.. and the earlier one, do you have a copy of that?

Mike Hostinsky: Yes.

Lane Kollen: Okay, the cost causative Corporate Functions assignment methodology was 75% to BS Enterprises, 25% to the predecessors at Bell South Telecommunications. Now, that was changed at some point in 1992 to the 1/3 to BSE, 1/3 to BST, and 1/3 to BBS. What has changed to your knowledge?

Mike Hostinsky: Nothing to my knowledge. I think you look back to the earlier ones, you'll see then in the Project section, Section 5, that a considerable amount of project billing is being done, and also in Section 3, there CX codes. So the distribution 75/25 is that's done on the residual on the Cost Assignment. Now, we've gone to a 1/3 : 1/3 : 1/3, let me look at the rationale. It looks like some of the reason for it is the fact that BBS has continued to grow in size. Many of the Enterprises companies, I think, during the '91 period were part of Enterprises'. Now, they are a part of BST or in fact BBS.

Lane Kollen: It strikes me, that with respect to the latter, the July 1992 effective date of this 1/3:1/3:1/3 allocation. The rational supporting the methodology strikes me as kind of just split on a 1/3:13/:1/3 basis. It doesn't appear that there was any further analysis, any mathematical computation or anything of that sort.

Mike Hostinsky: I'm not that familiar with this group. But it's in Comptrollers, but it's a stand-alone group, so I can't speak to that. I do know that a considerable number of Enterprises' subsidiaries moved over there in the July '92 time frame, or shortly thereafter. DataServe, Disen, I think there are some other smaller subsidiaries also.

Lane Kollen: Would you think that this was a matter of judgement on the part of Miss Hughes and Mr. Casey and whoever else it was that assisted in developing this in the policy group. That maybe it could not be reduced to a mathematical formula?

Mike Hostinsky: I think that certainly that there is judgement involved. All of these cost causative assignments and methodologies require judgement. Because you're not dealing with a precise process. You're dealing with a process that's trying to simply determine a fair and equitable allocation. So, I think that would have used judgement. Having something come out exactly 1/3:1/3:1/3, the law of probability is not great that this is not going to happen, so I would suspect that considerable judgement was used there.

Lane Kollen: It appears that they have the responsibility in the Risk Management group for property insurance? for liability, for workers' comp.. ? Would you agree that there is a diversity of insurance that they have responsibility for?

Mike Hostinsky: Yes.

Lane Kollen: Would you agree that some of the costs may be related to the asset base and some may be related to the number of employees, and some may be related just by number of entities?

Mike Hostinsky: That's correct. I think that the best indication that you can see when you start talking about groups that are not very homogeneous, is that the notations on the Cost Assignment Forms, that they use CX projects, which are basically projects on exception basis. Where specific costs have been identified that don't follow the normal composite for that particular group. So any time that you see those, I think that you can be sure that there is an attempt to deal with the non-homogeneity of the cost group.

Lane Kollen: One other thing I wanted to ask Mr. Deans is, with respect to the billing information that you provide to the subsidiaries and in particular Telecommunications, you don't segregate the costs, or do you, between regulated and non-regulated?

Mike Deans: No.

Lane Kollen: You just bill to the subsidiary, and it's up to them to segregate those costs.

Mike Hostinsky: Right.

Lane Kollen: And in fact, that's to the best of your knowledge maybe one of the reasons why you've prepared those special reports?

Mike Deans: I was simply asked for them, I assume that's true.

Mike Hostinsky: I don't supervise that group directly now, but I have in the past, and I know personally what happens is that we hear about these so-called Jurisdictional differences, or special rate making treatment provided by certain jurisdictions. Sometimes we hear about them and sometimes we don't and basically, we just rely on

...(Tape 1 over) Tape #2

Mike Hostinsky: the tape....If BST has special requests or needs special information to comply with some sort of jurisdictional treatment of costs, we don't provide that on a regular basis, except to the extent that they request that in a data request. Otherwise we just provide it upon request.

Lane Kollen: Does BST or anybody from the BST's Comptroller's department or anybody from BST for that matter, ever come to you at Corp. and say we want to audit this allocation methodologies, we want to locke at them we want to discuss with you why you chose these allocation methodologies? Do they ever come back to you and inquire as to why and how you did the allocation?

Mike Hostinsky: I think periodically, I think basically, nobody likes to have costs that they don't feel they have some control over. If they have questions or if there is a fluctuation, they'll ask about it.

Lane Kollen: Does that come from the Comptrollers' at Bell South Telecommunications?

Mike Hostinsky: Usually the comptroller's folks if they have questions, will raise those questions. But basically a lot of the differences have to do with budget versus actual. They raise questions about some of the costs, and frequently you get into the allocation methodology. But the responsibilities. of the allocation methodologies rests solely with us and we have the final say on that. And that happens, by the way, on all subsidiaries, not just Bell South Telecommunications, when there is

Mike Hostinsky: subsidiary billing. From time to time they question the amounts of the billing and we explain to them where they come from, how they're derived. I think that this was much more frequent in the early days of the joint cost order. But I think it's had a tendency to tail off as people have gotten more aware of the process, and they've become more comfortable with how we go through the process. The fact that we have a good system of control, we don't just like organizational changes happen without reflecting changes in the cost allocations.

Lane Kollen: There's not a situation where BST comes in and audits your allocation methodologies, to your knowledge, is there?

Mike Hostinsky: No, unless it would come under some internal audit, you know the internal auditing folks audit the methodologies in process , but the BST folks do not.

Lane Kollen: Principally, if there's a question based upon a variance analysis or something like that, its more of an informal type of thing, is that right?

Mike Hostinsky: That's correct.

Lane Kollen: In the end if, have you ever had, Telecommunications challenge, by challenge I mean disagree with an allocation methodology?

Mike Hostinsky: Um,, I can't recall ever having been confronted with any on my level, but that's not to say that the staff folks haven't, had questions raised over it. But I guess, our position is that the people that are incurring the cost, are in the best position to establish that cost causation linkage. That's why we go to all the trouble that we do in meeting with these people in the various departments, trying to understand what their functions are, and making sure that they are using a rational cost causative allocation. The very nature of the process because it involves judgements, what I view as fair and equitable may not be viewed as fair and equitable by someone else.

Lane Kollen: Okay. Going back to the response to 6-032 the next series of items are Assistant Vice President - Corporate Support, and then there's a description under the Cost Assignment Methodology as overhead, overhead, overhead, overhead. Just describe what that means to me, please.

Mike Deans: Well, since Corporate Support is building support function for BS Corp. those costs are incorporated with the other overhead costs..

Lane Kollen: Into the Corporate overhead?

Mike Deans: Into the Corporate overhead.

Lane Kollen: Alright... Okay. Let's go into the next page in the response to 6-032, we have a series of tax allocations under the Assistant Vice President of Taxes, first one is Responsibility Code is 15-000 and the methodology is composite of direct reports. The next one is 100% to Bell South Enterprises and the next one is the general allocator, and then other taxes is composite of direct reports and then Manager of Taxes is Headquarters' allocator. It seems like quite a variety of cost causation allocators here. What for example is the distinction between 15-020, Manager of Taxes/Audits allocating costs on the general allocator compared to a Manager of Taxes, RC 15-101 on the Headquarters' allocator. I guess the best thing to do would be to look at the Cost Assignment Forms... 15020

Mike Hostinsky: 15020 & 15101?

Mike Hostinsky: The 15-101 is the Manager of Other Taxes Compliance, and the Headquarter's allocator is chosen because this person basically does all the tax compliance with respect to sales use tax, payroll, other taxes for Bell South Headquarters.

Lane Kollen: Okay and this is with respect to 15-101

Mike Hostinsky: That's 15-101. And that person, you'll also note, or that group is a group, also project bills Tax *Compliance Research and office support for specific companies.* But that the portion of the total cost outside of projects gets a Headquarters' allocator because the residual all relates to Compliance work for Headquarters.

Lane Kollen: By Headquarters we're talking about there, only the Bell South Corporation Headquarters and not anything about the BSE consolidated?

Mike Hostinsky: That's correct.

Lane Kollen: That distinction exists here.

Mike Hostinsky: Yes. In the allocation process, we have Headquarters set up as a, I guess, with the special allocations factor.

Mike Deans: I don't know.

Mike Hostinsky: If somebody is doing work for Bell South Headquarters, we have the Headquarters allocated factor, to get those charges allocated down to the subsidiaries. The 15-020, um, is a Tax Research and also Audits function with respect to the consolidated tax return, and therefore it services benefits to all subsidiaries, and there was nothing better than the general allocator to utilize in that particular case. Very broad and general, all subsidiaries, impossible to separate audit activities and research activities.

Lane Kollen: The next item is the 15-110. which is Operations Manager of Compliance, the name is Sheppard, and the Cost Assignment Methodology is Investment of Subs. What is investments mean? What is the definition of that?

Mike Deans: That would basically be total assets, off the balance sheet.

Lane Kollen: And again, is that total assets off the balance sheet, is that on a consolidated basis?

Mike Deans: Yeah.

Lane Kollen: Okay. And by assets do you mean property planning and equipment type of assets or all assets including things like cash, and materials and supplies, and investments in subsidiaries companies?

Mike Deans: Right. Total assets, on the balance sheet.

Lane Kollen: Okay. The next one, O&M Operations Manager - Property, and the name is Flannigan, the RC is 15-140, the designation of the Cost Assignment Methodology is 5% to BSE, 95% to BST on investment.

Mike Deans: That's correct.

Lane Kollen: I guess my question there is where did the 5%/95% designation come from?.. first part of the question. The second question is why not just take investment from the non-regulated side of the business compared to the regulated side?

Mike Hostinsky: Of course, it's hard to say where to place it at this time and there is no way of obviously knowing other than going back to Mr. Flannigan, and finding out. But there is also is an indication on here that Tax Compliance Research and Audit for specific companies are project billed. So the residual is what we're talking about, the 5% unregulated operations, 95% Southern and South Central and the only rationale, the one that was accepted by the cost accountant conducting the review was that the cost portioned is based on an investment relationship, which is the driving force behind property taxation. But there is no indication as to why 5 and 95 as opposed to a straightforward relative relationship.

Wayne Hutchens: The investment on this RC, total assets again?

Mike Deans: No..

Mike Hostinsky: They should be.

Mike Deans: Yes, right it would be. The term investments would be the same for all of them.

Lane Kollen: Okay. But there's not a designation or a segregation of the assets by company of by subsidiary in this case. It's a percentage imposed..

Mike Hostinsky: Right.

Mike Deans: Right.

Mike Deans: Well, if you looked at the two Cost Assignment Forms, between '91 and '92. In '91 the 95% of investments was split between Southern and South Central based on investments. Those designations sort of went away in '92, so..

Mike Hostinsky: I think that the answer to that, we'd have to check to be able to tell you really why the 95/5 as opposed to a simple relative relationship.

Lane Kollen: Now, I've obviously not intending, or maybe not so obviously, but I don't intend to go through each one of the items in this response to 6-032, but I want to get through enough of them so that I thoroughly understand the rationale and the actual implementation through these Cost Assignment Forms, of them, and the Cost Allocation Methodology.

Mike Hostinsky: Sure. The only thing, you know, that I could even speculate on this one is perhaps that some of the Enterprises' subsidiaries are not covered in essence, do their own Property taxes. That's the only thing I could think of why you would use other than a relative relationship.

Lane Kollen: So it's a possibility at least that perhaps they performed a study that is not evident from the Cost Assignment Form.

Mike Hostinsky: Right. Analysis, because obviously, if you had 95/5, they're nice round numbers, there's obviously some judgement that's been used there, with respect to who, what companies are the cost causatives and which companies they're supporting.

Lane Kollen: Okay. Moving on down the list, and in response to 6-032, we've got an Operation Manager - Unregulated Income Taxes, followed by a Operations Manager - Regulated Income Taxes. And, we're dealing with the RC's 15-340 and 15-350. Conceptually, I guess I have a little bit of difficulty understanding how Responsibility Code that says unregulated Income Taxes could have any allocation to Telecommunications. Likewise any Responsibility Code designated as regulated could have any allocation to Enterprises. And so, I guess I'd like you to explain that to me. So, ... so, 340 & 350.

Mike Hostinsky: The 15-340 has as part of their function some administrative support costs other than departmental overheads which benefit BSE, BBS and BST. The 350 indicates that they've got some overall clerical support for the entire Income Tax division. So, there are some functions, administrative functions within both groups. In one case, it doesn't say whether it's clerical or not, the other one it specifically identifies it as clerical. Where in essence they support the work done by the entire clerical Income Tax division. And therefore that's how you get the small portions allocated to the reg/unreg in spite of what the names of the districts are entitled.

Lane Kollen: Okay. Going on to the next one, the Operations Manager - Consolidations, Demmick, the RC is 15-360, there is a Cost Assignment Methodology indicated there. I guess my questions there go to: What functions are performed within this Responsibility Code, are they only related to the consolidation of all of the subsidiaries of Bell South Corporation, or are they related to consolidations at intermediate levels, like up to BST, or up to BSE?

Mike Hostinsky: You know, the percents are simply allocated to the BSE & BBS or the general allocator in Gigi's case, a lot of the general allocator comes from the fact that they're working on the consolidated Federal Income tax return. I know that all the tax organizations have very detailed records, because they do so much project billing, about their times and activities and that's where the percents come from.

Lane Kollen: Okay. So, essentially the consolidations, we're still dealing with income tax issues and it's not financial statement consolidations as such.

Mike Hostinsky: Right, Consolidated Federal Income Tax Return.

Lane Kollen: Now with the reorganization, am I correct that a substantial portion of this function has been pushed down to BST?

Mike Hostinsky: Not Gigi Demett's. The ones pushed down, I'm not sure exactly how they are, but Susan Creel, the H15-350. and I think the 15-320 Leanne Harvey would have been pushed down. If you take a, if you look at that division, take the 50 percent rule those operation managers that have more than 50 percent going to Bell South Telecommunications, would be the ones that have been moved out in terms of the reorganization.

Lane Kollen: And the converse is then likewise true, that those Operations Managers or Responsibility Code's that have more than a 50 percent allocation to BSE would have been retained by the Corporation.

Mike Hostinsky: Well not necessarily, because remember there won't be a BSE company, so you really have to look within the BSE percentages and they are so fragmented that there is no one subsidiary that they would have been doing more than 50 % for. So my understanding of it is that the unregulated tax people will stay at Bell South Headquarters and will project bill. The only time that a tax organization would be pushed out on the un-regulated side would be if one of the companies gets so large and autonomous that you could push a group out. But from a cost standpoint, it was not effective to try to put an unregulated tax group out in one of the subsidiaries because they would have still had to bill the various subsidiaries to get the cost out. So there is no cost savings from that standpoint.

Lane Kollen: So, is this a true statement, at Bell South Corporation after this reorganization is completed that there will be no cost allocated to Enterprises as an entity for in turn reallocation to its subsidiaries if it chooses to do so, *but rather there will be only project billing* to specific Enterprise subsidiaries?

Mike Hostinsky: *Well, there will be cost allocation* billing to the various subsidiaries. Now, whether there'll be a two step process through a Bell South Enterprises shell or whether it will be direct, it really hasn't been determined until we figure out, here in the next few months, what we can do to minimize the functions and operations, what has to be contained from an accounting standpoint, in the Enterprises shell.

Lane Kollen: Because that would make a difference would it not? Whether or not you're allocating to individual subsidiaries of Enterprises' or whether you're allocating to Enterprise's on a consolidated basis and then there is a second tier allocation after that. It could, let me just put it that way.

Mike Hostinsky: Well, there is no difference except in how you do the accounting. The process would not be any different, in my view, I don't see anything significant about the process.

Lane Kollen: Well what with respect for example, in the unregulated Income Taxes if that function being retained by Bell South Corporation its not being pushed down to Bell South Telecommunications *or into Enterprises. And now that will be project* billed to the subsidiaries of Enterprises?

Mike Hostinsky: That's correct.

Lane Kollen: Even though perhaps, the work that is done by that Responsibility Code is not necessarily assignable to a specific subsidiary?

Mike Hostinsky: Well, it would be assignable to a specific subsidiary, in taxes it would be. But remember that today, we only allocate down to the Bell South Enterprises holding company. They use a management fee to allocate below that.

Lane Kollen: Right.

Mike Hostinsky: In the future there will be fully distributed cost billing. Now *whether there is an intermediate* step in the BSE cost holding, or whether it goes directly down, it will all take place at the same time. Because the plans are, at least right now, not to have any staff in the BSE shell.

Lane Kollen: Right. I guess my concern was more directed towards, if there is not a specific subsidiary taking general non-regulated related income tax work, then who are you going to project bill to?

Mike Hostinsky: Oh, well they'll project bill directly to the subsidiary.

Lane Kollen: Okay, there will have to be in effect some type of allocation of those general types of costs that go to non-regulated businesses.

Mike Hostinsky: Well it's not an allocation, it will be project billed. So the project system will capture the costs. They'll load departmental and corporate overhead on it and it will be billed specifically from corporation to that individual entity. Project billing will not go through any intermediate step, it'll be direct. Your allocated cost can, logically goes from one tier down to the next lowest tier in a hierarchial arrangement. But project billing does not, project billing goes directly from those providing the service to those receiving the service.

Lane Kollen: Using this as an example, the un-regulated income tax activity, that is a responsibility that is being retained by Bell South Corporation. Is that correct?

Mike Hostinsky: Uh-huh.

Lane Kollen: Okay. And most of the costs there is allocated, or was in 1992, allocated to BSE and BBS. 98%. Unregulated.

Mike Hostinsky: Uh-huh.

Lane Kollen: It wasn't allocated to individual subsidiaries of BSE. It was just allocated to BSE.

Mike Hostinsky: The allocated portion. But there were project billings that did push a lot of costs there.

Lane Kollen: Right. Right. I understand that. What I'm trying to get at is the portion of the costs that were not project billed. What happened under this new regime to those types of costs?

Mike Hostinsky: They're billed the same way, assuming the function stayed the same.

Lane Kollen: Okay. But instead of being allocated to BSE, they'll be allocated to each of the individual subsidiaries.

Mike Deans: On the Cost Assignment Form under Section 5 it talks about all services, including them and talks about what they do, will be billed to the specific companies, that's what they're doing now, and that will not change."

Mike Hostinsky: But even if there are some non-project costs,

Lane Kollen: Right, that's what I'm getting at,..

Mike Hostinsky: ... that remain in this RC,...

Lane Kollen: What do you do with those?

Mike Hostinsky: .. assuming that the functions don't change, they'll still go down in an allocation process, hopefully hitting the unregulated subsidiaries in BSE.

Lane Kollen: But directly rather than to BSE probably.

Mike Hostinsky: Yeah. That's the way it works right now. I know the tax folks also tried to clean up this administrative/clerical support thing, so that we did not end up with these wild billings back and forth, and create these "incestrializations" (?) between entities and things which really would be costly to do. I think they've cleaned those up too, in terms of the new organizational structure.

Lane Kollen: Okay. Let's turn to the next page. Again, I'm just trying to hit those that I think are differentiated from the earlier ones that we talked about. I want to repeat the same types of questions that we've gone through previously. We have an Operations Manager - Economist, and the cost of that Responsibility Code is 22-100, the Cost Assignment Methodology is operating expenses of subsidiaries. And what subsidiaries are included in that? All subsidiaries?

Mike Deans: Yes.

Lane Kollen: Again, on a consolidated basis?

Mike Deans: Consolidated basis, that's right.

Lane Kollen: But now, as you're aware, depending upon the accounting methods performed for the ownership interest of some of Enterprises' subsidiaries they're treated on the balance sheet under the equity method. The expenses don't actually get consolidated into Enterprises' financial statements. Just the net income does. So...

Mike Hostinsky: We don't have operating control though. So then that company would not benefit from Jim Young's group of economists. You're right in that there are some equity investments in there, but the equity investments in joint ventures, we don't have operating control. We also don't operate them and therefore they don't really impact what Jim Young does.

Lane Kollen: So in effect, the form or the level, form and level of ownership interest in a subsidiary could very well affect how much cost it's allocated?

Mike Hostinsky: That's right. And in turn it has a big impact as to whether or not that entity is a cost causer or not. If we don't have operating control, that generally means that we have a passive arrangement from a management standpoint, not that we don't have oversight. But in terms of overall operating responsibilities, and therefore those kinds of investments don't drive, or don't cause the same level of Headquarters' cost as subsidiaries that we actively manage and operate.

Lane Kollen: Turning to what was my Bates number 54, where we're into the Corporate Human Resources, this would be under the Director of Executive Benefits, Summer, RC 53-200. The Cost Assignment Methodology is the ratio of key managers and officers in each BS company. When you have something like that, is it only at the direct subsidiary level, like Enterprises' versus Telecommunications. Or do you add up all of the key managers and officers in each of the subsidiaries whether they're direct or indirect?

Mike Deans: It would be all subsidiaries.

Lane Kollen: And would that include those in which you don't have operating control? Like the International Cellular?

Mike Deans: No, we don't, if we wouldn't recognize their salaries, then we wouldn't recognize them..

Mike Hostinsky: It would if they were key managers. Because in a lot of those situations, I think, what happens is that you have an ex-patriat, ex-patriarch, patriot, I'm sorry, and they would be included in the calculation. Because Tom Summer does the research development administration of all the benefit plans for all key managers and officers in the corporation, wherever they are. So everybody has to be included.

Lane Kollen: Okay. What is the Sloan program? The next item on the list on the response to 6-032? Is that an Executive Development program?

Mike Hostinsky: Yes it is. At MIT.

Lane Kollen: Why does it exclude the BSE acquired companies? As far as the Cost Assignment Methodology? Is that because none of the BSE acquired companies officers/key managers are participants in the Sloan program?

Mike Hostinsky: Right, based on employees eligible for participation... And the Cost Assignment Form shows that exclusion.

Lane Kollen: Looks to me like the longest list here, with the most precision, shall we say, in cost allocation comes in under the VP & General Counsel, and all of the reports to that individual. Kind of interesting..

Mike Hostinsky: I think our legal folks generally keep calendars, and as we work with them, they basically make judgements about what the calendar tells them, in terms of who their clients are. We try to be very careful with them, to make sure they understand what their allocation is such that if they have a need to exception report that they're aware of, that needs to be done. If they find themselves getting outside who they have historically had their clients, if they find their client base changing and so forth. Then they either need to either update their form or exception time report if it's a temporary thing.

Lane Kollen: Okay. What I'd like to do now, is turn to the last two pages of the response to 6-032. And, um, we have here the Federal Regulatory, and prior to that the Director of Legislative Affairs. Basically, we have this governmental affairs area. The first question I have is, where does Bell South Bell Corporation, where do those costs enter into this picture here, as far as the Cost Assignment Methodology. Where, what Responsibility Code are they coming in on? You said that they were effectively treated as a separate department?

Mike Deans: Well they're coming in on these RC's that you're seeing here. HE0H7-OH71-100... all those, those are Bell South Corp. RC's. Over there in parentheses, under position names, are the S-, RC S10-100- whatever, those are the Bell South DC RC's.

Lane Kollen: Oh, I see. So that would be a good indication, well in fact it looks like almost all of these are coming in under Bell South DC?, with the exception perhaps of the last two on that page?

Mike Deans: I guess they just didn't put them down they would have their own Bell South DC RC's.

Lane Kollen: Even the last two would?

Mike Deans: Yeah, that whole section is Bell South DC.

Lane Kollen: Okay.

Mike Deans: There are a few other Responsibility Code' s besides these, that are being billed back to Bell South BC. But all of these on this page are Bell South BC

Lane Kollen: Okay. In the material that you have in the two binders there, there is information as to the billing for each one of the RC's. Is that right? In other words we have, earlier we talked about the summary of the billings by department to each one of the Bell South entities, and then back up to that, and obviously the computer program that you have, starts out with the RC level of information and then performs the allocations, and then, is there, there is a roll-up then to get the summary by department. Right?

Mike Deans: Right.

Lane Kollen: Okay. Now, the notebooks that you have here, do they contain the detail by Responsibility Code? As far as the cost collection?

Mike Deans: Well there's a output report given for that particular part of that particular month, it would have an RC.

Lane Kollen: Okay. Just in general, I'd like to ask you how it is that the determinations are made on legislative activity. To go with the General Allocator in some instances, and in some instances to have a direct allocation of 70% to BST, 30% to BSE or 90% BST or 10% BSE.. How can it be discerned in one situation how much time is being spent on, you know, on telecommunications activities and in another instance, that determination apparently can not be made.

Mike Hostinsky: I think it has to do with the functions. And basically look at the Cost Assignment Forms in the various functions, you know, and that would lead you to the rationale.

Lane Kollen: Okay, so if we look, for example to the Director of Legislative Affairs, Matthews, RC H71100. Okay that um, for that particular RC, the H71100, you use the general allocator. The rationale is that impact of issues generally dealt with is generally corporate wide and assessment of direct benefit to a specific subsidiaries is impossible or impractical. And then there is some exception, billing or project billing..

Mike Hostinsky: There are a couple big exceptions there. One of them is MFJ-Grass Roots lobbying. The other one is that 10% of salaries and all direct lobbying expenses in all direct for two registered lobbyists, and held in a PV project and not billed out to subsidiaries.

Lane Kollen: Okay. Presumably, non-regulated?

Mike Hostinsky: I don't know why the 10%, I assume it relates to the function of their time that they feel like they spend undertaking lobbying.

Lane Kollen: Okay. Let's contrast that to RC 73-010, which is the Director of Federal Regulatory.

Mike Deans: 73-010, is that what you said?.

Lane Kollen: I don't know if I have that. I don't have that. 73-010, I have 73-020.

Mike Hostinsky: Gary Dennis, who we're showing as H73-010.

Lane Kollen: Oh, you have that.

Mike Deans: Yeah, it's somewhere in the back for some reason.

(Long silence)

Lane Kollen: I've got that.

(Second Side of Tape #2)

Lane Kollen: .... come to the determination that, you know, as far as time involvement, they felt that they could identify them, some of the times between regulated and non-regulated activities. Is that your exception to this?

Mike Hostinsky: Well between different activity, I think, not just reg. & non-reg., but BST and Bell South Enterprises, and some things that relate to Corporation in general. I think that, one thing that jumps out to me on this one is, is that this person basically provides information and monitors activities at the FCC and therefore that is a ever-changing environment, in terms of what the mix is. And so while the mix at any one given point, may not exactly match the Cost Causative Allocation, that over a period of time, and with the mix of events, this person feels that a split of 70% BST, 15% BSE, 15% overall Corporate general allocator, is appropriate for their ongoing activities.

Lane Kollen: This person or this Responsibility Code, is that being retained at Corporation or I should say at Bell South DC, after the reorganization? The latest reorganization?

Mike Hostinsky: No, Bell South DC will be treated the same.

Lane Kollen: Okay, now, as it was before the reorganization.

Mike Hostinsky: That's correct.

Lane Kollen: Now, you had said earlier, there won't be any Bell South Enterprises allocations, so to speak, starting January 1, 1994?

Mike Hostinsky: Well, I guess that the question is that's not an absolute certainty. But we are working now to minimize the total functions, from an accounting standpoint at Bell South Enterprises Headquarters. So that the cost will get pushed down to subsidiaries in a fully distributed cost manner. The final determination as to whether it will be a two-step process, with the Enterprises, or direct, I guess we're uncertain there until we get the final picture from the Tax and Legal people.

Lane Kollen: So the issue of whether or not the Enterprise subsidiaries get an allocation of costs from this RC, for example, is not dependant upon whether or not there's a project billing situation.

Mike Hostinsky: That's correct.

Lane Kollen: They're going to get it if the time is spent on Enterprises type activities.

Mike Hostinsky: That's correct. Regardless of whether the Enterprises' holding company exists or doesn't exist at the beginning of January.

Lane Kollen: One thing I just want to make sure that I have real clear. I asked it earlier, but I just want to make sure that I have it clear. BS Corporation is not concerned with delineating between regulated or non-regulated conceptually. They're concerned with allocating the companies.

Mike Hostinsky: That's correct.

Lane Kollen: And that then, if Telecommunications, for example, wants to segregate those billings from Bell South Corporation, between reg and non-reg., that's entirely up to them.

Mike Hostinsky: That's correct.

Lane Kollen: And you don't directly provide them any information to do that, is that right?

Mike Hostinsky: Just the bill and the invoice and supporting documentation that we talked about earlier that we have here in the two binders for you to look at. The only thing outside of that, would be the special request items that they have in the request that we give them at certain times, or certain information.

Lane Kollen: Okay. Um, Let's turn to the last page. And I think we'll be done shortly after this. This is the last page in response to 6-032. This deals with Advertising and the Cost Assignment Methodology, just as an example, for RC 95-000, and this is Advertising, is 5% general allocator, 20% Marketing allocator, BST 65%, BSE 10%. I guess it was my impression from some of the earlier comments, that BST does its own product advertising, and that BSC does not do product advertising. Is that correct as a general rule?

Mike Hostinsky: I guess the thing I would say, is that all advertising reports to Don Reichert, who is the person in this Responsibility Code. So he has responsibility both in the holding company and in Bell South Telecommunications. So, if it's product advertising, then he's responsible.

Lane Kollen: Okay. I guess if we looked at the Cost Assignment Form, there's a number of Cost "Causative Corporate Functions Assignment Methodology", and that has to do with exceptions of reporting down..

Mike Hostinsky: Right.

Lane Kollen: In section 3 of that Cost Assignment Form?

Mike Hostinsky: Right. So if it's Marketing focused costs it goes to the Marketing joint allocator, if it's investment financial advertising it goes to the equity of subsidiaries. Other Advertising costs go to the general allocator. And then any other costs that are charged to Don's Responsiblity Code go to, 70% Marketing allocator, 20% Equity, and 10% Joint allocator.

Lane Kollen: And that's a matter of judgement, presumably.

Mike Hostinsky: Right. Bill, do you have any other questions?

Mike Deans: No.

Lane Kollen: That's all I have. Thank you very much.

Mike Hostinsky: Alright, let me cover one other thing, before you turn the tape off. And that's to clarify the question earlier about the Capital Funding. Capital Funding is the financing subsidiary of Bell South Corporation, that provides the debt funding for the un-regulated subs. of BS Enterprises. In doing so, while they have debt, they immediately turn around and push that debt down to the subsidiaries. They also have a, are a zero company when it comes to net income, and in pushing the debt down, they mark it up about 5 basis points over the interest rate that they get in the market to cover the operating expenses and SEC filings and so forth. So therefore if there is any debt in Capital Funding it's there for a very short time, a matter of days and weeks before it can get pushed down to the Enterprises subsidiaries. And the Enterprises subsidiaries have an excess of 500 million dollars so I forgot the exact number, when I made the call at the break, but an excess of one half a billion dollars of debt on their books. So there is no debt that would not be included in an allocation based on capital at any of the subsidiaries that are not covered in the allocation process.

Lane Kollen: Yes, but that actually though, issued by Capital Funding, and held in the name of Capital Funding. But then for accounting purposes allocated to the subsidiaries of Enterprises, is that the way it goes?

Mike Hostinsky: That's correct. That's the way it gets pushed down.

Lane Kollen: The debt isn't actually held by the subsidiaries, although it is reported on their books. Simply because of the accounting treatment of it, rather than the actual debt instrument as such.

Mike Hostinsky:	Capped Funding is essentially is the Treasury Department for all those companies that, they have a note executed with Capped Funding. So that they do have a legal liability to repay the debt from that company. So it is also secondary to the overall note that Capped Funding has with actual bond holders in the outside marketplace. That's the accounting process by which it gets pushed down.
Lane Kollen:	I do have a few more questions, if you don't mind, on Consolidation accounting. Um, at Bell South Corporations Consolidated Financial statements. Are those the types of questions you could answer in general?
Mike Hostinsky:	Yes sure.
Lane Kollen:	Okay. In some instances when you're making eliminating entries or consolidation entries, you have, I guess an opportunity to determine where the consolidation entry goes. For example, with respect to BellSouth Capital Funding, you could eliminate the debt there, or you could eliminate it on all of the subsidiaries of Bell South Enterprises. In other words, you can't count the same debt twice.
Mike Hostinsky:	Right.
Lane Kollen:	Okay. And so that on a consolidated financial statement basis for Bell South Enterprises, you have the discretion, I guess, of including that debt on the balance sheet of the Capital Funding, or on the balance sheet of enterprises. Is that right, or am I wrong?
Mike Hostinsky:	Well, we really don't have any choice, because Capped Funding is a subsidiary of Bell South Corporation. So when you do the Bell South Enterprises consolidation, the debt is already consolidated at the Bell South Enterprises level. So when the Bell South Enterprises consolidated financial statements are used in the allocation process, it's already there. And we really have no opportunity. When we do the Corporate Consolidation, we simply, because its already included there, we simply don't have to deal with that entry again.
Lane Kollen:	Okay. Now at the consolidated level, sometimes you make what I call reclassification entries. Is that right?
Mike Hostinsky:	Well, very seldom. Sometimes if amounts are small or external financial statement purposes we will include them in with another line. But I'm not sure if that's what you mean by reclassification or not.
Lane Kollen:	Um, yeah. Which line gets included in, and you do make those types of reclassifications entries.
Mike Hostinsky:	Right. Yeah, we do have a few of those things. For example, minority interests. While it's recorded up in detail in our external financial statements, we zero out that line and put it in other income net. We do the same thing with cumulative gain/loss in foreign currency transactions. Just to make a clean financial statement. That's what we're trying to do.
Lane Kollen:	With respect to the reclassification entry that's done on the consolidated books, related to ESOP, segregating ESOP "benefits" expense, between compensation expense and interest expense. Are you familiar with that reclassification entry?
Mike Hostinsky:	No, I'm not. I think that's one you would want to ask Greg Griffin.
Lane Kollen:	Okay. We will, I just wanted to know if you were familiar or not. Okay, very good, thank you.

(End Tape)

CONFIDENTIAL

SET M

MISCELLANEOUS WORKPAPERS

1. Cover letter followed by [illegible] Services Cost Report ([illegible] copies of report).

2. BellSouth Headquarters Cost Allocation Sorted by RC and Account
   a. Monthly
   b. RC → for each entity directs, OH, total
      FRN
      A/C ← need this report

3. BellSouth Headquarters OH Allocation Sorted by RC and Account
   a. Monthly
   b. same format as previous report but col. headings are
      Corp OH, dept OH, tot OH for each entity

4. BellSouth Headquarters Cost Allocation Summary Report by Account
   a. Monthly
   b. Same as #2 above but no RC or FRN detail

5. COPS Summary Report
   includes 100% retained accounts listing

6. Various reconciliation reports (for month only)

7. Factor Reference Numbers

	UNHQ	TELE	BSBS	BSHQ
FRN	.----			
↓	1.----			

} 4 digit decimals add up to 1.0000

8. Single page w/ data used for allocation purposes (June used data for July 1992 billing):

	UNHQ	TELE	BSBS	BSHQ	TOT
a. Net Expenses	116388	760798	44681	—	92181
b. Capital	3889846	19362490	279258	—	23531
c. Emp's P&B Plan	6297	76850	3495	—	866
d. Total Emp's	13254	76850	6018	-	9612
e. Investment	4590052	25977862	414682	-	309825
f. Total Equity	2766844	7404676	158060	-	1032952

g.	Non-Mgt Emp's P&S Plan	3155	56879	1230	–	61284
h.	Key Mgrs	140	262	22	–	424
i.	All Other Mgrs	5910	19669	1829	–	27408
j.	Total Sales Emp's	0	20	693	–	713
k.	Emp's Rep Co's	2226	56899	1230	–	60355
l.	Fed PAC Receipts	4775	26243	2311	–	33329
m.	Salaries & Wages	20744588	233552565	12617541	–	266914694
n.	Marketing Costs	29020	36874	22752	–	88646
o.	Gross Fixed Assets	1209373	37696084	112644	–	39018101
p.	Operating Expenses	153690	771403	54818	–	979911
q.	USA Emps	11750	76850	6018	–	94618
r.	Retired Emps	460	57769	117	–	58346
s.	Execs	14	32	2	–	48
t.	BSC Billing →	2693424	8669657	556335	–	11919416
u.	Key Mgrs Except BSE Acq.	122	262	22	–	406
v.	Oth " " " "	3020	19669	1829	–	24518

9. BellSouth Corp C.A.R.S. Corp Overhead Calculation Analysis

a. We have copies of this cover page but not A/C detail that follows

10. BellSouth Dept C.A.R.S.

a. Same as 9a.

11. BSC HQ Cost Alloc Master List of Composites (single page)

a) Name RC FRN UNHQ TELE BSBS BSHQ TOTAL

4 digit decimals

12. Composite computations (spreadsheets)

13. Composite Journal Report.

I LL INTERVIEW / HOSTI CY

I. CONFIRMATION THAT HOSTINSKY IS THE MOST KNOWLEDGEABLE IN EACH AREA. A. Review areas of resp. (6-024 p.133) B. who makes the calls?

B. PERSON RESP FOR DR RESPONSES C. B. STATUS / AVAIL OF INFO REQUESTED (GET SPECIFIC DRS) - WHO DECIDES WHAT & WHEN TO RESPOND?

II. GENERAL PRINCIPLES OF COST ALLOCATION

A. PART 64.901, 32
1. GENERAL 2. JUDGMENT 3. DIFFERING INTERPR

B. COST CAUSATION - 6-021 BSC/BSE Contract "cost/benefit"
1. DEFINITION 2. EXAMPLE 3. ULTIMATE BENEFIT 4. PHILOSOPHY
5. BASIS FOR COST ACCOUNTING

I.A. Expect independence complete review of all costs → C. COOPERATION W/ FED & STATE REGULATORS 6-021 BSC/BST (in compliance w/ ...)
1. WHAT DOES THAT MEAN 2. OBLIGATION OF BSC COMPARED TO BST
3. OBLIGATION OF BSE COMPARED TO BST 4. SCOPE LIMITATIONS 5. EX DIR 7 & 8 (6-01...

D. FCC'S POSITION ON USE OF REVENUE ALLOCATORS
1. WHY REJECTED

E. RESIDUAL THEORY (BST GETS IT ALL UNLESS...) - BSC IS FOR PURPOSE OF HOLDING BSE; NOT FOR BST.

F. "NOISE" V. AGGRESSIVE UTILIZ. OF AFFIL. BUSINESS OPPORT. G. State relationship 6-073 p. 49

III. RESPONSIBILITY FOR COST ALLOCATION a. Evaluation of alternatives

A. ORGANIZATIONALLY
1. LEVELS
2. REVIEW & APPROVAL

BSE 6-021 (contract)
3. SELECTION OF ALLOCATION BASES, DATA election/selection by BSE
4. STRUCTURE & FINANCING OF ENTITIES (6-024 Legal p.174)

B. TRAINING IN COST ALLOCATION PRINCIPLES & IMPLEMENTATION

C. CENTRALIZATION & ROLE OF BSC ACCOUNTING

IV. RELATIONSHIP OF BSC ORGANIZ. TO COST ALLOC PROCESS - asked for map 6-07 (no response yet

A. DEPARTMENTS listing 6-024 (but incomplete - confirm w/ Host.)

B. RC ; FRNS 6-032 walk through in detail later

6-041 list of FRNS → who decides these

C. CONSOLIDATION OF BSC, BSE (BST?)
1. Costs 6-013 only addressed BST!

D. COMPARISON OF BSC FUNCTIONS TO BST FUNCTIONS 6-024

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E. BSC COSTS UNNECESSARY TO BST

V. ALLOCATION OF ACCOUNTING COSTS

A. PENSION -

B. COMPENSATED ABSC — THRU OVERHEADS OR DIRECTLY → for those that BSC

C. 106

D. 109

E. TAX EXPENSE 6-075 (no resp) — each co. will make B/S adj.

F. OTHER REGULATORY ITEMS — SFAS 71 applies to reg CO's

1. Advert.

2. Charit Contrib 6-078 (no resp), etc.
incl. Foundation

VI. ESOP/CAPITALIZATION

A. ALLOCATION OF FINANCING COSTS

B. CAPITALIZ. OF AFFIL
-6-091 (no resp)
92
93

C. ESOP 6-084 (no resp)
85
86
87
88
89
90

Same general logic

VII. ALLOCATION PROCESS - confirm that it is basically labor driven

A. FREQ OF ALLOC. BASE REVIEW - at least annually
- treat it in post alloc process

B. SYSTEMS (PARS, CARS, DCBILLBACK 6-011)
6-033 identify types of project costs and why drop from 1991 to 1992

D. ACTUAL ALLOCATION PROCESS
6-032 walk through

C. Overhead (6-037/38) 1. Dept (38) 2. Corp (42) 3. When applied ? 4. Spreading [illegible]

VII.

E. FRNS 6-041

F. Walk team 6-041 v. 6-043 where
RCs are lined up to FRNs

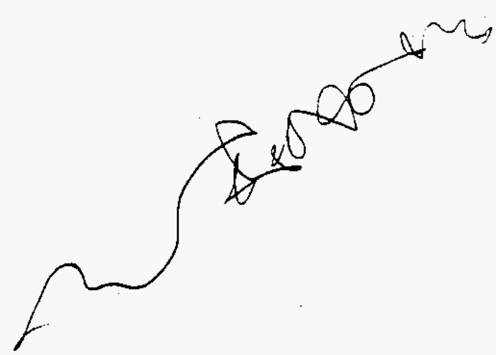
G. 6-047 asks for specific detail on
allocation bases, incl level, etc
Still no response - push this

H. Reconcile 6-030 & 6-049

I. Cost Assignment Methodologies
by RC 6-064

J. Cost Assignment Forms
6-065

VIII. START 6-100 (no response)



1

Dr, Corp Acctg Matters

Jan 1, 1993

April 1, 1993 Corp. Acctg Svcs Group { Mike Deans - Cost Allocation / John Robinson Oper Mgr } now reports to AVP Controller - not him

Cost accountants that do report to him prepare data

6-065 Cost Assignment forms

E.I. 10 - periodic interviews provides for at least annual review of cost assign. forms

Classic Activity based costing

Greg Griffin - Opn Mgr. reports to Hostinsky - resp for acctg stds ← in group Pat Magin, Kell DeMartin } go thru process w/ Dept head

DRs all provided to Gary Grace

Size allocations are only after you pick appropriate cost causative

dept folks not really that knowledgeable about cost alloc. process

generally lowest cost pool is the district

outside vendor cost also incl. in RC cost pool

OH only on S & W

* Transfer of tax org to BST

BSE & BST (to BST) pushed down functions

247

2

Starting in 1992 PB projects now at BSE (retained)

* Monthly Cost Allocation Billing
(Monthly Billing details) — this is their control record

10/05/93
interview of M. Hoshinsky
Subject: consolid of BSE & BSC

Enterprises won't be dissolved legally
Staffs have been combined & are in transition - everything under BSC
Mgt fee to BSE subs only thru end of 1993. No more mgt fee 1/1/94.
See response to 6-004, 2-097.21
Trying to limit BSC to be more like fin'l holding co. rather than as operating holding co.
BS Int'l now essentially S/A entity
Cost assignment forms will be updated Nov this year
"redundancy" and "duplication" existed at BSC and BSE

July 1992 Dec 1992
Room 531 Southern Bell Ctr.
Mike Deems will be w/ Hoshinsky

Who did Greater study ? Jan 20

How much did it cost ?

What was treatment of cost ?

How much booked for early retirement ? CTAP, DTAP, other program available to managers

What was treatment of cost ? - not aware of any tracking

* no Telecommunications represent on s/b teams as general rule

* normal corp. svcs allocation process

10/06/93

1

1. Admin costs of BS Foundation 6-059

2. leveraged ESOP is in BSC-HQ OH

721.311

3. detail coding

PD = Enterprise projects
PF = conductor flowthrough
PN = nonaffil. billings to 3rd parties
PS = general project for subsid.

4. 6-032 v. 6-065 attach I
↳ summary of 6-065

5. July & Dec 1992 Cops binders

6.

Policy group ← cost accountants ← tells which subsidiaries

reports from subsidiaries that they provide ←

Subs get copy of 6-030 response + letter w/ some detail on

1 FedPAC & admin. costs. Nothing

Jurisdictional differences reports (qtrly) – 2 BellSouth golf classic
- 3 Social and service memberships
- 4 Breakdown of fed regulatory & fed relations (doesn't know why)
-

BSD.C. afforded dept treatment at BSC for cost alloc.

Public relations – charitable contributions

6-043 Matrix linkage from RC to FRN

- No cost assignment forms for Executive
- JCO directs Chairman's costs to be alloc. ~~to~~ on gen'l allocator
(I don't think right)

- consolidated v. individual subsidiaries ← he confirmed that debt is pushed down to BSE subs.
(They're going to check on BSCF and whether debt is incl there or on subs of BSE & then incl. on BSE consolidated books).

- Headquarters Allocation (total billing to subs after all else)

- BST Comptrollers function question costs - informally
↓
but BSC has formal say on all allocations & billings

Investments in subs = total assets incl. investm. in subsidiaries

Operating control is distinction

13120 Corp Consolid/External Reporting

Greg Gruffin - Subject Areas of Interview

1) Acctg for ESOP
   a) Mechanics of calculations
   b) Assumptions
   c) Reconciliation among components

2) Tax treatment of ESOP
   a) Parallel components of calculations
   b) BSC dividends
   c) Reconciliation of tax treatment to accounting expense components

3) Assignment/Allocation to BST and other affiliates

4) Reclassifications on BSC Consolidated

5) Pensions accounting and cost assignment/allocation

6) OPEBs accounting and cost assignment/allocation

7) Other benefits " " " " "

BELL MULTI-STATE AUDIT
PRELIMINARY CONCLUSIONS

I. FAILURE TO OBTAIN KEY DATA REQUESTED IN JUNE 1993.

A. NO OBJECTION. WHAT IS BASIS FOR FAILURE TO PROVIDE?

SCOPE LIMITATIONS

II. TAX EXPENSE

A. BST AS STANDALONE NOT OK

1. NO CONSOLIDATED TAX SAVINGS SHARED W/ BST

2. AT LEAST TIME VALUE SHOULD BE SHARED

B. TAX TREATMENT OF ESOP EXPENSE ALLOCATION TOO HIGH SINCE INTEREST ALLOCATION FROM BSC TO BST

C. TAX DEDUCT OF BSC DIVIDENDS TO ESOP NOT FLOWED THROUGH TO BST

III. ESOP

A. BENEFITS EXPENSE ASSIGNED TO BST INCLUDES INTEREST COMPONENT

B. TAX EFFECTS OF BSC DIVID & ESOP BENEFITS EXPENSE

C. EFFECT ON CAPITALIZATION

IV. CAPITALIZATION

A. COST OF EQUITY – "BSC RISKIER THAN BST

2. INCONSIST TO USE BSC COST OF EQUITY COUPLED WITH BST CAPITAL & COST OF DEBT

B. CAPITAL STRUCTURE

1. BSC & BST VERY CLOSE AT 12/31/92

2. BSC FIN'L STMT CAPITAL STRUCTURE DOES NOT REFLECT FULL EXTENT OF NONREG LEVERAGE

V. BSC ORG INEFFIC & DUPLICATION HAVE RESULTED IN EXCESSIVE COSTS TO BST

A. BSC COSTS UNNECESSARY TO BST

B. BSC/BSE CONSOLIDATION SHOULD RESULT IN LOWER BST COST ALLOC FROM BS

C. BST ALLOCATED COSTS OF ORGANIZ. STUDIES

D. BST MUST ACCEPT ASSIGNMENTS & ALLOCATIONS

E. COSTS OF DOWNSIZIN TO BST

VI. COST ASSIGNMENT AND ALLOCATION

A. PRINCIPLES

1. JUDGMENT IS INVOLVED

2. DIFFERING INTERPR
a. FIN'L STMT REASONABLENESS V. REGULATORY

3. COST CAUSATION IS APPROPRIATE BASIS; NOT ULTIMATE BENEFIT; TWO WILL PROVIDE DIFFER RESUL

B. COST <u>ASSIGNMENT</u> GENERALLY FOLLOWS COST CAUSATION

C. COST <u>ALLOCATION</u> GENERALLY FOLLOWS ULT BENEFIT EXCEPT WHERE ULT BENEFIT & COST CAUSATION C/B CONSIDERED SA

D. PROCESS CONTROLLED BY BSC; MOTIVATION TO ENHANCE PROFITABILITY (86-111 JCO)

1. SELECTION OF ALLOCATION BASES
2. SELECTION OF DATA
3. LARGELY CONTROLLED BY BSC COMPTROLLERS
4. TAX EXP, PENSION EXP, OPEB EXPENSE, OTHER ACCTG EXP COMPUTE & ALLOCATED TO BST & OTHER SUBS AS SEPARATE PROCESS

614 ALLOC v. DIRECT ASSIGNM

E. COSTS OF COMPLIANCE IMPROPERLY CHARGED TO BST

F. 1. Comptrollers incl. compliance audit.
2. Internal Auditing
3. Legal

Regulatory specialist

F. CHARITABLE CONTRIBS
1. BSS FOUNDATION ADMIN
2. GOLF CLASSIC

G. LOBBYING
1. BSS D.C.

keep-cost

H. ADVERTISING

verify with Kathy W.

I. OTHER SPECIFIC ALLOCATION ISSUES

PREL CONCLUSIONS 9/30/93

(1)

fiber trials - most of it being charged to intrastate. FCC req only separation betw inter and intra

Mary Rose - R&D
Jack - R&D
Katy W. - R&D
J.P. Hebert
Tim D.
Ron M.
Ruth Y.
Bill B.
Rick

"disclosures"
"facts"
"recommendations"

Sonlink
DataServ
BellCore
BCI
BSE
BSC

Ruth & Katy & K&A
Ron

---

report will be style as FL report
put inform in report for various states & acknowledge by Tim in prel but recommend are in accord w/ FL. Lane to write short supplem. document to Simon (?)

Karen Katz
(205) 977-1569 1551

call Bell to setup 2nd interview w/ Hostinsky *

(2)

predetermination of stat time sampling since prenotified once selected

---

BellCore reorg in 1992 $53.9 mill in 1992 - flowed to BST (Kathy Trimbles)

---

* get rule from Tim on cost causation - as support for our position on cost allocation base

Exit conference 12/10 w/ Bell

Bell gets draft 11/24

* 2 Schedule

* basic regulatory principle is that utility has burden to support its costs

BELLSOUTH AUDIT STAFF
AGENDA
SEPTEMBER 30, 1993

(1) ***10:00 am to 11:45 am*** **Distribute Preliminary Issue/Findings Lists Followed by Discussion.**

Tim prel. issues portion of report incl. - problems w/ access to records & penalties - affiliate acctg - don't have to follow USOA

(2) ***11:45 am to 1:15 pm*** **Lunch**

(3) ***1:15 pm to 1:45 pm*** **Review Q&A Data Base for Accuracy--Make Corrections.**

(4) ***1:45 pm to 2:15 pm*** **Return of any Claimed Proprietary Information.**

(5) ***2:15 pm to 2:45 pm*** **Report Format.**

(6) ***2:45 pm to 3:30 pm*** **Strategy for Future.**

Lane:

Please ask Hostinsky to reconcile these two data responses:

6-030 - Summarizes BSC billings to its subsidiaries by BSC Department. There are 18 departments identified.

6-032 - Provides the Cost Allocation Methodology for BSC-HQ charges to its subsidiaries. There is not a direct link for many of the departments provided in the response to Question 6-030. For instance, there are no Cost Allocation Methodology Summaries for the following departments that appear in response 6-030:

- Corporate Secretary
- Security
- Internal Auditing
- Financial Management
- Assistant Secretary/Corporate Counsel
- Federal Relations (LANE: this could be represented by the Governmental Affairs CAM summary sheet. Verify for us)
- Advertising
- External Affairs
- Corporate Affairs

Are the above departments included in the CAM summary sheets with other departments? If so, why identify the charges separately in response 6-030?

Also, take a look at the cost allocation methodology provided in the summary for the Marketing Department. What is the rationale there?

You have the file copy for response 6-032

October 18, 1993

Lane:

A 10/18/93 review of the BST data responses indicates the following questions remain outstanding. If some of the items are in your office, please update the list.

6-005
6-007 through 009
6-013
6-015
6-018 through 020
6-022
6-024
6-026 through 030
6-031 and 6-032
6-036
6-047 through 049
6-052 through 054
6-056 through 058
6-061 and 062
6-064 and 065
6-085 through 087
6-089 and 090
6-091 and 092
6-096 through 099
6-101 through 6-104
6-105

Bill

7/19/93
-7/21/93/2

Review of Discovery Submitted by Other Audit
Team Members Related to BSC

See Master List as Marked

1. Item 2-0012 1991 & 92 Amounts billed by & to BST for 14 affiliates by A/C and by state. May not be complete representation of all BST interaffil cost flows since only 14 (see 2-012.1 for cost of affiliates).

2. Executive Directive 008 on Affiliate Trans (Item 2-0017)
   a. Policy stmt re: direct & indirect costs. Refers to fed and state statutes and regulations
   b. "There is no 'materiality' threshold for the regulatory requirements.
   c. Specific documentation req. for the review and approval process (by Bell)
   d. "Providing entity must also be prepared to produce, on demand, for inspection by the appropriate regulatory authorities, the documents necessary to substantiate the market price or the reasonableness of its costs." (signed by Chairman BSC, Vice Chair BSC, VP & Comptroller)

3. ABBS documentation (Item 2-0018)

4. BST agreements w/ other affil. (Item 2-0023)

5. FRN listing (Item 2-0031) incl. % allocations
   a. Does not identify or describe the FRNs
   b. 1992 Significantly more FRNs than 1991 (2 more pages - 5 compared to 3
   c. Still alloc. to SCBT & SBTT for some FRNs rather than all BST

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6. PN (project) billings to non-affil by BSC - no $ (Item 2-0032)
   a. Did not provide requested PN for affil. (see 2-0035)

Review of Discovery Submitted by Other Audit Team Members Related to BSC

7. 1991 & 2 PN & PS billed to BST (descript & $) (2-0035)
   a. $ mill in PN billings to BST for "Tax Support" - at least $5.7 million.

8. Flowchart of BSC, BSE, MAPS "acctg" processes (2-0044). Sketchy. Doesn't incl. all systems.

9. "BS Organization of Corporations" (2-0050) listing of BS affiliates. May not include partnerships.

10. ~~Plan~~ Limited affiliate billing $ to/from BST, BSE (2-0074-77, 89,

11. Rate of return guidelines for transactions betw. BST and nonreg. affil. (classif. 1 to 10-19) (2-084).

12. EI 4 (2-0091). Essentially an acctg proc. manual.

13. BSE info. Mostly refused to provide (2-0097).

14. 1992 Annual Report of SBT to FPSC
   a. Fin'l & statist info
   b. List of all changes to corpor structure ("Analysis of Diversification Activit
      i. "Graphics Holding Co. removed." Stevens Graphics now direct sub of BSE
   c. "Summary of Affiliated Transfers" by affiliate by A/C and $ (apparently FL)
   d. Cost of Capital
   e. Directory Advertising Operations - both Consolid & Per Books Amts
   f. Liaison Personnel (contacts w/ FPSC)

15. Conf'd info incl. Summary of BST billings to affiliates. (2-0034, 24, 79, 5-0006

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7/19/93

Review 12/31/92 CAM Sections IV, V ON

Affiliates, particularly BSC to BST, BST to BSC

Response to Item 2-109

1. Appears to be overlapping functions performed by one entity for the other

2. All BSC transfer pricing is described as "Fully Distributed Cost or Less"

3. CAM only addresses direct affiliate transactions w/ BST

4. BST provides HR, Procurement, Aircraft, Training, Procurement & Mgt of BellCore Services, ~~tx~~ etc. to BSC and other BSC affiliates incl. BSE

Review of 1992 A.R. (Summary) & Proxy Statement - BSC
(Response to Item No. 6-095)

1. Many changes in reclassific of revs & exp detailed - watch out for these in comparative tables, etc. betw 1991 & 2.

2. Telephone employees & BSC employees actually increased in 1992 compared to 1991 despite 1991 restructuring reductions of ≈ 4,000 employees.
   a. Early retirement amounts charged to expense in 1991

3. Charged debt refinancing costs to expense in 1992 as "Extraord. Loss" ($40.7 mill net of tax). Debt

4. Continues to issue new BSC common shares under DRSPP

5. Price cap regulation at federal level since 1/1/91

6. Amort. cost of transition obligation over 15 years rather than 20 allowed. Apparently, weren't using cash pay as you go previously. (Adopted 106 on 1/1/93). Also, see Note H.

7. 1992 I/S included $45.0 million in net exp. due to Hurricane Andrew. Another $64.0 mill was deferred to be amort over 4 years.

8. Note H re: ESOP
   a.

9. No Segment Information

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7/19/93

Comparison of BSC and BST Capitalization

(Source 1992 10-Ks)
Response to Item No. 6-096

1992

	BSC[1] $	BSC[1] %	BST[2] $	BST[2] %	Non-BST[3] $	Non-BST[3] %
Common	13,798.6	60.54	11,382.7	60.98	2,415.9	58.5
LTD[4]	8,994.3	39.46	7,282.9	39.02	1,711.4	41.47
Total	22,792.9	100.00	18,665.6	100.00	4,127.3	100.0

[1] p. 40 BSC 10K

[2] p. 26 BST 10K

[3] BSC - BST

[4] LTD + Current Maturities

1991

	BSC $	BSC %	BST $	BST %	Non-BST $	Non-BST %
Common	13,104.9	58.20	11,422.5	61.16	1,682.4	43.82
LTD	9,412.4	41.80	7,255.1	38.84	2,157.3	56.18
Total	22,517.3	100.00	18,677.6	100.00	3,839.7	100.0

Observations:

1) 12/31/92 BST Capital less than 12/31/91. Capital growth all on nonreg side
2) non-BST leverage flipped around betw. 1991 and 1992
3) BSC and non BST increased leverage in 1992 (almost on par w/ BST)

PART III - GENERAL MANAGEMENT REQUIREMENTS

25-4.034 Tariffs.

(1) Each telephone utility shall maintain on file with the Commission tariffs which set forth all rates and charges for customer services, the classes and grades of service available to subscribers, the conditions and circumstances under which service will be furnished and all general rules and regulations governing the relation of customer and utility. Such tariff filings shall be in compliance with the requirements of Chapter 25-9 of the Commission rules entitled "Construction and Filing of Tariffs by Public Utilities."

(a) Each company shall file, as an integral part of its tariff, maps defining the exchange service areas and base rate area. These maps shall delineate the boundaries in sufficient detail that they may be located in the field and shall embrace all territory included in the certificate of convenience and necessity unless portions of such territory are included in toll station areas.

(b) Each telephone company having toll station areas which are beyond its exchange service area boundaries but within its certificate of convenience and necessity shall file only with the Commission as an integral part of its tariff a toll station area map for each toll station area. These maps shall show the toll station area boundaries in sufficient detail that they may be located in the field.

(c) Where zone rate differentials are applicable, the zone boundaries shall be designated on the appropriate filed maps unless the language in the tariff is sufficient to identify the boundary locations.

(2) Intrastate toll message and WATS rates shall be fixed by Commission Order. The Commission may limit the amount of variation between any two companies' rates.

(3) Each telephone company shall maintain on file in each of its business offices, available for public inspection upon request, a copy of the local exchange tariff for exchanges under the administration of that office, the general exchange tariff and a schedule of intrastate toll rates for the entire State of Florida. Each business office shall likewise make available a copy of Chapter 25-4 of the Florida Public Service Commission Rules and Regulations for public inspection upon request.

Specific Authority: 350.127(2), F.S.
Law Implemented: 364.04, F.S.
History: Revised 12/1/68, Amended 3/31/76, 11/29/82, formerly 25-4.34, Amended 9/12/88, 4/16/90.

25-4.0345 Customer Premises Equipment and Inside Wire.

(1) Definitions: For purposes of definition under this rule:

(a) "CPE" includes terminal equipment intended for use on the customer's premises such as telephone sets, teletypewriters, data terminal equipment, mobile telephone terminal equipment, private branch exchange equipment, key system equipment, dialers and other supplemental equipment. CPE does not include 911 public safety answering point equipment (ALI, ANI, ACD equipment), local exchange company paystations, or telecommunications devices required by hearing or speech impaired subscribers.

(b) "Demarcation point" is the point of physical interconnection (connecting block, terminal strip, jack, protector, optical network interface, or remote isolation device) between the telephone network and the customers premises wiring. Unless otherwise ordered by the Commission for good cause shown the location of this point is:

1. Single Line/Single Customer Building - Either at the point of physical entry to the building or a junction point as close as practicable to the point of entry.
2. Single Line/Multi Customer Building - Within the customer's premises at a point easily accessed by the customer.
3. Multi Line Systems/Single or Multi Customer Building - At a point within the same room and within 25 feet of the FCC registered terminal equipment or cross connect field.
4. Temporary Accommodations Subscriber Premises with Inadequate Grounding (e.g. some mobile homes, trailers, houseboats, construction modules.) - On a permanent stake, pole or structure with a suitable safety ground.

(c) "Complex Equipment wire:" premises wiring owned by the local exchange company which may be used as station wiring and to connect off-premise extensions and is beyond the normal demarcation points.

(d) "Inside wire" is all wire or cable other than complex equipment wire located on the customer's side of the demarcation point.

(e) "Customer Premises" is the discrete real property owned, leased or controlled by a customer for the customer's own business or residential purposes.

(2) The provision and maintenance of Customer Premises Equipment (CPE) and inside wire:

(a) The provision and maintenance of CPE and insids wire, but not complex equipment wire, is deregulated for intrastate purposes.

(b) Companies using accounting allocation procedures in lieu of a fully separate subsidiary for the provision and maintenance of CPE and inside wire shall submit annual audit results and a formal opinion, rendered by an independent certified public accountant or auditor, on the reasonableness and accuracy of the allocation procedures employed. The expense of this audit shall be separately identified and shall not be chargeable to expense for ratemaking purposes. The Commission may, upon sufficient showing by a telephone company, modify or waive these requirements.

(3) Network facilities up to and including the demarcation point are part of the telephone network, provided and maintained by the telephone company under tariff.

(4) CPE Network Responsibility. No CPE may harm the network by introducing signals that interfere or affect other subscribers or network operations.

Specific Authority: 350.127(2), F.S.
Law Implemented: 364.03, F.S.
History: New 12/13/82, Amended 9/30/85, formerly 25-4.345, Amended 4/16/90.

25-4.035 Rate Area Boundaries.

(1) The boundaries of base rate and zone rate areas in each exchange service area which have been established in accordance with an order or tariff authorization by the Commission are approved and no change shall be made in any such boundaries except under authority granted by the Commission.