920260-TL

Attachment II
CROSS REFERENCE INDEX TO PROPRIETARY INFORMATION
IN DOCUMENT NO. 00759-94 (DRAFT AUDIT REPORT)

Reference in "Draft" Audit Report		Corresponding Reference In Final Audit Report		Reference to 1-3-94 Request for Confidential Classification Reason Why Proprietary
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Provided S.T
on 11/24/93

FLORIDA PUBLIC SERVICE COMMISSION

AUDIT REPORT

12 MONTHS ENDED DECEMBER 31, 1992

Field Work Completed

November 1, 1993

BellSouth Telecommunications Inc. and

Certain Affiliated Companies

Atlanta, Georgia

DRAFT

CONFIDENTIAL

Affiliate Transactions and Cost

Allocations Audit

Tim Devlin
Audit Manager

Audit Staff	State	Minority Opinion
Mary Rose Sirianni	Florida	yes_____no_____
Jack Hoyt	Florida	yes_____no_____
Ruth Young	Florida	yes_____no_____
Kathy Welch	Florida	yes_____no_____
Ron Mays	Florida	yes_____no_____
Illiana Piedra	Florida	yes_____no_____
Rick Wright	Florida	yes_____no_____
Paul Greene	Tennessee	yes_____no_____
Archie Hickerson	Tennessee	yes_____no_____
Terry Kramer	Florida	yes_____no_____
Lisa Harvey	Florida	yes_____no_____
Vivian Dowdy	South Carolina	yes_____no_____
Joe Werner	Tennessee	yes_____no_____
Lane Kollen	Louisianna	yes_____no_____
Bill Barta	Louisianna	yes_____no_____

(X-Ref DN 13433-93)

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I. EXECUTIVE SUMMARY

AUDIT PURPOSE: To evaluate whether cross subsidization exists between BellSouth Telecommunications Inc. regulated and non regulated operations and certain affiliate companies. Also, this audit addresses many of the concerns expressed by the National Association of Regulatory Commissioners (NARUC) Convention Floor Resolution No. 8 entitled "Resolution to Audit the Seven Regional Bell Operating Companies' dated November 13, 1991.

SCOPE LIMITATION: The Audit Team was unable to evaluate whether cross subsidy exists in selected areas because of the Company's reluctance to provide complete, direct and timely access to needed information.

DISCLAIM PUBLIC USE: The primary purpose of this audit is to assist the Commission in the performance of its duties. This does not preclude other state commissions from using information contained in this report. Generally, the opinions and recommendations relate to Docket No. 920260-TL and may not be consistent or applicable to the policies in other states in BellSouths' region. Information for other states is included for use in other states. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

OPINION: The Company through its parent company (BellSouth Corporation) could have provided direct, complete and timely access to information necessary to meet the audit objectives. Instead, the Company decided to use legal recourse and obstructive measures to significantly limit audit access and information provided the Audit Team. Consequently, the Commission will not be able to meet its statutory responsibility of ensuring that regulated operations do not subsidize non regulated operations.

RECOMMENDATION:

BACKGROUND

On November 13, 1991 the National Association of Regulatory Commissioners (NARUC) passed Convention Floor Resolution No. 8 entitled Resolution to Audit the Seven Regional Bell Operating Companies' (RBOCs) Affiliated Transactions. This resolution outlined the concerns over possible cross subsidies between regulated and non regulated operations. This includes both an evaluation of products and services provided between the regulated company and its affiliates as well as an evaluation of non structural safeguards.

As a result of the resolution, a NARUC State/Federal National Audit Oversight Committee (Oversight Committee) was formed to organize the seven audits. This committee selected Audit Managers for each region who would be responsible for the individual audits including staffing and development of audit programs. It was anticipated that a Policy Management Group (PMG) comprised of state commissioners would be formed for each region. The initial function of the PMG was to ensure an orderly and objective audit process.

The Oversight Committee developed six audit scope statements which reflected the goals of the NARUC resolution. Generally, the six areas addressed enhanced services, cost allocations, yellow page operations, billing and collection services, central management services and research activities. The scope statements were very broad in nature in recognition of specific regional concerns.

An earlier attempt to evaluate BellSouth Corporation and its affiliates was made by the Southeastern Regulatory Commission (SEARUC) Southern Task Force. This is known as the SEARUC Audit. However, the SEARUC Audit Team was denied access to "accounting data and other general business information essential to an investigation of the costs flowing into the BOC's from affiliates."

In early 1992, some commissioners expressed concern over the direction and scope of the audit. There was concern about possible duplication with other recent audit activity. Some commissioners questioned whether the scope statements went beyond the mission of the NARUC resolution.

Several RBOC's questioned the audit authority of an association such as NARUC. They also questioned whether there would be duplication with other current or recently concluded audits involving similar subject matter.

The FCC expressed concern over the distribution of the audit report and focus of the audit. The FCC stated that it would limit its efforts to a compliance audit of FCC rules and regulations such as the affiliate transactions rules and cost allocation manuals (CAM). The FCC commissioners approve audit reports. Also, FCC audit reports and workpapers are held confidential and therefore, there is a question on how the states could use such information in state proceedings. Regardless, the FCC has continually expressed interest in supporting these audits.

The BellSouth Audit Team was initially formed in February 1992 with representation from the Florida and Tennessee PSC's. However, further audit planning was suspended pending resolution of the above mentioned concerns

The Oversight Committee conducted a survey of all state commissions and RBOC's that addressed the above concerns. The responses would be used in developing individual RBOC audit work programs. On February 18, 1992 BellSouth expressed concern over duplication noting the 1990 SEARUC audit and current regulatory dockets in Florida and Georgia. BellSouth also expressed concern about "the ability of a consortium audit team to adequately protect confidential, competitively sensitive information and to provide control points on audit scope, completion and presentation."

On March 2, 1992, the Oversight Committee made presentations to the Communications Committee and Finance and Technology Committee. This presentation addressed scope/objectives as well as staffing plans. Before the Finance and Technology Committee the issue of FCC and state perspectives was addressed. The FCC would restrict its efforts to compliance with FCC rules and regulations whereas the states desired to address the broader goal of evaluating cross subsidy issues.

On March 13, 1992, Chairman Tucker of the Finance and Technology Committee solicited participation from state commissioners for the seven PMG's. On April 4, 1992, the BellSouth PMG was formed with commissioners from Florida, Tennessee and South Carolina. The intended purpose of the PMG was to address policy matters during the audit.

On April 13, 1992, BellSouth notified the president of NARUC that it was unwilling to fund the audit at that point. It did not see any "constructive purpose in another association audit" referring to the SEARUC audit. On April 15, 1992, BellSouth again stated it was unwilling to fund the audit "without first having input into the audit plans and procedures." This is contrary to audit independence.

On May 14, 1992 BellSouth made a presentation to the Audit Team. All six of the scope areas were addressed. However, BellSouth required a proprietary agreement signed by all members of the Audit Team before submitting to the audit.

The Audit Team commenced negotiations over a proprietary agreement. At the same time, the Audit Team developed audit work programs. BellSouth insisted that the proprietary agreement restrict the Audit Team from taking possession of information BellSouth claimed proprietary. This included related notes which would mean BellSouth would have to review the audit workpapers while the audit was in progress. BellSouth noted that there were various state rules and statutes and would be subject to the "most permissive" set of rules.

Regardless, on May 21, 1992 the Audit Team sent BellSouth an engagement letter outlining the audit process. This was sent after BellSouth had an opportunity for input. On June 11, 1992 BellSouth stated it must have assurance for the protection of proprietary information before it voluntarily participates in the audit. BellSouth suggested a Big 6 contract audit.

Also on June 11, 1992 the Audit Team sent BellSouth its initial data request along with signed or proposed proprietary agreements for Florida and Tennessee staff. These agreements would operate under the Florida and Tennessee rules and statutes respectively.

On June 24, 1992 BellSouth responded to the data request with an analysis of its concerns with the proprietary agreements. Again, it reiterated the "most permissive state" concern. BellSouth would not answer any of the data requests.

On July, 8, 1992 the seven regional audit teams met in Arlington Virginia. Most of the RBOCs were present for the open part of the meeting. It became clear that all seven regions were experiencing significant difficulty in initiating the audits. The problems cited by the RBOC's were consistent between them. However, in the closed part of the meeting, the audit teams were able to share information and strategies.

During this time, it was becoming increasingly apparent that the Audit Team and BellSouth would not be able to reach a mutually acceptable proprietary agreement that would cover multiple states. On August 28, BellSouth again outlined its concerns and insisted on continuous review of audit workpapers and would not let the Audit Team take possession of what it claimed to be proprietary. BellSouth presented arguments for a contract audit as a way to avoid problems with proprietary information.

On August 6, 1992, the Audit Team prepared an analysis that showed why a contract audit would fail to meet the objectives of the NARUC Resolution. Primarily, the perspective of regulatory staff is different then that of a outside CPA firm.

On September 1, 1992 the staff representatives of the Florida and Tennessee PSC's met with BellSouth to discuss the audit. At this point there was a gridlock and this was seen as staff's last attempt to resolve the legal issues. Again, a negotiated proprietary agreement was not reached at this meeting. Therefore, the staff suggested the audit be conducted under Florida statutes and rules which would mitigate the "most permissive state" problem. Further, as an added measure of protection for BellSouth, the staff agreed not to take possession of what BellSouth considered "extra sensitive" proprietary information. This would include market and business strategy plans.

The Audit Team with concurrence with the PMG decided to base the audit on Florida statutes and rules because of its broad authority over affiliate relationships embodied in FS 364.183 and specific statutes and rules regarding handling of confidential materials. One set of rules mitigates BellSouth concern over multiple rules for protection of confidential. Under this approach, it was not necessary to negotiate a proprietary agreement for this audit.

The Florida, Tennessee and South Carolina commissions all endorsed the concept of a Florida based audit. As a result, personnel loan arrangements were executed for these three states under the authority of Florida Statute 112.24. The Georgia, Kentucky and Mississippi commissions expressed interest in joining the audit at this time. The FCC also planned on assigning a staff member who would operate under FCC authority. In February 1993, the Louisiana PSC voted to support this effort. Seven of the nine states in BellSouth's region plus the FCC have showed support for this audit.

On October 26, 1992 the Audit Team served BellSouth with its initial data request. Since it was so voluminous (103 items) the due date was set for November 30, 1992. Eventhough the Audit Team made it clear at the September 1, 1992 meeting that the audit would be conducted under Florida rule, BellSouth insisted upon a meeting with the PMG before responding to the request. The Audit Team made it clear that the timing of the meeting did not affect the validity of the data request and due date.

On November 25, 1992 the PMG, certain Florida and Tennessee staff and BellSouth met to discuss BellSouth's concerns. At an early point in the meeting BellSouth started to discuss its objections to certain data requests. These related to issues in pending Florida Docket No. 920260-TL and therefore the Florida commissioners excused themselves from the meeting in order to avoid an ex parte communication. The other members of the PMG and staff continued with the meeting and again informed BellSouth that the audit was being conducted under Florida statutes and rules in connection with Docket No. 920260-TL.

On November 30, 1992 BellSouth informed the Audit Team that they "have now begun to process these requests and will provide you with responses as soon as possible". This was not acceptable to the Audit Team and the Company was contacted by the PMG. We were informed by the Company that the Company's response was inappropriate and would promptly comply with the October data request.

On December 18, 1992 members of the Audit Team met with BellSouth's Audit Coordinator to discuss procedural issues and the status of the October 26, 1992 data request. Based on this meeting it was anticipated that sufficient material would be provided that would justify the Audit Team's first field visit.

On January 11, 1993 the Audit Team met with BellSouth for its first field visit. It was readily apparent that most of the information requested in the October 26, 1992 data request would not be provided. Therefore, the field visit was prematurely terminated. The Audit Team did analyze all information provided which did not take much time. After two and a half months the Company did not even bother to respond to the majority of requests. In some cases, the Company objected to provide the requested information without giving any reason.

As a result, the staff of the Florida Commission prepared a recommendation to show cause why the Company should not be fined for failure to comply with staff requests. Also, the staff recommended that the Company be required to comply to the outstanding data request by February 10, 1993 and be required in the future to respond to data requests in writing within five days. The Florida Commission did not show cause the Company but did order the Company to respond by February 10, 1993 and in the future, respond within five days.

On February 10, 1993 the Company responded in writing to the October 26, 1992 data request. The Company objected to several requests. Generally, the Company refused access to affiliate records and stated it would provide information that the Company deems necessary to substantiate affiliate transactions. The Company objected to provide non Florida information. And last, the Company objected to certain other requests on grounds of relevancy. These included market studies and business strategy plans.

It was most troublesome that the Company objected to providing non Florida data in light of Florida Order No. PSC-93-0071-PCO-TL dated January 15, 1993. This order required Southern Bell to provide Florida's Public Counsel's Office non Florida information.

On February 24, 1993 the Florida PSC legal staff served a draft copy of a motion to compel access to affiliate records among other things. BellSouth responded on March 3, 1993 and stated it would not agree to the terms in the motion.

On March 5, 1993 the staff filed a motion to compel complete audit access to affiliate information. Three areas of dispute are argued in this motion. The staff is arguing in order to meet its statutory responsibility (FS 364.183) of ensuring no cross subsidy between regulated and non regulated operations it needs complete access to affiliate records, access to non Florida information and access to non financial information such as business strategy and marketing plans.

On March 17, 1993 the Company filed its response to the staffs' motion to compel complete audit access. First, the Company considers the statutory language regarding reasonable access to affiliate records is limited to those records the Company deems necessary to substantiate affiliate transactions (direct or chained), allocations or other forms of possible cross subsidy. Second, the Company maintains that "constitutional limitations prohibit the Commission from exercising jurisdiction over these entities that do not have certain minimum contacts with Florida". The Company states that "a number of these entities have absolutely no contact with Florida...". In this pleading, the Company also objected to providing non-Florida data because it states it is irrelevant.

On March 23, 1993, the Louisiana Public Service Commission authorized the consulting firm of Kennedy & Associates to participate in the Regional Audit. The Louisiana PSC instructed Kennedy & Associates to focus on affiliate transactions which meant the Audit Team could accommodate the joining of this firm. Also, this firm performed an audit for the Louisiana PSC in 1992 and encountered significant problems gaining access to affiliate records.

On April 9, 1993, Commissioner Clark, Prehearing Officer in Docket 920260-TL, issued Order No. PSC-93-0540-PCO-TL that granted the staffs' motion to compel. In this order the term "reasonable", as used in FS 364.183(1) modifies access in terms of time and place, not the quantity or quality of documents to which this Commission has access. The order recognizes that in order to have a creditable audit process it is essential for the Commission to determine audit scope and relevancy of data requests. Otherwise, the order states "SBT's interpretation of the statute would eviscerate the very power that it is intended to confer".

On April 19, 1993, the Company filed a Petition for Review of Order No. PSC-93-0540-PCO-TL. The Company alleges the order "is factually inaccurate, in that it seeks to order the production of documents that Southern Bell does not have in its possession custody or control, and that the order is legally insufficient in that the authorities relied upon are not applicable to the facts of this matter". The Prehearing Officers' order was upheld by the Commission in Order No. PSC-93-0812-FOF-TL dated May 26, 1993. The Commission voted to automatically stay the order in the event the Company seeks an appeal.

On June 14, 1993 the Company petitioned the Florida Supreme Court for a review of the Commission order. Again, the Company maintains it does not have custody or control of many of the documents the Commission seeks. Also, the Company mentions the affiliates have agreed to provide information necessary to substantiate affiliate transactions (direct or chained). The Company also states that "The Audit Team, on the other hand, wants to audit; that is, they want unrestricted access to books and records, and the unrestricted right to peruse all information in these books and records without regard to discoverability, relevance or any of the other concepts associated with discovery".

On July 5, 1993 the Florida PSC (Division of Appeals) filed its brief arguing there is a significant difference between discovery and auditing. The brief points out that the PSC internal procedures clearly distinguishes auditing from discovery and excludes auditors from the discovery process.

On July 19, 1993, Commissioner Clark held a "status" meeting in Docket No. 920160-TL. At this meeting all past due and incomplete responses to staff audit requests were addressed. New due dates were established. In response to a Company motion for more time to respond to audit requests, Commissioner Clark ruled that a fifteen day turnaround time is appropriate recognizing the complexity of this audit. The Commissioner made it clear that this was an audit not subject to discovery rules and the fifteen days was unique to this audit.

On August 27, 1993, Commissioner Clark held a second "status" meeting. At this meeting the Company represented that its affiliate, BellSouth Enterprises whom the Audit Team directed many requests, would comply to some of the audit requests but not under the timeframes established by Commissioner Clark. As a result, Commissioner Clark sent a letter to John Clendenin, CEO of BellSouth Corporation, requesting his assistance in getting BellSouth Enterprises to comply to audit requests on a timely basis. The Company responded by stating that "BellSouth Enterprises is committed to cooperation with the Florida Commission, within the law and the extent of its available resources, to provide timely and complete responses to requests that your audit team may make." Emphasis added. Obviously, the level of cooperation depends on the Company's interpretation of "within the law" and its designation of what resources will be available.

In summary, the Audit Team attempted to evaluate whether cross subsidy exists between BSTI's regulated and non regulated operations which is a national concern as evidenced by the previously mentioned NARUC resolution. Because of limited resources, the staff through analytical review limited its audit program to a relatively small number of affiliates and transactions. The Company displayed a consistent pattern of obstructionist behavior since May of 1992. Since an open and cooperative environment is essential for effective auditing, many of the audit objectives were not fulfilled. The proliferation of diversification activities by not only BellSouth but other telephone and electric companies has complicated the regulatory process. It will require regulation beyond the utility. The extent of that regulation needs to be defined.

AUDIT DISCLOSURE NO. 1

SUBJECT: ACCESS TO COMPANY RECORDS

STATEMENT OF FACT:

Florida Statutes 364.183 states "The Commission shall have reasonable access to all company records, and to the records of the telecommunications company's affiliated companies, including its parent company, regarding transactions or cost allocations among the telecommunications company and such affiliated companies, and such records necessary to ensure that a telecommunications company's ratepayers do not subsidize the company's unregulated activities."

The Company, in many instances, objected to the provision of affiliate information on grounds that "(1) Southern Bell does not have possession, custody or control of such information, (2) the entity that is in possession of such documents is not subject to the jurisdiction of this Commission and (3), in any event, such information is neither relevant nor reasonably calculated to lead to the discovery of admissible evidence (a) related to transactions or necessary to show that Southern Bell's Florida customers do not subsidize either Southern Bell's or its affiliates unregulated activities."

BSTI's operations exceed 80% of the total operations of BellSouth.

The Company has selectively provided affiliate information, ie. edited general ledger, to support certain transactions or cost allocations.

Notwithstanding information withheld pending judicial review, the Company states its affiliates will not abide by the timetable (fifteen day turnaround) established by Commissioner Clark in Docket No. 920260-TP due to lack of ample staff.

The Company had an attorney present at most of the interview sessions between the Audit Team and Company personnel. On many occasions the attorney would intervene and coach the Company staff person. The interviews were formal and not in the interviewee office. These conditions curtailed the free flow of information and audit efficiency.

The Company did not allow the audit staff to make copies of certain invoices regarding transactions between BellSouth Corporation and BellSouth Telecommunications. This is necessary to ensure complete workpapers which support disclosures in the audit report.

The Company reviews all documents before release to the audit staff. On one occasion a document that indicated an error in the attribution of certain costs of a fiber optic field trial was removed by the Company. A formal review process runs counter to "direct" access and undermines the creditability of information being audited.

The Company provided tapes of interviews that were inaudible.

The turnaround time for responses was initially set for five working days. After experiencing many delays this five day turnaround time was confirmed by Commission order on February 2, 1993. It was revised to a fifteen day turnaround time on July 19, 1993. % of the responses based on these requirements. This % is exclusive of those requests subject to the Supreme Court decision.

Even when certain information was readily available, the Company would respond that the information or a status report will be provided within forty days. Reference request 2-063 and memorandum from Kathy Welch dated May 25, 1993.

In many instances, the Company provided incomplete answers which necessitated follow up questions. This slowed the audit process down. Reference .

In some instances, interviews with the Companys' subject matter experts were cancelled or delayed. Reference March 23, 1993 memorandum from MaryRose Sirianni and July 7, 1993 memorandum from Jack Hoyt.

A summary of BSE Accounting Directive 10 (AD0010) requires specific documentation for affiliates using FDC is FDC system output supporting cost allocations, employee time reports, support for all directly assigned or attributed costs, such as vouchers, support for computation of allowable return, and FDC studies, if available. Ref. W/P binder 16 51-10/2 page 5.

OPINION: The Company did not cooperate with the Audit Staff. Because of the size of BST, it had the necessary influence to gain cooperation from its affiliates. BST chose to use legal challenge and other obstructionist behavior which impaired with the effectiveness of the audit.

AUDIT DISCLOSURE NO. 2

SUBJECT: ACCOUNTING REQUIREMENTS FOR AFFILIATE COMPANIES

STATEMENT OF FACTS:

Florida Statutes 364.18 (2) states "The Commission may also require such reports or other data necessary to ensure that a company's regulated rates do not subsidize the company's unregulated activities."

Part 32.27 (d) of the Uniform System of Accounts for telephone companies states "When a carrier provides substantially all of a service to or receives substantially all or a service from an affiliate which are not also provided to unaffiliated persons or entities, the services shall be recorded at cost...".

The Commission does not prescribe accounting requirements for affiliate companies. The Commission does not prescribe depreciation rates or tax normalization for affiliate companies.

Charges from an affiliate company to a utility may involve direct transactions or chained transactions. Chained transactions are those transactions where one affiliate company bills another affiliate company for a product (asset) or service and in turn, part of or all of the product (asset) or service and billed to the utility.

Charges from an affiliate company to a utility may involve a return component or carrying charge that varies from the Commission prescribed rate of return.

OPINION: Since charges from affiliate companies to regulated utilities may not be based on Commission prescribed accounting procedures, rate of return or depreciation rates, cross subsidies may result by virtue of the establishment of separate affiliates for certain lines of business. It may not be in the public interest for a utility to establish a separate affiliate when the majority of its business is with the utility.

RECOMMENDATION:

AUDIT DISCLOSURE NO. 3

SUBJECT: USE OF MARKET BASED PRICING FOR AFFILIATE TRANSACTIONS

STATEMENTS OF FACTS:

Part 32.27 (d) of the Uniform System of Accounts for telephone companies states: Services provided to an affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Services provided by an affiliate to the regulated activity, when the same services are also provided by the affiliate to unaffiliated persons or entities, shall be recorded at the market rate. 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.

The FCC staff stated on April 1, 1993 that in every case that the FCC reviewed the use of third party market for pricing affiliate transactions that such pricing was inappropriate and "fully distributed cost" should be employed.

In FCC Docket 93-251, the FCC proposed on September 23, 1993 to establish a benchmark of 75% for determining when affiliate transactions may be recorded using third party prices.

FCC policy on this matter is as follows: "The burden of compliance has been placed on the carrier, not the affiliate with whom they are doing business. Our rules are designed to prevent the booking, and subsequent recovery from the ratepayers, of exorbitant profits included in the price of products or services purchased from a non-regulated affiliate. The ultimate result of this rule is to hold certain "non-regulated affiliates" of the carrier, to full rate of return regulation." cite- Mr. Joseph Paretti, Federal Communications Commission, Presentation made to the NARUC Staff Subcommittee on Accounts on April 1, 1993.

BellSouth has made the following argument in objecting to providing certain information regarding affiliate information: "The Company objects to providing the requested information on the grounds that (1) Southern Bell does not have possession, custody or control of such information, (2) the entity that is in possession of such documents is not subject to the jurisdiction of this Commission and (3), in any event, such information is neither relevant nor reasonably calculated to lead to the discovery of admissible evidence (a) related to transactions or cost allocations among these companies or (b) necessary to show that Southern Bell's Florida customers do not subsidize either Southern Bell's or its affiliates unregulated activities."

The extent of Commission authority with regard to affiliate information will be addressed by the Florida Supreme Court. This matter was addressed before the Court on October 4, 1993 and a ruling is pending.

BellSouth Corporation is the parent company of BellSouth Telecommunications Inc. and has the necessary control over affiliate information.
BellSouth refused to provide complete third party market information when

requested. See **disclosure** numbers .

OPINION: Southern **Bell has** not met its burden of proof in using market based affiliate trans**actions**.

RECOMMENDATION:

AUDIT DISCLOSURE NO.

SUBJECT: FIBER BASED TRIALS - BELLSOUTH REGION

STATEMENT OF FACTS:

1. Fiber based trials have been conducted in seven of the nine states in the BellSouth region. The Company initially objected to providing cost information for 12 trials located in six states other than Florida. Cost information was provided at a later date for trials listed below in the six states:

Trial Name	State
The Grove of Riveredge	Tennessee
Council Fire	Tennessee
Morrowcroft	N. Carolina
Denver Wire Center	N. Carolina
Lakeview Terrace	S. Carolina
Summit	S. Carolina
Dunes West	S. Carolina
Bent Creek	S. Carolina
Springhurst	Kentucky
Marietta Riverhill	Georgia
The Landings	Georgia
Sherwood Forest	Louisiana

The four Florida fiber trials listed below are included in separate disclosures in this audit report:

Trial Name	Location
Heathrow	Lake Mary
Hunter's Creek	Orlando
Cypress Cove	Ft. Lauderdale
Cocoplum	Coral Gables

2. Fiber trials were conducted to evaluate commercially available fiber optic systems and equipment installed in the distribution loop to customers' premises. The two configurations are the following:

   a. Fiber in the loop (FITL) design with buried fiber cables terminating in pedestal enclosures located at the curb. Electronics at the pedestal convert digital optical signals to electrical analog signals for distribution to multiple residences using copper drop wires.

b. Fiber to the home (FTTH) design terminates fiber taken all the way to the customers' home where a distant terminal (DT) converts light signals to electrical analog signals.

Although customer services are now being limited to POTS, the systems are designed, with electronic updating, to transmit future video signals to the homes.

3. Total investment costs for the 12 trials and amount separated to interstate jurisdiction are shown below:

Total Booked Costs	Assigned to Interstate Jurisdiction
$7,123,423	$2,148,245

Thirty percent of the total investment for fiber distribution trials is assigned to interstate jurisdiction.

4. Bellcore information letter dated December 30, 1986, (Project No. 423340) concluded that "if the cost of supporting electronics and optical devices were included in the above analyses, then a comparison of the fiber scenario with the copper scenario would indicate that the fiber is many times more expensive than copper. The terminal equipment for optical systems is much more expensive than that needed for copper systems."

Substantiating cost studies documentation have not been made available which would indicate that the cost of fiber optics in the distribution loop is now cost effective when compared to copper plant investment.

5. The recent mergers of RBOCs with cable TV companies, namely, Bell Atlantic with Tele-Communications, Inc., have positioned the telephone companies for future revenue generating broadband services such as multichannel television.

OPINION:

Assignment of 70 percent of the total investment in fiber optic systems in the distribution loop to intrastate regulated rate base is disproportionate with respect to the intended future use of the broadband facilities.

POTS services utilize only a small percentage of the high signal transmission capacity of fiber optic systems and the present 30 percent separations ratio for assignment of investment costs to interstate fails to recognize that fact. With the hundreds of millions of dollars being budgeted for the eventual wiring of all homes to fiber optic networks, the separations ratios should more realistically reflect the proportionality of where the revenue streams are going - intrastate or interstate.

FCC authorization for the Heathrow fiber trials in 1987 required that separate books be maintained for telephone and broadband channel facilities to prevent broadband facilities from being subsidized by other common carrier services. The disproportionate allocation of 70 percent assigned to intrastate and 30 percent assigned to interstate is, in effect, a subsidization of broadband facilities by the present method of ratio assignment.

RECOMMENDATION:

AUDIT DISCLOSURE NO.

SUBJECT: COMBINED COSTS and SEPARATIONS for HUNTER'S CREEK and HEATHROW FIBER TRIALS

STATEMENT OF FACTS:

1. The Company was authorized by FCC under Section 214 of the Communications Act of 1934 to provide CATV transport services to the communities of Hunter's Creek and Heathrow near Orlando, Florida. FCC further ordered that the books of accounts for the broadband channel facilities be maintained separate from books of telephone facilities to prevent the construction and operation of broadband channel facilities from being subsidized by other common carrier services.

2. Trials described below were conducted at the two large residential developments to evaluate cable TV systems and market potential for ISDN and video services:

   Hunter's Creek - Installation of AT&T video digital switching equipment and fiber/coaxial cable systems. The trial was limited to CATV transport services with POTS services using copper cable plant placed in conjunction with fiber cables.

   Heathrow - Installation of Northern Telecom, Inc., (NTI) video digital switching equipment and fiber/coaxial cable systems for providing cable TV transport services. The Company also purchased an existing CATV coaxial cable system from Telcom International, Inc., as part of the Heathrow CATV transport business.

   The Heathrow fiber optic system was installed to provide POTS enhanced services, new concepts of ISDN, CATV, and advanced video high definition TV (HDTV).

3. Original request for fiber trial costs for Hunter's Creek and Heathrow was made October 26, 1992, and Company responded February 10, 1993, with the following which was restricted to outside plant costs:

	1989	1990	1991	1992	Total
Heathrow	465	383	92	0	940
Hunter's Creek	0	271	201	0	562

Combined Total Investment ($000) 1,502

Total booked investment in each trial, including CATV and fiber optic equipment, was requested April 26, 1993, and it was not until October 27, 1993, that estimated costs were received without supporting documentation. Grand totals submitted are the following based on August 1993 investments:

Heathrow	$13,935,615
*Hunter's Creek	3,946,842
Total	$17,882,457

*Includes $2,502,799 CATV investment retired in 1992

Company never provided grand total booked costs but calculated estimates based on expenditure authorizations identified by the auditor during field visits to Florida Operations Centers in Orlando, Ft. Lauderdale, Jacksonville and Miami.

4. Company could not provide separations documentation which identified assignment of investment to interstate jurisdiction individually for Hunter's Creek and Heathrow. The filed 1992 average CATV interstate assignment totaled $6,754,671. It could not be verified that the total Hunter's Creek investment of $3,946,842 which was 100 percent CATV was assigned to interstate.

   Company's reconciled separations received October 27, 1993, were based on total estimated costs using December 1992 separations ratios summarized as follows:

   Combined August 1993 Separations Estimates

Interstate	$8,449,028
Intrastate	$9,190,057

   There was a $1,694,357 increase in interstate assignment over the previously filed $6,754,671.

5. Copper cables at Heathrow are in place in the fiber optic test areas at Heathrow for cut over of POTS from fiber to copper.

OPINION:

1. Company failed to comply with the FCC authorization for CATV transport services at Heathrow which specified that separate books of accounts for broadband channel facilities be maintained separately from books of telephone facilities. The Company failed to provide total booked investments for Heathrow and Hunter's Creek and, in addition, CATV interstate costs were combined and not separately identifiable.

2. The length of time between initial request for cost information and receipt of estimates instead of booked information one year later did not permit verification of total booked costs and separations for Hunter's Creek and Heathrow.

3. The majority of the reconciled regulated intrastate investment of $9,190,057 for the combined trials does not reflect the actual use of fiber optic facilities for data, CATV and other video services. POTS services utilize only a small portion of high bit-rate digital optical capacity for a trial designed to test the marketability of future non-regulated services such as computer services using ISDN equipment and multichannel television.

RECOMMENDATION:

Inasmuch as the Company did not provide documentation to support the total investments in Hunter's Creek and Heathrow field trials and the associated separations process, it is recommended that the entire amount of $9,190,057 be removed from the Florida intrastate rate base.

AUDIT DISCLOSURE NO.

SUBJECT: BELLSOUTH ENTERPRISES PARTICIPATION in HEATHROW TRIAL

STATEMENT OF FACTS:

1. BellSouth Enterprises, through it's subsidiary, BellSouth Ventures Corporation, entered into a partnership agreement with Florida Seminole Communications, Inc., (related to Paulucci International, Ltd.) on August 11, 1988, to sell, install and maintain customer premises equipment (CPE) in the Heathrow Development. Each partner had an initial investment of $135,000.

   The business partnership was conducted under the name "Heathrow Telecommunications."

2. BellSouth Enterprises actively participated in the fiber trials as a member of the Heathrow Executive Steering Committee. BSE's responsibility involved the lease or purchase of Northern Telecom ISDN CPE sets, NTI T2317, and other CPE with the joint venture receiving revenue streams from the sales.

3. On April 1, 1989, BellSouth Ventures Corporation (BSE) assigned and transferred their partnership interest in Heathrow Telecommunications to BellSouth Services Incorporated for $35,376.07.

OPINION:

It was apparent that BellSouth Enterprises participated in the Heathrow fiber trials as a joint venture partner in anticipation of selling, installing and maintaining customer premises equipment which were non-regulated business. However, it appears that BSE sold their partnership interest to BellSouth Services when ISDN services did not sell at Heathrow.

AUDIT EXCEPTION NO.

SUBJECT: PURCHASE OF HEATHROW CATV SYSTEM - SEPARATIONS

STATEMENT OF FACTS:

1. The Company paid $119,891.05 for an existing coaxial CATV system from Telcom International for providing FCC tariffed transport services to Heathrow subscribers.

2. The Company stated that the investment was not charged to SBT - Florida rate base and that these assets were specifically identified and had been excluded from the intrastate rate base.

3. Subsequent work papers disclosed only 50 percent or $59,945.53 (FRC B45C) had been separated to interstate while $59,945.52 (FRC 45C) remained for separations treatment. $43,580.39 was incorrectly assigned to the Florida intrastate rate base.

OPINION:

Even though work papers showed incorrect separation of the purchased CATV system costs, the Company continued to state that all costs had been allotted to the interstate account until Commission review on September 21, 1993.

RECOMMENDATION:

Reassign $43,580.39 from Florida intrastate rate base to interstate jurisdiction.

AUDIT DISCLOSURE NO.

SUBJECT: HEATHROW FIBER BASED TRIAL
CUSTOMER SERVICES AND REVENUE

STATEMENT OF FACTS:

1. Voice communications (POTS) were provided over the fiber optic system at the Florida tariffed rate of $10.50 per residence line. There were 178 customers (211 lines) participating in the trial from June 1988 to present for an estimated annual revenue of $22,428 which amount was classified as intrastate.

2. The ISDN data services part of the trial consisted of ten customers for a period of thirty-six months at no cost to the users.

3. CATV FCC tariffed transport services were provided over the fiber and coaxial facilities as follows:

   - CATV over fiber - 117 customers from July 1988 to present for estimated annual revenue of $10,944.

   - CATV over coaxial - 510 customers from July 1988 to present for estimated annual revenue of $39,780.

   CATV revenue was assigned to interstate.

OPINION:

Total annual revenue of $22,428 for POTS services is extremely small when compared to a total plant investment estimated to be $13,935,615 by the Company for the Heathrow trial.

AUDIT DISCLOSURE NO.

SUBJECT: HEATHROW FIBER BASED TRIALS
INVESTMENT RETIREMENT STATUS

STATEMENT OF FACTS:

1. A Company memorandum from M. E. Balmes/J. M. Simpson dated February 1, 1993, to W. R. Perry recommended that the switched video system and associated special video electronics and fiber cables be retired since all subscribers were being cut over from fiber to coaxial systems. Furthermore, the marketing organization had no further plans to conduct trial activities at Heathrow.

2. Company states there are approximately 50 CATV subscribers in service and they will be moved from fiber to coaxial networks sometime in 1994.

3. The fiber optic network continues to serve POTS customers which are now capped at 178.

4. Company states that the video switch, video related equipment and optical network interfaces will be retired and removed. However, the potential for reusing the unique equipment is remote. Estimated retirements are shown below:

FRC	USOA	Description	Amount
57C	2362	Ckt.Equip.- Analog	$ 200,000
377C	2212	Digital Electronic Switch Equip.- Fiber Optic	$ 840,000
B958C	2362	Other terminal equip. - Fiber Optic	$1,400,000
		Total	$2,440,000

5. Retirement entries are not separated by intrastate and interstate jurisdictions.

OPINION:

The use of fiber cables to serve only POTS customers capped at 178 with no plans for data or video services justifies the complete retirement of the fiber optic system at Heathrow. Copper cables have been placed in conjunction with fiber distribution cables and are available for cut over of telephone services to copper plant.

RECOMMENDATION:

Retire the estimated $2,440,000 investment in the CATV switched video system and the entire fiber optic investment, including the fiber cables which support only 178 telephone customers. The estimated 11 million dollars booked in the Florida intrastate rate base are not justified for annual revenue estimated to be $22,428 for POTS with no future growth.

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AUDIT DISCLOSURE NO.

SUBJECT: FCC VIOLATION - HUNTER'S CREEK EARTH SATELLITE STATION

STATEMENT OF FACTS:

1. U.S. Department of Justice, Antitrust Division, in a letter dated May 8, 1987, to BellSouth Corporation, concluded that Southern Bell was in violation of Section II (D) of the Modification of Final Judgement (MFJ) by providing interexchange services at the Hunter's Creek development.

   Southern Bell had been granted a license for its receive-only earth station which received programming that was originated by a third party outside the Orlando LATA and relayed via satellite to the Company's earth station.

2. BellSouth complied with the direction of the U. S. Department of Justice by selling the Scientific Atlanta Receive-Only Antenna to Genstar Southern Development, Inc., on Bill of Sale dated October 12, 1987. The selling price was not provided.

3. The following retirement costs were documented:

   - o Debit 3100.2521 Depreciation Reserve - $8,112
   - o Credit 2231.2310 Radio System - $8,112

   The equipment was placed as part of Estimate No. V-0469 and charged to FRC 67C-Radio Systems Terrestrial Microwave - Other (SRC 2231.2310).

OPINION:

U.S. Department of Justice specifically limited BellSouth's early entry into the CATV business at the Hunter's Creek development to CATV transport from the headend to customers' premises.

AUDIT DISCLOSURE NO.

SUBJECT: HUNTER'S CREEK VIDEO TRIAL RETIREMENT

STATEMENT OF FACTS:

1. A Company memorandum from R. C. Capell dated September 29, 1992 to D. A. Kettler/R. B. Vogel stated that the "original fiber to the home switched video system from AT&T has been retired and the 1120 cable TV subscribers at Hunter's Creek are now served almost exclusively by a standard coaxial cable transport system."

2. Company states the CATV equipment and fiber cables were either retired in place or removed and junked. The uniqueness of the equipment makes any future use or removal remote.

3. A total of $2,502,799 was retired in 1992 under Estimate Nos. EF1629 and EF7201 which included the switched video and electronic equipment and multimode fiber optic cables. The cables could no longer support the increased channel requirements for CATV transport.

4. Retirement of $3,521,041 was identified in a letter from D.A. Kettler to B. R. Williams on December 16, 1991, for retirement of the Hunter's Creek CATV switched video system. Status of retirement of the remaining $1,018,242 of obsolete plant investment is unknown.

5. Retirement entries are not separated between interstate and intrastate jurisdictions.

OPINION:

The entire investment for CATV switched video services which totals a minimum of $3,521,041 should have been retired in 1992 instead of $2,502,799. The original total costs should have been booked under interstate jurisdiction. However, the actual booking with respect to intrastate and interstate separations are unknown since both Hunter's Creek and Heathrow total costs were combined and cannot be separated.

RECOMMENDATION:
AUDIT DISCLOSURE NO.

SUBJECT: FCC VIOLATION - HUNTER'S CREEK EARTH SATELLITE STATION

STATEMENT OF FACTS:

1. U.S. Department of Justice, Antitrust Division, in a letter dated May 8, 1987, to BellSouth Corporation, concluded that Southern Bell was in violation of Section II (D) of the Modification of Final Judgement (MFJ) by providing interexchange services at the Hunter's Creek development.

Southern Bell had been granted a license for its receive-only earth station which received programming that was originated by a third party outside the Orlando LATA and relayed via satellite to the Company's earth station.

2. BellSouth complied with the direction of the U. S. Department of Justice by selling the Scientific Atlanta Receive-Only Antenna to Genstar Southern Development, Inc., on Bill of Sale dated October 12, 1987. The selling price was not provided.

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   - Credit 2231.2310 Radio System - $8,112

   The equipment was placed as part of Estimate No. V-0469 and charged to FRC 67C-Radio Systems Terrestrial Microwave - Other (SRC 2231.2310).

OPINION:

U.S. Department of Justice specifically limited BellSouth's early entry into the CATV business at the Hunter's Creek development to CATV transport from the headend to customers' premises.

AUDIT DISCLOSURE NO.

SUBJECT: CYPRESS COVE FIBER TRIAL

STATEMENT OF FACTS:

1. The Cypress Cove trial in Ft. Lauderdale, Florida, consists of fiber cables in the distribution loop terminating in modular constructed pedestal enclosures located at curbs in residential neighborhoods. One pedestal serves up to six living units by buried copper drop wires.

2. A commercially available Reliance Comm/TEC DISC * FITL system was purchased which converts high bit-rate digital optical signals to electrical analog signals by means of electronic plug-in boards at the pedestal.

3. Only POTS services are currently being marketed. With upgraded electronics, the fiber optic system is designed to provide television services over the copper drop wires to the residences. This was verified during an on-site inspection by a Commission auditor on August 6, 1993.

4. Company reports the following expenditures and separations through 1992:

Total Booked Costs	Separations Intrastate	Interstate
$191,029	$131,216	$59,813

Investment assigned to the Florida Intrastate rate base is 69 percent of the total investment.

OPINION:

The recent Bell Atlantic/Tele-Communications, Inc., merger and the acquisition of 22.5 percent interest in Prime Management, Inc., by BellSouth makes it apparent that the RBOCs are in a position to provide their own programmed television services in the near future.

Assignment of 69 percent of the total investment in fiber distribution systems based on separations factors developed primarily for toll and common carrier services (Part 36, Jurisdictional Separations Procedures) is inconsistent with the Cypress Cove installation where the great majority of the fiber optic system capacity is for future data and video services.

AUDIT DISCLOSURE NO.

SUBJECT: COCOPLUM FIBER TRIAL

STATEMENT OF FACTS:

1. The Cocoplum trial in Coral Gables, Florida, consists of fiber cables in the distribution loop which terminate directly in subscriber homes. An AT&T SLC* Series 5 Carrier System extends the use of fiber optics to residences as part of an all-fiber network which will provide the capability for future data and video services with electronic upgrades. Only POTS service is currently provided.

2. The fiber optic system provides high bit-rate digital optical signals to a distant terminal (DT) located at the customers' premises where the light signals are converted to electrical analog signals.

3. Company reports the following expenditures and separations through 1992:

Total Booked Costs	Separations Intrastate	Separations Interstate
$843,572	$596,257	$246,316

Investment assigned to the Florida intrastate rate base is 70.8 percent of the total investment.

OPINION:

Assignment of 70.8 percent of total investment for fiber optic distribution systems which extend fiber into the residence is greatly disproportionate with respect to the intended use of the facilities. Although only POTS is now provided, the great majority of the megabit capacity is reserved for data and video services.

The recent merger of Bell Atlantic and Tele-Communications, Inc., signals the entrance of the telephone industry into the cable TV business.

RECOMMENDATION:

SCOPE LIMITATION: The following were requested from the company in Request 2-098 for Bellcore:

#5 For the projects C18-2-4-5-85 Video Market Research and C-14-2-1-2-06 Video Systems, provide the bill from Bellcore to BST that was recorded in the August 92 General Ledger.

#6 For these two projects mentioned above, provide all of the detail from Bellcore which supports that schedule summarizing all costs, vouchers, payroll information including employees charged, their duties and job titles, calculation of any overheads or allocated expenses including the detail for the accounts being allocated.

The company provided the bills and a detailed schedule of charges by account with allocation percentages for direct service center expenses and indirect expenses.

The company provided supporting documentation for direct department salaries and some direct expenses. They did not provide any detail to support the allocated expenses or the allocation percent allocations. Since staff was unable to review the response to this request until September, it was too late to make an additional request for the information not supplied in the response.

Staff had intended to use this one month test to support all 6XXXXX account charges for the year. The one month of these allocated charges totaled $1,123,473.50 for direct service centers and indirect were $22,737,762 for a total unsupported cost of $23,861,235.

SCOPE LIMITATION 2

The company has sent the information provided by their subject matter experts through several regulatory reviews and a legal review. This review process can result in editing of information which does not support the utility position and is detrimental to the audit process.

Staff is aware of at least one instance where a page of a memorandum containing information about the company's incorrect classification of an entry was removed from the experts papers in answering our request. The paper withheld was viewed by two members of the staff during a working session with the expert. It was later provided as the result of staff's discovery and oral request.

AUDIT DISCLOSURE NO

SUBJECT: BELLCORE COST REDUCTION

STATEMENT OF FACT: According to the Bellcore annual report, Bellcore went through a restructuring of its operations in 1992 to simplify and eliminate various internal processes and procedures.

In 1992 Bellcore incurred $53.9 million in non-recurring expenses (not including non-severance related salary amounts) according to their audited financial statements. In addition, according to the Bellcore Annual Report, there was a net reduction of payroll and contract labor of 922 employees. According to a request response, the pay reduction related is $37,483,388.26, excluding termination pay and other benefits.

Total 1992 expenses per the 1992 financial statements includes non-recurring expenses	$1,150,080,000
1993 approved budget for 1993 (Request 2-111)	$1,105,000,000
Budgeted reduction in expenses at the Bellcore Level.	$45,080,000
Percent of 1992 expense	3.92%
BellSouth Telecommunications Budget for 1993(2-111.0.1)	165,795,600
Actual 1992 billed BST per Bellcore Annual Report	168,793,000
Budgeted Reduction at BST Level	2,997,400
Percent of 1992 expense	1.78%
BST Florida budget for 1993 (Request 2-080.A)	42,638,700
BST Florida Bellcore charges 1992 (BST Annual Report)	42,490,866
Budgeted Reduction at Florida Level	(147,834)
Percent of 1992 expense-increase	-0.35%

OPINION: The reduction in the Bellcore budget does not even account for the entire $53.9 million in non-recurring expenses let alone any decrease in salary or employee related expenses such as benefits or building space for all of the employees let go in 1992.

The estimated reduction in salary expense alone is $37,583,388.26. The combination of the $53.9 million and the $37,583,388.26 is $91,483,388.26. Therefore, the total known decrease in Bellcore expenses not including overheads is $91,483,388.26 or an 8% reduction.

RECOMMENDATION: Further reductions appear to be needed in the 1993 Bellcore budget.

Using an 8% *reduction*, Florida expenses would decrease by $3,399,269 in 1993. Allocated based on 1992 activity to accounts being charged over 1% of the expenses(per the annual reports of Bellcore), the reduction is as follows:

ACCOUNTS	% ACTIVITY 1992	ALLOCATED DOLLARS	% REG	DOLLARS REGULATED	%INTRA	DOLLARS INTRA
6535	15.26%	518,728	99.45%	515,875	73.87%	381,077
6611	4.25%	144,469	96.51%	139,427	73.69%	102,744
6623	1.53%	52,000	96.15%	50,006	85.12%	42,566
6724	43.43%	1,476,303	94.55%	1,395,844	76.84%	1,072,567
6726	6.67%	226,731	95.37%	216,234	76.84%	166,154
6727	21.98%	747,169	98.76%	737,896	76.84%	566,998
6728	1.78%	60,507	94.07%	56,919	76.84%	43,737
6705	1.17%	39,771	94.66%	37,648	76.44%	28,778
6710	3.93%	133,591	94.66%	126,457	76.44%	96,664
		3,399,269		3,276,305		2,501,284

AUDIT EXCEPTION NO

SUBJECT: LOBBYING AND CONTRIBUTIONS CHARGED TO BST FROM BELLCORE

STATEMENT OF FACT: Bellcore had the following expenses in 1992:

Project 480004 Legislative Task Force	431,300.00
Contributions	719,197.15
Acct. 649-086 Corporate Legislative Regulatory Support	1,904,671.60
Acct. 671-151 Washington Regulatory Internal Services	446,639.43

	3,501,808.18

Accounts 649-086 and 671-151 are described on the following page from request 2-117.1.

Project 480004 was charged at $71,800 to Bellsouth Corp and allocated to the various states. The project overview provided in request 2-112, describes the project as:

Assist the Bellcore Client Companies by providing centralized coverage in Washington of events of national importance in telecommunications. Areas of focus include Congress, the Federal courts, regulatory agencies, and other national organizations headquartered in Washington.

All of the other accounts, totaling $3,070,508.10, were allocated to all projects through the internal allocation process of Bellcore. (Per Requests 2-101 and 2-117.1)

Using the Bellcore ownership billing in the Bellcore Annual Report, staff calculated that 16.3% of Bellcore billings were to BST.

OPINION: The above costs of $3,070,508.10 allocated to BST at 16.3% total $500,635.59. This along with the $71,800 charged to BSC for project 48004 total $572,435.59. Since most Bellcore billings are charged to accounts 6724 and 6727, the state allocators for these accounts are being used to determine the portion of these costs applicable to each state.

	%	DOLLARS
Florida	26.14%	149,635
Georgia	17.28%	98,917
North Carolina	9.62%	55,068
South Carolina	6.44%	36,865
Alabama	8.47%	48,485
Kentucky	4.92%	28,164
Louisianna	9.95%	56,957
Mississippi	5.85%	33,487
Tennessee	11.33%	64,857
		572,436

RECOMMENDATION: Remove the Florida share of costs from ratemaking.

ACCOUNTS	% ACTIVITY 1992	ALLOCATED DOLLARS	% REG	DOLLARS REGULATED	%INTRA	DOLLARS INTRA
6535	15.26%	22,834	99.45%	22,709	73.87%	16,775
6611	4.25%	6,360	96.51%	6,138	73.69%	4,523
6623	1.53%	2,289	96.15%	2,201	85.12%	1,874
6724	43.43%	64,988	94.55%	61,445	76.84%	47,214
6726	6.67%	9,981	95.37%	9,519	76.84%	7,314
6727	21.98%	32,890	98.76%	32,482	76.84%	24,959
6728	1.78%	2,664	94.07%	2,506	76.84%	1,925
6705	1.17%	1,751	94.66%	1,657	76.44%	1,267
6710	3.93%	5,881	94.66%	5,567	76.44%	4,255
		149,635		144,222		110,106

649-086: Corporate Legislative/Regulatory Support (Project 915XX)

Corporate Legislative/Regulatory Support expenses are charged to project 915XX and include all expenditures associated with the Regulation and Government Support organizations. These organizations assist the regions in identifying, monitoring, and analyzing regulatory issues of concern. They advise and assist the Regional Holding Companies in their interactions with Congressional Committees, the Federal Communication Commission and the Executive Branch.

Corporate Legislative/Regulatory Support expenses are charged back to all Area Support, Service Center, SDCPE/EC, and External Billable Projects on the basis of Average Bellcore Employee and Average Resident Visitor-Reported headcount.

671-151: Standard Rated Corporate Service Center Normalization (Washington Regulatory Internal Services (Project 815XX)

Bellcore's Corporate Service Centers are structured to provide on an economical basis, those services which are commonly required by most of the organizations in the company. Standard Rated Service Centers are billed directly to the user organization on a usage basis which is charged at standard rates. At year-end a normalization process may be performed to eliminate any residual over/under recovery that exists within the Standard Rated Corporate Service Centers. This normalization process allows any over/under recovery expenses to be charged back to the External projects on the basis of usage.

AUDIT DISCLOSURE

SUBJECT: BELLCORE RESEARCH AND DEVELOPMENT

STATEMENT OF FACTS: BST pays Bellcore for research and development costs which are charged to account 6727 according to the MP2702's. Total expenses for this account in 1992 related to Bellcore R & D were approximately $34,442,935. Of these costs, 26.14% were charged to Florida or $9,003,793.31. Of these costs, $111,945 or 1.24% were charged to non-regulated operations in 1992.

According to the Cost Allocation Manual (CAM), the Bellcore Research and Development is to be apportioned to reg and non-reg as follows:

Based upon an annual analysis of Contracted R & D to determine if projects are regulated or non-regulated.

The company is using a method where they separate the projects into catagories of Switched, Non-Switched, Composite Switched and Non-Switched, Support and Generic. These catagories were then allocated based on ARMIS report plant. Generic was allocated using a 3 month average of the general allocator. The three month average of the general allocator is 4.0537. The 12 month average is 5.233%. Staff attempted to audit the ARMIS report numbers for these items. When backup was finally received on 8/15, it was for the wrong year. Corrected data was not received in time to complete this audit.

Recent newspaper articles report that the FCC has recently given approval to Bell Atlantic to enter the video market and has recently scheduled rule setting for bidding for slots for wireless phone service or Personal Communication Systems(PCS). In October, BellSouth Cop. signed a $250 million agreement to acquire a 22.5% stake in Prime Management Co., a Texas-based cable TV company.

The company's 1992 Accounting for Internal R & D Analysis paper recommended annual reviews because of:

"Increasing competition and the relief of many MFJ restrictions will likely result in substantially increased internal R & D efforts beyond historical levels."

OPINION: Recent rulings by the FCC make allocation of R & D based on current non regulated services unreasonable. As the operating companies enter into more and more unregulated business, the unregulated businesses will be benefiting from the benefits from the technology obtained in their current research.

Because the company's new system allocates costs to regulated and non-regulated based on future investment (3 years) of current non-regulated services, and R & D account 6727 according to the USOA is a planned search or critical investigation aimed at

Bellcore Projects

Staff initially requested a detailed description of all 1991 and 1992 projects that BellSouth had authorized Bellcore to undertake on October 26, 1992, request No. 1-001. Project description summaries for 1991 and 1992 were provided on January 11, 1993. The company provided approximately 609 Bellcore projects that were charged to various BellSouth accounts in 1992. Staff limited their review to 1992 projects charged to Account 6727, Research and Development. There were roughly 70 projects charged to Account 6727 in 1992. Staff held interviews with BellSouth staff on March 11, 1993, and again on April 26-27, 1993 to understand how BellSouth interacts with Bellcore. Staffs primary interest was the budgeting and billing process of Bellcore projects and the project management of Bellcore projects within BellSouth.

To gain further knowledge of the R&D performed by Bellcore, staff requested interviews with the project managers of several Bellcore projects on July 22, 1993, request No. 1-101. The company responded on August 6, 1993 stating, "The Company objects to arranging the requested interviews on the grounds that this request is unduly burdensome and oppressive." When staff questioned BellSouth's objection, they were told that the objection was made by Bellcore, not BellSouth. The objections were based on the fact that Bellcore had recently participated in the audit conducted by NARUC and the FCC and believed that any further audits of Bellcore would be burdensome and duplicative for the auditors. Staff believes that the only way of gaining a thorough understanding of the nature of the projects and/or any specific applications to regulated or nonregulated products or services is to further examine the projects in question. It is apparent to staff through our limited exposure of the Bellcore projects that there is a potential for these projects to support future non regulated products or servcies. In many cases there may be no benefit to current residential ratepayers and therefore such Bellcore work benefiting future non regulated services justifies careful analysis of Bellsouths cost allocation methods.

An example of the future benefit nature of the Bellcore work are projects numbered 21411, 421301, 421303, 421306, and 621306. These are a few of the projects that relate to the development of a communications network based upon fiber optic broadband transport of voice, data and video information. A broadband network of this magnitude is not currently required for telephone service and many types of information services. However, it is required to support high quality entertainment television. Although video dial tone is allowed by Bellsouth, they are prohibited from owning or providing video programming in their service territory by the Cable Communications Policy Act of 1984. Moreover, in a recent US District Court decision, Bell Atlantic won a lawsuit to overturn restrictions in the Cable Act of 1984. Bell Atlantic basically gained the authority to become a cable television provider and compete with cable companies in its service area. This authority does not extent to any of the other Bell Operating Companies.

In addition, Bellsouth Corporation recently acquired 22.5% of Prime Management Company, a Texas based cable television company. This provides Bellsouth with entry into interactive television, pay-per-view, traditional cable and alternative telecommunications for business and residential customers. With the recent Bell Atlantic ruling and BellSouth's acquiring a stake in a cable company, it positions BellSouth a step closer to offering television service to their local telephone customers. This work performed by Bellcore is clearly

benefit current regulated products and services. In lieu of

TOTAL BELLCORE R & D COSTS 1992	34,442,935
AT 50% ALLOCATION	50.00%
AMOUNT TO BE REMOVED	17,221,468
% TO FLORIDA	26.14%
AMOUNT OF ADJUSTMENT FLORIDA	4,501,692
AMOUNT ORIGINALLY CHARGED R & D BELLCORE FLA	111,945
NET FLORIDA ADJUSTMENT	4,389,747

RECOMMENDATION: Transfer more of expenses to non-regulated operations using one of the above methods.

AUDIT DISCLOSURE

SUBJECT: BST GENERIC RESEARCH AND DEVELOPMENT

STATEMENT OF FACTS: BST has a research and development division which charges expenses to account 6727 according to the MP2702's. Total expenses for this account in 1992 related to Generic R & D were approximately $10,236,000. Of these costs, 26.14% were charged to Florida or $2,675,191.60. Of these costs, $142,848.84 or 5.34% were charged to non-regulated operations in 1992.

According to John Mast, the company allocated this portion of the account using the general allocator which is computed mechanically in the cost separations system and is based on the 6XXX expense account.

According to the Cost Allocation Manual (CAM), the Bellcore Research and Development is to be apportioned to reg and non-reg as follows:

"Based upon an annual analysis of Internal R & D to determine if projects are regulated or non-regulated."

In 1993, according to John Mast, the company is changing from the general allocator to a a method where they separate the projects into catagories of Switched, Non-Switched, Composite Switched and Non-Switched, Support and Generic. These catagories are then allocated based on ARMIS report plant. Generic is allocated using a 3 month average of the general allocator.

In interviews Research and Development personnel contended that all of the research is regulated even though possible future services may be unregulated because the projects determine how the products interface with the system.

According to recent newpaper articles, the FCC has recently given approval to Bell Atlantic to enter the video market and has recently scheduled rule setting for bidding for slots for wireless phone service or Personal Communication Systems(PCS). In October, BellSouth Cop. signed a $250 million agreement to acquire a 22.5% stake in Prime Management Co., a Texas-based cable TV company.

The company's 1992 Accounting for Internal R & D Analysis paper recommended annual reviews because of:

"Increasing competition and the relief of many MFJ restrictions will likely result in substantially increased internal R & D efforts beyond historical levels."

OPINION: Recent rulings by the FCC make allocation of R & D based on current non regulated services unreasonable. As the operating companies enter into more and more unregulated business, the unregulated businesses will be benefiting from the benefits from the technology obtained in their current research.

Because the company's new system allocates costs to regulated and non-regulated based on future investment (3 years) of current non-regulated services, and R & D account 6727 according to the USOA is a planned search or critical investigation aimed at discovery of new knowledge or translating research findings into a plan or design for a new product or process or for a significant improvement to an existing product or process, possible new unregulated services are not being taken into account.

According to the company workpapers, if the company had used their new allocation method in 1992, they would have allocated .7304% of R & D to non-reg instead of the 5.34% actually allocated. The 1993 forecasted rate case exhibits is probably based on this new lower percentage.

Several methods of accounting for these costs can be used by State Commissions:

1. Deferral of costs until potential products are determined.

2. Requirement of Keep Cost records by projects and product for retroactive adjustments.
   (If this is used, amounts recorded need to be audited periodically to make sure they are all inclusive)

3. Allocation of project based on estimated future benefits.

Some projects appear to have more non-regulated possibilities than others. Staff has reviewed each project and determined allocation methodology for each. We also contend that the absolute minimum that should be used is the general allocator. The companies new system, which bases the allocation on current

Since the company does not budget or record expenses by project, Staff has obtained cost reports for 1992 by responsibility code. The charges by responsibility code identify each manager and thus the projects which they supervise. The reports also identify costs by code for 2400 which is the Research and Development account code. These amounts were used by staff to allocate total account 6727 charges to managers.

The reasons for the allocations are as follows:

1. Wireless Access PCS Services

Bellsouth contends that a key component of their work on personal communication systems (PCS) is to evaluate the use of low-power radio technology and to identify and resolve network interface issues. In contrast with higher power cellular systems, which are currently not regulated in Florida, PCS's employ small, low power radio handsets with a larger number of base stations. These base stations have much smaller coverage areas than today's cellular stations. PCSs can provide flexible access to existing local telephone networks as well as alternate access to local and interexchange carrier networks.

Under a new federal law signed by President Clinton August 10, 1993 (H.R. 2264), beginning next August States can no longer regulate intrastate wireless service rates and market entry. The law calls for auctioning of FCC radio licenses. The FCC is setting aside blocks of radio frequencies, more than three times the amount now devoted to cellular telephone service, for a broad family of new portable telephone and computer service. The FCC awarded two 30-Megahertz blocks in each of 49 regions. There would also be a 20 MHz block and four 10MHz blocks in 487 subregions. This provides 120 MHz for PCS compared to the current 50 MHz for cellular.

In addition to telephone companies, strong interest in PCS has been expressed by the cable television industry, traditional mobile radio providers and entrepreneurs. To deal with the competitive aspects of PCSs, telephone companies may elect to enter the PCS business themselves. Not doing so might lead to an unacceptable degree of customer erosion.

BellSouth believes that the major benefits of this project is to deter complete bypass of the local networks. Bellsouth's work today in PCS is small relative to its overall program. However, the knowledge gained in this area will benefit Bellsouth both in serving PCS suppliers as customers, and in making plans for developing systems to compete with other PCS suppliers.

Staff believes the work on PCS is common to both non-competitive and competitive applications. The most recent federal bill preempting the states from regulating wireless service rates and the FCC decision on spectrum allocation opens a new generation of wireless communications for new types of services that could in time replace many of the phones and computers now secured by wire. Although staff understands the need for BSTI to continue research and development in this area, it is apparent from the action discussed above that PCS will clearly not be regulated by the States. Staff believes based on the above Federal decisions that the work performed on PCS services by BSTI should be allocated 20% to regulated and 80% to non-regulated.

2. Broadband ISDN
SMDS

The use of Integrated Services Digital Network (ISDN) technology with broadband suggests an evolution to a broadband network based on international standards. BISDN will enable BellSouth to support emerging broadband information networking services such as Switched Multimegabit Data Service (SMDS), frame relay, and video teleconferencing services. BISDN will enable the progression from voice networks to public information networks capable of flexible bandwidth to transport information in any form (voice, data, video, multi-media).

SMDS is one of the early broadband services planned for B-ISDN. The markets for SMDS are data transport applications requiring transmission rates above what the traditional telephone network can support. Introducing this service will require both wideband or broadband access and switching capabilities not currently part of the traditional telephone network. Bellsouth contends that SMDS is of strategic importance because it allows the LEC to develop expertise to support future broadband services. It is apparent that efforts to test SMDS will likely involve a stand alone overlay capability within the public switched network. In view of this, it appears that whatever market exists for SMDS services, could also be served by those outside the telephone company industry. Staff believes that should a market exist, SMDS is a potentially competitive service.

This Commission plays a major role in the deployment of residential broadband efforts through our jurisdiction over depreciation schedules, incentive regulation plans and cost allocation. Although Florida has been generally supportive of new technologies and the accompanying new services, our primary objective is to ensure that ratepayers are not harmed by the deployment of new technologies. A broadband network of this magnitude is not currently required for telephone service and many types of information services. The work performed by Bellsouth on BISDN and SMDS is clearly directed toward future enhancements that have the potential of supporting competitive services that may or may not be regulated in the future. Staff believes that until the services that these projects support are determined to benefit todays ratepayers that the work performed on these projects should be allocated 50% to regulated and 50% to non-regulated.

3. Video Transport Services
Fiber Distribution Networks

A broadband network can have the capacity to meet virtually all of the communication requirements of the public. Such a network could carry voice, data, image, and high quality video traffic simultaneously. Today's telephone network already uses fiber to carry voice communications as well as other traffic between switches. Broadband network access is not required for telephone service and many types of information services. However, it is required to support high quality entertainment television. BellSouth believes that in the long term they must become the low cost provider of residential broadband services. To accomplish this, they believe that the earlier a start can be made in learning how to deliver such services efficiently, the better their chances of success in the future.

It was stated by BellSouth that although fiber is less costly than copper, the lasers and electronics required for fiber are expensive, but are decreasing in costs. The declining cost of fiber and its associated electronics is allowing cost effective deployment of Fiber to the curb (FTTC) today. The range of cost effective broadband technologies will continue to grow in the future. BellSouth believes it is inevitable that broadband services, primarily video, will be delivered over these networks. The only question is when. They believe to prepare for the future, it is essential that they start to design a plan to address future business, technical, and regulatory needs. BellSouth's Fiber Distribution Networks project includes developing an overall company strategy for fiber in the loop. They also intend to continue their evaluation and analysis of new options to overcome any obstacles in the distribution network technologies such as powering, optical splitting, upgrading for future services, etc. BellSouth contends that fiber in the loop will become a reality in the near term.

Although the FCC authorized video dialtone in 1992 which allows Local exchange companies (LECs) to provide video transport service to non-franchised operators, the LECs are prohibited from owning and providing video programming in their service territories by the Cable Communications Policy Act of 1984. However, in a recent US District Court decision, Bell Atlantic won a lawsuit to overturn restrictions in the Cable Act of 1984. Bell Atlantic basically gained the authority to become a cable television provider and compete with cable companies in its service area. This authority does not extent to any of the other Bell Operating Companies.

In addition, Bellsouth Corporation recently acquired 22.5% of Prime Management Company, a Texas based cable television company. This provides Bellsouth with entry into interactive television, pay-per-view, traditional cable and alternative telecommunications for business and residential customers. With the recent Bell Atlantic ruling and BellSouth's acquiring a stake in a cable company, it positions BellSouth a step closer to offering television service to their local telephone customers.

Staff understands the need for Bellsouth to enhance their network and to prepare for future competitive services. However, based on the results of the recent Bell Atlantic court decision and the recent push for several of the Bell Operating Companies to purchase a stake in various cable companies, it is apparent that the local telephone companies want the right to compete directly in the video programming market. A major concern of this Commission regarding BellSouth's Research and Development efforts in the areas of advanced television, video services and fiber in the loop technologies is that it appears that a large portion of these investments are going to serve as a basis for future cable television services. Staff believes that the work performed in these areas have the potential of supporting competitive services that will benefit Bellsouth on both a regulated and non-regulated basis. Therefore, based on the above contentions staff believes that the work performed on these projects should be allocated 70% to non-regulated and 30% to regulated.

4. Network Evolution

BellSouth claims that new technologies, including B-ISDN, advanced intelligent network (AIN), and personal communications service (PCS), will be deployed in their network over the next decade. Many of these technologies overlap in a number of areas. This creates the need for a target architecture to be developed which combines these technologies together. BSTI's Network evolution project has been designed to address the relationship of new technologies in the target network architecture and the evolution issues associated with the introduction of new technologies in their network.

Staff realizes that the relationship between new technologies must be clearly understood and a plan must be developed to introduce new technologies economically. However, some of the new technologies discussed earlier in staffs analysis that BSTI are exerting Research and Developmnet efforts on are potentially competitive services and may or may not be regulated in the future. Therefore, staff believes that the work performed on this project should be allocated 50% to regulated and 50% to non-regulated until distinct benefits to the regulated ratepayers are determined.

5. Service Concepts Development
Community Lab Services Concept Development

The Service Concepts Development and Community lab services concept development projects support simulation and prototyping of potential services for analysis and market research by BSTI. BellSouth claims that these projects provide the necessary tools to be utilized by their marketing group for establishing the companies mid-term and long-term business strategies. BellSouth also asserts that this work is not directed toward any specific business case and therefore, the specific business impact is not quantifiable. Furthermore, the research efforts are directed toward finding new business opportunities for the company to support future growth in the business.

Staff understands the need for BellSouth to continue their research and development efforts in order to enhance their network and prepare for future and growth and competitive services. However, it appears that the R&D efforts in both of these projects is primarily oriented toward future enhanced (and potentially non-regulated) services which do not benefit current regulated products and services. Staff believes until it is determined the type of services that these projacts support that the research and development performed on these projects should be allocated 50% to regulated and 50% to non-regulated.

6. Advanced Intelligent Network Release 1&2

BellSouth states that the Advanced Intelligent Network Releases (AIN) 1&2 project provides an analysis of future (1994-1997) new services and revenue enhancement opportunities for the Company. AIN is an architecture that enables BellSouth to develop and introduce new telecommunications services faster and in many instances cheaper than can be accomplished when such services are derived from software in the switches. BellSouth contends that the research and development efforts of AIN Releases 1&2 architecture supports future strategic planning activities of BellSouth.

AIN was preceded by the Intelligent Network concept which shared the same basic objective of separating service logic from switching apparatrus. Since, AIN has evolved through a series of releases. In 1992, BellSouth had ongoing work efforts related to the AIN Release 0. BellSouth has established one regulated service based on the AIN release 0 architecture known as Caller Name Delivery and has several other services (personal number calling 2, area number calling, and basic AIN programability) in the development stage. Caller Name Delivery allows a subscriber to receive the directory name assoicated with the directory number of the calling party on a incoming call.

BellSouth stated that AIN releases 1&2 were initially targeted for 1995. However, the functional requirements issued by Bellcore were too stringent for the switch vendors which made this target date impossible. In fact, Randy Corn, a BellSouth Research Manager stated that these releases (1&2) would probaly never occur due to these requirements. The switch vendors must devote significant resources to develop end office capabilities in their existing switch products to support AIN. The requirements for AIN releases 1&2 have been scaled back to a more manageable level. BellSouth's work efforts have been shifted and are now being placed on AIN releases 0.1 & 0.2.

Staff believes that until a better understanding of the type of services that AIN Releases 1&2 architecture would support the work efforts could potentially be competitive and therefore benefit both regulated and unregulated services. Staff understands the need for BellSouth to continue their research and development efforts in order to enhance their network and prepare for future competitive services. However, it appears that the R&D efforts related to this project are primarily oriented toward future enhanced (and potentially non-regulated) services which do not benefit current regulated products and services. Staff believes until it is determined what type of services that the AIN Releases 1&2 architecture supports and if AIN Releases 1&2 ever becomes a reality that the research and development efforts should be allocated 70% to non-regulated and 30% to regulated.

A

MANAGER	PROJECT	% OF [redacted]	ALLOCATION OF TOTAL	% NON REG STAFF	DOLLARS NON REG
[redacted]	AIN 0	12.91%	1,321,466	5.34%	70,566
	AIN 1 & 2	14.64%	1,457,606	70.00%	1,020,324
	AIN 0	15.79%	1,616,264	5.34%	86,300
	AIN 0	11.63%	1,190,447	5.34%	63,570
		4.19%	428,868		
	BISDN		25.00%	50.00%	53,611
	SMDS		25.00%	50.00%	53,611
	FIBER DIST.		25.00%	70.00%	75,056
	VIDEO		25.00%	70.00%	75,056
	AIN 0	13.11%	1,341,940	5.34%	71,660
	MISC	0.29%	29,684	5.34%	1,585
		7.73%	791,243		
	SMDS		5.00%	50.00%	19,781
	NETWORK EV		5.00%	50.00%	19,781
	FIBER		15.00%	70.00%	83,080
	VIDEO		15.00%	70.00%	83,080
	BISDN		60.00%	50.00%	237,373
	A	10.34%	1,058,402	50.00%	529,201
	PCS	9.77%	1,000,057	80.00%	800,046
			10,236,000		3,343,690

PER COMPANY	142,849
DIFFERENCE	3,200,841
% Fla	26.14%
FLORIDA PORTION	836,700

A COMMUNITY LAB/SERVICE DEVELOPMENT

ALL PROJECTS NOT SPECIFICALLY WRITTEN UP WERE ALLOCATED USING THE GENERAL ALLOCATOR

RECOMMENDATION: Transfer more of expenses to non-regulated operations using one of the above methods. The minimum should be to change to the general allocator.

Audit Disclosure 1

Subject: Lack of Project Tracking

Statement of Fact:

1. Staff requested in several audit requests (Nos. 1-3.1, 3.4, 4.4, 4.5, 9.1, 9.3) the associated dollar cost by project for Science and Technology. The company provided response to request No. 1-3.4 stated, "BST does not track internal expenses by project, but rather along organizational lines. Therefore the amounts booked by account for 1992 Science and Technology projects are not available."

2. In request No. 1-72 staff asked if BSTI uses "keep costs" to track their R&D expenses to a project level. In response BSTI stated that they do not use "keep costs" to track costs by project and that these expenses are associated with normal job functions within the organization and are treated accordingly through the payroll system.

3. In response to request No. 1-4.6 BSTI indicated that the Science and Technology organization was in very early stages of evaluating the possibility of future tracking at the project level.

4. In response to request No. 1-52 BSTI stated that the Science and Technology organization had appointed a group of managers to discuss the possible development of a system of reporting time enabling the time worked to be linked to the specific projects supported. They stated only one meeting had been held and no minutes were taken at the meeting.

5. In staffs August 10, 1993 interview with BSTI Director, Rick White, it was acknowledged that a committee on How to Change the Accounting Process for Accounting for Time had been formulated.

6. In response to request No. 1-128, June and July 1993 memos, letters, notes, etc. from the committee on How to Change the Accounting Process for Accounting for Time were submitted to staff. The response was a "first cut" of a work breakout and considered dividing specific aspects of projects into various levels.

Opinion:

1. Staff believes that without proper project tracking that no audit ability for cross subsidy exists.

Recommendation:

1. BSTI should implement a cost tracking mechanism by project.

Audit Disclosure 2

Subject: Lack of Market Trials and Field Trial Evaluations

Statement of Fact:

1. In request No. 78, dated May 21, 1993, staff requested all studies or other information developed in determining the success or benefits derived from each market trial. On July 15, 1993, BSTI responded to staffs request.

2. BellSouth stated that three trials (IBM/BST High Speed Data Trial, Vistanet Trial and Medical Information Applications Trial) were not completed, therefore evaluations have not been documented.

3. The Redstone Arsenal Trial was completed in September, 1992 but only lasted a short period and little resources were expended on the trial. BellSouth stated that no report evaluating for this trial would be issued.

4. The Sesame trial was also completed in September, 1992 and BellSouth stated that the evaluation report would be available for review on or before August 5, 1993. A press release issued on July 6, 1993 was provided which contained general evaluation information. On August 24, 1993 staff was told that the report would be available on or before September 10, 1993. The evaluation report was made available in Tallahassee as "ESPI" infomation on September 16,1993.

5. In request No. 1-76 and 1-76.A, staff requested a copy of all of the BellSouth, including Science and Technology, and/or Bellcore final evaluation and recommendation reports for the Heathrow Field Trial. Initially, BellSouth stated in a response dated May 27, 1993 that the company was unable to locate any evaluation report but would continue to try to locate any such report. In BellSouth's response dated July 30, 1993 the company stated that no final evaluation and recommendation report was prepared on the Heathrow field trial.

6. In request No. 1-75, dated May 20, 1993, staff requested a copy of the field trial evaluation and recommendation reports completed by Science & Technology on the Hunter's Creek Video Trial. BellSouth responded on July 23, 1993 stating that no report was available for the Hunter's Creek Trial.

Opinion:

1. Staff believes that the proper evaluation of market trials and field trials are necessary to determine whether the general deployment of the product/and or service is warranted.

Recommendation:

1. BellSouth should be required to perform evaluations and recommendation reports of all market and field trials.

Scope limitation:

1. Part of staffs audit scope was to review the various market trials that BSTI has participated. Staff initially requested all BSTI services that market trials were performed as a result of research projects in 1991 and 1992 on October 26, 1992, request 1-009. A list of the market trials were provided to staff on February 10, 1993. Subsequently, staff requested the costs of each BSTI market trial in request 1-009.1 on March 1, 1993. On April 15, 1993, SBTI responded stating, "... at the time these trials began, BST was not tracking trial costs; therefore, this information is not available." In our August 9, 1993 interview with BSTI personnel it was stated that contracts, including costs, were available for two of the projects. On August 31, 1993 the costs incurred by BSTI for two of the projects were provided in response to requests nos. 123 and 124. However, because of the time delay in receiving the requested information from the company it has become impossible for staff to adequately evaluate these trials.

Scope limitation:

2. Part of staffs audit scope was to review the various fiber based trials that BSTI has participated. Staff initially requested all fiber based trials and their associated costs that BSTI had participated in request No. 1-013 on October 26, 1992. A partial list of the fiber based trials were provided to staff on February 10, 1993. On June 11, 1993, BSTI stated, " ... the information pertaining to the Coco Plum trial in Florida is being retrieved from archived files and will be provided to the audit team as soon as it becomes available." On October 25, 1993, the company responded to staffs request No. 1-013.1. However, because of the time delay in receiving the requested information from the company it has become impossible for staff to adequately evaluate this trial as initially anticipated in staffs audit scope.

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AFFILIATED COMPANIES AUDIT DISCLOSURE

SUBJECT: ORGANIZATION CHARTS

STATEMENT OF FACTS:

PSC staff obtained a copy of the 12/31/92 BELLSOUTH CORPORATE STRUCTURE listed in the Cost Allocation Manual (CAM), and a copy of BELLSOUTH'S ORGANIZATION OF CORPORATIONS (OC) as of 12/31/92.

The CAM does not include all the subsidiaries of each company, while the BS Organization of Corporations includes all the subsidiaries. FPSC Order No. 25218, Docket No. 890190-TL, Investigation into Southern Bell Cost Allocation Procedures, did not directly address the detail for inclusion of subsidiaries in the CAM.

The following is a summary of the differences and how BST responded to the differences.

1. 1155 Peachtree Associates (80%) is listed on Page 1 of the OC as a subsidiary of BellSouth Corp. This is not listed on the 12/31/92 CAM.

The company responded that "1155 Peachtree Associates is not considered a major operational entity as its only business isthe Campanile bulding. If it were listed on the CAM chart, it would be shown as a direct report to BellSouth Corporation just as BST and BSE are shown."

2. BellSouth Argentina S.A. (3%) is listed on page 1 of the OC as a subsidiary of BellSouth Enterprises. This is not listed on the 12/31/92 CAM.

The company stated that "While BSE owns a portion of BellSouth Argentina, the majority ownership of BellSouth Argentina is held by BellSouth International which is shown on the CAM organization chart."

3. BellSouth Mexico, S.A. de C.V. is listed on page 2 of the OC as a subsidiary of BellSouth Enterprises. This is not listed on the 12/31/92 CAM.

The Company stated that BellSouth Mexico, S.A. de C.V. is part of BellSouth Mexico, Inc. which is listed on the CAM organization chart.

4. BellSouth Mobile Systems, Inc. listed on page 3 of the OC. This is not listed on the CAM.

The Company said that Mobile Systems Group is listed in the CAM as one of four classification titles used to categorize BSE companies. The company said that BellSouth Mobile Systems, Inc. is the parent of BellSouth Cellular Corp and Mobile Communications Corp of America MCCA. Both of these are listed in the CAM.

5. Selective Paging and Skidax, Inc. (20%) are listed as subsidiaries of Bellsouth Mobile Systems, Inc. on Page 5 of the OC. These are not listed on the CAM Structure.

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The Company stated that these companies are not considered "major operational entities and/or BellSouth does not have managerial control of these companies. Therefore these companies are not shown on the organization chart.(CAM)" If these companies were on the CAM chart, they would be under the Mobile Systems Group.

6. Page 6 of the OC lists the following companies as subsidiaries of BellSouth Enterprises. They do not appear on the CAM strucutre.

BS Mobilfunk Holding GmbH; E-Plus Mobilfunk GmbH (22%); . Communication-Development S.A.(17%); Raynet International, Inc. (8%); TelCel Celular,S.A. (44%); Uniquest Incorporated (approx 5.29%).

The Company stated that:
A. BS Mobilfunk Holding GmbH was added to the CAM in the March 31, 1993 update.

B. E-Plus Mobilfunk GmbH (22%) is a sub of BS Mobilfunk Holding Gmbh and is listed in the 3/31/93 CAM up date.

The other companies "...are not considered major operational entities and/or Bellsouth does not have managerial control of these companies; therefore these companies are not shown on the CAM.." These companies would appear under the International Corporate Development Group if on the CAM.

7. Page 2 of the OC lists Bellsouth Marketing Programs, Inc. (80.8%). This is not listed in the CAM structure at 12/31/92.

The Company states that this company was not listed because it was inactive.

OPINIONS:

1. It appears that 1155 Peachtree Associates (80%), which falls directly under Bellsouth Corporation is not listed in the CAM.

2. It appears that the Company has left this 3% interest in BS Argentina S.A., which falls directly under BSE, off the CAM Chart, but included in the Organization of Corporations Chart. The subsidiary listed under the International Corporation is owned 97% by the International Corp.

3. It appears from the Company's answer that the Organization of Corporations Chart is incorrect; this company is listed as a subsidiary of BSE, not of BellSouth Mexico, Inc. BellSouth Mexico, Inc. has one subsidiary listed below it on the Organization of Corporations Chart, that is called Communications Celulares de Occidente, S.A. de C.V. (36.37%).

4. The two companies BSSC and MCCA do appear under BellSouth Mobile Systems, Inc. in the OC However, the parent company Bellsouth Mobile Systems, Inc. does not appear in the CAM.

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5. These companies, Selective Paging and Skildex, Inc. (26%), are directly under the Mobile Systems Group and do not appear in the CAM.

6. BS Mobilfunk Holding GmbH does appear on the 3/31/93 CAM update. Communication-Development S.A.(17%); Raynet International, Inc. (8%); TelCel Celular,S.A. (44%); and Uniquest Incorporated (approx 5.29%) do not appear under the International & Corporate Development Group in the CAM.

7. BellSouth Marketing Systems, Inc. does not appear in the CAM.

In order to audit affiliated transactions, it is necessary to have a clear picture of affiliate relationships. In the cases mentioned above, some companies were on the CAM structure chart at 12/31/92 and not on the Organization of Corporations and some the opposite.

RECOMMENDATIONS:

It is recommended that all subsidiaries that are directly under BSE and BSC be included in the CAM whether major or not.

It is also recommended that for all the Companies listed in the CAM Corporate Structure, the number of subsidiaries of each be included. An appendix should name the subsidiaries of each.

This would enable to auditors to choose the companies they desire to audit, and also when auditing assets and expenses, determine if the company is a related company and follow through on all that is necessary when this is the case.

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BCI AUDIT DISCLOSURE 1

SUBJECT: BCI METHODS OF ALLOCATION

STATEMENT OF FACTS:

BCI performs marketing services for certain affiliates, both regulated and nonregulated. BCI bills only to affiliates. They bill to BellSouth Telecommunications, Inc. (BST), BellSouth Communication Systems, Inc (BCS), BellSouth Information Systems (BIS), DATASERV, Mobile Cellular Communications of American (MCCA), BellSouth Advanced Networks (BSAN), BS MOBILE DATA, AND BellSouth Enterprises (BSE). In 1992 BCI billed all affiliates $258,470,525. The amount billed to BST was $210,218,285; that is 81.33%.

Of the $210,218,185 billed to BST, $205,011,106 or 97.52% was considered regulated by BCI.

A schedule of the amounts to each state follows this Disclosure.

PSC staff asked BST why a separate subsidiary was implemented when 81.33% of the billing goes back to BST and of the billing 97.5% was regulated in 1992.

The company stated that "BCI was formed as a separate subsidiary, based on information obtained through business customer feedback. Customer input indicated that BellSouth needed to be easier to do business with, and that consistency and uniformaity are critical to the customer." .... "BCI can offer its businss customers, as one unified organication, the ability to meet all of the integrated telecommunications needs." ...

BCI has a complex procedure for determining the amounts for fully distributed costs and the amounts to allocate to regulated and nonregulated. The amounts are allocated to regulated and nonregulated at BCI, before they are billed to BST.

For explanation purposes, staff has divided BCI costs into two categories. One is those costs that are generated within BCI or billed to BCI and allocated based on various procedures directly and indirectly to the premises sales cost pool. These costs are not yet allocated to regulated and nonregulated. (Call this area "support costs" for this explanation).

The second is at the premises sales cost pool. The costs in this pool are generated by the salaries of the premises marketing sales employees. (Call this area "Premises Sales Costs"). From here they are allocated to regulated and nonregulated based upon the number of hours charged in the month. The number of regulated and deregulated hours is determined by a statistical sampling method.

For the month of May, 1992 BST was billed $18,530,970; 34% of the costs were "Support costs" and 66% were "Premises Sales Costs".

"Support costs"

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There are 12 divisions within BCI which eventually allocate the majority of their costs either directly or indirectly to Premises Sales, National Accounts and Government Sales. A small percentage is allocated to Inforun each month.

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For the year 1% was allocated to Inforum. Inforum is a marketing services demonstration center in Atlanta.

These allocations are either based on ratios of three months averages of salaries and wages of the division they are being allocated to or a quarterly going forward estimate of the hours of the division they are being allocated to. The majority of the divisions are allocated based on the salary and wages method.

"Premises Sales"

The costs in this pool are salaries generated by the marketing employees who do the actual sales. For the month of May, premises sales cost was 66% of total costs. These costs along with the "Support Costs" are allocated to regulated and nonregulated.

A chart of the Cost Pools for both "Support Costs" and "Premises Sales" also follows this disclosure. Each cost pool notes the method of allocation.

Allocation to Regulated and nonregulated.

The total "Support costs" and "Premises Sales" are allocated to the affiliates based on the sales hours reported in the sample of sales hours prepared each month. This sample includes the hours for each affiliate and whether in the case of BST the hours are regulated or nonregulated.

OPINIONS:

General

PSC staff questions the use of a separate subsidiary to bill BST 81% of its costs.

We received the company's answer as to the reason BCI was separated; but at that time it was too late in the audit to review the customer input that initiated the change and to make a comparison of the system before BCI was separated with the separated system.

Fully Distributed Costs

PSC staff determined through audit procedures that the costs are billed to affiliates at fully distributed cost. (This does not mean that the staff agrees with the % used for the Return on Investment included in Fully Distributed Costs. This is addressed in BCI Disclosure 4.

"Support Costs"

PSC staff understands the need for support services to a sales organizations and realizes that there are many methods of allocation of these support services within a sales organization.

The types of "support cost" charges for ratemaking purposes are being addressed in BCI Disclosure 3.

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Allocation to Regulated and nonregulated.

PSC staff has analyzed the sampling method used to allocate both the "Support Costs" and "Premises Sales" costs to regulated and nonregulated and has certain questions regarding the method. These are addressed in BCI Disclosure 2.

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SCHEDULE FOR BCI DISCLOSURE 1

ANALYSIS OF BCI BILLING FOR 1992

STATE	REG	[redacted]	TOTAL	%REG TO TOTAL
ALABAMA	17,512,260	423,345	17,935,605	97.6396%
FLORIDA	50,936,339	1,667,113	52,603,452	96.8306%
GEORGIA	39,076,582	934,180	40,010,752	97.6652%
KENTUCKY	8,349,644	288,749	8,638,393	96.6574%
LOUISIANA	19,758,015	125,663	19,883,678	99.3680%
MISSISIPPI	8,807,082	329,645	9,136,727	96.3921%
NORTH CAROLINA	24,167,481	357,561	24,525,042	98.5421%
SOUTH CAROLINA	13,185,474	293,793	13,479,267	97.8204%
TENNESEE	23,219,279	786,149	24,005,428	96.7251%
	205,012,166	5,206,178	210,218,344	97.5234%

TOTAL BILLING FROM BCI TO ALL AFFILIATES	258,470,525
TOTAL BILLING TO BST REG AND NONREG	210,218,344
% BILLED TO BST REG AND NON REG FOR MARKETING	81.3317%
TOTAL BILLING FROM BCI TO ALL AFFILIATES	258,470,525
TOTAL REG BILLING TO BST MARKETING	205,012,066
	79.3174%

SOURCE: BCI 1992 BILLING SUMMARY

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BCI AUDIT DISLCOSURE 2

SUBJECT: METHODOLOGY FOR SAMPLING PREMISES SALES HOURS

STATEMENT OF FACTS:

In order to determine the products sold and the regulated and deregulated hours spent by BCI Premises Sales Representatives during a particular month, BCI uses an Interview Method. This is used instead of positive time reporting of each marketing sales representative every day.

According to the 1992 Interview Sampling Methods and Procedures, "The 1992 Sampling method conducts field interviews with thirty-three percent of Account Managers, Account Executives, System Designers, Service Consultants, Vendor Account Coordinators, and miscellaneous Premises Marketing Sales titles on a monthly basis. These interviews are designed to capture..." the time spent by the Marketing Sales Representatives.

There are six interviewers covering the following areas:

- North/South Carolina
- Kentucky/Tennessee
- Florida
- Alabama/Mississippi
- Louisiana
- Georgia

PSC staff interviewed Mr. Bob Jones, the interviewer for Florida, Mr. Raul Martinez, a Premises Sales Account Executive, and Ms. Dottie King, who runs the data base of BCI Premises Sales personnel and the mechanized program to select the sample for interview each month. Along with that, the 1992 Interview Sampling Methods and Procedures and Internal Audit Working Papers of Marketing Time Reporting, BCI, Premises Sales, Finance; November, 1992 (L20-24-14-SF) were reviewed by staff. The results of these procedures are described below.

Selection of Sample
-------- --------

The Premises Sales employee data base is updated as necessary. All employees are assigned a number 1,2, or 3 to make sure all employees are chosen in the three month period for an interview. The selection is made by a mechanized program. Internal Audit stated that "Controls over employee sample selection were satisfactory."

Notification of Premises Sales staff of interview.
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Mr. Jones receives a list monthly from Dottie King for the people he has to interview for the month. Mr. Jones sends out a memo to those he intends to interview a day or two before the end of the month. He instructs them to bring all time sheets, calendars and any supporting documentation from the first to the month up to the date of interview. He tells them what day they will be interviewed.

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The Premises Sales employees only keep documentation until the date of interview, i.e. he lets them know the first of the month that they will be seen that month and tells them in the same memo on what day they are scheduled for interview.

As of 1993 the interview months starts the 10th of the month to the 10th of the next month. Reports are finished before the 10th of the month. In 1992 it was the 5th of the month, there was no time to edit or to check possible errors.

Selection of Week to Interview Employee by Interviewer

Mr. Jones abstracts a week to be sampled when he goes to the interview, he does not let them know in advance what week he will sample, but they do know what month will be sampled. He captures five work days and if the employees works over the weekend, captures those days.

Internal Audit findings stated that:

Internal Audit stated in their workpapers that "This predictability may compromise the reliability of the data being reported."

They also stated in their workpapers that:

Internal Audit findings:

Post Audit Dicussions said that other methods to achieve a more random selection of weeks would be investigated, and that interviewers could no longer preview records.

PSC staff asked if other methods have been investigated. In answer to our request 2-127, part B, the company stated that "... in a given month, a minimum of 10 calendar days would elapse before the seven-day period sample was selected. Also, interviewers are now not allowed to begin interviewes until after the 10th workday, as compared to previous requirement of 3rd workday." "Both these changes allowed for a more random selection of weeks by increasing the days to be included in the population from which the sample is selected." This was done in November, 1992. This also agrees with our interview with Bob Jones where he stated that the interview month runs from the 10th to the 10th of the next month for 1993.

The company said that no other options were considered or documented due to the administrative burdens.

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In answer to our questions at the interview regarding how the Premises Sales Representatives plan their work, Mr. Jones stated that they do a plan at the beginning of the year, but that does not mean they adhere to that. For small businesses, he said that they project what services they think they can sell. He also said account executives and account managers can plan a week in advance what they are going to do.

Mr. Raul Martinez, an account executive, confirmed that he does plan in advance. He has a form and looks at all customers listed and is constantly reviewing this. He sees customers on a three to six month cycle. Also, at the beginning of the month, he has a plan of who he will see.

The Interview

There is a sample selected from each district every month.

At the interview, Mr. Jones asks what the Premises Sales Representatives do and walks through the entire day and checks the employees documentation to see if corresponds.

Employee documentation per the Internal Audit report.

According to the Internal Audit,

Per Internal Audit,

Mr. Raul Martinez, an account executive told us that he keeps a daily log with his appointments, a sheet of incoming calls with who called and what was discussed. He stated that he keeps detailed documentation for the month he is going to be interviewed and other documentation all years, not as detailed.

The interviewer, using the translation table included in the 1992 Sampling Methods and Procedures, translates the work done by the employees to codes which reflect what work was done and whether it is regulated or nonregulated.

Internal audit found that

A follow up memo from Anne Marie Sparrow, BCI, Business Markets division dated December 14, 1992 presented corrective actions. The log prepared by the interviewer will be compared with the employee's

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daily documentation for consistency; and the interviewers will make sure there is enough description on the log to know what activity was done.

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At the end of interview, Mr. Jones adds up time to make sure seven hours or more are in each day. Mr. Jones keeps copy of documentation in 1993. In 1992 the individual district has it.

Mr. Jones prepares a summary report of the district and reviews this with the District Manager. He also prepares a state report and this is distributed appropriately.

There are approximately 330-345 interviews in Florida every three months.

OPINIONS:

Selection of Sample

It appears from our interview with Dottie King, and Internal Audit report that the selection of the employees to be audited in any three month period is made on a random basis and includes the entire universe.

Since every employee has to be selected within a three month period, those that are not selected in the first two month automatically know that they will be selected in the third month.

Selection of Week to Interview Employee by interviewer

It appears that in 1993 the interviewer notifies the Premises Sales Representatives approximately 10 days before they have to start keeping records for the month that a week will be sampled from.

It also appears that the account managers and account executives can plan their work a week in advance.

Based on the way the Account Managers and Account Executives can plan their work a week in advance, it is possible that even though they do not know what week will be selected for interview, to bias the sample by planning each week in the month period a certain way.

From discussions with Bob Jones, the service consultants and systems designers support the account managers and executives. So, their time would probably follow accordingly.

The Interview

Although staff has problems with the selection technique of sample and selection of week used for the Premises Sales Representatives, staff believes that the consistency of having one person, who is knowledgable and experienced, code each employee in each district of a state will lead to reliability of data.

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However, there should be more checks and balances on the final product of one interviewer. There is always a possibility of bias when one person is interpreting the data.

Filling out the logs with narratives that are complete and compatible with employees documentation is important for an audit trail and should be tested in 1993 to see if it is being done. PSC staff had planned to test this, but time limits precluded us doing this.

RECOMMENDATION:

There should be more checks and balances on the final product of one interviewer. As a possibility, the person interviewed, along with the District Manager should be reviewing the final product. Another possibility is using more interviewers for each state and the interviewers alternating districts monthly.

BCI AUDIT DISLCOSURE 3

SUBJECT: TYPES OF EXPENSES AT BCI

I. STATEMENT OF FACTS -- RELOCATION EXPENSES:

According to the trial balance for BCI there was $2,452,548 in account 735, employee relocation expenses. The company explained in 2-126.1 that these expenses are to reimburse employees for moving expenses. We did not request the invoices backing up this account.

According to the information supplied to us in answer to 2-126.1, there were 111 employees relocated in 1992. Per the company, employees are relocated to fill vacancies created. Relocations are typically the result of a retirement, reorganization, termination, promotion or transfer. The total cost of these 111 relocations was $2,452,547.76.

In answer to our request to determine how much gets allocated to each state and to regulated and nonregulated, the company states that because BCI allocated by cost pool rather than by account number, they were unable to answer that question.

The company stated that there were 33 relocations through Sept. 15, 1993 with two more scheduled for October. The Company has no way of determining if they will need further relocations for 1993. Time limits precluded us from determining the amount of the 33 relocations for 1993.

The Florida Public Service Commission Digest of Regulatory Philosophies, Communications Department, describes the philosophies expressed in ratemaking proceedings. Regarding extraordinary expenses, the Digest states that " some extraordinary, nonrecurring test year expenses are normalized, other are disallowed. FPSC Order 8330, issued 6/2/78 states that "Elimination of nonrecuring rental, moving ... are proper adjustments to test period figures."

OPINION:

It appears that there are many more relocations in 1992 than there were in 1993. There were 111 relocations in the amount of $2,452,547.76; for an average amount of $22,095.03 per relocation.

Applying this amount to the 33 thus far in 1993 and the two scheduled would equal $729,135.99 thru October 1993. Dividing 35 by 10 = 3.5 relocations per month. Adding seven more relocations for the months of November and December brings the average amount for locations in 1993 to $927,991; that is 42 times $22,095.03.

The amount for 1992 less the Staff estimated amount for 1993 equals $1,524,557. This could be considered a nonrecurring amount for 1993 ($2,452,548 less $927,991).

RECOMMENDATION:

Remove $1,524,557 from account 735 for 1992. As the Company cannot tell us how much went to each State and how much to regulated and deregulatd, staff used the 1992 billing amounts to determine how much was charged in total to all affiliates, to BST, to each state and then to regulated and nonregulated. Rather than use the BST percent for Account 6612 to allocate to each state, staff used a ratio of % to total for each state to total states. This is because the allocations are performed for each state at BCI before the bills goes to BST or the states.

The amount for all nine states is 1,239,848.13, the amount for Florida is $310,275, the amount for regulated is $300,442, and the amount for intrastate is $227,024. See Schedule following this Disclosure for calculations.

II. STATEMENT OF FACTS -- CONTRIBUTIONS, MEMBERSHIPS, MATCHING GIFTS AND TUITION AID.

Included in the 1992 Florida Rate Case Adjustments is an Adjustment called OTHER REGULATORY ADJUSTMENTS. This adjustment *excludes the following amounts:*

	FL	Reg %	Reg Amount	Intra %	Intra Amount
Charitable Contributions charged to Fl from BCI for 1992	2,559	93.30%	2,388	75.58%	1,805
Service Memberships and Social Memberships to Fl from BCI for 1992	8,110	93.30%	7,567	75.58%	5,719
			9,954		7,523

There are accounts listed in the BCI Transaction Journal (Sequence 10) whose names indicate that they might not be reasonable for ratemaking purposes. These Accounts are Account 737.1, Service Organizations, Account 737.2, Social Organizations, Account 756, Contributions, Account 756.4, Matching Gifts, and Account 721.51, Tuition Aid.

The description of Account 737.1 ...."includes fees and dues, such as entrance or initiation fees and annual, quarterly or monthly dues assessed by service organizations." The total amount for 1992 in this account is $17,308.

The description of Account 737.2 ..."includes fees and dues, such as entrance or initiation fees and annual, quarterly or monthly dues assessed by social organizations. Luncheon club dues should also be charged to this account." The total amount for 1992 in this account is $20,502.31.

The description of accunt 756 ..." includes cost of all corporate contributions for civic, educational, charitable, or social reasons. Contributions include donations of cash, equipment or materials." The total amount for 1992 is $11,833.76.

The Company provided us with a explanation of the Matching Gifts Program. BellSouth will match personal contributions between $25 and $2,500 per individual to "...educational institutions at a 2:1 ratio...maximum $5000." "... cultural organizations will be matched on a 1:1 basis up to $1,000 per individual." The total amount for 1992 is $37,913.17.

The description of Account 721.51 includes ..."tuition and reimbursements made to employees and for payments made directly to educational institutions on behalf of employees." There is a total of $122,156.82 in this account in 1992.

The Florida Public Service Commission Digest of Regulatory Philosophies, Communications Department, describes the philosophies expressed in ratemaking proceedings. Regarding Membership Fees and Dues, "Social and service club dues are not proper for ratemaking expenses (including dues paid to the area Chamber of Commerce.)" FPSC Order No. 10449 issued 12/15/81 states "... amounts associated with membership fees and dues ... exclude them from rate case."

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Also, "Charitable contributions are currently disallowed as a ratemaking expense." FPSC Order No. 10418, issued 11/23/81 states that contributions "... should be from the company and its stockholders and not the ratepayers."

OPINION:

The 1992 Florida Rate Case adjustment removes $9,954 for Florida Regulated and $7,523 for Florida Intrastate.

Staff's calculation for Service, Social, and Charitable Contributions agrees with the 1992 Rate Case Adjustment. This is included here for the other states involved in the Florida audit. Staff's calculation from BCI books is on the schedule following this disclosure.

PSC staff believes that the Matching Gift Program should be included along with Social, Service and Charitable Contributions to be removed from the Rate Case. This is not an expense that would benefit the ratepayer.

	ALL OF BCI	Note 1 % TO BST	AMOUNT TO BST	Note 2 % TO FL	AMOUNT FLORIDA
ACCOUNT 765.4					
MATCHIN	37,913	81.33%	30,835	25.02%	7,715

Note 3 % TO REG	AMT TO FL REG	Note 4 % INTRA	INTRA REG
96.83%	7,470	75.58%	5,646

Note 1 --This percent calculated in thschedule to Part I of Disclosure 2
Note 2 -- This percent calculated in the schedule to Part I of Disclcsure 3 (based in ratio % of total to each state because the amounts are allocated to the States at BCI before the bill goes to BST.
Note 3 -- This percent calculated in the Schedule to Part I of Disclosure 3.
Note 4 -- This is the amount used in the 1992 Rate Case Adjustment.

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PSC staff also questions the Tuition Aid Expense. Time limits precluded us from determining the types of tuition that are included in this account. If the education aids the employee to become more proficient and efficient in their jobs, then we believe this should be allowed for ratemaking. If not, this should be disallowed.

	ALL OF BCI	Note 1 % TO BST	AMOUNT TO BST	Note 2 % TO FL	AMOUNT FLORIDA
ACCOUNT 721.51					
TUITION AID	122,157	81.33%	99,350	25.02%	24,857

Note 3 % TO REG	AMT TO FL REG	Note 4 % INTRA	INTRA REG
96.83%	24,069	75.54%	18,182

RECOMMENDATION:

Along with the Service Dues, Social Dues, and charitable contributions remove the Matching Gifts Program Amounts from the rate case expense in the above amounts. Also, consider removing the Tuition Aid Program after determining the benefits of these tuition payments.

III. STATEMENT OF FACTS -- NONRECURRING EXPENSE

19 One of the vouchers in the sample selected was to paid to
20 in the month ending 7/31/92. This was recorded in Account 899, Other Expense on the BCI books.

22 The source documentation shows that signed a release to discharge Souther Bell Telephone and Telegraph Company for any and all present and future
24 liability for telephone number In return, SBT would have to
25 credit with

26 From correspondence supplied to us, it appears that was billed in November, 1990 for calls they did not make and these were possibly fraudulent calls.

The Florida Public Service Commission Digest of Regulatory Philosophies, Communications Department, describes the philosophies expressed in ratemaking proceedings. Regarding extraordinary expenses, the Digest states that "some extraordinary, nonrecurring test year expenses are normalized, others are disallowed. FPSC Order 7419, issued 9/3/76 states that "a host of nonrecurrngand out of period expenses are properly excluded."

OPINION:

34 Included in Account 899 is for an expense that appears to be nonrecurring and applies to 1990 dollars.

From our sample, we cannot tell whether the remainder was paid to or a credit was issued, or a settlement was made for just the $. Time limits precluded further investigation.

RECOMMENDATION:

Remove $ from account 899 for 1992. As the company cannot tell us how much went to each State and how much to regulated and deregulated. Staff used the 1992 billing amounts to determine how much was charged in total to all affilaites, to BST, to each state and thant to regulated and nonregulated.

ADJUSTMENT FOR SETTLEMENT TIME % OF 1992 BILLING TO BST	81.33%
AMOUNT TO FLORIDA 25.03%	25.03%
AMOUNT TO FLORIDA REG	96.83%
AMOUNT TO FLORIDA INTRA	75.53%

IV. STATEMENT OF FACTS -- OUT OF PERIOD EXPENSES

A. SEMINAR EXPENSE

Included in Account 734, Employee Business, Training and Education, are two payments to Telecommunications Research Associates; each in the amount of $. These were paid in the months ending 5/31/92 and 12/31/92.

According to Source doucmentation both payments were for nine on-site presentations for State Government Training Seminars. Per conversation with a BST employee, the employees involved with Government Compliance around the states.

The source documentation to the voucher paid in the month ending 5/31/92 included that these on-site seminars were to be furnished in 1992. The voucher that was paid in the month ending 12/31/92 did not specify a year. Further conversation with a BST employee revealed that the voucher paid in the month of 12/31/92 was for presentation to be made in 1993.

According to the Trial Balance (Sequence 10) these vouchers were booked as follows:

	RC CODE	AMOUNT
5/31/92	POBO370	
12/31/92	POBO300	

The organization chart shows that FOBO3000 is a cost pool that is called Regulated, and allocated based on regulated sales hours. This is not the Government Compliance Cost pool.

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B. PRESIDENTS CLUB

Included in the sample selected was a charge in Account 899 in the amount of $52,000 to "Reflect the 1991 Presidents Club Properly on the books".

Also, included in the sample was a charge of $158,000 accruing for 1992 President's Honors.

The Florida Public Service Commission Digest o egulatory Philosophies, Communications Department, describes the philosophies expressed in ratemaking proceedings. Regarding extraordinary expenses, the digest states that "some extraordinary, nonrecurring test year expenses are normalized, others are disallowed. FPSC Order 7419, issued 9/3/76 states that "a host of nonrecurring and out of period expenses are properly excluded..."

OPINION:

18 A. Included in Account 734 is for an expenses that appears to be applicable to 1993.

B. Included in Account 899 is $52,000 for an expense that appears to be related to 1991.

RECOMMENDATION:

23 A. Remove from Account 734 for 1992 for charges applicable to 1993. As PSC staff did not have the total amount of hours for the year, staff estimated the adjustment based on the dollars of regulated to nonregulated as in prior recommended adjusments.

B. Remove $52,000 from Account 899 for 1992. As the company cannot tell us how much went to each State and how much to regulated and

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deregulated. Staff estimated the adjustment based on the dollars of regulated to nonregulated as in prior Audit Disclosures.

	A. SEMINARS	B. PRES CLUB
ADJUSTMENT FOR 1993 EXPENSE		52,000
TIMES % OF 1992 BILLING TO BST	81.33%	81.33%
		42,292
AMOUNT TO FLORIDA	25.03%	25.03%
		10,586
AMOUNT TO FL REG	96.83%	96.83%
		10,250
AMOUNT TO FLORIDA INTRA	75.53%	75.53%
		7,742

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SCHEDULE FOR PART I OF BCI DISCLOSURE 3

TOTAL BILLING FROM BCI TO ALL AFFILIATES	256,470,525
TOTAL BILLING TO BST REG AND NONREG	210,218,344
% BILLED TO BST REG AND NON REG FOR MARKETING	81.3317%

SOURCE: BCI 1992 BILLING SUMMARY

AMOUNT OF RELOCATIONS (FOR 1993 THROUGH OCT 14)	33
SCHEDULED RELOCATIONS FOR NEXT TWO MONTHS OF 1993	2
	35
DIVIDE 35 BY	10
ESTIMATED RELOCATIONS PER MONTH	3.5
TIMES TWO MONTHS LEFT	7
APPROXIMATE RELOCATIONS IN 1993	42

AMOUNT OF RELOCATIONS FOR 1992	111
TOTAL AMOUNT	2,452,548
APPROXIMATE AMOUNT FOR RELOCATION	22,095.03
TIMES	42
	927,991.26
TOTAL IN ACCOUNT 735 1992	2,452,548
NONRECURRING AMOUNT	927,991
ADJUSTMENT TO ALL OF BCI	1,524,557

ADJUSTMENT FOR RELOCATION EXPENSES	1,524,557.00
TIMES % OF 1992 BILLING TO BST	81.3317%
	1,239,948.13

ANALYSIS OF BCI BILLING FOR 1992

STATE	(1) REG	(2) DEREG	(3) TOTAL	(4) %REG TO TOTAL	(5) %STATE TO TOTAL	(6) (5)*1,181,501 AMOUNT TO STATE	(7) (6*4)
ALABAMA	17,512,260	423,346	17,935,605	97.6396%	8.5319%	105,791	103,294
FLORIDA	50,936,339	1,667,113	52,603,452	96.8306%	25.0232%	310,275	300,442
GEORGIA	39,076,592	934,160	40,010,752	97.6652%	19.0329%	235,999	230,489
KENTUCKY	8,349,644	[illegible]	8,636,393	96.6574%	4.1092%	50,953	49,249
LOUISIANA	19,758,015	[illegible]	19,883,578	99.3680%	9.4586%	117,282	116,540
MISSISSIPPI	8,807,062	[illegible]	9,136,727	96.3921%	4.3463%	53,892	51,948
NORTH CAROLINA	24,167,481	[illegible]	24,525,042	98.5421%	11.6665%	144,658	142,549
SOUTH CAROLINA	13,186,474	[illegible]	13,479,267	97.8204%	6.4120%	79,506	77,773
TENNESEE	23,219,279	[illegible]	24,005,428	96.7251%	11.4193%	141,593	136,956
	205,012,166	[illegible]	210,218,344	97.5234%	1		
ADJUSTMENT FOR RELOCATION EXPENSES						1,239,948	

SOURCE: BCI BILLING SUMARY

SCHEDULE TO PART II OF BCI DISCLOSURE 3
PSC STAFF CALCULATION OF RATE CASE ADJUSTMENTS

	ALL OF BCI	Note 1 % TO BST	AMOUNT TO BST	% TO FL	AMOUNT FLORIDA	% TO REG	AMT TO FL REG	% INTRA	INTRA REG
1992									
ACCOUNT 737.1									
SERVICE	17,308	81.33%	14,077	25.02%	3,522	96.83%	3,410	75.58%	2,578
ACCOUNT 737.2									
SOCIAL	20,502	81.33%	16,674	25.02%	4,172	96.83%	4,040	75.58%	3,053
ACCOUNT [illegible]									
CHARITABLE									
CONTRIB	11,834	81.33%	9,625	25.02%	2,408	96.83%	2,332	75.58%	1,762
					10,102		9,782		7,393

Note 1 --This percent calculated in the schedule to Part I of Disclosure 3.
Note 2 -- This percent calcualted in the schedule to Part I of Dislcosure 3 (based on ratio % of total to each state because the amounts are allocated to the states at BCI before the bill goes to BST.
Note 3 -- This percent calculated in the Schedule to Part I of Dislcosure 3.
Note 4 -- This is the amount used in the 1992 RateCase Adjustment.

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BCI AUDIT DISLCOSURE 4

SUBJECT: RETURN ON INVESTMENT

STATEMENT OF FACTS:

The fully distributed cost figures that BCI uses to bill affiliates contain 15.76% return on investment as follows:

	1992 BILLING BEFORE ROI	1992 BILLING AFTER ROI	DIFF ROI 1992
BST REG AL	17,323,087	17,512,260	189,173
BST REG FL	50,371,489	50,936,339	564,850
BST REG GA	38,637,466	39,076,592	439,126
BST REG KY	8,256,708	8,349,644	92,936
BST REG LA	19,545,734	19,758,015	212,281
BST REG MS	8,713,909	8,807,082	93,173
BST REG NC	23,901,032	24,167,481	266,449
BST REG SC	13,044,030	13,185,414	141,384
BST REG TN	22,959,734	23,219,279	259,545
BST NON REG AL	418,105	423,345	5,240
BST NON REG FL	1,649,569	1,667,113	17,544
BST NON REG GA	922,773	934,160	11,387
BST NON REG KY	285,879	288,749	2,870
BST NON REG LA	124,118	125,663	1,545
BST NON REG MS	325,998	329,645	3,647
BST NON REG NC	353,811	357,561	3,750
BST NON REG SC	290,111	293,793	3,682
BST NON REG TN	777,237	786,149	8,912
BST TOTAL	207,900,790	210,218,284	2,317,494

OPINION:

A lower rate of return could reduce the amounts billed to each affiliate and in turn reduce the amount included in regulated activities.

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BCI DISLCOSURE 5

SUBJECT: BELLSOUTH BUSINESS SYSTEMS, INC.

STATEMENT OF FACTS:

According to the 1992 Cost Allocation Manual, BellSouth Corporate Structure; BellSouth Business Systems (BBS) is a subsidiary of BellSouth Telephone (BST). BellSouth Communications, Inc. (BCI) is a subsidiary of BBS.

It was explained in an interview with BCI employees, that there are no employees in BBS. BCI employees provide staff for BBS. All the executives in BBS are paid out of BellSouth Corporation and are billed to BBS subs. The executives are assigned to BBS.

Part of the allocation process within BCI is allocating dollars to BBS, that parent of BCI and then allocating part of these dollars back to BCI and part to other BBS subsidiaries. The other subsidiaries are DataServ, BellSouth Communications Systems, Inc, and BellSouth Financial Services Corp. Inc.

BSE AUDIT DISCLOSURE 1

SUBJECT: BELLSOUTH ENTERPRISES' (BSE) BILLING TO NONREGULATED SUBSIDIARIES

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STATEMENT OF FACTS:

GENERAL

According to BSE Acounting Directive 005, Section 5.01 chaining is defined as follows: "When a carrier obtains an asset or service from a nonregulated affiliate that has obtained the asset or service from another nonregulated affiliate."

Section 5.02 says that BSE requires all intercompany transactions comply with the Joint Cost Order because costs that are included in chaining transactions that are several layers removed from the ultimate destination can be difficult to identify.

BSE Account Directive 008, Section 1.01 presents the rules for pricing goods and services transfered between regulated carriers and their nonregulated affiliates. "If no prevailing market rate exists, the price charged to the regulated affiliate must be based on the JCO fully distributed costing standards (FDC)."

BSE does not bill BST directly. BSE bills their nonregulated subs and in turn, according to the Cost Allocation Manual at 12/31/92, the nonregulated subs bill BST at fully distributed cost, market or tariff, etc. whichever applies.

BSE bills their subsidiaries a management fee. This fee is of the subsidiaries operating expenses (operating expenses less cost of goods sold, depreciation and management fee). The total management fee billed to subsidiaries for 1992 was

In order to determine if the management fee is less than FDC, BSE calculated what FDC would have been if it had been used. BSE calculated that FDC was $ for 1992.

As explained by the company, FDC is calculated as follows: BSE costs that are not project coded or retained are compiled by Responsibility Code (RC). These costs are then allocated to all subsidiaries based on subsidiary operating expenses, salary costs, marketing costs or equity and debt.

For example, the total costs at BSE associated with Human Resources that are not project coded or retained are compiled under Responsibility Codes U12100 to U12500. The total of these costs are allocated to all BSE subs based on the subsidiaries salary expenses.

The Company explained that the work activities in the Human Resources RC's include "developing and administering benefits and compensation for officers, key managers, and other employees ... directing planning activities for established companies ... developing, implementing and coordinating po... s and monitoring activities affecting all BSE international operations and

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locations ... developing and implementing quality programs at BSE Headquarters and within all BSE companies ..."

Total Marketing costs at BSE that are not project coded or retained are compiled under Responsibiltiy Codes U61E00 to RC's U61340. The total of these costs are allocated to all BSE subs based on the subsidiaries marketing costs.

The company explained that the work activities in the Marketing Group includes "...*providing corporate oversight* for marketing functions within all BSE subsidiaries... providing subject matter expertise on marketing issues for BSE's subsidiaries ... coordinating *efforts of* BSE *subsidiaries'* marketing organizations ... coordinating BSE subsidiaries' national accounts efforts... "

The same concepts are used for all RC's that are not project coded or retained.

PSC *staff addressed six areas of* BSE billing to Nonregulated Subsidiaried. They are as follows: Companies billed the Management fee vs. companies used to calculate FDC, BSE Income *Statement Reconciliation*, Management Fee, FDC Calculation, Companies billed a Project Fee, Types of Expenses at BSE Headquarters.

Each will be described separately with an opinion from the PSC staff. Finally, a conclusion and recommendation on all areas will be found at the end of this disclosure.

I. COMPANIES BILLED THE MANAGEMENT FEE VS. COMPANIES USED TO CALCULATE FDC.

BSE subsidiaries billed a management fee were: Mobile Data, BellSouth Advanced Networks (BSAN), BellSouth Information Network (BIN), Sunlink, BellSouth Information Systems, Inc. (BIS), BellSouth Advertising & Publishing Corp. (BAPCO), LM Berry, Stevens Graphics, Techsouth, Bellsouth Cellular, BellSouth Mobile Data, Inc. (BMD), Mobile Communications Corporations of America and affiliates (MCCA), International Operations Group, and BellSouth *Financial Services Corp (FINS).*

In calculating the FDC, the above *companies were included along with those* that were not billed a management fee in 1992. These companies were: Marketing Program, Executive Services, Data Service Financial Services, Inc. (DFINS), Corporate Health Network (CHN), Scientific Software, Inc. (SSI), Intelligent Messaging Services Inc. (IntellMssg), Dataserv International, Intelligent Media, Worldwide Wireless Trials (WWW), Retained Costs at BSE and Miscellaneous costs at BSE.

The Company states that BSE does not bill management fees to companies "...which fall within the following general *categories: (1) corporate* development entities, (2) recent acquisitions, (3) international joint venture investments/internationally wholly owned subs..."

OPINION:

BSE did not use the same companies to calculate the FDC as they billed a Management Fee. They are not using the same basis for comparison of whether billing FDC or fees.

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II. BSE INCOME STATEMENT RECONCILIATION

Part of BSE's billing to their subs includes Projects that are specifically coded to the subs for which the work was being performed. This is in addition to the Management fee. BSE also retains certain costs at headquarters that are not billed as Project costs or considered part of the FDC calcualtion.

In order to determine that all costs are used in the FDC calculation, BSE prepared an income statement reconciliation. All costs at BSE are reconciled here to the Trial Balance. These costs are Project Coded Costs, Total Expenses Allocated for FDC, and Costs Retained. BSE has objected to us having access to their financial records to verify these costs.

OPINION:

Because we did not have access to BSE financial records, we could not determine whether the Income Statement Reconciliation to the Trial Balance was correct.

III. MANAGEMENT FEE

In order to substantiate the management fee billed to each subsidiary, PSC staff requested financial statements for all BSE subsidiaries whether billed a management fee or not for December, 1992. The Company objected to providing the financial statements for all BSE subsidiaries.

OPINION:

If we cannot substantiate the basis for the management fee billed to each subsidiary through the income statements, we do not know whether the amounts that are eventually billed (chained through)to BST from the nonregulated subsidiaries are reasonable. All subsidiaries would have to be billed on the same basis.

IV. FDC CALCULATION

As explained by BSE, BSE costs that are not project coded or retained are compiled by Responsibility Code (RC). These costs are then allocated to all subsidiaries as listed above based on allocation factors.

The primary allocation factors for calculating FDC cost are subsidiary operating expenses, salary costs, marketing costs, and equity and debt.

PSC staff requested documentation for the allocation factors. We were able to see at company premises, without writing down numbers, the income statement for BSE. Staff traced the operation expenses used in the FDC calculation for BIS, BSAN, Sunlink and Data Serv International to the Income Statements. Marketing Expenses for BIS and Stevens Graphics were tied to "BSE Maketing Costs for year end 12/31/92". Again we were able to see this schedule at company premises, without writing down numbers. The subsidiary salary expense was traced for BIS and Graphics to "BSE Salary Costs for Year end 12/31/92.". We were able to see this schedule on company site, without writing down numbers.

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OPINION:

The allocation procedures to determine FDC might seem reasonable, but if we cannot audit the subsidiary amounts underlying the allocations, we cannot draw a conclusion on the calculation of the FDC.

V. COMPANIES BILLED A PROJECT FEE

BSE provided us with two formal contracts. One is for BSE, Inc. as agent for BellSouth Mobility, Inc. and American Cellular Communications Corp with BST. The second contract was for BSE, Inc. with BST.

We also requested agreements that BSE has with its nonregulated subsidiaries. We were supplied with agreements in the form of Project Descriptions, Project Budgets and Approval Forms, for only those BSE subsidiaries that bill BST at fully distributed cost (FDC). The company objected to providing agreements with BSE subsidiaries that did not bill BST at FDC.

Staff reviewed the Project Descriptions and Project Budgets and Approval forms, for the projects supplied to us. Many of the projects were allocated 100% to the particular subsidiaries that chain into BST, however, seven out of 31 projects reviewed, allocated parts to different subsidiaries. The parts that are allocated to subsidiaries that don't chain into regulation were not included. A list of these seven Projects follows this disclosure.

OPINION:

In order to obtain a complete picture of the amounts that are chained into the regulated entities from BSE nonregulated subsidiaries, in our opinion it is necessary to know how the determintion of billing to each of BSE's subs is arrived at. If the agreements we receive that are with the BSE subs that bill BST at FDC are equitable; we still do not know if BSE subs that do not bill BST are handling their fair share of projects where the project is allocated between subs chaining into BST and subs not chaining into BST.

By withholding these agreements and how the amounts to these other subs are arrived at, the staff cannot draw a conclusion that the amount that is chained into regulation is reasonable.

VI. TYPES OF EXPENSES AT BSE HEADQUARTERS.

BSE objected to our requests for Financial statements, Cumulative General Ledger, Cumulative Transaction Ledger, and Chart of Accounts as of 12/31/92; and a printout of all disbursements over $50,000 during 1992.

Without these financial records, we did not have information that would facilitate the selection of a sample of expenses items.

PSC staff reviewed an Internal Audit of "1992 Officer Expense Review -- BSE All Departments." The audit revealed certain expenses that were questionable for ratemaking purposes. See BSE Audit Disclosure 3 for details.

OPINION:

Because we could not have access to BSE's books, we could not select a sample to determine the types of exepnses, whether they are reasonable for ratemaking, whether reasonable to include in the FDC calculation, and what types of expenses are theoretically in the management fee.

CONCLUSION

BSE is not using the same number of companies in comparing FDC with the Management Fee. We cannot audit the amounts that make up the income reconciliation, we cannot substantiate the amounts that are used to calculate the management fee, we cannot audit the amounts that make up the FDC calculation that is used to determine whether BSE is billing at FDC or less, we cannot audit the expenses on the books of BSE, and we cannot determine in some of the projects how the project billing is established.

Because of this we cannot determine whether the FDC calculation is reasonable for ratemaking and whether the management fee is billed to all subs equitably, and therefore, whether the comparison of FDC to management fee is reasonable. We also cannot draw a conclusion that the amount of project billing chained into regulation is reasonable.

RECOMMENDATION:

Disallow the amount of management fee and project billing amounts that are chained through to BST because of billings from BSE subsidiaries. BSE Audit Disclosure 2 addresses the amounts of potential chaining to BST.

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SCHEDULE TO BSE AUDIT DISCLOSURE 1

SUBJECT: BSE AGREEMENTS WITH SUBSIDIARIES -- SCOPE LIMITATION

Project number	Department/Subsidiary Billed
ES6090	Accounting Methods and Procedures--Sunlink, BSFin Svs, BSAN, BIS
ES6100	Human Resources — BSAN, BIS, BAPCO, Berry Co., Stevens Graphics
ES8198	Human Resources--Stevens Graphics, BSAN
ES8199	Human Resources--BaPCO, Sunlink, BIS
ES8200	Human Resources -- BIS, Stevens Graphics, BAPCO, BSAN
ES8201	Human Resources -- Sunlink
ES8212	Human Resources -- Stevens Graphics, BIS, Sunlink, BAPCO, BSAN

This is 7 projects out of 31 that we do not have full amounts of allocation; that is 23%.

BSE AUDIT DISCLOSURE 2

SUBJECT: CALULATION OF POTENTIAL CHAINING INTO REGULATION

STATEMENT OF FACTS:

In BSE Audit Disicosure 2 staff recommended that the amount of management fee and Project Billings that are chained through to BST because of billings from BSE subsidiaries and BSE affiliates be disallowed for ratemaking.

According to the information in C&L workpapers, the BSE subsidiaries that are billed a management fee and in turn bill BST at FDC are: BAPCO, BIS, MCCA, Sunlink, BSAN, BSIN, Executive Services.

Per answer to request 2-097.8, the BSE affiliates that received Project Billing that in turn bill BST at FDC are: BellSouth Corporation, BellSouth Communications, Inc., BellSouth Communications Systems, BellSouth Financial Services.

According to BSE Accounting Directive 005, Section 5.01, chaining is defined as follows: "When a carrier obtains an asset or service from a nonregulated affilaite that has obtained the asset or service from another nonregulated affiliate".

In this case BST (the carrier) receives services from nonreglated affiliates who first received services from BSE (another nonreglated affiliate).

BSE CALCULATION OF CHAINING PERCENT

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BSE calculated a Weighted Average Chaining Percent. BSE first calculated a *percent of the billing to subsidiaries* and affiliates that bill at FDC to BST; to total BSE bills to all subsidiaries and affiliates. Then BSE calculated a chaining percent for each individual subsidiary or affiliate that bills BST at FDC. The methods in general for calculating the chaining percent for each individual subsidiary or affiliate is the percent of subsidiary or affiliate expenses related to BST to total sub or affiliate expenses.

Applying the Weighted Average Concept, these percents were multiplied and a
30 weighted average was determined to be [redacted] Applying the [redacted] total BSE
31 billing to all subsidiaries and affiliates in the amount of [redacted]
equals a potential chaining of $1,298,527.

See Schedule 1 following this Disclosure.

COOPERS & LYBRAND CALCULATION OF CHAINING PERCENT

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Coopers & Lybrand (C&L) in their audit of the 1992 Cost Allocation Manual,
36 calculated the chaining percent to be [redacted] of Total BSE Headquarter Billings to All Affiliates. However, the Coopers & Lybrand calculation included some different numbers than BSE. See Schedule 2 following this Disclosure.

C&L did not use a weighted average, but applied the individual chaining amount calculated by BSE to the total Project and Management Fee billings for subs that bill BST at FDC. Total amount chained rounded is $1,702,000; that

4 is [redacted] of [redacted]

The total of project billings and management fees to all affiliates used by

6 C&L is [redacted] rather than the amount that BSE used of [redacted] C&L

7 workpapers said that [redacted] agreed to the 1992 year end total affiliated billings on BSEHQ interco trend report.

C&L also used a different amount for billings to BSC. C&L used a rounded

10 number of [redacted] while BSE used [redacted] The Company explained that the project bilings are mostly from BSEHQ to BSCHQ which are retained at BSCHQ. Only BSEHDQ potential for chaining was included in the study.

13 C&L chained BCS at [redacted] while BSE chained BCS at [redacted] C&L said that BCS was not included in the information they received from the client when they performed their analysis.

16 C&L chained BSAN [redacted] while BSE chained BSAN at [redacted]

OPINION:

C&L assumed that BSE individual chaining percents are correct and applied the percents to the individual subs or affiliates who were billed by BSE.

The method used by BSE to calculate the individual chaining percents is the percent of sub or affilaite expanses related to BST to total sub or affiliate expenses. The Weighted Average concept was applied to this.

PSC staff did not have full and free access to the subsidiary books so we were unable to determine that in general and on an individual company basis that expenses were an appropriate way at arrive at the chaining percent. Nor were we able to determine if the expenses used were correct.

We agree with C&L's calculation because it is more conservative in determining the amount of potential chaining. It takes into account the total amounts BSE billed to nonregulated subs on an individual basis, and used 100% chaining for subs that they did not have information for.

There are a certain amount of dollars that potentially chain into regulation through BSE billings to their subs and other affiliates. We cannot audit the amounts at BSE to determine if these are reasonable as stated in BSE Audit Disclosure 1. Time limits precluded us from tracing to which accounts in BST the amounts from each subsidiary were booked. Therefore, PSC staff used the general allocator to estimate the amounts to the nine states. In order to allocate the percent to Florida regulated and then to intrastate, PSC staff used the Rate Case percents for "Various" accounts. These are 93.36% and 75.58% for Regualted and Intrastate respectively. See Schedule 3 following this disclosure.

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RECOMMENDATION:

It is recommended *that* $1,702,[illegible] be removed from BST allocations to the states. The amount to Florida is $446,165, the amount to regulation is $415,338, and the amount to intrastate is $313,913.

COMPANY: BST
TITLE: BSE -- DETERMINATION OF POTENTIAL CHAINING
PERIOD: TYE 12/31/92

PREPARED BY BSE
SCHEDULE 1 TO BSE DISLCOSURE NO.

BELLSOUTH ENTERPRISES.	AMOUNTS BILLED TO BST 9 states 1992 TOTAL	AMOUNTS BILLED BY BSE PROJ AND MGMT FEE TO AFFIL	TOTAL BSE COSTS BILLED	% TOTAL BSE HQ COSTS	1992 CHAIN % AS CALC BY BSE	WEIGHTED AVERAGE
	A	B	C	D	E	F
(1) CORPORATE AND ENTERPRISE GROUP						
Sunlink Corp.	3,269,678		70,848,504	0.6430%	30.00%	0.19%
(1)CSL CHASTAIN	694,717					
(2)CSL B'HAM	9,557,626					
Bellsouth Information Systems (BIS)	3,865,357					
(2) MOBILE SYSTEMS GROUP						
Mobile Communications Corp of America and affiliates. MCCA	2,249,818					
(3) ADVERTISING AND PUBLISHING GROUP						
BAPCO	4,416,365					
(4) INTERNATIONAL AND CORPORATE AND DEVELOPMENT GROUP						
BSAN	101,083					
BSIN	0					
EXEC SERVICES	0					
BSC	99,766,526					
BCI	209,991,149					
BCS	236,217					
		19,297,258				1.83%
						70,848,504
Potential Chaining of BSE HQ billing to all Affiliates.						1,296,527

TITLE: BSE -- DETERMINATION OF POTENTIAL CHAINING
PERIOD: TYE 12/31/92

PREPARED BY C&L
SCHEDULE 2 TO BSE DISLCOSURE NO.

BELLSOUTH ENTERPRISES GROUP	AMOUNTS BILLED TO BST 9 states 1992 TOTAL	AMOUNTS BILLED BY BSE FOR PROJ AND MGMT FEE TO AFFIL	1992 CHAINING % AS CALC BY BSE	ESTIMATED CHAINING POT.
	A	B	C	D
(1) CORPORATE AND ENTERPRISE GROUP				
Sunlink Corp.	3,269,678			
(1)CSL CHASTAIN	694,717			
(2)CSL B'HAM	9,557,626			
Bellsouth Information Systems (BIS)	3,865,357			
(2) MOBILE SYSTEMS GROUP				
Mobile Communications Corp of America and Affiliates. MCCA	2,249,516			
(3) ADVERTISING AND PUBLISHING GROUP				
BAPCO	4,416,365			
(4) INTERNATIONAL AND CORPORATE AND DEVELOPMENT GROUP				
BSAN	101,083			
BSIN	0			
EXEC SERVICES	0			
BSC	99,766,526			
BCI	209,991,149			
BCS	236,217			
		19,045,194		1,702,395
				70,217,000

Potential Chaining of BSE HQ billing to all Affiliates. 2.4245%

90

Southern Bell Tel. Co.
Docket 920260
For the 12 Months ended 12/31/92
Effect of Chaining from Affiliated Companies to BST

SCHEDULE 3 TO BSE DISCLOSURE

Affiliate	Amount (A)	FL (B)	GA (C)	NC (D)	SC (E)	ALA (F)	KY (G)	LA (H)	MISS (I)	TENN (J)
BSC										
BIS										
BCI										
Sunlink										
BAPCO										
MCCA										
BCS										
BSAN										
Total	1,703,000	445,164	294,278	163,829	109,673	144,244	83,788	169,449	99,626	192,950
Per Cent Allocation										
per General Allocator		0.2614	0.1728	0.0962	0.0644	0.0847	0.0492	0.0995	0.0585	0.1133

Rate Case percents for "Various Accounts" are 93.36% for Regulated and 75.58 % for Intrastate.

Amount allocated to Florida	445164
% to Regulated	93.30%

Regulated	415,338
% to Intrastate	75.58%

Intrastate	313,912
	========

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BSE AUDIT DISCLOSURE 3

SUBJECT: TYPES OF EXPENSES AT BELLSOUTH ENTERPRISES

STATEMENT OF FACTS:

PSC staff reviewed internal audit, 821-23-39-A-S, OCTOBER, 1992 OFFICER EXPENSE REVIEW -- BSE ALL DEPARTMENTS.

This internal audit revealed three types of expenses at BSE as follows:

7 1.

2.

19 3.

BSE stated that the Financial Counseling Plan was provided to 15 officers in BSE and its subs and objected to providing the amounts paid. The answer to staff's request stated that none of the expenses are allocated to BSE subs; that BSE subs pay a managments fee based on a formula.

As to participation in Mayo Clinic Research Study, the Company says that only one employee participates in this study which involves a very small population of individuals who have a rare disease, and the expense is maintained at the BSE sub level. BSE declined to provide the dollar amounts.

The company stated that BSE tracks the cost of any spousal expenses for retention by BSE-HDQ. BSE declined to provide the requested list of expenses and objected to providing.

OPINION:

Staff contends that in order to determine if BSE is billing at FDC or less, BSE performed certain calculations and allocated certain expenses to come up with FDC and compared that to the management fee. As we could not audit the specific type of costs and determine the specific amounts, we

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cannot determine whether this was included in the FDC calculation, whether it would make an impact on the FDC calculation, and whether it is reasonable for ratemaking.

Without access to the books, we cannot determine if the costs related to the participation in the Mayo Clinic Research Study and spousal expenses are retained and immaterial.

RECOMMENDATION:

As we cannot determine if these costs are included in the FDC calculation to the subsidiaries, and we cannot determine if they are reasonable for ratemaking, the entire amount of the management fee that is chained through to BST from billings from BSE subsidiaries should be disallowed as recommended in BSE Audit Disclosure 1. BSE Audit Disclosure 2 addresses the amounts of potential chaining.

BSE AUDIT DISCLOSURE 4

SUBEJCT: COMBINATION OF BELLSOUTH ENTERPRIES HEADQUARTERS (BSE) WITH BELLSOUTH CORP HEADQUARTERS (BSC)

STATEMENT OF FACTS:

In an interview with Mike Hostinsky of BSC, he stated that BSE Holding Company staff will be disolved. BSE and BSC will be combined under BellSouth Corp. BSE will bill the management fee only to end of 1993; and no management fee will be billed for 1994. At this point in time, Mr. Hostinsky believes BSE will be a shell for legal and tax purposes.

In a "Bellsouth Report" dated November 18,1992 a question was asked "How did you arrive at one-half of 1% of the total employee work force as the number of employees who would be kept at the financial holding company headquarters?"

The answer was "Compared with several of our sister Bell holding companies, we have a significantly higher percentage of our work functions at the headquarters level. The projected corporate headquarters staff size is a goal that will bring us more closely into alignment with other similarly situated companies."

The philosophy of the employee combination per Mr. Hostinsky is, if the function is primarily an operating company function of BSE holding company, then the people will be pushed down to the business units (BSE subs). Some of the Project billing from BSE will now be at BSCHDQ. The Company is in the process now of determining the types and amounts of Projects to be performed at BSCHDQ. There will not be any Project Billing from BSE.

BSC provided us with a study made to combine the workforce of BSE and BSC headquarters. This study is called the "Gunter Study" which had two versions of the combination. Version A will leave 113 employees available for reassignment and Version B will leave 149 employees available for reassignment.

When asked, Mr Hostinsky said he did not know of any sub teams that knew the costs associated with the force reduction; that there was no cost study with dollars for the reduction. The numbers reduced in head counts flow into budgets. He also stated that there was no tracking of incremental costs for this reorganization.

OPINION:

As BSE will no longer bill a management or project billing as it is today in 1992, the costs of these fees that chain into regulation as described in BSE Disclosures 1 and 2 should not be taken into account when setting rates.

Also, as the work force will be reduced, there could possibly be further reduction in the amounts from the nonregulated affiliates that flow into BST.

PSC staff performed an anlaysis of these 113 employees and approximated that the annual amount associated with them.

Of the 113 employees, staff was able to obtain 1992 "Position Rate Figures" for certain pay grades for 66 of the employees available for reassignment. We asked for average salaries in particular pay grades, but the company said they were not readily available and supplied us with these instead.

The rest of the employees were considered nonmanagement, unsupported and other. We did not request dollars for these types of positions.

Staff calculated that the amount of the 66 employees available for reassignemnt totalled $3,483,800. See Schedule following this Disclosure for calculation.

RECOMMENDATION:

Follow up in 1994 on the costs that chain into regulation from nonrgulated affiliates including BSC. Procedures need to be set up at BSC to make sure nonregulated affiliates are getting their share of the cots.

ANALYSIS OF GUNTER STUDY
TO COMBINE WORKFORCE OF BSE AND BSC HDQ.
TYE 12/31/92

SOURCE: CONSOLIDATED TRANSITION FORCE MATRIX, VERSION A AS OF 6/30/93.

DIVISION	AVAILABLE FOR REASSIGNMENT	NUMBER	PAY LEVEL	AVG PAY	NUMBER X PAY LEVEL
PUBLIC RELATIONS	1	1	1	30,000	30,000
		1			
		1	nonmgmt		
SECRETARY TREASURER	4	2	3	44,900	89,800
		1	4	50,100	50,100
		4			
BUDGET	13	2	USP		
		3	1	30,000	90,000
		1	3	44,900	44,900
		3	4	50,100	150,300
		3	5	55,900	167,700
		1	6	73,900	73,900
		13			
COMPTROLLERS	17	6	NONMGMT		
says 25 on lead sheet		2	1	30,000	60,000
SOURCE DOC'M ONLY		3	3	44,900	134,700
SAYS 17		2	4	50,100	100,200
		2	5	55,900	111,800
		2	6	73,900	147,800
		17			
INTERNAL AUDIT AND SECURITY	2	1	NONMGMT		
		1	5	55,900	55,900
		2			

ANALYSIS OF GUNTER STUDY
TO COMBINE WORKFORCE OF BSE AND BSC HDQ.
TYE 12/31/92

SOURCE: CONSOLIDATED TRANSITION FORCE MATRIX, VERSION A AS OF 6/30/93.

DIVISION	AVAILABLE FOR REASSIGNMENT	NUMBER	PAY LEVEL	AVG PAY	NUMBER X PAY LEVEL
HUMAN RESOURCES	33	8	NONMGMT		
		3	OTHER		
		9	3	44,900	404,100
		3	4	50,100	150,300
		6	5	55,900	335,400
		1	6	73,900	73,900
		1	7	88,000	88,000
		2	8	121,500	243,000
		33			
TAX	0	0			
PLANNING	13	2	NONMGMT		
		1	USP		
		3	OTHER		
		1	1	0	
		1	3	44,900	44,900
		3	5	55,900	167,700
		2	6	73,900	147,800
		13			
LEGAL	6	5	OTHER		
		1	3	44,900	44,900
		6			
REGULATORY	0	0			
INFORMATION SERVICES	5	1	USP		
		2	1	30,000	60,000
		1	5	55,900	55,900
		1	7	88,000	88,000
		5			

ANALYSIS OF GUNTER STUDY
TO COMBINE WORKFORCE OF BSE AND BSC HDQ.
TYE 12/31/92

SOURCE: CONSOLIDATED TRANSITION FORCE MATRIX, VERSION A AS OF 6/30/93:

DIVISION	AVAILABLE FOR REASSIGNMENT	NUMBER	PAY LEVEL	AVG PAY	NUMBER X PAY LEVEL
SUPPORT SERVICES AND QUALITY	[illegible]	1	NONMGMT		
		1	OTHER		
		2	3	44,900	89,800
		1	4	50,100	50,100
		1	7	88,000	88,000
		6			
STRUCTURE	0	0			
DC	0	0			
SECURITY	0	0			
EXECUTIVE	12	5	OTHER		
		1	3		44,900
		6	OFC		
		12			
TOTAL	112	112			3,483,800
PER GUNTER LEAD SHEET	113				
DIFFERENCE UNRESOLVED	-1				

BST SAMPLE AUDIT DISCLOSURE NO. 1

SUBJECT: EMPLOYEE SERVICE AWARDS

STATEMENT OF FACTS:

The following expenses were charged to Account 6728.9 – Other General and Administrative for 1992 for service awards.

JANUARY	151,018
FEBRUARY	114,206
MARCH	211,105
APRIL	104,655
MAY	135,963
JUNE	446,693
JULY	185,979
AUGUST	219,108
SEPTEMBER	177,254
OCTOBER	167,458
NOVEMBER	127,736
DECEMBER	13,003
TOTAL	2,054,177

These expenses represent the charges related to invoices from O.C. Tanner for anniversary service awards. The following page details the types of awards based on the service level. The amount for the month of June appeared in the sample selected by staff.

AUDIT OPINION:

Per the CSS/PPS User Guide, the amount pertained to Cost Pool 03 – Deferred Compensated Absences. Per the analysis of the account by cost pool per the MP2702, the charges for 1992 for Cost Pool 03 were charged 96.04% to Reg and 3.96% to Non-Reg.

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The following is the Florida portion:

Total	2,054,177	
Florida Portion	26.14%	(Per 1992 Apportionment % Report)
	536,962	
% Reg	515,698	
% Intrastate	396,262	
% Interstate	119,436	(.2316 per BST Separation report)
	515,698	

RECOMMENDATION:

The above amounts and the following page listing the types of awards given should be reviewed to determine if such charges should be allowable expenses to be paid by ratepayers.

30 Years continued

65. Oneida Countess Silverplate 4-piece Coffee Service. Includes coffeepot, sugar, creamer and tray with engraved company identification. Tray. D. 14¼"
66. Kirk Stieff 8-piece Polished Pewter Goblet Set. Goblet cap. 10 oz., tray, D. 16"
67. Orrefors Full Lead Crystal Bowl, H. 5", and Crystal Vase, H. 7⅜"*
68. Oneida Countess Silverplate Chafing Dish with engraved logo on tray. Cap. 1¾ qt., tray, D. 14¼"
69. Replogle Lafayette 16" Illuminated Globe, H. 33"
70. Royal Doulton Juliet China 4-piece Tea and Coffee Set. Includes coffeepot, teapot, covered sugar and creamer.*

35, 40, 45, and 50 Years

Any item numbered 43—70, or:

71. Cultured Pearl Ensemble. Includes necklace, 18", bracelet, 7", and earrings with 14K gold posts.
72. 14K Gold Double Cable "V" Link Necklace, 16", and Bracelet, 7"
73. Sterling Silver and 14K Gold Ensemble. Includes man's I.D. bracelet, 8", cuff links, key chain, tie bar and money clip/knife.
74. 10K Gold Man's Dress Ring with Black Finish and company identification engraved on inside**
75. 14K Gold Woman's Dress Ring with company identification engraved on inside**
76. Man's Longines Quartz Watch with company identification engraved on back
77. Woman's Longines Diamond Princess Quartz Watch with company identification engraved on back
78. Man's Longines Seafarer Quartz Watch with company identification engraved on back
79. Woman's Longines Diamond Royale Quartz Watch with company identification engraved on back
80. Howard Miller Thomas Tompion Clock, H. 18"
81. Baccarat Harmonie Crystal Vase, H. 11⅜"*
82. Oneida Countess Silverplate 5-piece Coffee and Tea Service. Includes coffeepot, teapot, covered sugar, creamer and tray with engraved company identification. Tray, D. 20"
83. Sheffield Lion's Head Silverplate 15-piece Punch Set with company identification engraved on back of tray. Cap. 3 gal., cup cap. 5 oz., Tray, D. 20"
84. Gerber Armory 23-piece Carving Set
85. Oneida Stainless and Gold 48-piece Flatware Set. Includes eight 5-piece place settings and eight serving pieces with solid wood chest. Note: Possible delivery delays experienced with this selection.
86. Howard Miller Jennison Wall Clock, H. 33⅜"
87. Tudor Full Lead Crystal Ship's Decanter with 6 Brandy Glasses and Oak Tray. Decanter cap. 27 oz., glass cap. 10 oz., tray, 21"x11"
88. Royal Doulton Juliet China 4-piece Tea and Coffee Set. Includes coffeepot, teapot, covered sugar and creamer. Also, Royal Doulton Juliet China 2-Tier Cake Stand, H. 10", China Sandwich Tray, L. 11", and China Cake Plate, D. 9"*

* Item will have no company identification.

** Your ring size should be obtained from your local jeweler.

In the event any item is discontinued by the manufacturer, an item of similar value and quality will be offered.

KEY: H. = Height
D. = Diameter
L. = Length
Cap. = Capacity.

To express our appreciation for your service, you are invited to make a selection based on your service level.

5—20 Years

You are invited to select one item from A01—A35. Your Company's emblem corresponding to your level of service will be placed on the item selected.

A framed certificate will also be awarded. Your Company's emblem and a framed certificate are shown on the page marked "Jeweling Sequence".

- A01. Serpentine Necklace, 24", with Polished Round Locket
- A02. 14K Gold-filled Knife/Money Clip Combination with Diagonal Pattern
- A03. Florentined Tie Bar with Cable Chain
- A04. Goldplate/Silverplate Western-style Floral Belt Buckle for 1¾" Belt
- A05. Tie Bar with Matte Black Insert
- A06. Rosewood Shotgun Shell Knife
- A07. Dressy Western Belt Buckle for 2" Belt
- A08. 14K Gold-filled Key Chain with Sunburst Design
- A09. Man's Watchband
- A10. Woman's Watchband
- A11. Gerber Sportsman Knife with Leather Scabbard
- A12. French Rope Ensemble. Includes necklace, 18", and bracelet, 7".
- A13. Serpentine Necklace, 24", with Sunburst Design Locket
- A14. Serpentine Necklace, 24", with Matte Finish Charm
- A15. 14K Gold-filled Money Clip with Lea Finish
- A16. 14K Gold Flattened Cable Bracelet, 7"
- A17. 14K Gold Cobra-link Bracelet, 7¼"
- A18. Braided Serpentine Ensemble. Includes necklace, 18", and bracelet, 7".
- A19. Onyx Bracelet with 14K Gold Roundel Accents, 7"
- A20. Man's Watchband (yellow)
- A21. Man's Watchband (white)
- A22. Woman's Watchband (yellow). Emblem will be appropriately sized for placement on this item.
- A23. Woman's Watchband (white). Emblem will be appropriately sized for placement on this item.
- A24. Kershaw Rosewood Inlay Knife with Scissors and Key Ring
- A25. Flat Herringbone Neck Chain, 20"
- A26. Heart Cobra Necklace, 18"
- A27. Lapel Pin
- A28. Onyx and 14K Gold-filled Brooch
- A29. Round Pendant Brooch
- A30. Polished Key Ring with Disc
- A31. Western Belt Buckle for 1½" Belt
- A32. Stickpin
- A33. Colibri Matte Black Pen and Letter Opener
- A34. Cross 10K Gold-filled Pen and Pencil Set. Emblem will be appropriately sized for placement on this item.
- A35. Cross Woman's 10K Gold-filled Pen and Pencil Set with Pouch

25 Years and Above

You are invited to select one item A, B, C, D, or E as shown on the page marked "Jeweling Sequence". Your Company's emblem corresponding to your level of service will be placed on item A, B, C, or D.

In addition, you may select one numbered item below based on your level of service. The appropriate company identification in the form of a small emblem (identifier) unless otherwise specified will be placed on this item.

- A Tie Tac with Bar and Chain
- B. Stickpin
- C. Charm
- D. Lapel Pin
- E. Framed Certificate

25 Years

- 43. 14K Gold Hollow "V" Link Necklace, 18", and Bracelet, 7"
- 44. 14K Gold Large Flat Herringbone Necklace, 20"
- 45. Lapis Necklace, 24", and Lapis Bracelet, 8"
- 46. 10K Gold Man's Dress Ring with Black Finish and company identification engraved on inside**
- 47. 14K Gold Woman's Designer Ring with company identification engraved on inside**
- 48. Man's Longines Seafarer Quartz Watch with company identification engraved on back
- 49. Woman's Longines Riviera Quartz Watch with company identification engraved on back
- 50. Howard Miller Graham Bracket Clock, H. 14"
- 51. Benchmark St. Helena Brass Clock, H. 11"
- 52. Oneida 1881 Silverplate 58-piece Flatware Set. Includes eight 6-piece place settings and ten serving pieces in a solid wood chest. Note: Possible delivery delays experienced with this selection.
- 53. Kirk Stieff Williamsburg Polished Pewter Coffee Service. Includes coffeepot, creamer, sugar and tray with company identification engraved on back of tray. Tray, D. 14"
- 54. Gerber Mounted Knight 12-piece Carving Set
- 55. Decatur Solid Walnut Musical Chest, H. 7"

30 Years

Any item numbered 43—55, or:

- 56. Cultured Pearl Necklace, 24"
- 57. 14K Gold Diamond-cut French Rope Necklace, 18", and Bracelet, 7"
- 58. Sterling Silver and 14K Gold Ensemble. Includes man's I.D. bracelet, 8", cuff links, key ring and money clip/knife.
- 59. 10K Gold Man's Signet Ring with company identification engraved on inside and your initials engraved on the ring top**
- 60. 14K Gold Woman's Cocktail Ring with genuine blue sapphires* **
- 61. Man's Hamilton Quartz Watch with engraved company identification on back
- 62. Woman's Hamilton Quartz Watch with company identification engraved on back
- 63. Howard Miller Worthington Tambour Mantel Clock, H. 10¾"
- 64. Howard Miller Sandringham Wall Clock, H. 24"

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BST SAMPLE AUDIT DISCLOSURE NO. 2

SUBJECT: COMPTROLLERS OPTIMIZING RESOURCE EFFECTIVENESS (CORE) PROJECT EXPENSES

STATEMENT OF FACTS:

The following expenses were charged to Account 6721 – Accounting and Finance for 1992 for the Core Project. These expenses represent the charges related to invoices from Arthur Andersen & Co.

APRIL	137,500	PLANNING PHASE
APRIL	1,320,000	PHASES TWO THROUGH FOUR
JUNE	660,000	PHASES TWO THROUGH FOUR
JULY	591,000	FINAL BILLING
TOTAL	2,708,500	

AUDIT OPINION:

Per the CSS/PPS User Guide, the amount pertained to Cost Pool 03 – Financial Services and Accounting. Per the analysis of the account by cost pool per the MP2702, the charges for 1992 for Cost Pool 03 were charged to Reg and Non–Reg using the General Allocator (5.22% – Non–Reg)

The following is the Florida portion:

Total	2,708,500	
Florida Portion	26.14%	Per 1992 Apportionment % Report
	708,002	
% Reg	671,044	

% Intrastate	515,630	
% Interstate	155,414	(.2316 per BST Separation report)
	671,044	

An explanation of this project is disclosed in the rate case audit as of 12/31/92. (See Audit Disclosure No. 1 – Docket 920260–TL)

RECOMMENDATION: Since these charges are non-recurring, they are disclosed to aid the Tallahassee staff performing the forecasted data review.

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BST SAMPLE – STAFF SCOPE LIMITATIONS :

SAMPLE ITEMS:

The sample selected by staff represents charges processed by Headquarters. The functions are distributed to the areas through the use of the Corporate State Allocation Process (CSAP).

Due to time limitations and to the complexity of certain sample items, staff did not fully complete the audit of the following sample items.

Item No.	Account	Amount
77	6728.3 – Other General & Administrative – Insurance	$72,041
114	6124.2 – General Purpose Computer – CDP	(1,898,115)
115	6124.2 – General Purpose Computer – CDP	(1,250,183)
116	6124.2 – General Purpose Computer – CDP	(1,726,863)
118	6724 – Information Management	(1,734,394)
119	6724 – Information Management	(351,627)

REASONABLENESS OF REG/NON-REG SPLIT:

Due to time limitations, staff was not able to review the methodology and data used to determine the reg/non-reg split for following accounts used in the sample:

6121.1 – Land and Building Expense – Other
Cost Pool 2 – Sub Pool 2, 5.

6728.9 – Other General and Administrative – Other
Cost Pool 3

6728.11 – Other General and Administrative – Benefit Plan Payments
Cost Pool 2

6124 – General Purpose Computer Expense
Cost Pool 11 – 530M, 630M

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6612 – Sales
Cost Pool 1 – Sub Pool 2

6725 – Legal
Cost Pool 3, 4

6535 – Engineering Expense
Cost Pool 2

6611 – Product Management
Cost Pool 1, 2

6623 – Customer Services
Cost Pool 3, 6

6711 – Executive
Cost Pool 5

6712 – Planning
Cost Pool 1

6721 – Accounting and Finance
Cost Pool 3

6722 – External Relations
Cost Pool 1, 3; 4

6723 – Human Resources
Cost Pool 1

BST SAMPLE – COMPANY SCOPE LIMITATIONS :

On May 28, 1993 staff requested documentation for the sampled transactions. The request asked the company to provide the following, "all journal entries and internal and external source documentation. Source documentation must include data from an outside source, for example, invoices, vouchers, time sheets, contracts, etc. For payroll, include employee job title, description of duties and business phone number."

SAMPLE ITEMS:

Item No.	Account	Amount
103	6728.19 – OTHER GENERAL AND ADMINISTRATION – BENEFITS	$3,043,756

Staff asked for additional documentation on 10/07/93, as of 11/02/93 no answer was provided.

71	6124.2 – GENERAL PURPOSE COMPUTER – CDP	92,993
72	6124.2 – GENERAL PURPOSE COMPUTER – CDP	98,311

Staff asked for additional documentation on 10/07/93, the answer was received on 10/28/93. At this point the auditor did not have time to further investigate.

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AUDIT DISCLOSURE NUMBER 1

SUBJECT: Non Compliance with existing Company Policies

STATEMENT OF FACTS: BellSouth Telecommunications financial systems documentation, application CJ06, headquarters apportionment contains the following:

Paragraph 2.01 Apportionment factors are developed annually by the Company's Corporate accounting office. Under normal conditions, the factors are calculated using data from August of the previous year through July of the current year and are effective with January business of the next year. It is the responsibility of the Corporate accounting office to verify all data sources and calculations prior to implementing the factors.

Paragraph 3.04 On a monthly basis throughout the study period, post the specified data to the appropriate supplemental worksheeets .....

Paragraph 3.05 Worksheets 1 through 12 and the associated supplemental worksheets are to be retained for a period of six years.

Paragraph 5.02 The procedures for completing Worksheet 2 are as follows:

Using the SN475 for the last month of the study period, post each Area's number of active vehicles (Line 37) to Line a on Worksheet 2. ......

The Company did not provide supporting worksheets by month for the South Central companies for worksheets 3, 9, 10, 11 until Sept 17, 1993. This was more than 30 days after backup data was provided in Atlanta for the auditors review. Per D. Retter, BSTHQ, the original amounts were obtained using FOCUS, a data retrieval system, and no monthly amounts were maintained and the Company would have to re-create the backup information.

The Company used 10 months of data for the South Central companies on worksheet 8. For the Southern Bell Companies 12 months was used.

The Company used the number of active vehicles as of May 91 in preparing worksheet 2. The Company could not provide the supporting documentation for the South Central Bell companies to permit an audit of the actual vehicles used.

OPINION: The Company is in violation of its internal policy CJ06. It has not followed the instructions for the various paragraphs noted above. The corporate accounting office should have discovered these errors in the verification process called for in P 2.01. The lack of monthly detail to support the annual amounts used in the worksheets made it impossible for the auditor to verify, on a sample basis, that the amounts used were correct. Although the information was ultimately provided there was not sufficient time for the auditor to travel to Atlanta to verify it.

The use of 10 months data for the South Central Bell companies in the calculation of worksheet 8, inventory adjustments, results in expense being allocated to the Southern Bell companies that should have been allocated to the South Central Bell Companies. Specifically the Florida company was allocated 1.26% more than it would have if the factors had been computed correctly. For the month of November 1992 this amounted to an additional $9,803.75 allocated to the Florida operations. The total amount of dollars related to the error has not been quantified due to time constraints.

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Disclosure 1 page 2 **Draft**

There was no explanation given as to why the Company used May 91 instead of July 91 in the preparation of worksheet 2. Although these errors do not effect the total distribution of BSTHQ costs, they do effect the distribution between the various companies. Since the Company was unable to furnish the supporting documentation the auditor was not able to determine an effect.

These errors beg the question as to whether other errors have occurred that were not detected during either the Company's review or the audit.

RECOMMENDATION: The Company should adhere to its own policies.

COMPANY COMMENTS:

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AUDIT DISCLOSURE NUMBER 2

SUBJECT: Non conformance with the Cost Allocation Manual

STATEMENT OF FACTS: In its allocation of expenses to its subsidiaries, Southern Bell Telephone Headquarters, (SBTHQ) uses the general allocator for accounts, 6112-Motor Vehicles for other than area 1140, 6113-Aircraft Expenses, 6114-Special Purpose Vehicles, 6115-Garage Work Equipment, 6116-Other Work Equipment, 6121-Land and Building Expense, 6122-Furniture Expense, 6123-Office Equipment and 6124-General Purpose Computers. The BellSouth Corporation Cost Allocation Manual (CAM) dated 6/30/92, which was provided to the auditors, does not indicate the general allocator is used for any of the above listed accounts. The CAM does list the following apportionments:

Account 6112 - Either directly assigned or based on the relative investment in Account 2112, Customer, Corporate and Plant Nonspecific cost pool.

Account 6113 - Either directly assigned, apportioned based on Executive salary and wage expenses or apportioned based on the salary and wage expenses of Customer, Corporate (excluding Account 6711) and Plant Nonspecific.

Account 6114 - Either directly assigned or apportioned based on Customer, Corporate and Plant nonspecific salary and wage expenses.

Account 6115 - Either directly assigned or apportioned based on the relative investment value of Account 2115, excluding investment leased to others.

Account 6116 - Either directly assigned or apportioned based on the relative investment value of Account 2116, Customer, Corporate and Plant nonspecific.

Account 6121 - Either directly assigned, apportioned based on the relative investment in Account 1220.1, Supplies or attributed using the same methodology as building investment in Account 2121.

Account 6122 - Either directly assigned or apportioned based on the relative investment value of Account 2122, excluding leased to others investment.

Account 6123 - Either directly assigned or apportioned based on the relative investment value of Account 2123, excluding Corporate Communications Equipment, demonstration equipment and leased to others.

Account 6124 - Has eleven elements based on either directly assigning or apportioned based on accounts that are relative to the related cost pools.

The CAM, Section 1, page 4 states .....total costs have been apportioned to the two cost objectives in a manner that.....apportions unattributable costs through a General Allocator. Further, Section 1, page 2 defines unattributable as - cost of resources, ... for which no casual relationship exists. Additionally Section 1, page 5 contains the under lined statement "The CAM Uses Direct Analysis To Minimize Use of the General Allocator."

OPINION: Although there are no specific regulatory requirements that requires ~~SBT~~HQ to use the CAM the Company does conform to the CAM in other accounts it is allocating to its subsidiaries. As the CAM does have the basis for the allocation methodology, it appears it would be relatively easy for them to use the CAM for all the accounts.

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The general allocator is a catch all comprised of a combination of access lines, access line activity, construction expenditures and salaries and wages. In the auditor's opinion this combination of items does not provide as proper an allocation basis as does the items as listed in the CAM.

RECOMMENDATION: The Company should adhere to the CAM procedures whenever allocating costs.

COMPANY COMMENTS:

Draft

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AUDIT DISCLOSURE NUMBER 3

SUBJECT: Failure to provide affiliated company invoices

SCOPE RESTRICTION: Document request number 58 requested all invoices received by Bell South Headquarters, (BSHQ), during the month of July 1992 from Bell South Telecommunications, (BST), Bell South Enterprises, (BSE), Bell South Information Systems, (BSIS), Bell South Advanced Networks, (BSAN), and the Bell South offices in Washington, D. C., (BSDC). The Company's response was, "BellSouth will make available for review .....the original invoices and supporting documentation for charges from the listed subsidiaries to BSC which were handled by BSC's cost allocation or project billing processes during August, 1992. A follow up request, 58-B emphasized the need for ALL invoices. Without the total amount of invoices as requested there can not be a valid audit decision as to whether the charges from the selected affiliates to BSHQ that are ultimately passed on to BST are valid for rate making purposes.

OPINION: The actual invoices as furnished to the auditor amounted to approximately eight, (8) per cent of the total amount as recorded on BSHQ's general ledger for July 1992. (Exhibit 1, attached). All invoices processed by BSHQ, as requested, were required in order to assure the auditor that information was not being filtered out by the Company. Without the total population of invoices a valid sample could not be selected. In absence of the supporting information all charges from the affiliated entities should be disallowed for rate making. The total amount of this adjustment has not been quantified at this time due to time constraints.

RECOMMENDATION: Do not allow any of the charges from the above stated affiliated entities to be included in the setting of rates.

COMPANY COMMENTS: **Draft**

BellSouth Telephone Co.
Docket 920260 - Rate Case
BellSouth Headquarters Invoices from Affiliates
For the month of 7/92

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Company	Amount
BS INFORMATION SYSTEMS	
TOTAL PER GENERAL LEDGER	531,796.34
TOTAL PROVIDED	287,311.92
TOTAL NOT PROVIDED	244,484.42
PER CENT NOT PROVIDED	45.97%
BS TELECOMMUNICATIONS	
TOTAL PER GENERAL LEDGER	12,705,065.00
TOTAL PROVIDED	12,705,065.00
TOTAL NOT PROVIDED	0.00
PER CENT NOT PROVIDED	0.00%
BS ADVANCED NETWORKS	
TOTAL PER GENERAL LEDGER	2,612,054.00
TOTAL PROVIDED	0.00
TOTAL NOT PROVIDED	2,612,054.00
PER CENT NOT PROVIDED	100.00%
BS ENTERPISES	
TOTAL PER GENERAL LEDGER	139,474,970.43
TOTAL PROVIDED	20,698.04
TOTAL NOT PROVIDED	139,454,272.39
PER CENT NOT PROVIDED	99.99%
BSDC	
TOTAL PER GENERAL LEDGER	1,810,456.24
TOTAL PROVIDED	28,517.31
TOTAL NOT PROVIDED	1,781,938.93
PER CENT NOT PROVIDED	98.42%
TOTAL	
TOTAL PER GENERAL LEDGER	157,134,342.01
TOTAL PROVIDED	13,041,592.27
TOTAL NOT PROVIDED	144,092,749.74
PER CENT NOT PROVIDED	91.70%

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AUDIT DISCLOSURE NUMBER 4

SUBJECT: Comparison of CAM's for Florida utilities

STATEMENT OF FACTS: Based on the latest available Cost Allocation Manuals as submitted by Southern Bell, GTE, United and CenTel, a schedule was prepared comparing the various allocation methods, by account, for the four companies. The intent of this exercise was to determine, based on the four companies procedures, if one company's methods were better than the others or if some entirely different method would be better than those now being used.

OPINION: The terminology used by the four companies is not consistent enough to determine the basic differences in allocation methods between them. It would take an in depth study of each company's records to determine how they are actually allocating costs.

RECOMMENDATION: A study should be made of the various utilities within Florida to determine if their is a basic allocation method that can be used by all the companies. This consistency would make both comparisons of and auditing of the companies easier.

COMPANY COMMENTS:

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AUDIT DISCLOSURE

STATEMENT OF FACTS: According to Request 2-163, the following costs have been charged to BST:

	AMOUNT	ACCOUNT
BELLSOUTH CONTRIBUTIONS	1,894,500.00	6711
BELLSOUTH MEMBER DUES	97,900.00	6722
BELLSOUTH CLASSIC	405,600.00	6722
BELLSOUTH CLASSIC BST COSTS	351,100.00	6613/6612
BELLSOUTH FEDERAL RELATIONS	2,547,500.00	6722
BELLSOUTH FEDERAL REGULATORY	896,800.00	6722
BELLSOUTH CORPORATE ADVERTISING	1,535,000.00	6722
	7,728,400.00	

OPINION: These costs were removed in the Florida Rate Case exhibits for 1992 actual test year adjustments to Net Operating Income. We are including this information for other states information purposes.

AUDIT DISCLOSURE NO.

SUBJECT: ALLOCATION TO INTERSTATE OF CATV COSTS

STATEMENT OF FACTS: The FCC requires that all costs related to Cable TV be separately recorded as interstate. An Accounting Plan for Cable TV transport was developed and issued by RT Bishop, the Comptroller, on August 17, 1990. (Letter 12-01)

Trials on Cable TV were conducted at Hunters Creek and Heathrow in Florida.

Staff engineer, Jack Hoyt's, review of Heathrow and Hunters Creek construction costs have revealed the following:

1 The company paid Northern Telecom $5 million dollars for equipment for the cable TV project. $2 million of these costs were capitalized and $3 million for system support was deferred and amortized to expense.
Based on a description of the $2 million dollars of equipment, $881,000 was for Video and the rest was for POTS. The company has charged the entire amount of system support to POTS. In doing so, these costs went through the normal accounting process of separations instead of the 100% special separation for video. The following amounts were charged with the amortization of the $3 million in 1992.

ACCOUNT	AMORTIZATION
6612	209,032
6232	69,677
6362	301,936
	580,645

2 The company miscoded the purchase of a Cable TV company. See exception .
The dollars to be adjusted are included in the revised schedules in this exception in Account 2423.

3 Expenses associated with these trials have not been expensed in accordance with accounting letter 12-01.

4 The company dollars for CATV for outside plant from the general ledger does not agree to the CATV amounts in the Separation System.

5 The revised company numbers did not recompute property tax or depreciation expense for some years. The revised depreciation expense for 1992 is the same as the original even though investment changed.

Staff did not receive the revised numbers until October 27, 1993. We never received supporting documentation for the new allocations of COE, the backup for the numbers used in the general ledger for outside plant or their calculation of depreciation.

Opinion: The company has prepared revised numbers with all the above adjustments. They were not received in time for adequate review but result in a decrease in intrastate plant, accumulated depreciation and expenses. The revised numbers include 44.05% of the amortization in 1 above, based on the percent of video plant to total plant in the Northern Telecom contract. The calculation below show the intrastate and regulated calculations that were originally used to record the investment and expenses in the 1992 rate case and books. It is necessary to remove the same portion as what was recorded. These amounts are computed as follows:

ACCOUNT	1992 AMOUNT REVISED	1992 AMOUNT AS FILED	DIFFERENCE	% ORIGINALLY TO INTRA	% REGULATED	AMOUNT TO BE ADJUSTED
2111	865		865	76.55%	97.19%	644
2112	71		71	76.55%	90.08%	49
2114	94		94	76.55%	90.08%	65
2115	94		94	76.55%	91.40%	66
2116	760		760	76.55%	92.02%	535
2121	449,456	230,004	219,452	76.55%	97.23%	163,337
2122	746		746	76.55%	93.08%	532
2123	1,388		1,388	76.55%	97.01%	1,031
2124	3,451		3,451	76.55%	93.34%	2,466
2212	870,145	752,699	117,446	80.84%	97.92%	92,969
2231	0	500,448	(500,448)	80.84%	100.00%	(404,562)
2232	2,780,268	1,551,365	[illegible]	80.84%	100.00%	993,445
2341	0	(300)	300	76.38%	96.98%	229
2362	1,519,640	1,315,531	[illegible]	72.70%	94.08%	139,603
2421	6,187	4,492	[illegible]	72.70%	100.00%	1,232
2422	563,364	556,741	[illegible]	72.70%	100.00%	4,808
2423	2,362,288	1,776,937	[illegible]	72.70%	100.00%	425,550
2441	66,786	66,754	12	72.70%	100.00%	9
	8,635,673	6,754,671	[illegible]			1,422,006
NET PERCENT INTRASTATE/REGULATED						76.01%
				AVG. INTRA/REG PER PLANT		
ACC. DEP.	2,361,484	3,022,198	[illegible]	76.01%		(487,005)

EXPENSES 1992:

ACCOUNT	1992 AMOUNT REVISED	1992 AMOUNT AS FILED	[illegible]	% ORIGINALLY TO INTRA	% REGULATED	AMOUNT TO BE ADJUSTED
6110	0		0		93.25%	0
6116	0		0		93.95%	0
6121	77		77	77.30%	97.45%	58
6212	82,163		[illegible],163	75.48%	97.77%	60,013
6231	42		42	75.48%	100.00%	32
6232	30,858		[illegible]	75.48%	100.00%	23,292
6362	135,258	(10,282)	[illegible]5,540	73.63%	36.18%	38,771
6421	0		0		100.00%	0
6422	1,468	1,468	0	72.[illegible]%	100.00%	0
6423	71,851	74,024	(2,173)	72.89%	100.00%	(1,584)
6441	0		0		100.00%	0
6512	0		0		94.75%	0
6531	0		0		90.50%	0
6532	0		0		97.12%	0
6533	0		0		77.05%	0
6534	38,348	38,349	0		89.76%	0
6535	1,180	1,180	0		90.46%	0
6711	1,547	1,547	0		94.36%	0
6712	514	514	0		94.94%	0
6721	4,733	4,533	200	84.75%	96.67%	162
6722	895	895	0		97.37%	0
6723	4,207	4,207	0		93.13%	0
6724	2,431	2,431	0		94.55%	0
6725	1,271	1,271	0		56.93%	0
6726	1,721	1,721	0		93.37%	0
6727	5	5	0		97.82%	0
6728.9	18,287	18,287	0		94.08%	0
	406,857	140,150	[illegible].707			128,744

CUMULATIVE EXPENSES 1986 TO 1993:

ACCOUNT	AMOUNT REVISED	AMOUNT AS FILED	DIFFERENCE	% ORIGINALLY TO INTRA	% REGULATED	AMOUNT TO BE ADJUSTED
6110	1,901		[illegible]	74.93%	93.28%	1,392
6116	1,646	1,532	114	74.93%	93.96%	80
6121	132		132	77.30%	97.46%	100
6212	453,665		[illegible]	75.48%	97.77%	334,790
6231	3,728	2,029	[illegible]	75.48%	100.00%	1,282
6232	165,427		[illegible],427	75.48%	100.00%	124,864
6362	712,571	21,218	[illegible]	73.63%	36.18%	184,172
6421	9,542	7,690	[illegible]	72.89%	100.00%	1,350
6422	29,519	9,343	20,176	72.89%	100.00%	14,706
6423	259,408	252,749	[illegible]	72.89%	100.00%	4,854
6441	115	53	62	72.89%	100.00%	45
6612	144	9	135	74.41%	94.75%	95
6531	182	182	0	73.96%	99.50%	0
6532	14,905	7,059	7,846	73.96%	97.12%	5,637
6533	2,212	690	[illegible]	73.96%	77.05%	868
6534	192,479	161,874	[illegible]	73.96%	89.76%	20,323
6535	10,249	9,757	[illegible]	73.96%	99.45%	362
6711	10,017	8,816	[illegible]	77.39%	94.36%	877
6712	3,289	2,783	[illegible]	77.39%	94.94%	372
6721	30,084	26,415	[illegible]	84.75%	95.67%	2,975
6722	9,711	7,293	2,416	84.75%	97.37%	1,995
6723	24,599	21,438	[illegible]	84.75%	93.13%	2,495
6724	14,395	12,878	[illegible]	84.75%	94.55%	1,218
6725	7,249	6,157	[illegible]	84.75%	56.93%	527
6726	21,054	18,839	[illegible]	84.75%	93.37%	1,753
6727	1,104	795	[illegible]	84.75%	97.82%	256
6728.9	104,678	91,519	[illegible]	84.75%	94.08%	10,492
	2,084,095	671,118	[illegible]			717,878

Recommendation: Post all of the above adjustment and retroactively adjust prior years.

AUDIT DISCLOSURE NO

SUBJECT: LEASES WITH SUNLINK AND DATASERV AND BELLSOUTH COMMUNICATIONS SYSTEMS, INC.

STATEMENT OF FACT: The company provided the lease agreements for the above but did not provide Fully Distributed Cost or Market Comparisons.

Per the answer to request 2-079, the following payments were made in 1992 to Sunlink:

	AMOUNT	CHARGED TO BST (REQ 2-012)
11 DATA SERV		

Data Serv charges BST through both Fully Distributed Costs for the Atlanta Repair Facility and market rate for other services. In response 2-001.A1, the company contends that the lease charges are not in the Fully Distributed Cost calculation and therefore none of the costs chain in to regulation.

Sunlink also had a lease with Bellsouth Communications Systems,
18 Inc. (BCS): ________ They did not provide the requested FDC analysis until October 6, 1993. All Sunlink Financial Statements and General Ledgers were requested June 7, 1993. The company said they would backup only chained transactions but in doing so did not include the BCS or Data Serv leases. The FDC analysis provided shows that FDC is more than the lease costs charged to BCS by
24 $227,078. However, the FDC analysis include: ________ of Return on Investment which was computed using a pretax return of 15.76%.

OPINION: The company has not adequately justified the charges for Data Serv even though the company uses market rates because these costs are chained through the market rates. The costs applicable to Florida have been determined as follows:

	% OF DATA SERV REVENUE FROM BST	3.82% (DATA SERV CHARGED TO BST R 2-012 $[redacted] 7/TOTAL REV [redacted] PER F/S)
2 3 4	LEASE AMOUNT	[redacted]
	BST ALLOCATION OF LEASE	54,664
	PERCENT TO FLORIDA	24.68% (CHARGES TO FLA 1,218,592/CHARGES TO BST 4,936,617 REQ. 2-012)
	FLORIDA AMOUNT	13,491

Because we have not received any detail on BSCS staff cannot
11 determine the amount of the [redacted] lease which has been chained
in to regulation.

	%	DOLLARS
Florida	26.14%	741,515
Georgia	17.28%	490,183
North Carolina	9.62%	272,891
South Carolina	6.44%	182,684
Alabama	8.47%	240,269
Kentucky	4.92%	139,566
Louisianna	9.95%	282,252
Mississippi	5.85%	165,947
Tennessee	11.33%	321,399
		2,836,707

RECOMMENDATION: Because the company would not provide complete access to support their numbers the entire lease should be removed. The Florida portion should be allocated as follows:

Florida	741,515	(used cost pool 8)
% Regulated	97.48%	(MP2702 analysis)
	722,829	
% Intrastate	77.33%	(Ratio-Separations Report)
Fla Intra/Reg	558,964	

AUDIT DISCLOSURE NO

SUBJECT: SUNLINK WAREHOUSE SPACE

STATEMENT OF FACT: According to the Coopers and Lybrand workpapers, Sunlink rents three warehouses to BST. They are as follows:

	FDC	RENT
6 BIRMINGHAM WAREHOUSE		
JACKSONVILLE WAREHOUSE		
ST AUGUSTINE WAREHOUSE		

9

The fully distributed cost figures contain 15.76% return on investment as follows:

	AVERAGE INVESTMENT	ROI
14 BIRMINGHAM WAREHOUSE		
JACKSONVILLE WAREHOUSE		
ST AUGUSTINE WAREHOUSE		

17

The company would not provide the General Ledger of Sunlink, only redacted pages showing individual items on the FDC analysis.

OPINION: A lower rate of return could make rent higher than FDC on all leases. The Jacksonville warehouse is already $240,056.10 higher than Fully Distributed Costs.

Redacted copies of the general ledger are not sufficient to determine the appropriateness of Fully Distributed Costs. We are unable to determine if there are contra accounts which change the balances used or if there are working capital accounts which should be included but have not been.

The amount of rent has been allocated by staff to the states using account 6121 allocation basis as follows:

AUDIT DISCLOSURE NO

SUBJECT: CSL BIRMINGHAM

STATEMENT OF FACT: CSL Birmingham has three complexes charged at Fully Distributed Costs (FDC) to BST. According to request 2-0038 they are:

	BUILDINGS	FDC	BASE RENT
6	BSSI		5,312,500
	BSSII		3,180,025
	3700 BLDG.		1,565,410
9			10,057,935

Additional rent is paid for operating expenses, taxes and insurance. These amounts were requested 8/9/93 (Request 2-131) and have never been provided. However, according to request 2-131, total rent revenue of CSL Birmingham from BST was $10,635,900.

The following amounts were included in the FDC analysis for Return on Investment computed at 15.76%.

		AVG. INV.	ROI
17	BSSI		
	BSSII		
	3700 BLDG.		

20

The company provided redacted pages from their general ledger which contained the numbers used in their FDC analysis but refused to provide their entire ledger.

The rent is being allocated to the states using the allocation percents for account 6121.

	%	DOLLARS RENT	RENT WITH PERATING EXP.
Florida	26.14%	2,629,144	2,780,224
Georgia	17.28%	1,738,011	1,837,884
North Carolina	9.62%	967,573	1,023,174
South Carolina	6.44%	647,731	684,952
Alabama	8.47%	851,907	900,861
Kentucky	4.92%	494,850	523,286
Louisianna	9.95%	1,000,765	1,058,272
Mississippi	5.85%	588,389	622,200
Tennessee	11.33%	1,139,564	1,205,047
		10,057,935	10,635,900

OPINION: Limited access to the general ledger is not sufficient to support their FDC analysis. Providing only certain accounts does not allow review for contra accounts which could change the balances needed to be used.

It also does not allow a review to determine if all necesssary accounts were included in working capital.

Questions also arose from the redacted copies of whether the 3800 building and the 3700 building were charged to the same cost center. By not being able to review the general ledger for charges for the 3800 building it was impossible to determine if the FDC analysis contained costs for the 3800 building. The company later provided redacted copies of the General Ledger showing the 3800 building as a separate line item but redacted the dollars.

It also was impossible to determine the reasonableness of other rents.

Reducing the rate of return to a lower level could reduce FDC to being lower than the actual rent charged.

RECOMMENDATION: Because the company refused to support their calculations by full access, the rent of $10,057,935 and additional rent should be removed.

	RENT ONLY	ALL COSTS
Florida portion	2,629,144	2,780,224
% Regulated	95.07%	95.07%
	2,499,527	2,643,159
% Intrastate	77.33%	77.33%
Florida Intra/Regulated	1,932,884	2,043,955

AUDIT DISCLOSURE NO.

SUBJECT: RETURN ON INVESTMENT USED FOR FULLY DISTRIBUTED COSTS ALLOCATED FROM AFFILIATES

STATEMENT OF FACT: Most of the affiliates charged BST for a Return on Investment of 11.25% and a pretax return of 15.76% computed as follows:

ALLOWABLE ROI	11.25%
DEBT RATIO	44.20%
DEBT COST RATE	8.80%
WEIGHTED DEBT COST	3.89%
WEIGHTED EQUITY COST	7.36%
GROSS UP FACTOR	6.20%
WEIGHTED EQUITY COST RATE GROSSED UP FOR INCOME TAXES	11.87%
ROI GROSSED UP FOR INCOME TAX	15.76%

The company was requested to provide the actual return on investment paid to each affiliate and chained to each affiliate. This was not received in time to include the information in this report. Where the information could be obtained it is included with other exceptions and disclosures.

OPINION: This rate of return should be reviewed by our cost of capital section for reasonableness.

AUDIT DISCLOSURE NO.

SUBJECT: CSL CHASTAIN CENTER

STATEMENT OF FACTS: According to leases between BST and CSL Chastain, BellSouth Telephone rents 59,267 square feet of space in the CSL Chastain Complex at ______ per the leases for Phase II and III.

The average rent over the 15 years net of the improvement allowance was ______ per square foot for the 48,468 in phase II and ______ square foot for the 10,799 square feet in Phase III.

The company compared the MOVATS lease because it was a non-affiliate company, at ______ per square foot for the 35,725 square feet. The improvement allowances averaged over the five years reduced the lease amount to an average of ______ per square foot.

The MOVATS lease was a five year lease which has expired. That space is now empty.

According to the company provided list of lessees, the next largest space is a lease with ATT in phase III for 28,307 square feet. The company refused to provide the lease because it wasn't used to determine market.

The rent allocated to the states using account 6121 allocations is:

	%	DOLLARS RENT	RENT W/ OTHER COSTS
Florida	26.14%		170,616
Georgia	17.28%		112,787
North Carolina	9.62%		62,790
South Carolina	6.44%		42,034
Alabama	8.47%		55,284
Kentucky	4.92%		32,113
Louisianna	9.95%		64,944
Mississippi	5.85%		38,183
Tennessee	11.33%		73,951
			652,700

AUDIT DISCLOSURE NO

SUBJECT: CAMPANILE LEASE-1155 PEACHTREE ASSOCIATES

STATEMENT OF FACT: The Campanile building in Midtown Atlanta, is owned by 1155 Peachtree Associates.

According to a response to Request 2-054A, Attachment G, as of 9/1/93 the space is occupied as follows:

	9/1/93	12/31/92*
BST and Affiliates	72.57%	75.10%
C&L and Carter	17.21%	17.21%
Non Affiliates	7.69%	7.69%
Vacant	2.53%	
	100.00%	100.00%

* Per lease charges from BSE having 6th floor in 1992

The company provided leases which show an average cost per year per square foot after averaging improvement allowances over the life of the lease as follows:

16 Coopers and Lybrand
BST
BSIS
BSE
BSC

21 BSC adjusted the [redacted] to amount to $[redacted] average per square foot per year according to their JCO Matrixes.

24 The total paid by BSC to 1155 Peachtree Assoc. before the adjustment and including other rent was $[redacted] according to request 2-156.

According to the Coopers and Lybrand workpapers, no adjustment was made by Coopers and Lybrand for the 3rd to 4th amendments of the lease which added 27,406 of space at 27 $20.20 at 12/1/95 and 1/31/96 respectively and [redacted] to the end of the lease. If 28 Coopers and Lybrand had adjusted these amendments from $[redacted] to $[redacted] they would have removed another $98,247.32.

Staff requested leases in the building other than Coopers and Lybrand. Gary Grace, the company representative said there were no comparable leases in the Campanile Building and that the only comparable space was a lease in the 1100 building accross the street. He provided a lease made in 9/1/93 with RR Donnelly and Sons Co. for 7,195 rentable square feet for 5 years. This

OPINION: It does not appear appropriate to compare a five year lease to a 15 year lease.

In a competitive market, it would be reasonable to give better rates to a company locking in to a lease for a large space for 15 years as this would assist the lessor in obtaining financing for the project and eliminates the need to pay commissions for finding new tenants. CSL Chastain paid Carter Associates
7 and Oxford Industries $[redacted] and $[redacted] for procuring the MOVATS lease.

If BST had a 5 year lease, they may have renegotiated a better lease rate at the end of five years, or moved as MOVATS did. By locking in to a 15 year lease, they did not have that option.

FDC could not be determined for comparison because the company would not provide the general ledgers.

RECOMMENDATION: Because the 15 year leases are not comparable to other leases and no tenants are comparable in size and because the company would not provide general ledgers to allow for a fully distributed cost
16 computation, the entire rent of $4[redacted] and other lease costs which total $652,700 should be removed as follows:

	RENT ONLY	ALL COSTS
19 Florida portion	[redacted]	170,616
Percent Regulated	95.07%	95.07%
21	[redacted]	162,204
Percent Intrastate	77.33%	77.33%
23 Florida Intra/Reg	[redacted]	125,433

If the rent were reduced only to the MOVATS lease amount of $5.65, the rent would be reduced by $241,699 computed as follows:

		PHASE II	PHASE III
27 BST RENT NET OF IMPROVEMENTS		[redacted]	[redacted]
28 MOVATS RENT NET OF IMPROVEMENTS		[redacted]	[redacted]
29 DIFFERENCE		[redacted]	[redacted]
TIMES SQ. FEET		48,468	10,799
31		198,719	42,980
Percent Florida	[redacted]		
33	[redacted]		
Percent Regulated	[redacted]		
35	[redacted]		
Percent Intrastate	[redacted]		
37	[redacted]		

lease was made for ______ base rent but included design cost and improvement allowances of ______ per square foot amortized over five years this reduces rent by $______ per square foot ______ per square foot.

It should also be noted that the company's that BST is using to compute market rates for both the Campanille Building and the 1100 building are doing business with BST and their affiliates. The amounts paid in 1992 are (per request 2-158):

	Coopers and Lybrand	Kilpatrick & Cody
BSC HQ AND BSE		
BST	3,781,000	258,000

OPINION: Since the company believes the 1100 building is comparable space, it is questionable why they did not use the Kilpatrick and Cody lease for comparison which was made in 6/91 for 141,414 square feet at an average per year of $______ per square foot. This space has more than the 72,000 square feet used by Coopers and Lybrand and is closer in time initiated than the RR Donnelly lease.

If market rate is appropriate, the Kilpatrick and Cody lease should be used for comparison thus adjusting the Coopers and Lybrand rate of $______ to $______ or a reduction of ______ Using the space of 305,696 for BSC less 1993 space of 8080 and storage and mailroom and computer space of 9,475 for a net of 288,141 x$4.58 is $1,319,685.70. The adjustment for amendment 3 and 4 needs to be reduced to the C & L rate for an additional 88,247.32. The total adjustment would be $1,407,933.

The attached charts allocates these costs to BST and to the states using 1992 billings as a base. The reductions to BST would be $1,048,317.52 and to Florida would be $274,030. This amount needs to be allocated to intrastate regulated dollars.

However, because the Campanile Building was rented 75% by BST and Affiliates and 17.2% by companies earning a substantial amount of their revenues from BST and affiliates and because the BSC space of 305,695 is not really comparable to either the Coopers and Lybrand space of approximately 72,000 or the Kilpatrick and Cody lease in the 1100 Building of approximately 141,000 square feet, a comparable market does not exist and fully distributed cost should be used.

In a competitive market, a lessor who would be guaranteed rent on 300,000 square feet of space for 10 years would probably be willing to negotiate a better price than they would on 72,000 square feet.

Since the company would not provide actual costs and the general ledger for the Campanile Building, staff was unable to determine FDC.

RECOMMENDATION: Since the company would not provide access to staff to the records necessary to compute Fully Distributed Cost, the entire rent for
3 1992 of ________ should be removed.

According to the attached computations, $5,543,669.26 relates to BST and $1,449,115.08 is Florida specific. This amount needs to be allocated to Intrastate Regulated.

Southern Bell Tel. Co.
Docket 920260
For the 12 Months ended 12/31/92
Rent expense allocated to Southern Bell

BellSouth Telecommunications			BellSouth Business Systems			BellSouth Enterprises			BellSouth Capital Funding	BellSouth DC	BellSouth Products	BellSouth Human Resources	Total
Services	Projects	Total	Services	Projects	Total	Services	Projects	Total					
Total billings from BSC to Affiliates - 1992													
93,215,900.0	4,453,000.0	97,668,900.0	4,464,100.0	397,300.0	4,861,400.0	22,689,400.0	5,212,800.0	27,902,200.0	701,000.0	8,000.0	25,100.0	6,700.0	131,173,300.0
71.0632%	3.3947%	74.4579%	3.4032%	0.3029%	3.7061%	17.2973%	3.9740%	21.2712%	0.5344%	0.0061%	0.0191%	0.0051%	100.0000%
1 (A) Reduction in Rent Expense from:													
1,556,928.59	74,375.76	1,631,304.36	74,561.15	6,635.86	81,197.01	378,967.27	87,066.23	466,033.51	11,708.38	133.62	419.23	111.91	2,190,908.00
(B) Reduction in Rent Expense for third and fourth amendments													
62,711.34	2,995.77	65,707.11	3,003.24	267.29	3,270.52	15,264.38	3,506.93	18,771.31	471.60	5.38	16.89	4.51	88,247.32
5 (C) Reduction in rental expense adjusting to													
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	226,269.80	52,444.04	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
(D) Total Rental Expense for the year 1992													
5,290,917.78	252,751.48	5,543,669.26	253,381.52	22,550.68	275,932.19	1,287,846.28	295,877.59	1,583,723.87	39,788.63	454.08	1,424.67	380.29	7,445,373.00

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Calculation of Item (A)				Total Rent		Adjustment
1) Average Cost per Sq Ft		100.00%				
Adjusted Cost per Sq Ft		70.57%				
2) Difference		29.43%		7,445,373.00	X 29.43% =	2,190,907.77

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outhern Bell Tel. Co.
ocket 920260
or the 12 Months ended 12/31/92
djustment for reduced Rental Expense

	FL	GA	NC	SC	ALA	KY	LA	MISS	TENN	Total
BTHQ General Allocator (From WP 44-1 page 2)	0.2614	0.1728	0.0962	0.0644	0.0847	0.0492	0.0995	0.0585	0.1133	1.0000
djustment for (A)	426,4[illegible]	281,889 33	156,931.44	105,055.98	138,171.45	80,260.16	162,314.75	95,431.28	184,826.74	1,631,304.00
djustment for (B)	17,1[illegible]	11,354.17	6,321.01	4,231.53	5,565.38	3,232.78	6,537.85	3,843 86	7,444.60	65,707.00
djustment for (C)	25[illegible].36	169,795.08	94,527.12	63,280.11	83,227.10	48,344.43	97,769.74	57,482.71	111,329.76	982,610.41
djustment for (D)	1,44[illegible]	957,946.00	533,300.96	357,012.28	469,548.76	272,748.51	551,595.07	324,304.64	628,097.70	5,543,669.00

a
(A) Reduction in Rent Expense from
(B) Reduction in Rent Expense for third and fourth amendments
(C) Reduction in rental expense adjusting to
(D) Total Rental Expense for the year 1992

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Comptrollers Department

Corporate Consolidations - External Reporting (RC H13120)

STATEMENT OF FACTS:

The Comptrollers Department/Corporate Consolidations - External Reporting RC is "[r]esponsible for maintaining and enhancing the BellSouth Financial architecture, providing SEC financial reporting policy guidance, and generating consolidated monthly/quarterly/annual internal and external reports." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the equity of subsidiaries allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that "[s]ervices are in support of all subsidiaries and are attributable based on the investment/interest BellSouth has in each." Certain corporate services costs are exception reported and allocated based upon employees in the wage and benefit plans. Costs of specific financing activities are project billed to BST, BSE, and to BSCF.

There is also a Comptrollers Department with accounting, reporting, and administrative responsibilities at the BST organization level.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H13120 in 1992 were $1,651.9 thousand, consisting of $850.3 thousand in direct costs and $801.6 thousand in overheads. BST's estimated allocation was $1,196.0 thousand, or 72.40% of this cost.

OPINION: The allocation of Comptrollers/Corporate Consolidation -External Reporting corporate services costs to BST was overstated by $1,196.0 thousand and was also inconsistent with the Company's stated rationale. BSC utilized an equity allocator but cited an "investment" rationale. Regardless of that inconsistency, these costs were not caused by BST, but rather are the direct result of the holding company structure that exists to facilitate the investment in and operation of nonregulated enterprises. BST has its own management and organizational structure, including a Comptrollers Department. The BSC costs are incremental to those incurred directly by BST. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION: 1992 BST expenses of $1,196.0 thousand should be disallowed. BSC should modify its allocation factor to retain 100% of these costs.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Comptrollers Department

Corporate Accounting (RC H13170)

STATEMENT OF FACTS:

The Comptrollers Department/Corporate Accounting RC is responsible for "[p]rovid[ing] traditional accounting services functions, such as intercompany billing (Headquarters & "flow through"), corporate books, and disbursement [; c]ompiling Corporate Financial reports from subsidiary data transmissions for BellSouth Corporation [; p]rovid[ing] mechanization support for BSHQ Comptrollers [; p]rovid[ing] support for Affiliated Accounting Witness." (Cost Assignment *Form* provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the headquarters allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the functions performed "are in support of BellSouth Headquarters and BellSouth D.C. operations and are not attributable to the subsidiaries." Certain corporate services costs are exception reported to BSHRA, BST, and BSE. Other costs are project billed to BSCF.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under *this methodology, the estimated total corporate services* costs incurred by and billed for RC H13170 in 1992 were $1,206.3 thousand, consisting of $620.9 thousand in direct costs and $585.4 thousand in overheads. BST's estimated allocation was $905.9 thousand, or 75.10% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Comptrollers Department

Affiliate Interest Matters (RC H13140)

STATEMENT OF FACTS:

The Comptrollers Department/Affiliate Interest Matters RC is responsible for "[s]ervices of BSC Affiliated Interest Witness on behalf of BellSouth Telecommunications (BST) before the state public utility commissions [; c]oordinating with interdepartmental representatives and regulatory staffs to collect and distribute data for BellSouth Headquarters [; p]erforming investigations, analyses, and ongoing monitoring of affiliate interest issues concerning BellSouth Headquarters and nonregulated subsidiaries [; and p]roviding information on BellSouth matters to BST regulatory personnel." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC allocates 100% of the costs of this RC to BST, based on the rationale that "[s]ervices are provided on behalf of BST concerning BellSouth Headquarters and other BellSouth entities."

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H13140 in 1992 were $127.5 thousand, consisting of $65.6 thousand in direct costs and $61.9 thousand in overheads. BST's estimated allocation was $127.5 thousand, or 100.00% of this cost.

DISCLOSURE NO.

SUBJECT: Employee Stock Ownership Plan (ESOP)

STATEMENT OF FACTS:

BellSouth incorporated a leveraged ESOP ("LESOP") feature into both the existing Management Savings and Employee Stock Ownership Plan ("MSP") and the existing Savings and Security Plan ("SSP") in 1990. The ESOP Trusts purchased shares of BSC common stock with the proceeds of bank loans subject to a thirteen year repayment schedule. BSC guaranteed the debt of the Trusts. (Note H of the BellSouth Corporation 1992 Annual Report, responses to data requests 6-084 and 6-088, and interview with Mr. Greg Griffin, the BellSouth Corporation Subject Matter Expert with respect to the LESOP.)

The usage of the leveraged ESOP provides BSC with certain tax benefits and has lowered its cost of financing. Certain tax benefits were obtained by BSC for common stock dividends paid into the Trusts for debt service and by the Trusts for principal repayments on the bank debt, neither of which are otherwise deductible to reduce tax expense except in conjunction with a leveraged ESOP. (Responses to Staff data requests 6-084, 6-089, and 6-090, and interview with Mr. Greg Griffin.)

The Emerging Issues Task Force Abstract 89-10 (Sponsor's Recognition of Employee Stock Ownership Plan Debt) and a publication authored by Gerald Kalish (ESOPS - The Handbook of Employee Stock Ownership Plans) discuss the leveraged ESOP and its use as a financing technique. These publications discuss the requirement that the LESOP be accounted for by recognizing the bank loan as debt and by reducing the common equity by an equivalent amount on the books of the corporation that guarantees the debt. BSC accounted for its leveraged ESOP in this manner. (Note H of the BellSouth Corporation 1992 Annual Report and responses to data requests 6-084, 6-085, and 6-088).

To illustrate how the LESOP serves as a financing technique, the following tables provide a pre and post illustration of the effect of the increased leverage on the capital structure and the concomitant reduction in the weighted cost of capital. The second table illustrates that although the <u>total capitalization</u> remains unchanged, its <u>composition</u> is changed to reflect the LESOP debt and the LESOP Trust acquisition of common shares. This financing technique reduces the illustrative company's weighted cost of capital and its total financing costs in a manner similar to any other form of borrowing in order to repurchase common shares.

ILLUSTRATION OF
PRE LESOP
CAPITAL STRUCTURE AND COST OF CAPITAL
($millions)

	Capital $	Capital %	Cost %	Weighted Cost %	Cost $
Common Equity	$4,000	57.14%	13.00%	7.43%	$520
LTD - Non ESOP	3,000	42.86	8.00	3.43	240
LTD - ESOP		--		--	--
Total	$7,000	100.00%		10.86%	$760

There are two primary authoritative sources that describe the accounting requirements under Generally Accepted Accounting Principles for ESOPs which the Company is required to follow. The first is Statement of Position 76-3, "Accounting Practices for Certain Employee Stock Ownership Plans," issued by the American Institute of Certified Public Accountants. Statement of Position of 76-3 requires that the obligation of the ESOP be recorded as a liability (debt) in the financial statements of the employer when the the employer has guaranteed the debt service requirements. It requires an offsetting reduction to common equity. Both the debt and the common equity offset amounts are reduced as the ESOP makes principal repayments on the loan(s). It also requires that the expense recognized by the employer be segregated between compensation and interest, stating:

> "Since the debt of the ESOP is, in substance, the employer's debt, the Division believes that the employer should report separately the compensation element and the interest element of the annual contribution, and should disclose the related interest rate and debt terms in the footnotes to the financial statements."

The second of the two authoritative accounting requirements is the Emerging Issues Task Force Abstract No. 89-8, "Expense Recognition for Employee Stock Ownership Plans." This Abstract requires the use of the shares allocated method of ESOP expense recognition in accordance with the following formula (the first component represents compensation expense):

$$\left(\frac{\textit{Shares Allocated for the Period}}{\textit{Total Shares Purchased}} \times \textit{Original Principal}\right) + \textit{Interest Incurred During Period}$$

Abstract No. 89-8 also requires that the common stock dividends utilized to service the ESOP debt be treated as a reduction to the amount of expense recognized.

The BSC Comptrollers Department initially computes the total expense, terming it "benefits expense." For BSC consolidated financial statement purposes only, BSC then allocates the common stock dividend offset between the compensation and interest expense components on the ratio of principal and interest in the ESOP debt service payments. It does not segregate the "benefits expense" into compensation and interest components on the accounting books of BST or BSC-HQ. (Responses to data requests 6-084 and 6-088.)

BSC assigns the total ESOP "benefits expense" to its subsidiaries, including BST and BSC-HQ, based upon the number of plan participants. The ESOP "benefits expense" assigned to BSC-HQ is subsequently allocated and billed to BSC subsidiaries including BST through the BSC overhead allocation process. (Interview with Mr. Greg Griffin.)

BSC does not provide a breakdown of benefits expense between compensation expense and interest expense to BST, BSC-HQ, or any of its subsidiaries. BSC only segregates the benefits expense between compensation and interest expense for the BSC consolidated financial statements. As a result of this accounting and assignment allocation process, the accounting books of BSC-HQ and BST do not segregate the interest expense component and, consequently, do not report the interest below the line as a financing cost. Rather, the BSC leveraged ESOP financing cost is reported as an operating expense by BST, not only for the directly assigned cost, but also for the portion of the BSC-HQ's assigned cost that is subsequently allocated to BST through the overhead allocation process. BSC commenced this accounting and assignment/allocation when the leveraged ESOP feature was added to the MSP and the SSP. The Company has not discussed this treatment with its external auditor. (Response to data request 6-088 and interview with Mr. Greg Griffin.)

The assignment by BSC to BST and other subsidiaries of BSC interest expense, which is then treated by BST as a recoverable operating expense for ratemaking purposes, results in a further reduction to BSC's cost of capital. The following table provides a further illustration, consistent with the illustrations in the two previous tables, of the effect on the parent company's capital structure and the weighted cost of capital. Note that the illustrative parent company's total capital outstanding continues to remain unchanged from the post-LESOP previous table, while the weighted cost of capital declines by the amount of interest assigned or allocated to its subsidiaries.

ILLUSTRATION OF
PARENT COMPANY ALLOCATION
OF LESOP INTEREST COST TO SUBSIDIARIES
($000)

	Capital $	Capital %	Cost %	Weighted Cost %	Cost $
Common Equity	$3,000	42.86%	13.00%	5.57%	$390
LTD - Non ESOP	3,000	42.86	8.00	3.43	240
LTD - ESOP	1,000	14.29	8.00	1.14	80
Subtotal	7,000	100.00		10.14	710
ESOP Interest					
Allocated to Subs		--		-1.14	- 80
	$7,000	100.00%		9.00%	$630

In 1992, BSC incurred ESOP expense of $112,300 thousand, consisting of $71,800 thousand in compensation expense and $40,500 thousand in interest expense. It assigned $101,502 thousand to BST and $1,940.9 thousand to BSC-HQ, of which BST was in turn allocated $1,503.4 thousand through the BSC overhead allocation process. Of the $103,442.9 thousand total assigned and allocated to BST for ESOP expense, $66,137.1 thousand was compensation expense and $37,305.8 thousand was interest expense based upon the BSC consolidated allocation between each of those components.

BSC recieves the tax benefit associated with deduction of dividends on the stock held by the ESOP trust. This tax benefit is retained by BSC and is not allocated to BST.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Affairs Department

External Affairs (RC H94040)

STATEMENT OF FACTS:

The Corporate Affairs/External Affairs RC is responsible to "[e]ncourage and support BellSouth corporate employees' involvement in community and civic volunteer efforts and handle related special projects. Develop a BellSouth arts program and an in-kind contributions policy and program. Develop a contributions policy handbook and corporate membership directory. Provide staff support and handle special projects for the Chairman related to his external activities, such as Chairman and Executive Board Committee Member of the U.S. Chamber of Commerce, member of United Way of America's Board of Governors, Business Roundtable, Boy Scouts of America, Woodruff Arts Center, Atlanta Historical Society, etc. Manage all fund-raising efforts related to the Chairman's external activities, including the National Alliance of Business, U.S. Chamber of Commerce, the JFK Center for the Performing Arts and National Junior Achievement." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that "[a]ll functions are provided at the corporate level and are not connected with any specific corporate entity." BSC utilizes exception billing to the marketing general allocator and the the BellSouth Classic. BSC does not utilize project billing for this RC.

Charitable contributions are not allowed rate recovery in Florida. (General Telephone Company proceeding, Order No. 10418, page 16, November 23, 1981.)

The methodology used to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H94040 in 1992 were $4,462.5 thousand, consisting of $3,774.0 thousand in direct costs and $688.5 thousand in overheads. BST's estimated allocation was $3,715.2 thousand, or 83.25% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Affairs Department

Corporate and Education Affairs (RC H94100)

STATEMENT OF FACTS:

The Corporate Affairs/Corporate and Education Affairs RC "[o]versees BellSouth's interests in education and its support for local, regional, and national issues of community interest. Directs the BellSouth Foundation which provides financial support to education in the nine-state operating territory; oversees the director of education affairs; coordinates the Global Leaders program; and directs the corporate contributions and membership. (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries based on the rationale that "[t]he education and community support provided through Corporate and Education Affairs support the subsidiaries' needs for qualified employees, for educated consumers, for strong communities and for economic development. Several methodologies, therefore apply." BSC utilizes exception billing to the marketing general allocator and to the BellSouth Classic. BSC utilizes project billing for the costs of scholarship programs available to employees' children.

Charitable contributions are not allowed rate recovery in Florida. (General Telephone Company proceeding, Order No. 10418, page 16, November 23, 1981.)

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H94100 in 1992 were $508.4 thousand, consisting of $429.9 thousand in direct costs and $78.5 thousand in overheads. BST's estimated allocation was $423.2 thousand, or 83.25% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Affairs Department

Headquarters (RC H94110)

STATEMENT OF FACTS:

The Corporate Affairs/Headquarters RC is responsible for the "[a]dministration of BellSouth sponsored programs dedicated to improving public education in the southeast, using existing corporate resources." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that "[s]ervices provided benefit all entities. (No methodology identified that would more accurately allocate services provided.)" BSC does not utilize exception or project billing for this RC.

Charitable contributions are not allowed rate recovery in Florida. (General Telephone Company proceeding, Order No. 10418, page 16, November 23, 1981.)

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H94110 in 1992 were $242.3 thousand, consisting of $204.9 thousand in direct costs and $37.4 thousand in overheads. BST's estimated allocation was $201.7 thousand, or 83.25% of this cost.

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Affairs Department

Charitable Contributions

STATEMENT OF FACTS:

BellSouth Corporation allocated and billed BellSouth Telecommunications and its other affiliates for the costs of the charitable contributions incurred during 1992. The direct costs and overhead loadings are recognized by BellSouth Corporation in the Public Relations Department and charged to BSC account 756. The costs are then treated as a departmental (corporate) overhead and allocated to BST and other BSC affiliates in proportion to the allocations of BSC direct costs (primarily salaries and wages). BST does not account separately for its allocation of BSC charitable contribution costs in a below the line account. (Response to data request 6-060.)

BellSouth Corporation Headquarters billed each of the subsidiaries the following amounts during 1992 for the costs of charitable contributions.

BELLSOUTH CORPORATION
BILLING TO SUBSIDIARIES
CHARITABLE CONTRIBUTIONS EXPENSE
1992
($000s)

	Amount	% of Total
BellSouth Telecommunications	$1,894.5	83.13%
BellSouth Business Systems	75.1	3.30%
BellSouth Enterprises	309.4	13.57%
Total	$2,279.0	100.00%

Source: Response to data request 6-060.

In 1992, BellSouth Corporation billed its subsidiaries a total of $2,279.0 thousand for charitable contributions expenses. The billings to BellSouth Telecommunications totalled $1,894.5 thousand, or 82.13% of the total charitable contribution costs billed by BSC.

The amounts billed by BSC to its subsidiaries for charitable contributions do not reflect the administration expenses incurred by the BellSouth Foundation. All administrative expenses associated with the BellSouth Foundation are charged to the BellSouth Corporate and Educational Affairs Department under RC H94100. The general allocator is applied to these expenses to allocate them among the subsidiaries. (Response to data request 6-083.)

Charitable contributions are not allowed rate recovery in Florida (General Telephone Company proceeding, Order No. 10418, page 16, November 23, 1981.)

OPINION: BST's accounting treatment of its allocation of BSC charitable contributions expense, in effect, places the ratepayers in a position of being involuntary donors since they have no control over whether the contribution should be made or what charity should receive the contribution, nor do residential ratepayers receive any tax benefits from the contributions. While such contributions are commendable, they are not necessary for the provision of regulated utility services and should be made on behalf of the Company and its shareholders and not the ratepayers. As a result, the charitable contributions incurred by BSC and allocated to BST through the overhead cost allocation and billing process results in the overstatement of above the line BST operating expenses.

RECOMMENDATION:

1992 BST operating expenses should be reduced by $1,894.5 thousand or 100% of the charitable contributions expense allocation from BSC. Charitable contributions should be treated consistently for rate recovery purposes whether incurred directly by BST or incurred by BSC or other BSC affiliates and allocated to BST as an operating expenses. BSC should retain 100% of these costs. As an alternative, BST should be directed to modify its accounting treatment to record the costs of charitable contributions assigned directly or allocated by BSC or other cost-based affiliate transactions in a below the line account.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Planning Department

Strategic Research (RC H23020)

STATEMENT OF FACTS:

The Corporate Planning/Strategic Research RC provides "[s]trategic primary and secondary marketing research in support of entity planning efforts [and l]ibrary resources for all BellSouth companies." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the "[f]unctions performed benefit the entire Corporation. No cost causative relationships between expenses incurred and duties performed exists." Marketing research services performed on behalf of specific subsidiaries are project billed.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H23020 in 1992 were $950.0 thousand, consisting of $441.3 thousand in direct costs and $508.7 thousand in overheads. BST's estimated allocation was $784.5 thousand, or 82.59% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Planning Department

Subsidiary Strategic Planning (RC H23400)

STATEMENT OF FACTS:

The Corporate Planning/Subsidiary Strategic Planning RC is responsible for "[d]eveloping guidelines for strategic planning and analyz[ing] strategic/operational plans of entities to ensure support of corporate goals. Conduct[ing] scenario planning to determine view(s) of the industry landscape and develop/evaluate strategic options for BellSouth. Based upon this evaluation, recommend[ing] changes to the corporation direction." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the "[f]unctions performed benefit the entire Corporation. No cost causative relationships between expenses incurred and duties performed exists." There is no exception billing or project billing for any planning that might be performed for specific subsidiaries.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the total estimated corporate services costs incurred by and billed for RC H23400 in 1992 were $618.2 thousand, consisting of $287.2 thousand in direct costs and $331.0 thousand in overheads. BST's estimated allocation was $510.5 thousand, or 82.59% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Planning Department

Advanced Strategic Planning (RC H23500)

STATEMENT OF FACTS:

The Corporate Planning/Advanced Strategic Planning RC is responsible for "[f]ormulat[ing] corporate strategic plan. Develop[ing] Performance Measurements System requirements. Analyz[ing] specific corporate issues and recommend[ing] direction." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the "[f]unctions performed benefit the entire Corporation. No cost causative relationships between expenses incurred and duties performed exists." There is no exception billing or project billing for any planning that might be performed for specific subsidiaries.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H23500 in 1992 were $1,355.5 thousand, consisting of $629.6 thousand in direct costs and $725.8 thousand in overheads. BST's estimated allocation was $1,119.4 thousand, or 82.59% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Planning Department

Technical Planning (RC H23600)

STATEMENT OF FACTS:

Corporate Planning/Technical Planning RC is responsible for "[p]erform[ing] research, conduct[ing] studies and [p]reparing position papers on specific projects as assigned by the Chairman of BellSouth and the Corp. Policy Council. Prepar[ing] supporting documentation and illustrations, as well as preparing presentations for corporate officers concerning the projects mentioned above. Address[ing] other specific questions and issues as appropriate concerning numerous BellSouth companies or LOBs and recommend[ing] corp. solutions to BellSouth executives." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the "[f]unctions performed benefit the entire Corporation. No cost causative relationships between expenses incurred and duties performed exists." There is no exception billing or project billing for any planning that might be performed for specific subsidiaries.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H23600 in 1992 were $948.7 thousand, consisting of $440.7 thousand in direct costs and $508.0 thousand in overheads. BST's estimated allocation was $783.5 thousand, or 82.59% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Corporate Secretary Department

Board Matters (RC H11101)

STATEMENT OF FACTS:

The Corporate Secretary/Board Matters RC coordinates the BellSouth Corporation Board of Directors' activities (board and committee meetings), administers the board compensation plans, and maintains the corporate records. (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the corporate services costs of this RC to its subsidiaries, based on the rationale that "Services provide support to all entities. No other method identified would more accurately identify the services provided." However, BSC utilizes an allocation base of subsidiary equity for the costs incurred by RC H11311 Corporate Secretary/Investor and Shareholder Relations, based on the rationale that "Headquarters management and shareholders services relate to subsidiary's equity."

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total BSC corporate services costs billed for RC H11101 Board Matters in 1992 were $2,104.9 thousand, consisting of $1,976.0 thousand in direct costs and $128.9 in overheads. BST's estimated allocation was $1739.2 thousand, or 82.62% of this cost. The 1992 allocation of RC H11311 costs to BST was 72.87%.

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Executive Department

STATEMENT OF FACTS;

The Company did not provide detailed descriptions of the activities of the Executive Department in response to data requests for that information

The Company also did not provide descriptions of the cost allocation bases, except for two RCs, that could be traced to the rationale underlying the selection of the specific allocation bases, although also requested to through data requests for that information. A listing of allocation bases necessary to make the determination that the information had not been provided, was not received until September 20, 1993, nearly three months after it was requested.

BellSouth Corporation Headquarters billed each of the subsidiaries the following amounts during 1992 for costs incurred by the Executive Department.

BELLSOUTH CORPORATION
BILLING TO SUBSIDIARIES
1992
($000s)

Executive Department

	Corporate Services Billing	Project Billing	Total	% of Total
BellSouth Telecommunications	[illegible],302.6	$176.2	$8,478.8	77.20%
BellSouth Business Systems	427.0	0.0	427.0	3.89%
BellSouth Enterprises	2,[illegible]	0.0	2,076.8	18.91%
Total	$1[illegible]06.4	$176.2	$10,982.6	100.00%

Source: Response to data request 6-[illegible].

In 1992, BellSouth Corporation billed its subsidiaries a total of $10,806.4 thousand for Executive Department corporate services costs consisting of $5,811.4

thousand in direct costs and $4,995.1 thousand in overhead costs. The billings to BellSouth Telecommunications totalled $8,302.6 thousand consisting of $4,428.3 thousand in direct costs and $3,874.3 thousand in overhead costs. BST was billed for 76.83% of the Executive Department corporate services costs.

The Executive Department is comprised of RCs that are headed by the senior executives of BellSouth Corporation. As disclosed in its 1992 Annual Report and Cost Allocation Manual, BellSouth Corporation is the holding company for BST, BSE, BSCF, BSDC, and holds an ownership interest in 1155 Peachtree Associates. In its response to data request 6-065, the Company provided detailed explanations of the costs and the rationale underlying the selection of the allocation bases for only two of the Executive Departments, both designated as RC HEOH40, Internal Auditing & Security and Information Services & Marketing Plans. BSC allocates the costs of these two RCs on the total number of employees, although the documentation for the latter RC states that the general marketing allocator is utilized. (Cost Assignment Forms provided in response to data requests 6-032 and 6-065 and the 12/92 COPS Billing Binder.)

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
External Affairs Department

Executive Speechwriting (RC H92030)

STATEMENT OF FACTS:

The External Affairs/Executive Speechwriting RC is responsible for "[w]rit[ing] speeches for senior corporate executives." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that "[a]ll functions are provided at the corporate level and are not connected with any specific corporate entity." There is exception reporting to the marketing general allocator and the BellSouth Classic. There is no project billing.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H92030 in 1992 were $145.9 thousand, consisting of $112.0 thousand in direct costs and $33.9 thousand in overheads. BST's estimated allocation was $121.0 thousand, or 82.90% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
External Affairs Department

Strategic Communications (RC H92010)

STATEMENT OF FACTS:

The External Affairs/Strategic Communications RC is responsible to "[d]irect Issues Management function that services all public relations entities. Coordinates internal and external opinion research for public relations purposes. Provide strategic planning and communications. Coordinate MFJ/grassroots efforts." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes total employees for all entities to allocate the costs of this RC, based on the rationale that "[a]ll functions are provided at the corporate level and are assumed to benefit all employees equally." BSC utilizes exception billing to the marketing general allocator and the costs of the BellSouth Classic. It utilizes project billing for the MFJ grassroots effort.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H92010 in 1992 were $1,246.2 thousand, consisting of $956.4 thousand in direct costs and $289.8 thousand in overheads. BST's estimated allocation was $1,006.9 thousand, or 80.80% of this cost.

OPINION: The allocation of External Affairs/Strategic Communication expense to BST was overstated by $1,006.9 thousand, the entire amount allocated to BST. The costs should be retained by BSC. These costs were not caused by BST but rather by the holding company structure that exists to facilitate the investment in and operation of nonregulated enterprises. BST has its own management and organizational structure. The BSC costs are incremental to those incurred directly by BST. Further, these costs were not caused by employees and bear no relationship to the number of employees. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Federal Relations Department

Federal Relations (RC H71100)

STATEMENT OF FACTS:

The Federal Relations Department/Federal Relations RC is responsible to "identify issues, policies and actions that could affect BellSouth and provide this information to BellSouth management and policymakers. Provide information on BellSouth's existing and future operations as well as its position on national business issues to Federal legislators, their staffs and other key decision makers and stakeholders." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC allocates the cost of this RC on the general allocator, based upon the rationale that the "impact of issues dealt with is generally corporate-wide and assessment of direct benefit to a specific subsidiary is impossible (or impractical)." Certain costs related directly to MFJ and registered lobbyists are project billed.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H71100 in 1992 were $1,880.9 thousand, consisting of $1,603.9 thousand in direct costs and $277.0 thousand in overheads. BST's estimated allocation was $1,552.9 thousand, or 82.56% of this cost.

OPINION: The allocation of Federal Relations/Federal Relations RC H71100 corporate services costs to BST is overstated by $612.5 thousand, based on a 50% BST/50% BSC retained (or otherwise allocated by BSE or BBS subsidiaries. The nature of these types of corporate services costs suggests that the regulated entity was no more the cost causer than the nonregulated entities. Thus, based upon equal cost causation, BST should be allocated no more than 50% of the RC's costs. A full disallowance may be required for states that do not allow any level of recovery for lobbying types of expense in the ratemaking process. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Federal Relations Department

BSDC Governmental Affairs Atlanta Office (RC H71410)

STATEMENT OF FACTS:

The Federal Relations Department/BSDC Governmental Affairs Atlanta Office RC (H71410) is responsible for "[p]rovision of staff support activities concerning budgets, business and strategic plans, human resources and comptrollers interface and administration of the BellSouth Federal Political Action Committee." BSC allocates the cost of this RC on a composite of direct reports, based upon the rationale that it "provides administrative support for entire Governmental Affairs staff." There is no exception billing or project billing indicated in the Commission's documentation, not even for the Bellsouth Fed PAC activities. (Cost Assignment Form provided in response to data request 6-065.)

The methodology utilized to quantify the 1992 billing activity for each RC is discussed on page 5 of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H71410 in 1992 were $260.5 thousand, consisting of $222.1 thousand in direct costs and $38.4 thousand in overheads. BST's estimated allocation was $215.2 thousand, or 82.63% of this cost.

AUDIT OPINION

The allocation of Federal Relations/BSDC Governmental Affairs Atlanta Office RC H71410 corporate services costs to BST is overstated by $85.0 thousand. The nature of these types of corporate services costs suggests that the regulated entity was no more the cost causer than the nonregulated entities. Thus, based upon equal cost causation, BST should be allocated no more than 50% of the RC's costs. A full disallowance may be required for states that do not allow lobbying types of expense recovery in the ratemaking process. Further, the costs of BellSouth Fed PAC should not be allocated to BST since the costs are not related by the provision of regulated utility services. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION

1992 BST expenses of $85.0 thousand should be disallowed. BSC should modify its allocation factor to allocate 50% to BST and to either retain 50% of the costs or otherwise allocate them to its nonregulated affiliates. In addition, BSC should exception or project bill the costs to Fed PAC activities and retain them 100%.

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Federal Relations Department

Governmental Affairs - Washington D.C. (RC H71420)

STATEMENT OF FACTS:

The Federal Relations Department/Governmental Affairs RC is charged with the "[c]ommon area costs for Governmental Affairs Washington Office." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes a composite of all Governmental Affairs RCs that the "RC established to cover common area costs in support of the entire BellSouth D.C. staff in the Washington office."

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H71420 in 1992 were $1,461.6 thousand, consisting of $1,246.4 thousand in direct costs and $215.2 thousand in overheads. BST's estimated allocation was $1,207.7 thousand, or 82.63% of this cost.

OPINION: The allocation of Federal Relations/Governmental Affairs - Washington D.C. RC H71420 corporate services costs to BST is overstated by $476.9 thousand. The nature of these types of corporate services costs suggests that the regulated entity was no more the cost causer than the nonregulated entities. Thus, based upon equal cost causation, BST should be allocated no more than 50% of the RC's costs. A full disallowance may be required for states that do not allow lobbying types of expense recovery in the ratemaking process. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION:
1992 BST expenses of $476.9 thousand should be disallowed. BSC should modify its allocation factor to retain allocate 50% to BST and to either retain 50% of the costs or otherwise allocate them to its nonregulated affiliates.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Federal Relations Department

Governmental Affairs - Federal Regulatory (RC H73070)

STATEMENT OF FACTS:

The Federal Relations Department/Governmental Affairs - Federal Regulatory RC has "[i]interface responsibilities with Congressional Staffs in Washington, D.C. for the states represented by North Carolina, South Carolina, Georgia & Florida House & Senate Members to provide them with information on BellSouth Corp.'s existing and future operations." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the "[i]mpact of issued dealt with is generally corporate-wide and assessment of direct benefit to a specific subsidiary is impossible (or impractical)." BSC does not utilize exception billing, but does project bill for MFJ grassroots lobbying and for social memberships dues.

Lobbying expenses have consistently been disallowed in Florida rate proceedings on the basis that they are more properly funded by shareholders. (Order No. 7669, page 10, March 7, 1977 and Order No. 10449, page 20, December 15, 1981.)

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H73070 in 1992 were $265.8 thousand, consisting of $226.6 thousand in direct costs and $39.2 thousand in overheads. BST's estimated allocation was $219.4 thousand, or 82.56% of this cost.

OPINION: The allocation of Federal Relations/Governmental Affairs - Federal Regulatory RC H73070 corporate services costs to BST is overstated by $219.4 thousand. For the other states, if any recovery of lobbying types of expenses is allowed for ratemaking recovery, the nature of these types of corporate services costs suggests that both the regulated and nonregulated entities cause the costs equally. Therefore, under the concept of equal cost causation, BST should be allocated no more than 50% of the RC's costs. A full disallowance may be required for states that do not allow lobbying types of expense recovery in the ratemaking process. Further, the costs of BellSouth Fed PAC should not be allocated to BST since the costs are not related by the provision of regulated utility services. As discussed more extensively in the General Section of this chapter of the audit report, the MFJ and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION: 1992 BST expenses of $219.4 thousand should be disallowed. BSC should modify its allocation factor to retain 100% of the costs or otherwise allocate them to its nonregulated affiliates.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation Federal Relations Department

Governmental Affairs - Federal Regulatory (RC H73080)

STATEMENT OF FACTS:

The Federal Relations Department/Governmental Affairs - Federal Regulatory RC has "[i]interface responsibilities with Congressional Staffs in Washington, D.C. for the states represented by Kentucky, Tennessee, Louisiana, Mississippi & Alabama to provide them with information on BellSouth Corp.'s existing and future operations." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that the "[i]mpact of issued dealt with is generally corporate-wide and assessment of direct benefit to a specific subsidiary is impossible (or impractical)." BSC does not utilize exception billing, but does project bill for MFJ grassroots lobbying and for social memberships dues.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H73080 in 1992 were $452.4 thousand, consisting of $385.8 thousand in direct costs and $66.6 thousand in overheads. BST's estimated allocation was $373.5 thousand, or 82.56% of this cost.

OPINION: The allocation of Federal Relations/Governmental Affairs - Federal Regulatory RC H73080 is overstated by $373.5 thousand. For the other states, if any recovery of lobbying types of expenses is allowed for ratemaking recovery, the nature of these types of corporate services costs suggests that both the regulated and nonregulated entities cause the costs equally. Therefore, under the concept of equal cost causation, BST should be allocated no more than 50% of the RC's costs. Further, the costs of BellSouth Fed PAC should not be allocated to BST since the costs are not related by the provision of regulated utility services. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION: 1992 BST expenses of $373.5 thousand should be disallowed. BSC should modify its allocation factor to retain 100% of the costs or otherwise allocate them to its nonregulated affiliates.

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Financial Management Department

Consolidated Operations (RC H22500)

STATEMENT OF FACTS:

The Financial Management/Consolidated Operations RC "[p]rovides support to senior management concerning financial matters which affect BellSouth." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes subsidiary operating expenses to allocate the costs of this RC to BST and BSE, based upon the rationale that this "most accurately sends the costs to our subsidiaries."

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H22500 in 1992 were $1,035.2 thousand, consisting of $431.2 thousand in direct costs and $604.0 thousand in overheads. BST's estimated allocation was $818.1 thousand, or 79.03% of this cost.

actor to retain 100% of these costs.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Human Resources Department and BellSouth Human Resources, Inc.

Staffing, Research and Development (RC H52050)

STATEMENT OF FACTS:

The Human Resources Department/Staffing, Research and Development RC has responsibility for performing the following functions: (Cost Assignment Form provided in response to data request 6-065.)

- "Provid[ing] basic research, development and validation for job qualification selection screens.
- Provid[ing] research, design and development, operations monitoring and quality assurance support for assessment programs used for selections.
- Develop[ing] and provid[ing] research support for management and non-management selection and staffing programs.
- Develop[ing] management and non-management hiring and staffing policy.
- Develop[ing] corporate policies on employee selection.
- Develop[ing] and maintain[ing] the BellSouth Testing Manual and the policy portion of the General Employment Manual and the Selection Workshop Manual.
- Develop[ing] and maintain[ing] BellSouth non-management performance appraisal policy. Focus[ing] and develop[ing] corporate responses to workplace enhancements and employee skills acquisition.
- Develop[ing] and maintain[ing] early retirement incentive programs.
- Develop[ing] and maintain[ing] force management programs.
- Develop[ing] and maintain[ing] career alternative plans.
- Address[ing] policy matters for match selection system.
- Focus[ing] and develop[ing] corporate response to work, family and personal life issues.
- Provid[ing] corporate monitoring, government reporting and corporate response (internal and external) for EEO/AA and other civil rights legislation."

The information included in the Cost Assignment Form states that BSC utilizes the number of employees in each subsidiary participating in the BellSouth pension and benefit plans to allocate costs, based on the rationale that "[u]se of services provided/functions performed is roughly proportional to employee headcount for regulated entities. Total headcount overstates BSE participation (particularly by acquired companies), therefore BellSouth pension participation is most accurate choice." No costs are exception billed or project billed.

In a Louisiana regulatory proceeding (Docket No. U-17949, Subdocket A), the Company acknowledged that in 1992 BSC incurred costs of various force management and early retirement programs. In late 1992, an article appearing in the Wall Street Journal reported that BSC announced that it had completed a restructuring study and would consolidate staff functions of BSE into BSC, reducing the number of positions and costs at BSE and BSC. This has been confirmed through interviews in this audit.

OPINION: The allocation of Human Resources/Staffing, Research and Development costs to BST was overstated by the costs of the restructuring study(ies) and by the costs of consolidating BSE and BSC functions. These costs were not caused by BST and should be retained by BSC. BSC can identify and quantify these costs, contrary to its response to the data requests. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION: BSC should be required to quantify the costs of its consolidation/restructuring studies as well as the implementation costs including those related to the force reduction and early retirement program activities of this RC. These costs should be disallowed. Further, BSC should project bill and retain these costs in the future unless directly related to and caused by the regulated activities of BST.

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DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Human Resources Department and BellSouth Human Resources, Inc.

Strategic Planning (RC H53040)

STATEMENT OF FACTS:

The Human Resources Department/Strategic Planning RC is responsible for the following functions: (Cost Assignment Form provided in response to data request 6-065.)

- "Research[ing], document[ing], track[ing] and forecast[ing] planning issues and provid[ing] technical support for policy development and programs, utilizing workforce planning information.
- Coordinat[ing] and develop[ing] the Human Resources Strategic Plan and provid[ing] Human Resources planning and consultative services to various planning constituencies.
- Provid[ing] planning and consultative services to aid in the development of high level plans for affiliated company Human Resources organizations and departmental staffs.
- Conduct[ing] internal demographic scans and employee opinion surveys (e.g. ExChange) plus external environmental scans and synthesize trend implications for planning purposes."

The information included in the Cost Assignment Form states that BSC utilizes the number of employees in each subsidiary participating in the BellSouth pension and benefit plans to allocate costs, based on the rationale that "[u]se of services provided/functions performed is roughly proportional to employee headcount for regulated entities. Total headcount overstates BSE participation (particularly by acquired companies), therefore BellSouth pension participation is most accurate choice." No costs are exception billed or project billed.

In a Louisiana regulatory proceeding (Docket No. U-17049, Subdocket A), the Company acknowledged that in 1992, BSC incurred costs of various force management and early retirement programs. In late 1992, an article appearing in the Wall Street Journal reported that BSC announced that it had completed a restructuring study and would consolidate staff functions of BSE into BSC, reducing the number of positions and costs at BSE and BSC. This has been confirmed through interviews in this audit.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation Human Resources Department and BellSouth Human Resources, Inc.

Performance Measurement (RC H53050)

STATEMENT OF FACTS:

The Human Resources/Performance Measurement RC has responsibility for performing the following functions: (Cost Assignment Form provided in response to data request 6-065.)

"• Develop[ing] and implement[ing] performance management processes for directing and motivating employee and organizational performance towards the accomplishment of commitments in support of business goals and strategic objectives.

• Develop[ing] and provid[ing] policy and research support for programs in the area of performance management including performance appraisal.

• Develop[ing] and implement[ing] new programs and processes to assist in the management of organizational change, redesign of organizations and jobs, and streamlining of work processes."

The information included in the Cost Assignment Form states that BSC utilizes the number of employees in each subsidiary participating in the BellSouth pension and benefit plans to allocate costs, based on the rationale that "[u]se of services provided/functions performed is roughly proportional to employee headcount for regulated entities. Total headcount overstates BSE participation (particularly by acquired companies), therefore BellSouth pension participation is most accurate choice." No costs are exception billed or project billed.

In a Louisiana regulatory proceeding (Docket No. U-17948, Subdocket A), the Company acknowledged that in 1992, BSC incurred costs of various force management and early retirement programs. In late 1992, an article appearing in the Wall Street Journal reported that BSC announced that it had completed a restructuring study and would consolidate staff functions of BSE into BSC, reducing the number of positions and costs at BSE and BSC. This has been confirmed through interviews in this audit.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Internal Auditing Department

General

STATEMENT OF FACTS:

BellSouth Corporation Headquarters billed each of the subsidiaries the following amounts during 1992 for costs incurred by the Internal Auditing Department.

BELLSOUTH CORPORATION
BILLING TO SUBSIDIARIES
1992
($000s)

Internal Auditing Department

	Corporate Services Billing	Project Billing	Total	% of Total
BellSouth Telecommunications	$2,866.5	$0.0	$2,866.5	57.84%
BellSouth Business Systems	88.3	0.8	89.1	1.80%
BellSouth Enterprises	1,663.3	336.7	2,000.0	40.36%
Total	$4,618.1	$337.5	$4,955.6	100.00%

Source: Response to data request 6-030.

In 1992, BellSouth Corporation billed its subsidiaries a total of $4,618.1 thousand for Internal Auditing Department corporate services costs. The billings to BellSouth Telecommunications totalled $2,866.5 thousand or 62.07% of the total Internal Auditing Department corporate services costs.

In the Louisiana regulatory proceeding (Docket No. U-17949, Subdocket A) involving BSC and BST, it was noted that the Internal Auditing Department conducts audits in many areas including compliance with the JCO and Part 64. The costs of these compliance audits are allocated 100% to BST.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Legal Department

Intellectual Properties (RC H61340)

STATEMENT OF FACTS:

The Legal Department/Intellectual Properties RC is responsible to [h]andle all lawsuits brought against BellSouth Corporation and regarding the adoption and use of trademarks, the protection of inventions, copyrightable materials and trade secrets, obtain trademark, patent and copyright protection of intellectual property, protect the Company against the misuse of third party intellectual property rights, enforce the Company's intellectual property rights against others, and negotiate and draft license agreements, nondisclosure agreements and other related documents." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes an allocator that allocates 35% to BST, 35% to BSE, and 30% through the general allocator, based upon the rationale that "[t]rademarks and patents developed by the BellSouth companies will be owned by BellSouth Corporation and the advice given to subsidiary companies protects the ownership interest of BellSouth Corporation. While copyrights and trade secrets are owned by the individual subsidiaries, the protection of such intellectual property is of general benefit to all of the BellSouth companies." Costs related to acquisitions are project billed.

BSC has determined that it, rather than BST, owns the Bell system trademarks, logos, and related intellectual property rights. The MFJ states that:

> "A. Not later than six months after the effective date of this Modification of Final Judgment, defendant AT&T shall submit to the Department of Justice for its approval, and thereafter implement, a plan of reorganization. Such plan shall provide for the completion, within 18 months after the effective date of this Modification of Final Judgment, of the following steps:
>
> 1. The transfer from AT&T and its affiliates to the BOCs, or to a new entity subsequently to be separated from AT&T and to be owned by the BOCs, of sufficient facilities, personnel, systems, and rights to technical information . . . ."

In an October 6, 1993 interview with Mr. Mike Hostinsky (Assistant Comptroller), it was confirmed that neither BSC or any of the nonregulated affiliates has provided any compensation through royalties or other means for the utilization of BST's intellectual property.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate service costs incurred and billed for RC H61340 in 1992 were $534.4 thousand, consisting of $308.4 thousand in direct costs and $226.0 thousand in overheads. BST's estimated allocation was $325.1 thousand, or 60.84% of this cost.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Legal Department

Litigation (RC H61350)

STATEMENT OF FACTS:

The Legal Department/Litigation RC is responsible to "[h]andle all lawsuits brought against BellSouth Corporation with the exception of labor law cases; provide record retention advice for BellSouth Corporation and BellSouth Telecommunications, Inc. ("BST"); provide legal advice to the BellSouth Telecommunications Data Security group, provide advice and assistance to BellSouth Corporation and BellSouth Telecommunications, Inc. concerning the organizational sentencing guidelines and negotiate and approve all contracts entered into by BellSouth Corporation." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC allocates 100% of the cost of this RC to BST, based on the rationale that "legal services are rendered in one of two ways: (1) directly on behalf of of BellSouth Corporation which benefit inures to regulated and non-regulated business as provided above; and (2) to the regulated companies in which case investment is an appropriate method of determining basis for allocation." There is no exception or project billing.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate service costs incurred and billed for RC H61350 in 1992 were $189.2 thousand, consisting of $109.2 thousand in direct costs and $80.0 thousand in overheads. BST's estimated allocation was $189.2 thousand, or 100.00% of this cost. The general allocator was 82.75% to BST.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Legal Department

Assistant Secretary - Corporate Counsel (RC H61410)

STATEMENT OF FACTS:

The Legal Department/Assistant Secretary - Corporate Counsel RC is responsible to "[p]rovide counsel to BSHQ and Board of Directors on corporate law and practice; coordination of actions and materials requiring Board approval; advice and review as to shareholder matters, proxy development and corporate governance practices; compliance with all foreign, federal and state securities laws, SEC rules and regulations, state and foreign corporate laws, stock exchange requirements (foreign and domestic) and other miscellaneous corporate matters." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC, based on the rationale that "[f]unctions directly support shareholder relations activities, general corporate and financial, and BSHQ Board of Directors which in turn benefits all entities. (No methodology identified that would more accurately allocate services provided.) Work for specific entities or related to mergers/acquisitions is captured and billed to the non-regulated entity involved."

BSC utilizes an allocation base of subsidiary equity for the costs incurred by RC H11311 Corporate-Secretary/Investor and Shareholder Relations, based on the rationale that "Headquarters management and shareholder services relate to subsidiary's equity." (Cost Assignment Form provided in response to data request 6-065.)

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred and billed for RC H61410 in 1992 were $519.3 thousand, consisting of $279.6 thousand in direct costs and $239.7 thousand in overheads.. BST's estimated allocation was $428.4 thousand, or 82.50% of this cost. The 1992 allocation of RC H11311 costs to BST was 72.87%.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Public Relations Department

Media Relations (RC H91000)

STATEMENTS OF FACTS:

The Public Relations/Media Relations RC is responsible for "[i]information on new services and products, education of national consumer groups, letters to the editor, Q & A's and statements on corporation's position, media training, write and edit articles for use in trade magazines, newsletters to Board members and all BellSouth managers." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes the general allocator to allocate the costs of this RC to its subsidiaries, based on the rationale that "[g]oods and services are provided at the corporate level and are not linked to any specific entity." Certain costs are exception allocated to the marketing general allocator and to the BellSouth Classic. There is no project billing.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H91000 in 1992 were $1,167.8 thousand, consisting of $941.5 thousand in direct costs and $226.3 thousand in overheads. BST's estimated allocation was $966.7 thousand, or 82.78% of this cost.

OPINION: The allocation of Public Relations/Media Relation costs was overstated by $382.8 thousand. This amount represents 50% of the costs allocated to BST based upon the general allocator. The remaining expenses allocated to BST are exception billed to the marketing general allocator and to the BellSouth Classic. There is no logical support for the position that BST is the causer of 82.78% of this RC's corporate services costs that are not exception billed. The nature of these types of corporate services costs suggests that the regulated entity was no more the cost causer than the nonregulated entities. Thus, based upon equal cost causation, BST should be allocated no more than 50% of the RC's costs. A full disallowance may be required for states do not allow any level of recovery for media relations expense in the ratemaking process. Further, the costs of the BellSouth Classic are not necessary the provision of regulated utility services. These costs should be retained by BSC. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION: 1992 BST expenses of $382.8 thousand should be disallowed. BSC should modify its allocation factor for this RC to reflect no more than a 50% allocation to BST with the residual either retained by BSC or allocated to its nonregulated affiliates. All BellSouth Classic costs should be retained by BSC.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Treasury Department

Corporate Finance - Fed PAC (RC H11400)

STATEMENT OF FACTS:
The Treasury Department/Corporate Finance - Fed PAC RC "[a]ssists Vice President in developing philosophy and guiding principles for the entire Treasury organizations. Formulates policy for activities within the cash management/Treasury operations, methods/information systems, cash investments, shareowner financial services, budget/FED PAC, capital funding (borrowing and lending), foreign currency management, global financial planning, and earnings analysis areas. Integrates and coordinates all aspects of Corporate Finance - from the creation of the corporate financial plans to the implementation of the financing, investment of corporate funds, and management of corporate cash - with other BellSouth departments and with all BellSouth subsidiaries. Performs special assignments for upper management affecting multiple organizations." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes a composite of direct reports allocator to allocate the costs of this RC to its subsidiaries, based upon the rationale that "[m]anagerial expenses assigned based on costs associated with position's direct reports." BSC utilizes exception billing for the costs of Fed PAC activities.

It is the auditors understanding obtained in other regulatory proceedings involving BSC and BST that there is also a Treasury Department with financing, budgeting, and administrative activities at the BST organization level.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate services costs incurred by and billed for RC H11400 in 1992 were $171.7 thousand, consisting of $103.0 thousand in direct costs and $68.7 thousand in overheads. BST's estimated allocation was $130.4 thousand, or 75.94% of this cost. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Treasury Department

Financial Planning (RC H11423)

STATEMENT OF FACTS:

The Treasury/Financial Planning RC is responsible for "capital formation, capital structure, earnings objectives, investment banker services, stock exchange interface, debt rating interface, and debt equity studies." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes a subsidiary capitalization allocator to allocate the costs of this RC, with some exception allocations to BST and to BSE for services directly provided to those subsidiaries. The rationale underlying the subsidiary capitalization allocator cited by the Company is that the "benefits derived from services will effect capital component."

There is also a Treasury Department with financing, budgeting, and administrative activities at the BST organization level. According to the Company, capital structure and debt equity studies have not been prepared by BSC for BSC or BST. The Company would not disclose whether such studies had been prepared for BSE or its affiliates.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate service costs incurred by and billed for RC H11423 in 1992 were $1,444.1 thousand, consisting of $866.6 thousand in direct costs and $577.5 in overheads. BST's estimated allocation was $1,196.0 thousand, or 82.82% of this cost.

OPINION: 1992 BST expenses are overstated by $1,196.0 thousand. BST should not be allocated any of the Treasury/Financial Planning corporate services costs. The costs should be retained by BSC. These costs were not caused by BST but rather by the holding company structure that exists to facilitate the investment in and operation of nonregulated enterprises. BST has its own management and organizational structure, including a Treasury Department. The BSC costs are incremental to those incurred directly by BST. As discussed more extensively in the General Section of this chapter of the audit report, the JCO and Part 64.901 require that costs be allocated on the basis of cost causation, not on ultimate benefit, and not on ability to bear.

RECOMMENDATION: 1992 BST expenses of $1,196.0 thousand should be disallowed. BSC should modify its allocation factor to retain 100% of these costs.

DISCLOSURE NO.

SUBJECT: BellSouth Corporation Cost Assignment and Allocation
Treasury Department

Corporate Finance - Methods (RC H11430)

STATEMENT OF FACTS:

The Treasury/Corporate Finance - Methods RC is responsible for "[c]onsulting and methods and information systems (hardware and software) support and analysis for all Treasury functions." (Cost Assignment Form provided in response to data request 6-065.)

The information included in the Cost Assignment Form states that BSC utilizes a subsidiary capitalization allocator to allocate the costs of this RC, with some exception allocations to BST and BSE for services directly provided to those subsidiaries and for Fed PAC costs. The rationale underlying the subsidiary capitalization allocator, cited by the Company is that the "[b]enefits derived from services provided will benefit capital component."

There is also a Treasury Department with financing, budgeting, and administrative activities at the BST organization level. According to the Company, capital structure and debt equity studies have not been prepared by BSC for BSC or BST. The Company would not disclose whether such studies had been prepared for BSE or its affiliates.

The methodology utilized to quantify the 1992 billing activity for each RC is discussed in the General section of the BSC chapter of the audit report. Under this methodology, the estimated total corporate service costs incurred by and billed for RC H11430 in 1992 were $329.7 thousand, consisting of $197.8 thousand in direct costs and $131.9 in overheads. BST's estimated allocation was $273.0 thousand, or 82.82% of this cost.

DISCLOSURE NO.1:

SUBJECT: Application of 364.037 F.S. relating to total BAPCO-Florida directory operations.

STATEMENT OF FACTS:

1. 364.037(1), F.S. states that the gross profit derived from directory advertising to be included in the calculation of earnings for ratemaking purposes shall be the amount of gross profit derived from directory advertising during the year 1982 adjusted, for each subsequent year, by the Consumer Price Index published by the United States Department of Commerce and by customer growth or, if lesser, the amount of gross profit actually derived from directory advertising in the local franchise area for the year.

2. 364.037(2), F.S. states that the gross profit derived from directory advertising to be allocated to the nonregulated operation of a company shall be the gross profit which is in excess of the adjusted 1982 amount determined in accordance with subsection (1).

3. 364.037(3), F.S. states that for the purpose of this section, the amount of gross profit of a company from directory advertising for the 1982 is the actual gross profit derived from such advertising for that year. If, however, the expense to a company to furnish directories in 1982 exceeded 40 percent of the gross revenue derived from its directory advertising, the 1982 level of gross profit shall be adjusted to reflect a cost of 40 percent of its 1982 gross revenue.

4. Prior to the breakup of the Bell System on January 1, 1984, Southern Bell published the white and yellow page directories distributed within their local exchange service territories. In Docket No. 810035-TP, Southern Bell requested to have the entire directory operations considered as a below-the-line operation. In that Docket, Southern Bell suggested competition from other yellow page publishers as a reason for excluding directory operations, however Order 10449 stated that Southern Bell, by virtue of its franchise, enjoys a position not available to other publishers of yellow pages in that only the telephone company has entry into every subscriber's home or business place via its directory and only the company has the complete up-to-date information concerning numbers. The Commission decided to continue to recognize yellow page operations for ratemaking purposes.

5. The assets of Southern Bell and South Central Bell related to the directory operations were transferred to BellSouth Advertising and Publishing Company (BAPCO), a separate affiliated company, on January 1, 1984 (D.R. 3-001). Shares of stock were issued by BAPCO for the adjusted net book value of the assets and the prepaid directory expenses. The shares of stock received by Southern Bell and South Central Bell were immediately transferred to BellSouth Corporation through a special dividend. Contracts were drawn up to establish percentages of net revenues to be paid to the operating telephone companies as a publishing fee.

6. In accordance with the contracts, BAPCO was granted the exclusive right to publish alphabetical and classified telephone directories for all telephone exchanges in which Southern Bell and South Central Bell provide communication services (D.R. 3-001). The contract also requires BAPCO to sell directory advertising and to compile, print, and deliver the directories. The operating companies provide BAPCO with subscriber listing data, directory delivery information, and billing and collection service. As compensation for the services Southern Bell-Florida and BAPCO provide each other, BAPCO is paid 45.75% of the advertising revenue and Southern Bell-Florida is paid 54.25%. Each state has its own percentage of net revenues depending on each state's contract with BAPCO. These percentages were calculated based on the estimated revenues and expenses of BAPCO for 1984 (D.R. 3-007).

7. Advertising rates charged by BAPCO for 1/4 and 1/2 page ads in the yellow pages in the cities of Jacksonville, Miami, Orlando, and Pensacola have increased on average over 5% a year from 1988 to 1993 (D.R. 3-005 and 3-145).

8. The following is a schedule comparing the actual 1992 gross profit on Southern Bell's books to the adjusted 1982 gross profit.

Analysis of Directory Advertising Operations
For the Year Ended December 31, 1992

Items	Per Books Amount
1. Revenues (Account 5230)	
2. Local	$205,212,446
3. National	19,723,600
4. Sales	1,120,891
5. Other	45,778
6. Total (line 2 thru 5)	$226,102,715
7. Expenses (Account 6622)	
8. Printing	0
9. Commissions	0
10. Other	2,144,835
11. Total (line 8 thru 10)	2,144,835
12. Gross Profit (Line 6 minus 11)	223,957,880
13. Gross Profit 1982	102,215,043
14. Customer Growth Factor	1.5950
15. CPI-U Factor	1.4539
16. Adjusted 1982 (L13 x L14 x L15)	237,033,669
17. Nonregulated	0

9. The $226,102,715 in directory revenue (line 7) that is on Southern Bell's per books amount for 1992 as shown above is made up of the following (D.R. #3-127).

Account	
5230.5 - Publishing Fee (Local)	$205,212,446
5230.5 - Publishing Fee (National)	19,723,600
5230.4 - Sale of Directories	1,120,891
5230.9 - Other	45,778

The directory expense included in account 6622.1 and included in the directory gross profit calculation for 1992 was $2,144,835 (line 10). The $2,144,835 in directory expenses includes expenses incurred in preparing copy, printing, binding, and distributing directories that is recorded on Southern Bell-Florida's books rather than BAPCO's books.

As demonstrated in the schedule on the previous page, the per book gross profit of $223,957,880 (line 12) is $13,075,789 less than the adjusted 1982 gross profit of $237,033,669 (line 16), therefore no amount is included in nonregulated on a per books basis. No amount was included in nonregulated operations in 1991 related to directory operations because the actual gross profit was $4,692,000 below the benchmark of the adjusted 1991 gross profit. In 1990 and previous years Southern Bell was over its directory gross profit benchmark and some amount of directory gross profit was recognized as nonregulated.

Based on MFR C-27 filed in Docket No. 920260-TL, the projected difference for 1993 between the actual booked directory gross profit and the benchmark 1982 adjusted gross profit is $26,918,060.

10. When the 1982 gross profit was set, the company was limited to including 40% of the expenses related to the directory operations per 364.037(3) F.S. That resulted in a majority of general and administrative type expenses being excluded when determining the $102,215,043 1982 gross profit. Approximately 25% of the administrative and general type expenses were included in the original gross profit calculation to bring Southern Bell up to the 40% expense level.

30 11. The year end equity balance for BAPCO-Florida for 1992 was [redacted] and the average equity balance for 1992 was [redacted] (D.R. 3-008). Prepaid product expenses for 1992 were [redacted] and fixed assets at net book value were [redacted] Revenue requirements associated with the equity balance would be approximately [redacted] million at a 13.2% Return on Equity. BAPCO's capital
35 structure is [redacted] equity (D.R. 3-008).

The revenue requirements related to BAPCO investment would change depending on the appropriate return that should be applied in the calculation. Income before
38 income taxes was [redacted] for BAPCO-Florida for 1992 after payment of the publishing fee to Southern Bell of $224,936,046 and after recognizing all operating expenses (including administrative and general expenses) and interest. Based on forecasted 1993 total BAPCO financial statements (October 1993 data
42 annualized), income before income taxes totaled [redacted] BAPCO-Florida
43 represents [redacted] of the [redacted] based on 1992 data (D.R. 3-008).

12. The directory statute (364.037 F.S.) was implemented when directory operations were still a part of the operating company and before Southern Bell's directory operations were spun off into a separate directory affiliate. Judge Harold Greene, the federal court judge supervising the Modified Final Judgment, awarded the Yellow Pages business to the regional Bell operating companies to "support the goal of providing affordable telephone service for all Americans." Many of the LECs established separate subsidiaries for the directory operations prompting Judge Green to be very critical in his July 26, Order:

> "When the Court required AT&T to turn over its Yellow Pages operations to the Operating Companies, it assumed that the revenues from the directory advertising would continue to be included in the rate base of the Operating Companies, providing a subsidy to the local rates. Instead of funneling the Yellow Page revenue to the Operating companies, they have created separate subsidiaries to handle their publishing operations which do not feed the revenues from these operations into the rate base."

The Directory Subsidiary Team's recommendation and reports (D.R. 3-018) presented to the Corporate Policy Council of BellSouth in 1983, stated that some of the directory goals in a post-divestiture environment were to:

1. Through contractual arrangements maintain a reduced level of financial support to the Operating Telephone Companies from traditional local exchange directories.

2. Provide new product and service revenue to the shareholder and protect these revenues form regulatory imputation.

The Directory Subsidiary Team's report stated that a directory subsidiary would position the corporation to make a stronger case for achieving judicial and legislative limits to current rate base support.

13. Including the investment and income before income taxes of BAPCO-Florida in the rate base and operating income and expenses of Southern Bell would result in recognizing the entire directory operations related to Southern Bell-Florida's franchise area similar to the way directory operations were included prior to the establishment of a separate directory affiliate. BellCore currently includes the investment and dividend received related to Florida above-the-line for regulatory purposes.

14. Disclosure numbers two through four will explain that certain adjustments should be made to BAPCO-Florida expenses in the amount of $10,463,517.

OPINION: Southern Bell is not applying 364.037 F.S. to recognize the entire directory operations related to their franchise area due to the establishment of BAPCO, a separate directory affiliate of Southern Bell.

RECOMMENDATION: 364.037 F.S. should be applied to Southern Bell by including the entire financial impact of directory operations of BAPCO-Florida, including investment and income before income taxes, since 364.037 F.S. was set into place before Southern Bell's directory operations became a separate directory affiliate. The effect for 1992 would be to increase rate base by ____________ and increase income before income taxes (actual gross profit) by ____________

DISCLOSURE NO. 2

SUBJECT: Management fees charged to BAPCO-Florida from BellSouth Enterprises.

STATEMENT OF FACTS:

1. BellSouth Enterprises (BSE-HQ) performs a number of holding company functions on behalf of its subsidiaries.

2. The costs incurred by BSE-HQ for performing these functions are recovered by BSE-HQ from its subsidiaries through a monthly management fee and project billings (D.R. 3-064). Total intercompany service contract expenses which includes management fees and project billings billed from BSE to BAPCO was
10 for 1992. BAPCO-Florida's share for these charges for 1992 was
11 which represents of

12 3. The monthly management fee is computed using a rate of applied to each subsidiary's adjusted operating expenses. Adjusted operating expenses are operating expenses, less Cost of Goods Sold, Depreciation, and the prior month's billed management fee (D.R. 3-063). The management fee for 1992 charged to BAPCO
16 from BSE was which represents of the total management fee billed to BSE affiliates.

4. The types of costs recovered by BSE-HQ through the management fee charges to BAPCO include costs from the Human Resources Department, Comptrollers, Treasury, Marketing, and the President's and the Vice President's office (D.R. 3-063 and interview with Maleese Whatley). These are basically the same general areas that are covered by BAPCO's own departments.

5. Project billings billed by BSE to BAPCO are in the areas of Human Resources, Legal Services, Treasury, and Accounting Support (D.R. 3-118). These are basically the same general areas that are covered by BAPCO's own departments.
26 The total 1992 amount of BSE projects billed to BAPCO was (D.R. 3-118)

6. BSE is being reorganized which will result in BSE being a shell corporation with the management fee being discontinued from BSE (Interview with Mike Hostinsky). The management fee may be replaced by a fully distributed costing process which will allocate BellSouth Corporate costs to the BSE subsidiaries (D.R. 3-104). The level of those possible replacement charges is uncertain at this time.

7. BAPCO's own major departments are Human Resources, Comptroller, Legal, Sales-Customer Service, Marketing, and Publishing (D.R. 3-078). The following is a description of the functions of BAPCO's departments:

Human Resources - Provides leadership and overall direction for the Human Resources of BAPCO. Through the performance of BAPCO duties, they work towards a qualified, affective, competitive and highly motivated work force.

Comptroller - Provides accurate and timely accounting service to BAPCO and externally to BellSouth Enterprises in the management of the corporate budget process.

Legal - The work performed by this department can be generally classified as "preventive law" and "reactive law". Preventive law is that activity which entails advice and counsel. Reactive law requires the department to take some affirmative action on behalf of the Corporation such as the prosecution or defense of a lawsuit or the acquisition of a new entity or the development and deployment of a new product or service, an appearance in court, or the filing of pleadings, briefs or other legal documents.

Sales-Customer Service - Sales is responsible for revenue generation through the handling of yellow pages advertising. Sales and Customer Service create and implement programs that assures improvement in customer satisfaction. Customer Service is responsible for handling customer inquiries and claims for all produces and services offered by BAPCO.

Marketing - the Marketing Department develops and implements strategies including product management, advertising, market analysis, pricing, new products, market research, national account marketing, training, methods, directory systems design, and automation planning.

Publishing - Publishing is responsible for directory production, ad design, and delivery functions for the nine-state BAPCO region.

8. Access to the BellSouth Enterprises general ledger and other records was denied therefore the appropriate verification of the management fee and project billings could not be accomplished.

22 OPINION: BAPCO-Florida was charged in 1992 for management fees and project billings from BellSouth Enterprises (BSE) which appear duplicative in nature, will discontinue in its present form due to BSE reorganization, and which could not be appropriately verified due to BellSouth's objection to providing BellSouth Enterprises general ledger and other supporting records.

RECOMMENDATION: The management fee being charged to BAPCO in the amount of
28 should not be included in BAPCO-Florida expenses when determining actual gross profit for several reasons: 1. The charges appear to be duplicative, 2. BSE-HQ is being reorganized which results in the discontinuance of the management fee and project billings being charged to BAPCO from BSE-HQ, and 3. Access to the general ledger and other records were denied, therefore, appropriate verification of the charges was not accomplished.

DISCLOSURE NO. 3

SUBJECT: Level of affiliated charges form Stevens Graphics to BAPCO.

STATEMENTS OF FACTS:

1. Stevens Graphics, an affiliated company of BAPCO, has an exclusive contract with BAPCO to print all of Southern Bell's telephone directories published by BAPCO (D.R. 3-001).

2. Stevens Graphics has two divisions which are the Directories Division and the Business Products Division. The Directories Division prints the directories for Southern Bell. The Business Products Division manufactures, distributes, and sills various printed business communication products.

3. Stevens Graphics uses market pricing for billings from Stevens Graphics to BAPCO. Prior to 1985, BAPCO purchased directory printing services form Stevens Graphics under a third party market based contract. In 1985, BellSouth purchased Stevens Graphics. Stevens Graphics net pricing to BAPCO has not changed since 1985 except for price changes which have occurred due to a restructuring of various prices for simplification and the introduction of prices to reflect new offerings (D.R. 3-079).

4. Stevens Graphics earned approximately ____ of its operating revenue in 1992 ________ out of $________ for directory manufacturing services provided to BAPCO (D.R. 3-052 and 3-102). Stevens Graphics for 1992 earned approximately a ____ return on equity (3-052). BAPCO-Florida represents approximately ____ of Total-BAPCO for directory manufacturing charges from Stevens Graphics to BAPCO with Total-BAPCO incurring ________ for directory manufacturing in 1992 and BAPCO-Florida incurring ________ D.R. 3-047).

Based on 1992 data, BAPCO-Florida accounted for earnings by Stevens Graphics of $________ above a 13.2% ROE (rate setting point established in Southern Bell's rate stabilization Docket - Order 20162) as shown on the following calculation:

1992 (000)

Stevens Graphics Average Equity	________
Allowed Return on Equity	13.2%
Allowable Net Income	
Actual Net Income	________
Net Income above 13.2%	________
Expansion Factor	1.60
Excess Earnings	
% Related to BAPCO Activity	________
% Related to BAPCO-Florida	________
Excess Earnings - BAPCO-Florida	________

5. The F.C.C. has proposed to tighten its accounting rules governing transactions between carriers and their unregulated affiliates. Under the current rules, carriers may use prevailing market rates for their transactions with unregulated affiliates if the affiliate's sales to third parties are "substantial." The F.C.C. has proposed that substantial should mean when the unregulated affiliate sells at least 75% of its output-whether services or assets-to nonaffiliates.

6. Stevens Graphics does not do a Fully Distributed Cost study on affiliated charges to BAPCO (D.R. 3-090).

9 OPINION: BAPCO-Florida made [redacted] in excess compensation payments to Steven Graphics for the manufacturing of white and yellow pages.

11 RECOMMENDATION: Excess payments of [redacted] were made by BAPCO-Florida to Stevens Graphics for compiling and publishing of the white and yellow page directories and should be excluded from expenses of BAPCO-Florida when determining the actual gross profit of the directory operations.

DISCLOSURE NO. 4

SUBJECT: Allocation of white page expense to the interstate jurisdiction incurred by the Directory Affiliate.

STATEMENTS OF FACTS:

1. BAPCO incurs expense of compiling and publishing white page (alphabetical) directories which are not recorded on Southern Bell's books (D.R. 3-031). BAPCO incurred [redacted] in 1992 related to the production and manufacturing (compiling and publishing) of white pages. BAPCO incurred [redacted] in 1992 related to the production and manufacturing of yellow pages that were recorded on BAPCO's books.

2. C.F.R. Part 36.375(b)(3) states that the expense of alphabetical and street address directories is apportioned among the operations on the basis of the subscriber line minutes-of-use applicable to each operation.

3. The interstate factor for 1992 related to directory expense was 16.17% based on F.C.C. ARMIS Report 43-04 for the subscriber minutes-of-use.

4. BAPCO incurred [redacted] in white page manufacturing expense and [redacted] in yellow page manufacturing expense with the majority being provided by Stevens Graphics. The white page manufacturing expense is [redacted] of the total manufacturing expense of $1[redacted] for yellow and white pages (D.R. 3-031).

5. The white page production and manufacturing expense that should be allocated to the interstate jurisdiction is calculated as follows:

Total BAPCO White Page Expense	[redacted]
% Related to BAPCO-Florida	35%
BAPCO-Florida White Page Expense	[redacted]
Interstate Factor	16.17%
Interstate allocation	[redacted]
Stevens Graphics Excess Earnings Related to Interstate White Pages ($3,079,000 x 37.43% x 16.17%)	[redacted]
BAPCO-Florida Interstate White Page Expense	[redacted]

6. The compiling and publishing of white pages is a function that was performed by Southern Bell before the directory operations were spun off to a separate affiliate.

7. Disclosure 1 recommends including the entire financial impact of BAPCO-Florida directory operations related to Florida's franchise area be included in Southern Bell-Florida operations.

OPINION: BAPCO-Florida does not allocate any of its expense of compiling and publishing the white page expenses to interstate consistent with the Code of Federal Regulations Part 36.375(b)(3).

RECOMMENDATION: The appropriate amount of BAPCO expense related to white page operations that should be allocated to the interstate jurisdiction is $3,106,517 and should be excluded from BAPCO-Florida expenses when computing actual gross profit from directory operations.

DISCLOSURE NO. 5

SUBJECT: BellSouth Petition For Nonstandard Language in its CAM.

STATEMENT OF FACTS:

1. BellSouth filed a petition for waiver for permission to use nonstandard language in its CAM with the FCC on June 29, 1993 pursuant to the FCC Order, DA 93-511, released May 7, 1993.

2. BellSouth provides billing, collection, subscriber listing data, directory delivery information, and directory publishing rights to BellSouth Advertising and Publishing Corporation ("BAPCO"). A 1991 Fully Distributed Cost Study was performed that identified the costs for these services as follows:

11 Billing and Collecting	
] Subscriber Listing Data	
13 Directory Delivery Information	
Total	$13,532,402

These costs represent the total of nine states and Florida would represent about 26% of the total cost. The total above does not include the intangible service of directory publishing rights.

BellSouth requests a waiver, as required by FCC Order DA 93-511, to be allowed to describe these services provided to BAPCO in its CAM as "More Than Fully Distributed Cost".

3. BAPCO provides the services of compiling, publishing, and the delivery of "white pages" directories and collection services. BellSouth requests a waiver to be allowed to describe the services BAPCO provides to BellSouth as being provided at "No Charge".

4. Both Southern Bell and BAPCO have responsibilities in providing yellow and white pages, and each incur costs relative to the entire operation as set out in the contract between Southern Bell and BAPCO making the provision of directories an integrated operation between Southern Bell and BAPCO. The contract between Southern Bell and BAPCO establishes a division of revenue whereby BAPCO is paid 45.75% of the advertising revenue and the remaining 54.25% of the advertising revenue is retained by Southern Bell as a right to publish fee.

The cost of compiling, printing, and delivering the white pages is incurred by BAPCO. Southern Bell is not specifically billed by BAPCO for this cost. BAPCO does recover the value of compiling, printing, and delivering the white pages through the contractual arrangement described previously (D.R. 3-099).

5. A petition for reconsideration has been filed with the F.C.C. by the Public Staff of the North Carolina Utilities Commission related to F.C.C. Order 93-511 and comments have been filed by the Tennessee Public Service Commission related to BellSouth's petition for waiver. Both states provide arguments in support of rejecting the language proposed by BellSouth as described above.

OPINION: BellSouth Telecommunications, Inc. ("BellSouth") has filed a Petition For Waiver with the FCC to use certain nonstandard language in its Cost Allocation Manual "CAM" related to affiliated transactions between BAPCO and BellSouth, which, if allowed, would be inaccurate.

RECOMMENDATION: Acceptance of the language change in the CAM being petitioned by BellSouth through a waiver should not be accepted as it is not consistent with the contractual arrangements between Southern Bell and BAPCO.

DISCLOSURE NO. 6

SUBJECT: 364.183, F.S. Reasonable Access To Records of Affiliated Companies

STATEMENT OF FACTS:

1. 364.183(1) states that the Commission shall have reasonable access to all company records, and to the records of the telecommunications company's affiliated companies, including its parent company, regarding transactions or cost allocations among the telecommunications company and such records necessary to ensure that a telecommunications company's ratepayer do not subsidize the company's unregulated activities.

2. BAPCO, an affiliated company of Southern Bell, markets and publishes telephone directory advertising (Yellow Pages), and publishes Southern Bell's telephone directories (White Pages).

3. Affiliated charges to BAPCO accounted for approximately 46% of BAPCO operating expenses for 1992.

4. Affiliated companies of BAPCO, which generate the majority of the affiliated charges to BAPCO, namely Stevens Graphics and L.M. Berry, earned ROEs well in excess of the current Southern Bell-Florida ceiling on ROE of 16%.

5. BAPCO-Total Company and BAPCO-Florida both earned ROEs well in excess of Southern Bell-Florida ROE ceiling of 16%.

OPINION: The charges to BellSouth Advertising and Publishing Company (BAPCO) from affiliated companies such as BellSouth Enterprises and Stevens Graphics could not be verified to the auditor's satisfaction due to Southern Bell's objection to providing the general ledgers and other records of these companies.

RECOMMENDATION: The books and records of BAPCO affiliates, Stevens Graphics and BellSouth Enterprises, should be made available to the staff for auditing in order to properly evaluate the affiliated charges to BAPCO.

AUDIT DISCLOSURE NO.

SUBJECT: BILLING AND COLLECTION

STATEMENT OF FACTS:

BST did not bill its affiliate BellSouth Communications Systems (BCS) for service provided for all of 1992 and the first six months of 1993 until August 1993. Company personnel explained that BCS was not billed because BST could not collect the data necessary to bill BCS. BST had to rely on information provided by BCS to bill BCS. BST requested that BCS provide BST with an estimate of the number of bills which BST had printed for BCS. BST then applied rates per cost studies to bill BCS. (ref w/p4-14)

OPINION: The company lacked necessary information to bill an affiliated company in a timely manner.

RECOMMENDATION: It is recommended that BST track the information necessary to bill its affiliated companies for all services which it provides to affiliates. Furthermore, it is recommended that the company bill its affiliated companies at least monthly.

AUDIT DISCLOSURE NO.

SUBJECT: ALLOCATION OF BILLING AND COLLECTION COSTS

STATEMENT OF FACTS:

Currently the program used to allocate costs between regulated and non regulated operations is based upon the ratio of non regulated bill lines printed to total bill lines printed. The total bill lines printed include common bill lines printed. Common bill lines printed are those which are attributable to both regulated and non regulated operations. The inclusion of common bill lines printed to total bill lines printed could distort the regulated/non regulated ratio. The proper ratio should be non regulated bill lines printed to the total of regulated and non regulated bill lines printed. The Company issued a Design Change Proposal in September 1992 to be effective January 1993. Discussions held with company personnel as late as August 16, 1993 indicate that the Design Change Proposal has not been implemented. (W/P 4-11)

OPINION: The current methodology used to calculate the non regulated percentage of Account 6623, Cost Pool 03 could distort the regulated/non regulated ratio.

RECOMMENDATION: It is recommended that BST implement the changes as described in the Design Change proposal.

DISCLOSURE NO.

SUBJECT: Use of sampling in assigning costs of testing facilities.

STATEMENT OF FACTS:

1. In 1992 BST adopted on a uniform basis the use of a sampling procedure to assign the cost incurred at its testing facilities to Part 32 accounts as well as to cost pools within those accounts. While sampling has been used to allocate cost pools to regulated and nonregulated operations, the use of sampling to assign cost to Part 32 accounts has not been approved by the FCC.

In accordance with this procedure, the employees at the testing facilities do not complete time report identifying the activity that they perform. Instead their pay and other associated cost are allocated to Account 6533- Testing, Account 6532- Network Administration, Account 6211- Analog Electronic Switching Expense, and Account 6212- Digital Electronic Switching Expense on the basics of job profiles. These profiles are a surrogate for time reporting and in theory identify the percent of time the employee are engaged in performing various task. This is the basis for determine the account to which the cost is to be charged as well as the cost pool used for the regulated nonregulated allocation process.

To develop these profiles, the work activity of all employees in a facility will be observed for one work day. Based on these observations, the percentage of time chargeable to each of the above accounts is computed. These percentage, however, are not computed on an individual employee basis but are computed for the facility as a whole. All employees time and cost are allocated on the same proportion. Once developed the profiles remain in effect for six months.

In 1991 the company had not adopted this approach on a uniform basis but instead used a mixture of both positive time reporting and profiles to assign the testing center cost. When the external auditor expressed concern that the basis for assigning cost was being applied inconsistently among testing centers, the company utilized the profiles and adjusted the allocation of the cost in Account 6532. This adjustment resulted in $11 million in cost being shifted from nonregulated operations to regulated operations.

In 1992 the company discontinued the positive time reporting and adopted the use of statistically developed profiles for all testing center employees. Also during 1992 it was determined that the profiles used to allocate the 1991 cost had not properly reflected the regulated/nonregulated allocation since several nonregulated function codes had been over looked. Using the 1992 profiles, the company recomputed the adjustment made in 1991. This resulted in a the reversal of $9.6 million of the previous adjustment and a corresponding shift of cost from regulated to nonregulated operations in 1992. It was also determine that the regulated time reported in account 6533(Testing Expense) had been overstated in 1991. To correct for this, an additional $3.1 million was deducted from regulated and added to non regulated operations for 1992.

While sampling techniques have been used to allocate cost between regulated and nonregulated operations, the use of such a technique to assign cost to different Part 32 account has not been approved by the FCC. Since sufficient testing was not conducted to determine the reasonableness of using the methodology for assigning cost to the Part 32 Accounts and cost pool within those accounts, an opinion on this procedure can not be expressed. However base on the problems encounter in developing the profiles, additional testing and analysis should be made before this process is adopted for use in assigning cost to the various Part 32 Account. BST should request authorization from the FCC and state commissions and be prepared to show that the process does result in the assignment of cost to the proper accounts, and to regulated and nonregulated operations before adopting the procedure on a permanent basis.

OPINION: While the sampling procedure may result in the proper assignment of cost to the Part 32 accounts and the related cost pool used for separating regulated and nonregulated cost, a detailed analysis should be conducted prior to acceptance of this method for regulatory accounting process.

RECOMMENDATON: BellSouth Telecommunication should request FCC and state commission approval of this use of this sampling procedure.

DISCLOSURE NO.

SUBJECT: The transfer of the CPE operations from BellSouth Telecommunication to its Subsidiary.

STATEMENT OF FACTS:

1. In 1991 BellSouth restructured it's communications operations. As part of this restructuring the Customer Premise Equipment (CPE) operations were moved form the BellSouth Telecommunications into a nonregulated subsidiary.

2. BST analyzed the financial impact of the transfer based on June 1991 data.

3. The study showed that the transfer resulted in a approximately $32 million of net cost being shifted from the nonregulatecd operations to the regulated operations of the Company.

4. The analysis shows that the CPE operation to have an annual pretax loss of 13 approximately ____ million prior to the transfer.

14 3. The shift of $32 million to the regulated operations equates to ____ reduction in this loss.

4. In addition to the shift in net cost, the transfer resulted in a $39 million shift in investment from the nonregulated CPE operations to regulated operations.

OPINION: result of this analysis, it appears that the cost allocation and affiliate transaction rules are not producing the desired results. In theory the transfer of the CPE operations from the regulated utility to a nonregulated subsidiary should not have materially changed the assignment of cost. If working properly, the cost allocation procedure should assign the correct cost to the CPE operations while it is included within the corporate structure of the utility. The transfer of the operation to another subsidiary should result in the transfer of the same level of cost and investment. The fact that there is a material change in the cost assignment indicates that either the proper cost was not being assigned before the transfer, or that the procedure used to account for the affiliate transaction after the transfer is not producing the correct assignment of cost. In either case the results are the same. While restructuring and modifying the way services are provided may very well produce reduction in cost for either or both the regulated and nonregulated operations, neither should benefit at the expense of the other. The utility should not be in the position of shifting cost from the nonregulated operations to the regulated operations by changing only the organizational structure.

RECOMMENDATION: This area was not investigate to the extent needed to determine the specific reason for the cost shift. It is recommended that this area be further investigated. The FCC presently has underway an investigation of the affiliate transaction rules. It would be appropriate to have rules relative to the allocation of cost within a utility reviewed in conjunction with that investigation.

DISCLOSURE NO.

SUBJECT: Cost Allocation Manual (CAM)

STATEMENT OF FACTS:

1. For Account 6723-Human Resources, the CAM provides for two account with one being directly assigned to regulated/non regulated, and the other allocated on the basis of salary and wages.

2. The CSS/PPS Guide call for one pool that is allocated on the basis of total salary and wages. This is the process used by the company.

3. The Company follows the procedure specified in the CSS/PPS Guide.

4. The Company's Cost Allocation Manual (CAM) identifies Account 6712 Planning as having two cost pool. One being directly assigned to reg/nonregulated operation with the other being allocated on the basis of the General Allocator.

5. The company does not follow this procedure. No cost is directly assigned. Instead the cost in the is account is allocated on the basis of the general allocator.

6. The Company's Cost Allocation Manual (CAM) show that Premise Sale cost Account 6612 is to be directly assigned to a reg/nonregulated cost pool.

7. The procedure used by the company as stated in the CSS/PPS Users guide allocates the cost "to regulated/nonregulated based on the ratio of hours reported by product in BBS on the BCI files."

8. The Company's Cost Allocation Manual (CAM) requires that the General Marketing cost pool of Account 6611 Product Management be indirectly attributed to reg/nonregulated operations using the resulting factor developed from the directly assigned pool in this account.

9. The directly assigned pool is separated into two sub pools: Direct Regulated/Nonregulatd -Product Specific, and Direct Regulated/Nonregulated -Product Non-Specific.

10. In stead of allocating the indirect cost pool using the total direct regulated/nonregulatled cost the Company assigned the cost the company based the its allocation on the Direct Regulated/Nonregulated Product Non-Specific sub pool.

OPINION: While it is recognized that the CSS/PPS Users Guide is the more detailed in its descriptive of the allocation process, it should agree with the CAM. The CAM is the basic document that is to identify the allocation process that should properly reflect the procedure being followed. There is a critical distinction between the allocation and direct assignment of cost. To miss state the CAM and indicate that cost is being directly assigned when it is in fact being allocated is miss leading.

RECOMMENDATION: It is recommended that the CAM be corrected to properly reflect the process being used to assign cost.

DISCLOSURE NO.

SUBJECT: Management does not appear to wholeheartedly embrace the use of documentation within their concept of management control.

STATEMENT OF FACTS:

1. Staff interviews were conducted with 33 employees in the management structure to provide us with a general sense of the management philosophy and conduct of the people who manage BellSouth Telecommunications. Of that number, 4 were Presidents (Interviews # 2/10/15/ & 25); 1 was a Senior VP (Interview # 3); 14 were Vice-presidents (Interviews # 1/3/8/9/12/16/17/18/21/22/24/27/31/ & 33); 7 were Assistant VP's (Interviews # 4/6/7/11/19/23 & 28); 2 were Managers (Interviews # 26 & 29); 3 were Directors (Interviews # 14/20/30); 1 was Treasurer (Interview # 13); and 1 was the Chief Accountant (Interview # 32). Ten of the interviewees report directly to Mr. Duane Ackerman, Chairman and Chief Executive Officer of the Corporation, who in turn is responsible directly to the Board of Directors and BellSouth Corporation.

   Six of the ten direct reports interviewed are responsible for each of the six major functions of BellSouth Telecommunications:

   - Network & Technology Group (Interview # 25)
   - Regulatory & External Affairs (Interview # 15)
   - Marketing Group (Interview # 2)
   - Services Group (Interview # 10)
   - Comptrollers & Treasury (Interview # 8)
   - VP & General Counsel (Interview # 5)

   The other 4 direct reports were responsible for Strategic Management, Security, Internal Auditing, and Corporate Responsibility & Compliance. The rest (23) of the 33 employees served in a variety of positions within the six groups.

2. Our interviews centered upon the exploration of the basic tenets of good fundamental management. We asked each interviewee what their operating philosophy and practice was in regards to the basic elements of management--*Planning*, *Organizing*, *Directing*, *and Controlling*. We asked them how these elements were applied within their areas of responsibility and how they were interfaced, both vertically (their boss & subordinates) and laterally (their peers in other functional areas).

3. The answers (concerning management philosophy and practice) that we received from each interviewee were surprisingly consistent among the

group. They portrayed a philosophy that can best be described as, "personal", "hands-on", "one-on-one", and "direct" in regards to management oversight. The managers like to do "field visits" and talk to their managers as well as the rank-and-file employees. They expressed an "open-door" policy and some even had direct (1-800) telephone lines to their offices. There is heavy reliability on "word-of-mouth" and personal integrity to expose things going wrong with the broad management and control aspects (not necessarily so for operational details where specific measurements tend to occur).

4. The use of written (or Computerized) reports to management (other than the standard Financial/Accounting reports) was not in evidence in so far as being used by most of the top managers we interviewed. Very few of them either received or generated high-level management information type reports which address problems/status of operations. Instead, they rely upon verbal communication (or their own observations) from their subordinates, and likewise, provide verbal reports to their superiors. A commonly expressed justification for this approach was the rapidly changing dynamics of the industry which dictates the need for rapid responses (face-to-face or telephone communication) and decision making. Most stated that they maintain at least daily contact with their bosses and daily or weekly contact with their direct reports, although, group meetings and meetings with "line" people are not frequent.

OPINION: While this personal,"soft information" (as opposed to written/computer documentation) philosophy is commendable and has benefits, it raises some doubts as to its effectiveness and reliability when our observations are coupled with other staff's observations which indicated a strong and consistent lack of control documentation (see Maryrose Sirianni's project tracking disclosure) at the functional (operational) levels. Staff has some concern that the top management's operating philosophy concerning the need for documentation may not only be prejudicial to their own responsibilities, but also, may manifest itself in subordinate behavior to the detriment of the whole organization over the long-term.

RECOMMENDATION: BellSouth Telecommunications Should Engage An Independent Consultant To Review Their Requirements And Practices In The Area Of Management Information Reporting. Emphasis Should Be Placed On Top Management's Need As Well As The Needs Of The Organization At The Manager/Supervisor Level.

DISCLOSURE NO.

SUBJECT: Effectiveness And Uniformity Of Policies and Procedures - Some Of The Policies and Procedures Originated At Southern Bell, South Central Bell, BellSouth Services and Selected BellSouth Enterprises Units Have Not Been Integrated Into Single (Uniformly Applicable) Manuals Under The Corporate Or BST Umbrella (As Appropriate).

STATEMENT OF FACTS:

1. Staff requested (Document Request No. S-039) a copy of the "Company's" travel policy; its conflict of interest policy; and its fraud, waste and abuse policy. The Company's response was to send us a copy of (1) "...BellSouth Services' *Executive Instruction Number* 4 which is the Corporate Travel Policy." (2) "...SCB Executive Instruction Number 4 which is the Corporate Travel Policy." (3) "...SBT Executive Instruction Number 4 which is the Corporate Travel Policy." Southern Bell Telephone's policy has a published date of August, 1989 while the other two were published in August, 1990 and updated in May, 1991.

   The Company's response to the conflict of interest request was a booklet titled *A Personal Responsibility*. It was published June 1, 1992 and does cover every employee of a BellSouth company.

   The Company's response to the fraud, waste and abuse request was a *BellSouth Telecommunications Policy Statement No. 1.2 - Business Conduct*. It was issued 1-1-93. Its scope as stated is: "This policy statement applies to all BST employees and to all aspects of BST domestic and foreign operations." While it does address itself to all employees of the newly combined organization (BST), it does not speak to the employees of the parent company - BellSouth Corporation, and it is unclear as to any subsidiaries.

2. Staff requested (Document Request No. S-041) a copy of the Table of Contents of all policies and procedures manuals used by BST and BSC, to include any publications whose purpose is to provide direction and guidance to employees, e.g., "Executive Instructions".

   The Company's response was to object on the grounds that Staff's request was "...so vague and broadly stated that BST cannot ascertain with any reasonable degree of specificity the information which has been requested." However, the objection notwithstanding, they did send us the indexes for the BSS, SCB, and SBT Executive Instructions which "...are currently being re-written at the BST level. However, until they are finalized, the Company continues to operate under existing Executive Instructions." Each of the three documents furnished, have different publication dates, with the latest being October 1990 and the oldest being October 1989.

3. Staff requested (Document Request No. 5-071) a copy of the Table of Contents of the "Treasury Practices." The Company's response to send us a copy of the South Central Bell *Treasury Practice* (no date indicated). Their comment was - "It is representative of the Treasury Practice currently being used in BST. The Company is in the process of updating the Treasury Practice."

OPININION: The lack of consolidation of the policies and procedures fragments management's right to expect uniform practices throughout the newly consolidated organization. It could also lead to personnel problems, especially where personnel have been shifted between the four differing work environments (BSC, BST, SCB, & BSS). Also, while the existing policies and procedures are waiting to be consolidated, they, more than likely, will not be kept up-to-date. Therefore, the longer the delay in completing any consolidation, the greater the probability that they will no longer reflect the reality of the workplace. While policies and procedures tend to change at a very slow pace, they are dynamic and must be kept up-to-date to be effective.

RECOMMENDATION: BellSouth Telecommunications Should Increase the Priority And Resources Given To The Task Of Consolidating The Policies And Procedures Which Existed Within The Three Companies That Preceded The Merger. Upon Completion Of The Consolidated Documents, Management Should Take The Necessary Steps To Ensure That All Employees Are Educated As To Their Existence And Application.

DISCLOSURE NO.

SUBJECT: BellSouth Telecommunications Has Not Taken Steps To Evaluate The Effectiveness Of Their 1991 Reorganization Which Merged *Southern Bell Telephone, South Central Bell Telephone, BellSouth Services*, And Selected Units Of *BellSouth Enterprises*.

STATEMENT OF FACTS:

1. In March 1991, *BellSouth Corporation* merged the operations of *Southern Bell, South Central Bell, BellSouth Services* and selected units of *BellSouth Enterprises* into one organizational entity known as *BellSouth Telecommunication Inc.*

   The criteria for reorganization were to:

   a. Improve responsiveness to customers
   b. Increase efficiency and/or effectiveness
   c. Be compatible with the environment.

   The objectives of the reorganization were to:

   a. Improve the Company's competitive position
   b. To enhance shareholder value.

   Staff's review of some indicators, before and after reorganization, revealed that the Company's expected benefits may not have been fully realized--

   a. Increasing responsiveness to customers should be manifested by improved customer satisfaction statistics. Results of a brief six state survey of customer complaint statistics showed that, in fact, the aggregate number is trending downward from the 1991 figures with Florida and Georgia accounting for the bulk of the change.

   b. Increasing efficiency could be evidenced by a decrease in operating expenses and/or a decrease in the number of employees. BSC's 1992 Summary Annual Report to Shareholders (Document Request # 5-0033) states that both of these indicators increased from 1991 to 1992. Operating expenses for BSC increased by 3.5%, from $11,635.8 million in 1991 to $ 12,040.9 million in 1992. Total BSC employees reported at year end 1991 was 96,084, while in 1992 it increased to 97,112. At the same time, the number of telephone employees (operating company) increased from 82,245 to 82,866.

c. Prior to the reorganization, a BellSouth monthly newsletter stated that "...the reorganization must be sensitive to regulation and in no way disguise regulated business transactions". However in the course of this audit alone, the audit team has run into several obstacles in attempting to verify regulated business transactions. The audit team has generated 1135 requests for documents, of that number, the Company has claimed confidential/sensitive or "proprietary" status on 215 documents, or 19% of the requests.

2. BellSouth claims (verified by numerous executive interviews) to be committed to the tenets of Total Quality Management (TQM).

One of the fundamental principles of any TQM program is the *Plan, Do, Check, Act* cycle. A quality organization will Plan their course of action, Implement the plan, Check to make sure the problems were corrected, and then take further corrective Action if necessary.

According to an interview (Interview # 22) with John Gunter, there has been no follow-up to determine if the reorganization criteria and objectives were achieved.
In an unrelated audit (Report No. SB-C-2-90169) of Southern Bell in 1991, the Florida Public Service Commission recommended (Recommendation No. 2) that the Company formally evaluate the results of the reorganization which was underway at that time. In an implementation follow-up on this recommendation (dated 10-19-93) the Company stated that: "The results of the Gunter Study are no longer relevant in Florida because several additional rounds of reorganization have subsequently taken place. The Company is constantly adjusting its management force based on changing conditions related to the economy and competition in the industry."

OPINION: Management should be interested in whether or not the money spent and the personnel turbulence which resulted, has been worth the changes forced upon the organizations involved. While some preliminary data has favorable indications, their true meaning is far from conclusive. Certainly, the evidence to justify this massive reorganization has yet to be seen in the operating results and in the market place.

RECOMMENDATION: **BSC And BST Should Evaluate Whether Or Not Their Expected Benefits Have Been Achieved As A Result Of The Reorganization.**