(Reid)

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January 4, 1994

Mr. Steve C. Tribble
Director, Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301

RE: Docket No. [redacted], 900960-TL, 910163-TL, 910727-TL

Dear Mr. Tribble:

Enclosed are an original and fifteen copies of Southern Bell Telephone and Telegraph Company's Rebuttal Testimony of Stephen P. Budd, Brad Branch, Walter Reid and Jerry L. Wilson. Please file these documents in the above-captioned dockets.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served on the parties shown on the attached Certificate of Service.

Sincerely,

Sidney J. White, Jr.

Enclosures

1 cc: All Parties of Record
6 A. M. Lombardo
H. R. Anthony
R. D. Lackey

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DOCUMENT NUMBER-DATE
00110 JAN-4
FPSC-RECORDS/REPORTING

CERTIFICATE OF SERVICE
Docket No. 920260-TL
Docket No. 900960-TL
Docket No. 910163-TL
Docket No. 910727-TL

I HEREBY CERTIFY that a copy of the foregoing has been furnished by United States Mail this 4th day of January, 1994 to:

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SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF STEPHEN P. BUDD

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

JANUARY 4, 1994

Q: Please state your name, title, employer, and address.

A: My name is Stephen P. Budd. I am employed by Theodore Barry & Associates ("TB&A") as a Managing Director. My business address is 50 Rockefeller Plaza, Suite 1035, New York, New York 10020.

Q: Have you previously filed testimony in this Docket?

A: Yes. I filed rebuttal testimony on December 10, 1993 in response to certain recommendations made by Office of Public Counsel Witness Kimberly H. Dismukes.

Q: Please give a brief description of your background and experience.

A: I have been employed by Theodore Barry & Associates since 1986, becoming a Director of the firm in 1989 and a Managing Director in 1991. I currently head our Telecommunications practice and our New York office. At TB&A, I have managed and actively participated in many varied assignments related to regulatory policy, operational improvement, incentive regulation, and management decision making and control processes. Related to affiliate transactions, I have managed or served as a lead technical consultant on assignments sponsored by commissions (e.g., Alabama, Tennessee, Kentucky, New York, Connecticut) and by companies (e.g., Southwestern Bell, BellSouth). In addition, I have led TB&A studies of productivity and network modernization at New York Telephone on behalf of the New York Commission. I have made formal presentations to various industry groups, including NARUC, on topics such as regulatory frameworks, cost-structure audits, and total quality management.

Prior to joining TB&A, I was employed by Price Waterhouse for seven years as a Managing Consultant where I specialized in management reporting systems and cost accounting. I hold an Bachelor of Science degree from Florida State University and a Master's of Business Administration from the University of Georgia.

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to present the results of an evaluation performed by TB&A of the fairness and reasonableness of the BellSouth Corporation ("BSC") services charged to BellSouth Telecommunications, Inc. (" BST"). This analysis was undertaken in order to respond to any concerns forthcoming in this Docket regarding BSC services that are charged to BST.

In addition, I will respond specifically to certain Disclosures related to BSC contained in the Affiliate Transactions and Cost Allocation Audit ("Audit Report") filed on December 17, 1993. My comments on the Audit Report are included as an attachment to Company Witness Wilson's testimony.

Q: Please summarize your testimony.

A: In the traditional regulatory environment, the need to continually monitor affiliate transactions to prevent cross-subsidization, and to allow ratepayers to participate fairly in the benefits of diversification, is understood and applied by both regulatory commissions and operating telephone companies alike. Numerous parties have applied a variety of methods to determine whether services have been appropriately charged into regulation. TB&A conducted an assessment of the BSC services charged to BST. Our assessment was based on analysis of three primary components:

- BST's need for each service;
- BSC's emphasis on and progress toward cost reduction, including an assessment of the organizational placement of the service and potential areas of duplication; and
- Methods and controls for allocating costs from BSC to BST.

My testimony discusses our approach and conclusions related to these components.

We have found that, overall, the services provided by BSC are necessary for the Company's operations, receive adequate cost reduction emphasis, and are appropriately allocated. Thus, we have concluded that the charges to BST associated with these services are fair and reasonable.

Q: Please describe the approach used by TB&A in assessing the fairness and reasonableness of BSC services provided to BST.

A: In a complex and dynamic industry environment, like telecommunications, the fairness and reasonableness of corporate service charges to subsidiaries can be neither proven nor disproven numerically. Typically, arguments are framed around various evidential criteria such as demonstrated efficiencies, necessity of services, fairness in pricing, and overall management controls. While various studies have been undertaken by various parties to demonstrate the "value" of corporate services through comparisons with alternative providers, these studies, while helpful, are heavily dependent on subjective assumptions, such as skill sets and service quality, and typically are less than fully convincing.

In fact, several recent trends with respect to BSC services have made alternative provider studies less relevant today than they might have been in the past. The nature of BSC services has changed over the last several years from primarily "transaction-based" services to primarily "knowledge-based" services. Transaction-based services are those services involving routine, repetitive, production-oriented activities where it is possible to clearly define the work product. (Examples include shareowner services and accounts payable.) In contrast, knowledge-based services typically are non-operational and involve some aspect of planning. These types of services usually involve non-routine, non-repetitive, advisory and oversight-oriented activities where it is difficult to clearly define the work product. (Examples include corporate planning and tax planning.) In the case of transaction-based services, availability of alternative providers is relatively high, as is the general usefulness and objectivity of alternative provider comparisons. In the case of knowledge-based services, the availability of alternative providers is relatively low, as is the usefulness and general objectivity of alternative provider comparisons.

Currently at BSC, transaction-based services are gradually being moved from the parent company to individual subsidiaries, while the parent company focuses on broader policy and planning-related activities. For these reasons, TB&A has opted to use a two-faceted approach to assess fairness and reasonableness of BSC charges to BST. First, we assessed the BSC management and operational controls associated with compliance with relevant affiliate transaction rules, primarily the FCC's Joint Cost Order ("JCO"). Although we did not test transactions, we did examine the overarching controls which guide the company's transactions. Second, we assessed the "need" for the services provided by BSC and, if the services were needed, we assessed the emphasis placed on the efficient provision of services by BSC and the methods for allocating costs to BST . Services were deemed to be fairly and reasonably charged if they were clearly needed, if there was evidence of cost-effectiveness, and if the costs were allocated in accordance with FCC pricing rules. In order to make our assessments, we reviewed the specific responsibility codes comprising each BSC functional area. A summary of BSC's functional areas, and their primary activities, is provided in Exhibit SPB-1.

Under our methodology, if the analysis related to any one of these criteria is not favorable to BST, we would conclude that all or part of the BSC service charged to BST is inappropriate. For example, if a given service is performed efficiently by BSC and allocated fairly, but is of questionable need by BST, we would conclude that the service is not appropriate and recommend that all or part of the charges associated with that service not be billed to BST.

Q: **Please discuss your conclusions related to BSC's compliance with affiliated transaction rules.**

A: TB&A has reviewed the management controls surrounding BSC's affiliate transactions on four occasions within the last six years (twice on behalf of state commissions and twice on behalf of the Company). We have met with numerous BSC managers and studied BSC's directives, policies, and guidelines related to affiliate transactions. Our overriding impression, confirmed through our current analysis, continues to be that (1) BSC is well aware of regulations and potential abuses regarding affiliate transactions; (2) BSC makes every attempt to adhere to those regulations; and (3) BSC is conservative and cautious in its interpretation of those regulations to avoid even the perception of impropriety.

The rules associated with appropriate pricing of services provided by affiliates are proscribed by the FCC (i.e., JCO, Part 32, Part 64) and have subsequently been utilized by most state commissions, including the Florida Public Service Commission. BSC has made a concerted effort to ensure compliance. This is evidenced by:

- A comprehensive policy framework delineated through a hierarchy of BSC documents, e.g.:

- Executive Directive 8 -- Affiliate Transactions
- Executive Instruction 10 -- BSC Cost Apportionment
- BellSouth Accounting Manual, specifically:
  - Chapter 1 -- Joint Cost Allocation
  - Chapter 2 -- Affiliate Transactions
  - Chapter 3 -- Overhead Costs
  - Chapter 5 -- JCO-Comptroller's Responsibilities

- Established mechanized and manual procedures to support specified BSC affiliate policies, e.g.:
  - Administrative Procedures 010-002-001 -- Cost Assignment Methodology
  - Administrative Procedures 010-003-001 -- Project Billing

- A clear assignment of responsibilities for interpreting regulations and monitoring compliance, e.g.:
  - Corporate Accounting Standards -- oversees cost allocation policies and determines underlying allocation methodology
  - Accounting Services -- administers accounting processes and disseminates data
  - Affiliated Interest Matters -- evaluates affiliate relationships as to benefits and controls

- Pervasive awareness by BSC personnel of JCO requirements and intentions, e.g.:
  - Emphasis on management controls to prevent cross subsidization
  - Emphasis on cost causation in developing allocation bases
  - Justification for allocation bases as an integral part of BSC budgeting and billing procedures.

Q: Please describe the process used by TB&A in assessing the need for BSC services provided to BST.

A: Prior to assessing the operational efficiency of a particular process, it is important to assess whether a service needs to be provided in the first place. "Need" has different connotations to different parties and frequently reflects a subjective assessment. Over the course of several engagements, we have developed a working definition of "need." Under TB&A's assessment, a service is considered necessary if any of the following criteria is met:

- The service is required to comply with external requirements or legal obligations of a publicly-held corporation and is regarded as mandatory. Examples of this type of service include activities needed to prepare federal tax filings or Securities and Exchange Commission filings.
- The service is required to meet generally accepted operational practices. Although not a legal requirement, a company would be unable to adequately deliver its end products if this service was not performed.

An example of a service meeting this criteria includes management of employee payroll and benefits.

- The service is required to meet generally accepted strategic practices. Again, although not legally required, these services are needed to ensure that a company is appropriately planning for the future to meet the needs of all its stakeholders. An example of this type of service includes corporate planning.

Thus, services are considered "necessary" if they are conducted to meet external requirements, fulfill the company's obligations on a day-to-day basis, or ensure that the company is able to meet its future obligations. In determining whether the services provided by BSC to BST were necessary, TB&A reviewed the services and activities related to each of the functional services listed in Exhibit SPB-1, interviewed BSC service providers, and BST recipients where applicable, and analyzed data to determine the use of the BSC service. The services were then assessed as to necessity according to the criteria discussed above.

Q: Please summarize your conclusions regarding the need for BSC services provided to BST.

A: Based on the definitions I described above, the services provided by BSC are necessary because of either external requirements, requirements associated with operational practices, or requirements associated with strategic practices. In many cases, the services are necessary for a combination of reasons. For example, tax services are required to meet external requirements (Federal tax filings), but are also of strategic importance (tax planning).

Q: Please describe the process used by TB&A in assessing BSC's emphasis on and progress toward cost reduction.

A: Continuous emphasis on and progress toward cost reduction, while maintaining or improving service levels, has become a tenet of generally accepted business practices. Cost reduction initiatives may take numerous forms, ranging from comprehensive productivity improvement projects encompassing all functions, to specific initiatives focusing on particular work activities. Most improvement efforts result in recommendations that enhance efficiency through organizational realignment, elimination of duplicative activities, or operational streamlining through new processes or techniques.

As part of our analysis, we reviewed the improvement activities associated with various BSC functional areas, including:

- Organizational Analyses, resulting in the centralization, consolidation, or decentralization of work activities.

- Work Flow Streamlining, resulting in the elimination of inefficient activities, better coordination of work processes, and/or the introduction of new processes or techniques.

- Right Sizing, resulting in staff size reductions.

It should be noted that the above improvement initiatives are frequently interrelated. For example, an analysis of work activities may result in a modification of the organizational placement of the activity, the streamlining of the work process, and the reduction of staff size, all accomplished while maintaining or improving the level of service quality.

Q: Please summarize your conclusions regarding BSC's emphasis on and progress toward cost reduction.

A: Overall, BSC has placed significant emphasis on and made considerable progress toward cost reduction. BSC has addressed cost reduction from two perspectives. First, within the last several years, BSC as a whole has highlighted the need to reduce headquarters staff while maintaining or improving service levels. Various corporate-wide studies have resulted in the movement of many transaction-based services out of the headquarters structure and have led to overall net staff reductions.

Second, BSC functional departments have engaged in specific process improvement projects and organizational realignments. During our review, we found numerous examples where BSC has actively examined the process and organization of the services that it provides with the intention of improving service levels and reducing costs. For example, the BSC Public Relations, Human Relations, and Media Relations departments currently are undertaking analyses of efficiency and organizational structure. Similar efforts are being conducted in the BSC Comptroller organization.

In my opinion, BSC's process improvement and cost reduction efforts are pervasive and will continue to intensify in the future, with BST being the driving force behind many of BSC's cost reduction initiatives. BSC process improvements - which deal primarily with the knowledge-based services that

I discussed earlier - will, in large part, be triggered by the direction and results of BST's current reengineering projects which address both the BST transaction-based and knowledge-based services that BSC supports. Also, as BST continues to improve its budgeting and monitoring process, BSC expenses will continue to be scrutinized in some detail by BST managers. Finally, BSC managers, as well as BST managers, will continue to have their compensation tied to operational improvements, such as the achievement of real cost-efficiencies.

Q: Please discuss the actual allocation bases used by BSC to distribute charges to BST.

A: BSC uses a wide range of allocators to assign costs to BST and its other subsidiaries. Exhibit SPB-2 shows the primary allocators used to distribute BSC costs. In fact, there are numerous additional variations of these bases. The allocation bases that are used by BSC to distribute incurred costs include a set of cost categories that are chosen to represent the most cost-causative elements for a particular service. For example, BSC services whose costs are a function of employee headcount may be distributed on any one of eleven bases, including paygrade, geographic assignment, and entity employment. The services that are provided by BSC that relate to human resource support are allocated to subsidiaries using ten of the eleven employee-based allocators. Over 90 percent of the costs incurred by BSC in this area are assigned on an employee-related basis.

Another type of cost category that is used by BSC captures various financial attributes. In several instances, BSC has determined that capital, equity, or investment factors are most closely identified with cost-causation. For example, almost 88 percent of the January through September 1993 costs associated with investor relations activities are allocated on the basis of the total equity or capital employed in each subsidiary. Other categories that are used to assign attributable costs include specific entities, operating expenses, and composite allocations that are used primarily to assign supervisory-related costs.

BSC distributes costs to its operating subsidiaries consistent with guidelines that have been established by the FCC. These guidelines require telephone operating companies to follow a cost allocation hierarchy that is designed to maximize distribution based on cost causation. Exhibit SPB-2 shows the percentage of costs by BSC department that are distributed according to each component of this hierarchy. For the first nine months of 1993, BSC distributed 18 percent of its costs to specific entities on a "directly attributable" basis. Directly attributable costs are costs that cannot be directly assigned but which can be associated with a direct measure of cost causation (e.g., employee time estimates).

The next level of charges are for services that are "indirectly attributable" to a specific entity. Indirectly attributed costs are costs that cannot be directly assigned or directly attributed but which can be associated with another cost category for which a direct assignment or allocation is available. BSC distributed 53 percent of its costs to specific entities on an indirectly attributable basis, including 18 percent based on employee-related factors, 15 percent based on financial-related factors, 2 percent based on expense-related factors, and 8 percent based on composite factors derived from the allocation bases of direct reports. In addition, BSC marketing-related costs, comprising 10 percent of BSC costs, were allocated on the basis of the proportional marketing expenditures by BSC subsidiaries.

When costs cannot be directly or indirectly attributed to an entity, BSC relies on general allocations. The general allocator was used to allocate 27 percent of all BSC distributed charges while the headquarters allocator was used to allocate 2 percent.

Q: Please summarize your conclusions regarding the cost allocation bases used by BSC.

A: The nature and variety of cost allocation bases used by BSC is indicative of a commitment to identify the most cost-causative bases for distributing corporate services costs. BSC has well-documented policies and procedures for developing cost assignment categories and assigning cost-causative bases to specific activities within BSC departments. Each department requires responsibility center managers, on a regular basis, to identify, for their particular activities, the most cost-causative methodology reasonably available. These managers also are responsible for describing the rationale to support the methodology selected. This process is well understood by managers in all BSC departments.

The cost allocation procedures that BSC follows are consistent with the FCC Part 64 rules that are used to apportion costs between regulated and non-regulated activities and entities. Where possible, BSC directly assigns costs to a specific entity through project coding when work is performed exclusively for that entity. The next priority is to assign costs on a directly or indirectly attributable basis. Finally, the general allocator is used when no direct or indirect causal relationship can be found. BellSouth procedures state, "the general allocator should only be used in the absence of a relationship between the functions performed and the entities billed."

It is my conclusion that BSC is in full compliance with the FCC rules and genuinely strives to identify and apply cost-causative allocation bases.

Q: To what extent did you examine the detailed calculations related to the derivation of cost allocation factors?

A: Our review of BSC's cost allocation methodologies focused on the process for determining allocation bases and did not examine specific transactions as to mathematical accuracy. Once the allocation bases are determined, the derivation of allocation factors is a straightforward, mostly mechanized procedure.

While we did not test the calculations, we have a high level of confidence in their accuracy due to the following:

- The results of these calculations directly affect the financial results of the corresponding entities which, in turn, directly affect the compensation of all executives. Corporate-wide, it is in the best interest of executives that allocation calculations be performed accurately, for reasons of both personal compensation and overall management decision making.

- In this and previous reviews, we have never directly or indirectly found evidence of any known or suspected problems with the calculation of allocation factors.

- Internal and external auditors regularly test cost allocation calculations. I am not aware of any exception conditions that have been identified.

Q: Please summarize your comments related to the Audit Report

The audit report contains a series of Disclosures that pertain to services provided by BSC to BST. The Disclosures include recommendations that the Company offer rebuttal testimony that mainly addresses the issues of service necessity and "possible" duplication of services at BSC and BST. TB&A has reviewed the cost assignment forms that the auditors relied upon to present their recommendations. In addition, we have interviewed BSC service providers and BST service recipients and have analyzed additional relevant data and documentation.

I have found that the services that are performed by BSC for BST are necessary from an operational or strategic perspective and contribute to the effectiveness of BST operations. I have also concluded that there is a strong emphasis within both BSC and BST on the efficient provision of service, including processes and incentives to discourage duplication of services. While both BSC and BST may have departments with similar names, that should not be the basis for speculation that there may be some duplication of effort. In fact, there is a high level of coordination between the respective organizations and BSC activities are designed mainly to support and complement the functions within BST. In the reply comments, I respond, on a functional area basis, to the audit concerns that are raised in each disclosure.

My comments are included as an attachment to Company Witness Wilson's testimony. I am sponsoring the Company's reply comments to Audit Disclosures: 58, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, and 71.

Q: Please summarize your testimony.

A: Any attempt to demonstrate fairness and reasonableness of corporate service charges must first consider the nature of the services provided. Where services are primarily knowledge-based, as at BSC, alternative provider analyses will be of marginal usefulness and the analysis approach should emphasize other evidential components. The components that we assessed included management and operational controls, necessity of the service, emphasis on and progress towards cost reduction, and the cost allocation methodology.

By all of these measures, we have found the services charged to BST by BSC to be fair and reasonable.

Q: Does this conclude your testimony?

A: Yes.

BELLSOUTH TELECOMMUNICATIONS, INC.

BellSouth HQ Corporate Services

EXECUTIVE

- Perform all executive duties required to manage corporate functions.

CORPORATE SECRETARY

- Coordinate all Board of Director and Committee meetings.
- Prepare and administer all Director-related policies and procedures.
- Provide certification, advice, and information regarding Board matters.
- Track Director affiliations and ensure against conflicts of interest.

TREASURY

- Research, develop, and document operating procedures, methods, and information systems for the Treasury function.
- Coordinate banking relations activities and manage cash investments.
- Develop and coordinate cash forecasts and arrange for all short-term borrowing.
- Develop financial objectives for the parent company and assist subsidiaries in the development of their financial plans.

INVESTOR RELATIONS

- Provide direction and guidance on corporate governance matters
- Serve as direct liaison with the stock transfer and shareholder services agent
- Manage the proxy process in support of the annual meeting and manage interface with shareowner services transfer agent.

COMPTROLLERS

- Coordinate corporate accounting policies and standards.
- Provide corporatewide payroll services for officers.
- Investigate and evaluate affiliate interest issues and prepare testimony as required.
- Prepare and file all legally-mandated financial reports.
- Provide billing, accounts payable, property records, corporate books, and other accounting support.
- Coordinate risk management program for all BellSouth entities.

TAX

- Oversee all federal, state, and local tax activities and filings.
- Research and review legislation.
- Prepare consolidated income tax data for financial statements.

FINANCIAL MANAGEMENT

- Produce corporate financial policy assumptions and develop financial outlook.
- Identify, quantify, and analyze alternative economic scenarios.
- Produce economic, financial, and demographic forecasts for developing corporate plans.
- Coordinate financial planning and analysis activities for all subsidiaries.

CORPORATE PLANNING

- Oversee corporate development and strategic planning programs
- Facilitate development of integrated vision/strategy for various BellSouth markets.
- Support BSC planning committees and executive management.

INTERNAL AUDITING

- Perform internal audits for management of BSC Headquarters.
- Develop and produce annual audit plans for entire corporation.
- Coordinate external auditing activities.
- Coordinate audit training and professional development needs of audit staffs.

SECURITY

- Conduct personnel, revenue, property, and security investigations.
- Coordinate security for annual shareholders' meetings and the Board of Directors.
- Oversee preemployment and vendor background checks.
- Administer various security-related programs, e.g., Fidelity Bond Program.

HUMAN RESOURCES

- Coordinate planning and administrative support functions for managing benefits programs for active and retired personnel.
- Provide support for executives and key managers in all subsidiaries, including design of compensation plans.
- Design and develop education, training, safety, and other compliance programs.
- Coordinate labor relations and negotiation activities and develop bargaining strategies.

ASSISTANT SECRETARY/CORPORATE COUNSEL

- Provide advice and review shareholder matters, corporate governance practices, and other miscellaneous corporate matters.
- Provide counsel to BellSouth Headquarters and Board of Directors on corporate law and practice.
- Assure compliance with all federal, state, and foreign securities law, SEC rules, foreign corporate laws, and stock exchange requirements.

LEGAL

- Represent BellSouth before FCC and other federal agencies.
- Provide legal support in areas of antitrust, securities, tax, intellectual property, and litigation.
- Furnish advice and assistance in matters related to labor relations and human resources.
- Provide advice and counsel on corporate governance matters and corporate law.

GOVERNMENTAL RELATIONS

- Collect and analyze information and coordinate policy on issues pending in various federal forums.
- Create and coordinate activities with industry and regulatory associations.
- Provide corporate liaison with FCC, Congressional staff, and executive branch offices.

MEDIA RELATIONS

- Seek consumer group support for corporate goals and advise subsidiaries of consumer concerns.
- Handle national media inquiries and refer media inquiries to subsidiaries.
- Fulfill legal and regulatory disclosure and reporting requirements.
- Develop background information for reporters and broadcast news producers.

PUBLIC RELATIONS

- Direct employee survey program and develop related information strategies.
- Write and produce annual report and coordinate annual shareholders' meeting.
- Research and produce speeches, articles, and related materials on industry and company issues.
- Coordinate executive support activities, including conferences and public presentations.

CORPORATE AND EXTERNAL AFFAIRS

- Coordinate educational initiatives within BellSouth region.
- Coordinate community and civic affairs programs.
- Develop donation policies and administer corporate giving program.
- Promote use of technology applications in education.

ADVERTISING

- Coordinate advertising operations, strategies, and policies for all subsidiaries.
- Negotiate and establish master agency contracts for all subsidiaries.
- Provide market research and advertising effectiveness evaluation.

BELLSOUTH TELECOMMUNICATIONS, INC.

BSC HQ Cost Allocation Bases*

Allocation Bases / Departments	Directly Attributed	Indirectly Attributed					General Allocations		Total
	(a) Entity-Specific	(b) Capital Investment Equity	(c) Employees	(d) Expenses	(e) Market Costs	(f) Composites	(g) Headquarters Allocator	(h) General Allocator	
Executive	11%	2%	7%	1%	1%	26%	1%	51%	100%
Corporate Secretary		55%				3%		42%	100%
Treasury (i)	14%	47%	6%			12%		18%	100%
Investor Relations		88%				12%			100%
Comptroller	26%	18%	24%			1%	23%	8%	100%
Tax	51%	6%				10%	2%	31%	100%
Financial Management	49%			51%					100%
Corporate Planning	5%					13%		82%	100%
Internal Audit	87%						13%		100%
Security	47%						53%		100%
Human Resources	3%		91%			4%		2%	100%
Assistant Secretary								100%	100%
Legal	59%					4%		37%	100%
Governmental Regulations	31%					20%		49%	100%
Media					1%			99%	100%
Public		35%	10%		20%	5%		30%	100%
Corporate & External Affairs						1%		99%	100%
Advertising	2%	1%			97%				100%
Total by Allocation Basis	18%	15%	18%	2%	10%	8%	2%	27%	100%

(a) **Entities** = BSE, BST, BBS
(b) **Capital Investment Equity** = Capital, Investment, and Total Equity
(c) **Employees** = Employment Pension & Benefit Plan, Total Employees, Non-Exempt Employees, Key Managers, Employees of Companies with "represented" employees, USA Employees PG 6 7 Up, Executive, Other Managers, Key Managers and Lawyers, BSE, BBS Key Managers
(d) **Expenses** = Operating Expenses and Other Expenses BST/BBS
(e) Market Costs = Proportional marketing expenses of subsidiaries
(f) Composites - Reflects composite allocations of reporting employees
(g) Headquarters Allocator - Costs associated with unattributable HQ costs
(h) General Allocator - Costs that are not directly assigned or directly or indirectly attributable
(i) Treasury - (i) Fed PAC receipts account for 3%

* Based on total charges distributed from 1/93 to 9/93

EXHIBIT SPB-2

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF J. BRADFORD BRANCH

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

JANUARY 4, 1994

Q. **Please state your name, address and occupation.**

A. My name is J. Bradford Branch. My business address is 100 Peachtree Street, N.E., Atlanta, Georgia 30303. I am a general partner in the accounting, auditing and management consulting firm of Deloitte & Touche ("D&T").

Q. **Have you previously filed testimony in this Docket?**

A. Yes. I filed testimony on December 10, 1993 regarding certain positions taken by Office of Public Counsel ("OPC") witness K. S. Dismukes.

Q. **What is the purpose of your testimony today?**

A. Southern Bell Telephone and Telegraph Company ("SBT&T") has requested that I comment on the Report of the Affiliate Transactions and Cost Allocations Audit ("Audit Report") of the Florida Public Service Commission ("FPSC") filed December 17, 1993 in Docket 920260-TL.

Q. **Mr. Branch, have you performed an engagement to evaluate the Audit Report and to review underlying information provided by the company in connection with this proceeding?**

A. Yes. The scope of my engagement could be generally described as a "parallel analysis" of information which I understand was also available to the Audit Staff in this proceeding. Specifically, the principal sources of information on which my testimony is based consist of the Audit Report, filed with this Commission on December 17, 1993, the previous incomplete Draft of the Audit Report provided to SBT&T on November 24, 1993, responses to data requests provided in this proceeding, and recordings of interviews with company personnel conducted by the Audit Staff and follow-up discussions with those personnel. My staff and I also reviewed other publicly-available industry or market information.

Q. **Please describe the specific information provided by the company in this proceeding which was accessible to you for your review.**

A. I understand from SBT&T that, prior to the release of the Draft Audit Report, we were only provided company data that had also been given to, or was otherwise publicly available to the Audit Staff and provided access to the personnel interviewed by the Audit Staff. The information provided included certain interrogatories and production of documents ("PODs"), both of which are commonly referred to as data requests, produced for the Audit Staff and Intervenors in Florida Docket 920260-TL. In addition to reviewing the data requests, my staff and I also reviewed certain testimony filed with the Florida Public Service Commission in Docket 920260-TL and earlier dockets.

Q. What publicly available industry or market information did you primarily utilize?

A. The information reviewed by myself or my staff included data and publicly-filed reports, pleadings, and orders from the following proceedings:

State	***Docket***	***Proceeding***
Florida	900960-TL	Investigation Into Southern Bell's Customer Billing
Florida	910757-TL	Regulatory Safeguards Required to Prevent Cross-Subsidization
Florida	910163-TL	Investigation Into Southern Bell's Repair Service Activities
Florida	920260-TL	Revenue Requirements and Rate Stabilization Plan
Georgia	3905-U	Investigation of Rates and Charges of Southern Bell
Georgia	3987-U	Cross Subsidy Investigation
Georgia	4230-U	Royalty Payments Investigation
Louisiana	U-17949-A	Ratemaking and Financial Audit of South Central Bell
South Carolina	90-626-C	Incentive Regulation Plan
Tennessee	92-13527	Investigation of Earnings of South Central Bell

Tennessee	93-00311	Petition for Conditional Election of Regulation

Q. Have you also issued your own Affiliate Transactions and Cost Allocations Audit Report based on your review of the information that was available to the Audit Staff?

A. No. The information requested by the Audit Staff would be insufficient to perform an audit under Generally Accepted Auditing Standards ("GAAS") of the company's affiliate transactions and cost allocations as specified by the Federal Communications Commission in Responsible Accounting Officer Letter No. 12. Indeed, if I had been asked to conduct an audit of the Company's affiliate transactions and cost allocations, I would have applied a different audit scope and methodology than that apparently employed by the Audit Staff.

Q. As an auditor, did you have any difficulties with the Audit Report?

A. Yes. The Audit Report does not contain a description of any generally accepted audit methodology (like GAAS) which may have been applied by the Audit Staff, or even a description of their audit plan. These are fundamental requirements for any audit and without them, meaningful review is difficult.

Nevertheless, given my review of the Audit Report and underlying information provided by the company, I am in a position to evaluate the Audit Report's findings and form an opinion about the Audit Report's conclusions. In certain areas where the underlying information requested and provided was clearly insufficient to reach a conclusion, I did request and receive additional data, after the Audit Report had been received and reviewed by my staff and me. The additional data was necessary to comment on certain matters addressed in the Audit Report.

Q. What is the nature of your comments?

A. First, I have general observations regarding the Audit Report. I also have observations regarding the audit scope and objectives employed by the Audit Staff, which are described in the Audit Report.

Second, SBT&T has requested that I comment on specific Audit Disclosures included in the Audit Report pertaining to the areas of research and development, real estate transactions, BellSouth Advertising and Publishing Company ("BAPCO") and BellSouth Corporation's Leveraged Employee Stock Ownership Plan ("LESOP"). Accordingly, my testimony is organized as follows: (1) general comments, (2) research and development issues, (3) real estate transactions issues, (4) BAPCO and affiliate company issues, (5) LESOP issues, and (6) other Audit Disclosures.

SECTION 1 - GENERAL COMMENTS

Q. Please summarize the content and format of the Audit Report.

A. The Audit Report generally consists of six topical sections covering specific subjects and four other sections: Executive Summary, Background, Audit Scope Statements and Objectives and Scope Limitations. The specific topical sections of the Audit Report address: Research & Development ("R&D"), BellSouth Telecommunications Inc. ("BST"), BellSouth Communications, Inc. ("BCI"), BellSouth Enterprises Inc. ("BSE"), Directory Operations, and BellSouth Corporation ("BSC"). The information in each of these topical sections is generally presented in a series of "Audit Disclosures," the most complete of which contain a "statement of facts," an "opinion," and a "recommendation."

Q. How do the specific topical sections compare to the Audit Scope and Audit Objectives outlined in the Audit Report?

A. The topics specified in the Audit Scope and Objectives section are generally different than the six topical sections of the Audit Report. Specifically, audit scope and objectives are outlined for: BSTI's Research Organization, Costing Methodologies and Practices, Yellow Page Operations, Billing and Collection Organization and Central Management / Service Organization. The difficulty with this is that there is no audit plan to link the stated Audit Objectives to the audit results contained in each topical section.

Q. Were you able to discern any methodology or standard audit approach or audit plan which was used by the Audit Staff in preparation of the Audit Report?

A. Unfortunately, no. The Audit Report does not include a complete description of any audit plan or methodology used by the Audit Staff. Further, the Audit Report does not specify the criteria by which the achievement of audit objectives, which presumably are to determine the company's compliance with affiliate transaction rules and regulations, can be objectively measured. In the absence of defined criteria for affiliate transactions and cost allocations against which to compare audit findings, a report reader can not determine if the report's findings are substantive. Similarly, without an audit methodology specified or a description of the extent of work required, a reader can not assess whether the work performed sufficiently supports the conclusions reached. The absence of clear criteria or methodology can lead to a foundationless audit.

Q. Could a comprehensive audit approach, like Generally Accepted Auditing Standards have been applied to audit affiliated transactions and cost allocations?

A. Yes. The Audit Report does note that "substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use." [page 5, Audit Report] Of course, it is highly unlikely, in fact difficult to conceive, that an audit of affiliated transactions and cost allocations would result in "...audited financial statements for public use." However, GAAS is routinely applied in the annual audit of the company's cost allocation practices and affiliate transactions (required by the Federal Communications Commission and described in Responsible Accounting Officer Letter 12) and could have been applied in this instance. GAAS is applied in this annual CAM audit to determine objectively whether the company's FCC Report 43-03, the ARMIS Joint Cost Order Report, presents fairly, in all material respects "the information of the company required to be set forth therein in accordance with the company's Cost Allocation Manual ("CAM"), the FCC's Joint Cost Orders ("JCO") issued in conjunction with FCC Docket No. 86-111 and the FCC's published rules and regulations thereto (including 47 CFR, Sections 32.23, 32.27 and 64.901)..." [FCC - RAO Letter 12]

Q. Does the failure to specify a generally accepted audit methodology and extent of testing performed in the audit disadvantage a user of the Audit Report?

A. Yes. A reader of the Audit Report is unable to put the report's findings "into context" without having a description of the extent of testing performed or a generally accepted audit methodology, like GAAS. A reader is simply not able to determine whether the Audit Report's findings are significant or not, without an understanding of the extent of testing and the auditing standards applied, or, if the noted matters are important in the context of all matters that were reviewed and the size of the underlying population of data.

Because Generally Accepted Auditing Standards are promulgated by a public body, the Auditing Standards Board, based on substantial public input and comment, an auditor applying GAAS generally need only refer to GAAS in his opinion to convey an understanding to the reader of his report about the underlying work he/she performed. Conversely, in this Audit Report the reader has little idea of the extent of the testing performed. GAAS addresses a variety of matters such as extent of testing, quality of evidential matter, completeness of scope, professional qualifications, proficiency and supervision of staff, and independence and objectivity.

Q. Based on your review of the Audit Report and the information available in this proceeding, have you formed any overall impressions about the Audit Report?

A. Yes. I have formed overall impressions in two areas: asserted scope limitations, and certain disclosures which appear out-of-context in an affiliate transaction and cost allocation audit.

Q. Would you please address the issue of scope limitations?

A. Yes. The issue of asserted scope limitations is pervasive throughout the Audit Report. It dominates the Executive Summary and Background sections, comprises an entire separate Audit Report section, and pervades a number of individual Audit Disclosures. The Audit Disclosures in which scope limitations / access to records are most notably addressed pertain to BSE charges, real estate transactions, and yellow pages operations.

The audit scope limitations appear to stem from two asserted causes: 1) the assertion that the Company did not provide access to records of unregulated affiliates, and 2) the assertion that the Audit Staff did not have time to review certain data request responses that they received. The Audit Report's position on the issue of scope limitations / access to records is summarized in Audit Disclosure No. 1, which partially reads as follows:

> "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 challenge the authority of the Commission with respect to affiliate transactions.
>
> RECOMMENDATIONS:
> 1. The Commission should disallow all costs stemming from affiliate transactions or cost allocations where the Company did not provide complete access to information the auditor deems relevant to validate such costs. The Commission should not opt to hold monies subject to refund pending further review since the Company had the opportunity to provide complete access to records."
> (emphasis added)

I understand that whether unregulated affiliate records are to be provided in this proceeding is the subject of a pending Florida court action.

Consequently, whether SBT&T had the "necessary influence to gain cooperation from its affiliates" was not determinable from the information we received. Also, the recommendation seems extreme given that if the recommendation were adopted, the disallowance of costs could be based on the sole opinion of an auditor as to relevance and necessity. If a comprehensive audit methodology like GAAS is not applied, the determination of whether information is relevant and necessary might be unfounded, arbitrary or erroneous, or based on "private" audit standards which were not developed based on public disclosure and comment.

Q. How significant would the effect of the asserted scope limitations be on the overall audit objectives and scope?

A. As I mentioned previously, the Audit Report does not specify any comprehensive audit methodology applied during the audit nor does it describe an audit work plan or extent of testing. Absent these elements, an objective reader can not determine whether the Audit Report's claims of the effect of scope limitations are substantive or overstated in importance.

Q. Why is that the case?

A. Under GAAS, an auditor may consider a variety of sources of evidence, in addition to directly examining information. For example, a routine source for obtaining audit evidence is relying on the work of other professionals or specialists. In this specific instance, information in the areas of BSE allocations and certain real estate transactions was included in the independent CAM audit workpapers of Coopers & Lybrand ("C&L") and was tested by them. I understand that the Audit Staff reviewed the entire set of the 1992 JCO CAM workpapers and received additional copies of an extensive number of C&L workpapers. Yet, the Audit Report seems to place no significant reliance on the work of C&L to validate specific financial statement balances and transactions, nor does the Audit Report describe why this audit evidence was unacceptable to validate transactions.

Also, GAAS prescribes that a study and evaluation of internal controls over transactions should be performed by an auditor to determine the extent of auditing procedures to be performed. In the absence of an audit workplan or a defined generally accepted audit methodology like GAAS, I find no evidence in the Audit Report of any review of internal accounting controls to specifically determine the appropriate extent of substantive testing.

Furthermore, GAAS also acknowledges the application of the concept of materiality to determine the extent of audit testing, to evaluate audit results, and to assess limitations of scope. Simply put, more work should generally be performed on more material transactions. This concept may not have been applied in reaching many of the Audit Report's Opinions and Recommendations. This is apparent when the value of Audit Disclosures that are based on asserted scope limitations is compared to the value of affiliate transactions affecting Florida intrastate operations. To put the magnitude of the asserted scope limitations in perspective, the value of recommended disallowances quantified in terms of scope limitations / access to information for affiliate transactions affecting Florida is approximately 6.4% of the total value of affiliate transactions included in Florida-intrastate expenses. A schedule detailing these amounts is included as **Exhibit JBB-6**.

Q. Please discuss your impression that certain Audit Disclosures appear inappropriate in an affiliate transaction and cost allocation audit?

A. The Executive Summary of the Audit Report describes the audit purpose as follows: "To evaluate whether cross subsidization exists between BellSouth Telecommunications Inc. regulated and nonregulated operations and certain affiliate companies." [page 5, Audit Report] The Audit Report, however, presents Audit Disclosures which seem out of place. For example, Audit Disclosure No. 22 contains the Opinion, "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." [page 73, Audit Report] Such topics seem removed from traditional affiliate transaction and cost allocation audits and have limited, if any, relevance to the determination of whether cross subsidization exists between BST's regulated and nonregulated operations and certain affiliates.

Likewise, Audit Disclosure No. 30 provides a discussion of whether expenses associated with the Comptrollers Optimizing Resource Effectiveness ("CORE") Project Expenses are non-recurring "...to aid the Tallahassee staff performing the forecasted data review." [page 86, Audit

Report] This Audit Disclosure appears to be included to address rate case issues, not affiliate transaction or cross subsidization issues.

Q. Do you have any overall comments on the Bellcore and Science and Technology ("S&T") Audit Disclosures in the report?

A. Yes. As I address more fully later in my testimony, I have comments on Audit Disclosure Nos. 17 and 18 in which the Audit Report asserts that a greater share of the research and development ("R&D") expenses incurred by BST should be borne by nonregulated operations. The Audit Report presents three radical alternatives for transferring more expenses to nonregulated operations including deferral of costs, using "keep cost" records, and allocation of project costs based on estimated future benefits.

My overall impression is that the Audit Report addresses this complicated, multi-faceted issue in a superficial fashion, and ignores the many and varied complexities of the assignment of research and development costs to different interest groups, customers or shareholders - present or future. Accounting for research and development is not a new issue, nor are the issues in this case.

The issues to be considered are conceptual as well as practical and require a careful review of the actions of other authoritative groups in the past, such as the FCC, the Securities and Exchange Commission ("SEC"), and the Financial Accounting Standards Board ("FASB"), all of which have specifically considered accounting for research and development. Further, the recommended allocation of project costs based on estimated future benefits is a radical departure from the cost causative allocation principles which underpin currently accepted cost allocation practices.

Q. Please describe the audit approach employed in Audit Disclosure Nos. 17 and 18.

A. Generally, the Audit Report attempts to 1) identify whether current R&D projects will result in further regulated or nonregulated products and services, 2) identify the costs incurred for specific lines of R&D research, 3) relate possible future products and services to current research and development efforts, and 4) assign a nonregulated allocation percentage for R&D currently in process.

Q. What limitations are inherent in this apparent approach?

A. This approach is not feasible for several reasons. First, whether products or services generated from current R&D will be nonregulated or regulated depends on the future actions of this Commission and other bodies and is not known with certainty. Because this approach requires speculation about the future, any suggested allocation percentages advanced in this Audit Report are arbitrary, at best. For example, the Audit Report describes one aspect of the R&D project review process, "some projects appear to have more non-regulated <u>possibilities</u> than others." [page 55, Audit Report, emphasis added]

Also, my review of the information requested and received by the Audit Staff regarding these topics leads me to believe the positions taken by the Audit Report in these areas tend to rely on anecdotal evidence. For instance, the Audit Report seems to cite the Bell Atlantic - TCI merger as evidence of the Company's intentions, although BellSouth and Bell Atlantic are not affiliated. Again, the uncertainty of the future inherent in all research and development severely restricts the practical application of judgementally-based allocation factors.

Q. Do you have any specific comments regarding the BellSouth Telecommunications Inc. ("BST") section of the Audit Report?

A. Yes. Within this section of the Audit Report, the Audit Staff addresses the "Billing and Collection Organization," as specified in the Audit Scope at the beginning of the Audit Report. More specifically, the Audit Report defined the audit scope of the billing and collection organization to include "...a comprehensive look at billing and collections applications in all affiliate companies as well as the operating company." [page 15, Audit Report] A substantial amount of discovery was conducted. The Company replied to about 49 initial data requests (many of which had multiple parts), replied to 10 supplemental data requests (again, most with multiple parts), and complied with at least seven requests for interviews regarding this topic.

Nevertheless, the extensive discovery produced by the Company concerning billing and collection resulted in neither an affirmation of company procedures nor substantive findings. The Audit Report contains only two disclosures that address the "Billing and Collection Organization" as specified in the Audit Scope Statements and Objectives section of the report. Given the extensive quantity of discovery produced, the apparent importance of a "comprehensive" investigation of the billing and collection organization, and no negative findings in the Billing and Collections area, a balanced audit should have included disclosures to that effect.

Q. Are there any other issues you would like to address in the BST section of the Audit Report?

A. Yes. One of the issues addressed within this section of the report is "Management Controls." This issue would be most properly a subset of the "Central Management/Service Organization" portion of the audit scope, although this part of the audit scope would properly not be limited to BST. The general objective of the Audit Staff's efforts within the central management/service organization section of the audit scope, as stated in the Audit Report is as follows:

> "Are the costs being charged or otherwise allocated to the regulated operations from the parent company and the central management / service organization costs that should not be recovered from ratepayers through regulated telephone rates." [page 16, Audit Report]

My review of the information available in this proceeding was guided by the Audit Report's stated objective as quoted above. My analysis, however, of the information requested in this proceeding did not substantiate the Audit Report's conclusions such as the following:

> "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." [page 73, Audit Report]

Conclusions such as that expressed in the Audit Report regarding management's operating philosophy might be properly the result of a focused and extensive review of the management techniques employed by the company. Because the field of "management operating philosophy" is inherently subjective and far removed from the study of "cross subsidization of nonregulated affiliates," I believe the appropriateness of the company's operating philosophy would be best left to experts in the field of organizational research and/or behavior.

Q. What general impressions do you have regarding the BCI section of the Audit Report?

A. The BCI section of the Audit Report encompasses Audit Disclosure Nos. 32 through 37, and covers pages 87 through 107. Although the discussion of BCI within the Audit Report is extensive, covering twenty pages, this section of the report appears incomplete. For example, Disclosure No. 32 contains the explanation that, "This area was not investigated to the extent needed to determine the specific reason for the cost shift." [page 87, Audit Report] Disclosure No. 34 states that, "PSC Staff had planned to test this, but time limits precluded us doing this." [page 95, Audit Report] Disclosure No. 35 contains similar disclaimers regarding inability to complete analyses due to time limitations. Disclosure Nos. 33 and 36 do not contain recommendations, while Disclosure No. 37 includes only a "Statement of Facts" section, with no opinions or recommendations.

Q. Do you have any general comments regarding the BSE section of the report?

A. The BSE section of the Audit Report contains comments for a variety of issues, but is typified by two primary categories - analysis of real estate leases with BSE nonregulated entities (Audit Disclosure Nos. 39 and 40) and analysis of BSE headquarters costs charged to BSE subsidiaries (Audit Disclosure Nos. 44 and 45). A common assertion made by the Audit Report for these Audit Disclosures is that lack of access to BSE financial records precluded analysis of the validity of these transactions. In turn, the Audit Report often recommends disallowance of all related expenses.

As mentioned previously in my testimony, alternate sources of audit evidence are often used to validate transactions. For these Audit Disclosures, a substantial amount of alternative audit evidence was available in the 1992 C&L CAM audit workpapers which were reviewed and copied in part for the Audit Staff. In the specific cases for Audit Disclosure Nos. 39, 40, 44, and 45 where the primary method of analysis was validation of fully distributed cost ("FDC") analyses, FDC analyses were already present in the C&L workpapers and subjected to testing by C&L as part of their annual CAM audit.

In the case of the Campanile building, addressed in Audit Disclosure No. 43, the Audit Report recommends "Since the company would not provide access to staff to the records necessary to compute FDC, the entire rent for 1992 of $7,445,373 should be removed." [page 117, Audit Report] This conclusion is incorrect. A fully distributed cost calculation for the Campanile building, described later in my testimony, shows that BSC's fully distributed cost for the Campanile exceeds the current lease cost, based on prevailing market rate pricing, by about 29%.

Q. **Do you have any general comments regarding the "Directory Operations" section of the Audit Report?**

A. I reviewed the financial information presented in the Audit Report and the corresponding financial information requested during the discovery period through data requests. My review, however, does not result in the same opinions and recommendations as the Audit Report. In this area, the Audit Report concludes that BAPCO-Florida made excess payments to Stevens Graphics based upon the logic that Stevens earned an excessive ROE. [page 146 and 147, Audit Report] The financial information requested by the Audit Staff and used to support this assertion, however, appears to include earnings by Stevens Graphics on about 29% of its revenues pertaining to services rendered to non-BAPCO affiliates and non-affiliates. Subsequent data request responses described the conclusion that the financial information requested included substantial sales to non-BAPCO entities. Because the financial information is the result of both BAPCO-related and non-BAPCO business, I do not reach the same conclusion as the Audit Report.

Q. **Do you have any general comments regarding the BellSouth Corporation ("BSC") section of the Audit Report?**

A. The most significant issues addressed within this section of the report are primarily of two types: 1) issues associated with the company's Leveraged Employee Stock Ownership Plan and 2) issues concerning the duplication and necessity of functions performed by BSC on behalf of BST.

Issues concerning BellSouth's Leveraged Employee Stock Ownership Plan will be addressed in detail later in my testimony.

In Audit Disclosure Nos. 58, and 60 through 71, the Audit Report deals with the functions performed by BSC and, in some cases, questions whether they are duplicative of those performed at BST and whether the functions are necessary for regulated telephone operations. Audit Disclosure Nos. 58, 60, 61, 63 - 65, 67, 70 and 71, however, only include recommendations that the Company should demonstrate the necessity of costs for the functions addressed in the Audit Disclosures in testimony to be filed by the Company. The remainder of the Audit Disclosures discussing BSC functions performed for BST either do not contain a recommendation (Audit Disclosure No. 72) or contain neither opinions nor recommendations (Audit Disclosure Nos. 62, 66 and 68).

Q. **If you were charged with determining the appropriateness of BSC charges to BST, what type of study methodology would you utilize?**

A. In addition to reviewing the transactions between BSC and BST from the perspective of governing affiliate transaction rules, I would have performed an analysis to assess the appropriateness of services rendered by BSC to BST. This study would evaluate the necessity and cost of services provided by BSC, and assess the potential for duplication between BST and BSC departments. Typical questions that would be addressed during such a review might include, "In the absence of BSC, would BST be forced to assume the responsibility for the functions performed by BSC?" and "Is the function in question most efficiently or effectively performed in a centralized manner or could it be performed as well by BST individually?"

I have not performed such a study, but I understand that Theodore Barry & Associates will offer testimony based on such an analysis.

SECTION 2 - RESEARCH AND DEVELOPMENT

Q. Does this section of your testimony address specific research and development related issues?

A. Yes. I address matters included in Audit Disclosure Nos. 17 and 18 in the Audit Report, and related issues.

Q. Please summarize the relevant facts surrounding research and development efforts conducted by and/or funded by the company?

A. The Company funds two research organizations. The first organization, Bellcore, conducts primary research on technologies and sciences that are strategic to the Company and the other six Regional Bell Holding Company owners of Bellcore. Some of the primary products of Bellcore are standards and frameworks on which product or service specific development can be based. The second research and development organization is the S&T group which is a department within the Company. The S&T group performs company-specific research and development and is intended to be complementary to Bellcore's efforts.

Bellcore R&D expenses are tracked in USOA account 6727 Cost Pool 01. S&T group R&D expenses are tracked in USOA account 6727 Cost Pool 03. Allocation of these expenses to regulated and nonregulated service offerings is discussed later in my testimony.

Although the R&D activities of Bellcore vary widely, the Audit Report has recommended the same allocation percentage of 50% regulated and 50% nonregulated for all Bellcore-generated expenses of the company. Conversely, the Audit Report has suggested various allocation percentages ranging from 20% to 50% nonregulated allocation for the company's S&T group expenses. Currently, R&D costs are expensed based on a forward-looking allocation of nonregulated investment in accordance with applicable regulations. The Audit Report recommends various methods of R&D cost capitalization, deferral and "keep cost" recordkeeping for both Bellcore and S&T expenses.

Q. Could you explain why it is inappropriate to defer or capitalize research and development costs as recommended by the Audit Staff in the Audit Report?

A. Yes. First, capitalizing R&D is not in accordance with the FCC's accounting rules or with Generally Accepted Accounting Principles ("GAAP"). The FCC defines R&D in 47 CFR Part 32.6727 as "costs incurred in making planned search or critical investigation aimed at discovery of new knowledge. It also includes 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, whether intended for sale or use."

Q. Was this always the case?

A. No. Accounting practices surrounding deferral of R&D were diverse in the past. The FCC reviewed its accounting rules in the Uniform System of Accounts ("USOA") proceeding and decided to adopt the GAAP approach to recovery of research and development costs. This approach specifies expensing unless cost recovery in future periods is reasonably assured. The Company's R&D costs which are in account 6727 do not meet this test.

In its USOA Order, the FCC emphasized the importance of regulated carriers adhering to GAAP. It found that movement of the accounting practices of the telecommunications industry closer to the more widely accepted accounting practices of the unregulated American business community is in the public interest. The Commission reaffirmed its policy in its 1987 Pension Accounting Order. All publicly-owned carriers must account for their activities in conformance with GAAP and, in particular, principles promulgated by the Financial Accounting Standards Board ("FASB").

Part 32 accounting principles which require that R&D costs be expensed, were developed to achieve the objective of providing reliable and consistent accounting information to satisfy the financial reporting needs of the telephone industry. Any ratemaking adjustments that do not follow GAAP would require the telephone company to keep separate books for the affected accounts. That was precisely the burdensome and confusing result the FCC minimized when it adopted GAAP.

Q. What is GAAP and who sets these standards?

A. The FASB is the body which promulgates the accounting and reporting standards commonly referred to as GAAP. The FASB is the principal authoritative standards setting body in existence today, and accordingly, sets required accounting standards for all non-governmental entities, including BST.

Financial Accounting Standard No. 2 requires charging to current operations, those costs related to research and development, defined as follows:

> "**Research** - planned search or critical investigation aimed at discovery of new knowledge with the hope that such activity will be useful in creating a new product, process or service.
>
> **Development** - the translation of research findings or other knowledge into a new or improved product, process or service capable of commercialization, including the conceptual formulation, design and testing of product, process or service alternatives and the construction of prototypes and pilot operations related to the new or improved product, process or service."

Additionally, the FASB addressed regulatory (ratemaking) concerns in Financial Accounting Standard 71. Such standards relate to the effect of rate regulation on accounting for regulated enterprises. In brief, FAS 71 allows the capitalization of costs if it is likely that revenues associated with those costs will be collected in future periods. This requires cost recovery to be probable.

The rationale for expensing rather than capitalizing or using "keep cost" accounting for deferring research and development costs is as follows:

- Current expensing recognizes that not all products are winners; "losers" will not be around long enough to generate revenues to cover deferred expenditures,

- Deferral requires that "benefits" will be realized sufficient to recover deferred costs. Not all benefits of R&D are quantifiable,

- More often than not, no direct relationship of costs to specific future revenue either by product or accounting periods, can be demonstrated,

- Future customers may not be current customers; deferring costs may cause an inequity,

- The tracking, valuation and quantification of R&D costs is often not practicable, and

- There is a risk that deferred expenditures can cause major fluctuations in financial operations if a "sudden write-off" of capitalized R&D costs occurs.

Q. Does the Securities and Exchange Commission have an opinion on the capitalization of R&D?

A. Yes, as a SEC registrant, BST is required to prepare general purpose financial statements in accordance with GAAP. Accordingly, GAAP requirements for accounting and reporting for research and development apply.

Q. Are there any other concerns voiced by the Audit Staff's report regarding R&D cost recovery?

A. Yes. The Audit Staff apparently views spending on research and development in terms of a "generational inequity" issue - that is to say that later generations of customers benefit from costs borne by the current generation of customers. To avoid this envisioned inequity, the Audit Staff proposes the adoption of an ultimate benefit paradigm for R&D cost allocation. This is inappropriate for several reasons. First, cost allocation based on ultimate benefit is counter to the FCC's accounting rules. Second, cost causation is the preferred method for cost allocation in all cases, not ultimate benefit. Specifically, the FCC has stated in 47 CFR 64.901, that R&D expenses are to be allocated in a cost causative manner. Ultimate benefit is not a consistent, valid basis for cost allocation. The company currently employs a method of cost allocation based on direct attribution of R&D costs. This methodology has been examined in numerous audits.

Q. Regardless of the FCC's rulings, what are the specific problems with the Audit Report's capitalization proposal?

A. First of all, the Audit Report's proposal ignores key attributes of the basic nature of research and development. The first basic premise that is ignored is that R&D expenditures represent an investment in the future that is necessary in all industries, especially those in dynamic fields such as telecommunications. The existing telephone network infrastructure that serves today's customer was researched, developed, and to an extent deployed at the expense of previous generations of customers. This is not unique. A portion of the selling price of virtually all consumer products is used to pay for the development of an improved "next year's model."

This "next year's model" is often improved service at reduced costs. For example, I understand that this is the case with digital Subscriber Loop Carrier ("SLC") service. This technology is transparent to the customer in that no additional charge is made for the equipment, but the benefits in terms of service quality can be significant. I understand that this technology can reduce the number of copper wires that otherwise must be run to a subdivision or community from 96 pairs to 5 pairs by combining up to 24 conversations over a pair of wires (a spare pair capable of carrying 24 conversations is reserved to increase reliability thus requiring 5 pairs as opposed to 4). In addition to the savings in cable installation and maintenance, the customer receives better quality voice service and greater reliability. Over the life of an SLC system, the savings can be significant for customers.

Furthermore, because the public telephone network is a critical enabler of economic development, the customers of the telephone company benefit in many ways both directly from improved services and lower costs, and indirectly from increased economic activity in the region stemming from the use of these improved telecommunications services.

The second premise not highlighted in the Audit Report is that if current generations of shareholders chose to maximize their return on investment today (at the expense of tomorrow's shareholders), then current R&D spending would be minimized. If shareholders had chosen to do this in the past, we might still be using outdated technology at significantly higher rates than we enjoy today. Investment in the future of the public network is critical for customer and shareholders.

Q. **But, couldn't investment continue and just be paid for by the eventual users of that technology?**

A. On the surface this sounds appealing, but when examined closely there are insurmountable problems with applying this concept. Critical questions that can not be satisfactorily answered include the following:

- What proportion of basic research should be applied to the first spin-off product that is based wholly or in part on that research? What percentage for the second, or third? How do you know which other products might be spawned and how much of the research investment should be recovered from each one?

- What is the appropriate recovery period for R&D expenses related to new products and what happens if the life of the product is significantly shorter or longer than the recovery period?

- Should the time value of money impact the recovery rate?

- Should amortization rates of R&D investment be adjusted up and down as infrastructure-related research products are introduced into the network?

- How do you determine what products or services have resulted from basic or applied research and in what proportion did the product depend on each?

- If the ultimate product or service that is developed stems from the amalgamation of multiple research efforts, have any of these efforts spawned previous products that may have defrayed some, most, or all of the R&D costs? If so, how is this accounted for and for how long into the future are adjustments made to the calculation as new services appear?

In addition to the impracticability of attempting to determine the specific R&D costs of developing all of the future products and services which arise from current research, this alternative is further limited by the necessity to make a regulated or nonregulated classification of those yet to be developed products and services.

Q. Could you explain the problems surrounding uncertainty of investment; it would seem as though researchers would know exactly what will result from their work?

A. The Audit Report apparently concludes that there is no guarantee of improved or new services resulting from specific R&D spending, which is true. The Audit Report, however, appears to also assert that the shareholders should pay for R&D out of earnings and that when there is a new product or service offered, the customer will pay for development of that service solely through rates for that product.

Historically, the R&D risk has been borne by both the customer and the shareholder. The Audit Report proposes shifting the risk associated with research and development more to the shareholder in the belief that this will reduce R&D costs for the customer. If this method of recovering R&D costs were to be adopted, the customer may not benefit. A shareholder evaluates the return on any investment after all taxes are paid and costs are covered including R&D. For any given amount of risk, there is a corresponding return that is demanded to secure needed investment. If the burden of risk is shifted to the shareholder (i.e., the level of risk has materially increased), the shareholder will logically demand a higher return on his/her capital to compensate for the increased risk. To pay this increased return, rates for services must be raised. If the Commission chose not to increase rates to the customer to cover the increased risk to the shareholder, the shareholder might forego some research that encompassed a higher level of risk. The research in jeopardy might include projects which could not assure a quantifiable return in the short term. The result of shifting R&D risk from the existing shareholder-customer balance more to the shareholder might be either higher rates for the customer, foregone network development, or both. Maintaining the current shareholder-customer partnership in shouldering research and development costs is in the best interests of the customer and the company.

Q. What about the assumption that money that is spent on R&D will likely be used to develop a greater percentage of nonregulated services in the future than exist today and that these improved services will not benefit the regulated customer?

A. Commissions and the judiciary decide what services are regulated, not the Audit Staff or the company. Only narrow definitions of nonregulated services have been historically permitted for the Company. Of all the services offered by the company, only a handful are nonregulated. Additionally, the services that are nonregulated drive the usage of the regulated network. For example, the current nonregulated protocol conversion service is provided by a single card placed in an existing piece of packet switching equipment that is otherwise required for regulated packet switching operations. The use of the nonregulated service requires the use of the regulated network and regulated packet service. All regulated services and network components employed in providing protocol conversion services are charged to nonregulated operations at tariffed rates and the resulting revenues accrue to regulated operations. The remaining revenues, those associated with the protocol conversion card are deemed nonregulated and are available to offset nonregulated expenses as determined in accordance with cost causative principles.

Additionally, various mechanisms exist today to protect the customer from subsidizing the development of nonregulated product offerings. For example, expenses related to developing nonregulated product offerings are currently magnified through the three year forecast process and borne by the shareholder. The result is that customers receive the benefit of any inherent imprecision in the estimate of regulated/nonregulated product development allocation.

Q. But wouldn't customers benefit from using "keep cost" recordkeeping or otherwise deferring R&D expenses?

A. No. Any benefit customers receive from the deferral of R&D costs would be short lived at best. Assuming that R&D spending remains relatively constant, then for the first year R&D recovered from customers would drop. After a few years, however, the amount of money recovered from customers would ramp back up to the same level as before deferral because the services developed by R&D would begin being offered. The short-term impact would be a decline in R&D recovery. The long-term effect would be an increase in recovery presuming the company is allowed to earn a return on the invested R&D money during its deferral period. The end result is that customers would pay more if R&D were to be deferred as the Audit Report recommends because they would be "financing" current R&D efforts with future dollars.

Q. How much does R&D cost current regulated customers?

A. To put R&D spending in perspective, BST's Research and Development costs represent about 0.42% of BST's total revenue or about $43 million for 1992.

Q. Could you comment on the Audit Report's suggestions regarding specific research and development allocations?

A. Yes, First of all, the suggestions are internally inconsistent. The suggestion for all Bellcore research is 50% regulated and 50% nonregulated. The recommendation, however, for research allocation conducted by BST's Science and Technology group is broken down by research area into widely varying percentages. There is no apparent analytical basis for these suggestions, which are listed as follows:

Entity	Field	Regulated	Nonregulated
Bellcore	All	50%	50%
BST	PCS	20%	80%
BST	SMDS	50%	50%
BST	Video Transport	30%	70%
BST	Network Evolution	50%	50%
BST	Service Concepts	50%	50%
BST	AIN	30%	70%

These recommendations appear inconsistent because the Bellcore R&D recommendation encompasses complementary elements of the specifically identified BST R&D subjects. Second, there appears to be no underlying information that supports these specific allocation factors.

Q. **The Audit Report calls into question the allocation of regulated and nonregulated research funding, as well as the method for determining these amounts. Would you briefly describe the current allocation method used by the company to allocate research and development costs between regulated and nonregulated service offerings?**

A. Yes. The currently accepted method of assigning costs to regulated/nonregulated operations is based primarily on existing network investment. The current method of cost assignment has been used several years for Bellcore and since January, 1993 for the S&T group of BST. The result of this methodology is that, on average, 1.9% of costs in account 6727 are allocated to nonregulated service offerings for 1992. On the surface, 1.9% of R&D assigned to nonregulated research may appear low. When compared to either the percent of revenue generated by nonregulated services, however, or when compared with the percentage of nonregulated research allocated to regulated services by the six other RBOCs, the percentage is shown to be reasonable. As shown in **Exhibit JBB-7,** BellSouth charges a greater percentage of R&D to nonregulated service offerings than four of the seven RBOCs. Put simply, BellSouth customers are proportionally paying less than most other customers for network advancing research.

Q. Could you describe the existing allocation mechanism and explain why its use is appropriate?

A. The existing mechanism for allocating R&D costs between regulated and nonregulated is not only sound, it is the most cost causative and reasonably auditable method available to the commission's staff. Additionally, this method has been the subject of an annual CAM audit.

Projects that are clearly going to result in either regulated or nonregulated services are appropriately assigned directly to regulated or nonregulated operations. The remaining "common" programs are attributed using existing network investment. Because existing network investment is based on past R&D efforts and future network investment will be based on current R&D efforts, R&D expenses can be reasonably attributed using network investment as a yardstick of cost causality.

Additionally, the current method of attributing R&D expenses is structured to favor the customer going forward. To protect the customer from "over-allocation", the company, in compliance with the JCO, forecasts the maximum utilization of nonregulated investment for the next three years and applies the highest forecast usage to the nonregulated attribution. In effect, the customer is receiving a three year "benefit of the doubt" R&D allocation percentage.

Q. **How would you characterize the overall nature of the R&D cost allocation methodology?**

A. The current R&D attribution method provides an incentive for the company to meet the challenge of improving the efficiency and reliability of the network infrastructure. The customer is successfully provided with a public network that is a key component of economic development throughout the region at a cost per line that is lower than four of the seven RBOC's. The shareholder is provided an incentive to continue funding critical R&D efforts without which the current levels of customer service and network modernization could be jeopardized.

Q. **Why was the S&T cost allocation mechanism changed for 1993, and generally how does the new method work?**

A. The method used to allocate S&T Research and Development costs was modified to improve its reflection of cost causation. The previous method of allocating S&T R&D expenses used a general allocator that was based on the weighted average percentage of all 6XXX (expense) accounts. The amount of nonregulated expense was then divided by the total expense to yield an allocation percentage to regulated and nonregulated operations. Although this method has been found acceptable in the past, a more cost causative method has been determined and is now used.

The FCC Joint Cost Order requires that the method used to allocate costs minimize the use of the general allocator and to the extent possible, directly assign or attribute costs. The new methodology does both. Each program is evaluated by the Company's Subject Matter Experts ("SME's") to determine if it is 100% regulated, 100% nonregulated, or common. S&T research projects are generally not directly assignable, meaning that there is no way to directly assign the R&D costs to an individual regulated on nonregulated technology or service. Therefore, the majority of the S&T R&D (Part 32 account 6727) expenditures are considered common and attributed to both regulated and nonregulated operations based on the relative levels of existing network investment. Furthermore, if the resulting research is not yet determined to be either regulated or nonregulated, it is assumed to be common. R&D is not assumed to be regulated as the Audit Report asserts in Audit Disclosure No. 18 [page 59, Audit Report].

Investment is a reasonable basis for attribution of R&D spending. All current network investment is based on past R&D effort. Current R&D effort will result in future services requiring network investment. The linkage of R&D and network investment is sound. Some may prefer that all R&D projects be assigned to regulated or nonregulated service offerings when the research is initiated. This is often impossible because of the uncertain nature of research and development. What research will result in unforeseen service offerings? What research will result in a "dry hole"? The Company cannot often determine with certainty which research will result in service offerings or even which service offerings will be nonregulated in the future. Investment based R&D attribution meets the JCO cost-causation requirement. Furthermore, using network investment as an attributing factor for R&D expense is auditable and verifiable by all parties concerned. It is the only method of R&D cost allocation that can be independently measured and evaluated with certainty.

Q. **What do you expect the impact of the new cost attribution method to be?**

A. The difference is only in those programs determined to be common. For the first six months of 1993, the S&T nonregulated R&D common attribution has been .7%. The common allocation for 1992 was about 5% which although higher, was not derived in the most cost-causative manner possible. Using 1992 actual numbers and applying the projected 1993 nonregulated R&D percentage, the new methodology would have resulted in a shift from nonregulated service operations to regulated operations of less than $365,000 (see **Exhibit JBB-8** for derivation) for the entire nine-state region.

Q. The workings of the new attribution process are not defined in the Audit Report. Could you explain in more specific terms the mechanics of the methodology used for Bellcore research expenses and now used for S&T research expenses?

A. Yes. I do so in **Exhibit JBB-9**. There are four major steps in the process which are outlined in detail in that Exhibit. In general they involve determining the existing percentage of nonregulated investment in the network and utilizing that relationship to determine the R&D allocation to regulated and nonregulated service offerings.

Q. The Audit Report's opinion in the R&D Section related to fiber trials on page 39 is that "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." Is the relationship of revenue to investment reasonable?

A. The relationship of investment to revenue identified by the Audit Report requires clarification. First, the $13,935,615 includes the central office switch (and building) that serves the trial area. The switch investment alone is $7,450,859. More importantly, however, trials are not intended as profitable ventures. They are intended to test a potential technology and the company's ability to field and maintain that service as well as measure potential customer acceptance. They are a natural part of the research and development process. They are not expected to generate profits. Any revenue generated by a trial that can defray costs is a benefit, but in no way does a trial represent the commercial viability of a service. Additionally, many trials are conducted with service provided free of charge to the user during the trial period.

SECTION 3 -REAL ESTATE RELATED ISSUES

Q. **Does this Section of your testimony address specific real estate issues?**

A. Yes. I will address matters included in Audit Disclosure Nos. 38, 39, 40, 42, and 43 and related issues.

Q. **Please summarize the relevant facts surrounding BellSouth Corporation's lease of office space in the Campanile Building addressed in Audit Disclosure No. 43?**

A. BSC leases office space in the Campanile building at 1155 Peachtree, a location approximately two miles north of what is generally considered downtown Atlanta. The Campanile Building is owned by 1155 Peachtree Associates, a joint venture between BellSouth Corporation and CA Fourteenth Investors, Ltd. The building serves as headquarters office space for BSC and provides space to BSC affiliates and other non-affiliated companies. Attached hereto as **Exhibit JBB-10** is a summary of the primary tenancy of the Campanile as of September 1, 1993 according to Company's response to Data Request No. 2-054 Amended, Attachment G.

According to this information, BSC leases approximately 67.2% of the building and the largest non-affiliated tenant, Coopers & Lybrand, leases 16.3% of the building. Space leased to BSC and affiliated entities totals approximately 72.6% of the building.

BSC treats its lease of the Campanile building space as an affiliate transaction. BSC's lease of office space in the Campanile Building is not governed by any tariff. BSC believes that 1155 Peachtree Associates participates in a substantial outside market in its leases of space in the Campanile building to non-affiliate tenants, and therefore, has applied the "prevailing market rate" affiliate pricing rule to this transaction. This pricing methodology is specified in the Cost Allocation Manual filed with the FCC, and has been subject to annual independent audits, without exception.

Of critical importance, if neither the "tariff pricing" provisions nor the "prevailing market rate pricing" provision of Section 32.27(d) and Section 64.901 were applicable to this transaction, BST would be required to compensate the nonregulated affiliate for its allocation of the charge for leased space using fully distributed cost pricing.

Q. Does the Audit Report recommend an adjustment regarding the Campanile Building?

A. Yes. The Audit Report contends that, "Since the Company would not provide access to staff to the records necessary to compute Fully

Distributed Cost, the entire rent for 1992 of $7,445,373 should be removed." [page 117, Audit Report]. Of this $7,445,373, $5,543,669.26 is directly related to BST and $1,449,115.08 is directly related to Florida [page 117, Audit Report]. This conclusion is incorrect.

Q. Have you performed an analysis of the lease cost to BST of the Campanile lease space if fully distributed costing were used by BellSouth Corporation?

A. Yes. I have refined my initial FDC analysis previously included in testimony filed in this docket based upon additional information requested and received from the Company pertaining to BSC.

My analysis shows that if prevailing market rate pricing were not allowed to be used, and consequently, BSC would then be required to use fully distributed cost as the pricing rule governing the Campanile lease, the lease cost would increase by approximately 29%. The current prevailing market rate lease cost is less than the fully distributed cost of BellSouth Corporation's lease.

Q. Have you prepared an Exhibit which supports your FDC computation?

A. **Exhibit JBB-11** contains the computations supporting the FDC lease rate specified above. **Exhibit JBB-11** was created by extracting estimated cost and investment information from source data, by using the current pretax allowable rate of return, and by applying the current BSC and affiliate company occupancy percentage specified by the company's response to Data Request 2-054 Amended, Attachment G (reproduced herein on **Exhibit JBB-11)**. Direct headquarters expenses included in the FDC analysis and investment balances were updated based on information requested and received from the company.

Q. Can you briefly summarize what this analysis demonstrates?

A. It demonstrates that the discontinuance of prevailing market rate pricing would significantly increase the 1993 cost of the Campanile lease to BST's regulated operations, and therefore, to ratepayers. This is particularly important considering the Audit Report's view described in Audit Disclosure No. 3 about prevailing market rate transactions and the prospective application of the FCC's proposed revision to affiliate transaction rules expressed in the Notice of Proposed Rulemaking ("NPRM"), FCC Docket No. 93-251.

Q. Please describe how BSC applied prevailing market rate pricing in the Campanile lease.

A. In applying the prevailing market rate pricing, BSC charges its subsidiaries, through allocation, no more than the price charged to the most comparable non-affiliate tenant in the building on a net present value basis over the life of the lease.

BSC performed a comparison of lease rates between BSC and C&L using this net present value methodology, which demonstrated that the lease rate payable by BSC to 1155 Peachtree Associates exceeded the prevailing market rate payable by C&L. The Audit Report notes, according to BSC's JCO matrices, that BSC reduced the BSC amount downward by 29% on the basis of this comparison.

Q. The Audit Report questions why BSC did not use the Kilpatrick and Cody lease in the 1100 Building as a comparison for the BSC lease in the Campanile Building. What comments do you have regarding the comparison of the BSC lease in the Campanile Building to the Kilpatrick and Cody lease in the 1100 Building?

A. At the time BSC entered into the lease agreement with 1155 Peachtree Associates for the space in the Campanile Building, the JCO had not yet been promulgated. When the JCO went into effect, BSC evaluated the lease rates in accordance with the new regulations. BSC determined that Coopers & Lybrand was the most comparable lease in the building at the time based on the "then current" market conditions. BSC appropriately continues to use Coopers & Lybrand as the comparison for this reason.

Although Kilpatrick and Cody's lease in the 1100 Building may be closer in size to the BSC space in the Campanile Building, this lease was entered into almost 4 years after the JCO went into effect. In assessing comparability, it is critical to compare transactions which were entered into under similar market conditions and time frames.

Q. Do you have any other comments related to Audit Disclosure No. 43?

A. Yes. It is also important to note that recommending the entire lease amount be removed for ratemaking purposes would, in effect, result in the ratepayers receiving free use of the Company's assets.

Q. What comments do you have regarding the adjustment proposed by the Audit Report related to Sunlink warehouse space in Audit Disclosure No. 39?

A. During my analysis of this Audit Disclosure, I noticed several errors in the statement of facts regarding the Sunlink warehouse space. Further, the recommendation that all the lease charges should be removed is not supported by the information I have reviewed.

Q. Please describe the errors you noticed in the statement of facts section.

A. Several facts appear incorrect in the Audit Disclosure. The FDC for each warehouse as stated in the Audit Report does not agree with the FDC amounts listed in the Coopers & Lybrand workpapers. This would explain the Audit Report's incorrect observation that, "The Jacksonville warehouse is already $240,056.10 higher than Fully Distributed Costs." [page 109, Audit Report] According to the Coopers & Lybrand workpapers, the Jacksonville warehouse is slightly above FDC for 1992. The Jacksonville warehouse, however, remains substantially <u>below</u> FDC for the cumulative period through December 31, 1992. It is BST's policy to limit the cumulative lease payments established under the terms of a lease agreement to not more than cumulative FDC cost for the warehouse space.

The mechanism used by BST to assure that the cumulative lease payments for the Jacksonville warehouse are less than FDC is straightforward. Each year, BST compares the actual lease payments for the current annual period with the affiliated lessor's fully distributed cost of providing the warehouse space. Any excess of lease payments over FDC, or conversely, any excess of allowable recovery by the lessor at FDC over the actual lease payments in the current period, is added to the cumulative excess of FDC over BST's actual lease payments for prior periods. This computation determines that, on a cumulative basis for all periods to date, the prices actually paid by BST are <u>no more than</u> allowable costs which could be recovered by the affiliated lessor under FDC pricing. If the cumulative charges actually paid by BST were to exceed the cumulative FDC calculations, BST would make an adjustment equal to the difference.

Additionally, I cannot verify the amount of rent listed in the Audit Report's statement of facts section using the Coopers & Lybrand workpapers. The Coopers & Lybrand workpapers disclose different amounts.

Q. What comments do you have specifically related to the Audit Report's proposed removal of the lease charges?

A. The Audit Report asserts, "Because the company would not provide complete access to support their numbers the entire lease should be removed." [page 110, Audit Report]

Auditors may consider a variety of sources of evidence, in addition to directly examining information. For example, a routine source for obtaining audit evidence is relying on the work of other professionals or specialists. In this specific instance, information related to the warehouses was included in the 1992 CAM audit workpapers of Coopers & Lybrand and was tested by them. Specifically, the Audit Staff clearly had access to the Coopers & Lybrand workpapers as evidenced in their statement of facts section and Data Request Nos. 2-001.A, 2-016, 2-026, 2-027, 2-051, 2-052, 2-054.C, 2-062, 2-062.A, 2-068.1, and 2-104.A. Contained in these workpapers is an FDC analysis performed for each of the warehouses.

Coopers & Lybrand is an independent auditor. As the FDC computation can be found within the Coopers & Lybrand workpapers, these workpapers provide substantive audit evidence for validating the FDC amounts. Evidence to substantiate the amounts paid in rent and charges was provided in response to Data Request No. 2-131 and can additionally be found in the ARMIS report. I believe it is also important to note that recommending the entire lease amount be removed for ratemaking purposes would, in effect, result in the ratepayers receiving free use of assets.

Q. What comments do you have specifically related to the Audit Report's proposed removal of the rent and other related costs for CSL Birmingham in Audit Disclosure No. 40?

A. The Audit Report recommends that, "Because the company refused to support their calculations by full access, the rent and other related costs should be disallowed..." [page 112, Audit Report] Again, the Audit Staff clearly had access to the Coopers & Lybrand workpapers as evidenced in their statement of facts section and Data Request Nos. 2-001.A, 2-016, 2-026, 2-027, 2-051, 2-052, 2-054.C, 2-062, 2-062.A, 2-068.1, and 2-104.A.

Coopers & Lybrand is an independent auditor and their 1992 CAM audit workpapers provide audit evidence about the CSL Birmingham FDC amount. Evidence to substantiate the amounts paid in rent was provided in response to Data Request No. 2-131 and can additionally be found in the ARMIS report. Again, recommending that the rent and other related costs be removed for ratemaking purposes would, in effect, result in the ratepayers receiving free use of assets.

Q. Can you address Audit Disclosure No. 38, which is related to the leases between Sunlink and DataServ and BellSouth Communications Systems, Inc.?

A. Yes. Although the Audit Report does not include a recommendation in Audit Disclosure No. 38, there are three assertions which require clarification.

Q. Can you explain what needs to be clarified?

A. Yes. First, the Audit Report asserts that costs are "chained" into regulation when prevailing market rate pricing is used. This misconception is evidenced by the statement, "The company has not adequately justified the charges for Data Serv [sic] even though the company uses market rates because these costs are chained though the market rates." [page 108, Audit Report, emphasis added] This is a fundamental error in logic. Prevailing market rates are not based upon costs, rather they are based on what the market dictates. Costs are irrelevant. The company responded in Data Request No. 2-001.A1 that the Sunlink lease charges are not included in any of the fully distributed costs from DataServ and made available the DataServ general ledger to justify the DataServ charges.

The second assertion for clarification is the Audit Report statement that, "Because we have not received any detail on BCS regarding this matter Staff cannot determine the amount of the $732,000 lease which has been chained in to regulation," on page 108 of the Audit Report. The Company supplied details regarding this matter in response to Data Request No. 2-001.A1 and provided access to the Coopers & Lybrand workpapers which contain applicable portions of the Sunlink Intercompany Revenue Report. This report states the amount of costs charged by Sunlink to BCS (i.e., lease costs).

As the third point for clarification, the Audit Report states that the company, "...did not provide the requested FDC analysis until October 6, 1993. All Sunlink Financial Statements and General Ledgers were requested June 7, 1993." [page 108, Audit Report] The Audit Report does not note that the request for the subject FDC analysis was not made until September 17, 1993 [Ref: Data Request No. 2-001.A1].

Q. What comments do you have regarding Audit Disclosure No. 42 pertaining to CSL Chastain?

A. The Audit Report proposes to disallow the Florida portion of the lease costs associated with CSL Chastain and derives the Florida portion based upon the allocation of Account 6121. There is no basis for this Audit Disclosure since information provided in response to Data Request No. 2-012 in this proceeding indicates that Florida is not allocated <u>any</u> portion of these lease charges. This Audit Disclosure should be disregarded.

SECTION 4 - DIRECTORY OPERATIONS

Q. Does this section of your testimony specifically address directory operations?

A. Yes. I will address matters included in Audit Disclosure Nos. 48, 49 and 50 and related issues.

Q. Would you please summarize the issues addressed in the Audit Report in Audit Disclosure Nos. 48, 49 and 50 ?

A. Yes. The Audit Report makes assertions on two principal fronts. First, the report asserts that there are excess profits of BAPCO [page 143, Audit Report] to be imputed based on an application of Section 364.037 ,F.S.

Second, the Audit Report asserts that excess profits of BAPCO stem from "excess charges from Stevens Graphics and BSE management fees" and a full imputation of BAPCO's operations for Florida intrastate purposes. [page 143, Audit Report]

A critical point to make is that the Audit Report's assertion that excess profits of BAPCO are imputable depends on a reinterpretation of Section 364.037, F.S., and the related Commission rule 25.0405. Under the current method of applying the Commission rule 25-4.0405, the costs of BAPCO arising from affiliates are not relevant. Although I will not offer testimony on the interpretation of the Florida Statute or the Commission's Rule 25-4.0405, Mr. Walter S. Reid has offered testimony in this docket addressing the history and practice of applying Commission Rule 25-4.0405.

My testimony in this matter will address whether assertions of BAPCO "excess profits" arising from BSE management fees or charges from Stevens Graphics are supported by the underlying information available in this proceeding, irrespective of the method of applying Commission Rule 25-4.0405.

Q. Please summarize the relevant facts surrounding BST's relationship with BAPCO.

A. The relationship between BST and BAPCO is presented in the directory publishing contracts provided in response to Staff Data Requests Nos. 3-

001 and 3-087. The contracts, effective January 1, 1984, grant to BAPCO the exclusive right to publish telephone directories in BST's name for all telephone exchanges in the nine states in which BST provides communications services. In addition to the rights specified above, the contracts provide for specific responsibilities of each of the parties to the contract.

BAPCO is responsible for all costs and expenses relating to compilation, printing, and delivery of its yellow pages directories. BST is responsible for furnishing to BAPCO subscriber listing data, directory delivery information and other data, information and materials necessary for BAPCO to carry out its responsibilities. BST is also responsible for billing and collecting directory advertising charges for advertising published in directories covered by the contract. BAPCO produces, at its own expense, white pages directories for BST.

The compensation for all services performed by BST is paid through the publishing fee arrangement as described in the contract. For BAPCO's Florida operations, the publishing fee arrangement provides that BST will be compensated for services rendered and rights granted to BAPCO at the rate of 54.25% of net collected BAPCO directory revenues.

Q. Please summarize the relevant facts surrounding BSE's relationship with BAPCO during 1992.

A. BSE is a holding company which provides legal, planning, financial and limited staff support for BSE's nonregulated companies. BSE recovers the costs incurred in providing these services to its subsidiaries through project billings and management fee billings.

Projects are services performed by BSE departments at the direction of a subsidiary. Project costs are directly attributable because they can be identified as incurred for a specific subsidiary. In addition to direct costs such as salaries, overhead is allocated to each project. An annual study is conducted to determine that the billed overhead percentage does not exceed the actual overhead percentage.

All other costs are defined as corporate function costs. These are costs that are not identifiable to specific subsidiaries, but rather are incurred on behalf of all or several BSE subsidiaries. Corporate function costs are incurred by BSE headquarters staff in performing the normal functions associated with a holding company. BSE recovers corporate function costs through a management fee assessed on the controllable operating costs of its subsidiaries (computed as operating expenses less cost of goods sold, depreciation, and the current month management fee). The management fee was originally calculated to recover all the corporate services costs, but since 1987 these costs have risen. BSE has not increased the management fee since it was originally developed, and therefore, the management fee is less than the fully distributed cost of providing corporate services according to analyses included in the Coopers & Lybrand 1992 CAM audit workpapers.

Q. **Does the Audit Report recommend an adjustment to the charges from BSE to BAPCO in Audit Disclosure Nos. 48 and 49?**

A. Yes. The Audit Report asserts that the management fee BSE charges BAPCO should not be included in BAPCO-Florida expenses when determining gross profit under the provisions of Florida Statute 364.037, F.S., and Commission Rule 25-4.0405. This assertion is based on the opinion in the Audit Report that, "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." [page 145, Audit Report] These assertions, however, are not supported by information received by us in this proceeding. I will discuss each in further detail below.

Q. **Given the current statutes and Commission rules governing regulatory accounting for BAPCO-Florida operations, would the Audit Report's recommendation impact intrastate revenue requirements in Florida?**

A. No. I understand from the Company that the current statutes and Commission rules define the formula for determining the amount of nonregulated directory publishing gross profit in terms of the 1982 gross profit, indexed by the consumer price index and access lines, and the revenues and expenses that appear on BST-Florida's accounting records. Given the current statutes and Florida Commission rules, the Audit Report's recommendation to "not include" BSE management fees and project expenses has no effect on BST-Florida intrastate revenue requirements. These expenses would not be part of the Commission-ordered formula.

Also, the BSE-HQ management fee and project billings being charged to BAPCO have no current relevance to the amount of subsidy payment received by BST-Florida from BAPCO because the current contract between BST and BAPCO does not subject BST to any expenses incurred by BAPCO. BST-Florida receives 54.25% of net revenues generated from BAPCO-Florida directory operations. Furthermore, I understand from the Company that Section 364.037, F.S., and Commission rule 25-4.0405, which guide BST's interpretation of the statute do not change this result. BSE-HQ charges to BAPCO are not treated as reductions of amounts includable in Florida intrastate regulated revenues. In order for BSE-HQ charges to BAPCO to be relevant, Commission Rule 25-4.0405 would need to be applied inconsistently with the historical application of this rule.

Q. What are your conclusions regarding the assertion in the Audit Report that the services BSE provides to BAPCO are duplicative?

A. My staff and I have reviewed the information available in this proceeding relative to the functions BSE performs on behalf of BAPCO and those functions BAPCO performs for itself. That is, we have reviewed the information requested by the Audit Staff, as well as the taped interviews concerning this topic. In particular, we have reviewed the data requests, Company responses and interview tapes referenced in the Audit Report in support of the Audit Staff's assertion of duplication.

Concerning the assertion in the Audit Report of duplication between functions performed by BSE and BAPCO, the information cited by the Staff in the Audit Report on this topic is inconclusive. For example, Data Request No. 3-063, cited in the Audit Report as support for the Staff's assertion that duplication exists between BSE and BAPCO in "The types of costs recovered by BSE-HQ through the management fee charges to BAPCO..." [page 144, Audit Report], contains insufficient information regarding the functions performed by either entity to reach a conclusion of duplication. Likewise, Data Request No. 3-118 cited in the Audit Report as support for the Staff's assertion that duplication exists in the "Project billings billed by BSE to BAPCO..." [page 144, Audit Report], contains only the project numbers and titles of the projects that give rise to BSE-HQ project costs.

Also, the audit evidence that is available on this subject does not point to duplication, but rather points to a complementary relationship between BSE and BAPCO. Data requests not cited by the Audit Report, but nevertheless available, indicate that different activities and functions are performed by BSE and BAPCO personnel. For example, the Audit Report states that the BAPCO Human Resources department "Provides leadership and overall direction for the Human Resources of BAPCO. Through the performance of BAPCO duties, they work towards a qualified, effective, competitive, and highly motivated work force." [page 144, Audit Report] Although not referred to in the Audit Report, a brief overview of the BSE-HQ Human resources department (RC U12000) is provided in Data Request No. 2-097.10G. It describes the representative functions performed by BSE-HQ Human Resources as:

- Develops and administers benefits and compensation for officers, key managers and other employees,
- Plans, designs, implements and administers domestic benefit plans for BSE companies,
- Develops and implements quality programs,
- Administers EEO, performance appraisal, salary and wage plans, relocations and staffing,
- Coordinates Employee Assistance Program planning and services.

This information indicates that the BSE-HQ functions tend to be those that can most effectively and efficiently be performed in a centralized manner.

Further, the determination of whether BSE Headquarters functions and BAPCO functions are duplicative or complementary would require considerably more information than appears to have been requested in this proceeding. The complexity of determining duplication between BSE and

BAPCO would entail a detailed investigation of the functions and activities performed at each entity.

Q. Is the Audit Report correct in stating that the management fee and project billings currently included in BAPCO-Florida expenses will be discontinued entirely?

A. No. As the Audit Report itself states concerning the consolidation of BSE-HQ into BSC, "The management fee may be replaced by a fully distributed costing process which will allocate BellSouth Corporate costs to the BSE subsidiaries." [page 144, Audit Report, emphasis added] The Audit Report acknowledges that the management fee of BSE may be replaced by an FDC costing process of charges from BSC, but it seems to ignore this in recommending that BSE charges be disallowed because of "...discontinuance of the management fee and project billings being charged to BAPCO from BSE-HQ..." [page 145, Audit Report]

Additionally, the information in this proceeding is clear regarding the expected effect of the consolidation of BSE-HQ into BSC. Interviews and data requests describe the reorganization as follows:

> "BellSouth Enterprises, Inc. has not been dissolved, and there has been no decision to dissolve it in the future. BSC-HQ and BSE-HQ functions have been restructured and merged, with some functions remaining at BSC-HQ and other functions being relocated into operating business

> units. During the auditor's on-site visit to Atlanta during the week of August 16, 1993, a number of issues of the BellSouth "Report," employee newsletter and various press releases were provided. This material contained explanations, Q's & A's, transition updates and organization structures of the restructured BSC organizations, all of which discuss the reorganization." (Data Request No. 2.097.21, page 2 of 2, September 3, 1993)

The assertions in the Audit Report of duplication of BSE costs at BAPCO and the impending discontinuance of BSE management fee and project billing are not consistent with the underlying information.

Q. Would you further discuss the information that was available in this docket concerning BSE charges to BAPCO?

A. Yes. My review of the information available in this proceeding indicates that access was provided to BSE invoices to BAPCO for management fee billing, BAPCO financial statements showing sources for management fee calculations, BAPCO transaction journals showing BAPCO's booking of the management fees, and the audit workpapers of Coopers & Lybrand, which document its test that the management fee was less than the fully distributed cost of providing the services.

Also, the nature of the services giving rise to project billings from BSE-HQ to BAPCO is such that they are requested by BAPCO and are directly charged to BAPCO. These costs will either continue to be provided in a similar manner, or the services and related costs will be pushed down to BAPCO. In either event, the services that are required by BAPCO and the corresponding costs can not be expected to simply disappear. It should also be recognized that C&L's CAM audit workpapers show that the management fee is approximately 60% of the amount that could be recovered by BSE-HQ if the fully distributed cost of such services were used as the pricing rule (as allowed by the CFR 47, Part 32.27(d) and the Joint Cost Order). All of this information provides audit evidence for validating the BSE management fees and project billing.

Q. Please summarize the relevant facts surrounding Stevens Graphics ("SGI") relationship with BAPCO.

A. A review of Stevens Graphics operations during 1992 reveals that SGI had two primary lines of business: 1) the Directory, Catalog and Publications division ("DCP"), and 2) the Business Products division ("BP"). Stevens Graphics is a diverse company providing printing services to BAPCO, as well as a large number of both affiliated and non-affiliated clients. Furthermore, SGI provides these clients with a wide array of printing services including yellow and white pages telephone directory printing, as well as printing of catalogs, and long- and short-run business forms. During 1992, Stevens Graphics revenues could be categorized as follows:

- SGI received 71.1% of its revenue in connection with printing services rendered to BAPCO, and

- SGI received 28.9% of its revenues in connection with printing services rendered to non-BAPCO affiliates and non-affiliates, such as GTE.

SGI is organized according to its two main types of customers, and provides printing services within two divisions entitled the Directory, Catalog Publications division and the Business Products division. As the division names would imply, the DCP Division is primarily responsible for the printing of telephone directories, catalogs and other similarly produced and bound materials. Conversely, the BP Division is primarily responsible for printing long- and short-run business forms and other similar materials. BAPCO purchases printing services primarily from the DCP Division, but also has some limited dealings with the BP Division.

Q. Does the Audit Report recommend an adjustment to the charges from SGI to BAPCO?

A. Yes. The Audit Report recommends an adjustment to the expenses of BAPCO-Florida when determining the actual gross profit of the directory operations. This recommended adjustment is based on the assertion that SGI achieved an excess return on equity.

Q. Can you agree with the Audit Report's assertion that BAPCO-Florida made "excess payments" to SGI for manufacturing the white and yellow pages?

A. No. The Audit Report's calculation is inappropriately based on the 1992 financial performance of SGI as a whole, when only 71% of SGI's revenues relate to directory printing services for BAPCO. To determine the return on affiliate transactions with BAPCO, the return achieved by SGI as a whole is irrelevant because it reflects returns achieved on the 29% of SGI's business that is not related to BAPCO. This portion of SGI's revenues is derived primarily from non-affiliates. These represent SGI's revenues and earnings from its participation in open market, competitive transactions. By using the financial statements for SGI as a whole, the Audit Report inappropriately commingles the results of SGI's services to affiliates with its non-affiliate operations, and therefore, contaminates its analysis.

It is unclear why the Audit Report uses the numbers in question, given that the financial statements requested were reflective of SGI's operations as a whole. Data Request No. 3-102, issued on 8-31-92, addresses this issue specifically:

> "What amount of Stevens Graphic's 1991 and 1992 revenue and expenses are a result of transactions with BAPCO?"

The Company's response, dated October 15, 1993 specifies the dollar-value of directory printing services SGI rendered to BAPCO during 1991 and 1992. Also, Audit Disclosure No. 50, Statement of Facts No. 4 states, "Stevens Graphics earned approximately 71% of its operating revenue in

1992...for directory manufacturing services provided to BAPCO (D. R. No. 3-052 and 3-102)." [page 146, Audit Report]

Q. Are there other issues in Audit Disclosure No. 50 that warrant clarification?

A. Yes. The Audit Report in Disclosure No. 50, Statement of Facts No. 5, makes mention of the FCC's proposed revision to affiliate transaction rules expressed in the NPRM, FCC Docket No. 93-251. There is no indication, however, of what implication, if any, this NPRM may have regarding the Audit Report's opinion or recommendation. The Audit Report makes mention of the definition of "substantial" outside market that the FCC advanced for comment, but does not utilize or otherwise apply any of the concepts contained within the NPRM to support their opinion or recommendation. In any event, speculation of the effects of the NPRM is not relevant for the 1993 test year, as the FCC has made no final ruling.

Also, the Audit Report in Disclosure No. 50 is somewhat confusing regarding the proposed adjustment. It identifies two differing amounts as the "excess payment" made by BAPCO to Stevens Graphics.

Q. All of the information presented thus far regarding the appropriate charges of SGI printing services to BAPCO has been based on SGI's financial information. Is there publicly available external information that would indicate the prices SGI charges BAPCO are fair and reasonable?

A. Yes. The outside market provides evidence to support the reasonableness of SGI's pricing of printing services provided to BAPCO. The information, which supports the assertion that SGI's prices are fair and reasonable, seems fundamentally inconsistent with any notion that SGI's charges to BAPCO may be excessive.

SIMBA/Communications Trends, Inc. ("CTI") is a recognized, leading research company specializing in the Yellow Pages industry. CTI has published more than 30 key reports covering all aspects of Yellow Pages Publishing. This company publishes research reports, newsletters, directories, databases and magazines covering virtually all aspects of the Yellow Pages Industry.

Data from CTI's *Yellow Pages Production & Supplier Market (YPP&SM)* report and the *Yellow Pages Source Book (YPSB), 1992-1993*, served as the foundation for a special analysis we performed to analyze SGI's prices compared to market prices. A summary of our analysis can be found in **Exhibits JBB-12, JBB-13** and **JBB-14**.

Using data contained in the reports developed by CTI (specifically the YPSB and the YPP&SM), we have conducted a comparison of the revenues per 1,000 printed pages for the 13 telephone directory printers for which information is available. The methodology utilized in our analysis is as follows:

- *Data Sources:* **Exhibit JBB-13** was developed from data shown in the YPP&SM (p. 50) and information contained in the YPSB (pps. 381 and 385). **Exhibit JBB-13** presents a summary of the data, as well as calculations supporting printing revenues per 1,000 printed pages. **Exhibit JBB-12** was created using the calculations in **Exhibit JBB-13**. Finally, the data in **Exhibit JBB-14** has been taken from the YPP&SM (p. 53).

- *Data Calculations:* The numbers in the last three columns of **Exhibit JBB-13** were calculated by dividing estimated directory revenues by estimated printed pages (in 000s). Discrete Low, Medium and High Revenues per 1,000 printed pages were calculated if a range was given for estimated printed pages.

- *Data Verification:* We have verified the following facts regarding the data taken from the YPSB and the YPP&SM reports:

  - The estimates of printed pages are intended to include yellow and/or white pages telephone directory printing only,
  - The estimates of revenues are intended for yellow and/or white pages telephone directory printing only, and
  - The data was gathered through surveys, interviews and follow-up discussions.

Q. Please discuss the results of your analysis of the data compiled by CTI.

A. The results of our analysis, based on the statistical data compiled by CTI, are shown in the attached tables and charts and can be summarized as follows:

- As shown in **Exhibit JBB-12**, the average price SGI's charges for directory printing, $1.69 per 1,000 printed pages, is extremely competitive. Overall, SGI's prices charged to BAPCO are among the lowest in the industry.

- SGI's average revenue per 1,000 printed pages of $1.69, based on estimates by CTI, compares favorably with all the other RBOCs and all the other non-telephone company printers of directories, including the nationally recognized R.R. Donnelley.

- The single printer that is estimated to have a lower charge per 1,000 printed pages is GTE, with revenue per 1,000 printed pages of $1.64.

- SGI's average price per 1,000 printed pages ($1.69) is 30% lower than the average price per 1,000 printed pages charged by the leading directory printers ($2.43) in the sample.

- When the industry is segmented into Small Community, Medium, Medium to Large, and Very Large printers, the appropriate grouping with which to compare SGI is the Very Large Printers.

As **Exhibit JBB-14** shows, SGIs revenue per 1,000 printed pages is very near the lower end of the $1.50 to $2.50 range for very large directory printers.

As the above statistics indicate, SGI's prices are indeed very competitive with the external directory printing marketplace. Comparisons to leading telephone industry directory printers show that SGI's prices compare favorably, and are in fact, among the lowest in the industry. When segmented by size, SGI's prices remain at the lower end of the range for the very large printers.

SECTION 5 - EMPLOYEE STOCK OWNERSHIP PLAN ISSUES

Q. Do you have any comments on Audit Disclosure No. 59 pertaining to the Leveraged Employee Stock Ownership Plan ("LESOP")?

A. Yes. The Audit Report expresses an opinion that "...tax savings associated with the dividend payments [made by BellSouth Corporation] into the Trust should also be allocated to BST..." [page 159, Audit Report].

As general background, the LESOP trusts were established as independent legal entities; they are not subsidiaries of BellSouth Corporation or any of its subsidiary companies. The LESOP trusts incurred debt and used the proceeds from these borrowings to purchase BSC common stock. The

LESOP debt is collateralized by the BSC common stock owned by the trusts and has been guaranteed by BSC. Projections prepared prior to the creation of the LESOP trusts indicated that net cost savings for the Company and its ratepayers could be realized through the formation of LESOP trusts.

Q. Is the Company's guarantee of the LESOP debt reflected in its financial statements?

A. Because BSC has guaranteed the debt of the LESOP, BSC records the LESOP debt on its balance sheet with a corresponding reduction to stockholders' equity. In essence, BSC is required to record the unallocated shares of BSC common stock held by the LESOP trusts as treasury stock. According to its established terms, the debt incurred by the LESOP trusts and collateralized by the BSC stock owned by the trusts is repayable over a 13 year period. As the debt is repaid, a portion of the BSC common stock owned by the LESOP trusts becomes available for allocation to employees.

Q. How is the expense related to the LESOP calculated and recorded in BSC's financial statements?

A. Expense related to the LESOP is calculated using the "shares allocated" method, as required under generally accepted accounting principles. The shares allocated method requires that compensation expense in a given period be recognized based on the shares of BSC common stock actually allocated to employees . Interest expense is also recognized equal to the actual interest expense of the debt of the LESOP trusts during that period.

Cash dividends paid on unallocated shares of BSC common stock owned by the LESOP trusts reduce the total expense recognized by BSC related to the LESOP.

Q. **What is the treatment for federal income tax purposes of cash dividends paid by BSC on the shares of BSC common stock held by the LESOP trusts?**

A. In its federal income tax returns, a company may generally deduct cash dividends paid on the shares of common stock held by a LESOP trust.

Q. **What is the treatment for financial accounting purposes of the tax benefit of the deductibility of cash dividends paid on shares of BSC stock held by the LESOP trusts?**

A. The majority of the tax benefit related to cash dividends paid on shares of BSC stock held by the LESOP trusts has been recorded as a direct increase to retained earnings.

Prior to 1993, generally accepted accounting principles required that the entire tax benefit related to cash dividends paid on shares of stock held by a LESOP trust be recorded as a direct increase to retained earnings.

With the adoption of SFAS 109 in 1993, the treatment for financial accounting purposes of the tax benefit of the deductibility of cash dividends paid on shares of common stock held by a LESOP trust is different for the cash dividends paid on shares which have been allocated to employees than for the cash dividends paid on shares which have not yet been allocated to employees.

SFAS 109 considers the benefits related to cash dividends paid on unallocated shares to be capital transactions. As a result, the tax benefit of the deduction for cash dividends on shares of stock which have not been allocated by a LESOP trust to employees is recorded as a direct increase to retained earnings.

SFAS 109 considers the benefits related to cash dividends paid on allocated shares to be earnings events. As a result, the tax benefit of the deduction for cash dividends on shares of stock which have been allocated by a LESOP trust to employees is recorded as a reduction of federal income tax expense.

Q. **Does BSC allocate to its subsidiaries the tax benefit of the deduction for cash dividends paid on shares of BSC common stock held by the LESOP trusts?**

A. No. The cash dividends which result in the tax benefit are made by BSC from equity earnings. These tax benefits do not result from expenses charged to subsidiaries, and appropriately, are not allocated to the subsidiaries. Conceptually, the tax benefit of the dividend compensates BSC for its risk and burden associated with its guarantee of the debt of the LESOP trusts.

SECTION 6 - OTHER AUDIT DISCLOSURES

Q. Are there other Audit Disclosures included in the Audit Report on which you would like to comment?

A. Yes. The Audit Report asserts in Audit Disclosure No. 2 that cross subsidies may exist between the company and affiliates when the majority of the affiliates' business is with the utility. This Disclosure also includes a recommendation that "In the event that over 50% of an affiliates' [sic] revenues result from transactions (direct or chained) with the affiliated utility, then the affiliate should be required to comply with Commission prescribed accounting, tax and depreciation practices." [page 29, Audit Report]

The Audit Report's recommendation, however, contains no distinction for market or tariff based affiliate relationships. To the extent the recommendation pertains to tariff or prevailing market rate based transactions, the recommendation is inconsistent with existing affiliate transaction pricing rules contained in 47 CFR, Part 32.27(d) and the JCO. These affiliate transaction pricing rules specify the use of tariffed rates and prevailing market rate pricing, where appropriate. When using tariff or prevailing market rate pricing to govern transactions with the regulated affiliate, a nonregulated affiliate's costs are not considered and are irrelevant.

Furthermore, transactions that are based on the cost of the affiliate (i.e., fully distributed costs) in providing the service to the regulated carrier are already subject to regulatory scrutiny. Fully distributed cost transactions are subject to numerous audits, such as this one. No exceptions are noted in the Audit Report concerning the depreciation rate and tax normalization policy facets of affiliate transactions reviewed in this audit.

The recommendation specifies that the Commission should require nonregulated affiliates to comply with Commission-prescribed accounting, tax and depreciation practices. BSC may not have exclusive control over these affiliates when the nonregulated affiliate is only partially-owned by BSC.

The Audit Report's recommendation that affiliates which generate over 50% of their revenues from transactions with the utility be required to comply with prescribed accounting, tax and depreciation rules may also not be practicable to monitor and implement. Whether the nonregulated affiliate had secured over 50% of its revenues from transactions with the utility may not be known until after the event, which may be too late to install an accounting system and procedures to account for transactions in accordance with the Audit Report's recommendation. In this situation, the nonregulated affiliate could not know whether it was required to comply with the rules until after the transaction had occurred. Finally, the Audit Report contains no substantiation as to why "...50% of an affiliates' [sic] revenues..." [page 29, Audit Report] is the appropriate point at which a nonregulated affiliate must convert to a commission-prescribed accounting system and policies.

The Audit Report's recommendation seems of limited value, given that the affiliates' records are already governed by GAAP. In this manner, nonregulated affiliates that transact business with an affiliated entity are not allowed to follow whatever accounting, tax and depreciation policies they choose, but are governed by the rules promulgated by GAAP. One of the tenets of the FCC in prescribing "Part 32" accounting for regulated telecommunications carriers was to more closely mirror GAAP.

Finally, the Audit Report's recommendation does not take into consideration the competitive market in which the nonregulated affiliates participate. Commission-prescribed accounting, tax and depreciation practices are relevant and appropriate for the regulated utility, but may be economically inconsistent with the nonregulated affiliate's business.

Q. Do you have any additional Comments?

A. Yes. I have prepared or contributed to comments pertaining to Audit Disclosures which are included in **Exhibit JLW-1**. Rather than repeat them again, I will incorporate them by reference. These comments, responsive to Audit Disclosure Nos. 2, 17, 18, 38, 39, 40, 42, 43, 49, and 50, are identified earlier in my testimony and are also identified by having my name appear on the appropriate pages in Mr. Wilson's exhibits.

Q. Does this conclude your testimony?

A. Yes.

Summary of Quantified Recommended Disallowances/Adjustments
Based on Asserted Scope Limitations/Access to Information

INFORMATION FROM 1992 ARMIS 43-02 REPORT - CHARGES FROM AFFILIATES

NAME OF AFFILIATE	FDC	PMR	TOTAL
BellSouth Communications, Inc.	$209,991,000	$0	$209,991,000
Bell Communication Research	$162,850,000	$0	$162,850,000
BellSouth Corporation	$99,780,000	$0	$99,780,000
Sunlink	$3,270,000	$10,252,000	$13,522,000
BellSouth Advertising and Publishing	$5,800,000	$0	$5,800,000
DataServ	$0	$4,937,000	$4,937,000
BellSouth Information Systems	$3,865,000	$0	$3,865,000
Stevens Graphics	$2,614,000	$0	$2,614,000
Mobile Communications Corp of America	$2,250,000	$0	$2,250,000
BellSouth Mobility Inc	$0	$2,139,000	$2,139,000
BellSouth Communication Systems	$236,000	$0	$236,000
BellSouth Financial Services	$0	$235,000	$235,000
BellSouth Advanced Network	$101,000	$0	$101,000
All Others	$100,000	$0	$100,000
			$508,420,000

INFORMATION FROM 1992 FLORIDA ANNUAL REPORT - CHARGES FROM AFFILIATES

NAME OF AFFILIATE	TOTAL
Bell Communications Research	$42,490,866
Scientific Software	$1,961
Mobile Communications Corp of America	$600,902
Stevens Graphics	$664,870
L M Berry	$7,232
DataServ	$1,218,592
BellSouth Direct Marketing	$253,508
BellSouth Resouces Inc	$33
CSL Birmingham	$2,241,640
BellSouth Mobility	$880,695
BellSouth DC	$551
BAPCO	$1,064,303
BellSouth Financial Services	$51,372
BellSouth Enterprises	$4,169
BellSouth Corp.	$26,088,273
BellSouth Communications Inc	$52,729,091
BellSouth Information Systems	$980,216
Sunlink	$1,630,138
BellSouth Advanced Network	$17,122
BellSouth Communication Systems	$16,262
	$130,941,796

**Summary of Quantified Recommended Disallowances/Adjustments
Based on Asserted Scope Limitations/Access to Information**

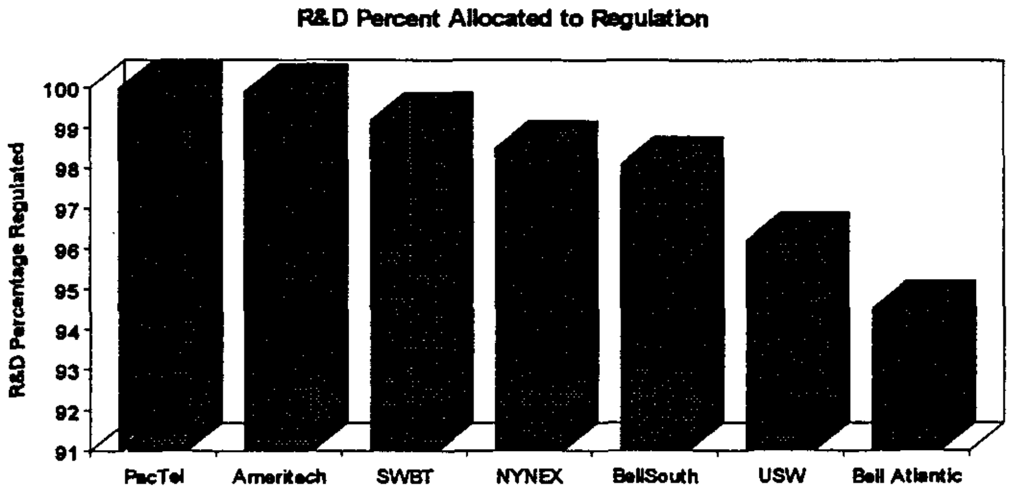
QUANTIFIED RECOMMENDED DISALLOWANCES/ADJUSTMENTS BASED ON ASSERTED SCOPE LIMITATIONS/ACCESS TO INFORMATION

PAGE	ISSUE	BST	FLORIDA REG/INTRASTATE
109	Sunlink Warehouse Space	$2,836,707	$558,964
111	CSL Birmingham Lease	$10,635,900	$2,043,955
114	CSL Chastain Lease	$652,700	$125,433
116	Campanile Lease	$5,543,670	$1,065,355
128	BSE Management Fee	$1,702,395	$313,913
145	BAPCO/BSE Management Fee		$4,278,000
		$21,371,372	$8,385,620

Percent of Total Affiliate Charges	4.20% (1)	6.40% (2)

(1) BST based upon ARMIS 43-02 Report - Charges from Affiliates

(2) Florida Reg/Intrastate based upon Florida Annual Report - Charges from Affiliates



According to the 1992 ARMIS Reports, BellSouth Allocates a Lower Percentage of R&D to the Ratepayer than Four of the Seven RBOCs

Source: 1992 ARMIS Report

Account 6727 for 1992

State	*Cost Pool*	*Regulated*	*Nonregulated*	*Total*
Alabama	Pool 01	2,880,821	36,269	2,917,090
	Pool 03	837,151	34,073	871,224
Florida	Pool 01	8,891,848	111,945	9,003,793
	Pool 03	2,532,343	142,849	2,675,192
Georgia	Pool 01	5,877,654	73,997	5,951,651
	Pool 03	1,723,944	71,219	1,795,163
Kentucky	Pool 01	1,674,437	20,235	1,694,672
	Pool 03	483,666	19,719	503,385
Louisiana	Pool 01	3,384,475	42,609	3,427,084
	Pool 03	976,057	41,767	1,017,824
Mississippi	Pool 01	1,989,780	25,050	2,014,830
	Pool 03	577,385	20,772	598,157
N. Carolina	Pool 01	3,272,368	41,198	3,313,566
	Pool 03	953,328	31,170	984,498
S. Carolina	Pool 01	2,190,643	27,580	2,218,223
	Pool 03	663,196	24,136	687,332
Tennessee	Pool 01	3,853,847	48,518	3,902,365
	Pool 03	1,106,835	51,289	1,158,124

total index		
a	Total Cost Pool 01 Bellcore	34,443,274
b	Total Cost Pool 03 S&T	10,290,899
c	Total Regulated R&D	43,869,778
d	Total Nonregulated R&D	864,395
e	Total Account 6727 CP 1&3	44,734,173
f	Overall Percent Non-reg d/e	1.93%
g	Percent Bellcore R&D a/e	77.00%
h	Percent S&T R&D b/e	23.00%
j	S&T Non-Reg dollars CP03	436,994
k	S&T Reg dollars CP03	9,853,905
l	S&T Percent Non-reg j/b	4.25%
m	Bellcore Non-Reg Dollars CP01	427,401
n	Bellcore Reg Dollars	34,015,873
o	Bellcore Percent Non-Reg m/a	1.24%
Hypothetical equations below		
p	Non-Reg with .7% allocation (.7% x line b)	72,036
q	Actual 1992 S&T non-reg less hypothetical j-p	[redacted]

Allocation Method for Regulated and Nonregulated Research

1) The *TOTAL* budgeted S&T R&D program spending is determined and broken down into the following 5 categories from the NEPCOT (NEtwork Product COsT) report.

Switched	221X
Non-Switched	2230, 2231, 2232, 24XX
Composite	All of the Above
Support	All of the Above and 2124
Generic	No Specific Application

2) The total *NONREGULATED* investment for the first 3 categories is determined through the ARMIS 495-A report and takes into account growth in usage for the next three years. The ARMIS 495-A report uses the following accounts:

221X Investment
22XX Other
24XX

3) The non- regulated CPAM (Cost Pool Allocation Matrix) output from the CSS system is added to the *NONREGULATED* investment account category 4.

4) For each of the first 4 categories, *NONREGULATED* investment is divided by the *TOTAL INVESTMENT* in that category. The resulting percentages are weighted by dollar size in each category and used to determine the overall percentage of nonregulated investment. The 5th category still uses the 3 month average expense general allocator that is based on the weighted average of the 6XXX expense accounts.

Under the previous calculation method, the following monthly allocations of nonregulated R&D for 1992 have been provided in response to data requests:

Jan 7.1%	July 4.5%	The non-weighted average is 5.23%
Feb 6.9%	Aug 4.4%	
Mar 6.0%	Sep 4.6%	
Apr 4.4%	Oct 4.9%	
May 4.4%	Nov 5.5%	
Jun 4.4%	Dec 5.7%	

Under the current method of allocating S&T R&D common projects, the allocator was .7% non-reg for the first 6 months of 1993.

SOUTHERN BELL
DOCKET NO. 920260-TL
EXHIBIT JBB-10
WITNESS: BRANCH

Item No. 2-054
Amended Request
Attachment G

CAMPANILE STACKING PLAN
SQUARE FOOTAGE
As of 9/1/93

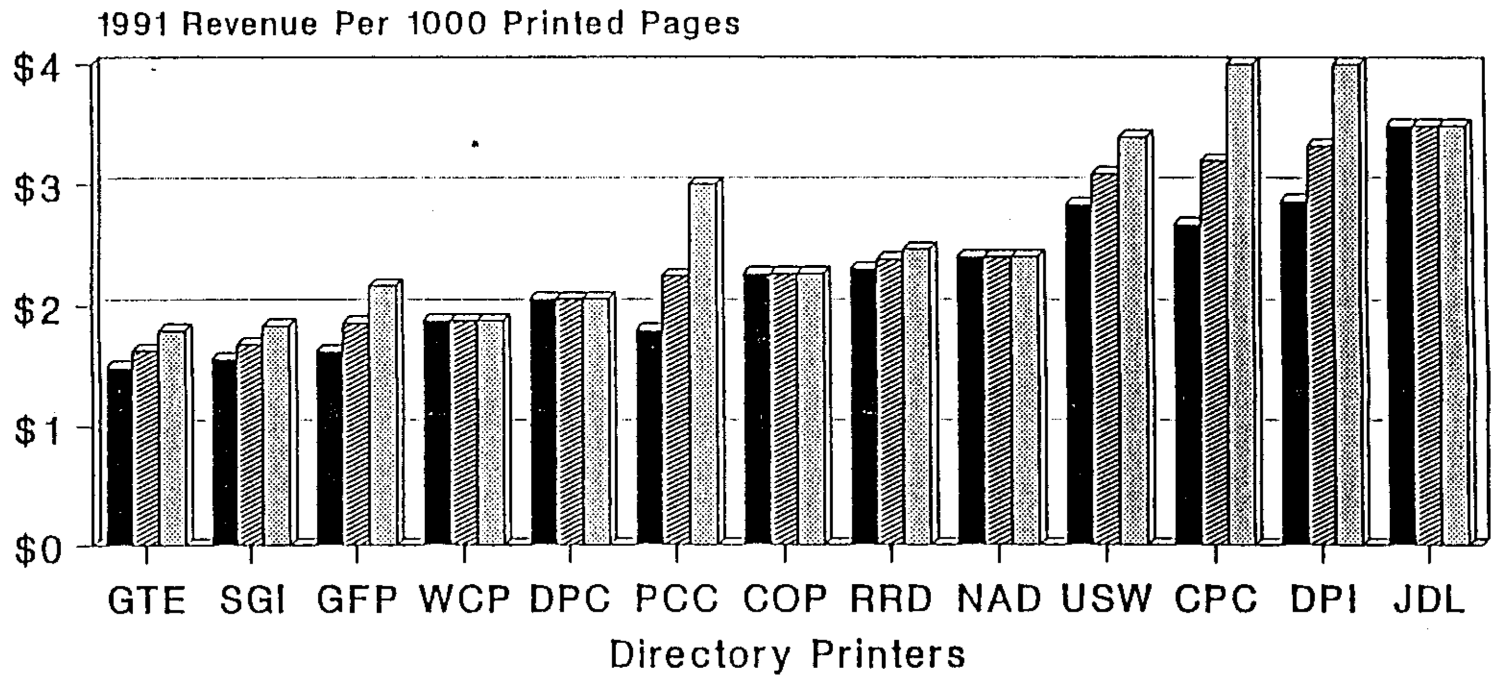
FLOOR	TENANT	RENTABLE SF
21	BELLSOUTH INFORMATION SYSTEMS	5351✓
	BELLSOUTH CORPORATION	3107✓
20	BELLSOUTH CORPORATION	23296✓
19	BELLSOUTH CORPORATION	23296✓
18	BELLSOUTH CORPORATION	23296✓
17	BELLSOUTH CORPORATION	23296✓
16	BELLSOUTH CORPORATION	23296✓
15	BELLSOUTH CORPORATION	23296✓
14	BELLSOUTH CORPORATION	23271
13	BELLSOUTH CORPORATION	22886
12	BELLSOUTH CORPORATION	22609
11	COOPERS & LYBRAND	22627
10	COOPERS & LYBRAND	22627
9	COOPERS & LYBRAND	22392
8	BELLSOUTH CORPORATION	22392
7	BELLSOUTH CORPORATION	18523
	CARTER	3869
6	BELLSOUTH CORPORATION	8080
	BELLSOUTH TELECOMMUNICATIONS	3079
	AVAILABLE FOR LEASE	11233
5	BELLSOUTH TELECOMMUNICATIONS	15360
	GEORGIA TELCO CREDIT UNION	2205
	COOPERS & LYBRAND	4827
4	GEORGIA TELCO CREDIT UNION	22392
3	BELLSOUTH CORPORATION	16494
2	BELLSOUTH CORPORATION	14526
1	PRUDENTIAL-BACHE SECURITIES	8405
	PEACHTREE NEWS	1101
P2	BELLSOUTH CORPORATION	260
P1	BELLSOUTH CORPORATION	6108

BSC Fully Distributed Costs Analysis Estimate
Campanile Building
1992

	1992
DIRECT COSTS (BLDG)	
BLDG. OPERATING EXP.	$3,660,802
TENANT MAINT.	291,295
DEPRECIATION	1,620,805
TOTAL	5,572,902
AVG. % OCCUPIED - BSC	67.20%
BUILDING OPERATING EXPENSES	3,744,990
BSC OCCUPIED SQ. FT.	298,032
BSC DIRECT COSTS PER SQ. FT.	$12.57
RETURN ON INVESTMENT: 1992 Average	
Land	$2,765,551
Landscaping	511,829
Building	46,511,811
Depreciation & Amortization	(8,315,549)
Deferred Charges	3,426,697
Deferred Taxes	(4,662,157)
SUB-TOTAL	40,238,182
WORKING CAPITAL	889,263
TOTAL INVESTMENT	41,127,445
AVG. % OCCUPIED - BSC	67.20%
PORTION ALLOCABLE - BSC	27,637,643
ALLOWABLE RATE OF RETURN	15.76%
ALLOWABLE RETURN	4,355,693
BSC OCCUPIED SQ. FT.	298,032
ALLOWABLE RETURN PER SQ. FT.	$14.61
TOTAL FDC PER SQ. FT.	$27.18

Note: FDC is greater than prevailing market base rate and lease costs by 29%

TELEPHONE DIRECTORY PRINTERS
1991 DIRECTORY PRINTING REVS. PER PAGE



Estimate Type

Low Medium High

KEY TO PRINTERS

GTE – GTE Directory Printing
SGI – Stevens Graphics
GFP – Gulf Printing
WCP – World Color Press
DPC – Directory Printing Co.
PCC – Printing Center
COP – California Offset Printers
RRD – R.R. Donnelley
NAD – NADCO
USW – US West Mktg. Res.
CPC – College Publishing
DPI – Downey Printing
JDL – J.D. Lucas

Source: Communications Trends/SIMBA
1992-93 Yellow Pages Studies

SOUTHERN BELL
DOCKET NO. 920260-TL
EXHIBIT JBB-12
WITNESS: BRANCH
PAGE 1 OF 1

LEADING DIRECTORY PRINTERS
1991 REVENUES AND VOLUMES

SOURCE: CommunicationsTrends, Inc./SIMBA 1992–93 Yellow Pages Studies				EST. PRINTED	EST. DIRECTORY	DIRECTORY PRINTING REVS. PER 1000 PRINTED PAGES		
PRINTER	CODE	AFFILIATION	YEAR	PAGES (Bs)	REVS. (MMs)	Low	Medium	High
GTE Printing	GTE	GTE	1991	50–60	90	$1.50	$1.64	$1.80
STEVENS GRAPHICS	SGI	BELLSOUTH	1991	57–67	105	$1.57	$1.69	$1.84
Gulf Printing	GFP	Southwestern Bell	1991	30–40	65	$1.63	$1.86	$2.17
World Color Press	WCP	KKR, Merrill Lynch	1991	48	90	$1.88	$1.88	$1.88
Directory Printing Co.	DPC	Independent	1991	3.1	6.4	$2.06	$2.06	$2.06
Printing Center	PCC	Independent	1991	3–5	9	$1.80	$2.25	$3.00
California Offset Printers	COP	Independent	1991	.220	.5	$2.27	$2.27	$2.27
R.R. Donnelley	RRD	Independent	1991	150–160	370	$2.31	$2.39	$2.47
NADCO	NAD	BCE	1991	29	70	$2.41	$2.41	$2.41
US West Mktg. Res.	USW	US West	1991	5–6	17	$2.83	$3.09	$3.40
College Publishing	CPC	Independent	1991	2–3	8	$2.67	$3.20	$4.00
Downey Printing	DPI	Independent	1991	5–7	20	$2.86	$3.33	$4.00
Lucas, J.D.	JDL	Independent	1991	2	7	$3.50	$3.50	$3.50
					MAX	$3.50	$3.50	$4.00
					AVG	$2.25	$2.43	$2.68
					MIN	$1.50	$1.64	$1.80

SOUTHERN BELL
DOCKET NO. 920260-TL
EXHIBIT JBB-13
WITNESS: BRANCH
PAGE 1 OF 1

TELEPHONE DIRECTORY PUBLISHERS' 1991 PRINTING REVENUE PER COPY AND PRINTED PAGE

SOURCE: Communications Trends, Inc./SIMBA 1992–93 Yellow Pages Studies			EST. PRINTED PAGES (MMs)	EST. PRINTING REVENUE	
TYPE OF DIRECTORY	PRINT RUN	PAGES		PER COPY	PER 1000 PAGES
Very Large	1,000,000 or greater	2,000 or greater	1,700 – 3,500	$3.00 – $4.00	$1.50 – $2.50
Medium to Large	175,000 – 350,000	800 – 1,200	140 – 420	$1.50 – $3.00	$1.50 – $2.50
Medium	50,000 – 150,000	300 – 750	15 – 113	$1.50 – $2.50	$2.00 – $4.00
Small Community	25,000 – 50,000	150 – 500	4 –25	$1.00 – $3.00	$2.00 – $6.00

AVERAGE FOR THE ENTIRE INDUSTRY	$1.91	$2.02

SOUTHERN BELL
DOCKET NO. 920260-TL
EXHIBIT JBB-14
WITNESS: BRANCH

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF WALTER S. REID

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

JANUARY 4, 1994

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

A. MY NAME IS WALTER S. REID, AND MY BUSINESS ADDRESS IS 675 WEST PEACHTREE STREET, ATLANTA, GEORGIA. MY POSITION IS DIRECTOR-REGULATORY MATTERS FOR THE COMPTROLLERS DEPARTMENT OF BELLSOUTH TELECOMMUNICATIONS, INC. D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY (SOUTHERN BELL OR THE COMPANY).

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS DOCKET?

A. YES. I FILED DIRECT TESTIMONY REGARDING THE COMPANY'S HISTORICAL AND GOING LEVEL EARNINGS ON JULY 2, 1993 AND OCTOBER 1, 1993. I ALSO FILED

REBUTTAL TESTIMONY ON DECEMBER 10, 1993 IN RESPONSE TO CERTAIN RECOMMENDATIONS MADE BY WITNESSES FOR THE OFFICE OF PUBLIC COUNSEL (OPC).

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. THE PURPOSE OF THIS REBUTTAL TESTIMONY IS TO INDICATE WHICH OF THE COMPANY'S COMMENTS I WILL SPONSOR IN RESPONSE TO THE AFFILIATE TRANSACTIONS AND COST ALLOCATIONS AUDIT (AFFILIATE AUDIT) FILED ON DECEMBER 17, 1993. I WILL ALSO PROVIDE ADDITIONAL EXPLANATIONS FOR SOME OF THE MORE COMPLEX FINANCIAL ISSUES RAISED IN THE AFFILIATE AUDIT AND WILL CROSS REFERENCE TO MY PREVIOUS REBUTTAL TESTIMONY ON SOME ISSUES WHICH ARE SIMILAR TO ISSUES RAISED BY OPC.

ALL OF THE COMPANY'S REPLY COMMENTS IN THE AFFILIATE AUDIT ARE INCLUDED IN EXHIBIT JLW-1 TO COMPANY WITNESS JERRY L. WILSON'S TESTIMONY. I AM RESPONSIBLE FOR THE COMPANY'S REPLY COMMENTS TO AUDIT DISCLOSURES 7-9, 11, 14, 27-30, 32, 35, 48, 52, 55, 57, 59, AND 72.

IN ADDITION I WILL SPONSOR THE COMPANY'S RESPONSES

TO THE AUDIT DISCLOSURES IN THE WORK ACTIVITY STATISTICAL SAMPLING PROCESS (WASSP) AUDIT, THE RATE CASE AUDIT AND THE CONTINUING PROPERTY RECORDS (CPR) AUDIT. I HAVE ATTACHED THE COMPANY'S RESPONSES TO THESE AUDITS AS EXHIBITS WSR-13, WSR-14 AND WSR-15, RESPECTIVELY.

Q. ARE AUDIT DISCLOSURES 7-9, 11, AND 14 IN THE AFFILIATE AUDIT ALL ASSOCIATED WITH THE COMPANY'S VIDEO TRIALS AT THE HEATHROW AND HUNTERS CREEK SUBDIVISIONS?

A. YES.

Q. PLEASE SUMMARIZE THE NATURE OF THESE AUDIT DISCLOSURES AND THE COMPANY'S RESPONSES.

A. IN SUMMARY, THESE AUDIT DISCLOSURES RAISE ISSUES CONCERNING: 1) THE ACCURACY OF SOME OF THE ACCOUNTING TRANSACTIONS ASSOCIATED WITH THE VIDEO TRIALS; 2) THE RELATIONSHIP BETWEEN THE REVENUES GENERATED BY THE TRIAL SERVICES AND THE COSTS; AND 3) THE APPROPRIATENESS OF RETIRING SOME OF THE REMAINING INVESTMENTS AT THE TRIAL SITES. THE COMPANY HAS SPENT A GREAT DEAL OF TIME OVER THE

LAST YEAR RESEARCHING THE ACCOUNTING TRANSACTIONS ASSOCIATED WITH THESE VIDEO TRIALS FOR THE AUDITORS. THE COMPANY ACKNOWLEDGES THAT OVER THE PERIOD, 1986 THROUGH 1993, THERE WERE ERRORS MADE, SOME OF WHICH INCREASED REPORTED COST OF SERVICE AND OTHERS WHICH DECREASED REPORTED COST OF SERVICE. THESE ERRORS ARE BEING CORRECTED AS INDICATED IN THE COMPANY'S COMMENTS TO THE AUDIT DISCLOSURES.

Q. PART OF THE AUDIT TEAM'S ANALYSIS AND CONCLUSIONS REVOLVED AROUND THE LACK OF PROFITS GENERATED BY THE VIDEO TRIALS. CAN YOU COMMENT?

A. YES. REGARDING THE RELATIONSHIP BETWEEN THE REVENUES GENERATED BY THE TRIALS AND THEIR COSTS, THE COMPANY WOULD NOTE THAT THE TRIALS ARE NOT CONDUCTED WITH THE INTENT TO GENERATE PROFITS, BUT TO GAIN KNOWLEDGE AND EXPERIENCE. THE COMPANY ALSO NOTES THAT THE INVESTMENT THE AUDITOR IS USING TO COMPARE WITH REVENUES FROM CERTAIN TRIAL SERVICES IS INAPPROPRIATE SINCE IT INCLUDES THE ENTIRE INVESTMENT FOR THE LAKE MARY CENTRAL OFFICE. IN UNITED TELEPHONE COMPANY DOCKET 910980-TL, ORDER NO. PSC-92-0708-FOF-TL, THE COMMISSION STATED ON

PAGE 12: "...WE BELIEVE THAT EXPERIMENTS AND TRIALS, ALTHOUGH THEY MAY BE UNECONOMIC IN THE INITIAL STAGES, ARE PART OF THE COST OF DOING BUSINESS..." THE COMMISSION OBVIOUSLY UNDERSTANDS THE ECONOMIC NATURE OF TRIALS SUCH AS THESE.

Q. ARE AUDIT DISCLOSURES 27, 28, 32, 52, 55 AND 57 IN THE AFFILIATE AUDIT ALL RELATED TO COST ALLOCATION ISSUES ASSOCIATED WITH THE COMPANY'S COST ALLOCATION MANUAL (CAM)?

A. YES.

Q. PLEASE SUMMARIZE THESE ISSUES AND THE COMPANY'S RESPONSES.

A. THESE AUDIT DISCLOSURES ADDRESS ISSUES SUCH AS WHETHER THE COMPANY HAS SECURED ADEQUATE APPROVAL FOR THE COST ALLOCATION METHODOLOGIES WHICH IT IS USING, WHETHER IT IS APPLYING ITS APPROVED METHODOLOGIES APPROPRIATELY AND WHETHER A STUDY IS NEEDED IN FLORIDA TO DETERMINE IF THERE IS A BASIC ALLOCATION METHOD THAT CAN BE USED BY ALL COMPANIES. THE COMPANY'S RESPONSES TO THESE ISSUES EXPLAIN THAT IT IS FOLLOWING APPROPRIATE COST

ALLOCATION PROCEDURES IN ACCORDANCE WITH ITS APPROVED CAM.

REGARDING THE AUDITORS' RECOMMENDATION THAT A STUDY BE CONDUCTED IN FLORIDA TO DETERMINE IF COST ALLOCATION UNIFORMITY IS NEEDED AMONG THE COMPANIES, IT SHOULD BE NOTED THAT THE FCC IS ALREADY PURSUING CAM UNIFORMITY FOR THOSE CAMS WHICH ARE FILED WITH IT AND AN EFFORT OF THIS NATURE IN FLORIDA COULD BE DUPLICATIVE AND/OR EVEN COUNTERPRODUCTIVE.

Q. HOW WOULD YOU CATEGORIZE THE REMAINING AUDIT DISCLOSURES IN THE AFFILIATE AUDIT FOR WHICH YOU HAVE RESPONSIBILITY?

A. I WOULD CATEGORIZE AUDIT DISCLOSURES 29, 30, 35, AND 72 AS GENERAL DISCLOSURES INTENDED TO INFORM READERS ABOUT THE NATURE OF CERTAIN EXPENSES WHICH THE AUDITORS REVIEWED IN THEIR AUDIT OF THE COMPANY'S 1992 RESULTS. AUDIT DISCLOSURES 48 AND 59 RELATE TO MORE COMPLEX SITUATIONS INVOLVING THE PROPER RATEMAKING TREATMENT TO BE APPLIED TO THE COMPANY'S DIRECTORY OPERATIONS AND TO THE COMPANY'S LEVERAGED EMPLOYEE STOCK OWNERSHIP PLAN (LESOP),

RESPECTIVELY.

Q. PLEASE SUMMARIZE THE COMPANY'S RESPONSES TO GENERAL DISCLOSURES 29, 30, 35 AND 72 IN THE AFFILILATE AUDIT.

A. THE COMPANY HAS NOT CONTESTED THE REMOVAL OF CERTAIN COSTS FROM THE REGULATED COST OF SERVICE IN FLORIDA TO CONFORM WITH PRIOR DECISIONS OF THE FLORIDA PUBLIC SERVICE COMMISSION. THESE EXPENSES INCLUDE CONTRIBUTIONS, SOCIAL AND SERVICE CLUB DUES, BELLSOUTH CLASSIC COSTS, AND LOBBYING. IN FACT, AT LEAST TWO OF THE DISCLOSURES ACKNOWLEDGE THAT THE COMPANY HAS EXCLUDED AMOUNTS FOR THESE ITEMS. IN SOME INSTANCES THE AUDITORS HAVE FOUND SMALL AMOUNTS OF 1992 EXPENSES WHICH WOULD FALL INTO THE SAME CATEGORY AS THE EXCLUDED COSTS BUT WERE NOT REMOVED FROM REGULATED RESULTS BY THE COMPANY. IN THESE INSTANCES, THE COMPANY AGREES THAT THE AMOUNTS SHOULD BE REMOVED FROM THE 1992 SURVEILLANCE REPORT.

THE COMPANY'S COMMENTS PROVIDE SUPPORT FOR ITS TREATMENT OF CERTAIN EXPENSES WHICH THE AUDIT DISCLOSURES QUESTION. EXPENSES SUCH AS EMPLOYEE

SERVICE AWARDS AND TUITION AID ARE PRUDENT COSTS WHICH THE COMPANY INCURS IN THE PROPER MANAGEMENT OF ITS WORKFORCE.

Q. PLEASE SUMMARIZE THE RATEMAKING ISSUES RAISED BY AUDIT DISCLOSURE 48 IN THE AFFILIATE AUDIT.

A. IN AUDIT DISCLOSURE 48, THE AUDITORS ARE CLAIMING THAT SOUTHERN BELL IS NOT APPLYING SECTION 364.037, F. S., APPROPRIATELY. THIS FLORIDA STATUTE PROVIDES FOR A SPECIFIC REGULATORY TREATMENT TO BE APPLIED TO DIRECTORY ADVERTISING REVENUES AND EXPENSES. THE AUDITORS ARE GIVING THIS OPINION EVEN THOUGH THE COMPANY IS FOLLOWING BOTH THE STATUTE AND COMMISSION RULE 25-4.0405 AND HAS CONSISTENTLY FOLLOWED BOTH SINCE THEY WERE ESTABLISHED. THE OBVIOUS INTENT OF THIS DISCLOSURE IS TO GET THE COMMISSION TO ALTER THE METHODOLOGY USED TO APPLY 364.037, F.S., SO THAT MORE OF THE DIRECTORY ADVERTISING INCOME IS COUNTED AS REGULATED INCOME, THUS REDUCING THE INTENDED INCENTIVES GIVEN BY THE STATUTE TO THE COMPANY FOR GROWING THE DIRECTORY BUSINESS.

THE COMPANY IS CORRECTLY APPLYING THE STATUTE TO

ITS DIRECTORY OPERATIONS. THE COMPANY'S DIRECTORY AFFILIATE AND THE RELATED PUBLISHING FEE AGREEMENT HAVE ACTUALLY BENEFITED THE RATEPAYERS IN THE APPLICATION OF THE STATUTE. THE AUDITORS' ATTEMPT TO ALTER THE MANNER IN WHICH THE STATUTE IS APPLIED IS DISTORTIVE AND SHOULD NOT BE ACCEPTED.

Q. WHAT IS THE BASIS FOR THE AUDITORS OPINION THAT SOUTHERN BELL IS NOT APPLYING 364.037, F.S., APPROPRIATELY?

A. IN THE AUDIT OPINION, THE AUDITORS STATE THAT SOUTHERN BELL IS NOT APPLYING 364.037, F.S., <u>TO RECOGNIZE THE ENTIRE DIRECTORY OPERATIONS</u> RELATED TO THEIR FRANCHISE AREA DUE TO THE ESTABLISHMENT OF BAPCO, A SEPARATE DIRECTORY AFFILIATE OF SOUTHERN BELL. UNDER STATEMENT OF FACTS NO. 15, THE AUDITORS STATE THAT: "INCLUDING THE INVESTMENT AND INCOME BEFORE INCOME TAXES OF BAPCO-FLORIDA IN THE RATE BASE AND OPERATING INCOME 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."

BASED ON THESE STATEMENTS, THE AUDITORS ARE ARGUING THAT SOUTHERN BELL SHOULD ADD BAPCO-FLORIDA OPERATING AMOUNTS TO THE DIRECTORY AMOUNTS ON SOUTHERN BELL'S BOOKS BEFORE APPLYING 364.037, F.S.

Q. HOW HAS SOUTHERN BELL BEEN APPLYING 364.037, F.S.?

A. THE COMPANY HAS BEEN CALCULATING THE ACTUAL DIRECTORY GROSS PROFITS FOR APPLICATION OF 364.037, F.S., BY USING THE DIRECTORY REVENUES AND EXPENSES WHICH ARE RECORDED ON SOUTHERN BELL'S BOOKS.

Q. DO YOU HAVE EVIDENCE THAT THE COMPANY IS CORRECTLY FOLLOWING COMMISSION RULE 25-4.0405 AND SECTION 364.037 F.S.?

A. YES. IN MY REBUTTAL TESTIMONY FILED ON DECEMBER 10, 1993, I ADDRESSED A SIMILAR ISSUE RAISED BY OPC WITNESS DE WARD. THE TESTIMONY REGARDING THIS ISSUE BEGINS ON PAGE 28 OF THAT TESTIMONY AND ENDS ON PAGE 35. ATTACHED TO THE DECEMBER 10 TESTIMONY AS REID EXHIBITS WSR-6 AND WSR-7 ARE THE STAFF RECOMMENDATIONS TO THE COMMISSION FOR ADOPTION OF RULE 25-4.0405 AND OPC'S

COMMENTS TO THE COMMISSION REGARDING THE RULE. I BELIEVE THESE DOCUMENTS CLEARLY SHOW THAT THE COMPANY IS FOLLOWING THE COMMISSION'S RULE AND THAT THE AUDITORS ARE NOT ONLY INCORRECT IN THEIR OPINION, BUT INCONSISTENT WITH THE STAFF'S VIEW AT THE TIME THE RULE WAS ADOPTED.

AS FURTHER PROOF THAT SOUTHERN BELL HAS CONSISTENTLY FOLLOWED THE COMMISSION'S RULE, I HAVE ATTACHED TO THIS TESTIMONY AS WSR-11, COPIES OF THE SCHEDULES IN THE COMPANY'S ANNUAL REPORTS TO THE COMMISSION WHICH DETAIL THE APPLICATION OF THE DIRECTORY STATUTE GROSS PROFIT CALCULATIONS FROM 1984 THROUGH 1992. THE ONLY VARIATION IN THE GROSS PROFIT DETERMINATION ON THESE REPORTS OCCURRED IN 1992 WHEN THE COMMISSION STAFF ALTERED THE FORMAT OF THE REPORT TO REQUIRE THAT THE COMPANIES REPORT INFORMATION ON A CONSOLIDATED BASIS AS WELL AS ON THE "PER BOOKS" BASIS PREVIOUSLY USED.

Q. WHAT WOULD BE THE RESULT OF APPLYING 364.037, F.S., TO THE COMBINED SOUTHERN BELL AND BAPCO-FLORIDA DIRECTORY OPERATIONS?

A. I HAVE PREPARED REID EXHIBIT WSR-12 TO DEMONSTRATE

THIS CALCULATION. AS SHOWN ON THIS EXHIBIT, THE RATEPAYERS ARE RECEIVING THE BENEFIT OF MORE REGULATED DIRECTORY PROFITS UNDER THE CURRENT METHODOLOGY THAN THEY WOULD UNDER STAFF'S PROPOSAL (WHEN CALCULATED IN ACCORDANCE WITH 364.037, F.S.). UNDER THE STAFF'S PROPOSAL REGULATED PROFITS WOULD DECREASE BY $ AND RATE BASE WOULD INCREASE BY $. AN INCREASE IN RATE BASE OF THIS AMOUNT WOULD CORRESPONDINGLY INCREASE REVENUE REQUIREMENTS BY APPROXIMATELY $. THE OVERALL REVENUE REQUIREMENT IMPACT WOULD THEREFORE BE AN INCREASE OF APPROXIMATELY $.

THE AUDITORS DID NOT PROVIDE A CALCULATION OF THE APPLICATION OF 364.037, F.S., USING CONSOLIDATED DIRECTORY OPERATIONS. THEY MERELY STATED THAT AN IMPUTATION OF $17 MILLION SHOULD BE MADE TO THE EXTENT ALLOWED BY 364.037, F.S. MY CALCULATIONS SHOW THAT NOT ONLY IS THE $17 MILLION NOT ALLOWED BY 364.037, F.S., BUT REGULATED PROFITS WOULD ACTUALLY BE REDUCED.

Q. HAVE YOU PREVIOUSLY ADDRESSED THE ISSUE RELATED TO AUDIT DISCLOSURE 59 IN YOUR DIRECT OR REBUTTAL

TESTIMONIES?

A. YES. ON PAGES 100 THROUGH 102 OF MY REBUTTAL TESTIMONY TO OPC WITNESS DE WARD, FILED ON DECEMBER 10, 1993, I ADDRESS A SIMILAR RECOMMENDATION FOR A TAX SAVINGS IMPUTATION RELATED TO DIVIDEND PAYMENTS TO THE COMPANY'S LESOP TRUST. AS STATED IN THAT TESTIMONY AND IN THE COMPANY'S COMMENTS IN RESPONSE TO THIS AUDIT DISCLOSURE, THE COMPANY DOES NOT AGREE WITH THE PROPOSED IMPUTATION.

Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

A. YES, IT DOES.

Annual Report of Southern Bell - Florida Year Ended December 31, 19 84

40A Analysis of Directory Advertising Operations

Line	Item (1)	Amount (2)
1	REVENUES (Acct. 523)/(526-10)	
2	Local	$120,941,296
3	National	8,510,461
4	Sales	529,063
5	Commissions	0
6	Other	32,158
7	Total (L2 thru L6)	$130,012,978
8	Expenses (Acct 649)	
9	Printing	0
10	Commissions	0
11	Delivery	0
12	Salvage	0
13	Other	$1,082,655
14	Total (L9 thru L13)	$1,082,655
15	Gross Profit (L7 - L14)	$128,930,323
16	Gross Profit 1982 (1)	$102,215,043
17	Customer Growth Factor (2)	1.0857
18	CPI-U Factor (3)	1.0761
19	Adjusted 1982 (L16 x L17 x L18)	$119,420,060
20	Non-Regulated (4)	$9,510,263

(1) Gross profit base as stated in FPSC Rule 25-4.405.

(2) Equals $\frac{3,329,380}{3,066,516}$ = 1.0857 $\frac{\text{average current year access lines}}{\text{average 1982 access lines as stated in FPSC Rule 25-4.405}}$

(3) Equals $\frac{311.1}{289.1}$ = 1.0761 $\frac{\text{annual average CPI-U for current year}}{\text{annual average CPI-U for 1982}}$

(4) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

Annual Report of Southern Bell- Florida Year Ended December 31, 19 85

40A Analysis of Directory Advertising Operations

Line	Item (1)	Amount (2)	
1	REVENUES (Acct. 523)/(526-10)		
2	Local	$134,418,557	
3	National	10,448,999	
4	Sales	887,226	
5	Commissions	0	
6	Other	152,858	
7	Total (L2 thru L6)	$145,907,640	(5)
8	Expenses (Acct 649)		
9	Printing	0	
10	Commissions	0	
11	Delivery	0	
12	Salvage	0	
13	Other	$ 2,307,953	
14	Total (L9 thru L13)	$ 2,307,953	(6)
15	Gross Profit (L7 - L14)	$143,599,687	
16	Gross Profit 1982 (1)	$102,215,043	
17	Customer Growth Factor (2)	1.1328	
18	CPI-U Factor (3)	1.1145	
19	Adjusted 1982 (L16 x L17 x L18)	$129,047,064	
20	Non-Regulated (4)	$ 14,552,623	

(1) Gross profit base as stated in FPSC Rule 25-4.405.

(2) Equals $\frac{3,390,501}{2,993,084} = 1.1328$ $\frac{\text{average current year access lines}}{\text{average 1982 access lines as stated in FPSC Rule 25-4.405}}$

(3) Equals $\frac{322.2}{289.1} = 1.1145$ $\frac{\text{annual average CPI-U for current year}}{\text{annual average CPI-U for 1982}}$

(4) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(5) This amount represents the total revenues retained by Southern Bell under the contractual agreement with BAPCO. The commissions paid to BAPCO for Directory Advertising operations under this agreement was $122,142,140 for 1985.

(6) This Directory Expense amount excludes commissions paid to BAPCO per note (5) above.

Annual Report of Southern Bell - Florida Year Ended December 31, 19 86

40A Analysis of Directory Advertising Operations

Line	Item (1)	Amount (2)	
1	REVENUES (Acct. 523)		
2	Local	$142,936,642	
3	National	12,046,125	
4	Sales	1,434,822	
5	Commissions	(6,759)	
6	Other	254,570	
7	Total (L2 thru L6)	$156,665,400	(5)
8	Expenses (Acct 649)		
9	Printing	0	
10	Commissions	0	
11	Delivery	0	
12	Salvage	0	
13	Other	$1,306,314	
14	Total (L9 thru L13)	$1,306,314	(6)
15	Gross Profit (L7 - L14)	$155,359,086	
16	Gross Profit 1982 (1)	$102,215,043	
17	Customer Growth Factor (2)	1.1892	
18	CPI-U Factor (3)	1.1359	
19	Adjusted 1982 (L16 x L17 x L18)	$138,073,335	
20	Non-Regulated (4)	$17,285,751	

(1) Gross profit base as stated in FPSC Rule 25-4.405.

(2) Equals $\frac{3,559,277}{2,993,084} = 1.1892$ $\frac{\text{average current year access lines}}{\text{average 1982 access lines as stated in FPSC Rule 25-4.405}}$

(3) Equals $\frac{328.4}{289.1} = 1.1359$ $\frac{\text{annual average CPI-U for current year}}{\text{annual average CPI-U for 1982}}$

(4) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(5) This amount represents the total revenues retained by Southern Bell under the contractual agreement with BAPCO. The commissions paid to BAPCO for Directory Advertising operations under this agreement was $132,658,737 for 1986.

(6) This Directory Expense amount excludes commissions paid to BAPCO per note (5) above.

Annual Report of Southern Bell - Florida Year Ended December 31, 1987

40A - ANALYSIS OF DIRECTORY ADVERTISING EXPENSE

Line	Item (1)	Amount (2)	
1	REVENUES (ACCT 523)		
2	Local	$153,553,716	
3	National	13,639,929	
4	Sales	1,356,690	
5	Commissions	0	
6	Other	644,522	
7	Total (L2 thru L6)	$169,194,857	(5)
8	EXPENSES ACCT 649		
9	Printing	0	
10	Commissions	0	
11	Delivery	0	
12	Salvage	0	
13	Other	$1,375,635	(6)
14	Totsl (L9 thru L13)		
15	Gross Profit (L7 - L14)	$167,819,222	
16	Gross Profit 1982 (1)	$102,215,043	
17	Customer Growth Factor (2)	1.2615	
18	CPI-U Factor (3)	1.1774	
19	Adjusted 1982 (L16 X L17 X L18)	$151,818,991	
20	Nonregulated (4)	$16,000,231	

(1) Gross profit base as stated in proposed FPSC Rule 25-4.405.

(2) Equals = 3,775,905 average current year access lines
2,993,084 --
1.2615 average 1982 access lines as stated in proposed FPSC Rule 25-4.405

(3) Equals = 340.4 annual average CPI-U for current year
289.1 ------------------------------
1.1774 annual average CPI-U for 1982

(4) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(5) This amount represents the total revenues retained by Southern Bell under the contractual agreement with BAPCO. The commissions paid to BAPCO for Directory Advertising operations under this agreement was $141,370,198 for 1987.

(6) This Directory Expense amount excludes commissions paid to BAPCO per note (5) above.

40A - ANALYSIS OF DIRECTORY ADVERTISING EXPENSE

Line	Item	Amount	
1	REVENUES (ACCT 5230.5000)(5)		
2	Local	$164,477,699	
3	National	14,888,239	
4	Sales	1,246,118	
5	Commissions	0	
6	Other	819,665	
7	Total (L2 thru L6)	$181,431,721	(5)
8	EXPENSES ACCT 6622.1000		
9	Printing	0	
10	Commissions	0	
11	Delivery	0	
12	Salvage	0	
13	Other	$2,403,487	
14	Total (L9 thru L13)		
15	Gross Profit (L7 - L14)	$179,028,234	
16	Gross Profit 1982 (1)	$102,215,043	
17	Customer Growth Factor (2)	1.3356	
18	CPI-U Factor (3)	1.2255	
19	Adjusted 1982 (L16 X L17 X L18)	$167,303,313	
20	Nonregulated (4)	$11,724,921	

(1) Gross profit base as stated in proposed FPSC Rule 25-4.405.

(2) $\dfrac{\text{average current year access lines}}{\text{avg. 1982 access lines per Rule 25-4.0405}} = \dfrac{3,997,580}{2,993,084}$

(3) $\dfrac{\text{annual average CPI-U got current year}}{\text{annual average CPI-U for 1982}} = \dfrac{354.3}{289.1}$

(4) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(5) Only those revenues and expenses included in accounts 5230.5000 and 6622.1000 should be included on this schedule. The publishing fees paid by BAPCO in 1988 under contractual agreement with Southern Bell were $ 179,365,936.

Analysis of Directory Advertising Operations

Schedule Z-9

Company: Southern Bell Telephone and Telegraph Company – Florida

For the Year Ended December 31, 1989

Items	Amount
1. Revenues (Account 5230.5000) (e)	
2. Local	$176,945,995
3. National	16,893,794
4. Sales	1,291,904
5. Commissions	0
6. Other	320,214
7. Total (line 2 thru 6)	195,451,907
8. Expenses (Account 6622.1000) (e)	
9. Printing	
10. Commssions	
11. Deliver	
12. Salvage	
13. Other	2,258,462
14. Total (line 9 thru 13)	2,258,462
15. Gross Profit (Line 7 minus 14)	193,193,445
16. Gross Profit 1982 (a)	102,215,043
17. Customer Growth Factor (b)	1.4135
18. CPI-U Factor (c)	1.2850
19. Adjusted 1982 (L16 x L17 x L18)	185,658,038
20. Nonregulated (d)	7,535,407

Footnotes:

(a) Gross Profit Base as Stated in FPSC Rule 25-4.0405.

(b) $$\frac{\text{Average Current Year Access Lines}}{\text{Average 1982 Access Lines Per Rule 25-4.0405}} = \frac{4{,}230{,}741}{2{,}993{,}084} = 1.4135$$

(c) $$\frac{\text{Annual Average CPI-U for Current Year}}{\text{Annual Average CPI-U for 1982}} = \frac{124.0}{96.5} = 1.2850$$

(d) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(e) Only those revenues and expenses included in accounts 5230.5 and 6622.1 should be included in this schedule. The commissions paid to BAPCO for Directory Advertising operations under the contractual agreement with Southern Bell were $164,425,585 for the Year 1989.

Analysis of Directory Advertising Operations
Schedule Z-9

Company: Southern Bell Telephone and Telegraph Company – Florida
For the Year Ended December 31, 1990

Items	Amount
1. Revenues (Account 5230.5000) (e)	
2. Local	$188,927,862
3. National	18,671,008
4. Sales	1,316,335
5. Commissions	0
6. Other	139,555
7. Total (line 2 thru 6)	209,054,760
8. Expenses (Account 6622.1000) (e)	
9. Printing	
10. Commssions	
11. Deliver	
12. Salvage	
13. Other	3,087,177
14. Total (line 9 thru 13)	3,087,177
15. Gross Profit (Line 7 minus 14)	205,967,583
16. Gross Profit 1982 (a)	102,215,043
17. Customer Growth Factor (b)	1.4855
18. CPI-U Factor (c)	1.3544
19. Adjusted 1982 (L16 x L17 x L18)	205,652,701
20. Nonregulated (d)	314,882

Footnotes:

(a) Gross Profit Base as Stated in FPSC Rule 25-4.0405.

(b) $\frac{\text{Average Current Year Access Lines}}{\text{Average 1982 Access Lines Per Rule 25-4.0405}} = \frac{4,446,331}{2,993,084} = 1.4855$

(c) $\frac{\text{Annual Average CPI-U for Current Year}}{\text{Annual Average CPI-U for 1982}} = \frac{130.7}{96.5} = 1.3544$

(d) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(e) Only those revenues and expenses included in accounts 5230.5 and 6622.1 should be included in this schedule. The commissions paid to BAPCO for Directory Advertising operations under the contractual agreement with Southern Bell were $ 176,444,020 for the Year 1990.

Analysis of Directory Advertising Operations

Schedule Z-9

Company: Southern Bell Telephone and Telegraph Company – Florida

For the Year Ended December 31, 1991

Items	Amount
1. Revenues (Account 5230) (e)	
2. Local	$198,853,320
3. National	19,207,306
4. Sales	1,117,024
5. Commissions	0
6. Other	403,451
7. Total (line 2 thru 6)	219,581,101
8. Expenses (Account 6622) (e)	
9. Printing	
10. Commssions	
11. Deliver	
12. Salvage	
13. Other	2,289,629
14. Total (line 9 thru 13)	2,289,629
15. Gross Profit (Line 7 minus 14)	217,291,472
16. Gross Profit 1982 (a)	102,215,043
17. Customer Growth Factor (b)	1.5387
18. CPI-U Factor (c)	1.4114
19. Adjusted 1982 (L16 x L17 x L18)	221,982,574
20. Nonregulated (d)	0

Footnotes:

(a) Gross Profit Base as Stated in FPSC Rule 25-4.0405.

(b) $\frac{\text{Average Current Year Access Lines}}{\text{Average 1982 Access Lines Per Rule 25-4.0405}} = \frac{4,605,532}{2,993,084} = 1.5387$

(c) $\frac{\text{Annual Average CPI-U for Current Year}}{\text{Annual Average CPI-U for 1982}} = \frac{136.2}{96.5} = 1.4114$

(d) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(e) Only those revenues and expenses formerly included in accounts 5230.5 and 6622.1 should be included in this schedule. The commissions paid to BAPCO for Directory Advertising operations under the contractual agreement with Southern Bell were $ 185,977,594 for the Year 1991.

Analysis of Directory Advertising Operations

Schedule Z-9

Company: Southern Bell Telephone and Telegraph Company – Florida
For the Year Ended December 31, 1992

Items	Consolidated (f) Amount	Per Books Amount
1. Revenues (Account 5230) (e)		
2. Local	378,484,000	205,212,446
3. National	37,356,000	19,723,600
4. Sales	1,120,891	1,120,891
5. Commissions	0	0
6. Other	1,072,778	45,778
7. Total (line 2 thru 6)	$418,033,669	$226,102,715
8. Expenses (Account 6622) (e)		
9. Printing	73,225,000	0
10. Commssions	32,681,000	0
11. Deliver	0	0
12. Salvage	0	0
13. Other	14,858,835	2,144,835
14. Total (line 9 thru 13)	$120,764,835	$2,144,835
15. Gross Profit (Line 7 minus 14) (g)	297,268,834	223,957,880
16. Gross Profit 1982 (a)	102,215,043	102,215,043
17. Customer Growth Factor (b)	1.5950	1.5950
18. CPI-U Factor (c)	1.4539	1.4539
19. Adjusted 1982 (L16 x L17 x L18)	237,033,669	237,033,669
20. Nonregulated (d)	$60,235,165	$0

Footnotes:

(a) Gross Profit Base as Stated in FPSC Rule 25-4.0405.

(b) $\frac{\text{Average Current Year Access Lines}}{\text{Average 1982 Access Lines Per Rule 25-4.0405}} = \frac{4,773,911}{2,993,084}$ 1.5950

(c) $\frac{\text{Annual Average CPI-U for Current Year}}{\text{Annual Average CPI-U for 1982}} = \frac{140.3}{96.5}$ 1.4539

(d) (Line 15 less Line 19) or (1/3 of Line 15) whichever is smaller but not less than zero.

(e) Only those revenues and expenses formerly included in accounts 5230.5 and 6622.1 should be included in this schedule. The commissions paid to BAPCO for Directory Advertising operations under the contractual agreement with Southern Bell were $ 191,761,964 for the Year 1992.

(f) The consolidated amount should contain the entire or gross amount from the Directory Advertising operation in the local franchise area to be considered in setting rates for telecommunications service. This will include the gross amounts billed from all sources, including all amounts from the publishing or directory companies as well as the Local Exchange Companies.

(g) Consolidated Gross Profit (line 15) is not comparable to Adjusted 1982 (line 19) because line 15 excludes uncollectibles, general and administrative expenses, income taxes and interest.

Comparison of Directory Advertising
Calculations Under 364.037, F.S.

	"Per Books" Basis as Used by the Company	Consolidated Basis as Proposed by the Staff
Account 5230 Directory Revenues	226,102,715	418,033,669
Account 6622 Directory Expenses	2,144,835	120,764,835
(Actual Gross Profit)	223,957,880	297,268,834
(364.037, F.S. Gross Profit)	237,033,669	237,033,669
Non-Reg Gross Profit	0	60,235,165
Regulated Gross Profit	223,957,880	237,033,669
Other Expense#	0	
(Regulated Profit Before Income Tax)	223,957,880	
Regulated Rate Base	0	

Directory overhead expenses including uncollectible revenues of $

Company Response to Audit Disclosure 2

The cost savings from implementation of the Work Activity Statistical Sampling Process (WASSP), while represented by incremental labor cost savings, are primarily expected to be in terms of efficiency gains through the avoidance of the continuous paper work previously required to be generated by outside plant personnel. Any time saved as a result of WASSP will be available for the outside plant personnel to perform their designated job duties, such as service installation, maintenance, and other customer service functions. The WASSP process will continue to provide the proper documentation for regulatory purposes while increasing efficiency within the Network Department in BST. Also, to the extent these efficiency gains make it possible to reduce force levels, such effects would be reflected in adjusted head counts as applicable.

Southern Bell Telephone & Telegraph Company
Response to Rate Case Audit
November 11, 1993

Florida Update Audit
Audit Disclosure No. 1

Subject: Management Study

COMPANY POSITION: The $43.9M represents the greatest possible savings over time *if* the Company were to adopt *all* of the consultant's recommendations. However, the Company recognized that it could not adopt all of the recommendations and this fact would necessarily reduce the possible savings. In addition, there are significant up-front costs of reorganization including relocation of employees and records and costs of separations program such as VEER and CTAP to create employee force reductions. These costs will be incurred in the early years before any cost savings are realized. We anticipate that any potential cost savings would materialize beginning in the 1995 timeframe.

The 8,000 employee reduction is a total Company number and the product of numerous re-engineering project initiatives. Many of these various initiatives are not yet underway, but are being considered for implementation in the future. Thus, the timing of such impacts contains a high degree of uncertainty.

Southern Bell Telephone & Telegraph Company
Response to Rate Case Audit
November 17, 1993

Florida Update Audit
Audit Disclosure No. 2

Subject: Obsolete Inventory

Computer Spare Parts

Write-downs of computer spare parts were identified in the Staff audit of 1991. In the Company's response, we stated that, given the continuing improvements in computer technology, we expect similar adjustments to be recurring in the future. Therefore, it is not appropriate for this item to be proformed.

Warehouse Inventory

Periodic physical inventories on warehouse inventory are performed as part of the Company's internal control procedures. As a result, these inventories identify materials which should be junked due to obsolescence and materials which should be junked due to surplus caused by lower usage which results from obsolescence or discontinued use by departments. These write-offs result from this process.

History of Inventory Adjustments

Below are shown the average inventory for account 1220 and the net amount of inventory adjustments for account 6512.6000 for the years 1988 through year-to-date 1993. It shows that the inventory adjustments are recurring in nature.

Year	Average 1220 Balance (000)	Inventory Adj 6512.6000 (Net) (000)	Percentage
1988	$ 37,323	$ (1,099)	(2.9) %
1989	40,563	492	1.2
1990	44,795	546	1.2
1991	46,313	5,606	12.1
1992	56,700	2,687	4.7
1993	55,455	1,244 Oct YTD	2.2

Prior to 1992, the central stock warehouse inventories were carried on the books of BellSouth Services; therefore, both the inventory balances and amount of inventory adjustments increased beginning in 1992. In 1991, the computer spare parts inventory write off added $2,972 to the net inventory adjustments.

Southern Bell Telephone & Telegraph Company
Response to Rate Case Audit
November 11, 1993

Florida Update Audit
Audit Disclosure No. 5

Subject: Lobbying Expense

COMPANY POSITION: The Company has been computing this type-of lobbying adjustment since 1988, as a result of discussion with the Florida Audit staff and has never included an adjustment for Marshall Criser's expenses. Mr. Criser is not a registered lobbyist. Mr. Criser works in the Tallahassee Regulatory/Industry Relations office. He is responsible for strategic planning and evaluation of alternatives to accomplish regulatory objectives. In this capacity he reviews briefs, petitions, orders, rulings, tariffs and other documents to provide regulatory input and direction to other departments, and assists with testimony preparation for hearings before the PSC. He oversees strategy and implementation procedures related to settlement processes, network coordination, provisioning of end-to-end interLATA services and maintains interactive relationships with other Local Exchange Companies and IXC's in the state. Mr. Criser provides the primary interface between the Company and the Florida PSC staff, the Public Counsel and the Attorney General staff on industry issues, regulatory policy and framework, financial data, tariffs and related docket activity. His expenses have been and should be allowed for ratemaking purposes. In addition, Mr. Criser directly charges certain costs not allowable for ratemaking to a below-the-line account. In 1992, SB charged approximately $12,300 for these activities below-the-line.

Beginning in 1992, Mr. Meiners charges a percent of his time and expenses directly below the line as Other Lobbying costs. Mr. Meiners is a registered lobbyist and a primary contact for the Company with members of the Legislature on both state and federal levels. However, Mr. Meiners also has significant responsiblities in the area of ongoing review and analysis of legislation for its impact on corporate operations. Therefore, the percent is determined by an analysis of the amount of time spent performing lobbying activities. In 1992, Mr. Meiners charged approximately $26,000 as Other Lobbying costs out of ratemaking. In addition, he directly charged certain costs not allowable for ratemaking to a below-the-line account totaling approximately $19,000. A total of $104,000 was charged to Other Lobbying, and ultimatley charged to Account 7370 for Florida for 1992; this amount included lobbying costs for Meiners as well as other personnel. Since these costs are already charged below the line, SB will no longer analyze his above-the-line costs to determine an exclusion amount.

CONCLUSION: No additional expense should be removed for Criser and Meiners.

SUMMARY OF LOBBYING COMPUTATION

1992	Above Line Percent Deemed Lobbying	Weighted Composite Percent	Intrastate Adjustment to Exp.
Florida Public Affairs Office			
Raynor	100.0000%		
Meiners	0.0000%		
		61.0402%	
Florida State Regulatory Office			
Lombardo	100.0000%		
Criser	0.0000%		
		33.6484%	
			(446,200)
Other Lobbying - below the line			(104,256)
Grassroots Lobbying - FL			(529,970)
Total Lobbying Adjustment			(1,080,426)
DC Federal Relations		61.0402%	(497,000)
DC Federal Regulatory		33.6484%	(175,000)
BS Grassroots			0
Included in Other Regulatory Adjustments			(672,000)

NOTE: Effective in 1992, Meiners charges directly to Account 7370 a percent of his costs deemed to be lobbying related. These are included in the Other Lobbying - Below the line amount.

Southern Bell Telephone & Telegraph Company
Response to Rate Case Audit
November 11, 1993

FLorida Update Audit
Audit Disclosure No. 6

Subject: Uncollectible Revenue

The revenue base used in the econometric model prior to April, 1993 did not match the revenue base to which the uncollectible factor was applied. The main difference was that the model used billed revenue (without adjustments or accruals) instead of earned revenue.

The model was rerun using the correct revenues and produced a factor of 1.52% (vs. the 1.53% previously calculated). The correction would have resulted in very small deviations in the accruals (0.65%) and ROE (less than .01%).

The model produces a factor which approximates what the accrual should be. However, the results may be adjusted if management feels that such an adjustment is warranted. In fact, in December, 1992 a manual adjustment was made to reduce the uncollectible reserve by $2,761,079. Thus, any revision to the factor would have had no effect on the eventual accrual for uncollectibles.

The 1992 revenues totaled	$2,284,665,000
Accrual using 1.53%	$34,955,375
Accrual using 1.52%	$34,726,908
Accrual difference	$228,467
Percentage difference	-0.654%

Revenue increase	$228,467
Value of 100 basis points	$32,778,000
ROE impact	0.007%

<u>Company Response to Audit Disclosure 1</u>

The auditor's opinion is unfounded. Section 32.2000(f)(5), CFR, provides that "There shall be shown in the continuing property record or in record supplements thereof, a complete description of the property records units in such detail as to identify such units." Southern Bell is in compliance with Part 32.2000(f)(5). Southern Bell maintains extensive property record details and record supplements which, when considered together, allow for specific asset verification within the accounting area as required by FCC rules.

Part 32.2000(f)(1)(i) defines accounting area as "...the smallest territory of the company for which accounting records of investment are maintained for all plant accounts within the area." In Southern Bell this equates to a regulatory jurisdiction or state. More specific location data is maintained by Geographic Location Code (or accounting location in PICS/DCPR terminology) which equates to a COE building or carrier site.

For still more detailed information, floor and frame identification information is directly available in the PICS/DCPR investment data base for hardwired assets. In the case of plug-in assets, no frame identification is carried in the PICS/DCPR system. This type of detailed plug-in location information would appear to be virtually impossible to produce and maintain in a PICS/DCPR environment due to the highly mobile nature of plug-in assets (shipped as needed to meet a service requirement and returned to stock when the need passes) and because of the wide substitutability of plug-in equipment. For plug-in assets, a HECI type identification is maintained in a separate PICS/DCPR data base from those requested by and provided to the auditor. Further, office drawings, TIRKS and/or CPC type records will provide additional information regarding the specific bay and slot in which specific types of plug-ins are physically located.

Southern Bell does not agree with the recommendations that are part of this disclosure. such recommendations would necessitate duplicating information that is already stored in other records into the PICS/DCPR investment records. This would result in the maintenance of redundant data in the investment records. Moreover, the transition to this arrangement would be prohibitively expensive in that data base structures and mechanized flows would require extensive modification. Overall, this would appear to be a very inefficient use of resources resulting in higher costs for Southern Bell and its ratepayers.

Company Response to Audit Disclosure 2

Disclosure 2 appears to indicate that Unallocated Other Cost (UOC -- hardwired CPR 040004) and Plug-in Other Cost (PIOC -- plug-in CPR 040001) records are discrepancies simply because of their presence in an investment record. These records do not represent retirement units of equipment, but do have specific meanings and are generally appropriate. Generic explanations of UOC and PIOC follow below:

UOC: Dollar amounts will flow into hardwired CPR 040004 as UOC during each year's PICS/DCPR annual processing. UOC occurs at any location/Field Reporting Code (FRC) combination which receives charges for capital labor, engineering, or material of less than retirement unit size (commonly referred to as minor items) during a calendar year in which no hardwired retirement units are placed in service. These types of charges are normally included in the installed cost of hardwired retirement units if such are placed in service, but they are captured as UOC if no retirement units are being placed in service during the calendar year under study.

PIOC: Dollar amounts are captured under plug-in CPR 040001 to reflect the capitalized cost of labor to place, line up and test growth deferrable plug-in units. A ratio of these costs to deferrable plug-in costs is developed and stored by the PICS/DCPR annual processes so that a proportional amount of PIOC may be retired for each dollar of deferrable plug-in investment recovered without replacement from a field location.

From these descriptions, it is Southern Bell's position that UOC and PIOC cannot be verified as one would a physical piece of equipment and should be excluded from the disclosure. Following this path, the discrepancies shown in Disclosure 2 would be reduced to the following:

A. Line entries of CPR records (note references in parentheses)

	TOTAL # ENTRIES	# ENTRIES W/DSCRPNCS	% ENTRIES W/O DSCRPNCS	% ENTRIES W/DSCRPNCS
HARDWIRED	180	52 (1)	71.11%	28.89%
PLUG-IN	693	46 (2,5)	78.93%	21.07%

B. Dollar amount of discrepancies (note references in parentheses)

	TOTAL $ BOOKED	$ AMT OF DSCRPNCS	PERCENT OF DSCRPNCS
HARDWIRED	782,813.50	172,199.08 (3)	22.00%
PLUG-IN	510,000.00	77,720.01 (4)	15.24%

All of the plug-in discrepancies and some of the hardwired discrepancies have been adjusted. The remaining hardwired discrepancies will be adjusted in early 1994.

NOTE 1: This figure was reduced by 16 line entries as a result of the UOC explanation above.

NOTE 2: This figure was reduced by 26 line entries as a result of the PIOC explanation above. Three additional lines were eliminated because the units were not "actual discrepancies." (E0126 - CPR 172864, E0027 - CPR 372580, and E0027 - CPR 470828)

NOTE 3: This reflects the dollar adjustments addressed in Note 1.

NOTE 4: This reflects the total dollar adjustment for plug-ins at the nine remote sites.

NOTE 5: The company does not necessarily agree with the number of plug-in discrepancies counted. It is virtually impossible to determine which line contains the "actual" discrepancy, since the majority of the plug-ins have more than one line. Further, because of the mobile nature of plug-ins, there is an inherent accuracy risk involved in comparing plus-in investment as of one date with a physical inventory conducted on a later date.

Company Response to Audit Disclosure 3

Southern Bell agrees with the need to periodically examine its Continuing Property Records (CPRs) and subsequently retire any obsolete equipment. Currently, as Field Reporting Codes (FRCs) and/or Equipment Category Numbers (ECNs) are identified as being obsolete, Southern Bell's records are analyzed for potential equipment, and associated investment, that can be retired.

In recent years, Southern Bell has escalated its efforts by forming an asset management group which provides procedures and guidelines necessary to coordinate the identification and retirement of obsolete equipment. Implementation of the process is performed by the state asset management team. Additionally, a requirement to inventory circuit equipment in every central office by the end of 1994 has been completed. The reconciliation effort is currently underway.

The attached spreadsheet provides the action taken, or action that will be taken, regarding the disposition of the ten hardwired and four plug-in retirement units mentioned in the disclosure.

PSC DOCKET 920260-TL-REQ 6			
RESPONSE TO DISCLOSURE # 3			
HARDWIRED ITEMS NOT USED PER PSC REVIEW			
CPR#	LOCATION	IN USE	COMMENTS
000436	E9406	NO	NOT THERE;ENGINEER TO RETIRE FROM RECORDS
002012	E8508	NO	NOT THERE;ENGINEER TO RETIRE FROM RECORDS
006127	E8801	YES	ENG TO CORRECT STENCILING;1 BAY RET IN PLACE
020666	E4101	NO	NOT THERE;ENGINEER TO RETIRE FROM RECORDS
060321	E8508	NO	NOT THERE;ENGINEER TO RETIRE FROM RECORDS
065304	E8805	NO	NOT THERE;ENGINEER TO RETIRE FROM RECORDS
129072	E4348	NO	NOT THERE;ENGINEER TO RETIRE FROM RECORDS
HARDWIRED ITEMS COULD NOT BE IDENTIFIED PER PSC REVIEW			
CPR#	LOCATION	IN USE	COMMENTS
008774	E4512	NO	NOT THERE; ENGINEER TO RETIRE FROM RECORDS
020785	E4512	NO	NOT THERE; ENGINEER TO RETIRE FROM RECORDS
069105	E8423	NO	NOT THERE; ENGINEER TO RETIRE FROM RECORDS
PLUG-IN ITEMS NOT USED PER PSC REVIEW			
CPR#	LOCATION	IN USE	COMMENTS
070472	E8632	NO	NOT THERE; RECORDS CORRECTED
070474	E4449	NO	NOT THERE; RECORDS CORRECTED
071185	E4205	NO	NOT THERE; RECORDS CORRECTED
072125	E8508	NO	NOT THERE; RECORDS CORRECTED

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF JERRY L. WILSON

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET 920260-TL

JANUARY 4, 1994

Q. PLEASE STATE YOUR NAME, ADDRESS AND BY WHOM YOU ARE EMPLOYED.

A. MY NAME IS JERRY L. WILSON AND MY BUSINESS ADDRESS IS 3700 COLONNADE PARKWAY, BIRMINGHAM, ALABAMA. I AM EMPLOYED BY BELLSOUTH TELECOMMUNICATIONS, INC. D/B/A/ SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY, (HEREINAFTER REFERRED TO AS "COMPANY" OR "SOUTHERN BELL").

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS DOCKET?

A. YES. I FILED REBUTTAL TESTIMONY ON DECEMBER 10, 1993 IN RESPONSE TO CERTAIN RECOMMENDATIONS MADE BY WITNESSES FOR THE OFFICE OF PUBLIC COUNSEL ("OPC").

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. MY TESTIMONY WILL ADDRESS THE AFFILIATE

TRANSACTIONS AND COST ALLOCATIONS AUDIT ("AUDIT") REPORT FILED IN DOCKET 920260-TL ON DECEMBER 17, 1993. I WILL COMMENT ON THE BACKGROUND AND NEGOTIATIONS LEADING UP TO THIS AUDIT AND THE NATURE OF THE AUDIT. ALSO, I WILL RESPOND TO CERTAIN OF THE AUDIT DISCLOSURES AND SCOPE LIMITATION ALLEGATIONS. I WILL ALSO INTRODUCE ADDITIONAL COMPANY WITNESSES WHO WILL RESPOND TO OTHER DISCLOSURES AND VARIOUS ASPECTS OF THE AUDIT.

EXHIBIT JLW-1 TO MY TESTIMONY PROVIDES THE COMPANY'S RESPONSE TO EACH AND EVERY SCOPE LIMITATION AND AUDIT DISCLOSURE.

Q. WHAT EVENTS LED TO THIS AUDIT?

A. THIS AUDIT STEMS FROM A RESOLUTION PASSED BY THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS ("NARUC") IN NOVEMBER 1991, WHICH CALLED FOR AN AUDIT OF EACH OF THE REGIONAL BELL OPERATING COMPANIES' AFFILIATED TRANSACTIONS. MR. TIM DEVLIN IS THE DESIGNATED AUDIT MANAGER FOR THE REGIONAL AUDIT OF BELLSOUTH CORPORATION AND IS SPONSORING THE AUDIT REPORT IN THIS PROCEEDING.

Q. DESCRIBE THE NATURE OF YOUR INVOLVEMENT IN THIS AUDIT.

A. SHORTLY AFTER THE NARUC MEETING IN WHICH THE PREVIOUSLY MENTIONED RESOLUTION WAS APPROVED, THE PRESIDENT OF NARUC ASKED FOR BELLSOUTH'S PARTICIPATION IN SUCH AN AUDIT. I WAS APPOINTED TO WORK WITH THE AUDITORS AND TO RESOLVE ANY ISSUES NECESSARY TO ALLOW THE AUDIT TO PROCEED. THEREAFTER, I WAS RESPONSIBLE FOR GENERAL OVERSIGHT OF THE AUDIT.

Q. CAN YOU DESCRIBE THE PROBLEMS THAT YOU SOUGHT TO RESOLVE IN MORE DETAIL?

A. YES. WE WERE CONCERNED WITH THE TREATMENT OF OUR CONFIDENTIAL, PROPRIETARY BUSINESS INFORMATION IN SUCH AN AUDIT, AS WELL AS THE POSSIBLE DUPLICATION OF EFFORTS THAT HAD BEEN UNDERTAKEN IN OTHER AUDITS. I WAS GIVEN THE TASK OF TRYING TO RESOLVE THESE PROBLEMS BEFORE ANOTHER AUDIT WAS BEGUN.

Q. WILL YOU DESCRIBE HOW THESE CONCERNS WERE FINALLY RESOLVED?

A. YES. AFTER SEVERAL LETTERS, DISCUSSIONS AND MEETINGS INVOLVING BOTH MR. DEVLIN AND MYSELF, AN AGREEMENT WAS REACHED TO CONDUCT THIS AUDIT UNDER THE RULES OF THE FLORIDA PUBLIC SERVICE COMMISSION ("FPSC") AND THE LAWS OF THE STATE OF FLORIDA.

UNDER THIS ARRANGEMENT, THE FIELD WORK FOR THE AUDIT BEGAN IN EARLY 1993 AND WAS COMPLETED IN NOVEMBER 1993.

Q. WERE THE COMPANY'S CONCERNS REGARDING THE CONDUCT OF THIS AUDIT ADDRESSED?

A. NOT ENTIRELY. WHILE AN ARRANGEMENT WAS WORKED OUT TO PROVIDE FOR THE PROTECTION OF CONFIDENTIAL BUSINESS INFORMATION, OUR CONCERNS REGARDING DUPLICATION OF EFFORT AND COMPETING DEMANDS ON OUR RESOURCES PROVED TO BE WELL FOUNDED.

IN ADDITION, THIS AUDIT, AS CONDUCTED, ENCOMPASSED A SCOPE WHICH WAS MUCH BROADER THAN WHAT WE UNDERSTOOD TO BE THE ORIGINAL INTENT OF THE NARUC RESOLUTION--NAMELY, AFFILIATE TRANSACTIONS.

IMPORTANTLY, THERE IS REALLY LITTLE, IF ANYTHING,

NEW WHICH SURFACED IN THIS AUDIT. MUCH OF THE EFFORT WAS DUPLICATIVE OF OTHER DEMANDS PLACED ON THE COMPANY. FOR EXAMPLE, WHEN KENNEDY AND ASSOCIATES ("K&A") JOINED THE AUDIT TEAM, THEY IMMEDIATELY BEGAN COVERING THE SAME AREAS WHICH THEY HAD JUST PURSUED IN A RECENT LOUISIANA AUDIT. AS AN ASIDE, I MIGHT ALSO NOTE THAT WHEN EMPLOYEES OF K&A JOINED THE AUDIT TEAM, THEY BEGAN DUPLICATING WORK THAT OTHER AUDIT TEAM MEMBERS HAD ALREADY DONE IN THE AUDIT.

OVERALL, THE COMPANY RESPONDED TO HUNDREDS OF DATA REQUESTS, PARTICIPATED IN ABOUT 100 INTERVIEWS AND MADE AVAILABLE TO THE AUDITORS LITERALLY MILLIONS OF PAGES OF DOCUMENTS. THIS EFFORT CONSUMED THOUSANDS OF HOURS OF OUR EMPLOYEES' TIME AND EFFORT, AND COMPETED WITH OUR HANDLING OF OTHER MATTERS ASSOCIATED WITH FLORIDA DOCKET 920260-TL AND ACTIVITY IN OTHER JURISDICTIONS.

Q. WHAT IS THE COMPANY'S OVERALL ASSESSMENT OF THE AUDIT REPORT FILED WITH THE FPSC ON DECEMBER 17, 1993?

A. OVERALL, THE REPORT LACKS SUBSTANCE AND

OBJECTIVITY. MOST OF THE ISSUES RAISED ARE REDUNDANT OF FINDINGS IN PREVIOUS AUDITS OR IN THE TESTIMONY OF OTHER WITNESSES IN THIS PROCEEDING. THE COMPLAINTS ABOUT THE AUDIT TEAM BEING UNABLE TO DO ITS JOB BECAUSE OF LIMITED ACCESS TO INFORMATION ARE UNFAIR AND MISLEADING. IN SEVERAL INSTANCES THE REPORT DOESN'T PUT DISCLOSURES IN FULL CONTEXT. LITTLE, IF ANY, MENTION IS MADE OF THE AREAS AUDITED IN WHICH NO ADVERSE DISCLOSURES RESULTED. FURTHER, IN SOME INSTANCES THE REPORT FAILS TO MENTION CORRECTIVE ACTIONS ALREADY TAKEN BY THE COMPANY AND POINTED OUT TO THE AUDITORS.

MOREOVER, OF THE 68 DISCLOSURES PRESENTED IN THE AUDIT REPORT, ONLY 51 HAVE RECOMMENDATIONS UPON WHICH THE COMPANY MAY COMMENT. FURTHER, ONLY 18 OF THE DISCLOSURES HAVE RECOMMENDATIONS WITH A QUANTIFIED IMPACT ON THE COMPANY. OF THE 17 DISCLOSURES WITHOUT RECOMMENDATION, AND THE 33 WITH RECOMMENDATIONS BUT WITHOUT QUANTIFIED FINANCIAL IMPACT, SEVERAL ARE VAGUE AND IRRELEVANT TO FLORIDA REGULATORY ISSUES, AND CONSEQUENTLY DIFFICULT TO MEANINGFULLY CRITIQUE. AN EXAMPLE OF THIS INCLUDES AUDIT DISCLOSURE NO. 52 WHICH OFFERS THE AUDIT TEAM'S OBJECTIONS TO A COST ALLOCATION MANUAL

("CAM") WAIVER FILED BY THE COMPANY WITH THE FCC AND FOR WHICH THE APPROPRIATE FCC COMMENT CYCLE HAS BEEN COMPLETED. THERE SIMPLY APPEARS TO BE NO POINT IN THIS DISCLOSURE. ANOTHER EXAMPLE IS AUDIT DISCLOSURE NO. 37 WHICH DOES NO MORE THAN OFFER A BRIEF STATEMENT DESCRIBING BELLSOUTH BUSINESS SYSTEMS, INC. SIMILARLY, DISCLOSURES NO. 62 AND NO. 66 OFFER NO MORE THAN A FEW BRIEF FACTS RELATED TO BSC ACTIVITIES, WITH NO OPINION OR RECOMMENDATION.

FINALLY, THE "TONE" OF THE REPORT SUGGESTS, RATHER THAN BEING IMPARTIAL AND OBJECTIVE, THAT THE AUDITORS OPERATED FROM THE BASIS THAT THE COMPANY WAS "GUILTY UNLESS PROVEN INNOCENT." FOR INSTANCE, BECAUSE WE CHOSE TO EXERCISE OUR LEGAL RIGHT TO APPEAL WHAT WE BELIEVE TO BE REQUESTS THAT WERE OUTSIDE THE SCOPE OF THE AUDIT, THE AUDIT TEAM HAS RECOMMENDED A COMPLETE DISALLOWANCE OF THE AFFECTED COSTS. IN ANOTHER EXAMPLE, THE AUDITORS INCLUDE THE ENTIRE INVESTMENT FOR THE LAKE MARY, FLORIDA CENTRAL OFFICE IN COMPARISON WITH THE REVENUES FROM ONLY 178 HEATHROW TRIAL CUSTOMERS THAT ARE SERVED OUT OF THAT OFFICE. THIS COMPARISON IS ENTIRELY UNREASONABLE GIVEN THAT BASIC TELEPHONE SERVICE IS

PROVIDED TO OVER 6100 LINES FROM THAT OFFICE AND REVENUES FROM THOSE CUSTOMERS ARE EXCLUDED FROM THE COMPARISON.

Q. WILL YOU PLEASE RESPOND TO THE CONCERNS RAISED BY THE AUDIT TEAM REGARDING ACCESS TO INFORMATION?

A. YES. THE COMPANY TRIED TO PROVIDE FULL AND TIMELY ACCESS TO RELEVANT INFORMATION REQUESTED BY THE AUDIT TEAM. THIS WAS SUPPOSED TO BE AN AUDIT OF AFFILIATE TRANSACTIONS. THE COMPANY AND ITS AFFILIATES AGREED TO ALLOW THE AUDITORS ACCESS TO ANY INFORMATION NECESSARY TO TRACE INDIVIDUAL TRANSACTIONS BETWEEN THE COMPANY AND ANY AFFILIATE. THE AUDIT TEAM FAILED TO DO THIS, INSTEAD ARGUING THAT ACCESS TO THE COMPLETE GENERAL LEDGERS OF SOUTHERN BELL'S AFFILIATES WAS REQUIRED, REGARDLESS OF WHETHER OR NOT TRANSACTIONS WITH THE COMPANY EXISTED. IN SHORT, AT LEAST PART OF THE TONE OF THE AUDIT REPORT IS BASED SOLELY ON THE FACT THAT THE AUDIT TEAM WAS UNHAPPY WITH THE ACCESS THEY HAD, EVEN THOUGH THE AUDIT TEAM NEVER AVAILED ITSELF OF THE ACCESS OFFERED BY THE COMPANY TO DETERMINE WHETHER IT WAS SUFFICIENT.

MOREOVER, IT IS TRUE THAT THE COMPANY OBJECTED TO PRODUCING MATERIAL WHERE IT DID NOT HAVE POSSESSION, CUSTODY OR CONTROL OF THE MATERIAL REQUESTED AND WAS FORCED TO APPEAL TO THE COURT WITH REGARD TO SEVERAL OF THE AUDIT TEAM'S REQUESTS. HOWEVER, SOUTHERN BELL SHOULD NOT BE PENALIZED FOR MERELY EXERCISING ITS LEGAL RIGHT, WHICH IS THE TENOR OF THE REPORT.

Q. TURNING TO THE AUDIT REPORT ITSELF, CAN YOU PROVIDE THE COMPANY'S RESPONSES TO THE PARTICULAR AUDIT DISCLOSURES, OPINIONS AND RECOMMENDATIONS PRESENTED IN THE REPORT?

A. YES. TO RESPOND TO THE AUDIT IN GENERAL AND ITS DISCLOSURES IN PARTICULAR, THE COMPANY ENGAGED DELOITTE & TOUCHE ("D&T"), ONE OF THE COUNTRY'S MAJOR ACCOUNTING FIRMS. THE COMPANY ASKED D&T TO REVIEW THE SAME INFORMATION PROVIDED TO THE AUDIT TEAM, AND FROM ITS INDEPENDENT REVIEW, EVALUATE AND COMMENT ON THE AUDIT TEAM'S OPINIONS AND RECOMMENDATIONS PRESENTED IN THE REPORT. MR. J. BRADFORD BRANCH OF D&T WILL PROVIDE TESTIMONY ON BEHALF OF THE COMPANY REGARDING THEIR FINDINGS. MR. BRANCH HAS ALSO SPONSORED, ON BEHALF OF THE

COMPANY, SPECIFIC COMMENTS TO VARIOUS AUDIT DISCLOSURES INCLUDED IN MY EXHIBIT JLW-1.

ALSO, THE COMPANY REQUESTED THEODORE BARRY & ASSOCIATES ("TB&A") TO PROVIDE AN OBJECTIVE ASSESSMENT OF THE SERVICES PROVIDED TO THE COMPANY BY BELLSOUTH CORPORATION. MR. STEPHEN BUDD OF TB&A WILL PROVIDE TESTIMONY ON BEHALF OF THE COMPANY, AND HE WILL ALSO RESPOND TO VARIOUS AUDIT DISCLOSURES DEALING WITH BSC.

FURTHER, COMPANY WITNESS WALTER REID WILL ADDRESS PARTICULAR DISCLOSURES AND ADJUSTMENTS FROM THE COMPANY'S ACCOUNTING PERSPECTIVE.

FINALLY, I AM SPONSORING THE COMPANY'S COMMENTS TO SCOPE LIMITATIONS 1-6, AND AUDIT DISCLOSURES 1, 3-6, 10, 12, 13, 15, 16, 19-26, 33, 34, 36, 37, 41, 44-47, AND 54. MY SPECIFIC REMARKS ARE CONTAINED IN MY EXHIBIT JLW-1, AS ARE THOSE SPONSORED BY D&T, TB&A AND WALTER REID.

Q. CAN YOU SUMMARIZE YOUR TESTIMONY?

A. YES. THE AUDIT INVOLVED HERE WAS AN AMBITIOUS

UNDERTAKING WHICH, IN THE COMPANY'S VIEW, SIMPLY GOT OUT OF HAND. INSTEAD OF CONCENTRATING ON DEVELOPING A BALANCED VIEW OF SUBSTANTIVE ISSUES, THE AUDIT TEAM SEEMED MORE DETERMINED TO SIMPLY PROVE THAT IT COULD HAVE ITS OWN WAY. THE PRODUCT, AS D&T WILL POINT OUT, IS A REPORT THAT IS ESSENTIALLY FLAWED, AND AS THE COMPANY'S DETAILED RESPONSES SHOW, SHOULD BE REJECTED.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. YES.

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SCOPE LIMITATION: 1

SUBJECT: **BELLCORE RESEARCH AND DEVELOPMENT**

COMPANY'S COMMENTS:

In this Scope Limitation, the auditor complained that the Company, in response to Data Request No. 2-098, did not provide enough information for the auditor to complete the analysis and because of time constraints, there was not enough time to submit additional requests. The limitation expressly targeted the responses to Data Request No. 2-098, sub-parts 5 and 6.

Data Request No. 2-098, which contained 11 sub-parts, was received by the Company on June 10, 1993. The response to Data Request No. 2-098, sub-part 5, which dealt with two specific Bellcore projects, was provided to the auditor on June 22, 1993.

The response to Data Response No. 2-098, sub-part 6, the detailed backup supporting the costs associated with the two projects referenced in Data Request No. 2-098, sub-part 5, was Proprietary and **was sent to the Company's Miami office on July 7, 1993 for the auditor's review.**

The Company considered the information provided in response to Data Request No. 2-098, sub-parts 5 and 6, to be fully responsive and does not understand what additional information the auditor was seeking. Further, since the auditor had the responses in question by no later than July 8, 1993, the Company cannot understand why the auditor was not able to review, or ask further questions about, the information prior to September. Finally, even if the documents were not reviewed until September, there were still two months which could have been used by the auditor to request any additional information deemed necessary.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

SCOPE LIMITATION: 2

SUBJECT: **LACK OF DIRECT ACCESS TO INFORMATION**

COMPANY'S COMMENTS:

It is correct that, where possible, the responses provided to the audit team's requests were given regulatory and legal review. This audit has been included as a part of the rate case pending before the Florida Public Service Commission which is a contested proceeding. In these circumstances, Southern Bell is entitled to have anything provided to the audit team reviewed by its legal and regulatory staff.

Indeed, even if this were not an audit undertaken in the context of a rate proceeding, there is nothing in the rules or regulations of the Florida Public Service Commission, nor could there legally be, which would allow the examination of Southern Bell's materials and information without the benefit of legal counsel.

Moreover, on a more practical level, at least part of the regulatory review function, and to a lesser extent the legal review, was to insure that the answers provided and the information shared was responsive to the questions asked. One complaint voiced by the audit team from time to time was the failure of Southern Bell to provide precisely what the audit team requested. The regulatory and legal reviews of the material enhanced Southern Bell's ability to provide responsive materials to what were often confusing requests.

With specific reference to the instance referred to in "Scope Limitation No. 2", it is correct that there was a draft answer to an interrogatory and that the audit team obtained a copy of the draft response. It is also true that the final version of the answer deleted one portion of the draft answer. The draft version was not the expert's "papers", but merely a draft prepared by the comptroller's department to answer a specific question posed by the audit team. The final answer was different, but included more information responsive to the specific inquiry than did the draft. Furthermore, the deleted material was removed by the comptroller's department before any regulatory or legal review. It is absolutely incorrect to suggest or otherwise imply that any portion of any preexisting document was altered or changed for any reason, including preventing information from being provided to the audit team.

In the context of the specific instance raised by the audit team, it is also unreasonable to suggest that a response to a question or interrogatory must be written perfectly the first time and that no draft responses are allowed, which would be the result if the audit team's comments in its "Scope Limitation No. 2" were taken literally. This would be akin to suggesting that the audit team should not have been allowed to prepare a draft audit report and then to correct or amend that report before it was issued, as it did in the case of this audit.

Finally, "Scope Limitation No. 2" fails to reveal that in the instance in question, the deleted material referred to a portion of the draft response concerning the reclassification of a cable investment. Southern Bell brought the issue of the reclassification of the cable investment to the auditor's attention. The auditor did not learn of the reclassification transaction as a result of discovering the draft version of the interrogatory answer as the scope limitation seems to imply.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

W. S. Reid

BellSouth Telecommunications, Inc.

SCOPE LIMITATION: 3

SUBJECT: **TIME DELAYS IN PROVIDING INFORMATION CONCERNING VARIOUS MARKET AND FIBER BASED TRIALS**

COMPANY'S COMMENTS:

1. The auditor has two primary complaints in part 1 of this Scope Limitation. The first complaint is that the auditor received conflicting information as to whether the Company tracked trial costs. The auditor was told in response to Data Request No. 1-009.1 that the Company did not track trial costs, and then in response to later requests, contracts which included cost figures were provided.

   This resulted because the Company interpreted Data Request No. 1-009.1 as seeking **all** costs, both internal and external, associated with the trials. As stated in response to Data Request No. 1-009.1, the Company **did not** track the costs associated with the trials. The cost information contained in the contracts provided in response to Data Request Nos. 1-123 and 1-124 was limited to amounts paid to parties identified in the contracts and did not represent total trial costs. Consequently, the responses were not contradictory.

The second complaint is that by the time the auditor received the cost information provided in responses to Data Request Nos. 1-123 and 1-124, it was impossible for the auditor to evaluate these trials. The specific information requested in these items was provided in a timely manner, and the Company therefore, cannot be responsible for the time the auditor had to review the material requested.

2. As stated by the auditor, the staff did request the costs associated with all fiber based trials on October 26, 1992, and the Company provided cost information related to the Florida fiber based trials on February 10, 1993. The Company, however, inadvertently overlooked the CocoPlum trial when providing cost information for the Florida fiber trials. The Company did not realize that the CocoPlum information had not been provided until the auditor brought it to the attention of the Company.

The Company then began gathering the CocoPlum cost information. The estimates and routine job orders for this undertaking date back to 1989 and required an extensive search of the files. The auditor was provided with the cost information in September, 1993 in Miami. Because the Company had difficulty locating one routine job order, total cost by account for the CocoPlum trial could not be provided until October 25, 1993.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

SCOPE LIMITATION: **4**

SUBJECT: **BST SAMPLE**

COMPANY'S RESPONSE:

This Scope Limitation covers two separate and distinct issues. The first issue is that the auditor chose not to pursue, because of time limitations and complexity of subject area, certain sample items and the reasonableness of regulated/nonregulated splits of certain accounts.

The second issue relates to the provision of additional information for sample items 103, 71 and 72. The auditor stated that the additional documentation requested on October 7, 1993 for sample item 103 was never provided and that the additional documentation for sample items 71 and 72 was not received until October 28, 1993.

The Company prepared and shipped on October 28, 1993 via Federal Express the additional requested information for sample items 71, 72 <u>and</u> 103. Federal Express records indicate that the auditor responsible for this area of the audit signed for this package of information on October 29, 1993. The Company is not responsible for this limitation.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

SCOPE LIMITATION: 5

SUBJECT: **RESTRICTIONS ON ACCESS TO RECORDS OF DIRECTORY COMPANIES**

COMPANY'S COMMENTS:

Scope Limitation No. 5 generally complains about the audit team's access to certain records related to directory operations. The Company stated that all of BAPCO's records would be available and that any "chained" transactions could be pursued to original source documents or to documents necessary to support market pricing. The audit team failed to do this, and consequently, this Scope Limitation is neither reasonable nor attributable to Southern Bell.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

SCOPE LIMITATION NO. 6

SUBJECT: **FAILURE TO PROVIDE AFFILIATED COMPANY INVOICES**

COMPANY'S COMMENTS:

The auditor correctly states that BellSouth Corporation agreed to provide original vouchers and invoices received from various subsidiaries which were handled by BSC's cost allocation or project billing systems during August, 1992. BellSouth Corporation did so. Any invoices not handled by those systems would *not* have been billed to BST, and therefore, could not have been recorded on BST's books.

The issue here involves invoices to BSC from its subsidiaries that were not handled by BSC's cost allocation or project billing system. The auditor states that "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 ratemaking purposes". The auditor apparently did not know how the system works since BellSouth still asserts that it provided to the auditor all invoices from the selected subsidiaries that resulted in charges to BST (and would have been recorded on BST's books) in August, 1992. The auditor does not need to determine whether other invoice items are appropriate to be included in ratemaking since they were not charged to BST, and therefore, would not have affected ratemaking anyway.

The auditor further states "All invoices . . . 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 fact, the auditor did not have to select a sample of invoices for items charged to the subsidiaries. The auditor was provided <u>all</u> invoices related to such charges. If the auditor thought that there were charges to BST that were not processed through the BSC cost allocation or project billing system, the auditor could have reconciled the data furnished to detect such discrepancies, which the auditor did not do.

Finally, in the auditor's schedule attached to this disclosure, the auditor compares what he/she apparently believes to be the total billing to BSC from each of the selected subsidiaries to the total of the invoices provided by BSC. The auditor does not state a source for the information presented, but even though irrelevant, it also appears to be wrong. For example, the auditor indicates that 45.97% of invoiced amounts from BellSouth Information Systems were not provided. BSC's records show that invoices for only 2.5% were not supplied, again because these invoices were not processed through the system that would have allocated or billed the charges to BST.

Apparently the auditor cannot believe that transactions take place between BSC and other affiliates that do not result in charges to BST. The Company explained that the invoiced amounts not provided pertained primarily to equity infusions, short term operating advances, and amounts retained at BSC or BSE. The auditor recommends disallowance of all BSC charges which result from affiliate bills - even bills originating at BST, when the auditor acknowledges that 100% of invoices from BST were supplied. This scope limitation is simply baseless and should be ignored.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 1

SUBJECT: **ACCESS TO COMPANY RECORDS**

COMPANY'S COMMENTS:

This audit disclosure recommends that (1) the Florida Public Service Commission disallow all costs stemming from affiliate transactions or cost allocations where the Company did not provide complete access to information the auditor deems relevant to validate the costs; and (2) that auditors should be allowed unfettered access to any documents they want, without any review by the Company, without any argument regarding the relevancy of the information requested and all within 3 days, unless the auditor grants more time.

The recommendations are petty and unconscionable. They represent an attempt to punish Southern Bell for (1) things that were beyond its control; and (2) for exercising its legal rights.

With regard to the first point, Southern Bell said, with the agreement of its affiliates, that any auditor could examine any affiliated or allocated transaction and could trace the transaction back to either original source documents, if the transaction were based on Fully Distributed Costs, or back to the market information, if the Company relied on a market price for the transaction. Not only were the affiliate's records to be made available, but Southern Bell stated with the agreement of its affiliates, that any "chained transactions" that resulted in an affiliate's costs being passed through to Southern Bell could also be audited. The audit team apparently determined that this was not sufficient, but rather that complete and unfettered access was required to the records of any affiliate chosen by the audit team, without regard as to whether its costs were passed to Southern Bell. As Southern Bell has indicated, that is beyond Southern Bell's legal ability to provide, and unless the Supreme Court of Florida rules otherwise, is beyond the scope of the Florida Public Service Commission to require. In these circumstances, particularly since the audit team did not utilize the less intrusive alternatives available, there is no basis to disallow any affiliated or allocated expenses.

With regard to the remaining points, Southern Bell has already commented in response to Scope Limitation No. 2 regarding free and direct access to all of the Company's records and personnel. This audit is occurring in the context of a rate proceeding and Southern Bell is entitled to legal representation in all phases of the proceeding and is entitled to be present when its employees are questioned and to review any documents before they are provided to the audit team. Southern Bell strongly objects to any implication in this disclosure that it has altered or changed any documents prior to providing them to the audit team. As explained in response to Scope Limitation No. 2, a number of requests received from the staff were questions which required analysis and response. Those responses are usually done in draft form first and then in final form. Indeed, the responses may pass through numerous drafts as the Company attempts to understand the request and provide a response that is accurate and complete. Having drafts of responses to questions and changing them as the responses are finalized does not constitute altering or deleting information as the audit disclosure suggests. If the audit team has found a preexisting document that it maintains that Southern Bell has altered or changed, Southern Bell is unaware of this and would request that the audit team produce such a document for Southern Bell's inspection.

With regard to the final point, the response time, staff points out that it asked 1135 data requests. Southern Bell will not quibble about the number and whether or not it includes subparts, but would point out that vast numbers of these requests were directed at the same general subject matters, and therefore, had to be responded to by the same people. In a number of cases, these were the same people who were also filing testimony or assisting in the preparation of testimony, and who were answering interrogatories and requests for production of documents from other parties in Southern Bell's rate case. Southern Bell does not question that in an ordinary run-of-the-mill audit, done on-site where the appropriate personnel and materials are located, three days to respond to an audit request might be appropriate. That was not the case in this audit. For instance, consider the following request that was given to Southern Bell:

> Request Item No. 5-027: "Provide a list of all counsels, committees, teams, etc made up of employees from the different groups that deal with activities affecting more than one group."

It is not possible for a reasonable person to even understand what information this request is seeking, much less provide an answer in three days. A number of the audit team's requests put Southern Bell in a similar situation. By the time the request was faxed from Tallahassee, received in Birmingham, reviewed to determine the proper person who should respond (a person who could be in Atlanta, Birmingham or anywhere in 9 states), sent to that person (who could have been in the office or elsewhere), answered and returned to Birmingham, three days and three weeks simply were not enough.

Indeed, a casual review of the requests the audit team made would clearly indicate that what was transpiring here was not the making of simple audit requests, but the posing of questions as complicated and detailed as the interrogatories sent in the most complex litigation. In these circumstances, thirty days is hardly enough time to gather the necessary information and provide adequate responses: three days is simply ridiculous. The Florida Public Service Commission should reject any effort by the audit team to suggest an arbitrary and unworkable time limit for responses to audit requests.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 2

SUBJECT: **ACCOUNTING REQUIREMENTS FOR AFFILIATE COMPANIES**

COMPANY'S COMMENTS:

The auditor asserts in this disclosure that cross subsidies may exist between the Company and affiliates when the majority of an affiliate's business is with the utility. This disclosure recommends that affiliates deriving more than 50% of their revenue from transactions with the utility, be required to comply with commission prescribed accounting, tax, and depreciation practices.

The recommendation contains no distinction for market or tariff based affiliate relationships, as opposed to those based on fully distributed costs. To the extent the recommendation pertains to tariff or prevailing market rate based transactions, the recommendation is inconsistent with existing affiliate transaction pricing rules contained in 47 CFR Part 32.27 (d) and the Joint Cost Order ("JCO"). These affiliate transaction pricing rules specify the use of tariffed rates and prevailing market rate pricing, where appropriate. When using tariff or prevailing market rate pricing to govern transactions with the regulated affiliate, a nonregulated affiliate's costs are not considered and are irrelevant.

Furthermore, transactions that are based on the cost, i.e., fully distributed costs, of the affiliate in providing the service to the regulated carrier are already subject to regulatory scrutiny. Fully distributed cost transactions are subject to numerous audits, such as this one.

The recommendation specifies that the Commission should require nonregulated affiliates to comply with Commission prescribed accounting, tax and depreciation practices. BSC, however, may not have exclusive control over these affiliates when the nonregulated affiliate is only partially-owned by BSC.

The recommendation that affiliates which generate over 50% of their revenues from transactions with the utility be required to comply with prescribed accounting, tax and depreciation rules may also not be practicable to monitor and implement. Whether the nonregulated affiliate had secured over 50% of its revenues from transactions with the utility may not be known until after the event, which may be too late to install an accounting system and procedures to account for transactions in accordance with the recommendation. In this situation, the nonregulated affiliate could not know whether it was required to comply with the rules until after the transaction had occurred. Finally, the Audit Report includes no substantiation as to why "50% of an affiliate's revenues" is the appropriate point at which a nonregulated affiliate must convert to a Commission prescribed accounting system and policies.

The recommendation is of limited value, given that the affiliate's records are already governed by Generally Accepted Accounting Principles ("GAAP"). In this manner, nonregulated affiliates that transact business with an affiliated entity are not allowed to follow whatever accounting, tax and depreciation policies they choose, but are governed by the rules promulgated by GAAP. One of the tenets of the FCC in prescribing "Part 32" accounting for regulated telecommunications carriers was to more closely mirror GAAP.

Finally, the recommendation does not take into consideration the competitive market in which nonregulated affiliates participate. Commission prescribed accounting, tax and depreciation practices are relevant and appropriate for the regulated utility, but may be economically inconsistent with the nonregulated affiliate's business.

The recommendation in this Disclosure should be disregarded.

PREPARED BY: J. B. Branch

Deloitte & Touche

J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 3

SUBJECT: **USE OF MARKET BASED PRICING FOR AFFILIATE TRANSACTIONS**

COMPANY'S COMMENTS:

The auditor's recommendation that the Commission adopt a rule regarding market based pricing for affiliate transactions. In each instance where Southern Bell had transactions with an affiliate, Southern Bell and its affiliate agreed to produce either the source documents underlying the transaction, or if the transaction were based on a market price, the information relied upon in setting the price. Any suggestion to the contrary in the disclosure is inaccurate.

To the extent that the disclosure suggests that a rule should be adopted establishing what constitutes a market price, Southern Bell suggests that this will vary from case to case and should be handled on that basis, rather than trying to establish a single rule for every occasion.

The recommendation in this Disclosure is simply unfounded and should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 4

SUBJECT: **FIBER BASED TRIALS - BELLSOUTH REGION**

COMPANY'S COMMENTS:

The auditor is recommending that the Company demonstrate that using fiber distribution plant in field trials is economical for POTS. The purpose of field trials is not necessarily to make a profit, but rather to gain knowledge and expertise. Indeed, the Commission has recognized in other proceedings that trials are not necessarily economical. In one instance, United Telephone Company of Florida proposed to include $850,000 in the rate base for outside plant construction for a fiber-to-the-curb trial. The Commission, in ORDER NO. PSC-92-0708-FOF-TL, 92 FPSC 7:566, recognized that the trial would be uneconomical and even with the OPC and Staff recommendation to remove half of the investment from the rate base, ruled as follows: "We believe that experiments and trials, although they may be uneconomic in the initial stages, are part of the cost of doing business. Therefore, we find the $850,000 associated with the fiber-to-the-curb trial shall be included in the rate base."

The Company believes that the Commission was correct. These

trials have the potential of benefiting customers and are appropriately included in the rate base.

The excerpt contained in the disclosure from the Bellcore information letter dated December 6, 1986 is correct. The auditor failed to specify, however, that the analysis of the cost of fiber vs. copper was based on 1985 data and is now obsolete and no longer relevant. Technology and the price of technology have evolved so drastically in the past eight years as to render the results of that study invalid for use today. The auditor should not have based any opinion or recommendation on outdated information.

The auditor also states that "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." The Company can find no record of these studies having been requested by this audit team; however, the studies were provided to the Florida staff during the recent depreciation case.

Finally, the auditor has included his opinion as fact. The auditor states that "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."** The highlighted portion of this quote appeared to be an unqualified assumption made by the auditor.

This recommendation is inappropriate and should be disregarded.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 5

SUBJECT: **COSTS OF HUNTER'S CREEK AND HEATHROW FIBER TRIALS**

COMPANY'S COMMENTS:

This disclosure covers in more detail the information provided in Disclosure No. 4. The auditor is again recommending that the Company demonstrate that using fiber for distribution plant in the field trials, in this case specifically Hunter's Creek and Heathrow, is economical for POTS. The purpose of field trials is not necessarily to make a profit, but rather to gain knowledge and expertise. The Commission has recognized in other proceedings that trials are not necessarily economical. In one instance, United Telephone Company of Florida proposed to include $850,000 in the rate base for outside plant construction for a fiber-to-the-curb trial. The Commission, in ORDER NO. PSC-92-0708-FOF-TL, 92 FPSC 7:566, recognized that the trial would be uneconomical and even with the OPC and Staff recommendation to remove half of the investment from the rate base, ruled as follows: "We believe that experiments and trials, although they may be uneconomic in the initial stages, are part of the cost of doing business. Therefore, we find the $850,000 associated with the fiber-to-the-curb trial shall be included in the rate base."

The Company believes that the Commission was correct. These trials have the potential of benefiting customers and are appropriately included in the rate base.

It is true that the Company encountered time delays in providing the requested investment information. The auditor fails to mention, however, the age of some of the information requested and that the Company does not keep all records associated with each individual development separately identified. Provision of the information required massive search through archived information. Since the information is quite old, employees knowledgeable of the information are no longer employed by the Company which also makes the provision of complete data difficult.

The auditor's statement that estimates rather than actual costs were provided is incorrect. Actual investment was provided to the auditor.

The auditor further states that the Company could not provide separations documentation which identified assignment of investment to the interstate jurisdiction individually for

Hunter's Creek and Heathrow. While it is true that the Company does not maintain outside plant records at the level of detail necessary to provide the separations information requested, all other investments were separately identified and that information **was** provided to the auditor.

The recommendation in this Disclosure is inappropriate and should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 6

SUBJECT: **BSE PARTICIPATION IN HEATHROW TRIAL**

COMPANY'S COMMENTS:

The Company takes exception to the auditor's opinion that BellSouth Ventures sold its interest in the Heathrow Partnership to BellSouth Services Incorporated ("BSS") just because they were not able to sell ISDN Services at Heathrow. The purpose of BellSouth Ventures was to develop new business products. Once Southern Bell determined that the scope of the Heathrow trial would not be expanded beyond then currently offered services, BellSouth Ventures transferred its assets associated with the trial to BSS. There was no impact from this transfer on the regulated business since BSS did not bill the associated amounts to the operating companies.

The Company notes that the auditor offers no facts to substantiate the stated opinion, and therefore, it constitutes nothing more than speculation on the auditor's part. This Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 7

SUBJECT: **PURCHASE OF HEATHROW CATV SYSTEM - SEPARATIONS**

COMPANY'S COMMENTS:

The Company acknowledges that fifty percent of the Heathrow CATV system was allocated to the intrastate jurisdiction incorrectly. This error and the corrective actions taken, however, were disclosed to the auditor by the Company at a September 20, 1993 meeting in Miami, Florida. A copy of the reclassification documentation that corrected the error was given to the auditor at that time and is contained in the audit work papers.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 8

SUBJECT: **HEATHROW FIBER BASED TRIAL CUSTOMER SERVICES AND REVENUE**

COMPANY'S COMMENTS:

Based on the Audit Opinion, the Company does not believe the auditor understands the reason for trials such as the Heathrow Fiber Based Trial. Field trials are not performed with the intent of making profits on the trial. Trials are performed to gain knowledge of new technology, marketing intelligence, new designs and equipment. If there is an opportunity to produce revenue from a trial, however, the Company would take advantage of that opportunity.

The Company also would point out that the relationship which the auditor is trying to draw between $22,428 of revenue and the total plant investment of $13,935,615 is not appropriate. The $13,935,615 amount was provided by the Company in response to Data Request No. 1-075 and represents the total of all investments, a portion of which may be used for the trial. The auditor requested the grand total of all costs related to the trial and was provided the total investment for all shared and all dedicated CATV investment. This includes the entire

Lake Mary Central Office, both Building Investment and Central Office equipment. In addition to providing dial tone and switching for the 178 telephone fiber trial customers, this investment serves 6,104 access lines (3,797 business, 2,237 residence and 70 coin). Given these facts, it is obvious that the comparison of the $22,428 of revenue generated by the 178 customers and the $13,935,615 of investment necessary to serve these customers as well as 6,104 other customers, is meaningless.

This Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 9

SUBJECT: **HEATHROW FIBER BASED TRIALS INVESTMENT RETIREMENT STATUS**

COMPANY'S COMMENTS:

The Company responds that it plans, during 1994, to transfer all POTS fiber service to copper plant and to retire the fiber plant from service as recommended. The Company has received correspondence from Northern Telecom, Inc., the manufacturer of the DMS switch at the Lake Mary Central Office, which advises that new software changes planned for the Lake Mary Central Office will not support POTS over fiber-to-the-home service. As the elements of the fiber plant are removed from providing telephone service, the appropriate investment amounts will be retired in accordance with FCC and Florida PSC rules governing retirement accounting. As long as customers are being served by the fiber plant, it is appropriate that this investment remain in the Telecommunications Plant Accounts in order to meet the requirements of the Uniform System of Accounts ("USOA").

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 10

SUBJECT: **HUNTER'S CREEK EARTH SATELLITE STATION**

COMPANY'S COMMENTS:

The auditor is correct that (1) the U. S. Department of Justice, Antitrust Division alleged that Southern Bell's participation in the Hunter's Creek project included the provision of interexchange services which violated the Modification of Final Judgement ("MFJ"); and (2) Southern Bell remedied the alleged violation by selling the receive-only antenna which was involved. The auditor is incorrect, however, in making the statement that "the selling price was not provided." This information was contained in the bill of sale which was provided to the auditor.

Additionally, it should be noted that although the Company disagreed with the Department of Justice's interpretation of the MFJ, Southern Bell wanted to avoid any unnecessary disputes over matters of Decree interpretation and disposed of the earth station.

The auditor opines that by taking this action, the U.S. Department of Justice was attempting to limit Southern Bell's entry into the CATV business. The letter from the Department of Justice did not address the CATV business, but rather stated that any reception of signals from outside the Orlando LATA constituted interexchange telecommunication which was a violation of the MFJ, a different proposition entirely.

This Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 11

SUBJECT: **HUNTER'S CREEK VIDEO TRIAL RETIREMENT**

COMPANY'S COMMENTS:

The Company agrees that additional investment amounts related to the Hunter's Creek Video Trial need to be retired and is proceeding with an investigation to resolve the discrepancy between the amount originally retired and the amount which should have been retired. The total investment amount for the equipment at this location can not be retired, however, since some of this investment amount relates to CATV COAX cable that is still in service. The Company believes one of the reasons for the discrepancy in retirement amounts is due to the fact that when the fiber cables were retired, average unit cost factors were used that were lower than the actual unit cost of placing these cables. Once an appropriate adjustment is determined, the correcting entries will be made to the books and continuing property records.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 12

SUBJECT: **CYPRESS COVE FIBER TRIAL**

COMPANY'S COMMENTS:

The auditor is recommending that the Company demonstrate that using fiber for distribution plant in the Cypress Cove fiber trial is economical for POTS. The purpose of field trials is not necessarily to make a profit, but rather to gain knowledge and expertise. The Commission has recognized in other proceedings that trials are not necessarily economical. In one instance, United Telephone Company of Florida proposed to include $850,000 in the rate base for outside plant construction for a fiber-to-the-curb trial. The Commission, in ORDER NO. PSC-92-0708-FOF-TL, 92 FPSC 7:566, recognized that the trial would be uneconomical and even with the OPC and Staff recommendation to remove half of the investment from the rate base, ruled as follows: "We believe that experiments and trials, although they may be uneconomic in the initial stages, are part of the cost of doing business. Therefore, we find the $850,000 associated with the fiber-to-the-curb trial shall be included in the rate base."

The Company believes that the Commission was correct. These

trials have the potential of benefiting customers and are appropriately included in the rate base.

This recommendation is inappropriate and should be disregarded.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 13

SUBJECT: **COCOPLUM FIBER TRIAL**

COMPANY'S COMMENTS:

The auditor is recommending that the Company demonstrate that using fiber for distribution plant in the Coco Plum fiber trial is economical for POTS. The purpose of field trials is not necessarily to make a profit, but rather to gain knowledge and expertise. The Commission has recognized in other proceedings that trials are not necessarily economical. In one instance, United Telephone Company of Florida proposed to include $850,000 in the rate base for outside plant construction for a fiber-to-the-curb trial. The Commission, in ORDER NO. PSC-92-0708-FOF-TL, 92 FPSC 7:566, recognized that the trial would be uneconomic and even with the OPC and Staff recommendation to remove half of the investment from the rate base, ruled as follows: "We believe that experiments and trials, although they may be uneconomic in the initial stages, are part of the cost of doing business. Therefore, we find the $850,000 associated with the fiber-to-the-curb trial shall be included in the rate base.

The Company believes that the Commission was correct. These

trials have the potential of benefiting customers and are appropriately included in the rate base.

This recommendation is inappropriate and should be disregarded.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. **14**

SUBJECT: **ALLOCATION TO INTERSTATE OF CATV COSTS**

COMPANY'S COMMENTS:

The Company has reconciled the investments and expenses for these projects from 1986 through August 1993. Beginning in September 1993, the reclassification, methodology and procedural changes were completed to correct the errors.

The Company is currently making an adjustment to the 1992 surveillance report. The reclassification necessary to correct the coaxial cable noted in the Audit Disclosure was completed in July 1993, and the previous months were reconciled to reflect the correction.

The Company has reviewed the conditions that caused the errors and has made changes to ensure that the proper procedures are followed. The Company has made corrections, or is in the process of making corrections, to adjust the books for these errors.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 15

SUBJECT: **BELLCORE COST REDUCTION**

COMPANY'S COMMENTS:

The auditor makes a recommendation to reduce the Company's 1993 Bellcore expenses by 8% when compared to the Company's charges to Florida in 1992.

The basis for the recommended 8% reduction was as follows:

1992 Bellcore Non-recurring Expense	$53.9M
Pay Reduction Related Expense	37.5
Total	$91.4M
1992 Total Bellcore Expenses	$1,105.1M

$91.4M divided by $1,105.1M = 8%

There are several flaws in the auditor's analysis that invalidate this opinion and recommendation.

First, to totally exclude 1992 non-recurring expense for the purpose of forecasting future expense is not appropriate. Non-recurring charges include such things as severance payments, outplacement services, and benefit/payroll taxes. Even though these types of expenses are referred to as non-recurring, expenses of this nature can be expected to occur every year.

Second, the auditor apparently did not realize that 1993 Bellcore expenses allocated to Florida ($40.2M) for ratemaking is 5.4% less than the actual 1992 expense ($42.5M). This resulted because the auditor apparently used a 1993 Bellcore Budget for Florida of $42.6M. The $42.6M in expense was provided as an **estimate** in response to the specific question, "What is Florida Bellcore Budget expense for 1993?." The Company provided a July 1993 budget number as requested. This was not, however, the Bellcore expense which was used in the test year financial information. Based on this 1993 estimated expense, the auditor concluded that the 1993 expense increased 0.35% over 1992 expense, when in fact the Company has anticipated a decrease in the rate case filing.

Finally, and most importantly, it is unrealistic and inappropriate to hold the Company to a downward trendline based only on Bellcore's cost cutting efforts. The Company's Bellcore expenses are determined not only by Bellcore's cost/price efficiency, but also by the amount of work which is purchased from Bellcore not only by the Company, but by Bellcore's other clients as well.

Based on these flaws in the analysis, the auditor's recommendation in this Disclosure to reduce Bellcore's expense by $2.5M should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 16

SUBJECT: **LOBBYING AND CONTRIBUTIONS CHARGED TO BST FROM BELLCORE**

COMPANY'S COMMENTS:

The auditor recommends that specific Bellcore expenses allocated to Florida be removed from ratemaking. The specific expenses, which the auditor has titled Lobbying and Contributions, are identified as follows:

1. Project 480004 Legislative Task Force (Correct Project Name is Washington Information Services)
2. Contributions
3. Account 649-086 Corporate Legislative Regulatory Support
4. Account 671-151 Washington Regulatory Internal Services

Following are the Company's comments on each of the four areas of the recommended disallowance:

1. The Company feels that an allocated portion of the expenses associated with **Project 480004** should be included in regulation. Deliverables to the Bellcore

clients from this project include information concerning national organizations' activities, such as Congress, the Federal Courts, and various regulatory agencies. Information received through this project benefits BST and its customers. Further, it should be noted that the auditor is recommending the disallowance of the entire cost of this project when in fact only 66% of this cost was charged to BST.

2. The **Bellcore contributions** were identified in the minimum filing requirements provided to the Florida PSC Staff and have been excluded from ratemaking.

3. & 4. The costs associated with **Bellcore Accounts 649-086 and 671-151** are for the following activities:

Consultation and advice including up-to-date reports on the FCC, U. S. Courts, Federal agencies and Congressional initiatives and actions to Bellcore officers and other employees;

Consultation with each of the owner company Washington regulatory offices for purposes of advising them of Bellcore activities and coordinating any joint informational presentations at the FCC;

Primary liaison with the FCC, NARUC, and/or Congress when Bellcore action or information is required;

Bellcore Advisory Council, which is comprised of fifteen non-affiliated members, four of which are appointed by NARUC;

Governance of the regulatory functions at Bellcore and Regulatory input into Network Technical Analysis.

These functions represent normal and necessary corporate functions which are legitimate overhead to Bellcore's provision of services in support of exchange and exchange access service. This work is not focused on nonregulated activities.

The Company disagrees with the auditor's recommendation to exclude these Bellcore expenses from ratemaking except for the treatment of Bellcore contributions, as previously discussed.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 17 and 18

SUBJECT: **BELLCORE RESEARCH AND DEVELOPMENT**

BST GENERIC RESEARCH AND DEVELOPMENT

COMPANY'S COMMENTS:

The auditor seeks to shift more of the costs of research and development ("R&D") activities more to the Company's nonregulated activities. The recommended mechanism to achieve this is a proposal to adopt one of three new accounting methods for R&D: deferral of R&D until potential products are determined, "keep cost" recordkeeping for projects, or allocation of project costs based on future benefits. Currently, R&D costs are expensed based on a forward-looking allocation of nonregulated investment in accordance with applicable FCC cost allocation rules.

Accounting for research and development is not a real issue, nor are the issues in this case. Capitalizing R&D is not in accordance with the FCC rules or Generally Accepted Accounting Principles ("GAAP"). In its USOA Order, the FCC emphasized the importance of regulated carriers adhering to GAAP. It found that "movement of the accounting practices of the telecommunications industry closer to the more widely public interest." All publicly owned carriers must account for their activities in conformance with GAAP and, in particular, changes promulgated by the Financial Accounting Standards Board ("FASB"). Additionally, as a Securities and Exchange Commission ("SEC") registrant, BST is required to prepare general purpose financial statements in accordance with GAAP.

The rationale for expensing rather than capitalizing or using "keep cost" accounting for development costs is as follows:

- Deferral requires that "benefits" will be realized sufficient to recover deferred costs. Not all benefits of R&D are quantifiable,

- Current expensing recognizes that not all products are winners; "losers" will not be around long enough to generate revenues to cover deferred expenditures,

- More often than not no direct relationship of costs to specific future revenue either by product or accounting periods, can be demonstrated,

- Future ratepayers may not be current ratepayers; deferring costs may cause an inequity,

- The tracking, valuation and quantification of R&D costs is not often practicable, and

- There is a risk that deferred expenditures can cause major fluctuations in financial operations if a "sudden write-off" of capitalized R&D occurs.

The auditor's recommendation to capitalize R&D is not feasible for many reasons - a number of critical questions are not answerable and include the following:

- What proportion of basic research should be applied to the first spin-off product that is based wholly or in part on that research? What percentage for the second, or third? How do you know what other products might be spawned and how much of the research investment should be recovered from each one?

- What is the appropriate recovery period for R&D expenses related to new products and what happens if the life of the product is significantly shorter or longer that the recovery period?

- Should the time value of money impact the recovery rate?

- Should amortization rates of R&D investment be adjusted up and down as infrastructure related research products are introduced into the network?

- How do you determine what products or services have resulted from basic or applied research and in what proportion did the product depend on each?

- If the ultimate product or service that is developed stems from the amalgamation of multiple research efforts, have any of these efforts spawned previous products that may have defrayed some, most, or all of the R&D costs? If so, how is this accounted for and for how long into the future are adjustments made to the calculation as new services appear?

The third allocation method recommended by the auditor recommends assigning R&D cost to nonregulated operations based on estimated future benefits. For this recommendation, the auditor suggests an "equal split" percentage of 50% regulated and 50% nonregulated for all Bellcore expenses and suggests other apparently arbitrary allocation percentages for company-conducted R&D efforts, even though there is no definitive analytical basis for these allocation percentages.

In addition to the impracticability of attempting to determine the specific R&D costs of developing all of the future products and services which arise from current research, this alternative is further limited by the necessity to make a regulated or nonregulated classification of those yet to be developed products and services.

In summary, the current method of allocating R&D expenses to regulated/nonregulated operations is sound. Accounting for R&D costs has been considered by a number of parties (FCC and FASB) in the past and has been subjected to extensive public comment.

The auditor's recommendations are not sound or practicable. Implementation of the recommendations would lead to uncertainty and imprecise allocation of R&D costs and should not be adopted.

The auditor quotes an internal Company memo recommending annual R&D accounting reviews as "because of increasing competition and the relief of many MFJ restrictions will likely result in substantially increased internal R&D efforts beyond historical levels." This statement is taken out of contest. The memo in question goes on to state that complexity of the accounting issues is the primary reason for conducting such reviews and mentions several other factors to support the need for annual accounting reviews. The memo states that the review's goal is to assure appropriate Part 32 and 64 R&D expense allocation.

PREPARED BY: J. B. Branch

Deloitte & Touche

J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. **19**

SUBJECT: **LACK OF PROJECT TRACKING**

COMPANY'S COMMENTS:

The auditor's opinion relative to BST's Science & Technology organization that "without proper project tracking no audit ability for cross subsidy exists" is unsubstantiated.

Costs are currently assigned between regulated and nonregulated operations based on the job function code assignments of the Science & Technology employees working on **individual** work projects. The auditor was told this fact on numerous occasions throughout the audit process. The auditor cited no evidence that this process had not properly assigned costs to the unregulated part of BST's business.

The auditor's recommendation in this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 20

SUBJECT: **LACK OF MARKET TRIALS AND FIELD TRIAL EVALUATIONS**

COMPANY'S COMMENTS:

The auditor requested studies and evaluations of certain market and field trials that were not available. The auditor states 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."

The Company does not perform field trials with the intent of making money. If there is an opportunity to produce revenue from a trial, however, the Company would take advantage of the opportunity. The trials are performed in order to gain knowledge of new technology, marketing intelligence, new designs, and equipment. Trials are undertaken as appropriate to study a product's functionality when the Company is unfamiliar with the product.

The auditor recommends that "BellSouth should be required to perform evaluations and recommendation reports of all market and field trials."

The Company in fact now has guidelines in place which call for such evaluations. These guidelines, however, did not exist at the time the Hunter's Creek or Heathrow trials began.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 21

SUBJECT: **ORGANIZATION CHARTS**

COMPANY'S COMMENTS:

The Company disagrees with the auditor's recommendation to include all BSC affiliates in the Cost Allocation Manual ("CAM"). The Company's criteria for the inclusion or exclusion of subsidiaries in the CAM are:

1) Entities where BellSouth does not have managerial control are not considered affiliates for CAM purposes.
2) The Company does not list every subsidiary under the various BSE related holding companies unless BST has direct affiliate transactions with a subsidiary over which BellSouth has managerial control. Affiliates with direct transactions with BST are listed in Section V of the CAM.
3) Inactive subsidiaries are not included in the CAM.

No CAM purpose would be fulfilled with the inclusion of these types of subsidiaries.

An organizational listing would not include the expense or asset data. Such information for the nonregulated subsidiaries is proprietary information and would not be released in a public document such as the CAM. The auditor states that such a CAM list would assist the audit team in determining "if the company is a related company and follow through on all that is necessary when this is the case". Direct affiliated transactions with BST are listed in Section V making such a determination by the auditor unnecessary.

This is an administrative issue with no economic impact other than the increased costs for production of the list in the CAM and the numerous copies thereof. The Organization of Corporations Chart which was made available to the auditor serves a different managerial purpose from the purpose the CAM serves, and consequently, there is no need for the two to be the same. Therefore, this recommendation is unnecessary and should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 22

SUBJECT: **MANAGEMENT CONTROLS**

COMPANY'S COMMENTS:

The Company believes the style its upper management uses to convey and receive information is appropriate. Therefore, this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 23

SUBJECT: **EFFECTIVENESS AND UNIFORMITY OF POLICIES AND PROCEDURES**

COMPANY'S COMMENTS:

The facts presented by the auditor that the Company has made no effort or progress in consolidating policies and procedures since the January 1, 1992 merger of BSS, SCB and SBT are very misleading.

Since the merger, BST has followed a prudent strategy to replace existing "individual company" Executive Instructions ("E.I.s") with BST regional Policy Statements. Since the January 1, 1992 merger, BST has developed and issued nine Policy Statements. In addition, numerous "file with" policy letters have been issued in order to keep policies up-to-date. Moreover, the consolidated management structure has facilitated the promulgation of many uniform departmental practices and procedures.

BST is continuing its careful, prudent strategy to consolidate and improve the effectiveness of corporate policies. Maintaining up-to-date policies is an on-going effort while consolidation of policies is expected to be completed by mid-1995.

Individual Company E.I.s have not yet been fully consolidated, but those remaining are not materially different in content and do not "fragment management's right to expect uniform practices throughout the newly consolidated organization" as opined by the auditor. The BST merger has clearly increased the overall uniformity of policies and procedures by bringing the operations of the previous three operating units under common management. It is incorrect for the auditor to assume otherwise, and the auditor offers no facts or evidence to substantiate the assertion.

The auditor also asserts that lack of consolidation of policies and procedures "would also lead to personnel problems especially where personnel have been shifted between the four differing work environments (BSC, BST, SCB and BSS)." The assertion is so vague and lacking in content that a reply is impossible to develop. The Company knows of no instances, and again the auditor offers no evidentiary matter to the contrary, that "personnel problems" have been caused by unconsolidated E.I.s. Also, it is incomprehensible how the auditor can point to the shifting of personnel between BST, SCB and BSS when SCB and BSS have not existed since 1/1/92. Shifts of personnel between BSC and BST continue to occur, but separate corporate policies do not cause "personnel problems" or any other problems.

Finally, the auditor opines that "while existing policies and procedures are waiting to be consolidated, they, more than likely, will not be kept up-to-date." The auditor is clearly speculating as evidenced by the qualifying phrase "more than likely." First, policies and procedures are not "waiting" to be consolidated. As described above, BST is following a prudent plan to consolidate and improve the effectiveness of corporate policies. Until consolidation is completed, policies are being kept up-to-date through the use of Interim Policy Statements, "file with" letters and uniform departmental practices and procedures.

BST has an AVP level steering committee and a management project team charged with the responsibility of consolidating and improving the effectiveness of corporate policy. This project already has a significant priority commensurate with the applicable business risk. Part of the plan is to develop a "communication plan" to ensure that all employees are properly informed about the existence and importance of corporate policies.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 24

SUBJECT: **1991 REORGANIZATION**

COMPANY'S COMMENTS:

1. The auditor stated that "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." The auditor states that "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. While it is not clear, the auditor may believe that a downward trend in customer complaints is an indicator of a decline in performance. In fact, a downward trend indicates fewer customer complaints. As Southern Bell stated in testimony filed on July 2, 1993 in Florida Docket 920260-TL

(Testimony of A. Wayne Tubaugh):

> "Justified complaints, on the other hand, are verifiable and are more indicative of actual service quality. In this regard, Southern Bell's justified complaints were lower in 1988, 1989 and 1990 than in 1987. Furthermore, while complaints in 1991 did increase, the 1992 results showed almost a 40% decrease compared to 1991. Results for 1993 to-date are similar to the results for 1992." (p.6, lines 6-14)

In the same testimony, data on all complaints (not only justified complaints) and on delayed connection complaints are presented: "...as the auditor noted, complaints against Southern Bell were down in 1992 over 1991 by 25%." (p.7, lines 16-18) "...even the auditor acknowledged that Southern Bell's delayed connection complaints were down over 50% when comparing 1992 over 1991." (p. 8, lines 8-10)

Witness Tubaugh's testimony provides additional information related to the quality of service that Southern Bell has provided over the past four years, including the period following the reorganization.

b. <u>Increasing efficiency could be evidenced by a decrease in operating expenses and/or a decrease in the number of employees.</u>

The auditor's selection of the absolute number of telephone employees in 1992 as compared to the number of employees in 1991, and the comparison of total operating expenses for 1992 to total operating expenses for 1991, are misleading and inappropriate indicators of improved efficiency for several reasons. As the auditor is aware, Southern Bell faced the post-Hurricane Andrew disaster recovery work in 1992, and was therefore unable to reduce its number of telephone employees by the end of 1992 when service was still being restored to south Florida. Furthermore, the efficiency gains from reorganization do not accrue immediately. As Southern Bell has stated publicly, it plans to decrease the number of telephone employees by more than 10,000 by 1996. While reorganization has contributed to this plan, it is not the single event that produces the reduction. Nor should it be. To achieve such reductions, the Company has undertaken numerous multi-year programs that will produce greater efficiency while maintaining service quality standards.

c. The auditor claims "the audit team has run into several obstacles in attempting to verify regulated business transactions" and points to the fact that the Company has claimed confidentiality or proprietary status on 215 documents. Southern Bell has exercised its legal rights to the classification of these documents. The Company's action is in keeping with proper and appropriate business practices. Moreover, the auditor received those documents and was not prevented from reviewing those documents in as much detail as the auditor desired. The Company's actions relative to these documents do not indicate any attempt to disguise business transactions; rather, they are the appropriate actions to take concerning sensitive or proprietary business information.

2. The auditor stated that "BellSouth claims (verified by numerous executive interviews) to be committed to the tenets of Total Quality Management (TQM)", but suggests somehow that BellSouth has not followed those tenets because it has not evaluated its recent reorganizations.

   In an attempt to support the claim that reorganization criteria and objectives were not evaluated, the report misrepresents statements by John Gunter (Interview # 22). In the interview, Mr. Gunter was asked by an auditor whether any follow-up was done after the 1991 reorganization.

   Mr. Gunter's response was that he did not know because he had left the job. The report's conclusion that there has been no follow-up is wrong.

In summary, the auditor's recommendation that the Company evaluate the expected benefits of the reorganization is based on the erroneous conclusion that the Company has not evaluated the benefits of the reorganization when in fact, it has. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO: 25

SUBJECT: **BILLING & COLLECTION**

COMPANY'S COMMENTS:

The auditor correctly states that BST did not bill its affiliate, BellSouth Communications Systems, Inc. ("BCS"), for billing and collection services provided in 1992 and until August, 1993. It is also true that BST encountered difficulty in collecting information necessary to bill for these services. The auditor failed to mention, however, that the service provided to BCS is unlike services provided by BST to any of its other customers (affiliates or non-affiliates).

The auditor's opinion does not reflect that the problem encountered in billing BCS was an isolated incident, nor does it reflect that the situation has been corrected. In addition, the opinion doesn't reflect the good faith effort made by the Company to correct the problem and the fact that appropriate billing for all prior period services has been made.

The auditor's recommendation erroneously implies that BST does not track information to bill its affiliated companies for services. The Company has processes in place to perform appropriate billings to affiliates for services rendered. In an isolated instance, BST was not able to bill the affiliate at the initiation of the service. During this period of time, the affiliate accrued estimated amounts they expected to pay for the service. Once BST was able to accurately prepare the bill, the affiliate was billed for all past services. In addition, the process to bill the affiliate for this specific service has now been put in place.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO: **26**

SUBJECT: **ALLOCATION OF BILLING AND COLLECTION COSTS**

COMPANY'S COMMENTS:

The auditor's statement that the inclusion of common bill lines printed to total bill lines printed could distort the regulated/nonregulated ratio is a correct statement. The statement does not reflect, however, that the Design Change Proposal which was issued in September to avoid such a problem was successfully implemented in October, 1993. The auditor was told that the change would go into effect in October and that two months of data would be studied, and based on the studied information, any necessary adjustments would be made retroactive to January, 1993. That adjustment was made in December, 1993.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications

DISCLOSURE NO. 27

SUBJECT: **USE OF SAMPLING IN ASSIGNING COSTS OF TESTING FACILITIES**

COMPANY'S COMMENTS:

This audit disclosure recommends that BST request FCC and state Commission approval of the use of the sampling process used to assign the costs of testing facilities. Neither Part 32 nor Commission rules require FCC or state commission approval for a change of this nature. Additionally, implementation of the reporting profile process was not a change in time reporting as cited in the audit, but simply a refinement to the existing time reporting procedures.

There is an apparent misunderstanding by the auditor of the profile process being used to assign costs to Part 32 Accounts for the testing facilities. The employees in these facilities perform numerous work operations within very short time intervals (i.e., testing, trouble dispatching, service order dispatch, etc.). Because the reporting intervals are so short and frequent, it is impractical to require these employees to positive time report each activity. The Company feels the following clarifications are in order:

- The audit disclosure title is misleading ("Use of sampling in assigning costs of testing facilities"). The profile process incorporates a semi-annual "time and motion" study of 100% of the employees in each testing facility. The study results are used to populate the time reporting profiles for the testing facility employees.

- Historically, testing facility employees have used studies/analyses to determine the appropriate Part 32 accounting treatment. These studies were used to report the proper accounting data to the time reporting system via profiles, or in some cases, the daily time reporting process. The process in question formalized the profile process for all testing facilities. As a result, BST has easily verifiable, consistent and correct accounting treatment for these employees.

- The process was recommended by the Company's external auditors in 1992 as part of their annual audit. Copies of the recommendation were provided to the FCC in the 1991 Attest Opinion and ARMIS Report filed in mid-1992.

- The 1991 and 1992 adjustments cited were not the result of faulty implementation of the formalized procedures, as implied by the auditor.

- The 1991 adjustments were made to correct apparent errors in the accounting data used prior to the development of the formal profile process. After the formal process was developed, a true-up entry was made to the 1991 adjustment in mid-1992.

- The Account 6532 adjustment was made to properly classify service order dispatch time. Prior to the adjustment, service order dispatch time was being inadvertently charged to Account 6533.

The auditor stated that "...a detailed analysis should be conducted prior to acceptance of this method for regulatory accounting process". A misunderstanding of the 1991 and 1992 adjustments and the implementation process apparently led to this opinion. BST <u>did</u> perform a detailed analysis and trial of the process prior to implementation.

The external auditors performed an audit of the process in 1992. Regarding the inconsistencies and inadequate documentation noted in their 1991 audit, the external auditors stated in their work papers that:

> "Now, the employees' time is allocated based on the performance of a semi-annual study that takes into account the variables associated with testing center operation. Therefore no current year comment is necessary."

The external auditors are currently performing an audit of the process for 1993.

The recommendation in this Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 28

SUBJECT: **COST ALLOCATION MANUAL ("CAM")**

COMPANY'S COMMENTS:

There is no need to correct the CAM to properly reflect the process being used to assign costs. The CAM and the CSS/PPS User Guide ("User Guide") Documentation are in agreement and the auditor's recommendation should be ignored. The auditor's recommendation seems to result from the fact that portions of the version of the User Guide relied upon by the auditor were dated 1993 and reflected processing in 1993 business, while the CAM version was dated 6/30/92.

The auditor is incorrect in stating that one of the cost pools in Account 6723 is directly assigned to regulated/ nonregulated. The 1992 User Guide indicates that CP01 contains the entire amounts for this account. This refers to the amounts which are allocated in CSS. The direct assigned-regulated CP99 was fully documented in the "General" section of the User Guide. The CAM and the User Guide dated 6/30/92 both reflected two cost pools, CP01 - Other, and CP99 - Direct Regulated. In the March 1993 CAM filing, the two cost pools in account 6723 were collapsed into one cost pool labeled

"Other" which contains the entire account and is allocated to regulated/nonregulated based on total salaries and wages. As a result, the CP99 - Direct Regulated was removed from the CAM.

The auditor is similarly incorrect in stating that one of the cost pools in Account 6712 is directly assigned to regulated/nonregulated. The 1992 User Guide indicates that CP01 contains the entire amounts for this account. This refers to the amounts which are allocated in CSS. The direct assigned-regulated CP99 was fully documented in the "General" section of the User Guide. Again, the CAM and the User Guide dated 6/30/92 reflected two cost pools, CP01 - Other, an CP99 - Direct Regulated. In the March 1993 CAM filing, the two cost pools in Account 6712 were also collapsed into one cost pool labeled "Other" which contains the entire account and is allocated to regulated/nonregulated based on the general allocator. As a result, CP99 - Direct Regulated was removed from the CAM.

Regarding the premises sales cost pool (Account 6612), the 6/30/92 CAM indicates that the costs are identified from billing system details. These details, which come from BellSouth Communications, Inc. ("BCI"), include a breakdown of sales costs by state into regulated/ nonregulated. This breakdown is determined using the ratio of hours reported by product on the BCI files, as stated in the User Guide. This process of apportionment to regulated/ nonregulated is considered direct assignment since the actual apportionment is based upon positive time reporting by BCI employees. Therefore, the User Guide documentation simply documents the process used for direct assignment stated in the CAM.

Regarding the general marketing cost pool (Account 6611), the allocation of cost pool 02 in 1992 was based on CP01, Subpool (SP) SP01 because the work functions included in CP02 were most closely aligned with the work functions in CP01 SP01. Effective 1/1/93, the classification of work functions between SP01 and SP02 was revised to reflect Job Function Code simplification efforts and management accounting needs. Under this redefinition, CP02 is now allocated using both CP01, SP01 and CP01, SP02.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 29

SUBJECT: **EMPLOYEE SERVICE AWARDS**

COMPANY'S COMMENTS:

Service Awards are presented to each employee upon attainment of five years (or multiple of five thereafter) of net credited service. The Service Award Program is administered by the Company's Employee Benefit Committee which has established guidelines for operation of the program.

The Company's position is that it is appropriate to reward employees for continuous service. In addition, the cost of the program is reasonable and does not burden ratepayers. For these reasons, the costs should remain in regulation. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 30

SUBJECT: **COMPTROLLERS OPTIMIZING RESOURCE EFFECTIVENESS ("CORE") PROJECT EXPENSES**

COMPANY'S COMMENTS:

This disclosure indicates that it is made to aid the Tallahassee Staff performing the forecasted data review in the rate case. The Company points out that the core project is one of the 13 major business work processes which are currently being re-engineered to provide better customer service at lower costs. A discussion of the Company's announced re-engineering plans is included on pages 45 through 51 of Company witness Walter Reid's Rebuttal Testimony filed on December 10, 1993.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 31

OMITTED FROM FINAL AUDIT REPORT

DISCLOSURE NO. 32

SUBJECT: **THE TRANSFER OF THE CPE OPERATIONS FROM BELLSOUTH TELECOMMUNICATION TO ITS SUBSIDIARY**

COMPANY'S COMMENTS:

Regarding the audit opinion, the Company responds that it is in compliance with Part 64.901 and Part 32.27 of the FCC rules. The fully distributed cost concept ("FDC") is the same in both the cost allocation rules and the affiliate transaction rules. The Company believes that the reason for the cost shift is that under a structurally integrated organizational arrangement, the FDC process assigns certain common costs to the nonregulated operation based on general allocators which may be in excess of the costs that can be justified based on the cost of services provided to the nonregulated operation. When the operations are provided on a structurally separate basis, more discreet identification of the services actually utilized by the nonregulated operations is available, and the resulting FDC cost assignment is more precise.

In response to the audit recommendation, the Company replies that its cost allocation procedures have also been reviewed extensively by its regulators. The issue that the auditor is raising does not appear to be whether the Company has followed the FCC's cost allocation rules correctly, but whether the FCC's rules differ in cost assignment between a non-structural and a structural organizational alignment. The Tennessee Commission Staff, for example, issued a report in Docket No. 91-4279 in which it stated:

> "Bell interprets the 'shared costs' clause of this package as meaning that after the CPE operations are set up as a structurally separate company, only those regulated telephone company departments that incur costs to benefit CPE are billed to the CPE operations.
>
> Our discussions with the FCC staffers indicate that they agree with Bell's interpretation of the rules..." (The reference to "this passage" in the quote refers to a passage from the FCC's Order on Reconsideration of CC Docket 86-111 released October 16, 1987.)

The Company believes that the reason for the cost shift when an operation is restructured is that common costs may be over assigned to structurally integrated nonregulated operations. The Company believes that if these common cost assignments to structurally integrated nonregulated operations were more cost-based, there would be less difference between the cost assignments for a structurally separate and an integrated operational alignment.

The recommendation in this Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 33

SUBJECT: **BCI METHODS OF ALLOCATION**

COMPANY'S COMMENTS:

The auditor questions the use of a separate subsidiary to bill BST 81% of its costs. It is the Company's opinion that the auditor may not appropriately dictate this entity's form of organization. Although the current structure was brought about by customer input, it also created internal efficiencies by providing centralized management of a professional sales force. Although BST-Regulated does receive the largest portion of the sales and related costs, several other nonregulated subsidiaries are billed for their share of the costs, since the sales force sells nonregulated products as well.

The auditor states that the answer to the question was received too late to review the customer input which initiated the change. The question was not asked, however, until very late in the audit. The Company received this request on October 4, 1993 (Data Request No. 2-172) and provided the response on October 21, within the allotted time.

It should be noted that the auditor states that the costs in the premises sales cost pool are generated by the salaries of the premises sales employees. Actually, the costs in this pool consists of both salaries and other departmental expenses.

This Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 34

SUBJECT: **METHODOLOGY FOR SAMPLING PREMISES SALES HOURS**

COMPANY'S COMMENTS:

Selection of Sample

The auditor states regarding the methodology for sampling the time of BCI sales representatives that those employees not selected in the first two months automatically know that they will be selected in the third month. While this was true in the past, effective with the second quarter of 1994, a pure random sample will be selected monthly from the payroll database, the size of which will be determined by established sampling rules. This technique will employ sampling with replacement. Accordingly, each salesperson will always have an equal chance of selection and will not be able to predict the month in which they will be interviewed.

Selection of Week to Interview Employee by Interviewer

The auditor implies that because account managers and account executives can plan their work a week in advance that they might bias the sample by planning their work in a certain way. It is the Company's opinion that all employees must plan their work in order to be effective in their jobs. Since the sales force spends so much time out of the office, some notice must be given so that the person to be interviewed will know to be available.

The Interview

The auditor states that there should be more checks and balances on the final product of one interviewer and that there is the possibility of bias when one person is interpreting the data. It appears that the auditor is unaware of current checks and balances already in place. Not only does the interviewee have to agree with the interviewer's interpretation, he or she also has to sign the logs. These logs are retained by the interviewer. Additionally, a summary report of monthly time reported is generated by the interviewer and distributed to the district managers.

The auditor states that filling out the logs with narratives that are complete and compatible with employees' documentation is important for an audit trail, implying that this is not being done. As indicated above, signed logs, narratives and other documentation are kept by the interviewer for purposes of an audit trail.

The Company disagrees with the auditor's recommendation. As indicated above, the person interviewed does review and sign the final product. The district manager is provided a monthly summary of the time reported in his/her district. Having interviewers alternate districts on a monthly basis is impractical. As the interviewers are assigned according to geographic location, alternating districts would involve extensive travel costs and would not be cost beneficial. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 35

SUBJECT: **TYPES OF EXPENSES AT BCI**

COMPANY'S COMMENTS:

This disclosure consists of four items representing four separate classifications of costs, namely:

Item I - Relocation Expenses

Item II - Contributions, Memberships, Matching Gifts and Tuition Aid

Item III - Nonrecurring Expenses

Item IV - Out of Period Expenses

The responses to each are separately shown.

Item I

The Company disagrees with the auditor's recommendation to remove $1,524,557 ($227,024 Florida Intrastate) from expenses for 1992. The amount of relocation cost incurred by BCI in 1992 represents valid business costs which should be recognized on the books and in reports of earnings for 1992. Therefore, the recommendation in this Disclosure should be rejected.

In addition, there is a notation error on page 105 of the audit schedule. The $927,991 is shown as a "nonrecurring amount". In the narrative, however, this is indicated to be the estimated relocations in 1993.

Item II

The Company agrees with the auditor's recommendation regarding contributions, memberships and matching gifts. The amounts for contributions and memberships for historical 1992 and test year 1993 expenses were removed. Adjustments will be made for matching gift costs as well.

Regarding tuition aid costs, employees develop skills needed to keep pace in the changing business world on their own time. The auditor's opinion states that tuition aid should be allowed if the education aids the employee to become more proficient and efficient in their jobs. This condition is a prerequisite for reimbursement of tuition to employees. It is the Company's opinion that tuition aid expense benefits the Company and customers. Therefore, the recommendation in this Disclosure should be rejected.

Item III

This item incorrectly portrays this billing adjustment as a nonrecurring expense. Billing adjustments are a routine cost of doing business and are recurring in nature. The Company strongly disagrees with the recommendation to remove $34,329.02 from 1992 expenses.

<u>Item IV</u>

The Company agrees that the $162,000 in Account 734 ($24,119 Florida Intrastate) and the $52,000 in Account 899 ($7,742 Florida Intrastate) both appear to be out-of-period expenses. No adjustment should be made, however, because the amounts are minimal and because they would have no impact on ratepayers. The $24,119 for Account 734 would reduce 1992 expense but would increase 1993 expense. The $7,742 for Account 899 would reduce 1992 expense but would increase 1991 expense. Neither adjustment would have any significant impact on Florida's achieved rate of return nor on any sharing calculation. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 36

SUBJECT: **RETURN ON INVESTMENT ("ROI")**

COMPANY'S COMMENTS:

The Company does not dispute that, mathematically, using a lower rate of return in the FDC calculation could reduce the amounts billed by BCI to each affiliate, and in turn reduce the amount included in regulated activities. The 15.76% return on investment that BCI utilizes, however, is based on the FCC's Order on Reconsideration, CC Docket 86-111 which allows affiliates to charge a rate of return. The rate being used is that which has been prescribed by the FCC to be used by regulated carriers not subject to price caps. Since this rate has been approved by the FCC and is common industry practice, it is the Company's opinion that it is an appropriate rate to use in determining a return on investment for cost-based affiliate billing. Further, the auditor ignores the fact that a reduced ROI billing component would also reduce BST's revenue, since BST's billing to its affiliates, which includes the same charge, would also be reduced.

Also, if the Company was charged a return on investment based upon the comparable rate presently authorized by the Florida PSC, the resultant charge would be higher than present. This is because the equivalent Return on Equity used in the development of the 11.25% ROI is 13.19%. If a 13.2% ROE, which was authorized by the FPSC in setting rates under the Company's present plan, were utilized along with the capital structure and debt cost as shown by the auditors in Audit Disclosure No. 41, then the resultant ROI would be 11.26%.

The statement of facts is incomplete in that it doesn't explain that the 15.76% return on investment includes a tax effect of 4.51% and is, accordingly, a pretax rate. The after tax rate is 11.25%.

This Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 37

SUBJECT: **BELLSOUTH BUSINESS SYSTEMS, INC.**

COMPANY'S COMMENTS:

This Disclosure has no opinion or recommendation, and therefore, calls for no response. This Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 38

SUBJECT: **LEASES WITH SUNLINK AND DATASERV AND BELLSOUTH COMMUNICATIONS SYSTEMS, INC. ("BCS")**

COMPANY'S COMMENTS:

Although this disclosure does not include a recommendation, there are three points which require clarification.

First, the auditor asserts that costs are "chained" into regulation when prevailing market rate pricing is used. This misconception is evidenced by the statement, "the Company has not adequately justified the charges for Data Serv (sic) even though the Company uses market rates because these costs are chained through the market rates." (page 108, Audit Report, emphasis added) This is fundamental error in logic. Prevailing market rates are not based on costs, rather they are based on what the market dictates. Costs are not relevant. The Company responded in Data Request No. 2-001.A1 that the Sunlink lease charges are not included in any of the fully distributed costs from DataServ and made available the DataServ general ledger to justify the DataServ charges.

The second area for clarification is the auditor's assertion that "because we have not received any detail on BSC (sic) regarding this matter, Staff can not determine the amount of the $732,000 lease which has been chained into regulation." The Company supplied details regarding this matter in response to Data Request No. 2-001.A1 and provided access to the Coopers & Lybrand workpapers which contain portions of the Sunlink Intercompany Trend Report. This report states the total revenues billed by Sunlink to BCS (lease costs).

As the third point for clarification, the auditor states that the Company "...did not provide the requested FDC analysis until October 6, 1993. All Sunlink Financial Statements and General Ledgers were requested June 7, 1993." The auditor fails to disclose that the request for the subject FDC analysis was not made until September 17, 1993.

This disclosure is not significant considering the premise upon which it is based.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO. 39

SUBJECT: **SUNLINK WAREHOUSE SPACE**

COMPANY'S COMMENTS:

The auditor asserts that the Company would not provide complete access to information to determine the fully distributed costs for the Sunlink warehouses, and therefore, the entire amount of lease charges for the warehouses should be removed.

Auditors may consider a variety of sources of evidence, in addition to directly examining information. For example, a routine source for obtaining audit evidence is relying on the work of other professionals or specialists. In this specific instance, information concerning warehouse real estate transactions was included in the independent CAM Audit workpapers of Coopers & Lybrand ("C&L") and was tested by them.

Specifically, the auditor clearly had access to the C&L workpapers as evidenced in their statement of facts section and Data Request Nos. 2-001.A, 2-016, 2-026, 2-027, 2-051, 2-052, 2-054.C, 2-062, 2-062.A, 2-068.1 and 2-104.A. Contained in these workpapers is an FDC analysis performed for each of the warehouses.

C&L is an independent auditor. As the FDC computation can be found within the C&L workpapers, these workpapers provide substantive audit evidence about the FDC amounts. Evidence to substantiate the amounts paid in rent and charges was provided in response to Data Request No. 2-131 and can also be found in the ARMIS report.

Several series of facts also appear incorrect in this disclosure. In this instance, the auditor has an incorrectly transcribed FDC for each warehouse from the C&L workpapers to which the auditor was provided access.

This would explain the auditor's incorrect observation that "the Jacksonville warehouse is already $240,056.10 higher than Fully Distributed Costs." According to the C&L workpapers, the Jacksonville warehouse is slightly above FDC for 1992. The Jacksonville warehouse remains substantially <u>below</u> FDC, however, for the cumulative period through December 31, 1992. BST's policy for these leases is to limit the cumulative lease payments established under the terms of a lease agreement to not more than cumulative FDC cost for the warehouse space.

The mechanism used by BST to assure that the cumulative lease payments for the Jacksonville warehouse are less than FDC is straightforward. Each year, BST compares the actual lease payments for the current annual period with the affiliated lessor's fully distributed cost of providing the warehouse space. Any excess of lease payments over FDC, or conversely, any excess of allowable recovery by the lessor at FDC over the actual lease payments in the current period is added to the cumulative excess of FDC over BST's actual lease payments for prior periods. This computation determines that, on a cumulative basis for all periods to-date, the prices actually paid by BST are no more than allowable costs which could be recovered by the affiliated lessor under FDC pricing. If the cumulative charges actually paid by BST were to exceed the cumulative FDC calculations, BST would make an adjustment equal to the difference.

It is also important to note that recommending the entire lease amount be removed for ratemaking purposes would, in effect, result in the customers receiving free use of assets and investments. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO. **40**

SUBJECT: **CSL BIRMINGHAM**

COMPANY'S COMMENTS:

The auditor asserts that "because the Company refused to support their calculations [of fully distributed cost of CSL Birmingham] by full access, the rent and other related costs should be disallowed..."

Auditors may consider a variety of sources of evidence, in addition to directly examining information. A routine source for obtaining audit evidence is relying on the work of other professionals or specialists. In this specific instance, an FDC analysis for CSL Birmingham was included in the independent CAM Audit 1992 workpapers of Coopers & Lybrand ("C&L") and was tested by them.

The auditor clearly had access to the C&L workpapers containing the FDC analysis as evidenced in their statement of facts section and Data Requests Nos. 2-001.A, 2-016, 2-026, 2-027, 2-051, 2-052, 2-054.C, 2-062, 2-062.A, 2-068.1 and 2-104.A.

C&L is an independent auditor and these workpapers should have provided substantive audit evidence about the CSL Birmingham FDC rate. Evidence to substantiate the amounts paid in rent was also provided in response to Data Request No. 2-131 and can additionally be found in the ARMIS report.

Recommending that the rent and other related costs be removed for ratemaking purposes would, in effect, result in the customers receiving free use of assets and investments. The recommendation in this Disclosure should not be adopted.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO. 41

SUBJECT: **RETURN ON INVESTMENT USED FOR FDC ALLOCATED FROM AFFILIATES**

COMPANY'S COMMENTS:

As correctly noted in the auditor's opinion statement, the 11.25% ROI used by the Company equates to 13.19% ROE. What is not stated is that this level of ROE is less than the 13.2% ROE authorized by the FPSC in setting rates for the Company's present incentive regulation plan. Therefore, there is no need for SBT to recompute all affiliate transactions.

The gross up factor should be 62% which is the gross up factor contained in policy guidance issued by BST, not 6.2%. The 11.25% rate of return is the FCC authorized rate of return prescribed for non-price cap carriers. Use of the FCC authorized ROI of 11.25% is consistent with guidance provided by the FCC in its order relating to the audit of NYNEX affiliated transactions, and by the FCC's Chief, Audits Branch letter, dated April 20, 1992. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. **42**

SUBJECT: **CSL CHASTAIN CENTER**

COMPANY'S COMMENTS:

The auditor proposes to disallow the Florida portion of the lease costs associated with CSL Chastain and derives the Florida portion based upon the allocation of account 6121. There is no basis for this Audit Disclosure since information provided in response to Data Request No. 2-012 in this proceeding indicates that Florida is not allocated any portion of these lease charges.

This Disclosure should be disregarded.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO. 43

SUBJECT: **CAMPANILE LEASE-1155 PEACHTREE ASSOCIATES**

COMPANY'S COMMENTS:

BellSouth Corporation leases office space in the Campanile building at 1155 Peachtree. The building serves as headquarters office space for BSC and provides space to BSC affiliates and other non-affiliated companies. BSC leases approximately 67.2% of the building and the largest non-affiliated tenant, Coopers & Lybrand, leases 16.3% of the building. Space leased to BSC and affiliated entities totals approximately 72.6% of the building.

BSC treats its lease of the Campanile building space as an affiliate transaction. BSC's lease of office space in the Campanile Building is not governed by any tariff. BSC believes that 1155 Peachtree Associates participates in a substantial outside market in its leases of space in the Campanile Building to non-affiliate tenants, and therefore, has applied the "prevailing market rate" affiliate pricing rule to this transaction. This pricing methodology is specified in the Cost Allocation Manual filed with the FCC, and has been subject to annual independent audits, without exception.

Of critical importance, if neither the "tariff pricing" provisions nor the "prevailing market rate pricing" provision of Section 32.27(d) and Section 64.901 were applicable to this transaction, then BST would be required to compensate the nonregulated affiliate for its allocation of the charge for leased space using Fully Distributed Cost (FDC) pricing.

The auditor contends that, "since the Company would not provide access to Staff to the records necessary to compute Fully Distributed Cost, the entire rent for 1992 of $7,445,373 should be removed." Of this $7,445,373 -- $5,543,669.26 is directly related to BST and $1,449,115.08 is directly related to Florida. This conclusion is incorrect.

An FDC analysis shows that if prevailing market rate pricing were not allowed to be used by BSC, and consequently, BSC was required to use FDC as the pricing rule governing the Campanile lease, the cost to the ratepayer would increase by about 29%. The current prevailing market rate lease cost is less than the FDC of BellSouth Corporation's lease.

If FDC pricing were to be used, the cost of the Campanile lease would increase to BST's regulated operations, and therefore, to customers. This is particularly important considering the view described in Audit Disclosure No. 3 about prevailing market rate transactions and the prospective application of the FCC's proposed revision to affiliate transaction rules expressed in the Notice of Proposed Rulemaking, FCC Docket No. 93-251, dated October 20, 1993.

The auditor questions the comparability of the Coopers & Lybrand lease with BellSouth Corporation's lease in the Campanile Building. In applying the prevailing market rate pricing, BSC charges its subsidiaries, through allocation, not more than the price charged to the most comparable non-affiliate tenant in the building on a net present value basis over the life of the lease. The portion of the lease rates paid by BSC above the market rate are retained at BSC-HQ.

At the time BSC entered into the lease agreement with 1155 Peachtree Associates for the space in the Campanile Building, the JCO had not yet been promulgated. When the JCO went into effect, BSC evaluated the lease rates to the regulated affiliate in accordance with the new regulations. BSC determined that Coopers & Lybrand was the most comparable lease in the building based on the "then current" market conditions at the time the leases were negotiated. BSC appropriately continues to use Coopers & Lybrand as the comparison for this reason.

The auditor questions why BellSouth did not use Kilpatrick and Cody's lease for comparison purposes. Although Kilpatrick and Cody's lease in the 1100 Building may be closer in size to the BSC space in the Campanile Building, this lease was entered into almost four years after the JCO went into effect. In assessing comparability, it is critical to compare transactions which were entered into under similar market conditions and time frames.

It is also important to note that recommending the entire lease amount be removed for ratemaking purposes would, in effect, result in the customers receiving free use of assets and investments. This Disclosure should be disregarded.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO. **44**

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

COMPANY'S COMMENTS:

This disclosure begins with approximately 1 and 1/2 pages of factual statements which are, on balance, generally accurate. From these facts, however, the audit staff then moves to six areas of analysis, each of which is generally wrong. The areas and the Company's responses are as follows:

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

The audit staff asserts that the Company did not use the same basis for comparing FDC to BSE's management fee when it concluded that the management fee was less than the comparable FDC. The audit team is wrong. Each year an FDC analysis is done for BSE, and a calculation is made of every subsidiary's proper share. Based on that FDC calculation, the management fee for each subsidiary that pays a management fee is then compared to that subsidiary's share of the FDC. There is absolutely no inconsistency in the comparison.

II. BSE INCOME STATEMENT RECONCILIATION

In the second area outlined by the audit staff, the conclusion was that, because of a lack of access to certain data, the audit staff could not reconcile certain costs. The auditors were shown financial data, however, concerning the development of the FDC amounts used in the analysis, and in addition, were provided multiple detailed interviews with the BSE representative who designed and performed the analysis. The auditors reviewed the FCC JCO Compliance Audit performed by the independent auditors concerning the FDC analysis, including the reconciliation to the BSE general ledger, which confirmed the validity of the FDC analysis. There was sufficient information to reach a conclusion regarding these matters.

III. MANAGEMENT FEE

In this area, the audit staff complained about a lack of access to the financial statements of every BSE subsidiary. The Company offered to provide, however, any documentation necessary to substantiate the transactions between affiliates which affect the Company and its regulated operations. BSC and BSE did provide sample data upon which the management fees were calculated for affiliates which bill BST on a fully distributed cost basis. Unlimited disclosure of financial statements is not necessary to verify the management fee calculations.

IV. <u>FDC CALCULATION</u>

In this area, the audit staff asserted that it, again, was denied access to the financial records of BSE's subsidiaries, and therefore, could not validate the allocators used to allocate costs to BSE's subsidiaries. All costs incurred and booked by BSE are identified by responsibility code in BSE's accounting system. The amounts identified as "retained" are non-project coded costs that would not be included in fully distributed charges if BSE utilized a fully distributed costing system. Actually, BSE's only true cost-based billing is related to projects. Management fees are based on the expenses of the individual subsidiaries - not BSE-HQ costs. As shown on the Management Fee vs. FDC analysis, BSE's management fees actually billed are significantly less than otherwise billable FDC costs. The auditor agrees that information to verify the source of data and methodologies utilized were provided for review and explained in person by BSE personnel.

Once again, however, the auditor's opinion is that unless the auditor has access to unnecessary underlying data, a conclusion that the analysis was done properly cannot be made. BellSouth originally offered to provide information to the auditors, on a representative sample basis, to document each step in the FDC calculation process from the source documents to the final analysis summary. The auditor was allowed to review unredacted documents containing much more information than was necessary to verify specific figures. The auditor was provided an interview with the representative who had originally prepared the FDC study, and was free to ask any questions needed for clarification or discuss any items needed for understanding of the material. There was sufficient material provided, and this opinion should be rejected.

V. COMPANIES BILLED A PROJECT FEE

Again, the audit staff complained about access to data related to the unregulated subsidiaries of BSE, this time invoking the chaining of project costs. Allocated projects costs are determined equitably, however, for each subsidiary. Each subsidiary receives its fair share of costs. BSE, in fact, retains a portion of costs from these allocated projects to ensure no subsidiaries are overcharged.

In summary, the Company states that 1) All figures and documents needed to understand the analyses under review were provided; 2) These figures were accurate and completely disclosed; 3) The C&L workpapers reference the general ledger and other audited financial information; and, 4) Nothing was withheld from the regulatory body which would have affected the Company's results and conclusions.

The exhibit showing the projects which are allocated includes project ES8201 and clearly shows that costs are for Sunlink and not allocated to other entities. It appears then the alleged inadequately disclosed portion of allocated projects should be 6 of 31 or 19% and not 23%.

BSE project billing staff pulled all requested project papers for those companies billing BST at FDC. Several follow ups with project billing staff concluded all requested information had been provided.

VI. TYPES OF EXPENSES AT BSE HEADQUARTERS

Again, the audit team bases its opinion on the lack of access to BSE documents, concluding that some of BSE's expenses were reasonable for inclusion in its FDC analysis.

BSE-HQ performs periodic analyses to determine the amount of costs it would have billed to its subsidiaries if it had used a fully distributed cost allocation methodology. In this analysis, BSE strived to take the conservative approach - that is, any expense categories it feels would be questionable were not included in the analysis. The management fees actually billed to subsidiaries were about 40% below what would have been billed out under an FDC allocation approach.

With the kind of margin between actual management fees and theoretical FDC calculations discussed above, and with actual billings not even being based on BSE-HQ incurred costs, it is not necessary, contrary to the auditor's implication, to select a sample of expense items for detailed examination to determine whether they are appropriate for ratemaking. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 45

SUBJECT: **CALCULATION OF POTENTIAL CHAINING INTO REGULATION**

COMPANY'S COMMENTS:

The companies listed as billing BST at FDC are incorrect. In 1992, BSIN and Executive Services did not bill BST directly. Also, Executive Services was not billed a management fee. The companies that have transactions with BST directly at FDC or below are: BAPCO, BSAN, LMB, MCCA, SGI, Sunlink and BIS.

The BSE Chaining Study workpapers were made available to the auditor on company premises on October 5, 1993. A BSE representative was on hand to review the study with the auditor and answer all relevant questions.

The amount included in the BSE analysis for billings to BSC excludes amounts retained by BSC as recognized in the facts statement. The amount included in the auditor's schedule, however, does not exclude BSC retained costs. Since the study only calculates chaining to BST, it is appropriate to exclude costs which are retained by BSC and are not being passed to BST.

A reference is made to BSE Accounting Directive 005 ("AD005") regarding the definition of chaining. The quote included in the Report is out of context. The reference fails to include the part of the directive that presents BSE's overall approach to chaining. BSE AD005 goes on to read "transactions that are several layers removed from the ultimate destination.. may be difficult to identify as a JCO transaction. Therefore, BSE requires <u>all</u> intercompany transactions to comply with the JCO."

The Coopers & Lybrand Joint Cost Order Compliance Audit workpapers referenced by the auditors recognize that only a very small proportion of BSE-HQ's bills to its subsidiaries could possibly chain into BST. Furthermore, the BSE FDC compliance analysis verifies that the chained billing, arising from BSE management fees, is less than would be possible under a FDC billing system.

Based on the above discussion and the fact that costs chained to BST are appropriate and in compliance with JCO, these costs should be allowed. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. **46**

SUBJECT: **TYPES OF EXPENSES AT BELLSOUTH ENTERPRISES**

COMPANY'S COMMENTS:

The types of costs referenced for BSE in this disclosure are based on information contained in a BSE Internal Audit. Such costs are retained by BSE and not included in the FDC study. For instance, officers' personal expenses are distinctly project coded to BSE and retained for purposes of the study and are not billed. In any event, the management fee is generally less than 60% of what the comparable FDC charge would be, and therefore, the expenses are not sufficiently material to change that relationship even if they were included.

As verified by the Coopers & Lybrand Joint Cost Order Annual Compliance Audit, reviewed by the auditors, BSE's allocation procedures are reasonable, are in accordance with the JCO, and are calculated correctly. All figures and documents needed to understand the analyses were provided to the auditors along with an interview with a BSE representative who performed the BSE analysis. The figures were accurate and completely disclosed. The C&L workpapers document references to general ledger and other audited financial information. Finally, nothing was withheld from the auditor's which would have affected the Company's results and conclusions.

The auditor's recommendation is inappropriate and should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 47

SUBJECT: **COMBINATION OF BELLSOUTH ENTERPRISES HEADQUARTERS ("BSE") WITH BELLSOUTH CORPORATION HEADQUARTERS ("BSC")**

COMPANY'S COMMENTS:

While the BSE management fee and project billing will not be continued after December 31, 1993, BellSouth Corporation will continue to bill the combined corporate holding company costs on a fully distributed basis. Cost savings from BSC headquarters work force reductions underlying the reorganization will flow downward to BST and to other BSC subsidiaries in accordance with the FDC cost allocation process. The BSC-HQ Cost Assignment forms will be updated prior to 1994 billing to ensure that the cost allocation process continues to result in fair and equitable subsidiary billing. Periodic updates to cost assignment forms will be made thereafter to assure that subsidiary billing reflects current organization structure and functions.

The charts from which the auditor calculates the salary amount for employees "available for reassignment" are based on preliminary force projections and average position rate salaries. BellSouth's purpose in the reorganization and consolidation of BSC-HQ and BSE-HQ was to streamline and realign work functions and work force levels to meet the needs of the corporation and its subsidiaries in a rapidly increasingly competitive environment. During and following this period of rapid transition, it is the intent of BellSouth to increase its cost efficiency and operate at a significantly reduced force level as compared to BSC-HQ and BSE-HQ prior to restructuring. If this results in cost reductions which can be flowed through to BST, they will be.

Procedures are already in place at BSC to ensure proper billing to affiliates, and therefore, the auditor's recommendation is unnecessary.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 48

SUBJECT: **APPLICATION OF 364.037 F.S. RELATING TO TOTAL BAPCO FLORIDA-DIRECTORY OPERATIONS**

COMPANY'S COMMENTS:

The Company disagrees with the auditor's opinion that the Company is not applying 364.037 F.S. appropriately. The Company is following the provisions of Commission Rule 25-4.0405, which was created to precisely spell out how the provisions of Section 364.037 F.S. would be applied in the ratemaking process. The Company has consistently followed this rule since it was first adopted in 1985.

The Company also disagrees with the auditor's recommendation to impute additional earnings to the regulated operations. As stated previously, the Company is properly following Commission Rule 25-4.0405 for the calculation of its regulated gross profit under 364.037 F.S. If the Company included the investment and income before income taxes of BAPCO-Florida in the rate base and operating income of Southern Bell to derive a situation similar to the way directory operations were prior to the establishment of a separate directory affiliate, as suggested by the auditor, the application of Section 364.037

F.S. would result in a lower level of contribution to regulated operations from directory operations than currently exists under the contract with BAPCO. The BAPCO contract and the Company's consistent following of Rule 25-4.0405 has, therefore, benefitted customers. If the decision were made that the directory operations should be consolidated in a manner similar to the way they were in 1982 for application of the statute, the only proper earnings adjustment would be a reduction in regulated earnings, not an imputation of additional earnings.

The Audit Report also contains several material factual errors. It incorrectly characterizes the contractual relationship between BST and BAPCO (See the Company's Comments to Audit Disclosure No. 52).

The recommendation should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO: **49**

SUBJECT: **MANAGEMENT FEE CHARGED TO BAPCO FROM BSE**

COMPANY'S COMMENTS:

The auditor asserts that the management fee BSE charges BAPCO should not be included in BAPCO-Florida expenses when determining gross profit under the provisions of Florida Statute 364.037 and Commission Rule 25-4.0405. This assertion is based on the opinion that "1. The charges appear 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."

Florida Statute 364.037 and Commission Rule 25-4.0405 define the formula for determining gross profit. The Company has procedures to apply these rules. Under the Company's procedures, the recommendation to "not include" BSE management fees and project expenses has no effect on BST-Florida intrastate revenue requirements. These expenses would not be part of the Commission ordered formula.

The BSE-HQ management fee and project billings being charged to BAPCO have no current relevance to the amount of subsidy payment received by BST-Florida from BAPCO because the current contract between BST and BAPCO does not subject BST to any expenses incurred by BAPCO. BST-Florida receives 54.25% of net revenues generated from BAPCO-Florida directory operations. In order to BSE-HQ charges to BAPCO to become relevant, Commission Rule 25-4.0405 would need to be applied inconsistently with the historical application of this rule.

Concerning the assertion contained in the audit report of duplication between functions performed by BSE and BAPCO, the information cited in the audit report by the Audit Staff on this topic is inconclusive. For example, Data Request No. 3-063, cited that duplication exists between BSE and BAPCO in the "types of costs recovered by BSE-HQ through the management fee charges to BAPCO" contains insufficient information regarding the functions performed by either entity to reach any conclusion of duplication. Likewise, Data Request No. 3-118, cited to support that duplication exists in the "Project billings billed by BSE to BAPCO" contains only the project numbers and titles of the projects that give rise to BSE-HQ project costs.

The audit evidence that is available in this proceeding on this subject does not point to duplication, but rather points to a complementary relationship between BSE and BAPCO. Data Requests not cited as evidence of duplication, but nevertheless available, indicate that differing activities and functions are performed by BSE and BAPCO personnel. For example, the auditor states that the BAPCO Human Resources department "provides leadership and overall direction for the Human Resources of BAPCO. Through the performance of BAPCO duties, they work toward a qualified, effective, competitive and highly motivated work force." Although not referred to in the audit report, a brief overview of the BSE-HQ Human Resources department (RC U12000) is provided in Data Request No. 2-097.10G. It describes the representative functions performed by BSE-HQ Human Resources as:

- Develops and administers benefits and compensation for officers, key managers and other employees
- Plans, designs, implements and administers domestic benefit plans for BSE companies
- Develops and implements quality programs
- Administers EEO, performance appraisal, salary and wage plans, relocations and staffing
- Coordinates Employee Assistance Program planning services

This information indicates that the BSE-HQ functions tend to be those that can most effectively and efficiently be performed in a centralized manner.

Further, the determination of whether BSE-HQ functions and BAPCO functions are duplicative or complementary would require a detailed investigation of the functions and activities performed at each entity.

The auditor states that, "BSE-HQ is being reorganized which results in the discontinuance of the management fee and project billings being charged to BAPCO from BSE-HQ" as support for the recommended disallowance of such costs, which implies that the costs underlying the management fee and project billings currently included in BAPCO-Florida expenses will be discontinued entirely. This is not a reasonable expectation. As the auditor states, "The management fee may be replaced by a fully distributed costing process which will allocate BellSouth Corporate costs to the BSE subsidiaries."

Also, the nature of the services giving rise to project billings from BSE-HQ to BAPCO is such that they are requested by BAPCO and are directly charged to BAPCO. These costs will either continue to be provided in a similar manner or the services, and related costs, will be pushed down to BAPCO. In either event, services that are required by BAPCO, and the corresponding costs will not simply disappear. The assertions of impending discontinuance of BSE management fee and project billings are not supported by underlying information.

With respect to the assertions of lack of information, access was provided to BSE invoices to BAPCO for management fee billing, BAPCO financial statements showing sources for management fee calculations, BAPCO transaction journals showing BAPCO's booking of the management fees, and the audit work papers of Coopers & Lybrand, which documents its test that the management fee was less than the fully distributed cost of providing the services.

Specifically, the Coopers & Lybrand CAM Audit workpapers show that the management fee actually charged to BAPCO from BSE-HQ is approximately 60% of the amount that could be recovered by BSE-HQ if the fully distributed cost of such services was used as the pricing rule (as allowed by the CFR 47, Part 32.27(d) and the Joint Cost Order). All of this information provides evidence for validating the BSE management fees and project billing.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO: 50

SUBJECT: **AFFILIATED CHARGES FROM STEVENS GRAPHICS TO BAPCO**

COMPANY'S COMMENTS:

The auditor recommends an adjustment to the expenses of BAPCO-Florida when determining the actual gross profit of the directory operations. This recommended adjustment is based on the assertion that Stevens Graphics achieved an excess return on equity on the printing services it performs for BAPCO. This recommendation is not supported, however, by information in this proceeding.

Southern Bell believes that affiliate charges from Stevens Graphics to BAPCO do not affect revenue requirements in Florida, given the provisions of the directory publishing agreement, Florida Statute 364.037 and Commission Rule 25-4.0405. Given the current application of statutes and Florida Commission rules, the auditor recommends to exclude "excess payments" of BAPCO to Stevens Graphics "when determining the actual gross profit of the directory operations" has no effect on BST-Florida intrastate revenue requirements. The expenses would not be part of the Commission ordered formula. In order for the Stevens Graphics charges to BAPCO to become relevant, Commission Rule 25-4.0405 would need to be applied inconsistently with the historical interpretation of this rule.

During 1992, Stevens Graphics had two primary lines of business: 1) the Directory, Catalog and Publishing division ("DCP"), and 2) the Business Products Division ("BP"). Based on the 1992 financial performance of Stevens Graphics as a whole, only 71% of Steven Graphics revenues relates to directory printing services for BAPCO. To determine the return on affiliate transactions with BAPCO, the return achieved by Stevens Graphics as a whole is irrelevant because it reflects returns achieved on the 29% of Stevens Graphics business that is not related to BAPCO. This portion of SGI's revenues is derived primarily from non-affiliates, and represent Stevens Graphics revenues and earnings from its participation in open market, competitive transactions. By using the financial statements for Stevens Graphics as a whole, this disclosure inappropriately commingles the results of Stevens Graphics services to affiliates with its non-affiliate operations, and therefore, contaminates its analysis.

Commingling this final data is obviously inconsistent with

Statement of Facts No. 4 which states, "Stevens Graphics earned approximately 71% of its operating revenues in 1992 from directory manufacturing services provided to BAPCO" (Data Request Nos. 3-062 and 3-102).

Also, Audit Disclosure No. 50 is somewhat confusing regarding the proposed adjustment. It identifies two differing amounts as "excess payment" made by Florida to Stevens Graphics.

The recommendation in this Disclosure is not appropriate for adoption.

PREPARED BY: J. B. Branch

Deloitte & Touche

DISCLOSURE NO: **51**

OMITTED FROM FINAL REPORT

DISCLOSURE NO: 52

SUBJECT: **BELLSOUTH PETITION FOR NON-STANDARD LANGUAGE IN ITS CAM**

COMPANY'S COMMENTS:

The auditor incorrectly describes the contractual relationship between BST and BAPCO. BST has the regulatory responsibility for the provision of white page directories and has contracted with BAPCO to fulfill this duty. BAPCO has complete responsibility for publishing its yellow page directories. These are not joint responsibilities, nor are they integrated operations between the utilities. BAPCO provides specific services to BST related to BST's white pages at no charge. BST provides specific services to BAPCO related to its publication of yellow page advertising directories, for which BST receives a large percentage of BAPCO's revenues. This percentage is well above fully distributed cost.

This Disclosure apparently stems from an FCC Order, released on May 11, 1993, that addressed the same type of issues raised in this disclosure. In that proceeding, the Public Service Commissions of North Carolina and Tennessee claimed that the descriptions of certain relationships in the Company's CAM did not meet Joint Cost Order rules. After analysis of the industry pricing arrangements between the operating companies and their directory publishing companies, the FCC concluded in its Order, that including these types of affiliate transactions in the CAM at "FDC Plus Subsidy" was sufficient to meet the joint costing and affiliate transaction rules.

The FCC's Order also stated that if LEC's want to use similar nonstandard language that the LEC must seek a waiver of the affiliate transaction rules. BellSouth filed a petition for waiver requesting that it be allowed to describe the following: The services which BellSouth provides to BAPCO at "more than fully distributed cost"; compiling, publishing and delivery of white pages directories and collection services which BAPCO provides to BellSouth at "no charge"; and other services BAPCO provides to BellSouth at "less than fully distributed cost". It is this waiver that the disclosure addresses.

Since the waiver is pending at the FCC and the comment cycle is complete, the matter is ripe for decision at the FCC and this recommendation does not appear to have any impact.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 53

OMITTED FROM FINAL AUDIT REPORT

DISCLOSURE NO. 54

SUBJECT: **NON COMPLIANCE WITH EXISTING COMPANY POLICIES**

COMPANY'S COMMENTS:

In this Disclosure, the auditor opines that the Company is in violation of its internal policy, specifically referred to by the auditor as CJ06. CJ06 is in fact a component of Financial Systems Documentation ("FSD") and is not a policy. Rather, it is a procedure used by the Company to accomplish a task -- in this case, the apportionment of cost for motor vehicles used in Company Headquarters to the states.

The auditor's recommendation that the Company should adhere to its own policies is unnecessary as the Company **does** adhere to its own policies and will continue to do so. Further, the auditor's opinion that the Company violated FSD CJ06 is misleading. The Company did not violate this procedure but simply did what made good business sense to overcome a one-time data collection problem. The Company provided the Audit Team with information concerning the situation fully and responsively.

This recommendation should be rejected.

PREPARED BY: J. L. Wilson

BellSouth Telecommunications, Inc.

DISCLOSURE NO: 55

SUBJECT: **NON CONFORMANCE WITH CAM**

COMPANY'S COMMENTS:

The Company agrees with the recommendation that the Company should adhere to the Cost Allocation Manual ("CAM") procedures whenever allocating costs, and it does. This should apply, however, only to costs under the CAM jurisdiction, i.e., regulated versus nonregulated costs. The CAM should not and does not apply to allocation of costs from Headquarters to the nine states, nor should it apply to separations between interstate and intrastate costs.

This disclosure reflects a certain lack of understanding with regard to the BST organization structure and its allocation procedures. BST Headquarters expenses are assigned or allocated to its nine- state entities based on procedures covered in Accounting Practice CJ06: Headquarters Apportionment. These procedures were not only provided to the staff auditor, but a presentation was made on these procedures on April 27, 1993. This procedure is referred to as the Corporate/State Allocation Process ("CSAP"). Therefore, the lead statement that SBT-HQ allocates its costs to its subsidiaries using the general allocator is entirely inaccurate.

The CSAP should not be confused with the CAM. Once costs are assigned or allocated to the states by CSAP, the CAM process, using the Cost Separations System ("CSS"), separates costs between regulated and nonregulated. Although these processes use similar logic, contrary to this disclosure, they have distinct functions. Whereas the CAM uses causal relationships to first assign or attribute costs to nonregulated, it uses the CAM general allocator to allocate costs to nonregulated where no causal relationship exists. Similarly in CSAP, where costs are incurred in support of a specific state or group of states, these costs are assigned based on causality to those states. Where no direct causal relationship exists, the CSAP general allocator, consisting of the size-related factors identified in the audit disclosure, are used to allocate costs. CSAP has been used for many years, long before the CAM. In fact, the CAM is an extension of the allocation process. Both use direct assignment, attribution and allocation of costs under the appropriate conditions of the defined cost category.

This recommendation implies that CAM allocation procedures should dictate other allocation processes. There is no inherent relationship between factors used for the CAM allocation to regulated and nonregulated and other allocation procedures.

The Company disagrees with this disclosure.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 56

OMITTED FROM FINAL AUDIT REPORT

DISCLOSURE NO. 57

SUBJECT: **COMPARISON OF CAM'S FOR FLORIDA UTILITIES**

COMPANY'S COMMENTS:

The Federal Communication Commission ("FCC") Accounting staff spent approximately two years working on CAM uniformity. During these two years, the FCC held periodic meetings with the United States Telephone Association ("USTA") to question the Local Exchange Carriers and gain understanding on current processes and organization structures. This two year effort ended with the Implementation of Further Cost Allocation Uniformity Memorandum Opinion and Order released July 1, 1993. The Order prescribed uniformity for ten Part 32 accounts. The FCC's selection of these ten accounts was based on the magnitude of nonregulated impact for the industry. The Order indicated the FCC will embark on additional phases of CAM uniformity.

Rather than go through a similar multi-year process for various sets of accounts for Florida, CAM uniformity efforts should continue as prescribed in the Report and Order released December 20, 1991 in CC Docket 90-623. As there will be other CAM uniformity phases, provisions resulting from the efforts expended for a Florida uniform CAM could be reversed and different changes made to the CAMs of BellSouth, GTE, United and CenTel to comply with future FCC Orders. Therefore, the recommendation in this Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. 58

SUBJECT: **BSC-COMPTROLLERS DEPARTMENT**

COMPANY'S COMMENTS:

This disclosure expresses concern about three BSC Comptrollers functions in light of possible duplication within BST:

- The necessity of the costs for RC H13120 (Corporate Consolidations/External Reporting)
- The necessity of the costs for RC H13170 Corporate Accounting
- The reason for and necessity of the costs for RC H13140 Affiliated Interest Matters

These concerns are not well-founded. Each of the Comptrollers functions in this disclosure are necessary and do not duplicate BST functions.

1. The particular services provided by RC H13120 (Corporate Consolidations and External Reporting) are functions which must be performed by any large, publicly held corporation and which, given the current corporate structure, complement and do not duplicate functions performed by BST. Such services include:

- Providing subject matter expertise corporate-wide concerning the Securities Act of 1933, the Securities Exchange act of 1934, and the 1939 Trust Indenture act;
- Preparing and filing all "33 Act" registration statements;
- Preparing and submitting all "34 Act" Filings;
- Assisting in the preparation of the BellSouth Notice of Annual Meeting and Proxy Statement;
- Analyzing and interpreting accounting pronouncements which affect the Company's disclosure requirements;
- Controlling the consolidation process, including the consolidation of BST and its subsidiaries;
- Compiling monthly consolidated financial reports, including those for BST and its subsidiaries; and
- Developing quarterly and annual financial statements for BellSouth and subsidiaries.

2. Similarly, the specific comptroller's activities undertaken at BST related to RC H13170 (Corporate Accounting) are not duplicated at BSC. This RC provides billing, accounts payable, property records, classification, corporate books and reports services for

BSC Headquarters, BellSouth DC, and BellSouth Capital Funding Corporation. Costs associated with functions performed for BellSouth Capital Funding Corporation are project billed directly to that subsidiary. Additionally, the implementation and maintenance of the Comptrollers' PC-based systems are handled by this RC. In contrast, the BST Comptroller performs similar functions for BST operations. Both sets of services are necessary for day-to-day operation of the companies.

3. In 1992, RC H13140 (Affiliated Interest Matters) was responsible for the following three functions:

- Providing regulatory support, such as responses to data and document requests, to assist BST in matters pertaining to BellSouth Corporation affiliated interest issues;
- Preparing and filing testimony addressing BellSouth Headquarters affiliated interest matters as required in state Public Service Commission proceedings; and
- Investigating and evaluating potential affiliated interest issues involving BellSouth Headquarters and BellSouth Corporate operations and addressing

those issues with BellSouth management.

In 1993, as part of the BSC/BSE staff consolidation, the functions performed by this RC were reassigned within BellSouth, and the related costs are no longer being billed to BST. Consequently, even though these functions continue to be performed at BSC to support BST's regulatory activities, their costs do not affect BST, and therefore, the necessity and duplication of these services is no longer an issue.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 59

SUBJECT: **LEVERAGED EMPLOYEE STOCK OWNERSHIP PLAN ("LESOP")**

COMPANY'S COMMENTS:

The Company agrees with certain statements in the auditor's opinion; however, it does not agree with the auditor's recommendation. The Company agrees with the substance of the auditor's opinion regarding the flow of benefits of the LESOP, in that the Company anticipated that the growth in stock price and dividends associated with the Company's shares would continue to reduce the costs of the LESOP, and over the life of the plan, would result in lower expenses for the Company and customers. The tax savings were viewed as a benefit designed to encourage corporations such as BellSouth to establish a LESOP. In addition, GAAP requires that the tax savings for dividend payments on unallocated shares held in the LESOP be recorded as a direct equity entry instead of being recorded to an income statement account. Therefore, if the tax savings are allocated to Southern Bell-Florida as regulated income, this will lead to an overall reduction in BellSouth income since a large portion of the tax savings cannot be reported externally as income. For these reasons, the Company does not believe the Commission should impute the tax savings to Southern Bell-Florida associated with BellSouth Corporation's dividend payments into the LESOP trusts, as is recommended by the Audit staff.

The recommendation in this Disclosure should be rejected.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.

DISCLOSURE NO. **60**

SUBJECT: **BSC-CORPORATE AFFAIRS DEPARTMENT**

COMPANY'S COMMENTS:

The auditor recommends that the Company file comments in its rebuttal testimony to demonstrate "the necessity of these costs for public utility service." The activities performed by RC H94040 during the test year focused primarily on BellSouth employee involvement with community and civic affairs. Given the size of BST, whether measured in terms of revenues, product and service scope, number of employees, tax receipts, or any other attribute, it would be improper for the Company to ignore its external obligations. The Company exercises care in determining which community projects represent values that are consistent with those of BellSouth and, consequently merit corporate support. Policies related to contributions are standardized at the BSC corporate level to ensure that Company assets are effectively utilized and that all contribution and support activities are coordinated. Furthermore, the involvement of employees in community and civic affairs builds goodwill for the Company that, in many instances, translates into BST business opportunities.

Another set of activities referred to in the auditor's report are those performed by RCs H94100 and H94110. These units are primarily involved with the oversight of educational programs that support educational institutions within the nine-state operating territory. Some of the funding associated with these support activities is derived from the BellSouth Foundation that was established for that purpose. The commitment that BellSouth has made to enhance the educational infrastructure within its operating territory goes well beyond corporate altruism. BellSouth has concluded that the quality of education offered in the region has a direct impact on the ability of the Company to hire qualified personnel and on the overall economic vitality of the region. As a major business force within the community, BellSouth has seen the need to contribute some of its resources to improve the educational infrastructure within its operating territories. Most major companies today recognize the need to be involved with educational issues and institutions. The level of BellSouth's activities in this area is appropriate in light of the general concern for, and emphasis on, education among industry, national, and local leaders.

These activities are necessary in order for the Company to operate effectively in the communities it serves and to satisfy legitimate ongoing business requirements. BellSouth plays a major role in the information and telecommunications industry and it will be accountable to numerous stakeholders for ensuring that it contributes to the economic vitality of the region for many years to come. BellSouth engages in a variety of community activities and supports numerous educational initiatives as a way of fulfilling what it deems to be its obligation in these areas.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 61

SUBJECT: **BSC-CORPORATE PLANNING DEPARTMENT**

COMPANY'S COMMENTS:

BSC's Corporate Planning function has undergone considerable evolution since 1992, the test period for the audit. Since 1992, the BSE and BSC Corporate Planning functions have been merged into a consolidated BSC department, with three general areas of responsibility:

- First, the department conducts long-range strategic planning regarding the future of the telecommunications industry.
- Second, the department conducts specific planning and analyses with respect to special projects.
- Third, the department is involved in development activities, which may include the analyses associated with mergers and acquisitions.

The primary service provided by BSC Corporate Planning to BST is long-range planning. Special projects may be allocated or project billed, depending on whether the project is conducted on behalf of all BSC subsidiaries or for a specific BSC company. The costs of activities associated with corporate development, as they are primarily associated with mergers and acquisitions, are billed to BSC subsidiaries other than BST.

Long-range strategic planning is an essential component to planning the future of the regulated local exchange business. BST requires data and analyses related to the trends in all aspects of the telecommunications industry in order to maintain their current market effectiveness as well as to adapt to a rapidly changing telecommunications industry. Tactical, or shorter-term, planning may once have been an acceptable level of planning in a stable industry environment. As communications technology converges and markets change, the lines between local exchange and other types of telecommunications become increasingly blurred. Understanding the inter-relationships among communication services, analyzing associated opportunities and competition, and developing strategies has become an imperative. By design, long-range strategic planning addresses all aspects of communications. For example, in the past BST has been minimally involved in wireless telecommunications. This rapidly evolving technology may possess significant threats and opportunities, however, for BST's wire-line local exchange business. It is imperative that BST have long-range planning support to prepare for whatever changes occur within the industry.

The corporate planning functions conducted at BSC are distinct from the planning functions currently conducted at BST. BST planning is LEC and tactically focused, while the planning conducted at BSC has a longer-term horizon and considers all aspects of telecommunications. Both elements of planning are required, and the efforts of BSC and BST in this area compliment each other. Absent the long-term planning element provided by BSC, BST inevitably would need to incorporate this element into its own planning department.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 62

SUBJECT: **BSC-BOARD MATTERS**

COMPANY'S COMMENTS:

The auditors offered no opinion or recommendation associated with this disclosure; therefore, the conclusion is that the Statement of Facts has been provided for information purposes only. The auditor implied, however, that there is some inconsistency in BSC's approach to cost allocations because RC H11001 is allocated differently from the RCs associated with Investor and Shareholder Relations.

The type of activities included in Board Matters are significantly different than the activities associated with Investor and Shareholder Relations. The activities conducted as part of Board Matters deals with the myriad issues before the BellSouth Board of Directors. In fact, approximately 85% of the costs associated with RC H11001 are the fees and expenses incurred by the Directors. The remaining expenses primarily involve the labor costs associated with supporting the Directors, including maintaining minutes of meeting and official documentation. Thus, the activities included in RC H11001 reflect the full range of Board of Directors activities.

Investor and Shareholder Relations, on the other hand, has a very different role. For example, the RCs associated with Shareholder Relations are responsible for dealing with the holders of BSC equity by overseeing proxy solicitations, planning and holding the annual meeting for BSC's stockholders, and dealing with BSC's stock transfer agent. Thus, the subsidiary equity more closely approximates the cause of the costs associated with Shareholder Relations.

This Disclosure should be rejected.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 63

SUBJECT: **BSC-EXECUTIVE DEPARTMENT**

COMPANY'S COMMENTS:

During 1992, the audit test year, the BSC Executive Department was composed of the corporation's 10 highest positions. For this period and during 1993, these positions covered 11 responsibility codes due to the retirement of the corporation's vice chairman and the appointment of a new vice chairman using a new RC. During 1993, the Executive Department has undergone considerable organizational change and personnel retirements. These changes are reflected in new responsibility codes which are effective at January 1, 1994. The new Executive Department will consist of several responsibility codes reflecting the activities of the following executives:

- Chairman
- Vice Chairman
- Executive Vice President and General Counsel
- Associate General Counsel
- Executive Vice President and Chief Financial Officer
- Vice President - Comptroller and Financial Management

- Vice President - Secretary & Treasurer
- Vice President - Strategic Planning & Corporate Development
- Vice President - Corporate Development
- Executive Vice President - Corporate Relations
- Executive Vice President - Governmental Affairs
- Vice President - Governmental Affairs
- Vice President - Corporate Responsibility and Compliance
- Senior Vice President - Broadband Strategies

BSC's Chairman and Vice-Chairman are responsible for developing the Company's vision, directing the strategies of the Company, and providing leadership. This role is necessary to ensure viability as a business venture, especially in industries like telecommunications which are experiencing fundamental changes in its competitive and technological composition.

With the exception of the Chairman and Vice-Chairman, BSC's "Executive Department" represents a billing mechanism, not an actual department. Cost allocations for each executive directly follow the functions and allocations of the organization overseen by the executive. For example, the cost allocation associated with the Vice President - Comptroller and Financial Management is determined by taking the composite of all positions reporting to that executive. This composite approach is the most equitable treatment of executive costs since executives spend most of their time leading, directing, and supervising the functions for which they have responsibility. The functions themselves develop cost assignments based on cost-causation. Thus, an executive's cost assignment reflects the cost-causation of the functions overseen, which protects BST from being allocated costs that are unrelated to telephone operations.

For four executives, since their positions involve responsibilities in addition to departmental leadership, specific cost causative factors are provided. These positions are Vice President - Secretary & Treasurer, Executive Vice President and General Counsel, Vice President and Associate General Counsel, and Vice President - Corporate Responsibility and Compliance.

The leadership, direction, and supervision provided by the BSC Executive department is a necessary component to successfully running a large corporation like BellSouth. These positions are needed to the extent that the functions for which they are responsible are needed. As is discussed throughout the responses to the audit disclosures, the functions provided by BSC are needed and do not duplicate functions performed at BST, even though the functions might have similar titles.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. **64**

SUBJECT: **BSC-EXTERNAL AFFAIRS DEPARTMENT**

COMPANY'S COMMENTS:

The auditor's report comments on the activities associated with external affairs functions related to executive speech writing and strategic communications. After describing the functions performed and the basis for allocating the related costs, the auditor recommends that the Company demonstrate the necessity of these costs in light of possible duplication with BST and the questionable nature of such costs.

The preparation and coordination of speeches by executives generally is accepted as an essential component of managing a large telecommunications enterprise of the size and scope of BellSouth. The industry currently is in the midst of profound technological, market structure and regulatory changes. These forces will continue to have a significant effect on BST's business and it is the obligation of senior executives to communicate the nature and effect of these changes on the customer, the Company, and the industry to a variety of parties in a variety of forums. BellSouth executives address such diverse groups as industry associations, civic groups, investors, college graduates, customer groups, employees, and others. These speeches must be tailored to the needs and style best suited to each group. The need to communicate these issues in a consistent and effective manner justifies the support of professional speech writers.

The ability of BellSouth to manage the forces of technology, markets, and regulation in ways that benefit BST customers is largely dependent upon the ability of BSC executives to convey effectively the significance and impact of these events to business and policy decision makers. While BST handles its own speech writing responsibilities for its executives, the interests of BST customers are also promoted by BSC executives. Therefore, it is appropriate for BST to share in the costs of services that support the activities of BSC senior management.

BSC also provides subsidiaries with services related to employee communications. RC H92010 is the unit responsible for coordinating internal and external research that is used for public relations purposes. In addition to providing employee-related research, this BSC group also operates as a clearing-house to BST and other subsidiaries for information that relates to the telecommunications industry or issues relevant to BellSouth.

Much of the public relations emphasis at BSC is on planning and communications, is strategic in nature, and is designed to avoid duplicative and inconsistent execution of the public relations functions within the subsidiaries. As both BSC and BST continue to strive for cost reduction, there is an ongoing effort to ensure that critical support functions are not duplicated.

There are also some activities performed in this unit that are designed to support directly the business operations of BST. For example, in 1993 the Strategic Communications group at BSC conducted surveys of BST employees to help plan and implement internal communications and training programs. These survey activities help shape and produce management initiatives that enhance customer service and boost employee morale and productivity. These are essential activities in today's operating environment, and BST would have to perform these functions were it a stand-alone company.

The BSC-HQ group is also responsible for activities related to external communications with customers, suppliers and community groups. BSC activities are designed to support BST public relations programs in ways that most effectively align the capabilities of BellSouth and the needs of the marketplace. Here too, the efforts are designed to avoid duplication. The research results and analysis that are provided to BST produce public relations and marketing initiatives that address issues and concerns of BST's customers in such areas as privacy, new service introductions, and regulatory developments. The ability to understand the needs and interests of customers and the ability to develop campaigns that communicate corporate activities and information is a legitimate and essential component of any business enterprise. The costs associated with these functions are appropriately distributed to BST customers.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 65

SUBJECT: **BSC-GOVERNMENT RELATIONS**

COMPANY'S COMMENTS:

The auditor's comments on the activities performed and the associated cost allocation methodology for five RCs within the Governmental Affairs group at BSC. Included in the report is an opinion that some of the costs within these RCs involve lobbying. Another opinion provided in the report is that "there may be duplication with functions performed by BST." The report includes a recommendation that the Company demonstrate the necessity of these costs in the light of possible duplication with BST and "the questionable nature of such costs."

The functions that are performed by RC H71100 within the BSDC Governmental Affairs office involve a broad spectrum of issues related to legislative and government agency initiatives. The issues that are debated, and ultimately resolved in this arena, directly affect the economic and operational viability and vitality of BST. The identification, analysis, and management of issues that are coordinated by this unit operate as a critical support component of BST's national regulatory operations.

The FCC promulgates rules and regulations that directly affect the availability, functionality, pricing and quality of BST services. Legislative initiatives are being proposed in Congress that could, in the near term, fundamentally change the national and local telecommunications landscape. The extent and nature of local competition, infrastructure development, network reliability and monitoring policies, privacy issues, and numerous other aspects of telecommunications service are decided by federal legislators, their staffs and other key decision makers.

BST, through the services provided by BSDC, has the capacity to engage proactively in the development of public policy and law. It should be noted that a portion of salaries and all direct lobbying expenses for two registered lobbyists are retained at BSC-HQ and not billed to subsidiaries. The functions that are performed in Washington D.C. office with respect to this particular RC are distinct from those performed at BST. Given the relevance and necessity of these activities to ongoing BST operations, they are improperly characterized as "questionable" in the report and in our opinion are appropriate for recovery.

The RC H71410 is used to track costs associated with various administrative support functions including human resources and comptroller interfaces and the administration of the Federal Political Action Committee (Fed-PAC). The auditor comments that "there is no exception billing or project billing indicated in the Commission's documentation, not even for the BellSouth Fed PAC activities." The costs associated with the BellSouth Fed-PAC are for administration of the PAC and for compliance with Federal Election Commission rules. Since certain states including Florida disallow administrative costs associated with Fed-PAC, a project coding process is, in fact, in effect and these costs are identified and excluded in those jurisdictions. All other administrative support activities, such as copy machines, office supplies, rent and utilities are necessary to the operation of the D.C. office and are properly recoverable.

Common area costs for the Governmental Affairs Washington office are captured in RC H71420 and, as indicated in the auditor's report, are allocated in accordance with the composite allocation for all governmental affairs RCs. This allocation methodology is reasonable and forms an appropriate basis for recovery.

Activities related to interfacing with Congressional staff are located with two RCs in the Governmental Affairs organization. RC H73070 handles responsibilities for the states represented by North Carolina, South Carolina, Georgia and Florida. RC H73080 work with the House and Senate member staffs of Alabama, Kentucky, Louisiana, Mississippi and Tennessee.

It is important to distinguish between BellSouth interfaces with congressional members (characterized as lobbying and retained at BSC-HQ) and interfaces with congressional staff. The work performed within these RCs does not entail "lobbying" activities as currently defined by the FCC and federal lobbying reporting statutes. BSDC governmental affairs staff also engage in non-lobbying activities with OSHA, the Department of Labor, FASB, and other governmental agencies related to legislative and non-legislative issues that affect the cost of service to BST ratepayers.

The purpose of BSDC contact with congressional staff members is to exchange information regarding important legislative initiatives and to educate staff on critical issues that affect BellSouth, its employees, and its customers. In many instances, staff members will initiate requests for information or solicit BellSouth's reaction to a particular piece of legislation. These activities are not lobbying as defined by the FCC and the Company. Given the critical role that congressional staff play in drafting and promoting legislation that will have an immediate and direct impact on the availability and cost of service to BST customers, it is appropriate for the Company to seek recovery of these expenses.

In conclusion, there is no basis for the claim of possible duplication of effort associated with the DC Governmental Affairs operation. Furthermore, the rapidly changing nature of the telecommunications industry and the stakes associated with Washington initiatives, highlight the fact that these activities are necessary in order for BellSouth to effectively represent the interest of BST as well as those of its customers.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 66

SUBJECT: **BSC-FINANCIAL MANAGEMENT DEPARTMENT**

COMPANY'S COMMENTS:

The BSC Financial Management/Consolidated Operations group performs three primary functions:

1. Consolidates the budgets of all BellSouth operating entities
2. Directs the preparation of the BSC HQ budget
3. Prepares management reports and analyses for the BellSouth Board of Directors and for information provided to the investment community

In addition, the department provides all BellSouth subsidiaries with the broad economic and other financial budget assumptions to be reflected in the subsidiaries' operating budgets. It also assists in the development of, and performs analyses of prospective and actual results for, various incentive compensation plans which are designed to improve the operating efficiencies, increase competitive response, and improve profitability of all the BellSouth subsidiaries, including BST.

The budget consolidations function is necessary, both on a prospective basis and a retroactive basis, in providing senior management, both at BSC and BST, with the expected results of the collective operating plans of the BellSouth subsidiaries. This ensures that the corporation's operations and budgets are consistent with the stated corporate goals and objectives and that these operations will generate the levels of returns expected by BellSouth's shareholders and the investment community.

The BellSouth-HQ budget preparation and analysis process is an important element in controlling the costs incurred at BSC-HQ, part of which are charged to BST. The Financial Management/Consolidated Operations group is responsible for establishing the budget parameters for each of the BSC-HQ departments, including establishment of targets for the expenses of each BSC-HQ department.

On a monthly basis, the Department prepares management reports for, and makes presentations to, the senior executives of BellSouth, including BST; the BellSouth Board of Directors; and the investment community who follow BellSouth's stock on behalf of their investor clients. These reports provide information, explanation, and recommendations about the results of BST and the other BellSouth subsidiaries, so that management and the Board may take the appropriate actions in ensuring that BellSouth meets its obligations to its shareholders, investment analysts, and the various credit-rating agencies.

The functions of the BellSouth Financial Management/Consolidated Operations organization are distinct from the functions performed at BST. The functions performed at BSC are beneficial to BST and its ratepayers in that they support BST directly through the provision of economic, demographic, and financial assumptions for the budgeting process; analysis, reports, and presentations to stakeholders concerning operating and financial results; and specific budget preparation and tracking of the organizations directly supporting the BSC subsidiaries, including BST. If the foregoing functions were not performed at BSC-HQ, BST would be required to perform these same functions on its own behalf and at its own expense.

This recommendation should be rejected.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 67

SUBJECT: **BSC-HUMAN RESOURCES DEPARTMENT**

COMPANY'S COMMENTS:

The auditor describes the activities within three BSC Human Resources RCs based on BSC Cost Assignment Forms. The auditor speculates based on a review of those cost assignment forms that there may be duplication between BSC and BST in these areas and recommend that the Company demonstrate the necessity of the work in light of possible duplication.

RC H52050 is one of the units within the BSC Human Resources function related to labor-management relations. This unit is responsible for providing BST and other BellSouth subsidiaries with research, design and development support related to most aspects of management and non-management hiring and staffing. The BSC unit develops, among other things, policy directives regarding qualification selection criteria, assessment programs, skills acquisition, retirement incentive programs, and work, family and personal life issues.

The human relations research activities and coordination of policy that are managed at BSC are essential elements of any business enterprise and would need to be performed by BST were it a stand-along entity. The purpose of providing centralized support is to ensure uniformity across all subsidiaries and to design policies that reflect the values and objectives of BellSouth Corporation. In addition, given the centralized nature of these services, there are economies of scale that benefit all entities including BST, and consequently, flow through to BST ratepayers. The focus of the efforts at BSC are policy and program development-related and strategically oriented as opposed to the tactical and operational focus at BST. BST perceives itself, and is perceived by BSC, as the client of those services and there is on-going dialogue to ensure that the services provided to the subsidiary clients are fair and reasonable.

RC's H53040 and H53050 are part of the executive personnel matters unit within BSC. During 1992 many of the research, planning, and strategic functions related to executive management resided at BSC. In 1993, some of these functions have been transferred to BST, giving BST direct control over the design, development, and implementation of its own Key Manager-related personnel matters. At no time was there duplication of these activities. BSC continues to provide high-level plans for affiliated company Human Resources organizations, as well as some consultative services.

It should also be noted that the auditor references a Louisiana regulatory proceeding in which the Company acknowledged that in 1992 BSC incurred costs of various force management and early retirement programs. As a result of the consolidation, functions performed at BSC which could be performed at BST were re-assigned to BST staff. Additionally, through consolidation, BST gained access to human resources expertise developed in the BSE headquarters organization for other subsidiary companies. BST was not billed during 1993 for staff support to BST provided by former BSE employees, even though the consolidation was completed in April, 1993.

The recommendation in this Disclosure is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. **68**

SUBJECT: **BSC-INTERNAL AUDITING DEPARTMENT**

COMPANY'S COMMENTS:

This disclosure has no opinion or recommendation, and therefore, calls for no response. An inference may be taken that the Company has inappropriately charged 100% of the costs of JCO and Part 64 compliance audits to BST. The allocation of these costs to BST is proper and entirely consistent with FCC rules regarding cost causation.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 69

SUBJECT: **BSC-LEGAL DEPARTMENT**

COMPANY'S COMMENTS:

The auditor discusses activities related to intellectual property legal activities in RC H61340. The context in which third paragraph quotes from the Modification of Final Judgment implies that BellSouth's ownership of certain intellectual property rights is contrary to the Decree. Neither the text quoted, nor the Decree, permits such a conclusion. The quoted language does not relate to the subject of intellectual property. Further, the Decree Court approved the trademark assignments from AT&T to BellSouth and the other regional holding companies. As such, the auditor is in error in concluding that BellSouth utilizes, or should pay compensation for, "BST's" intellectual property.

This disclosure, which relates to RC H61340, fails to state any opinion or recommendation. The charges represent costs which BST would have to incur on its own if not provided by BellSouth.

The allocation percentages between entities reflect time and expense incurred for BST and BSE entities and for the benefit of all BellSouth companies. The Report contains no facts to challenge these allocations.

The auditor also discusses activities related to litigation work in RC H61350. The auditor implies that the allocation of all costs under RC H61350 to BST are in error because they exceed the general allocator percentage. The general allocator is used by BellSouth only when a specific allocation cannot otherwise be established. In this instance all costs under this RC were incurred directly for or related to BST and were appropriately allocated to BST. The services rendered and costs incurred here for 1992 were directly to BST as a regulated entity. For 1994, in consideration of the merger of the BSC and BSE staffs, this RC has been reallocated.

These costs were not duplicative of BST costs. If BellSouth did not perform these functions, BST would have incurred them on its own behalf. BellSouth's provision of services for both entities avoided duplication and unnecessary costs.

While the Report contains no recommendation BST asserts that the charges to BST are appropriate and proper.

With respect to RC H61410 Assistant Secretary - Corporate Counsel, the auditor states no opinion but implies that the allocation of costs under RC H61410 based upon the general allocator is in error.

Such general allocation is made by BellSouth whenever costs cannot be specifically allocated to specific entities. This RC appropriately fits such circumstances. Utilization of the general allocator as a method of allocation is proper where the services relate to functions associated with corporate governance.

This recommendation should be rejected.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 70

SUBJECT: **BSC-PUBLIC RELATIONS DEPARTMENT**

COMPANY'S COMMENTS:

The auditor describes the functions provided by in RC H91000 as they were summarized in a 1992 Cost Assignment Form and, based on that document, recommend that the Company demonstrate "the necessity of these costs in light of the questionable nature of such costs." This recommendation is unnecessary and should be disregarded.

The media has a critical role in disseminating information about BST's services and operations, as well as the policy issues that directly affect consumers. In addition to the traditional concern for affordable and reliable service, the media has shown an intense interest in new technology, the applications that may be derived from the technology, the impact on the market and consumers generally. The media also follow local and national legal and policy developments as they continue to unfold and play a vital role in analyzing these events and communicating the effect that these developments have on the lives of their readers (and BST's customers).

The issues that affect the industry are complex and the ability to assess these issues is often undermined by the frantic pace of developments. In order to communicate these issues to the public, a solid understanding of how technology, markets, and regulation interrelate in this dynamic environment is required. It is in BST's best interest to educate its customers on a variety of issues including competition, regulatory subsidies, and future service opportunities. Furthermore, a well-planned and organized media response, like the one during and after Hurricane Andrew, is an essential element of crisis management when dealing with a lifeline service like the telephone.

As competition continues to develop, and potentially explode in the local communications market, this emphasis on media relations is critical to BST's success in providing regulated telecommunication services at a reasonable price. Moreover, the media often rely on BSC's media relations group to provide "real-time" information about events or activities that affect telephone service. It is often the case that the BSC and BST media support functions are the only place where timely information on certain subjects can be obtained. Through an efficient media operation focused on distinct local and national media outlets, the Company is able to communicate effectively with its customers.

The activities performed in this RC are a necessary and legitimate part of BellSouth and provide an appropriate level of support to BST. Accordingly, the costs of this RC, as currently allocated, are properly charged to BST.

This recommendation is unnecessary.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 71

SUBJECT: **BSC-TREASURY DEPARTMENT**

COMPANY'S COMMENTS:

The auditor has raised issues concerning three areas of BSC's Treasury Department:

. Corporate Finance - Fed PAC RC H11400

. Financial Planning RC H11423

. Treasury Methods RC H11430

RC H11400 (Corporate Finance - Fed PAC) - This RC has been inaccurately titled by the auditor. In fact, the costs associated with Fed PAC administration are separately identified and reported to BST Comptrollers for the appropriate ratemaking treatment. As indicated in the cost assignment form, the correct center name is Corporate Finance and only a very minor part of the RC responsibilities relate to the Fed PAC function. As accurately indicated in the auditor's statement of facts, this function assists the Vice President in a wide variety of initiatives designed to improve the effectiveness of the entire BSC Treasury organization.

RC H1140 oversees BSC Treasury functions which are necessary for the functioning of BST and its other subsidiaries, and which do not duplicate the specific activities undertaken by BST. This RC oversees functions which BSC subsidiaries do not perform themselves, including shareowner relations, pension and trust investment, cash investment, treasury methods, and financial planning, or which support the operation of BellSouth Corporation, such as cash management.

RC H11423 (Financial Planning) - This RC has been changed to RC H11440 due to a reorganization of the Treasury department. The RC's responsibilities remain unchanged, however, and continue to support BSC and BST in the following fashion:

- Develops financial objectives for the parent company and assists the subsidiaries in the development of their own financial objectives;
- Works with subsidiaries in developing financing plans;
- Coordinates rating agency interfaces with BellSouth and its subsidiaries;
- Plans and coordinates BellSouth debt and equity financing; and
- Researches new and innovative financing techniques and analyzes capital markets.

The auditor's comment stating "according to the Company, capital structure and debt equity studies have not been prepared by BSC for BST" is incorrect. Capital structure and debt equity are constantly being studied by BSC and financial objectives are published and revised annually in the Financial Planning Guide.

There is no apparent duplication of effort between BSC and BST in the financial planning area, as the two financing groups work together and in parallel in accomplishing their own, distinctly different objectives. BST is concerned with the day-to-day matters relating to the long-term debt financing for BST itself, while BSC is concerned with more long-range, analytical, and coordination issues related to the corporation's debt and equity financing plans and activities.

Both types of activities are necessary to support BST or any other publicly held corporation the size of BST. Furthermore, nearly one-half the cost of the function which is allocated to BST relates to the combination of stock exchange listing fees and the amortization of ESOP debt issuance costs. As a stand-alone company, BST would need to pay its own stock exchange listing fees which, due to economies of scale, would be higher than what it currently is charged by BSC. The ESOP directly benefits BST and BST employees, and consequently a prorata share of the costs should be paid by the Company.

RC H11430 (Treasury Methods) - This RC provides the following services to BSC subsidiaries:

- Research, development, and documentation of operating procedures, methods, and management information systems for the Treasury Department;
- Provision of centralized planning and analyses of methods, procedures, and management information systems needed in the Treasury Departments of various BellSouth companies;
- Monitoring of the implementation and adherence to accepted Treasury procedures; and
- Performance of various administrative duties such as budgeting, force, and space planning.

There is no comparable function at BST. A centralized Treasury Methods function is a common industry practice, necessary for reasons of efficiency and effectiveness of operation of the company's treasury activities. In addition, the centralization of the function offers economies of scale from the aggregation of a wide range of expertise in such areas as accounting, banking, data processing, and treasury.

Recently, a large share of this RC's costs were directly assigned to BST reflecting projects which are solely applicable to BST. The most notable example is the consolidation of the BST Treasury organization from twelve to two units. Other major RC projects, the costs of which were allocated to all subsidiaries, have included development of an information system disaster recovery program, negotiation of a corporate credit card program, and implementation of the shareholder services contract.

The recommendation associated with this Disclosure is unnecessary and should be disregarded.

PREPARED BY: S. P. Budd

Theodore Barry and Associates

DISCLOSURE NO. 72

SUBJECT: **COSTS REMOVED IN FLORIDA RATE CASE**

COMPANY'S COMMENTS:

Concerning the auditor's statement of facts, the Company would like to clarify certain points. First, the amount of $405,600 reported for the BellSouth Classic represents the non-advertising costs for the Classic which were billed to BST. The difference of $166,000 which is discussed in the statement of facts is related to advertising expenses for ads run concurrent with the tournament. To the extent these ads were corporate advertising in nature, the related expense would be included in the corporate advertising category listed in response to Data Request Item No. 2-163.

The amount reported for dues and memberships of $666,600 includes $568,700 of professional dues and memberships and $97,900 for dues and memberships in social and service organizations. Only the social and service organization memberships amounts have been excluded.

The difference in amounts reported for costs of BellSouth D.C. charged to BST are due to the fact that the amounts for the

BellSouth Federal Relations and Federal Regulatory organizations, as reported by the Company in response to Data Request No. 2-163, represent the portion of these organizations costs that are deemed to be lobbying in nature according to criteria used in Florida ratemaking. The response to Data Request No. 6-061 includes the total cost for the Federal Relations and Federal Regulatory organizations.

PREPARED BY: W. S. Reid

BellSouth Telecommunications, Inc.