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AUDIT REPORT
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FPSC-RECORDS/REPORTING

FLORIDA PUBLIC SERVICE COMMISSION

AUDIT REPORT

12 MONTHS ENDED DECEMBER 31, 1991

Field Work Completed

December 2, 1992

SOUTHERN BELL TELEPHONE AND TELEGRAPH

Miami, Florida

Dade County

Rate Case Audit

Docket Number 920260-TL

Audit Control Number 92-143-4-1



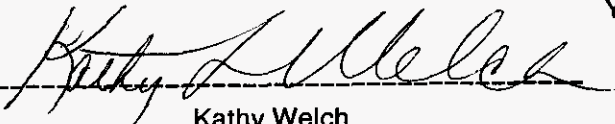
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Minority Opinion

Yes ___ No IF
Yes ___ No SP
Yes ___ No SG
Yes ___ No SH



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I. **Executive Summary**

Audit Purpose: We have applied the procedures described in Section II of this report to company filed schedules of Rate Base, Net Operating Income, and Capital Structure for the twelve month period ending December 31, 1991 for the Southern Bell Telephone and Telegraph Company for Rate Case, FPSC Docket 920260-TL.

Scope Limitation: The exit conference was held December 2, 1992. This report is based on confidential information which is separately filed with the Commission Clerk.

Staff did not have time to adequately review software costs found in the sample because the Company did not provide additional supporting documentation requested until November 19, 1992.

The Company did not provide sections of the Board of Directors Minutes because they claim attorney client privilege.

Every paragraph in the Board of Directors Minutes which related to Mr. Fitzgerald, Vice-President and General Legal Counsel, were deleted. According to our Company contact, Eric Rudolph, these briefings related not only to litigation but also to any advice presented in relation to commission orders or actions. These representations may contain information which could affect the rate case.

The following Board of Directors Minutes were redacted:

Meeting	Page	Paragraph	Subject
1/90	8729 & 30	Last and First	Mr. Fitzgerald briefed the Board. Mr. Fitzgerald is the Company's legal Counsel.
7/23/90	8761	1	Company received recent Commission order and called on Sassoms & Fitzgerald.

Meeting	Page	Paragraph	Subject
10/22/90	8771 & 2	4 & 1	Mr. Fitzgerald briefed the Board on-- also in these minutes discussion of job fatality in Jacksonville 10/16/90.
11/26/90	8779	4	Mr. Fitzgerald updated the Board on current status of?
2/25/91	8793	4	Mr. Fitzgerald reviewed status of
3/25/91	8821	4	Mr. Fitzgerald reviewed developments
5/20/91	8830	4	Mr. Fitzgerald updated the Board
7/22/91	8850	1	Mr. Fitzgerald updated the Board
9/23/91	8859	4	Head of Audit Committee called on Mr. Fitzgerald.
10/28/91	8864-5	5 & 1	Mr. Fitzgerald
11/25/91	8870-1	5 & 1	Head of Audit Committee called on Mr. Fitzgerald
1/27/92	8892 8896 8897 8898 8892		Mr. Fitzgerald update debenture dates interest %, \$'S related to future bond extinguishment (considered insider trading information).
2/24/92	8923	4	Head of audit committee called on Mr. Fitzgerald
3/23/92	8923	4	Mr. Fitzgerald update

Coopers and Lybrand withheld the attorney client representation letter and the partner review note related to that contingency (Wp. 1.6 - MAP # 4, binder 10 of corporate current files). They claimed this contained attorney/client information. Both contingencies and settlements paid during the test year can affect the rate case. Non-recurring expenses may be in test year expenses.

The following internal audits were not provided to staff due to attorney/client privilege:

17-12 Public Communications Proposals for Broward County
17-13 Accuracy of Coin Commission Payments
51-02 Personnel Guidelines
17-10 Service Order-Public Communications
17-14 Commission Accuracy-Coin
17-15 Commission Accuracy-Coin
17-16 Coinless Telephone Commission Accuracy
18-01 Coin Telephone Settlements
15-03 Customer Adjustments-Loop Maintenance Operations
Systems (LMOS)
16-06 Mechanized Adjustments-Mechanized Out of Service
Adjustments (MOOSA)-FI
53-15 Key Service Indicator (KSRI)-Network Customer Trouble
Rate
63-04 PSC Schedule 11
G-10-21-15 Independent Contractor vs. Employee Status
B-10-62-02 Environmental Management

Because access to the above items was denied based on attorney client privilege staff cannot determine the accuracy of the MFR's. These documents could contain information which could cause material misstatements of the MFR's. Since the coin case has been settled, these audits should not have a material effect.

Disclaim Public Use: This is an internal accounting report prepared after performing a limited scope audit; accordingly, this document must not be relied upon for any purpose except to assist the Commission staff in the performance to their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

Opinion: The schedules of Rate Base, Net Operating Income, and Capital Structure for the twelve month period ending December 31, 1991 represent Southern Bell Telephone and Telegraph Company books and records maintained in substantial compliance with Commission Directives; The expressed opinions extend only to the scope of work described in section II of this report.

- 1 **Summary Findings:** A management study was conducted by Arthur Andersen. This study shows a total savings of \$43,900,000 for the nine state area if the Company were to consolidate it's operations. It is currently implementing this plan.
- 2 An adjustment was made because the computer parts inventory was overvalued because it had not been properly monitored in the past is nonrecurring and Florida expenses should be reduced by \$3,220,354.
- 3 In a proforma adjustment to Rate Base and Net Operating Income the Company estimated the adjustment to be \$186,000 to Net Operating Income and \$1,653,000 to Rate Base. The actual amounts are \$791,000 dividend adjustment to Net Operating Income and \$5,121,000 adjustment to Rate Base.
- 4 When the Company revised their adjustments in July for SFAS106 they failed to change a number in their calculations based on updated costs. In addition, the Company used the 1993 figures from the actuary study which were the highest of the four years presented.
- 5 An Engineer Contract Audit found problems with the treatment of software costs. This is being addressed in a separate docket.
- 6 A total of \$255,606.79 total Florida regulated miscellaneous aircraft expenses found in the sample were charged to Account 6113, Aircraft Expenses on the Net Operating Income Schedule. Several items charged to aircraft expense relate to items such as lobbying and legal expenses relating to attorney general investigations which were removed in proformas. No adjustment was made for the aircraft expense in the proforma.
- 7 When reviewing the sample of expenses staff found several invoices related to Grand Jury Investigations which were not removed in a proforma adjustment for \$438,460.85.

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II. Audit Scope:

The opinions contained in this report are based on the audit work described below. When used in this report **COMPILED** and **EXAMINED** means that audit work includes:

COMPILED – Means that the audit staff reconciled exhibit amounts with the general ledger; visually scanned accounts for error or inconsistency; disclosed any unresolved error, irregularity, or inconsistency; and, except as noted performed no other audit work.

EXAMINED – Means that the audit staff reconciled exhibit amounts to the general ledger; traced general ledger account balances to subsidiary ledgers; applied selective analytical review procedures; tested account balances to the extent further described; and disclosed any error, irregularity, or inconsistency observed.

The Cost Allocation Manual Audit for 12 months ended 12/31/91 and audits of two Construction Contracts (Remodeling of Brentwood Building, AFAD #92027-4-1, and Construction of the Sawgrass Central Office), AFAD #A92027-4-2 are incorporated into this Rate Case Audit.

RATE BASE: Two Construction Contract Audits were reviewed as explained above. Traced Rate Base Adjustments to supporting documentation and to proper Commission Orders. Reviewed internal audits related to plant from 1982 through the test year.

Accumulated Depreciation is being audited by Pat Lee, Engineer Supervisor in Tallahassee.

Compiled Working Capital. Traced amounts to Company books. Tested Working Capital for interest bearing amounts, allocation between regulated and nonregulated and non-utility transactions.

Compiled Capital Structure accounts. Recalculated the components of the Capital Structure which are allocated from the Parent. Traced cost rates for all components to Company provided supporting documentation, and Commission orders.

Examined Net Operating Income for the 12 months ended December 31, 1991. Staff prepared an analytical review for all expenses for years 1988-1991. The accounts with the largest variance from year to year and accounts that represented a high percentage of total expenses were sampled. A total of 16 expense accounts and a sample of 951 items were looked at for the following attributes:

- 1) Correct amount
- 2) Correct account
- 3) Proper Test Period
- 4) Recurring Expense
- 5) Correct allocation between regulated and non-regulated
- 6) Correct allocation from the Parent Company, if applicable

Staff did not review allocations of BellSouth Corporation legal cost except for tracing to BellSouth Billing. Total costs in the sample amount to \$2,073,399.00. These costs were for legal staff and overhead at BellSouth that do work on taxes, securities and union bargaining.

Staff analyst Rick Wright requested staff to review account 7360 "Other Nonoperating Income". Staff took a judgemental sample of 24 items out of a total of 34 items charged to this account, in addition to the 951 expense items sampled.

Net Operating Income proforma adjustments were recalculated and traced to proper supporting documentation.

Adjustments related to ENFIA, SPF, DEM and USF were audited by Rick Wright, staff analyst in Tallahassee and are not included in this report.

The adjustment on attrition is being reviewed by Bill McNulty in Tallahassee.

Staff was unable to review the backup for adjustments related to Proposed Switch Access Reduction, Proposed Optional Expanded Local Service, and Proposed Interconnect Rate Reduction. A supplemental audit will be issued on these items.

Taxes were audited by Christine Romig in Tallahassee.

Other:

**Reviewed Coopers and Lybrand audit workpapers for 1991.
Reviewed all 1991 Internal Audit Reports.
Traced interstate expense amounts to MRB1000 Reports
(report generated from the Separations Information System).**

Staff did not audit the Separations System.

AUDIT DISCLOSURE NO. 1:

SUBJECT: Management Study

Comptroller's

10/1/92

STATEMENT OF FACT: Arthur Andersen conducted a study called "Comptrollers: Optimizing Resource Effectiveness", dated May 1992. This study reports an estimate of the total savings to the Company of \$43,900,000 for the nine state area if the Company were to simplify the work, mechanize the work, and consolidate its operations. The reorganization announcement was made in November and it is attached. All changes should be implemented by June 1994.

OPINION: If this study is implemented, costs will be reduced and the Company may be in a sharing or refund situation. This condition also means that all records will be maintained out of state which will affect audits done by the Public Service Commission.

COMPANY COMMENTS: See Section IV. of this report.

CORE SAVINGS ANALYSIS

<i>FUNCTIONAL TEAM</i>	<i>SIMPLIFY WORK</i>	<i>MECHANIZATION</i>	<i>SIMPLIFY & MECHANIZE</i>	<i>CONSOLIDATION</i>	<i>TOTAL</i>
<i>CRIS</i>	114.8 FTE	44.0 FTE	23.7 FTE	94.0 FTE	276.5 FTE \$9.9M
<i>CABS, TOLL, MIC</i>	81.0 FTE	43.3 FTE		50.7 FTE	175.0 FTE \$6.4M
<i>CMR</i>	38.5 FTE	12.0 FTE		39.0 FTE	89.5 FTE \$3.2M
<i>PROPERTY & COST</i>	153.0 FTE	38.0 FTE	4.0 FTE	50.0 FTE	245.0 FTE \$9.2M
<i>PAYROLL, VOUCHERS, & CTO</i>	73.3 FTE	19.7 FTE		23.1 FTE	116.1 FTE \$4.5M
<i>ACCTG. SUPPORT & FINANCIAL ANALYSIS</i>	66.0 FTE			14.0 FTE	80.0 FTE \$4.4M
<i>CORPORATE BOOKS</i>			7.0 FTE	9.0 FTE	16.0 FTE \$0.8M
<i>METHODS & PROCEDURES</i>	83.0 FTE				83.0 FTE \$5.6M
<i>TOTAL SAVINGS</i>	609.6 FTE \$25.2M	157.0 FTE \$5.2M	34.7 FTE \$1.2M	279.8 FTE 12.3M	1,081.1 FTE \$43.9M

Data Represents Functional Areas (middle of savings range)

CORE

COMPTROLLERS REORGANIZATION ANNOUNCEMENT

Beginning in February, 1992, the Comptrollers Department began a re-engineering study. The purpose of the study was to identify work process changes that would simplify the work, make work activities more relevant to our business environment, and improve the cost effectiveness of the organization. The study was driven by several factors including the need to position ourselves more competitively, by establishing a lower cost, more flexible organization. The formation of BellSouth Telecommunications made it timely to pursue this opportunity.

The re-engineering study found that multi-million dollar economies could be gained. The recommendations range from relatively simple work elimination or streamlining to complex consolidation initiatives. The recommendations focus on such things as editing and error correction processes, duplication of work efforts, job work flow and organization structure.

Currently each of the nine states performs a variety of functions. Most of these functions will be consolidated.

The consolidation plans are as follows:

- .. Post-bill MIC (Message Investigation Center) will be consolidated into the existing fraud center in Columbia.
- .. Revenue Accounting (CRIS, CABS, Toll, Pre-Bill MIC) will be consolidated into one organization located in Birmingham.
- .. Centralized Mail Remittance (CMR) will be consolidated into three locations: New Orleans, Atlanta, and Charlotte.
- .. Bill Mailing will be consolidated into five locations: Jackson, Miami, Nashville, Charlotte, and Birmingham.
- .. Property and Cost will be consolidated into one location, Atlanta. The existing Regional Functions Group will remain in Birmingham.

10/28/92

COMPTROLLERS REORGANIZATION ANNOUNCEMENT

In addition, certain functions will be performed in each state. These are:

- .. Enhanced Billing Services (i.e., CLUB)
- .. State Billing Coordination
- .. Outside Plant Record Posting in the five western states
- .. Outside Plant Current Reconciliation, Credit Balance, Material Edits, and Tax Annexation in eight states

The conversion to this new organizational structure is a significant undertaking. Initial conversions will begin in first quarter, 1993. Completion of the new structure is anticipated by mid-1994.

The Company has a strong history of treating our employees well in these circumstances. And, we will continue to use sound policies in working with the individuals affected by these changes. We will be offering some voluntary transition programs for management. Also, the CWA has been informed about these changes. Our contract with them has specific steps to be followed in these situations and we will follow these procedures carefully.

Later today, we will have additional meetings to discuss the process for staffing the consolidated organizations and to discuss force management alternatives, including early exit incentive programs.

10/28/92

The following anticipated schedule of conversion is provided to you for informational purposes. It is our best current estimate, but is subject to change.

INTEGRATED SITE CONVERSION SCHEDULE

MO/YR	REVENUE					COST	DISB
	CRIS	CABS/MP	MIC	CMR	BILL MAILING		
NOV 92	AL	AL	AL			GA	TN-P
DEC 92							
JAN 93				GA/LA/NC	AL/NC/TN/SF		
					MS		
FEB 93							
MAR 93	MS				KY		AL/KY
APR 93		MS				AL	
MAY 93	GA		MS	TN	NF		LA/MS
JUN 93		GA		AL	GA	MS	
JUL 93	LA		GA		LA		
AUG 93		LA		NF		LA	
SEP 93	TN		LA	MS	SC	KY	
OCT 93		TN		KY		NC	
NOV 93	NF		TN	SF		SC/TN	
DEC 93		NF					
JAN 94	SC/KY		NF				
FEB 94		KY				FL	
MAR 94	NC		SC/KY				
APR 94		SC/NC					
MAY 94	SF		NC				
JUN 94		SF	SF				

AUDIT DISCLOSURE NO. 2

SUBJECT: COMPUTER PARTS INVENTORY

STATEMENT OF FACTS: During a review of the Coopers and Lybrand audit workpapers and our sample of account 6512 we determined that an adjustment increasing expenses by \$11,700,000 total Company and \$3,220,334 for Florida was made. Coopers and Lybrand found the entry during an analytical review process because the account was higher than in previous years. We sampled account 6512 for the same reason. The Coopers and Lybrand notes stated that the adjustment was made because the computer parts inventory was overvalued because it had not been properly monitored in the past.

OPINION: Proper monitoring should eliminate the need for this entry in the future and therefore the expense should not be recurring. The regulated amount was computed using the Company MP2702 report as follows:

	TOTAL FLORIDA	% REGULATED	REGULATED AMOUNT	% INTRASTAT	INTRASTATE AMOUNT
Account 6124.1010	\$248,116.00	95.2700%	\$236,380.11	76.9536%	\$181,903.01
Account 6512.6000	\$2,972,216.00	94.1200%	\$2,797,449.70	73.2142%	\$2,048,130.42
	----- \$3,220,332.00		----- \$3,033,829.81		----- \$2,230,033.42
	-----		-----		-----

COMPANY COMMENTS: See Section IV attached.

AUDIT DISCLOSURE NO. 3

SUBJECT: BellCore Investment and Dividend

STATEMENT OF FACT: The Company included \$186,000 of BellCore Investment and Dividend as an adjustment to increase revenue on the Net Operating Income Schedule and a \$1,653,000 increase to Rate Base. According to the Company's response to a staff request on Net Operating Income, "The proforma adjustment came from the budget detail for 1992 and 1993. The budget shows a Florida dividend amount of \$769,000, whereas our workpaper shows a Florida dividend amount of \$254,000 ($\$254,000 * 73.2283\% = \$186,000$). This needs to be corrected. However, we need to revise this proforma based on actuals year to date, for revised testimony to be filed in December. The correct amounts have not yet been determined."

The Company provided staff with revised proformas based on actuals year-to-date, annualized. The Net Operating Income adjustment related to the dividend is \$791,000 ($\$1,077,704 * 73.3577\%$) and the revised investment adjustment to Rate Base amounts to \$5,121,000 ($\$6,980,543.50 * 73.3577\%$). The Company has stated that they will revise the proformas for this change.

OPINION: The adjustment on the Rate Base Schedule and Net Operating Income Schedule needs to be changed to actual.

AUDIT DISCLOSURE NO. 4

SUBJECT: SFAS 106 PROFORMA ADJUSTMENT

STATEMENT OF FACT: When the company revised their adjustments in July, they failed to change a number in their calculations based on updated costs for BST Expense Under FAS 106 net of BellSouth Business System and Business as Usual net of BellSouth Business Systems. The calculation follows:

	PER COMPANY	PER STAFF	DIFFERENCE
BST UNDER SFAS 106	232,000	232,000	\$0.00
BST BUSINESS AS USUAL	192,000	192,000	\$0.00
DIFFERENCE	40,000	40,000	\$0.00
BST UNDER FAS 106 NET OF BBS	201,700,000	223,269,600	(\$21,569,600.00)
BST BUSINESS AS USUAL NET OF BBS	166,924,138	184,857,600	(\$17,933,462.00)
DIFFERENCE	34,775,862	38,412,000	(\$3,636,138.00)
FLA. ALLOCATION	25.59%	25.59%	
INCREMENTAL BENEFIT TO FLA	8,899,143	9,829,631	(\$930,487.71)
BENEFITS CLEARED TO REGULATED EXPENSE	7,590,402	8,405,873	(\$815,471.00)
AVERAGE BENEFITS CLEARED TO PLANT	307,214	340,220	(\$33,006.00)
SHORT TERM CWIP	73,630	81,540	(\$7,910.00)
ACCUM DEPREC.(REMOVAL)	25,134	27,834	(\$2,700.00)
TAX ON EXPENSES	2,865,797	3,173,682	(\$307,885.00)
DEPRECIATION EXPENSE	25,321	28,041	(\$2,720.00)

These changes affect the proforma adjustment as follows:

TOTAL INTRA REG OPER. EXP.	5,820,000	6,446,000	(\$626,000.00)
PLANT IN SERVICE	231,000	256,000	(\$25,000.00)
PLANT UNDER CONSTRUCTION	55,000	61,000	(\$6,000.00)

In addition to the above, the company used the 1993 figures from the actuary study which were the highest of the four years presented.

In the numbers above, where the company used \$232,000,000 as the BST expense under FAS 106 including BBS, the average of 1993 to 1996 was \$227,750,000.

If the \$228,000,000 were used, the estimated effect on expenses would be:

1993 amount used by company	232,000,000
AVERAGE	227,750,000
DIFFERENCE	4,250,000
STATE ALLOCATOR	25.59%
	1,087,575
PERCENT ALLOCATED TO REGULATED EXPENSES	85.29%
	927,593
PERCENT ALLOCATED INTRA	76.43%
ESTIMATED OPERATING EXPENSE REDUCTION	
BEFORE DEPRECIATION	708,959

The company has used a discount rate in their calculation of SFAS 106 of 6% for management costs, 8% for non-management costs and 9% for expenses.

OPINION: The company should revise their filing for the error made in the BellSouth Business System allocation.

Since a rate case extends for a period of more than one year, an average of the SFAS costs may be more reasonable. If the commission chooses to use the average, the company should input the average amounts into their model to arrive at new proforma figures.

The discount rate used is lower than the cost of capital rate.

Staff never received adequate documentation on the portion of the adjustment related to working capital.

COMPANY COMMENTS: See Section IV attached.

AUDIT DISCLOSURE NO. 5

SUBJECT: SOFTWARE COSTS

STATEMENT OF FACTS:

The company purchases right to use fees for computer software associated with central office equipment and general purpose computers. Right to use fees consist of both operating system and applications software. The company provided a brief explanation of the treatment of software costs:

- Capitalize initial operating system software costs
- Capitalize software costs which are bundled with the hardware
- Expense applications software costs (both initial and subsequent) and subsequent operating system software costs.

In addition, a detail explanation of the treatment of software costs was provided in response to FPSC CWIP Audit AW9-032-5-1. See the following pages.

Per review of an FCC letter dated September 18, 1992, addressed to FPSC staff, the following was found.

"In Responsible Accounting Officer Letter No. 7 (RAO No. 7) some interpretive guidance is provided based on the USOA and the Commission's Report and Order in Docket 78-196 adopting the USOA. While the Report and Order -- and RAO No. 7 by reference to the Report and Order -- indicates an expectation that software additions and updates subsequent to the original purchase will be expensed, it does not preclude as a matter of course the capitalization of applications packages or right to use fees of any kind associated with the initial computer purchase."

"RAO No. 7 states: The disposition of all other software (i.e., that which is not considered initial operating system software) shall be determined by management and shall be in conformance with generally accepted accounting principles at the time such determination is made. Currently, this could result in the expensing or the capitalization of software costs, depending on an evaluation of all relevant circumstances."

"The general guiding principle is that any software essential for initiating the function for which the computer was purchased should be capitalized--including initial operating system software and applications software."

AUDIT OPINION: This issue was addressed by the FPSC Engineer in CWIP Audit AW9-032-5-1. Audit staff was initially informed this issue would be handled as a separate investigation by the Tallahassee staff. Therefore, other than items which came to our attention through our sampling procedures, we did not do any further work in this area. (See scope limitation).

COMPANY COMMENTS: See Section IV attached.

AUDIT EXCEPTION 1

OPINION 1

SBT is not in compliance with FCC Part 32 and other authorities listed above by expensing 96.5% of a total of \$1,526,734.68 initial software costs instead of capitalizing all software costs with the initial equipment installation.

COMPANY RESPONSE

There is no authoritative support for any requirement to capitalize all software costs.

The distinction between operating system and application software is essential in determining whether a software should be expensed or capitalized. The FCC's Chief, Accounting and Audits Division, included a definition as part of the Responsible Accounting Letter 7 (RAOL 7):

"Telephony's Dictionary (First Edition: June, 1982) defines "operating system" as "software that controls the management and execution of programs." On the other hand, an "application package" is defined as "a computer program designed to perform a particular type of work."

FCC Part 32, Report and Order released May 15, 1986 requires the capitalization of the operating system by stating:

"In the case of COE software, the initial right-to-use fee or operating system shall be classified with the central office equipment to which it predominantly relates."

The FCC's Memorandum Opinion and Order released on May 1, 1990 (RM-6911) underscores the FCC's intent to only require the capitalization of initial operating system software:

"Several of the commenting parties point to the record in the CC Docket 78-196 and indicate that our adoption of Section 32.2000(i), which requires only the capitalization of initial operating system software, did little to change a common practice already followed by the large carriers."

The Financial Accounting Standards Board (FASB) is the body which promulgates the accounting and reporting standards commonly referred to as Generally Accepted Accounting Principles (GAAP). The FASB has not directly addressed the accounting requirements for software purchased or developed for internal use. However, the issue was addressed indirectly in Appendix B to Financial Accounting Standard (FAS) 86, where the FASB decided not to broaden the scope of FAS 86 or add a new project to address this issue because a majority of the commenting companies were expensing all costs of software developed for internal use.

In accordance with Southern Bell's practices, estimate V2251 capitalized \$53,475.13 of initial operating system software and expensed \$1,473,259.55 of application software. Southern Bell's accounting policy for software is in conformance with the FCC directives mentioned above. Additionally, Southern Bell's policy is consistent with the predominant industry practice, and therefore is in conformance with GAAP and the general guidance provided by the FASB on this issue.

OPINION 2:

It appears that SBT has expensed the majority of software costs based on company (BellSouth) definitions of account 6210, Central Office Switching Expense, paragraph 2.1 (Exhibit VII) which states in part that "operating system fees (software), either for upgrades and maintenance of operating systems or for additional features in the same central office are chargeable to the expense account." The new 5ESS switch is an entirely new central office and the software costs are neither upgrades nor associated with maintenance and, therefore, do not meet the FCC Part 32 criteria for expensing.

COMPANY RESPONSE

Southern Bell agrees that the new 5ESS switch at Melbourne is an entirely new central office and that the software costs are neither upgrades nor associated with maintenance. That is why the \$53,475.13 of operating software costs were capitalized. However, the FCC's distinction between operating and application software supports the company's expensing of the \$1,473,259.55 in application software costs. Furthermore, application system software is synonymous with additional features. The fact that this is a new switch is only relevant with regard to operating system software costs, and not with the cost of the application software.

AUDIT DISCLOSURE NO 6

SUBJECT : AIRCRAFT EXPENSES

STATEMENT OF FACT: The list of miscellaneous aircraft expenses on the following pages were found in the sample of expenses charged to recoverable operational Account 6113 on the Net Operating Income Schedule.

OPINION: Since the legal expenses related to the Florida Attorney General Investigation including inside wire, non-contact sales and repair service were removed in the proforma adjustment; the aircraft expenses related to the investigation should also be removed. Lobbying expenses have also been removed in a proforma adjustment, therefore, the associated aircraft expenses should also be removed.

There may have been other aircraft expenses for the same purposes that were included in test year expenses that were not selected in the sample.

The Company should provide proof that the other trips shown provide a benefit to the ratepayers.

COMPANY COMMENTS: See section IV of this report.

Miscellaneous Aircraft Expenses

Item	Charge Code	Ending Date	Trip ID	Passenger Name/Title	Itinerary	Purpose	Trip Miles	Total Costs
463	N20000	12-13-90	JLAC	Crittenden, L.	Atl-Miami-Jax-Atl Jax-Miami-Atl	Exec. Officer Christmas Function	1056	\$5,227.20
463	N20000	12-13-90	JLAC	Crittenden, L.	Atl-Miami-Jax-Atl Jax-Miami-Atl	Exec. Officer Christmas Function	484	\$2,395.80
464	C30000	1-2-91	JLAC	Lacher, J. P.	Bham-Miami-Talla Miami-(RON)-Bham	Governors Inauguration	1850	\$18,315.00
472	C30000	4-17-91	JFIT	Skinner, B.	Atl- Talla-Atl- Miami-Atl	Attend Meeting on Florida repair investigation and non-contact sales investigation.	1474	\$14,592.60
473	N20000	4-1-91	LCR1	Crittenden, L.	Atl-Jax-(RON)-Atl Jax-Atl	Attend meeting concerning sales and reporting fraud investigation; Meeting with Financial Consultant	968	\$9,583.20

Item	Charge Code	Ending Date	Trip ID	Passenger Name/Title	Itinerary	Purpose	Trip Miles	Total Costs
473	N20000	4-24-91	LCR1	Boone, C. B.	Atl-Bham-(RON)-Atl	Attend Retirement Function	242	\$798.60
	N20000	4-24-91	LCR1	Boone, Suza	Jax-Atl-Jax-Atl	for L.E. Crittenden;	242	\$598.95
	N20000	4-24-91	LCR1	Cobble, Elna	"	Attend Function in honor of	242	\$598.95
	N20000	4-24-91	LCR1	Coble, R. M.	"	Elna Crittenden on behalf	242	\$798.60
	N20000	4-24-91	LCR1	Crittenden, L.	"	of L.E. Crittenden's	726	\$3,793.35
	N20000	4-24-91	LCR1	Crittenden, L.	"	retirement.	366	\$905.85
	N20000	4-24-91	LCR1	Crittenden, E	"	"	242	\$598.95
	N20000	4-25-91	EMC4	Coble, R. M.	Atl-Miami-Jax-Atl	Attend Retirement Function	124	\$153.45
	N20000	4-25-91	EMC4	Cobble, Elna	Bham-(RON)-Atl-Bha	for L.E. Crittenden;	124	\$153.45
	N20000	4-25-91	EMC4	Coble, R. M.	Atl-Jax-Miami-(RON)-		242	\$299.48
	N20000	4-25-91	EMC4	Sanders, C. J	Atl	"	775	\$1,274.96
	N20000	4-25-91	EMC4	Sanders, C. J	"	"	652	\$1,198.89
	N20000	4-25-91	EMC4	Sanders, Mar	"	"	484	\$698.78
	N20000	4-25-91	EMC4	Sanders, M.	"	"	124	\$153.45
	N20000	4-25-91	EMC4	Cobble, Elna	"	"	242	\$299.48
477	C30000	7-17-91	JLAC	Lacher, J. P.	Bham-Miami-(RON)-Ja Atl-Orlando-Miami-Bh	Attend Meeting on Florida repair investigation and non-contact sales investigation.	2212	\$21,898.80
477	C30000	7-31-91	JLAC	Lacher, J. P.	Atl-Miami-Atl-Miami- Atl	Attend Meeting on Florida repair investigation and non-contact sales investigation.	2112	\$20,908.80
479	C30000	8-27-91	JLAC	Lacher, J. P.	Atl-Miami-(RON)- St.	Attend Florida Repair	1070	\$7,830.90
	C30000	8-27-91	JLAC	Lacher, J. P.	Augustine-Atl- St. Augustine-Miami-Atl	Investigation Meeting	1056	\$5,227.20

Item	Charge Code	Ending Date	Trip ID	Passenger Name/Title	Itinerary	Purpose	Trip Miles	Total Costs
481	C30000	9-3-91	JLAC	Lacher, J. P.	Atl-Miami-(RON)-Wes Palm Beach-Atl-Miami Atl	Attend Meeting on Florida repair investigation and non-contact sales investigation.	2121	\$20,997.00
481	C30000	9-10-91	JLAC	Lacher, J. P.	Atl-Miami-Atl-Miami-Atl	Attend Meeting on Florida repair investigation and non-contact sales investigation.	2112	\$20,908.80
483	C30000	10-25-91	JLAC	Lacher, J. P.	Atl-Washington, D. C. Miami-Atl	Participate in taping of "Watch On Washington"	1788	\$17,701.20
483	C30000	10-31-91	JLAC	Lacher, J. P.	Atl-Miami-(RON)-Talla Washington D. C.-Atl-Miami	Make Congressional Contact	3016	\$29,858.40
484	N20000	10-17-91	WEER	Sanders, C. J	Atl-Bham-Jax-Talla-B Atl	Attend Meeting with Exec. State Rep. Glenn Mayre	138	\$455.40
486	C30000	11-20-91	JLAC	Lacher, J. P.	Bham-Miami-Atl-Mia Bham	Attend Meeting on Florida repair investigation and non-contact sales investigation.	2206	\$21,839.40
486	C30000	12-02-91	JLAC	Lacher, J. P.	Atl-Miami-Talla-Miami Bham	Attend Governor's Forum on State Economy	1803	\$17,849.70
487	N20000	11-27-91	SAND	Sanders, C. J	Atl-Pensacola-Atl-	Attend H. B. Jacks retirement function	502	\$1,242.46
487	N20000	11-27-91	SAND	Sanders, C. J	Bham-Atl-Pensacola-(RON)-Atl		750	\$5,460.84

Item	Charge Code	Ending Date	Trip ID	Passenger Name/Title	Itinerary	Purpose	Trip Miles	Total Costs
485		11-20-91	RET2	Snelling R. K.	Atl-Bham-Atl	Attend M. P. Greene's Retirement Function	248	\$716.10
485		11-27-91	RET2	Snelling R. K.	Atl-Bham-Atl	Attend H. B. Jacks	612	\$272.80
								<u>\$255,606.79</u>
								=====

AUDIT DISCLOSURE NO. 7

SUBJECT: Working Capital

STATEMENT OF FACT: Working Capital contains the following:

1140 Special Cash Deposits–Portion Accrues Interest	\$1,189,593.60
4360.2 Reorganization Deferred Credit–Relates to Expenses	(\$87,072.09)
1200.29 Miscellaneous Notes Receivable–Accrues Interest	\$98,150.63

Staff did not review the backup to the adjustment for \$36,083,285 on Schedule B–6C which removes the FR Adjustments which accrue the overearnings contingent liability.

COMPANY COMMENTS: See comments in Section IV of this report.

AUDIT DISCLOSURE NO. 8

SUBJECT: Legal Fees

STATEMENT OF FACT: The Company removed legal fees related to Grand Jury Investigations in their proforma adjustments. During our sampling of expenses we discovered invoices which were not removed. They are as follows:

Adorno & Zeder	\$188,153.84
Adorno & Zeder	\$236,608.21
Manuel Hernandez	\$13,698.80

	\$438,460.85
	=====

In addition, the Company booked an accrual for an expense and the actual expense without reversing the accrual entry. The entry is in December 1991, account 6725, (V01P, JAL410000) for \$42,197.55.

OPINION: A total of \$480,658.40 should be removed from expense account 6725.

86.00380%	Regulated	\$413,384.48
72.6068%	Intrastate	\$300,558.62

COMPANY COMMENTS: See section IV of this report.

RATE CASE

Audit Disclosure No. 1: CORE Study

The impact of the CORE study falls outside of the period which is being pro-formed. If anything, there may be an expense increase in 1993 due to costs of implementing the study, e.g., relocation, separation payments, etc. These work simplification, mechanization and consolidation efforts and the resulting force reductions such as this are part of the Company's productivity efforts. Taking away this savings and giving us a productivity hurdle results in taking these costs out of regulation twice. The current Incentive Plan's sharing and refund mechanisms and those proposed in the Price Regulation Plan provide protection for Florida ratepayers.

With regard to the movement of Company records, the Company plans to make every effort to continue to make necessary records and information accessible to the Audit Staff in order for it to meet its audit responsibilities.

Audit Disclosure No. 2: Computer Spare Parts Inventory

The write-down of the Computer Spare Parts Inventory was the result of an analysis of the activity affecting the computer spare parts held in SRC 1220.1980. The conclusions drawn from the analysis are threefold:

1. The value of some materials has become impaired (i.e., not useful to the company) due to obsolescence or overstocking.
2. The current value of some material has been overstated due to different pricing practices.
3. Maintaining materials with a value of \$100 or less in the perpetual inventory record is not cost-effective.

The write-down of Computer Spare Parts was an inventory adjustment to the company's books. However, given the continuing improvements in computer technology, the company expects similar adjustments will be recurring in the future. Therefore, it is not appropriate that this item be pro formed for 1993 results.

Audit Disclosure No. 3: BellCore Investment and Dividend

The Company plans to update its earnings calculation with the revised BellCore Investment and Dividend amounts.

Audit Disclosure No. 4: SFAS 106

Although we have not been able to recompute the proforma adjustment to verify the column labeled "Per Staff", we have made a cursory review of the calculations and agree that the "Per Staff" figures represent a reasonable recalculation of the proforma adjustment. However, the SFAS 106 price-out has been revised since the July 15, 1992 MFR filing to adjust for the terms of the new agreement reached by the Company and the CWA. The net result of that new agreement and the re-pricing of the BST "Business as Usual" amount should result in a smaller incremental cost to Florida. The proforma will be revised to reflect this latest SFAS 106 price-out for the testimony to be filed on December 18, 1992.

The pro forma adjustments take 1991 results and adjust them for known changes for 1993. Our estimate of 1993 (indeed our MFR filing) is not based on a long-range forecast. Our estimates of the SFAS 106 costs in years beyond 1993 will be trued-up each successive year. It is more likely that cost increments for these years will be greater at that time due to improvements in the contracted working agreement, than they are presently forecast to be. Therefore, it is more than likely that 1993 costs will not be the highest of the four years, even though it presently appears that way. These projections only take into account terms and conditions as they presently exist. They do not take into account possible changes in the working agreement.

The productivity offsets which the Company has proposed, and the sharing clause offered in the Price Regulation Plan are the control mechanisms for this and other cost-level changes which will take place over the course of the Plan.

Audit Disclosure No. 5: Software Costs

Our treatment of software costs is in compliance with Part 32 and Generally Accepted Accounting Principles (GAAP). We also feel that the treatment is in the best interest of consumers. As a result of increasing competition, we feel that the Florida Commission should continue to move forward full GAAP accounting. The Company will address the issue involving the treatment of software costs in the generic hearings.

Audit Disclosure No. 6: Aircraft Expense

The Company agrees that aircraft expenses related to issues previously reclassified out of regulation, e.g., inside wire, noncontact sales and repair service investigation, should also be removed from regulation. These were not reclassified previously through oversight. In addition, we will adjust for items not in the sample for reclassification and also will review other issues identified in the sample for proper classification.

Audit Disclosure No. 8: Legal Fees

The Company plans to remove the identified costs out of regulated costs via proforma adjustment. In addition, the Company has been in the process of reviewing legal costs for items which may have been missed in the previous reclassifications. Any additional items which are uncovered will also be removed from regulated costs.

Rate Base Summary
Adjusted
(000)

FLORIDA PUBLIC SERVICE COMMISSION
Company Southern Bell Telephone & Telegraph Co.
Rochester 920260-FL
Test Year 1991

Schedule B-1s
Page 1 of 1
Witness Responsible

Check whether data is:
Historic [X] or Projected []
Average [X] or Year End []

Line No.	Rate Base Component (1)	(3 + 4) Total Company (2)	Interstate Toll (3)	(5 + 8) Total Intrastate (4)	(6 + 7) Intrastate Toll (5)	Intrastate Toll		
						InterLATA (6)	IntraLATA (7)	Local (8)
1.	Plant in Service	8,678,429	2,175,503	6,501,126	1,423,631	712,285	704,346	3,001,496
2.	Less Reserve for							
3.	Accumulated							
4.	Depreciation	3,197,401	812,428	2,384,927	528,159	267,506	260,651	1,856,768
5.	Net Plant in Service	5,481,223	1,363,025	4,118,199	895,471	444,779	443,692	3,274,728
6.	Plus Short-Term Plant							
7.	Under Construction on							
8.	which an Interest Has							
9.	Charged	35,620	33,499	42,211	9,304	9,651	4,650	32,907
10.	Plus Property Held for							
11.	Future Telephone Use	327	83	244	55	21	27	189
12.	Plus Working Capital							
13.	Allowance	(110,801)	(10,841)	(110,164)	(2,600)	(973)	(1,825)	(7,560)
14.	Other Items	0	0	0	0	4	0	0
15.	Rate Base	5,510,371	1,367,876	4,150,495	900,231	453,487	444,744	3,250,264

Supporting Schedules: A-1a, A-1b, B-2a, B-2b, C-1b

Recap Schedules: A-1a, A-2a, A-2b, A-2c, A-2e

P0002

1/15/92

FLORIDA PUBLIC SERVICE COMMISSION

COMPANY: Southern Bell

DOCKET NO.: 920260-TL

EXPLANATION: Reconcile the total capital structure (as shown on Schedule D-1a) with the jurisdictional 15-month average rate base for the corresponding time period (as shown on Schedule D-3b). Provide this schedule for the test year, and the prior year if the test year is projected.

Type of Data Shows:

1 Historical Test Year Ended 12/31/91
 Projected Test Year Ended / /
 Prior Test Year Ended / /

Witness:

Line No	Description	Long-Term Debt (1)	Short-Term Debt (2)	Preferred Stock	Customer Deposits	Common Equity (3)	Tax Credits Zero Cost	Tax Credits Weighted Cost	Deferred Inc. Taxes	Total
1	Total Southern Bell									
2	per Books (000)	3,428,080	532,655	0	103,699	6,665,509	613	911,400	2,260,438	13,402,390
3	Allocation Percentage	42.13%	42.13%	N/A	N/A	42.13%	N/A	N/A	N/A	N/A
4										
5	Florida	1,444,361	224,425	0	54,382	2,808,393	179	194,557	972,858	5,699,134
6	Allocation Percentage	99.11%	99.11%	N/A	98.24%	99.11%	99.59%	99.62%	99.41%	N/A
7										
8	Regulated Florida	1,431,553	222,435	0	53,423	2,783,491	178	193,824	967,154	5,652,059
9	Intrastate I	73.16%	73.16%	N/A	73.16%	73.16%	72.78%	74.88%	74.99%	N/A
10										
11	Intrastate, unadjusted	1,047,344	162,736	0	39,085	2,036,439	130	145,138	725,253	4,156,125
12	Specific Adjustments:									
13 a.	Customer Deposits				15,297					15,297
14 b.	WECO Tax Credits								33,366	33,366
15 c.	SPF Transition, 1991-92								6,218	6,218
16 d.	SPF Transition, 1992-93								6,218	6,218
17 e.	DEM Transition, 1991-92								5,500	5,500
18 f.	DEM Transition, 1992-93								2,750	2,750
19 g.	Reorganization							206	750	956
20 h.	1992 Depreciation						0	302	3,220	3,522
21 i.	1993 Depreciation						1	725	7,719	8,445
22 j.	1992 Impact-Represcription						0	11	117	128
23 k.	1993 Impact-Represcription						(10)	(280)	(3,673)	(3,952)
24										
25	Subtotal	1,047,344	162,736	0	54,382	2,036,439	131	146,102	787,440	4,234,573
26 j.	BSF Capital Structure	43,162	(30,603)			(12,559)				(0)
27										
28	Subtotal	1,090,506	132,133	0	54,382	2,023,880	131	146,102	787,440	4,234,573
29										
30	Pro Rata Adjustments	16,064	1,946	0	801	29,813	2	2,152	11,600	62,378
31										
32										
33	Jurisdictional									
34	Capital Structure	1,106,570	134,080	0	55,183	2,053,693	133	148,254	799,039	4,296,951
35										
36	Percent of Total									
37	Capital	25.73%	3.12%	0.00%	1.28%	47.79%	0.00%	3.45%	18.68%	100.00%

(1) Includes total long-term debt from Schedule D-3b and Account 1407, Unamortized Bond Issuance Expense.

(2) Includes accounts 4020, 4050, and 4050.

(3) Includes Account 4120.2000, Accrued Dividends as follows: Southern Bell, 69,636; Florida Regulated, 29,080; Intrastate, 21,275.

12-07-92 02:51 PM

Rate of Return
Per Book, Adjusted and Proposed
(000)

FLORIDA PUBLIC SERVICE COMMISSION
Company Southern Bell Telephone & Telegraph Co.
Docket No. 920260-TL
Test Year 1991

Schedule A-2e
Page 1 of 1
Witness Responsible

Check Whether Data Is:
Historic [X] or Projected []
Average [] or Year End []

Line No.	Account (1)	Intrastate Per Books (2)	Commission Basis †		Company Basis †	
			Adjusted Results (3)	Earnings at Proposed Rates (4)	Adjusted Results (5)	Earnings at Proposed Rate (6)
1.	Operating Revenues					
2.	Local Service	1,347,886	1,325,915	1,325,915	1,336,315	1,336,315
3.	InterLATA	274,884	274,694	274,694	269,694	269,694
4.	IntraLATA	346,847	347,383	347,383	328,683	328,683
5.	Miscellaneous	294,813	317,940	317,940	317,941	317,941
6.	Uncollectibles	39,941	39,415	39,415	39,177	39,177
7.	Total Operating Revenues	2,224,489	2,226,517	2,226,517	2,213,456	2,213,456
8.	Operating Expenses					
9.	Plant Specific	369,711	366,878	366,878	368,635	368,635
10.	Plant Nonspecific	196,745	179,928	179,928	181,347	181,347
11.	Depreciation	546,255	518,897	518,897	538,179	538,179
12.	Customer Operations	307,497	294,138	294,138	296,199	296,199
13.	Corporate Operations	212,453	201,781	201,781	202,345	202,345
14.	Other (483)		187	187	602	602
15.	Total Operating Expenses	1,632,178	1,561,809	1,561,809	1,587,306	1,587,306
16.	Taxes					
17.	Federal income tax	76,165	100,533	100,533	89,993	89,993
18.	State income tax	15,187	22,256	22,256	20,549	20,549
19.	Other taxes	122,509	124,399	124,399	124,273	124,273
20.	Total Tax Expense	213,861	247,188	247,188	234,815	234,815
21.	Total Operating Expenses and Taxes	1,846,039	1,808,997	1,808,997	1,822,121	1,822,121
22.	Net Operating Income	378,450	417,521	417,521	391,335	391,335
23.	Rate Base (from Schedule A-2d)	4,115,390	4,159,207	4,159,207	4,150,495	4,150,495
24.	Rate of Return	9.20%	10.04%	10.04%	9.43%	9.43%

† The difference between Commission Basis and Company Basis includes entries 29, 32, 34, 35, 36, 38, 39, and 40 on Schedule A-6a.

Supporting Schedules: A-2a, A-2b, A-2d, A-6a, A-6b, B-1a, B-1b, B-2h, C-1a, C-1b

Recap Schedules: A-1a