

M E M O R A N D U M

January 15, 1998

TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (VANDIVER) *W*

RE: DOCKET NO. 920260-TL -- BELLSOUTH TELECOMMUNICATIONS
SURVEILLANCE AUDIT REPORT - PERIOD ENDED DECEMBER 31, 1996
AUDIT CONTROL NO. 97-155-1-1

The above-referenced audit report is forwarded. Audit exceptions document deviations from the Uniform System of Accounts, Commission rule or order, Staff Accounting Bulletin and generally accepted accounting principles. Audit disclosures show information that may influence the decision process.

The audit was prepared using a micro computer and has been recorded on three diskettes. The diskettes may be reviewed using IBM compatible equipment and LOTUS 1-2-3 software. There are confidential working papers associated with this audit.

Please forward a complete copy of this audit report to:

BellSouth Telecommunications, Inc.
Nancy H. Sims
150 South Monroe Street, Suite 400
Tallahassee, Florida 32301-1556

DNV/sp

Attachment

cc: Chairman Johnson
Commissioner Clark
Commissioner Deason
Commissioner Garcia
Commissioner Jacobs
Mary Andrews Bane, Deputy Executive Director/Technical
Legal Services
Division of Auditing and Financial Analysis (Devlin/Salak/Causseaux/
Wright/Mailhot/Maurey/File Folder)
Tallahassee District Office (Hicks)

Research and Regulatory Review (Harvey)
Office of Public Counsel

DOCUMENT NUMBER-DATE

00962 JAN 16 88

FPSC-RECORDS/REPORTING

FLORIDA PUBLIC SERVICE COMMISSION
AUDIT REPORT
12 MONTHS ENDED DECEMBER 31, 1996
FIELD WORK COMPLETED
JANUARY 12, 1998
BELLSOUTH TELECOMMUNICATIONS, INC.
FLORIDA
SURVEILLANCE AUDIT
DOCKET 920260-TL
AUDIT CONTROL NUMBER 97-155-1-1


MICHAEL E. BUCKLEY
AUDIT MANAGER

AUDIT STAFF


BOB MOORE

EDWARD BASS

MINORITY OPINION

YES ___ NO RTM

YES ___ NO EB


RHONDA HICKS
REGULATORY ANALYST SUPERVISOR
TALLAHASSEE DISTRICT OFFICE

DOCUMENT NUMBER-DATE

00962 JAN 16 88

FPSC-RECORDS/REPORTING

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I. Executive Summary

Audit Purpose: We have applied the procedures described in Section II of this report to audit the Schedules of Rate Base, Net Operating Income, and Capital Structure for the year ended December 31, 1996 prepared by BellSouth Telecommunications, Inc. - Florida, for their Earnings Surveillance Report in support of Docket 920260-TL. This report is based on confidential information which is separately filed with the Division of Records and Reporting. There are no audit staff minority opinions. The audit exit conference was held on January 12, 1998.

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

Opinion: In our opinion, the schedules referred to above present fairly, in all material respects, BellSouth Telecommunications, Inc. - Florida's books and records, maintained in conformity with the accounting practices prescribed by the Florida Public Service Commission. The attached findings discuss all differences and other matters which were noted during our examination.

II. Audit Scope

The opinions contained in this report are based on the audit work described below. When used in this report, the following definition shall apply:

COMPILED - 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.

RATE BASE: Obtained workpapers for selected adjustments; verified that accounting adjustments to Rate Base are computed correctly and are consistent with the interim statute (requiring adjustments consistent with the Company's last Rate Case/MMFR); compiled Rate Base components and adjustments; traced adjustments to supporting documentation; compiled Working Capital; analyzed and recalculated the Cash Working Capital Allowance schedule, which is an allocation from the parent; agreed Cash Working Capital to the Company's computation of Cash Working Capital.

NET OPERATING INCOME: Compiled net operating income; performed analytical review of operating revenue and expense accounts, and non-operating expense accounts; performed statistical sampling of selected function codes from regulated operating expenses.

CAPITAL STRUCTURE: Compiled and recalculated 13-month averages for each General Ledger account in capital; recalculated the cost of long-term debt; obtained copies of all long-term debt agreements; agreed the allowed cost rates for the equity to the Company's last Commission order governing equity rates; verified short-term debt outstanding at year-end; recomputed customer deposits; recalculated cost rate for investment tax credit; recomputed cost free capital; verified Company specific and pro rata adjustments to applicable capital structure items; recomputed BellSouth Telecommunications, Inc. weighted cost of capital as of December 31, 1996.

OTHER: Read Coopers and Lybrand financial and cost allocation working papers for BellSouth Telecommunications and BellSouth Corporation (Headquarters) for 1996. Read 1996 Internal Audit Reports. Read all BellSouth Telecommunications and BellSouth Corporation Board of Directors minutes including minutes for meetings of the Committees of the Board of Directors. Prepared Trial Balance and agreed to the General Ledger.

II. Audit Disclosures

AUDIT DISCLOSURE NO. 1

SUBJECT: Removal of Sharing Accruals

STATEMENT OF FACTS: Account 4120.82 is used for accruals of estimated overearnings. It has a year end credit balance of \$42,833,000. This amount included credits totaling \$28,000,000 accrued in 1996 and debits of \$1,500,000 in January 1996 and \$7,217,000 in July 1996 for prior accruals. Also included in the account was a credit of \$23,550,000 accrued in prior years.

The \$7,217,000 debit was for the remainder of 1994 sharing refund. There was no sharing refund in 1995. The Preliminary refund of 1996 Sharing Amount per Order No. PSC-97-0632-FOF-TL is \$50,100,000. The Surveillance Report shows an adjustment of \$50,115,000 as "Sharing Computation" reducing revenue and shows an adjustment of \$26,500,000 increasing revenue to: "Remove sharing accruals booked". This would leave a credit balance of \$16,333,000 in the accrual account.

RECOMMENDATION: Surveillance Report revenue should be increased by \$16,333,000. Since an adjustment for actual overearnings is made, the total accrual of estimated overearnings should be reversed.

AUDIT DISCLOSURE NO. 2

SUBJECT: Long-Term Debt

STATEMENT OF FACT: The Company recorded a \$500,000,000 long-term debt titled Zero-To-Full (ZTF) Debenture at the price to the public of \$126,175,000, due December 15, 2095. The interest is calculated monthly at 6.65% and charged to expense. The credit is added to the principal balance of \$126,175,000. No interest is currently paid out. Beginning December 15, 2015, interest on the \$500,000,000 aggregate principal amount of the ZTF Debentures will accrue and be payable semiannually on June 15 and December 15 of each year, commencing June 15, 2016, and such principal amount will be payable at maturity. The Debentures will not be redeemable prior to maturity.

Long-Term Debt	Principal Amount	Price to the Public
Per ZTF Debenture	100.00%	25.235%
Total	\$500,000,000	\$126,175,000

RECOMMENDATION:

Long-Term Debt	Principal Amount	Price to the Public Issued 12/15/95	Discount
Per ZTF Debenture	100.00%	25.235%	74.765%
Total	\$500,000,000	\$126,175,000	\$373,825,000

The Zero-To-Full Debenture should be recorded at the principle amount of \$500,000,000.

In accordance with GAAP, the discount of \$373,825,000 should be amortized over the 100 year life of the bond. This results in an annual amortization expense of \$3,738,250. Also in accordance with GAAP, the total issuing expense of \$2,175,000 should be amortized over the life of the bond for an annual amortization issuing expense of \$21,750.

The books should not reflect interest expense until paid beginning June 15, 2016.

AUDIT DISCLOSURE NO. 3

SUBJECT: Investment Tax Credit Cost Rate

STATEMENT OF FACT: The Company's Investment Tax Credit (ITC) cost rate is calculated using Long-Term Debt and Common Equity. The Company's ITC cost rate is calculated on the Surveillance Report as follows:

Average Capital	Adjusted Amount	% of Total	Cost Rate	Weighted Cost Rate
Long Term Debt	\$1,134,539,417.97	37.39%	6.61%	2.47%
Common Equity	\$1,899,468,626.58	62.61%	14.12%	8.84%
Total	\$3,034,008,044.55	100.00%		11.31%

RECOMMENDATION: There are times when the ITC cost rate is calculated using Long-Term Debt, Common Equity, and Short-Term Debt. Further analysis may determine that it is appropriate to include short-term debt in BellSouth's ITC cost rate calculation. The ITC cost rate using Short-Term Debt is calculated as follows:

Average Capital	Adjusted Amount	% of Total	Cost Rate	Weighted Cost Rate
Long Term Debt	\$1,134,539,417.97	34.85%	6.61%	2.30%
Short Term Debt	\$221,321,699.54	6.80%	5.41%	.37%
Common Equity	\$1,899,468,626.58	58.35%	14.12%	8.24%
Total	\$3,255,329,744.09	100.00%		10.91%

AUDIT DISCLOSURE NO. 4

SUBJECT: Olympics and Special Olympics Expense

STATEMENT OF FACT: The Company reports a total expense related to the Olympics and Special Olympics of \$11,255,293. Since the Olympics were held in Georgia, most of the expenses were charged to Georgia. The Florida portion is \$102,198, with \$55,207 being included in Florida intrastate expense. Olympic costs to Florida were charged to the following function codes and accounts:

Code	Function Code Code Name	Account Number Name	Amount	Regulated Intrastate
0820	Summer 96 Olympics	7370 Special Charges	(A) \$19,616.00	0.00
2220	Sales - Summer 96 Olympics	6612 Sales	(B) \$79,315.00	(C) \$55,207.00
222007	Sales - Olympics Voice Mail	6612 Sales	(A) \$ 1,168.00	0.00
222047	Sales - Olympics Inside Wire	6612 Sales	(A) \$ 2,099.00	0.00
Total Olympic Charges to Florida			\$102,198.00	\$55,207.00

- (A) Non-Operating Expenses
- (B) Both Operating and Non-Operating Expenses
- (C) Portion charged to Regulated Operating Expenses.

RECOMMENDATION: The \$55,207 is a nonregulated expense. The Company should reduce regulated expenses by this amount.

AUDIT DISCLOSURE NO. 5

SUBJECT: Centennial Olympic Park Fund

STATEMENT OF FACT: An invoice dated July 9, 1996 payable to the Atlanta Chamber Foundation in the amount of \$50,000 was charged to account 6728.90, Other General and Administrative Expense. The payment was a contribution to the Centennial Olympic Park Fund.

Subsequent to the filing of the 1996 Surveillance Report, the Company discovered a Headquarters payment of \$50,000 for the Olympic Centennial Park Fund. The Florida intrastate portion of this payment is \$9,303.

RECOMMENDATION: The \$9,303 is a nonregulated expense. The Company should reduce regulated expenses by this amount.

FLORIDA PUBLIC SERVICE COMMISSION
 TELEPHONE EARNINGS SURVEILLANCE REPORT

Page 1

Company : BellSouth Telecommunications, Inc. - Florida
 12 Months Ended : December 31, 1996

RATE BASE(000)	(1) Total Company Columns (2 + 3)	(2) Interstate Toll	(3) Total Intrastate Columns (4 + 7)
AVERAGE RATE BASE			
1. Plant in Service	\$10,482,055	\$2,652,770	\$7,829,285
2. Accumulated Depreciation and Amortization	<u>5,149,860</u>	<u>1,313,559</u>	<u>3,836,301</u>
3. Net Plant in Service	5,332,195	1,339,211	3,992,984
4. Property Held for Future Use	0	0	0
5. TPUC	38,049	9,611	28,438
6. Working Capital Allowance	<u>(\$173,677)</u>	<u>(\$33,112)</u>	<u>(\$140,565)</u>
7. Per Books Average Rate Base	<u>5,196,567</u>	<u>1,315,710</u>	<u>3,880,857</u>
8. % Distribution	<u>100%</u>	<u>25.32%</u>	<u>74.68%</u>
ADJUSTMENTS TO AVERAGE RATE BASE			
9. Adjustments for Achieved Rate Base			<u>\$22,662</u>
10. Adjusted Achieved Rate Base			<u>3,903,519</u>
RATES OF RETURN			
11. Average Per Book	<u>9.62%</u>	<u>13.93%</u>	<u>8.16%</u>
12. Average FPSC Adjusted			<u>9.32%</u>

FLORIDA PUBLIC SERVICE COMMISSION
TELEPHONE EARNINGS SURVEILLANCE REPORT

Page 2

Company : BellSouth Telecommunications, Inc. - Florida
12 Months Ended : December 31, 1996

NET OPERATING INCOME (000)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Total Company Columns (2 + 3)	Interstate Toll * Toll *	Total Intrastate Columns (4 + 7) #	Intrastate Toll Columns (5 + 6)	— Intra Toll — Inter- territory Intra- territory		Local
BOOKED REVENUE							
1. Basic Local Service Revenue	\$1,880,681	\$286	\$1,880,395	\$0	\$0	\$0	\$1,880,395
2. Network Access Revenue							
a. BHMOC	0	0	0	0	0	0	0
b. MOU Access	707,275	462,703	244,572	244,572	238,838	5,734	0
c. Special Access	9,560	0	9,560	9,560	9,511	49	0
d. Other Access	431,201	424,732	6,469	6,469	7,368	(899)	0
3. Long Distance Revenue							
a. MTS	80,745	156	80,589	80,589	0	80,589	0
b. Other	84,792	264	84,528	84,528	0	84,528	0
4. Subsidy Revenue	(1,429)	0	(1,429)	(1,429)	(1,179)	(250)	0
5. Miscellaneous Revenue	237,338	28,439	208,899	17,776	13,592	4,184	191,123
6. Uncollectible Revenues	38,884	8,366	30,518	6,770	1,834	4,936	23,748
7. Net Booked Revenue	<u>\$3,391,279</u>	<u>\$908,214</u>	<u>\$2,483,065</u>	<u>\$435,295</u>	<u>\$266,296</u>	<u>\$168,999</u>	<u>\$2,047,770</u>
OPERATING EXPENSES							
8. Plant Specific Operation Expense	601,290	150,079	451,211				
9. Plant Non-Specific Operations Exp	236,835	60,710	176,125				
10. Access Expense	9,225	0	9,225				
11. Depreciation and Amortization	732,216	190,543	541,673				
12. Customer Operations Expense	485,104	91,367	393,737				
13. Corporate Operations Expense	444,122	110,944	333,178				
14. Other Income and Expense	(240)	(325)	85				
15. Total Operating Expense	<u>\$2,508,552</u>	<u>\$603,318</u>	<u>\$1,905,234</u>				
16. % Distribution	<u>100%</u>	<u>24.05%</u>	<u>75.95%</u>				
OPERATING TAXES							
17. Federal Income Tax	160,716	74,804	\$85,912				
18. State Income Tax	29,017	14,720	14,297				
19. Other Taxes	193,201	32,093	161,108				
20. Total Operating Taxes	<u>\$382,934</u>	<u>\$121,617</u>	<u>\$261,317</u>				
NET OPERATING INCOME							
21. Per Book NOI	<u>\$499,793</u>	<u>\$183,279</u>	<u>\$316,514</u>				
22. NOI Effect of Adjustments			47,130				
23. Adjusted NOI			<u>\$363,644</u>				

NOTES:

2. (a) Busy Hour Minutes of Capacity Charge
 - (b) Includes Local Switching, Local Transport, Line Termination, Carrier Common Line, Inter-toll Trunking and Toll Switching
 - (c) For Intrastate, Interterritory Station Terminals.
 - (d) Includes testing, ordering, labor, etc.
3. (a) Includes only charges billed to customers and retained by the company, not charges billed on behalf of IXCs.
 - * Includes \$ 11,606,682 for Universal Service Fund
 - # Above expenses include regulatory and legislative liaison expenses of \$ 1,169,000. See the Lobbying Expense and Other Regulatory Adjustments proformas for the legislative and liaison expenses excluded for rate making purposes.

FLORIDA PUBLIC SERVICE COMMISSION
TELEPHONE EARNINGS SURVEILLANCE REPORT

Company : BellSouth Telecommunications, Inc. - Florida
12 Months Ended : December 31, 1996

AVERAGE CAPITAL (INTRASTATE) (000)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	Average Per Books	Specific Adjustments	Pro Rata Adjustments	Adjusted Amount	% of Total	Sharing *	Cost Rate Actual	Ceiling	Sharing *	Weighted Cost Rate Actual	Ceiling
1. Long Term Debt	1,150,681		(16,142)	\$1,134,539	29.06%	6.61%	6.61%		1.91%	1.91%	
2. Short Term Debt	224,471		(3,149)	221,322	5.67%	5.41%	5.41%		0.31%	0.31%	
3. Preferred Stock	0		0	0	0.00%	0.00%	0.00%		0.00%	0.00%	
4. Customer Deposits	15,807		(222)	15,585	0.40%	6.69%	6.69%		0.03%	0.03%	
5. Common Equity	1,907,916	18,578	(27,025)	1,899,469	48.66%	13.11%	14.12%	14.50%	6.38%	6.87%	7.06%
6. Investment Tax Credits	64,688		(907)	63,781	1.63%	10.31%	11.31%	11.55%	0.17%	0.18%	0.19%
7. Cost Free Capital	544,520	32,396	(8,093)	568,823	14.58%	0.00%	0.00%		0.00%	0.00%	
8. Total Capital	\$3,908,083	\$50,974	(\$11,538)	\$3,903,319	100.00%				8.80%	9.30%	9.30%

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FINANCIAL RATIO

9. Intrastate achieved return on equity
FPSC Adjusted Basis 14.12% @

See Attachment A to Page 3 for signature.

* The 13.11% sharing cost rate for equity is based on the most recent AA Utility Bond rates available.
@ This ROE includes accruals of \$50.1M for sharing for 1996.