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AUDITING & FINANCIAL ANALYSIS
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Public Service Commission

March 11, 1999

BellSouth Telecommunications, Inc.
Tom Lohman
675 West Peachtree Street
Atlanta, Georgia 30375

**Re: Docket No. 920260-TL
Audit Report - Earnings Review**

Mr. Lohman:

The enclosed audit report is forwarded for your review. If you desire to file a response to the audit, please file one with the Division of Records and Reporting so it may be forwarded for consideration by the staff analysts in their review of the audit.

Sincerely,

Denise N. Vandiver
Bureau Chief - Auditing

- ACK _____
- AFA _____
- APP _____
- CAF _____ DNV/:sp
- CMU _____ ee: ✓ Division of Records and Reporting
- CTR _____ Division of Auditing and Financial Analysis (Devlin/Causseaux/Wright/File Folder)
- EAG _____ Tallahassee District Office (Hicks)
- LEG _____ Division of Legal Services
- LIN _____ Office of Public Counsel
- OPC _____ Research and Regulatory Review (Harvey)
- RCH _____
- SEC _____ I
- WAS _____
- OTH _____

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FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING

Tallahassee District Office

BELLSOUTH TELECOMMUNICATIONS, INC.

EARNINGS REVIEW

HISTORICAL YEAR ENDED DECEMBER 31, 1997

DOCKET NO. 920260-TL

AUDIT CONTROL NO. 98-156-1-1

Michael E. Buckley

Michael E. Buckley, *Audit Manager*

Edward D. Bass

Edward Bass, *Audit Staff*

Rhonda J. Hicks

Rhonda Hicks, *Audit Supervisor*

TABLE OF CONTENTS

I.	AUDITOR'S REPORT	PAGE
	PURPOSE	1
	DISCLAIM PUBLIC USE	1
	OPINION	1
	SUMMARY OF SIGNIFICANT FINDINGS	2
	SUMMARY OF SIGNIFICANT PROCEDURES	2
II.	DISCLOSURES	
1.	INTRALATA PRESUBSCRIPTION	3
2.	BAPCO	4
3.	NON-REGULATED EXPENSES	5
4.	ACCOUNTING CORRECTIONS	6
5.	ADVERTISEMENTS	7
III.	EXHIBITS	
	RATE BASE	8
	NET OPERATING INCOME	9
	CAPITAL STRUCTURE	10

**DIVISION OF AUDITING AND FINANCIAL ANALYSIS
AUDITOR'S REPORT**

FEBRUARY 26, 1999

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the historical 12-month period ended December 31, 1997, for BellSouth Telecommunications, Inc. - Florida (BST - Florida). These schedules were prepared by the Utility for its Earnings Surveillance Report in support of Docket No. 920260-TL. There is confidential information associated with this audit. Copies of this information were sent to the Company on March 8, 1999. The information is separately filed with the Division of Records and Reporting. There are no audit staff minority opinions.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon 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 auditing standards and produce audited financial statements for public use.

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.

SUMMARY OF SIGNIFICANT FINDINGS

Intralata Presubscription was overstated. This reduces Rate Base by \$7,663,002. BellSouth Advertising and Publishing Company (BAPCO) Gross Profit was overstated by \$6,464,002. This reduces gross profit. Non-regulated expenses in the amount of \$13,973.34 were reported above the line. This increases gross profit. Various accounting adjustments need to be made which will increase income \$5,632.86. Advertisements for non-regulated items were charged above the line. This will increase income \$44,138.67.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Verify - The item was tested for accuracy, and substantiating documentation was examined.

RATE BASE: Obtained work papers for selected adjustments; verified that accounting adjustments to Rate Base are computed correctly and are consistent with the Company's last Rate Case; 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 parent; agreed reported 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 and clearing accounts.

CAPITAL STRUCTURE: Compiled and recalculated 12-month averages for each general ledger account; recalculated the cost rate for long-term debt; agreed the allowed cost rate for 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; verified cost free capital; verified Company specific adjustments to applicable capital structure items; recomputed Company's weighted cost of capital as of December 31, 1997.

OTHER: Read Coopers and Lybrand financial and cost allocation working papers for BellSouth Telecommunications and BellSouth Corporation (Headquarters) for 1997. Read 1997 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.

Disclosure No. 1

Subject: Intralata Presubscription

Statement of Fact: Intralata Presubscription gives the telephone customer the ability to preselect a telecommunications company to carry that customer's instate toll calls. Intralata Presubscription expenses are reversed on the surveillance report and charged as if they were an amortization of a deferral. In the 1997 surveillance report BST increased rate base \$5,482,790 for Intralata Presubscription. The \$5,482,790 represents the rate base impact of Intralata Presubscription. The breakdown by account is as follows:

Account 2212 - Digital Electronic Switching Investment	\$2,321,100
Account 3100 - Depreciation Reserve	(140,888)
Account 1439 - Deferred Charges	<u>3,302,577</u>
Total	<u>\$5,482,790</u>

Recommendation: After reviewing the amounts used on the surveillance report, the Company discovered the rate base impact should have been a reduction to rate base for the net of account 2212 less account 3100, or \$2,180,212, since these amounts are on BST-Florida books. The account 1439 amount represents what the deferred charges would have been if the costs were deferred.

Therefore, Rate Base in the June 1998 filing of the 1997 surveillance report should be reduced by \$7,663,002 (\$5,482,790 + \$2,180,212).

Disclosure No. 2

Subject: BAPCO

Statement of Fact: Prior to 1997, total operating revenues reported by BellSouth Advertising and Publishing Company (BAPCO) included National Yellow Pages (NYPS), net of commissions.

Recommendation: In 1997 total operating revenues of \$268,668,080 reported by BAPCO included NYPS commissions of \$6,504,281. Revenues for 1997 need to be reduced by the commissions. BAPCO's reported revenues are used in the computation of the Publication Fee used on BST books under the old contract. This results in reducing revenue by \$6,504,281.

In addition, BST stated that BAPCO expenses should be adjusted from \$1,785,998 to \$1,745,719, resulting in reducing expenses by \$40,279.

The revenue and expense adjustments reduce Gross Profit for BAPCO in the annual report Schedule (Z-7) by \$6,464,002.

Disclosure No. 3

Subject: Non-regulated Expenses

Statement of Fact: A random sample of expenses selected by resource type code was examined by the auditors. Because of confidentiality, the invoices will be referenced by number only. The invoices are filed with the confidential work papers.

Recommendation: Staff auditors recommend the following expenses be transferred from above-the-line to below-the-line because they are non-regulated.

<u>Voucher</u>	<u>Amount</u>
B1 - 37	\$1,980.55
B1 - 44	888.00
B1 - 7	2,506.65
B1 - 8	2,149.79
B1 - 60	952.19
B1 - 46	1,904.24
B1 - 49	356.75
B2 - 57	527.71
B2 - 75	754.51
B2 - 77	176.22
A2 - 86	61.11
B2 - 53	149.47
B1 - 48	328.15
B1 - 15	438.00
A2 - 68	<u>800.00</u>
Total	<u>\$13,973.34</u>

Disclosure No. 4

Subject: Accounting Corrections

Statement of Fact: The following errors were discovered in the random expense sample. Because of confidentiality, the vouchers are referenced by number only. The invoices are filed with the confidential work papers.

<u>Voucher</u>	<u>Account</u>	<u>Amount</u>	<u>Error</u>
C1-1	7150.1000	(\$3,264.35)	Entry was made in error.
C1-15	7150.2000	370.94	Entry was made in error.
C1-16	7150.2000	3,491.31	Entry was made in error.
C1-19	7150.2000	9,000.00	Allocation error.
C1-24	7150.2000	437.59	Allocation error.
C2-14	7160.2000	7.16	Incorrect account charged.
C2-15	7160.2000	28.35	Incorrect account charged.
C2-16	7160.2000	95.21	Incorrect account charged.
C2-19	7160.2000	(3,184.00)	Incorrect account charged.

Recommendation: The following accounting corrections should be made by the Company to reverse the entries above made in error.

<u>Account</u>	<u>Amount</u>	
	<u>Debit</u>	<u>Credit</u>
7150.1000 - Gains from Disposition of Land and Artworks	\$3,264.35	
1439.9500 - Cost of Sale/Purchase - Deferred		\$3,264.35
1439.9500 - Cost of Sale/Purchase - Deferred	370.94	
7150.2000 - Losses from Disposition of Land and Artworks		370.94
1439.9500 - Cost of Sale/Purchase - Deferred	3,491.31	
7150.2000 - Losses from Disposition of Land and Artworks		3,491.31
1439.9500 - Cost of Sale/Purchase - Deferred	7,837.87	
7150.2000 - Losses from Disposition of Land and Artworks		7,837.87
1439.9500 - Cost of Sale/Purchase - Deferred	381.09	
7150.2000 - Losses from Disposition of Land and Artworks		381.09
6535.0000 - General Engineering Expense	7.16	
7160.2000 - Other Operating Losses		7.16
6535.0000 - General Engineering Expense	28.35	
7160.2000 - Other Operating Losses		28.35
6535.0000 - General Engineering Expense	95.21	
7160.2000 - Other Operating Losses		95.21
7160.2000 - Other Operating Losses	3,184.00	
7370.5000 - Special Charges - Entertainment		3,184.00

The total increase to income is \$5,632.86.

Disclosure No. 5

Subject: Advertisements

Statement of Fact: Several advertisements were selected in our random sample of expenses selected by resource type code. Because of confidentiality, the invoices will be referenced by number only. The invoices are filed with the confidential work papers.

Recommendation: The following expenses, which are non-regulatory, were charged above-the-line. These advertisements should be charged below-the-line:

1. Invoice B1-3, Amazing Phone Mysteries (This advertisement was for the Power Touch 350 telephone. Sales of telephones are non-regulatory and should be recorded below-the-line.)	\$38,045.44
2. Invoice B1-2, Mission Possible (This advertisement consisted of three items. Two of the items, Additional Line and Back-up Line, are regulated and should be above-the-line. The third item, Memory Call, is non-regulated and should be below-the-line. Therefore, one-third of the invoice amount of \$ 18,279.69 should be below-the-line.)	<u>6,093.23</u>
Total	<u>\$44,138.67</u>

FLORIDA PUBLIC SERVICE COMMISSION
 TELEPHONE EARNINGS SURVEILLANCE REPORT

REVISED 6-26 98

Page 1

Company BellSouth Telecommunications, Inc. - Florida
 12 Months Ended December 31, 1997

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	\$10,860,342	\$2,775,638	\$8,084,704
2. Accumulated Depreciation and Amortization	<u>5,638,410</u>	<u>1,454,003</u>	<u>4,184,407</u>
3. Net Plant in Service	5,221,932	1,321,635	3,900,297
4. Property Held for Future Use	1	0	1
5. TPUC	60,304	15,392	44,912
6. Working Capital Allowance	<u>(\$278,693)</u>	<u>(\$47,909)</u>	<u>(\$230,784)</u>
7. Per Books Average Rate Base	<u>\$5,003,544</u>	<u>\$1,289,118</u>	<u>\$3,714,426</u>
8. % Distribution	<u>100%</u>	<u>25.76%</u>	<u>74.24%</u>
ADJUSTMENTS TO AVERAGE RATE BASE			
9. Adjustments for Achieved Rate Base			<u>\$3,497</u>
10. Adjusted Achieved Rate Base			<u>\$3,717,923</u>
RATES OF RETURN			
11. Average Per Book	<u>8.75%</u>	<u>16.88%</u>	<u>5.92%</u>
12. Average FTSC Adjusted			<u>9.97%</u>

FLORIDA PUBLIC SERVICE COMMISSION
TELEPHONE EARNINGS SURVEILLANCE REPORT

REVISED 6-26-98

Page 2

Company BellSouth Telecommunications, Inc. - Florida
12 Months Ended December 31, 1997

	(1) Total Company Column (2 + 3)	(2) Interstate Toll *	(3) Total Intrastate Column (4 + 7) #	(4) Intrastate Toll Column (5 + 6)	(5) Inter- territory	(6) Intra- territory	(7) Local
NET OPERATING INCOME (000)							
BOOKED REVENUE							
1. Basic Local Service Revenue	\$1,841,189	\$325	\$1,840,864	\$0	\$0	\$0	\$1,840,864
2. Network Access Revenue							
a. B18MOC	0	0	0	0	0	0	0
b. NOU Access	674,230	470,767	203,463	203,463	199,992	3,471	0
c. Special Access	145,815	136,662	9,153	9,153	9,022	131	0
d. Other Access	365,856	348,547	17,309	17,309	5,972	11,337	0
3. Long Distance Revenue							
a. NTS	62,860	291	62,569	62,569	0	62,569	0
b. Other	80,476	325	80,151	80,151	0	80,151	0
4. Subsidy Revenue	(1,666)	0	(1,666)	(1,666)	(1,381)	(285)	0
5. Miscellaneous Revenue	131,568	26,742	104,826	20,960	16,229	4,731	\$3,866
6. Uncollectible Revenues	36,178	6,265	29,913	6,501	1,652	4,849	23,412
7. Net Booked Revenue	<u>\$3,264,150</u>	<u>\$977,394</u>	<u>\$2,286,756</u>	<u>\$385,438</u>	<u>\$228,182</u>	<u>\$157,256</u>	<u>\$1,901,318</u>
OPERATING EXPENSES							
8. Plant Specific Operation Expense	610,059	154,935	455,124				
9. Plant Non-Specific Operations Exp	235,715	58,774	176,941				
10. Access Expense	10,401	0	10,401				
11. Depreciation and Amortization	758,569	197,172	561,397				
12. Customer Operations Expense	456,340	104,729	351,611				
13. Corporate Operations Expense	367,166	99,720	267,446				
14. Other Income and Expense	254	51	203				
15. Total Operating Expense	<u>\$2,478,504</u>	<u>\$615,381</u>	<u>\$1,823,123</u>				
16. % Distribution	100%	25.24%	74.76%				
OPERATING TAXES							
17. Federal Income Tax	188,198	94,052	94,146				
18. State Income Tax	39,384	16,675	22,709				
19. Other Taxes	160,217	33,637	126,580				
20. Total Operating Taxes	<u>\$387,799</u>	<u>\$144,364</u>	<u>\$243,435</u>				
NET OPERATING INCOME							
21. Per Book NOI	<u>\$437,847</u>	<u>\$217,649</u>	<u>\$220,198</u>				
22. NOI Effect of Adjustments			150,349				
23. Adjusted NOI			<u>\$370,547</u>				

NOTES

2 (a) Busy Hour Minutes of Capacity Charge

(b) Includes Local Switching, Local Transport, Line Termination, Carrier Common Line, Intertoll 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 LNC's

* Includes \$ 12,015,156 for Universal Service Fund

Above expenses include regulatory and legislative liaison expenses of \$ 967,069. See the Lobbying Expense and Other Regulatory Adjustments performat for the legislative and liaison expenses excluded for rate making purposes

FLORIDA PUBLIC SERVICE COMMISSION
 TELEPHONE EARNINGS SURVEILLANCE REPORT

REVISED 6/26/98

Company: BellSouth Telecommunications, Inc. - Florida
 12 Months Ended: December 31, 1997

AVERAGE CAPITAL (INCREASE)	(1) Average Per Books	(2) Specific Adjustments	(3) Pro Rata Adjustments	(4) Adjusted Amount	(5) % of Total	(6) Sharing	(7) Cost Rate		(8) Ceiling	(9) Sharing	(10) Weighted Cost Rate		(11) Ceiling
							Actual	Ceiling			Actual	Ceiling	
1 Long Term Debt	1,146,000		(33,317)	\$1,112,683	29.94%	6.58%	6.58%			1.97%	1.97%		
2 Short Term Debt	176,972		(5,142)	171,830	4.62%	5.59%	5.59%			0.26%	0.26%		
3 Preferred Stock	0		0	0	0.00%	0.00%	0.00%			0.00%	0.00%		
4 Customer Deposits	14,833		(431)	14,402	0.39%	6.50%	6.50%			0.03%	0.03%		
5 Common Equity	1,888,173	26,541	(59,636)	1,859,078	50.00%	13.11%	13.11%	15.11%		6.56%	7.55%	7.56%	
6 Investment Tax Credits	50,149		(1,463)	48,686	1.32%	10.29%	11.91%	11.91%		0.14%	0.16%	0.16%	
7 Cost Free Capital	497,204	28,507	(15,276)	510,435	13.73%	0.00%	0.00%			0.00%	0.00%		
8 Total Capital	\$3,774,140	\$55,048	(\$11,265)	\$3,717,923	100.00%					8.96%	9.97%	9.99%	

FINANCIAL RATIO

9 Intrate achieved return on equity
 FPSC Adjusted Basis

13.11%

See Attachment A to Page 3 for signature

a This ROE includes sharing for 12 months ending 12/31/97