REGULATORY AUDIT OF PACIFIC BELL FOR THE YEARS *1997*, *1998* AND *1999*

Prepared for:

California Public Utilities Commission

VOLUME 1:

Executive Summary

Audit Background, Scope, Objectives and Recommendations

CPUC Financial Reporting and Regulated Intrastate Earnings

By:

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February 21, 2002

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February 21, 2002

Mr. Jack Leutza
Director - Telecommunications Division
California Public Utilities Commission
505 Van Ness Av.
San Francisco, CA 94102

Dear Mr. Leutza,

The attached report describes the results of Overland Consulting's regulatory audit of Pacific Bell performed in accordance with the requirements set forth in California Public Utilities Commission (CPUC) Decision 96-05-03, and reflected in contract PS-985044, which was approved by the CPUC and dated June 21, 1999.

The scope of the audit included a review of Pacific Bell's affiliate transactions, procedures for allocating costs between regulated and non-regulated activities, regulatory financial reporting and monitoring reports. The audit period included the years 1997, 1998 and 1999. Audit objectives included determining compliance with CPUC accounting policies, affiliate transaction rules and cost allocations; assessing internal accounting and administrative control with respect to CPUC requirements; adjusting regulated intrastate operating income reported by Pacific Bell to correct errors and non-compliance with CPUC requirements; assessing the potential for cross-subsidies and anti-competitive behavior with respect to affiliate transactions; and determining Pacific Bell's compliance with the CPUC's New Regulatory Framework (NRF) monitoring requirements. To the extent the data and information Pacific Bell provided enabled us to do so, we conducted our audit in accordance with Generally Accepted Auditing Standards applicable to the regulatory audit ordered by the Commission in Decision 96-05-036. The audit was not designed to develop an opinion concerning financial statements Pacific Bell or its parent, SBC Communications, Inc., filed with the Securities and Exchange Commission or in annual reports to shareholders.

The audit disclosed areas in which Pacific Bell did not comply with the CPUC's accounting, non-regulated allocation and affiliate transaction requirements. We also found areas in which Pacific Bell did not comply with the CPUC's NRF monitoring requirements. The audit disclosed certain weaknesses in Pacific Bell's internal controls as they relate to CPUC requirements. Our audit report includes recommendations to correct compliance errors and internal control weaknesses, and recommendations to improve the quality of reporting to the CPUC.

Pacific Bell prepares and submits an Intrastate Earnings Monitoring Report (IEMR). The IEMR is intended to show regulated intrastate net operating income calculated in accordance with CPUC accounting and ratemaking rules. The IEMR is a regulatory report and is not a financial statement subject to annual audit. To the extent our audit identified instances of non-compliance with CPUC requirements that affected the calculation of regulated intrastate operating income, we calculated adjustments to the revenues, expenses and rate base that Pacific Bell reported on its IEMR. In making adjustments we were required to interpret existing CPUC rules and administrative precedents as they applied to Pacific Bell's IEMR results. Based on our audit, we believe the regulated intrastate net operating income Pacific Bell reported in audit period IEMRs was substantially understated.

The IEMR results filed by Pacific Bell did not show sufficient earnings to trigger customer sharing under the NRF. After our recommended audit adjustments, regulated intrastate net operating income was substantially higher than Pacific Bell reported to the CPUC in all three years of the audit period. Audit-adjusted IEMRs show that earnings sharing was triggered in 1997 and 1998. Had sharing not been suspended beginning in 1999, sharing would also have been triggered in 1999.

In attempting to meet audit objectives, we were constrained by limits on access to relevant information. Pacific Bell controlled our audit efforts within an adversarial litigation framework. Although litigation procedures often apply in regulatory audits, audits subjected to litigation restrictions cannot be relied upon to provide full disclosure of relevant information. Certain data and information we requested and believe to be relevant was not provided and certain data requests remained unanswered at the conclusion of the audit. Provision of this information could result in additional findings, identification of additional areas of regulatory concern, and additional audit adjustments to IEMR results.

The accompanying report was prepared for the CPUC to document Pacific Bell's compliance with CPUC requirements and related internal controls, to identify issues of regulatory concern in specified areas, and to develop recommendations for the CPUC. It is not intended to be used for any other purpose. The report contains information that Pacific Bell and its affiliates may consider to be proprietary and confidential. Until confidentiality issues concerning the report are settled, its distribution should be limited to individuals who are covered by CPUC confidentiality policies or have entered into appropriate non-disclosure agreements with Pacific Bell.

Sincerely,

Howard E. Lubow

Howard Lubow,
President, Overland Consulting

REGULATORY AUDIT OF PACIFIC BELL
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Chapter 1 - Executive Summary

I. Introduction

In 1989 the California Public Utilities Commission (Commission or CPUC) adopted an incentive-based regulatory framework for Pacific Bell and Verizon California (at the time GTE California, Inc.). The New Regulatory Framework (NRF) incorporated financial incentives, streamlined regulation and safeguards for customers and shareholders. The Commission established a set of regulatory goals and linked the success of the NRF to its ability to obtain information of sufficient quality and depth to determine whether the goals were met. The Commission adopted a monitoring program intended to provide specific utility data and reports to assess progress in meeting its NRF regulatory goals.

This report documents the results of a regulatory audit of Pacific Bell performed by Overland Consulting. The audit was performed for the Commission under the supervision of the Telecommunications Division (TD). The audit covered calendar years 1997 through 1999 and included reviews of Pacific Bell's compliance with CPUC accounting requirements, procedures to allocate costs between regulated and non-regulated activities, policies and rules for pricing transactions between Pacific Bell and its affiliated companies and NRF monitoring reports. This audit report focuses on Commission-prescribed regulatory accounting and is not intended to express any opinion on financial statements that Pacific Bell or its parent, SBC Communications, Inc. (SBC), filed with the Securities and Exchange Commission (SEC) or in annual shareholder reports.

II. Overview of Audit Findings and Conclusions

The audit of financial results identified 67 corrections to Pacific Bell's regulated operating revenues, expenses and rate base. Audit corrections to bring financial results into compliance with CPUC requirements increased the regulated intrastate net operating income that Pacific Bell reported during the audit period by $1.94 billion. This translates into recommended customer refunds under NRF earnings sharing rules of $349 million for the years 1997 and 1998. NRF earnings sharing rules were suspended by the CPUC effective in 1999. Customer refunds for 1999 would have totaled $457 million if the sharing rules had been effective. Following are additional key findings and conclusions from the audit.

Understatement of Regulated Earnings

C Pacific Bell did not comply with CPUC accounting requirements in reporting regulated financial results to the CPUC. Most significantly, Pacific Bell did not account for pension expense, other post retirement benefits expense, depreciation expense or income tax expense in compliance with CPUC regulatory requirements.

C Because Pacific Bell did not comply with CPUC accounting requirements, regulated net operating income reported to the CPUC was substantially understated in each of the three audited years. As a result of understated regulated net operating income, earnings owed to customers under NRF sharing rules were not reported or refunded.

Issues Raised by Affiliate Relationships

- C Pacific Bell's recent transfer of telephone company functions, assets and employees to corporate shared services affiliates controlled by SBC has the potential to significantly reduce the CPUC's control and authority in regulating telephone operations and accounting.

- C Pacific Bell and its affiliates did not always comply with CPUC affiliate transactions rules. Internal control over certain affiliate transactions was inadequate.

- C Pacific Bell and its affiliates were unable or unwilling to provide sufficient support for some affiliate transactions, including adequate cost support for affiliate transfer pricing and certain costs allocated by shared services affiliates. Pacific Bell did not answer questions regarding its policies for transferring telephone company customer information to affiliates.

The NRF Monitoring Program

- C NRF monitoring program reports filed by Pacific Bell did not provide sufficient information to enable the CPUC to determine whether it was meeting its NRF goals.

A. Summary of Intrastate Financial Results

The table below summarizes intrastate financial results prepared for the CPUC and customer-refundable earnings as reported by Pacific Bell and as determined by the audit.

Table 1-1
Pacific Bell's CPUC-Basis Financial Results & NRF Customer Refunds Reported By Pacific Bell and Audit-Adjusted

Source: Pacific Bell Financial Reports and Audit workpapers

	Reported By Pacific Bell	Audit-Adjusted
1997		
Net Regulated Intrastate Operating Income	652,499,328	1,114,302,393
Return on Regulated Intrastate Rate Base	6.49%	11.72%
Customer Refunds Under NRF Sharing Provisions	0	17,638,716
1998		
Net Regulated Intrastate Operating Income	922,472,419	1,549,326,224
Return on Regulated Intrastate Rate Base	9.07%	15.86%
Customer Refunds Under NRF Sharing Provisions	0	331,184,800
1999		
Net Regulated Intrastate Operating Income	962,198,083	1,817,964,464
Return on Intrastate Regulated Rate Base	9.66%	18.22%
Customer Refunds Under NRF Sharing Provisions (1)	0	457,244,588
Audit Period Combined		
Net Regulated Operating Income	2,537,169,830	4,481,593,081

1. Audit-adjusted amount is pro forma. The CPUC suspended customer sharing effective in 1999.

Intrastate financial results prepared for the CPUC were the product of an overly complicated and poorly disclosed process involving the adjustment of FCC-basis financial data. The subsidiaries included in intrastate results Pacific Bell reported to the CPUC varied from year to year. Pro-forma financial information necessary to make the results comparable between years was not presented. There was insufficient disclosure of the amounts and basis for differences between FCC and CPUC financial results. CPUC-basis financial reporting adjustments and many ratemaking adjustments were bundled together on Pacific Bell's Intrastate Earnings Monitoring Reports (IEMRs) and were not separately identified or explained in materials filed with the CPUC.[1]

B. Affiliate Transactions

Pacific Bell's regulated telephone company functions, employees and proprietary information are being transferred to corporate "shared services" affiliates. Several thousand telco employees were transferred at the end of 1999 alone. The transfer of functions out of the telephone company has the potential to significantly reduce the control and authority the CPUC has traditionally exercised over regulated telephone operations. Evidence for this can be seen in Pacific Bell's resistance to auditing affiliate transactions, in the fact that the functions transferred to affiliates are no longer accounted for under FCC Part 32 accounting rules, in the lack of sufficient affiliate organizational documentation, and in the accounting complexities introduced by affiliate transactions that make them harder to track and evaluate than transactions incurred within Pacific Bell.

Internal accounting controls governing certain affiliate transactions processes were inadequate. Pacific Bell and SBC did not always comply with CPUC requirements governing affiliate transactions and could not adequately support certain affiliate transaction components, such as the cost basis for pricing transactions between Pacific Bell and its affiliates. The structure of SBC's affiliate organizations maintained for regulatory accounting purposes was undocumented and details about the activities and functions that constituted inter-company billing affiliates were sometimes poorly understood even by employees that Pacific Bell represented to be subject matter experts. Given the growing magnitude of affiliate transactions, unless control weaknesses and compliance problems are corrected they may materially affect the regulated operating income Pacific Bell reports to the CPUC in the years after the audit period. Audit corrections to affiliate transactions recorded in Pacific Bell's Intrastate Earnings Monitoring Reports increased regulated audit period intrastate net operating income by $97 million.

C. Cost Allocations Between Regulated and Non-Regulated Activities

A majority of the FCC procedures for allocating telephone company costs between regulated and non-regulated accounting categories were well controlled. However, we found certain allocation procedures were inconsistent with attributable cost principles adopted in FCC and CPUC rules and increasing levels of affiliate transactions has weakened Pacific Bell's compliance with Part 64 regulated / non-regulated cost allocation rules. Audit corrections to recorded Part 64 cost allocations increased audit period regulated intrastate net operating income by $44 million.

[1]The IEMR is a regulatory report intended to show regulated intrastate net operating income calculated in accordance with CPUC accounting and ratemaking rules. Its results are not subject to annual audit.

D. NRF Monitoring Program

The NRF monitoring program, last revised in 1992, does not provide sufficient information to enable the CPUC to determine whether it is meeting its NRF goals. Specific deficiencies include data to assess competition, service quality and customer satisfaction, technological advancement and intrastate regulated earnings.

E. Difficulties Encountered in Completing the Audit

The audit required approximately 18 months to complete, six months longer than originally scheduled. We met most, but not all, audit objectives. Impediments to successfully completing the audit within the time originally scheduled included restrictions that Pacific Bell imposed on the data it considered to be relevant and within the audit scope, data request response times that averaged more than two months and sometimes extended for many months, and, notwithstanding objections to requests based on scope or relevance, Pacific Bell's inability or unwillingness to provide certain information and data.

We attempted to perform the audit in accordance with Generally Accepted Auditing Standards (GAAS) applicable to a regulatory audit. GAAS requires that auditors obtain sufficient competent evidential matter to provide a basis for findings and conclusions. The restrictions imposed on the audit prevented us from obtaining sufficient data to develop conclusions in some areas. To the extent that available time and Pacific Bell's responses to outstanding data requests permit us to complete our analysis and develop conclusions in these areas, we will supplement our report. Completing these areas will not affect our conclusion that regulated income was significantly understated during the audit period; however, it may result in a change in the calculated amount of NRF refunds owed to customers.

III. Discussion of Significant Audit Findings and Issues

A. Regulated Operating Revenue, Expense and Rate Base (Chapters 4 - 11)

Combined audit period corrections to amounts recorded directly in regulated accounts increased audit period (1997 to 1999) intrastate regulated operating income by $1.8 billion and decreased average intrastate regulated rate base by $314 million. Four corrections account for 75 percent of the change in intrastate operating income. These corrections address 1) depreciation reserve deficiency amortization; 2) pension costs; 3) other post-retirement benefits costs; and 4) income tax accounting policy.

1. Reserve Deficiency Amortization Adjustment

Pacific Bell increased its intrastate regulated depreciation expense by $612 million in 1999 to reflect "reserve deficiency amortization." The increase reflects the amortization, over a six year period, of the intrastate portion of a plant write-down Pacific Bell recorded for external financial reporting purposes in 1995.[2] By 1999, the assumptions underlying the 1995 plant write-down had been proven to be highly inaccurate. In spite of this, Pacific Bell chose to amortize the reserve deficiency on the CPUC books, causing a significant reduction in the earnings reported the 1999 IEMR.[3] The reserve deficiency

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[2] A plant write down is the removal of plant from the books. Essentially, it is an acceleration of future years' depreciation expenses into the current period.

[3] Because it takes place over six years, the reserve deficiency amortization determined by Pacific Bell will continue to significantly reduce reported IEMR earnings through 2004.

amortization was not implemented pursuant to accounting requirements; rather, it was implemented at management's discretion to achieve regulatory objectives. The six-year amortization period was arbitrary and also based on management's regulatory objectives, rather than accounting principles.

The reserve deficiency amortization is not an allowable cost for ratemaking purposes because it does not reflect a real increase in the cost of providing utility service. Pacific Bell did not request CPUC approval for the reserve deficiency amortization and has not made any showing that the reserve deficiency amortization would be allowed for ratemaking purposes. Therefore, we removed Pacific Bell's reserve deficiency amortization in calculating audit-adjusted regulated operating expense.

2. Pension Costs

Intrastate regulated pension expenses reported to the CPUC were overstated by $357 million during the audit period as a result of Pacific Bell's failure to correctly apply CPUC pension cost accounting requirements. As set forth in Decision 88-03-072, the CPUC requires the use of the Aggregate Cost Method (ACM) to determine pension costs. Essentially, ACM pension cost is the difference between the present value of pension benefit payments owed and funded pension assets attributable to the current year. The amount attributable to the current year is calculated by spreading the total difference over the average remaining employment period for active plan participants. Because Pacific Bell's pension plan is significantly overfunded (i.e. funded pension assets significantly exceed forecasted benefit payments), proper application of the ACM produces *negative* intrastate regulated pension expense of $357 million during the audit period. Pacific Bell did not use the ACM to determine its pension costs during the audit period. Instead, Pacific Bell arbitrarily set its intrastate pension costs equal to zero in all three years. This caused an overstatement of pension expense under CPUC accounting requirements.

Under Generally Accepted Accounting Principles (GAAP), pension costs are determined in accordance with Statement of Financial Accounting Standards (SFAS) 87. GAAP calculations of pension cost, which are different from the costs calculated for CPUC purposes, are used for Pacific Bell's FCC and SEC (external) financial reporting. Over time, pension costs calculated under GAAP have been lower than the pension costs Pacific Bell has been permitted to recover for CPUC purposes. Pacific Bell maintains a regulatory liability account to track the intrastate portion of the difference between its GAAP and CPUC pension costs. The December 31, 1999 balance of $1.1 billion in this account represents the cumulative amount by which the pension costs Pacific Bell recognized for CPUC purposes exceeded pension costs recognized under GAAP. Pacific Bell's decision to set pension costs equal to zero when the ACM produces negative expense has contributed to a large and growing disparity between GAAP and CPUC pension costs. The audit correction, designed to bring CPUC pension expense into compliance with CPUC accounting requirements, will slow the growth of the disparity.

3. Other Post-Retirement Benefit Costs

Pacific Bell provides post-retirement benefits other than pensions (PBOPs) to retired employees. The PBOPs consist of post-retirement medical, dental and life insurance benefits and discounts on telephone service. Medical and dental benefits account for 85% of Pacific Bell's PBOP liability.

The CPUC's PBOP policy limits annual PBOP costs to the amount of tax-deductible contributions made to external trust funds established to pay PBOP benefits. Pacific Bell contributed $444 million to its PBOP external trusts during the audit period, on an intrastate regulated operations basis. Therefore, under the CPUC's PBOP policy, Pacific Bell's maximum allowable PBOP expense was $444 million. Pacific Bell claimed $972 million in PBOP intrastate regulated expenses on its IEMR reports for the audit period. The

PBOP operating expenses claimed by Pacific Bell exceeded the maximum amount permitted under the CPUC's PBOP policy by $528 million.

The $528 million of PBOP expense improperly claimed by Pacific Bell largely reflects the accelerated recognition of costs for employees terminated in a 1993 force reduction program. Pacific Bell recognized the accelerated costs in 1993 when it announced the force reduction program and deferred the costs as a regulatory asset. Pacific Bell increased the PBOP costs claimed on its 1998 IEMR by $400 million to reflect the immediate write-off of that regulatory asset. The CPUC's PBOP accounting policies do not permit accelerated recognition of PBOP costs for terminated employees. Under the CPUC's policy, PBOP costs associated with terminated employees are recognized when the contributions needed to pay their PBOP benefits are actually made to the PBOP external trusts. Limiting Pacific Bell's PBOP costs to the amount permitted by the CPUC's PBOP policy (i.e. the amount actually funded during the audit period) will not deny Pacific Bell an opportunity to fully recognize its reasonable PBOP costs over the appropriate funding period.

Pacific Bell withdrew $98 million from its management pension plan trust fund in December 1999. In the same month, Pacific Bell withdrew $180 million from its PBOP life insurance trust. The withdrawals violated the CPUC's policies concerning the use of pension and PBOP trust fund assets. The pension and PBOP trust fund withdrawals potentially impact the amount of PBOP costs reportable under CPUC accounting requirements in 1999. The proper accounting and ratemaking treatment for those transactions will be determined after Pacific Bell responds to outstanding data requests.

4. <u>CPUC Regulated Income Tax Expense</u>

The CPUC has a long-standing policy of requiring flow-through accounting treatment for temporary differences between book and taxable income to the extent permitted by federal income tax regulations.[4] Under the flow-through accounting method, income tax expense reported for regulatory financial results reflects the actual taxes paid to the government for the current year. Pacific Bell provided flow-through accounting treatment to some temporary differences during the audit period. However, Pacific Bell provided tax normalization treatment to many temporary differences that should have been accounted for on a flow-through basis. After considering the impact of other audit corrections on temporary difference amounts, the proper application of the CPUC's flow-through policy reduces audit period intrastate regulated deferred income taxes by $438 million compared to the level produced by Pacific Bell's income tax normalization policy. Temporary differences attributable to pension expense and the California universal service fund account for 86 percent of that amount. Therefore, from the standpoint of audit period regulated operating income, the key income tax accounting issue is whether the pension and universal service fund temporary differences should be accounted for on a flow-through or a normalization basis.

The proper application of the aggregate cost method to determine CPUC pension expenses results in negative intrastate regulated pension expense of $357 million during the audit period. Negative pension expense increases book income but does not increase taxable income. Under the normalization method, book income tax expense is set as if the negative pension expense was taxable income. The flow-through method results in lower tax expense than the normalization method in years in which pension

[4] Temporary differences reflect differences in the timing of the recognition of revenues and expenses for financial reporting and income tax return purposes. Temporary differences are caused by differences between financial reporting accounting policies and the tax requirements for determining taxable income. Because the same expenses and revenues are ultimately recognized on the financial statements and the tax returns over time, the differences eventually reverse and are therefore called temporary differences.

expense is negative because negative pension expense does not increase the amount of taxes owed to the government for the current tax year. Under the CPUC's flow-through policy, the pension temporary difference should be accounted for on a flow-through basis.

The universal service fund temporary difference is a new temporary difference resulting from the implementation of the California High Cost Fund-B. For income tax purposes, the payments received from the fund are treated as a reduction of construction costs because the payments are made to subsidize the provision of service requiring plant investment in high cost (rural) areas. As a result, the fund payments are taxed over the lives of associated assets (as smaller depreciation expense deductions due to the reduction of plant costs), rather than in the year of receipt. For financial reporting to the CPUC, Pacific Bell included the money it received from the fund as operating revenue and normalized the temporary difference in revenue recognition on its CPUC-basis books. Under the CPUC's income tax expense accounting policy the universal service fund temporary difference should be accounted for on a flow-through basis. Income tax expense for IEMR purposes should be based on the tax law, which recognizes the high-cost fund revenue over the life of the assets it subsidizes.

5. Operating Revenues and Expenses

Our review resulted in four audit corrections to Pacific Bell's 1997 regulated operating revenues and other operating income. These include 1) eliminating unsupported and unauditable accruals for regulatory contingent liabilities; 2) correcting a posting error related to Bellcore dividends; 3) removing uncollectible revenues recorded in 1997 but attributable to 1996 operations; and 4) increasing other operating income to reflect the ratepayer's portion of the pre-tax gain on the sale of Bellcore. We did not identify any corrections to Pacific Bell's 1998 and 1999 revenues. The four corrections increased Pacific Bell's 1997 intrastate regulated revenues by $116 million.

We identified and calculated nine audit corrections to operating expenses. These include 1) removing $138 million in local number portability (LNP) costs from intrastate operating expenses that the FCC explicitly ruled should be assigned directly to the interstate jurisdiction; 2) removing $49 million in local competition implementation costs that should have been deferred and amortized over the period of CPUC-authorized surcharge recovery that began in 2001; 3) reducing operating expense by $35 million to reflect the allocation of merger savings between ratepayers and shareholders ordered in the CPUC decision that approved the merger of SBC and Pacific Telesis; 4) removing $41 million in cost associated with the shut down of an Advanced Communications Network that was never placed into service; 5) reducing operating expenses by $44 million to correct Pacific Bell's accounting for a December 1999 software buy-out agreement; 6) removing $103 million of unsupported and unauditable litigation and regulatory accruals from operating expense; 7) reducing incentive compensation accruals by $29 million to reflect the actual payout levels for the 1997, 1998 and 1999 performance years; 8) reducing 1997 and 1998 operating expense by $42 million to remove the cost of settlements paid to contract billing customers for an increase in uncollectible amounts attributable to 1996 operations; and 9) increasing operating expense by $19 million to correct the classification of traffic bound for internet service providers for separations purposes. In total these nine corrections reduce audit period intrastate regulated operating expense by $463 million.

In addition to the reserve deficiency adjustment discussed above, we made a correction to eliminate the impact of an accounting error associated with depreciation expense. The formula used to calculate the jurisdictional adjustment for intra-building cable amortization contained an error that resulted in a $61 million overstatement of 1997 and 1998 intrastate depreciation expense. We corrected this error.

6. Rate Base

We made five corrections to net plant that increased average audit period intrastate net plant by $34 million. A sixth correction involving Allowance for Funds Used During Construction (AFUDC) could not be quantified because the necessary information had not been provided at the time of this report.[5] Overland identified numerous errors in Pacific Bell's cash working capital lead-lag studies. The errors imply significant deficiencies in Pacific Bell's internal controls over the preparation of cash working capital studies. Cash working capital is impacted by other audit corrections to revenues and expenses. After considering these other audit corrections, Pacific Bell's corrected intrastate regulated cash working capital requirement averaged $149 million during the audit period, $324 million lower than the average amount claimed by Pacific Bell.

B. Affiliate Transactions (Chapters 12 - 19)

Combined audit period corrections to affiliate transactions recorded in Pacific Bell's IEMR increased audit period regulated intrastate net operating income by $97 million. This discussion presents summarized findings and conclusions for our audit of Pacific Bell's affiliate transactions. It is divided into the following subjects:

- Internal Accounting Controls
- CPUC Regulatory Authority and Control
- Pacific Bell's Management Control
- Compliance with FCC and CPUC Affiliate Transaction Requirements
- Issues Affecting Markets and Competition
- Cross Subsidization
- Affiliate Transaction Audit Adjustments

1. Internal Accounting Controls

SBC and Pacific Bell had accounting systems in place during the audit period to identify and bill affiliate services in all of the areas we reviewed. However, we found a number of control weaknesses in these systems. Internal accounting controls were weakest with respect to the new shared services affiliates, SBC Services and SBC Operations. We did not conclude that internal control weaknesses affecting affiliate service transactions had a material impact on Pacific Bell's financial results reported to the CPUC during the years 1997 through 1999. In part, this is because the level of transactions between Pacific Bell and affiliates, although growing at a rapid rate, was relatively small for most of the audit period. Significant transfers of telephone company assets to shared services affiliates, although pending, did not take place during the audit period. We were unable to evaluate the impact of transactions involving intellectual property and proprietary information because we did not have the time or the resources to effectively audit these areas and because Pacific Bell would not answer certain data requests.

2000 was a watershed year for Pacific Bell's affiliate relationships. There was significant movement of employees from the telephone company to the unregulated shared services affiliates at the end of 1999 and "advanced services", a significant component of the Pacific Bell's evolving telecommunications

[5] Allowance for Funds Used During Construction includes the financing (interest) cost of funds employed to construct plant. It is usually calculated using the company's overall average interest rate on debt.

business, was transferred from Pacific Bell to SBC Advanced Solutions, Inc. (ASI).[6] The absolute value of reported income statement transactions between Pacific Bell and affiliates doubled between 1999 to 2000, from $1.3 billion to $2.5 billion. By 2000, services provided by affiliates constituted more than 25 percent of Pacific Bell's regulated operating expenses. SBC Services, which did not have sufficient accounting controls established during the audit period, increased its billings to Pacific Bell more than 30 fold in 2000, to $1.1 billion. It is reasonable to conclude that unless internal accounting controls improved, the impact of control weaknesses could have a growing and potentially significant impact on Pacific Bell's intrastate financial results in the years after 1999.

2. CPUC Regulatory Control

Because the affiliates to which Pacific Bell's functions are being transferred are unregulated and managed from the corporate level, the possibility exists that the CPUC could lose some or much of its ability to regulate traditional telephone operations. The Commission should consider the potential loss of authority to set accounting and operating standards and reporting requirements as a consequence of transferring functions out of the regulated telephone company. Pacific Bell's resistance to a review of its affiliate transactions is on the record at the CPUC and was evident to us during the audit. Prior to the audit Pacific Bell argued that affiliate transactions were not a legitimate component of an audit performed under California Public Utilities Code Section 314.5. At one point during the audit, Pacific Bell declared a moratorium on affiliate transaction data requests and requested that affiliate information already provided be returned. SBC and Pacific Bell would not or could not provide the information necessary to complete an audit of some affiliate issue areas.

Accounting procedures are also a concern as affiliate transactions grow. The corporate shared services affiliates to which telephone company functions are being transferred do not use the FCC's Part 32 Uniform System of Accounts. Certain cost information required by the CPUC is lost from Pacific Bell's general ledger when activities are transferred to affiliates and costs are incurred as inter-company charges. In most respects, affiliate transactions were more difficult to audit than transactions incurred within Pacific Bell.

Pacific Bell could not produce documentation describing SBC's organizational structure as it existed for inter-company billing purposes. It took months to acquire a database of SBC employees and weeks more to piece together the database codes that described the individual components of the organizations billed to Pacific Bell. An understanding of the components and activities of an affiliate's organization is an absolute requirement to effectively audit the amounts billed to the telephone company. The lack of adequate affiliate organizational documentation is a notable internal control weakness.

3. Pacific Bell's Management Control

Pacific Bell's and PTG's management control of Pacific Bell's operations declined after the merger with SBC. Strategic decision making by PTG's corporate management, whose primary focus was Pacific Bell, was ceded to SBC executives in Texas after the merger. Shared services affiliates were established to run Pacific Bell's marketing, network, and general and administrative functions from a corporate perspective. Pacific Bell's internal management control continued to decline after the audit period as several thousand employees and additional telco departments migrated to affiliates controlled by SBC.

[6] Scope limitations precluded us from determining whether Pacific Bell was compensated for the value of the business transferred to ASI.

As management control of Pacific Bell shifts to SBC, Pacific Bell's unique interests become less significant in decision making. Corporate management's attention is naturally more focused on the interests of SBC as a whole. Although it is likely that consolidating telephone company functions into corporate shared services entities can produce economies of scope and scale for SBC, it is not at all certain that this will always have a positive impact on Pacific Bell. For example, after the SBC / PTG merger Pacific Bell's operating expenses increased because of a substantial increase in corporate charges. Pacific Bell's corporate charges increased from less than $120 million in 1996, the year before the merger, to nearly $300 million in 1999. Most of the increase was due to new and higher cost levels billed by SBC's Texas-based corporate organization, which was added to the California-based PTG organization that existed prior to the merger. Pacific Bell's corporate charges continued to climb in 2000. This occurred in part because cost allocations from Management Services Inc., SBC's Texas-based parent organization, were layered on top of costs being charged by PTG's parent organization prior to the merger.

4. Compliance with FCC and CPUC Affiliate Transaction Requirements

Pacific Bell billed non-regulated affiliates the CPUC-mandated 10 percent markup on affiliate services. It did not bill the mark up for services provided to other regulated telephone companies. Fully distributed cost calculations used to establish transfer prices for services Pacific Bell provided to affiliates were based on what appeared to be a flawed methodology. Pacific Bell charged the 25 percent-of-salary fee for transferred employees; however, it sometimes billed the parent for employees transferred to other affiliates. In 1997 the parent charged some employee transfer fees back to Pacific Bell. Pacific Bell failed to accrue inter-company revenue for a large employee transfer that occurred in December, 1999.
Pacific Bell charged a CPUC-required fee to affiliates for sales referrals; however, the support Pacific Bell provided was insufficient to determine whether the fee was correctly calculated or applied to affiliate sales. Although Pacific Bell would not answer our data requests on the subject, it is possible or likely that SBC Operations' outbound call centers used Pacific Bell's customer database to sell services to non-regulated affiliates. It does not appear that SBC Operations or the non-regulated affiliates on whose behalf it provided marketing paid the 13 percent sales referral fee. SBC Operations or another shared services affiliate may eventually do all of Pacific Bell's telemarketing. Although similar in substance to the affiliate marketing conducted by Pacific Bell, it does not appear that the CPUC has specifically ordered SBC Operations to collect and pay a referral fee when it uses Pacific Bell's customer database to sell services to non-regulated affiliates.

SBC and its subsidiaries did not always comply with affiliate transaction requirements. SBC was unable to provide FCC-mandated documentation supporting the allocation of employee time among subsidiaries. Pacific Bell recorded or attempted to record certain below-the-line parent company charges in above-the-line regulated accounts and in some cases affiliates did not supply Pacific Bell with sufficient information to properly direct affiliate charges to the correct accounts or the correct regulatory category (above or below-the-line) . In some cases, the data available from the parent and shared services affiliates was insufficient to determine whether the charges to Pacific Bell were reasonable, consistent with FCC Part 64 attributable cost principles, or properly charged to customer (above-the-line), rather than shareholder (below-the-line), accounts. Most of our affiliate transaction audit adjustments related to improperly directed charges, and most misdirected charges were from the parent company. In some cases, affiliate employees did not properly track the nature of their costs; in others the costs were identifiable but Pacific Bell did not receive the information necessary to record the charges from the affiliate in the proper account.

5. **Issues Affecting Markets and Competition**

Because our audit was largely confined to transactions affecting Pacific Bell's accounts, it did not include an in-depth analysis of operations and business practices or the operational interaction between affiliates and Pacific Bell. As such, we did not determine whether competitive practices were reasonable. However, one of our audit objectives was to determine whether affiliate transaction procedures were sufficient to prevent anti-competitive behavior. In analyzing SBC's organization and the changes in affiliate structure, we identified several areas of concern. The most significant involved the transfer of telephone company marketing and network planning functions to SBC Operations and the transfer of "advanced services" to SBC Advanced Solutions Inc. (ASI).

a. Joint Marketing and Use of Telephone Company Customer Data

The transfer of the marketing function to SBC Operations creates a probability, if not a certainty, that telephone company customer data will be made available to non-regulated affiliates for marketing purposes. This could confer a competitive advantage on Pacific Bell's non-regulated affiliates. To the extent customer data is currently being shared with non-regulated affiliates, it raises customer privacy concerns, particularly for customers with unlisted phone numbers. Pacific Bell did not respond to our requests concerning customer data sharing. We recommend the CPUC consider the competitive consequences of transferring customer data collected in a regulated monopoly environment to an unregulated corporate affiliate, and the implications that the use of customer data by unregulated affiliates has for customers' privacy rights.

b. Advanced Services

The transfer of Pacific Bell's advanced services (digital subscriber line, frame relay and cell relay services) to ASI was mandated by the FCC as a condition of the 1999 SBC / Ameritech merger. Because these services have better potential to become competitive than many local exchange services, the relationship between ASI and Pacific Bell has a direct bearing on whether the NRF goal of "opening telecommunications markets to competition" is met. The affiliate relationship created by the transfer produces a significant increase in the co-mingling of telephone company and affiliate activities and raises some important competitive and cross subsidy concerns. These include Pacific Bell's ownership of the network underlying advanced services that it does not control, the identification of Pacific Bell network components and activities indirectly supporting ASI's advanced services and the separation of these elements and activities from those charged to Pacific Bell's customers, the joint marketing of "advanced" telephone company services, and affiliate and competitor access to the network and Pacific Bell's operational support systems. Some of these issues are addressed in Appendix C of the FCC's SBC / Ameritech merger order. Audit scope limitations precluded us from reviewing the working relationship and transactions that have occurred between ASI and Pacific Bell since the advanced services transfer. We recommend the CPUC review the Pacific Bell / ASI relationship to determine whether concerns relating to competitive practices in California are properly addressed.

c. Purchase and Control of Competitors

In September, 2000, SBC announced a $150 million, 6 percent investment stake in Covad Communications, a company that describes itself as "the leading national broadband service provider of high-speed internet and network access utilizing Digital Subscriber Line technology."[7] Covad is one

[7] Covad Communications Press Release, December 13, 2001.

of SBC's local exchange competitors. In December, 2001, after Covad received court approval of a plan to emerge from bankruptcy, SBC and Covad closed on the planned funding.[8] The benefits of competition can be negated if potential competitors are simply purchased or otherwise controlled by the incumbent provider with which they are supposed to compete. The Commission should consider monitoring the ownership and management control relationships between SBC and other California local exchange companies so that it may take these relationships into account when evaluating the extent of local exchange competition in the state.

6. Cross-Subsidies

Notwithstanding the possibility that affiliates benefited from uncompensated use of Pacific Bell's customer database and other intellectual property and proprietary data (areas in which we were unable to complete our analysis), the audit period inter-affiliate cross subsidies we quantified were relatively minor. Examples included Pacific Bell being charged for SBC corporate acquisition investigation costs and for corporate executive awards for accomplishments unrelated to Pacific Bell.

We found other cross subsidies flowing from Pacific Bell's customers to SBC shareholders. Examples included parent company political and legislative influence costs and secondary cost allocations of parent company "management fees" charged to Pacific Bell's customer (above-the-line) accounts. We were unable to determine whether transfer-priced services provided by Pacific Bell and Southwestern Bell Telephone resulted in cross subsidies because support for the units of affiliate service was inadequate.

The potential for affiliate cross-subsidies increased significantly after the audit period with the planned transfer of several thousand telephone company employees to shared services affiliates and the transfer of advanced services to ASI. As marketing functions are transferred to SBC Operations, Pacific Bell will probably lose the revenue from fees Pacific Bell collects for sales referrals to non-regulated affiliates. In addition, it appears unlikely that SBC Operations is compensating Pacific Bell for the use of its customer database.

The transfer of advanced services to ASI represents a transfer of a business opportunity. When Pacific Bell made a similar transfer of its voice mail business to PBIS in 1992, the CPUC ordered PBIS to reimburse Pacific Bell for the going-concern value of the business transferred. To the extent Pacific Bell's regulated operations are not reimbursed for ADSL's development costs, Pacific Bell's regulated customers have cross-subsidized ASI by at least $190 million. The precedent established in CPUC Decision 92-07-072, which addressed the transfer of Pacific Bell's Information Services Group to PBIS, suggests that ASI should reimburse Pacific Bell for the going-concern value of the advanced services transferred, an amount that could be significantly greater than audit period development costs.

Time and scope constraints prevented us from assessing the potential for cross-subsidies relating to the transfer of intellectual property and proprietary information. Although difficult to quantify for accounting purposes, SBC's reorganization of major telephone company marketing, network and administrative functions into corporate shared services subsidiaries creates a significant potential for affiliate cross subsidies in the form of uncompensated or under-compensated transfers of intellectual property, customer and network data, telco operating know how and trade secrets.

[8] Covad Communications Press Release, December 20, 2001.

7. Audit Adjustments to Affiliate Transactions Recorded in Pacific Bell's Accounts

We adjusted affiliate transactions billed by and to Pacific Bell to bring the charges on Pacific Bell's books and audit period IEMRs into compliance with attributable cost principles and CPUC policy on regulated cost recovery. The majority of audit adjustments to expense involved costs that were either not attributable to Pacific Bell or were attributable to SBC shareholders, rather than Pacific Bell's regulated customers. Audit adjustments reduced affiliate amounts charged to Pacific Bell's intrastate regulated expenses by $19.4 million, $64.9 million and $51.9 million in 1997, 1998 and 1999, respectively. An audit adjustment increased Pacific Bell's inter-company revenue by $30.7 million in 1999. Audit adjustments to affiliate revenues and charges are discussed in detail Chapters 13 through 18.

C. Regulated and Non-Regulated Cost Allocations (Chapter 20)

The majority of Pacific Bell's procedures for allocating cost between regulated and non-regulated activities were well controlled and consistent with CPUC requirements and FCC Part 64 attributable cost principles. The most significant control weakness in the overall process was Pacific Bell's failure to maintain the Profitability Information (PI) system required by the CPUC to allocate costs to specific services. It is unclear whether the service-specific embedded cost allocations produced by PI continue to serve a purpose. Notwithstanding this overall conclusion, we found a number of allocation procedures that were not consistent with attributable cost principles and we found costs that were incorrectly classified between regulated and non-regulated categories. In most cases in which Pacific Bell failed to employ procedures consistent with Part 64 cost allocation requirements, the result was an over-statement of above-the-line operating expense and an understatement of regulated earnings. Corrections to audit period cost allocations increased regulated intrastate net operating income by $44 million.

D. Pacific Bell's NRF Monitoring Program (Chapter 21)

The NRF monitoring program, last revised in 1992, does not provide sufficient relevant information to assist the Commission in meeting all of its NRF goals. Neither the program itself nor the content of existing reports have been modified to adapt to changes in the telecommunications industry. More than half of the total reports submitted during the audit period were service-specific "embedded cost" reports produced by a system (the Profitability Information system) that Pacific Bell no longer maintains. Some of the monitoring reports Pacific Bell filed bore only a tangential relationship to NRF regulatory goals. At the same time, data that appear critical to evaluating the success of NRF, including statistics to measure technological advancement and customer satisfaction, were sometimes lacking even though required by the monitoring program. Some reports appeared to be missing because Pacific Bell placed a strict, limiting interpretation on what it was required to file with the CPUC.

The CPUC identified "opening telecommunications markets to competition" as a regulatory goal. Statistics necessary to objectively evaluate the progress of competition in California are not available from the monitoring reports filed by Pacific Bell. A "Competitive Environment Report" Pacific Bell submitted as a monitoring report was a white paper advocating further deregulation of Pacific Bell. Monitoring reports in the area of technological advancement produced a small fraction of the information required in the May, 1992 NRF Monitoring Report Assessment. Pacific Bell failed to file the results of customer surveys it conducted during the audit period as required by the monitoring program. We requested, but did not receive, copies of the customer surveys Pacific Bell conducted during the audit period.

Financial reports filed in the monitoring program were obtuse and inadequate for the purpose of evaluating Pacific Bell's financial position and results in accordance with CPUC specific requirements. Some of the earnings adjustments Pacific Bell included in its audit period IEMRs were made to achieve regulatory objectives, rather than reflect the impact of CPUC rules and decisions on regulated earnings. As a result, absent an audit for CPUC policy compliance, IEMR results cannot be relied upon as an objective measure of Pacific Bell's regulated intrastate earnings.

Chapter 2 - Background, Scope, Objectives and Recommendations

This chapter discusses audit background, approved objectives and scope and difficulties we encountered in performing the audit. It also contains audit recommendations. Many of the recommendations address New Regulatory Framework (NRF) monitoring reports, particulary those intended to monitor financial and ratemaking-adjusted results. Recommendations also address accounting for affiliate transactions, compensation for Pacific Bell for the transfer of its advanced services business to an affiliate, compensation for customer data Pacific Bell may share with affiliates, and changes in non-regulated allocation procedures. All audit recommendations are directed to the Commission.

I. Audit Background

This is the first comprehensive regulatory audit of Pacific Bell since the Commission implemented the New Regulatory Framework in 1990. The audit was initially ordered at the conclusion of the first NRF triennial review. In Decision 94-06-011 the CPUC ordered the Division of Ratepayer Advocates (DRA) to file a plan for "an inspection of the books and recorded of Pacific . . . pursuant to Public Utilities Code Section 314.5."[1] In Decision 95-06-036, the CPUC ordered the Division of Ratepayer Advocates (DRA) to develop an audit workplan. As guidance, the Commission provided the following clarifying directives for objectives and scope:

> The CPUC objective is to obtain the results of a thorough, aggressive audit. Depth and scope should be consistent with the CPUC policies of opening telecom markets, reducing the burden of regulation, and NRF reliance on price-cap regulation.
>
> The services we are authorizing . . . are limited to an in-depth audit on an account-by-account basis with appropriate detailed follow up. The resulting work product should include an analysis of all issues uncovered, including any relevant documentation.

In March, 1999 the Office of Ratepayer Advocates (ORA), DRA's successor organization, issued a Request for Proposals to perform the Pacific Bell audit. The RFP indicated the audit was to include "a comprehensive review of [Pacific Bell] and affiliate procedures, policies, practices for the period January, 1996 through December, 1998." The general objective was to "provide current, relevant information regarding Pacific Bell's operational and financial processes to assist the CPUC in regulation." The tasks listed in the RFP included analyzing Pacific Bell's NRF monitoring reports, cost allocations, and accounting procedures to ensure against any cross subsidization or anti-competitive behavior, determining whether Pacific Bell and its affiliates were following CPUC affiliate transactions rules, and determining whether non-structural safeguards adequately protected ratepayer and competitor interests regarding non-regulated activities.

In June, 1999, after contractor proposals were submitted and ORA selected finalists, Pacific Bell filed a motion to suspend award of the audit contract. Pacific Bell stated that the RFP went beyond the Commission's authorization and guidelines and requested the Commission review any audit plan. Pacific Bell also asked that audit oversight be transferred from ORA to the Commission's Telecommunications Division. Shortly thereafter, Overland Consulting was awarded the contract to perform the audit. In July,

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[1] California Public Utility Code Section 314.5 states "The commission shall inspect and audit the books and records for regulatory and tax purposes (a) at least once in every three years in the case of every electrical, gas, heat, telegraph, telephone and water corporation servicing over 1,000 customers."

1999 the CPUC denied Pacific Bell's motion, but ordered the Commission's Executive Director to review Overland's proposal for consistency with the clarifying directives issued in 1996. This review produced three minor modifications in the proposed work.[2]

Pacific Bell's effort to shift the supervision of the audit away from ORA continued after the Commission denied its June, 1999 motion. In February, 2000, the Commission reassigned audit oversight from ORA to the Commission's Telecommunications Division (TD).[3] A brief history of the litigation of the audit is set forth in Attachment 2-1.

In April, 2000, we conducted an audit kickoff meeting with Pacific Bell and the TD staff. As a result of delays in starting the audit, Overland, TD and Pacific Bell agreed to update the audit period to the three year period 1997 through 1999. In June, 2000, after working through scheduling details with Pacific Bell, we held our first technical audit meeting with Pacific Bell subject matter experts. It took approximately 6 months to complete preliminary audit work and approximately one year to complete detailed audit work and produce a draft audit report. At the conclusion of preliminary work, we prepared a risk analysis to assess areas that warranted detailed review. A copy of the risk analysis is presented in Appendix 2-1.

II. Audit Scope and Objectives

Approved audit objectives and scope included the following:

- Regulated Financial Reporting
    - Determine compliance with CPUC accounting policies.
    - Restate audit period intrastate regulated earnings to correct accounting errors and properly reflect CPUC accounting and ratemaking policies.
    - Explain significant factors impacting audit period intrastate regulated earnings.

- Affiliate Transactions
    - Determine compliance with CPUC affiliate transaction rules.
    - Determine whether current affiliate transaction procedures are sufficient to ensure cross-subsidies are avoided.
    - Assess the adequacy of affiliate transaction internal controls.
    - Determine how organizational and business changes have affected Pacific Bell.
    - Determine whether affiliate transactions were properly recorded in regulated accounts.

- Assignment and Allocations to Non-Regulated Telco Operations
    - Document the non-regulated assignment / allocation framework and compare with CPUC fully distributed cost distribution requirements.
    - Assess the adequacy of internal controls.
    - Conduct a detailed analysis of non-regulated cost assignment and allocation procedures.
    - Consider the potential for cross subsidization between SBC regions, service categories, and services.

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[2] The modifications were 1) we were not to review the sale of Bellcore or 2) the SBC/Ameritech merger. 3) We were not to interview regulatory agencies, competitors or other interested parties about Pacific Bell's practices or affiliate relationships. The modifications did not change the audit objectives, and had a minor impact on audit scope.

[3] The transfer of oversight to TD did not change our approach to the audit.

C NRF Monitoring

- S Determine if Pacific Bell submitted timely and accurate monitoring reports.
- S Recommend new reports to address changing regulatory, technological and competitive telecommunications environments, changes to make existing reports more useful and deletion of obsolete reports.

Audit scope and objectives were the subject of considerable debate and litigation. Attachment 2-2 is a discussion of how the approved audit scope and objectives evolved. Ultimately, the areas we were able to audit and the objectives met were shaped not only by the approved list of objectives, but also by the data Pacific Bell was willing and able to provide, the amount of time it took to acquire responses to data requests, and by the calendar time available to complete the audit. Although the calendar acted as a constraint, the TD staff gave us sufficient flexibility to successfully meet most audit objectives. Given the difficulties we encountered in obtaining data, without this flexibility our ability to accomplish objectives would have been significantly reduced.

A. Factors Affecting the Performance and Completion of the Audit

The audit was time consuming and labor intensive, taking 18 months to complete, six months longer than initially estimated. Most audit objectives were met, but some were not. The key factors affecting the time it took to complete the audit and our ability to meet objectives are described below:

1. Pacific Bell's Attempts to Define Data Relevancy and Limit Audit Scope - Pacific Bell imposed restrictions on the data it considered to be relevant and within the audit scope. It was clear from litigation prior to the audit that Pacific Bell did not believe the audit should include the review of affiliate transactions set forth in the Commission's Request for Proposals.[4] The company carried this point of view into the audit itself, at one point indicating it would not answer requests for data it perceived to be related to affiliate transactions and asking that affiliate transactions data already provided be returned. At various times, Pacific Bell imposed restrictions on the time periods that requested data could cover. A theme running throughout these restrictions was the company's contention that data created in or relating to periods other than the years 1997 through 1999 was outside the scope of the audit. When data relating to periods outside the 1997-1999 time-frame was provided, it was at Pacific Bell's discretion and based on Pacific Bell's, not the audit team's, judgement as to what was relevant.

2. Data Request Turnaround Time - In April, 2000, we met with Pacific Bell and the TD staff to establish ground rules for conducting the audit. At the time, Pacific Bell agreed to target 10 days as the maximum time to respond to data requests, with quicker turnaround for "off the shelf" requests. As of January 7, 2002, the average age of data responses (both answered and unanswered) was 75 days, more than seven times the agreed-upon target. 200 data requests

[4] In litigating this issue prior to the audit, Pacific Bell asserted that ORA's original Request for Proposals was "inconsistent with the Commission's directions as set forth in Decision 96-05-036", in part because the RFP referred to the CPUC's statutory authority under California Public Utilities Code Sec. 797 that had not been discussed in the Decision ordering the audit. (See I.87-11-033, Pacific Bell's Emergency Motion to Suspend Awarding of an Audit Contract, June 15, 1999, p.6). We note the following: 1) After Pacific Bell's Emergency Motion and a subsequent Commission Decision, the Commission's Executive Director approved a revised audit proposal that included most of the affiliate transactions work requested by ORA in its RFP; 2) Public Utilities Code Section 797 requires the CPUC to "periodically audit all significant transactions . . . between a . . . telephone corporation and every subsidiary or affiliate . . . "; and 3) prior to this audit, Pacific Bell's affiliate transactions had not been reviewed since the New Regulatory Framework was implemented in 1992.

remained outstanding, 155 of which had an average age of more than 5 months.[5] More than any other factor, Pacific Bell's inability and / or unwillingness to provide data within a reasonable period after receiving a written request degraded the efficiency of the audit and caused it to consume more calendar time and effort than originally budgeted. Throughout the audit we managed the inventory of data responses using our computerized data log application, with the assistance of the CPUC's TD staff. We conducted status meetings with Pacific Bell every two weeks to encourage the company to respond to specific requests and to measure data response progress. We tracked the timeliness and responsiveness of data received in the data log. Without continuous data management and the assistance of the TD staff, a majority of audit objectives would not have been met. Even with the data management effort there were data requests that Pacific Bell would not answer. Copies of our data status reports are included in Appendix 2-2. A copy of the final data log update prior to the release of our report is included in Appendix 2-3.

3. Inability or Unwillingness to Provide Data - Pacific Bell was unable or unwilling to supply some of the data necessary to complete audit objectives. Examples include:

   - Support for contingent liability costs and regulatory cost accruals factoring directly into the calculation of CPUC-regulated earnings.
   - Service-specific revenue data; for example, revenue from sales of caller ID
   - Cost support for affiliate transfer prices.
   - Affiliate-specific functional organization charts
   - Practices and policies relating to the sharing of telephone company customer data with unregulated affiliates.

4. Objections to Providing Data - Pacific Bell alternated between objecting to and providing data covering periods outside the 1997 to 1999 audit time frame. Pacific Bell objected to questions on some subjects. At one point during the audit, Pacific Bell declared a moratorium on responses concerning affiliate transactions and requested data already provided to be returned.

5. Incomplete and Non-responsive Answers - A number of data responses were incomplete or not responsive to our requests. In some cases, it took several months and several attempts on our part to complete a data response. We classified a number of responses as complete - non-responsive. In these cases, which usually involved some response on Pacific Bell's part, we determined that Pacific Bell was unlikely to provide all of the data specifically requested.

6. Unanswered Data Requests - In some cases, Pacific Bell simply left requests unanswered. For example, as discussed above, we asked Pacific Bell to describe its policies with respect to sharing customer information with affiliates. Pacific Bell did not object to the requests; yet, after more than six months, the requests remained unanswered.

[5] Data Status Report, January 7, 2002. This was the last data status report prior to the completion of the audit report.

III. Audit Recommendations

We consolidated all audit recommendations into this chapter. Recommendations are organized by major audit report section. Due to the nature of the audit, recommendations are directed to the Commission, rather than Pacific Bell. In doing so, it is our intention that the Commission direct Pacific Bell to implement the recommendations it finds should be adopted.

A. Monitoring - Financial and Operational Reporting

We found CPUC-basis financial reports provided during the audit period were confusing and lacked necessary disclosures. Due to complexities associated with CPUC financial reporting and the specific changes needed to make the Pacific Bell's regulatory financial reports usable and understandable, the recommendations described below are detailed. Most of the recommendations in this section are based on an assumption that the Commission will continue to monitor Pacific Bell's regulated earnings and require Pacific Bell to produce financial results consistent with CPUC accounting policies.

1. The Commission should consider whether Pacific Bell's process for obtaining and reporting IEMR results is consistent with the NRF goal of simplifying and streamlining the regulatory process. As discussed in Chapter 3, Pacific Bell's audit period regulated earnings calculations were the product of a complicated and confusing process that 1) began with Pacific Bell's FCC -basis results, 2) added Pacific Bell subsidiaries, various "jurisdictional" adjustments and consolidating eliminations to obtain CPUC-basis financial results and 3) removed subsidiary amounts, interstate costs and non-regulated allocations and added various "ratemaking" adjustments to calculate regulated earnings. In addition to being complicated, during the audit period the components of the process were poorly disclosed. To meet the NRF goal of streamlined regulation and to shed light on the many financial and ratemaking adjustments embedded in various stages of the process, the Commission should consider whether the process should be simplified. For example, CPUC-basis financial statements that serve as an intermediate stage between FCC-basis separate and the IEMR could be eliminated (to our knowledge they were never ordered by the Commission in the first place). Instead, "jurisdictional" adjustments to FCC-basis financial results (some of which are actually ratemaking adjustments) could be incorporated into the IEMR. FCC-basis financial results, which are already compiled on a Pacific Bell stand-alone basis, would then form the foundation for the IEMR, eliminating unnecessary steps and enhancing the understandability of IEMR results.

2. To the extent separate FCC and CPUC regulatory statements continue to be presented and are similarly titled, they should be presented in a consistent manner, preferably on a Pacific Bell stand-alone basis. If subsidiary results are included in financial results, the subsidiaries should be disclosed in the title or in notes to the statements. During the audit period Pacific Bell's MR (FCC-basis) financial statements reflected Pacific Bell on a stand-alone basis. FR (CPUC-basis) reports, although similarly entitled "PB California", contained results for Pacific Bell consolidated with different mixtures of subsidiaries.[6] The changes from year to year were not disclosed, nor was pro-forma information provided for comparison purposes. Subsidiary results should not be

[6] In 1997, Pacific Bell's FR reports contained the consolidated results for Pacific Bell, Pacific Bell Information Systems (PBIS), Pacific Bell Directory, Pacific Bell Development, Pacific Bell Wireless, Pacific Bell Internet and Pacific Bell Network Integration. In 1998, FR reports included consolidated results only for Pacific Bell and PBIS. FR data used as input to the 1999 Intrastate Earnings Monitoring Report (IEMR) reflected consolidated results for Pacific Bell and PBIS, while FR results in the 1999 Results of Operations report reflected Pacific Bell by itself.

included in Pacific Bell's CPUC-basis statements, particularly when they are excluded from the FCC-basis financial statements. At a minimum, common sense suggests that any subsidiaries included in financial statements that are entitled "Pacific Bell" or "PB California" be clearly identified.

3. If Pacific Bell continues to maintain separate MR (FCC-basis) and FR (CPUC-basis) financial results, all adjustments explaining differences between the statements should be fully disclosed and the basis for each adjustment should be fully explained in notes or analytical documentation accompanying the FR statements. Pacific Bell should annually provide a complete set of support for "C3" ("jurisdictional") adjustments that reconcile FCC-basis and CPUC-basis financial results. Support should include descriptions and full calculation support for each adjustment. Pacific Bell's financial transactions are initially recorded on an MR (FCC) basis. During the audit period there were significant differences between FCC-basis and CPUC-basis financial statements. Some were presentation differences caused by including different sets of subsidiaries in MR and FR results. Apart from the presentation differences were real differences resulting from C3 (FCC to CPUC) financial reporting adjustments. Many of the C3 adjustments were caused by differences in FCC and CPUC accounting requirements. However, some were ratemaking adjustments made by Pacific Bell at its own discretion. The ratemaking adjustments were not disclosed and partly explain Pacific Bell's understated IEMR earnings and lack of reported shareable earnings. Assuming the Commission believes it needs separate CPUC-basis financial statements, the only effective way to monitor them is to 1) have FR (CPUC) and MR (FCC) results presented side-by-side on a comparable basis (i.e. a basis in which both reports contain results for the same set of subsidiaries), 2) maintain an understanding of the nature and magnitude of jurisdictional differences between FCC and CPUC reporting, and 3) be able to distinguish between adjustments resulting from jurisdictional accounting differences and discretionary adjustments designed to meet regulatory objectives (the latter are ratemaking adjustments that should be included in the IEMR). The problems discussed in this recommendation are not corrected by Resolution T-16545 adopted in August, 2001.[7]

4. Pacific Bell's Intrastate Earnings Monitoring Report (IEMR) should reflect Pacific Bell's results on a stand-alone, CPUC (FR) basis Pacific Bell's audit period IEMR was unnecessarily confused by the inclusion of subsidiary results in the FR (CPUC-basis) financial data entered into the first column of the report. Subsidiary results should be excluded from the "Total California Operations" data input into Column 1 of the IEMR.

5. IEMR "intrastate ratemaking adjustments" should be supported by a separate schedule breaking out the amounts associated with each adjustment and by descriptions of the basis for each adjustment and the CPUC authority for making it. Audit period IEMRs contained a number of

[7] In fact, by approving Pacific Bell's request to eliminate 13 financial monitoring reports in Resolution T-16545 in August, 2001, the CPUC may have unknowingly eliminated its ability to see even the magnitude of the differences between FCC-basis and CPUC-basis results. Among the 13 monitoring reports no longer required are those containing MR (FCC-basis) results: PD-01-14, the MR summary of reports; PD-01-15, the MR income statement; PD-01-016, the MR balance sheet and PD-01-19, the FR summary of reports, part of which (PD-01-19a) showed MR and FR results side-by-side. The new USOA Summary Report approved in Resolution T-16545 is not specified to provide MR results or MR / FR differences. *At a minimum*, Pacific Bell should be required to provide comparable (preferably Pacific Bell stand-alone) MR and FR results as separate columns in the new USOA Summary Report, in addition to the support for C3 adjustments.

ratemaking adjustments that were incorrectly referred to in the plural as "disallowances."[8] Most of the ratemaking adjustments in the report were squeezed into a column labeled "Other Misc." IEMRs provided no documentation of the adjustments in the "Other Misc" column. IEMR ratemaking adjustments should be broken out on a separate schedule and the basis and CPUC authority for including them in the IEMR should be provided in a narrative description.

6. Pacific Bell should annually provide workpaper support for "intrastate ratemaking adjustments" with calendar year-end IEMR results. Overland obtained workpaper support for IEMRs in response to Data Request OC-66. This support should be filed with the year-end IEMR to enable the CPUC staff to understand how Pacific Bell computed its CPUC-regulated earnings. We recommend that the CPUC staff tie Pacific Bell's IEMRs to supporting workpapers, review IEMR and C3 adjustment workpapers and obtain an understanding of C3 adjustments, IEMR ratemaking adjustments and regulated earnings calculations at least once per year.

7. Pacific Bell should provide the CPUC staff an electronic spreadsheet download of monthly trial balance data providing account, sub-account and EXTC detail for Pacific Bell (on a stand-alone basis) and Pacific Bell Directory (PBD) in support of year-end IEMR results. A trial balance is critical for understanding financial results and detecting significant fluctuations at the account and sub-account level. Electronic trial balances in spreadsheet format are easy to prepare, download, send and review and take up almost no space. We obtained electronic versions of trial balances for this audit. The Commission should require that trial balances tie to the amounts in column 1 of the IEMR. PBD trial balance data should tie to the amounts in the "Directory" column of the IEMR.[9]

8. Pacific Bell's Annual Report on Significant Affiliate Transactions (O.I.R. report) should be designated as a monitoring report. To the extent its content duplicates the content of existing monitoring reports covering affiliate transactions, the other reports should be eliminated. We found duplication between some of the affiliate transaction data required in the monitoring program and Pacific Bell's annual O.I.R. report in the areas of employee transfers and company procedures. The requirements for the O.I.R. report cover most of the key data needed to monitor affiliate transactions. Pacific Bell and the CPUC staff should compare notes on affiliate transactions data provided to the monitoring program. Monitoring reports that duplicate what is provided in the O.I.R. report should be eliminated and replaced by the O.I.R. report. The Commission should consider asking the CPUC staff to carefully review the content of the O.I.R. report and order additional information as necessary to properly monitor the affiliate relationships that have evolved and increased since the end of the audit period.

9. Pacific Bell's O.I.R. report should provide organizational data that reflects the affiliate structure used in intercompany billing and financial reporting. The organizational data provided in O.I.R. reports during the audit period consisted of a list of legal entities. It contained no organizational structure information and was not filed on a timely basis. Pacific Bell's organization can be defined in several dimensions (legal, payroll, management, and inter-company accounting). Pacific Bell should continue to provide the listing of legal entities it provided during the audit period with the O.I.R report, but should do so on a timely basis with the rest of the report. In addition, Pacific Bell should provide management organization charts reflecting the department

[8] Some of the adjustments added to reported expense or subtracted from reported revenue, and were, in fact, the opposite of a "disallowance".

[9] We include PBD's trial balance data in the recommendation because it is treated like a department of Pacific Bell for the purpose of calculating regulated earnings on the IEMR.

structure of the entities defined for *inter-company accounting and billing purposes* (for example, the departments of the parent entity whose costs are billed to Pacific Bell through the parent's billing model). This is necessary to permit an understanding of the organizations behind the inter-company transactions presented in other sections of the O.I.R. report.

10. Pacific Bell should adjust and reissue 1997 through 2001 FR (CPUC-basis) financial statements and IEMRs to reflect the Commission's Findings of Fact and Conclusions of Law with respect to audit adjustments and accounting issues discussed in this report. Pacific Bell should adopt accounting practices necessary to reflect audit period adjustments adopted by the Commission in years after 2001. The adjustments resulting from this audit were made necessary by a failure to maintain accounting in accordance with CPUC rules. These adjustments will continue to affect CPUC-basis financial results in the years after the audit period unless the Commission orders the adjustments to be implemented in financial results for years after 1999. To the extent the Commission adopts audit recommendations that require a change in Pacific Bell's audit period accounting procedures, Pacific Bell should adopt the change to comply with the Commission order. Because 2000 and 2001 accounting will be complete by the time a Commission order is issued, Pacific Bell should restate 2000 and 2001 CPUC-basis financial results as required to bring these results into compliance with the Commission's order. CPUC-basis financial results and IEMR results for the 1997 - 1999 audit period should also be restated to comply with the Commission order.

11. Pacific Bell should provide stand-alone actuarial reports, certified by SBC's independent actuary, for the Pacific Bell component of SBC employee benefit plans. The 1999 merger of Pacific Bell's management pension plan into the SBC management pension plan creates the risk that Pacific Bell's pension costs will be overstated because of the misallocation of assets and liabilities. The 1999 actuarial report for the SBC management pension plan provides only limited summary information for the Pacific Bell component of the overall SBC management plan. Preparing stand-alone Pacific Bell actuarial reports each year will promote the tracking of Pacific Bell's pension assets and liabilities on a consistent basis, discourage and help to identify transactions that effectively transfer pension assets funded by Pacific Bell's regulated customers to cover pension liabilities in other SBC subsidiaries, and provide the full disclosures required by generally accepted actuarial principles and practices.

12. Cash Working Capital should be excluded from future IEMR reports. Cash working capital requirements are not recorded on Pacific Bell's books. Instead, they are calculated in complex lead-lag studies prepared exclusively for IEMR purposes. The amount of time required to audit Pacific Bell's cash working capital studies is disproportionate to the impact of cash working capital on rate base. Pacific Bell's cash working capital studies were particularly difficult to audit because of the lack of support for the factors used in the studies and the numerous errors made by Pacific Bell. Auditing the cash working capital allowances claimed by Pacific Bell is simply not practical under the existing IEMR review process. Pacific Bell's corrected cash working capital averaged $147 million during the audit period (before consideration of outstanding data requests). Based on the audit results, excluding cash working capital from rate base will not result in a material misstatement of rate base. Accordingly, we recommend that cash working capital be excluded from rate base in future IEMR results.

B. Monitoring - Competition, Technology and Service Quality

1. The CPUC should evaluate the types of statistics it needs to monitor competition and consider developing a program to monitor the progress of local exchange competition. In recent years the CPUC and the FCC have taken steps intended to make local exchange markets competitive. The introduction of competition is the basis most often cited to support the reduction or elimination of traditional cost and price regulation for incumbent local exchange carriers. SBC cites local exchange competition as justification for being allowed into the interLATA long distance market. In recent years regulations have been implemented to open the network to local exchange competitors. During this period Pacific Bell had significant NRF requirements, such as customer earnings sharing, suspended. Although SBC asserted in a "Competitive Environment Report" filed with the CPUC that the local exchange is "highly competitive", our review showed that the CPUC's monitoring program produces almost no information to permit an objective evaluation of competition or the progress competing companies have made in penetrating local exchange markets. The CPUC should consider revising monitoring program requirements to incorporate objective market share data and data concerning competitors' use of Pacific Bell's network.

2. The CPUC should consider monitoring SBC's, PTG's and / or Pacific Bell's ownership interests in and management control of California competitive local exchange providers. Recent events surrounding Covad Communications provide an example of why it may be important for the CPUC to monitor SBC's acquisition of California competitors in order to meet its NRF objective of opening local exchange markets to competition. Covad competes with SBC in the broadband services market, providing digital subscriber line, virtual private networking and virtual internet provider services.[10] On December 13, 2001, as a part of a plan to emerge from bankruptcy, Covad announced that SBC would make a $150 million investment in the company[11]. CNBC described the investment as an "equity infusion."[12] The benefits of competition can be negated if competitors are simply purchased or otherwise controlled by the incumbent provider with which they are intended to compete. We recommend that the CPUC consider a monitoring report tailored to track the ownership and management control relationships between SBC and other companies certified to provide local exchange telecommunications in California. This would help the Commission determine whether companies other than SBC in the California local exchange market are bona fide competitors.

3. Pacific Bell should provide the unit data required in report PA-03-00 - *Market Penetration Data for Category II Services* so that the report can serve its intended purpose. Category II services are services for which competition is emerging and Pacific Bell is granted some pricing flexibility. The data Pacific Bell filed for this existing monitoring report was limited to revenue. Without unit data, the report cannot be used to assess market penetration for Category II services, as implied by the report title.

4. The CPUC should consider whether it is worthwhile to have Pacific Bell continue filing service-specific embedded cost reports. If the CPUC determines that it needs the reports, Pacific Bell

[10] Yahoo Finance, Profile, Covad Communications, Business Summary, December 19, 2001.

[11] Reuters, "Update 1 - Covad Expects to Exit Bankruptcy on Dec. 20", December 13, 2001.

[12] CNBC, Power Lunch, December 19, 2001. CNBC described SBC's $150 million investment as an "equity infusion".

should be required to resume maintenance of the Profitability Information (PI) system used to produce them. If the reports are not used, they should be eliminated. Service-specific embedded cost study reports comprised approximately half the reports filed under the monitoring program during the audit period. It is not clear whether these reports are useful. They are not used directly as a basis for service pricing. For several years, Pacific Bell has continued to send copies of the reports to the CPUC but has not maintained the computer system used to produce them. As a result, the reliability of the reports is questionable. The CPUC should consider eliminating the reports from the monitoring program. If the reports continue to serve a purpose, Pacific Bell should maintain the PI system used to produce them.

5. Pacific Bell should file customer survey data required by the monitoring program in report PA-02-03. The Commission should consider developing a basic set of customer survey statistics designed to help it measure and detect trends in Pacific Bell's service quality. Customer surveys can serve as a barometer of service quality and customer satisfaction and help the Commission determine whether and how relaxed regulation and competition have affected service quality. The NRF monitoring program requires Pacific Bell to file customer survey results as surveys are initiated. Pacific Bell conducted customer surveys during the audit period but did not file the results as required. Pacific Bell also refused to make its customer survey results available for our review in this audit. We recommend the Commission reiterate Pacific Bell's existing requirement to file surveys and obtain copies of the results of surveys conducted during and since the audit period. We also recommend the Commission consider requiring Pacific Bell to obtain customer survey data specifically designed to monitor statistics historically used by the CPUC staff to measure service quality.

C. Affiliate Transactions Accounting

1. SBC should maintain Part 32 account translation detail for all affiliates allocating cost to Pacific Bell and for all subsidiaries that may be combined with Pacific Bell for financial reporting purposes. Pacific Bell should make use of account translation detail to accurately record affiliate charges from shared services subsidiaries in the correct Part 32 accounts, and to accurately classify subsidiary financial results in consolidated financial reports it may provide to the CPUC. Pacific Bell's costs for services provided by affiliates grew seven-fold between 1996 and 2000. By 2000 affiliate services accounted for approximately 25 percent of Pacific Bell's operating expenses. Trends suggest affiliate transactions will comprise a growing portion of Pacific Bell's expenses in the future. During the audit period Pacific Bell began to transfer several large telco functions (customer service, marketing, information technology) to shared services affiliates such as SBC Operations and SBC Services. These affiliates allocate their costs back to Pacific Bell but do not maintain their books using the FCC Part 32 Uniform System of Accounts (USOA). Neither the shared services affiliates nor Pacific Bell were able to provide support demonstrating that affiliate accounting data was accurately translated to Pacific Bell's Part 32 accounts in the affiliate transaction process. In addition, Pacific Bell incorporated general ledger results for subsidiaries into Pacific Bell's financial reporting system for the purpose of presenting consolidated FR (CPUC-basis) results. Pacific Bell indicated in response to our request that detail for translating financial data from subsidiaries such as Pacific Bell Information Systems and Pacific Bell Network Integration was unavailable.[13] Pacific Bell should maintain an audit trail (specifically, a detailed account translation table, also known as an account mapping) to ensure that affiliate charges and subsidiary financial results accurately translate to the Part 32 USOA.

[13] Response to OC-622

The fact that Pacific Bell could not provide this data casts doubt on the reliability of the translation of affiliate costs into Pacific Bell's accounts during the audit period.

2. Pacific Bell should maintain the unique identity of the types of costs it receives from affiliates, particularly for those functions historically performed by Pacific Bell. This could be accomplished by requiring Pacific Bell to follow its expenditure-type-code (EXTC) structure for all costs of services provided by affiliates based on the nature of the affiliate's underlying costs. As Pacific Bell transfers an increasing number of its telephone company functions to affiliates, it is losing much of the financial detail that Part 32 accounting requires. In addition to the functional groupings established in the USOA account structure, Part 32 accounting calls for the maintenance of subsidiary record categories such as salaries and wages, benefits, rents, etc. (types of costs). This requirement is referred to as the "expense matrix". In Decision 87-12-063 the CPUC ordered "a separate and unique sub-account" (e.g., function code, reporting code, or expenditure code) to be set up to record the affiliate costs chargeable for each Part 32 account to which costs are assigned.[14] Rather than maintain an accounting field to separately track the type of cost in conformance with the Part 32 expense matrix, in many cases Pacific Bell aggregated affiliate charges in the same sub-account *and* same expenditure type code within the Part 32 account in which it recorded the affiliate transactions. As a result, the underlying identity of the types of costs from affiliates was "lost" to Pacific Bell. We do not believe the intent of the 1987 decision was to permit Pacific Bell to arbitrarily discontinue the use of expense-matrix accounting (or, for that matter, expenditure-type-code accounting) simply because telephone company functions were transferred to affiliates that do not use Part 32. We recommend the Commission require Pacific Bell to continue maintaining the financial detail required by Part 32 (including expense matrix detail) for functions performed for the telephone company, regardless of the affiliate status of the employees performing the functions.

3. The parent company should stop billing Pacific Bell for costs identified with charge code 80 - Mergers, which are not attributable to Pacific Bell. In the alternative, if the parent continues to bill the costs, it should specifically identify the costs in supplemental billing information and Pacific Bell should record them below-the-line. Beginning in 1998, MSI began billing subsidiaries - including Pacific Bell - for merger and acquisition costs incurred by the parent company's Corporate Development organization. During the audit period most of these costs related to unsuccessful acquisition scouting projects in other countries. Under attributable cost principles these costs should not be charged to Pacific Bell. Because they are not separately identified on Pacific Bell's affiliate bill, they cannot be isolated for below-the-line accounting treatment. MSI should stop billing these costs to Pacific Bell and Pacific Bell Directory. In the alternative, MSI should separately identify the charges and Pacific Bell should record them below-the-line in account 7370 - Special Charges.

4. Account 7370.39 - *Special Charges - Lobbying* should be the default account for the parent company's California Regional External Affairs departments. Alternatively, the CPUC should consider requiring an IEMR adjustment to remove "lobbying" expenses from account 6722 - External Relations. During the audit period, the costs of MSI's California Regional External Affairs organization were automatically directed to above-the-line account 6722 - External Relations, unless exception time reporting was employed. The predominant objectives of the California regional external affairs departments meet the FCC definition of "lobbying", requiring the associated cost to be recorded in below-the-line account 7370. Because the departments

[14] D.87-120-63 (Ordering Paragraph 14a.)

failed to use the project codes available to properly classify costs for below-the-line account treatment, costs that should have been recorded below-the-line were instead recorded in account 6722. The account to which a department's costs are automatically directed should be one reflecting the department's predominant activities. In the regional departments of California's parent company external affairs organization, activities qualifying for above-the-line account 6722 are the exception rather than the rule. In these departments, costs should default to below-the-line account 7370.39, and exception time reporting and accounting should apply to above-the-line account 6722. The easiest way to implement this would be to hard-code the appropriate lobbying, legislative advocacy and political action committee project codes into timesheets, payment vouchers and other accounting source documents. In theory, this would prevent costs from being charged above-the-line unless exception coded.[15] To the extent the parent company's External Affairs department does not account for activities in accordance with FCC rules in the future, the Commission should consider requiring Pacific Bell to make an IEMR adjustment to remove the cost from the calculation of IEMR regulated operating income.

5. <u>The parent company should provide affiliate billing support for legal expenses to enable Pacific Bell to determine that legal billings are properly assigned to Pacific Bell and can be properly divided between customer (above-the-line) and shareholder (below-the-line) categories. Pacific Bell should use this information to divide legal costs between customers and shareholders on its FR (CPUC-basis) books. To the extent the nature of parent legal costs is either unavailable or not provided with affiliate billings, they should be recorded below-the-line on the FR books.</u> Most of Pacific Bell's legal costs reflect billings from the parent company, which houses the legal department. Costs recorded in above-the-line account 6725 (Legal Expense) increased from $22 million in 1996 (the year before the SBC / PTG merger) to $85 million in 2000.[16] Some of the cost increase was caused by the addition of a second legal department (SBC's) to Pacific Bell's cost allocations after the SBC / PTG merger. It is likely that some of the increase was caused by factors such as local exchange competition and SBC's initiative to implement intraLATA long distance. Some of these costs may not have been attributable to Pacific Bell or its regulated services customers.

Pacific Bell indicated in data responses that the parent company did not maintain a centralized project-based accounting for legal expenses. No information on the nature of parent legal expenses was provided in Pacific Bell's parent company billing. Discretionary project codes used by the parent company to track certain outside legal costs were not used for internal legal efforts and explanations of the nature of the legal costs that were tracked were not supplied with Pacific Bell's affiliate billings. Pacific Bell had no basis for segregating and properly accounting for legal charges that may have been attributable to shareholders, rather than customers. If legal expenses are to be properly divided between customers and shareholders and between Pacific Bell and other subsidiaries, costs must be identified and assigned on the basis of the legal efforts that give rise to them. This information must be provided to Pacific Bell and be available to Commission auditors. The best way to accomplish this is project-based accounting with full explanations of the nature of legal efforts. To the extent SBC or Pacific Bell determine that

[15] We use the term "in theory" because during the audit period Pacific Bell failed to properly use the supplemental billing information provided by MSI to identify lobbying, legislative advocacy and political action committee charges. Implementing this recommendation would require Pacific Bell to make proper use of the supplemental data provided with parent company billings.

[16] Per FCC Armis Report 43-03, totals before Part 64 allocation and Part 36 separation. The average recorded in account 6725 during the period 1990 through 1996 was $31 million.

information concerning the nature of legal efforts is privileged and cannot be shared with the Commission, it should be automatically charged below-the-line to shareholders, rather than above-the-line to regulated customers.

6. <u>The parent company should provide supplemental information with Pacific Bell's affiliate billing to identify corporate sponsorship payments and corporate public relations, both of which are image advertising expenses not recoverable through regulated earnings. Pacific Bell should record corporate sponsorship expenses in the correct Part 32 account. The CPUC should instruct Pacific Bell to remove parent billings of corporate public relations and corporate sponsorships from regulated expense for the purpose of calculating regulated intrastate earnings on the IEMR</u>. After the SBC / PTG merger, the parent company billed Pacific Bell more than $10 million annually for corporate sports and cultural sponsorships and more than $8 million annually for corporate public relations consulting services. Corporate sponsorships are a form of corporate image advertising. Contrary to FCC Part 32 requirements, Pacific Bell recorded corporate sponsorships in Account 6613 - Product Advertising. In 1986, the CPUC determined that corporate public relations expenses were a form of image advertising. The CPUC has prohibited Pacific Bell from recovering image advertising through regulated expense. Contrary to CPUC requirements, Pacific Bell included corporate sponsorship and corporate public relations expenses in regulated earnings calculations. In order to correctly account for these costs, Pacific Bell needs the information broken out in a supplement to the parent company's affiliate billing. We recommend the Commission require Pacific Bell to obtain this information. We also recommend the CPUC instruct Pacific Bell to remove these costs from regulated expense in future IEMRs.

7. <u>The parent company should provide supplemental affiliate billing information identifying Pacific Bell's share of executive compensation costs exceeding the CPUC's recovery limit. Pacific Bell should use this information to eliminate "excess" executive compensation from regulated expense on the IEMR.</u> During the audit period Pacific Bell made an IEMR adjustment to remove "excess" executive compensation from regulated expense for regulated earnings measurement. However, Pacific Bell did not have the information it needed to properly calculate the "excess" compensation flowing from parent company billings. We recommend Pacific Bell obtain the following supplemental information for each SBC executive whose total compensation exceeds the CPUC's regulated cost recovery limit: 1) total compensation included on the parent's general ledger (which should include salary, bonus, "retention", short and long term incentive, supplemental (non-qualifying) retirement, severance and post-severance "consulting" pay); and 2) the percentage billed to Pacific Bell. With this information, Pacific Bell should be able to calculate the amount exceeding the limit recoverable through regulated accounts. Executive compensation expense exceeding the CPUC limit should be recorded below-the-line to ensure recovery from shareholders, rather than regulated customers. We recommend the executive compensation limit be raised and indexed to an inflation measure such as the consumer price index. The $200,000 limit established by the CPUC in 1986 was approximately $300,000 when adjusted for inflation to 1998, the mid-point of the audit period. We used $300,000 in calculating audit period adjustments to regulated earnings.

D. Affiliate Transactions - Compensation for Business Transfers and Use of Customer Data

1. The CPUC should consider requiring Pacific Bell to be compensated for the "advanced services" business it transferred to SBC Advanced Solutions, Inc. If the CPUC determines Pacific Bell should be paid, it should consider whether Pacific Bell should be compensated based upon the going concern value at the time of the transfer, or whether compensation should be limited to reimbursement of Pacific Bell's development costs. In 1992, when the Commission approved Pacific Bell transfer of its information services business to PBIS, it was treated as the transfer of a business opportunity. The Commission required Pacific Bell to be reimbursed for the going concern value of the business. In 2000, Pacific Bell encountered a similar situation when it transferred its advanced services business, including digital subscriber line services (ADSL), to SBC Advanced Solutions, Inc. (ASI). During the audit period Pacific Bell charged regulated customers approximately $200 million to develop ADSL and recorded significant ADSL investment in rate base. To the extent the transfer is not appropriately compensated, Pacific Bell has cross-subsidized ASI. The CPUC should consider whether Pacific Bell should be compensated for the transfer and whether the compensation should be based on the going concern value of the business opportunity that was transferred, as was the case with the voice mail business transferred to PBIS in 1992.

2. The CPUC should evaluate and develop regulatory policy governing the use of Pacific Bell's telephone company customer data by affiliates. Pacific Bell's customer list is a valuable intangible asset. In Data Requests OC-839 through OC-844 (submitted in June, 2001) we asked Pacific Bell to describe its policies for supplying customer names, telephone numbers (including unlisted and unpublished numbers) and other customer record data to affiliates. We also asked Pacific Bell whether and how it was compensated for providing the data and for copies of any available written policies relating to affiliate use of customer data. To date, Pacific Bell has not answered these questions.

   Non-regulated affiliate use of customer data collected by a regulated utility raises a host of competitive, cross-subsidy and customer privacy issues. For example, if an affiliate such as Prodigy (an internet service provider in which SBC holds an ownership interest) directly or indirectly uses Pacific Bell's customer data, how much should it pay Pacific Bell? Should unaffiliated internet service providers also have access to Pacific Bell's customer data under similar terms? If not, does exclusive access to a database comprising a majority of California's telephone subscribers confer an unwarranted competitive advantage on Prodigy? If customer data is made available to affiliated and non-affiliated companies, should Pacific Bell's customers be required to provide consent or be allowed to "opt out" before having their information turned over to marketers? Should any company, affiliated or non-affiliated, be permitted to use unlisted or unpublished telephone numbers for marketing without the consent of the unlisted customer and if so, is there any value in being "unlisted"? If Prodigy or any affiliate is provided free use of customer data developed by Pacific Bell in a monopoly environment, are they being cross-subsidized in a manner contrary to CPUC rules, particularly when the CPUC requires Pacific Bell be compensated for transfers of intellectual property and proprietary information?

   To complete its understanding in this important audit area, the CPUC should consider requiring Pacific Bell to fully document the customer data it has shared with or transferred to affiliates (including shared services affiliates) since the SBC / PTG merger and provide any internal policies relating to compensation for the use of the data. We recommend the CPUC determine whether and how customer data has been used for marketing on behalf of non-telco affiliates and whether unaffiliated competitors have similar access to the data. We also recommend the CPUC consider the competitive, cross-subsidy and customer privacy issues discussed above. With the movement of the telco's customer service function to shared services affiliates, it is possible that direct control of telephone company customer data may transfer to the corporate level. Ownership of customer data may also be legally transferred to SBC without compensation to Pacific Bell. If this has occurred or could occur, the CPUC should consider whether and how much Pacific Bell should be compensated by SBC for the value of its customer list.

3. The CPUC should consider whether SBC Operations, SBC Services and / or other shared services affiliates should be required to collect the CPUC's 13 percent sales referral fees from non-regulated affiliates when they provide referral services to customers in Pacific Bell's local exchange territory. The CPUC requires Pacific Bell to charge affiliates a fee for sales referrals. During the audit period, Pacific Bell recorded a significant amount of revenue from referrals provided to affiliates such as PBIS and PB Wireless. During the audit period Pacific Bell's marketing operations were being transferred to SBC Operations and may now reside in SBC Services. During the audit period SBC Operations ran several large call centers to sell telephone company services. It is likely that these shared services affiliates used Pacific Bell's customer database to perform sales and marketing activities. As Pacific Bell transfers sales activities to shared services entities that conduct marketing and provide referrals to non-regulated affiliates, Pacific Bell's inter-company sales referral revenue will be lost unless the CPUC extends the sales referral fee requirement to the shared services entity, requiring them to collect the fees and pass them on to Pacific Bell. A properly designed fee applicable to sales referrals provided by shared services affiliates could serve as a mechanism to compensate Pacific Bell for non-regulated affiliates' use of Pacific Bell's customer database.

E. Non-Regulated Allocation Procedures

1. The CPUC should consider whether it was reasonable for Pacific Bell to reclassify Category III ADSL service to above-the-line status. If the CPUC determines it was reasonable for Pacific Bell to move ADSL development costs above-the-line, it should consider whether, for regulatory purposes, development costs should have been deferred and amortized in periods following service deployment. Because of the magnitude of costs involved, an adjustment of 1998 and 1999 regulated operating income should be made if the CPUC determines either that ADSL's Category III status warranted below-the-line accounting treatment or that ADSL's development costs should have been amortized and matched with ADSL revenues. ADSL was introduced in 1998 but was not widely available until after the audit period. During the three year audit period Pacific Bell incurred net expenses of $196 million to develop ADSL service and placed substantial ADSL plant investment into rate base. In 1997 Pacific Bell recorded ADSL development costs below-the-line. In 1998 Pacific Bell moved ADSL accounting above-the-line. In July, 1998, Pacific Bell filed Advice Letter 19543 with the CPUC proposing to classify ADSL as a Category III service. Although Pacific Bell requested Category III treatment, in a document attached to the proposed advice letter Pacific Bell claimed that ADSL should be accounted for above-the-line because it was a form of special access service. On September 17, 1998, the CPUC issued Resolution T-16191 giving Pacific Bell provisional authorization to provide ADSL service. The Resolution stated "TD believes at this time that ADSL is a form of special access", but did not specify that Pacific Bell should receive above-the-line accounting treatment. At the end of 1999, at about the time the service was ready to be widely marketed, Pacific Bell transferred ADSL to SBC Advanced Solutions, Inc.. As a result, regulated customers paid a substantial amount for ADSL's development, but never received the benefit of significant ADSL revenue. We have not adjusted 1998 or 1999 FRs or IEMRs to reflect a change in ADSL accounting treatment because CPUC policy was not clear. An adjustment to 1998 and 1999 regulated earnings should be made if the CPUC determines that ratepayers should not have funded ADSL costs without CPUC

authorization or if the CPUC determines that for regulatory purposes development costs should be deferred and matched with revenues.

2. Pacific Bell should adhere to the FCC's Part 64 attributable cost hierarchy when assigning or allocating advertising and customer service expenses. Costs that can be directly identified with services should be assigned based on the regulated or non-regulated classification of the services. Pacific Bell allocated advertising agency fees, media costs, printing, postage and other advertising expenses billed by the parent company based on the time distributions of as few as two administrative employees assigned to the advertising function. Advertising should have been directly assigned to regulated and non-regulated activities based on the services for which the advertising was incurred. Information needed to assign and allocate advertising on the basis of services and business sectors advertised is readily available in parent billing detail and should be used instead of the regulated and non-regulated time distributions of administrative employees. The regulated and non-regulated distributions of the salaries of employees administering the advertising function should be based on telephone service assignments and allocations of Pacific Bell's advertising expenses, rather than the other way around. In addition, customer service expenses, including unclassified productive and non-productive time, should follow appropriate allocation methodology based on representative productive allocation ratios.

3. The CPUC should develop a policy for the treatment of costs associated with developing services marketed to customers outside the boundaries of Pacific Bell's local exchange territory. During the audit period Pacific Bell incurred costs to market telephone company services in GTE's franchised service territory. Pacific Bell charged the expenses above-the-line to customers in its own franchised service territory. Most costs that SBC incurs to develop competitive local exchange services are, or should be, charged to SBC's "National Local" (competitive local exchange company) subsidiary. The CPUC should consider whether costs incurred to develop competitive services outside Pacific Bell's franchised territory should be 1) charged to regulated services customers within Pacific Bell's franchised territory, 2) charged below-the-line, or 3) charged to the National Local (competitive local exchange) affiliate. If the CPUC determines it is reasonable for Pacific Bell to record these costs in regulated expense accounts, it should require Pacific Bell to record revenue above-the-line as well.

4. The CPUC should develop a policy concerning treatment of costs incurred to enter the long distance market. During the audit period Pacific Bell incurred costs to meet regulatory and operational requirements associated with entry into the interLATA long distance market. Pacific Bell charged costs incurred to enter the long distance business to regulated expenses on the telephone company's books. The revenues from providing interLATA long distance services will go to SWBT Communications, Inc., SBC's long distance subsidiary. The CPUC should consider whether it is reasonable for Pacific Bell to charge its regulated customers for costs incurred to make ready services that will provided by another affiliate.

5. Pacific Bell should maintain an up-to-date California Cost Allocation Manual. The California Cost Allocation Manual was out of date in the following areas: 1) PI System Descriptions; 2) Cost Allocation Table; 3) Pacific Bell Reporting Systems Flowchart; 4) Category I and II Lists of Services. It should be brought up to date each year. Although Pacific Bell acknowledged its CAM was out of date, it did not acknowledge the problem areas noted in this recommendation. If the CPUC adopts this recommendation and orders Pacific Bell to update its CAM, we recommend the Commission specifically address in its order the areas in the CAM that need to be updated.

Attachment 2-1
Litigation History of Pacific Bell's New Regulatory Framework Audit
June 1994 through October 2001

Litigation History of Pacific Bell's New Regulatory Framework Audit June, 1994 through October, 2001

1. June, 1994 - In Decision 94-06-011 the Commission orders the Division of Ratepayer Advocates (DRA) to file a plan to allow the results of an inspection of the books and records of Pacific and GTEC to be filed in the 1995 New Regulatory Framework (NRF) review.

2. October 14, 1994 - DRA submits an audit plan to the Commission.

3. November 2, 1994 - Pacific files a petition to modify the June, 1994 order, seeking to have the audit performed by the Commission's Advisory and Compliance Division (CACD) instead of by DRA.

4. May 8, 1996 - In Decision 96-05-036 the Commission denies Pacific Bell's motion. It states that it does not intend to miss doing the audit in time for the 1998 NRF review. It also states that the staff must have "full access to utility information." The DRA is directed to perform the audit with outside auditors if necessary. The Commission states that DRA's 1994 audit plan is not specific enough to guide a consultant and sets out the following clarifying directives:

C DRA should engage a CPA "who lacks real or apparent conflicts."

C DRA should adhere to Generally Accepted Auditing Standards, except DRA should determine materiality because the Commission is interested in full compliance with it rules and regulations.

C The CPUC objective is to obtain results of a thorough, aggressive audit. Depth and scope should be consistent with the CPUC policies of opening telecom markets, reducing the burden of regulation, and NRF reliance on price-cap regulation.

C DRA should revise the audit plan to include i.) an audit time line and milestones; ii.) functions that will be performed by specific DRA personnel.; iii.) work product responsibilities and expectations; iv.) defined activities the auditor is expected to perform; v.) other relevant information need to provide outside auditor with clear direction.

C DRA should request a specific amount of funding for the audit.

C Services should be limited to an in-depth audit on an account-by-account basis with appropriate detailed follow up, work product to include analysis of issues uncovered, no lengthy policy discussions, accurate and fully supported by factual analysis, recommendations as to specific accounting measures, examples where DRA's audit plan fails these measures: rate comparisons, analysis of benefits to customers, service quality, management restructuring.

C The plan is to be submitted to the Executive Director for review of consistency with above guidelines.

5. March 29, 1999 - The Office of Ratepayer Advocates (ORA), DRA's successor organization, issues a Request for Proposal (RFP). The RFP gives the following scope and objectives:

C The audit period is to include calendar years 1996 through 1998.

- General objectives - current, relevant information regarding Pacific Bell's operational and financial processes to assist the CPUC in regulation

- Audit Scope - comprehensive review of Pacific Bell and affiliate procedures, policies, practices for the period 1/96 through 12/98.

- Audit objectives: 1) Analyze Pacific Bell's NRF monitoring reports, cost allocations, and accounting procedures to ensure against any cross-subsidization or anti-competitive behavior; 2) Determine if Pacific Bell and affiliates are following CPUC affiliate transactions rules; 3) Determine if non-structural safeguards adequately protect ratepayer and competitor interests regarding non-regulatory activities.

6. May 20, 1999 - Overland submits its proposal to perform the audit

7. June 10, 1999 - Pacific Bell files an "emergency" motion to suspend the award of the audit contract. The motion asserts that ORA's RFP goes "well beyond" the authorization and guidelines set forth in Decision 96-05-036. It states the Executive Director does not have authority to modify the Commission's decision, and requests further review of any audit plan to ensure compliance with Decision 96-05-036. Pacific Bell again requests the audit be transferred from the ORA, this time to the Telecommunications Division (TD). Pacific Bell asserts that ORA's RFP expands the Commission's intended scope by referencing Public Utilities Code Section 797 and that a Section 797 audit is beyond the intended scope because it "deals exclusively with transactions among affiliates and requires a far broader audit that contemplated by PUC 314.5."[1] Pacific Bell claims that ORA's candidates, including Overland and Liberty Consulting, are "firms with a long history of anti-utility work." Pacific Bell asserts that Overland's recent work with Roseville Telephone Company and PG&E demonstrates the "highly litigious" nature of its work[2]. Pacific Bell asserts that ORA is seeking a "hired gun" to oppose reform under the guise of protecting consumer interest.

8. June 21, 1999 - Overland is awarded the contract to perform the audit.

9. July 7, 1999 - The Commission issues a ruling denying Pacific Bell's motion to suspend award of the audit contract, directs the Executive Director to meet with ORA to ensure the audit is undertaken in conformance with scope and directions set forth in prior decisions, and to report to the CPUC and other parties by letter within 30 days.

10. August 6, 1999 - The Executive Director issues a memorandum to the Commission finding three areas where he believes Overland's audit plan exceeds the Commission directives:

    - Sale of Bellcore. Finds that the Bellcore sale was the subject of a settlement between

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[1]Section 797 states "the CPUC shall periodically audit all significant transactions, as specified by the Commission, between an electric, gas or telecommunications corporations and every subsidiary or affiliate".

[2]Editorial note - At the time Pacific Bell made this assertion, Overland had not even begun working on the Roseville audit. Roseville, like Pacific Bell, was engaged in litigation to stop or delay its audit. Litigation that took place prior to the Roseville audit was initiated by Roseville, not by Overland or the Commission staff.

Pacific Bell and ORA and should not be reviewed.

- C SBC / Ameritech merger. Finds that the merger is not complete and does not fall within the 1996-1999 time-frame.

- C Interviews of Regulatory Agencies and Other Interested Parties. Finds that interviewing competitors is not an appropriate part of the audit.

The Executive Director also makes a recommendation that audit oversight responsibility be transferred from ORA to the Telecommunications Division (TD).

11. December 6, 1999 - Commissioner Duque issues a Draft Decision granting Pacific Bell's June 10 Motion to transfer the audit oversight responsibility from the ORA to the TD, citing "the appearance of bias" as a sufficient and compelling ground for reassignment of audit oversight. Administrative Law Judge Weismehl issues an Alternate Draft Decision denying Pacific Bell's Motion, stating it is untimely and presents no basis on which a modification should be granted. The Alternate Draft Decisions directs ORA to adopt the audit scope modifications in the Executive Director's August 6, 1999 letter.

12. February 17, 2000 - In Decision 00-02-047, the Commission adopts Commissioner Duque's Proposed Decision. Audit oversight is transferred from ORA to the TD.

13. March, 2000 - Overland modifies its audit proposal workplan to comply with the directives in the Executive Director's August, 1999 letter.

14. April 21, 2000 - Overland, TD and Pacific Bell conduct an administrative meeting in San Francisco to establish ground rules for the audit. Pacific Bell agrees to 10 day turnaround time for responses to data requests and 3 days for requests that can be obtained "off the shelf".. Overland submits 59 data requests to Pacific Bell.

15. May 22, 2000 - Overland and Pacific Bell conduct an audit kickoff meeting with subject matter experts identified by Pacific Bell. Approximately 12 of the 59 data requests submitted 30 days earlier have been fully answered. (Overland considers this the official start date for the audit).

16. June 7, 2000 - The TD sends its first letter to Pacific Bell documenting its concern about data response timeliness.

17. October 4, 2000 - In Decision 00-10-004, the Commission determines that in January it had issued the wrong document in Decision 00-02-47. It issues a corrected version of Decision 00-02-047 with three new Findings of Fact. These included number 5 - The Overland proposal identifies only 4 percent of the total hours as audit work and number 6 - The Overland proposal allocates 58 percent of total consulting time to the analysis of affiliate relations. It also includes a new Conclusion of Law: The audit contract services incorporated by reference to the Overland Proposal are inconsistent with an audit performed consistent with an audit performed pursuant to Pub.Util.Code Sec. 314.5. This conclusion essentially mirrors Pacific Bell's comments. However, it contradicts the August, 1999 finding by the Commission's Executive Director.

18. October 20, 2000 - Pacific Bell notifies TD that "we observe that the corrected version of Decision 00-02-047 determined that an audit of affiliate transactions and cost allocation makes little sense for a company subject to price cap regulation and is inconsistent with an audit performed pursuant

to Public Utilities Code Section 314.5." Pacific Bell informs the TD that is expects Overland to revise its audit plan to conform to the Commission's corrected order by eliminating the affiliate transactions and non-regulated cost allocations review from future data requests and asks for all data responses on the subjects be returned to Pacific Bell.

19. October 20, 2000 - Based on its interpretation of the newer version of Decision 00-02-047, Pacific Bell establishes a moratorium on data responses it believes relate to affiliate transactions and non-regulated cost allocations.

20. November 9, 2000 - Pacific Bell rescinds it moratorium on affiliate transaction and non-regulated allocation data requests.

21. November - December, 2000 - At the instruction of the TD, Overland begins a analysis of audit risk focused on Pacific Bell's CPUC-regulated financial statements. As a result of the analysis, the focus of the audit shifts from the objectives defined in the modified proposal workplan to focus on an "account-by-account" review of Pacific Bell's regulated statements. The TD staff reviews and approves Overland's detailed workplan.

22. February 8, 2001 - In Decision 01-02-041 the Commission vacates Decision 00-02-047, which provided for transfer of audit oversight from ORA to the TD, but also orders that TD continue to oversee the current audit. The Commission finds that statutory audit authority described in the California Public Utilities Code was provided by the California Legislature to the Commission, not to a particular division of the Commission. Decision 01-02-047 affirms ORA's right to inspect or review Pacific Bell account data or other information and it affirms the changes in audit scope recommended by the Executive Director in August, 1999.

Attachment 2-2
Development Of Audit Scope and Objectives

Development of Audit Scope and Objectives

A. Decision Ordering the Audit

In Decision 94-06-011 the CPUC ordered DRA to file a plan for "an inspection of the books and recorded of Pacific . . . pursuant to Public Utilities Code Section 314.5."[1]

B. CPUC Directives Concerning Audit Scope

In Decision 95-06-036, the CPUC ordered the Division of Ratepayer Advocates (DRA) to develop an audit workplan. As guidance, the Commission provided the following clarifying directives for objectives and scope:

> The CPUC objective is to obtain the results of a thorough, aggressive audit. Depth and scope should be consistent with the CPUC policies of opening telecom markets, reducing the burden of regulation, and NRF reliance on price-cap regulation.
>
> The services we are authorizing . . . are limited to an in-depth audit on an account-by-account basis with appropriate detailed follow up. The resulting work product should include an analysis of all issues uncovered, including any relevant documentation.

C. ORA's Request for Proposals

In March, 1999 the Office of Ratepayer Advocates (ORA), DRA's successor organization, issued a Request for Proposals to perform the Pacific Bell audit. The RFP indicated the audit was to include "a comprehensive review of [Pacific Bell] and affiliate procedures, policies, practices for the period January, 1996 through December, 1998." The general objective was to "provide current, relevant information regarding Pacific Bell's operational and financial processes to assist the CPUC in regulation". The audit objectives (tasks) in the RFP included analyzing Pacific Bell's NRF monitoring reports, cost allocations, and accounting procedures to ensure against any cross subsidization or anti-competitive behavior, determining whether Pacific Bell and its affiliates were following CPUC affiliate transactions rules and determine whether non-structural safeguards adequately protected ratepayer and competitor interests regarding non-reg activities.

D. Litigation After Submission of Proposals

The audit scope and objectives set forth in our proposal were consistent with those in the RFP.
In June, 1999, after contractor proposals were submitted and ORA selected finalists, Pacific Bell filed a motion to suspend award of the audit contract. In July, 1999 the CPUC denied Pacific Bell's motion, but ordered the Commission's Executive Director to review our proposal for consistency with the clarifying

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[1] California Public Utility Code Section 314.5 states "The commission shall inspect and audit the books and records for regulatory and tax purposes (a) at least once in every three years in the case of every electrical, gas, heat, telegraph, telephone and water corporation servicing over 1,000 customers . . .". .

directives issued in 1996. This review produced three minor modifications in proposed work.[2] In April, 2000 we began preliminary work based on the objectives set forth in the RFP and our proposal, as modified based on the Executive Director's review.

Pacific Bell's effort to change the supervision of the audit from ORA continued after the Commission denied its June, 1999 motion. In Decision 00-02-047, the Commission reassigned audit oversight from ORA to the Commission's Telecommunications Division (TD).[3] In April, 2000, we conducted an audit kickoff meeting with Pacific Bell and the TD staff. As a result of delays in starting the audit, Overland, TD and Pacific Bell agreed to update the audit period to the three year period 1997 through 1999.

E. Changes in Scope and Objectives After the Audit Began

In October, 2000 the CPUC issued a corrected version of Decision 00-02-47.[4] The corrected decision, distributed while we were conducting preliminary analysis, contained Findings of Fact and a Conclusion of Law addressing audit scope that had not been in the draft version of the decision issued in December, 1999 or in the decision adopted by the Commission in February, 2000. The differences between the original and corrected Decision focused primarily on audit effort directed toward affiliate transactions. Additional Findings of Fact in the corrected decision included the following:

> The Overland Proposal identifies only 4 percent of the total hours as audit work.[5]
>
> The Overland Proposal allocates 58 percent of total consulting time to analysis of affiliate relations[6].

An additional Conclusion of Law stated:

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[2] The modifications were 1) we were not to review the sale of Bellcore or 2) the SBC/Ameritech merger. 3) We were not to interview regulatory agencies, competitors or other interested parties about Pacific Bell's practices or affiliate relationships. The modifications did not change the audit objectives, and had a minor impact on audit scope.

[3] From our perspective, the transfer of oversight to TD did not change the conduct or findings of the audit. Prior to conducting this audit, we performed audits under the supervision of both ORA and the Commission Advisory and Compliance Division. Other than establishing scope and objectives in a Request for Proposals and overseeing work to ensure that stated objectives were met, no one on the CPUC staff has ever attempted to influence the direction or findings of an audit we conducted.

[4] See Decision 00-02-047, February 17, 2000 (corrected version) and Decision 00-10-004, Order Correcting Error.

[5] This Finding of Fact appears to have been derived from a statistic in Pacific Bell's Comments on the Proposed (draft) version of the decision, but it conveyed a different meaning than the statement from which it was derived. Pacific Bell's comments stated that "[l]ess than 4 percent of the 9,500 hours Overland estimates for the audit work *are designed to determine whether books and records are being maintained in compliance with CPUC rules and regulation"* (emphasis added).

[6] Derived from Pacific Bell's comments on the Proposed (draft) version of the decision, which stated "[t]he tremendous emphasis on affiliate transactions (over 5,500 hours, or 58% of audit time) is unwarranted".

> The audit services incorporated by reference to the Overland Proposal are inconsistent with an audit performed pursuant to Public Utility Code Section 314.5"

The additional Conclusion of Law in the corrected decision appeared to override the Executive Director's August, 1999 finding that the audit proposal, with indicated modifications, was consistent with Commission directives. Based on discussions with the TD staff, we revised our audit scope and objectives. We did not eliminate affiliate transactions or non-regulated account allocations as subjects of the audit. However, based on an analysis of the risk of regulated account balance mis-statements, we shifted audit effort toward Pacific Bell's regulated operating revenues, expenses and investment. Our risk analysis is shown in Appendix 2-1.

F. **<u>Final Approved Scope and Objectives</u>**

Decision 00-02-047 was vacated by the Commission in Decision 01-02-041. However, by this time, the audit scope and objectives described in the Executive Summary had already been revised and approved by the TD staff. We proceeded along the lines of our revised scope and objectives.

Chapter 3 - CPUC Financial Reporting and Pacific Bell's Audit Period Intrastate Regulated Earnings

Pacific Bell reports financial results in three separate sets of financial statements. Pacific Bell's "external" financial results are consolidated with those of other SBC subsidiaries and provided to shareholders and the Securities and Exchange Commission on a basis consistent with Generally Accepted Accounting Principles (GAAP). Pacific Bell also presents separate sets of financial results to the FCC and CPUC. These are based on GAAP with certain modifications intended to conform to the accounting policies of each regulatory agency. Financial results intended to conform to CPUC accounting policies are derived from adjusted FCC-basis financial results and are presented in CPUC-basis financial statements. CPUC-basis financial results form the input to Pacific Bell's Intrastate Earnings Monitoring Report (IEMR), a New Regulatory Framework (NRF) report intended to show CPUC-basis regulated intrastate operating income and return on rate base adjusted for compliance with CPUC ratemaking policies.

Audit period intrastate financial results reported to the CPUC were the product of an overly complicated and poorly disclosed process involving the adjustment of FCC-basis financial data. Results were presented on a consolidated basis and included the results of subsidiaries. The subsidiaries included in the results varied from year to year and were not disclosed in financial statement notes or explanations. Pro forma financial information necessary to make the results after subsidiary changes comparable with prior years was not presented. The ostensible reason for separate FCC and CPUC-basis statements is to reflect accounting requirements unique to each regulatory jurisdiction. There was insufficient disclosure of the amounts and basis for differences between FCC and CPUC-basis results. Adjustments to FCC financial data reflected not only accounting requirements unique to the CPUC, but also regulatory adjustments, such as a reserve deficiency amortization, that Pacific Bell made at its own discretion. The adjustments made to produce the CPUC statements were not separately identified or explained in materials filed with the CPUC. Some of the adjustments made on audit period IEMRs were also made at Pacific Bell's discretion and were not properly disclosed or explained.

As discussed in Chapters 4 through 20 of this report, Pacific Bell failed to comply with existing CPUC accounting policies in a number of areas. As a result, regulated intrastate operating income and return on regulated intrastate rate base reported in IEMRs was significantly understated and earnings owed to customers under NRF's sharing rules were not reported or refunded. Our audit identified 67 corrections to Pacific Bell's regulated intrastate operating revenues, expenses and rate base. As a result of these corrections, audit-adjusted regulated intrastate net operating income was $1.94 billion higher than Pacific Bell reported in audit period (1997, 1998 and 1999) IEMRs. Audit results show unreported NRF customer refunds totaling $17.6 million in 1997 and $331.2 million in 1998. The CPUC suspended NRF's customer sharing provisions effective in 1999. Customer refunds of $457.2 million would have been owed if sharing had been required for 1999. IEMR results reported by Pacific Bell and adjusted by the audit are compared in table below.

Table 3-1 **Summary of Pacific Bell's CPUC IEMR Results and NRF Sharable Earnings As Reported By Pacific Bell and Audit-Adjusted 1997-1999** Source: Pacific Bell Financial Reports and Audit workpapers		
	Reported By Pacific Bell	**Audit-Adjusted**
1997		
Intrastate Regulated Operating Revenue	7,503,569,782	7,604,120,275
Intrastate Regulated Operating Expense	6,569,897,784	6,052,529,636
Intrastate Regulated Operating Taxes	281,172,671	437,288,245
Net Intrastate Regulated Operating Income	652,499,328	1,114,302,393
Return on Regulated Intrastate Rate Base	6.49%	11.72%
Customer Refunds Under NRF Sharing Provisions	0	17,638,716
1998		
Intrastate Regulated Operating Revenue	8,021,747,100	8,029,208,013
Intrastate Regulated Operating Expense	6,493,962,343	5,803,783,872
Intrastate Regulated Operating Taxes	605,312,338	676,097,917
Net Intrastate Regulated Operating Income	922,472,419	1,549,326,224
Return on Regulated Intrastate Rate Base	9.07%	15.86%
Customer Refunds Under NRF Sharing Provisions	0	331,184,800
1999		
Intrastate Regulated Operating Revenue	8,325,126,201	8,385,003,365
Intrastate Regulated Operating Expense	6,855,791,651	5,830,823,818
Intrastate Regulated Operating Taxes	507,136,467	736,215,083
Net Regulated Intrastate Operating Income	962,198,083	1,817,964,464
Return on Regulated Intrastate Rate Base	9.66%	18.22%
Customer Refunds Under NRF Sharing Provisions (1)	0	457,244,588
Audit Period Combined		
Net Regulated Intrastate Operating Income	2,537,169,830	4,481,593,081
1. Audit-adjusted amount is pro forma. The CPUC suspended customer sharing in 1999.		

Attachment 3-1 shows the derivation of shareable earnings and amounts owed to customers based on audit-adjusted IEMR net operating income. Attachment 3-2 contains complete audit-adjusted IEMRs for 1997, 1998 and 1999. The basis for the IEMR is FR (CPUC-basis) financial results. Attachment 3-3 includes audit period trial balances showing MR (FCC-basis) amounts, FR (CPUC-basis) amounts, and the various amounts that create differences between the MR and FR books. Pacific Bell's process of adjusting FCC-basis financial results to obtain CPUC-basis results is described in section II of this chapter.

I. Discussion of Audit Findings

A. CPUC-Basis Statement Disclosures

During the audit period Pacific Bell's FR (CPUC-basis) financial statements included results for Pacific Bell together with subsidiaries which varied from year to year. In 1997, FR statements were based on the consolidated results for Pacific Bell, Pacific Bell Information Systems (PBIS), Pacific Bell Directory, Pacific Bell Development, Pacific Bell Wireless, Pacific Bell Internet and Pacific Bell Network Integration. In 1998, FR reports included consolidated results only for Pacific Bell and PBIS. 1999 FR results that formed the input to the IEMR was based on the consolidated results for Pacific Bell and PBIS; however, the FR results included in Pacific Bell's 1999 Results of Operations report reflected Pacific Bell on a stand-alone basis. These differences were not disclosed. The subsidiaries included in audit period FR statements were not identified in the financial statement titles, nor were year-to-year changes in the subsidiaries disclosed in notes accompanying the statements. In the 1999 Results of Operations report, ten-year historical operating income data reflecting different groups of subsidiaries were combined, leaving the incorrect impression that results from different years were stated on a comparable basis.

FR and MR (FCC-basis) reports for the same year were based on different sets of subsidiaries. In general, MR results reflected Pacific Bell by itself and FR results reflected Pacific Bell and its subsidiaries on a consolidated basis. Despite being based on different sets of subsidiaries, both MR and FR financial statements were styled "PB California". In addition to not being evident in the titles, the MR and FR subsidiary differences were not disclosed in footnotes or in a management discussion and analysis. The fact that FCC and CPUC statements were similarly titled while being based on different sets of subsidiaries created a situation in which financial statement users were unable to compare the two sets of statements and understand the basic differences between them.

B. FCC to CPUC Jurisdictional (C3) Adjustments

As noted above, some of the differences between MR and FR financial statements were the result of the different companies reflected in the MR and FR results. In addition, Pacific Bell's FR results included "C3" adjustments to FCC results, intended to reflect accounting requirements unique to the CPUC jurisdiction. C3 adjustments, which were not disclosed or discussed in CPUC-basis statements, reduced audit period net income reported to the CPUC by $778 million compared to the income reported to the FCC. The combined effect of C3 adjustments on Pacific Bell's total company operating revenue, expenses, taxes and net income is summarized in the table below.

Table 3-2
Impact of "C3" (MR to FR) Jurisdictional Adjustments on Pacific Bell's Total Company Net Operating Income
Source: MR and FR Financial Data

	1997	1998	1999
MR (FCC) Total Company Operating Revenue	8,460,235,399	9,158,779,940	9,677,191,521
C3 Adjustments	(92,503,367)	69,339,912	62,277,224
FR (CPUC) Total Co. Operating Revenue	8,367,732,032	9,228,119,852	9,739,468,745
MR (FCC) Total Company Operating Expenses	7,300,294,577	7,182,441,890	7,627,132,976
C3 Adjustments	368,059,328	201,850,431	763,337,537
FR (CPUC) Total Co. Operating Expenses	7,668,353,905	7,384,292,321	8,390,470,513
MR (FCC) Total Co. Income & Other Taxes	302,350,232	748,637,312	755,704,232
C3 Adjustments	(173,340,420)	(32,162,330)	(308,775,321)
FR (CPUC) Total Co. Income & Other Taxes	129,009,812	716,474,982	446,928,911
MR (FCC) Total Company Net Income	857,590,590	1,227,700,738	1,294,354,313
C3 Adjustments	(287,222,275)	(100,348,189)	(392,284,992)
FR (CPUC) Total Company Net Income	570,368,315	1,127,352,549	902,069,321

The ostensible reason for C3 adjustments is to reflect accounting requirements unique to the CPUC that create a difference in the financial results reflected on FCC books. In fact, we found that C3 adjustments were not limited to amounts compelled by CPUC-specific accounting requirements. Instead, the adjustments resulted from a mixture of 1) accounting requirements unique to the CPUC and 2) regulatory adjustments made by Pacific Bell at its own discretion. Examples of the latter include 1) the reserve deficiency amortization, which was not ordered by the CPUC and which lowered 1999 intrastate pre-tax operating income reported to the CPUC by $612 million (Chapter 8), and 2) a series of contingent liability adjustments Pacific Bell decided to record for CPUC, but not for FCC purposes (Chapter 6). C3 adjustments were not properly disclosed or explained in CPUC-basis statements. Because they were made as part of the financial process, they were also not disclosed in Pacific Bell's IEMR. In the case of contingent liabilities, Pacific Bell refused to disclose the nature of the liabilities giving rise to expense accruals on the CPUC books in response to specific data requests made during this audit.

C. IEMR Results

The IEMR is a NRF report intended to reflect Pacific Bell's financial results adjusted for the effects of CPUC ratemaking policy. Like the CPUC-basis statements, IEMR results were based not only on adjustments compelled by CPUC ratemaking requirements, but also on adjustments made by Pacific Belll at its own discretion. IEMR adjustments were not properly explained or disclosed. The IEMRs filed with the CPUC contained no explanations or workpaper support for the adjustments. It was not even possible to separately identify the amounts associated with many of the adjustments because they were bundled together in a single column entitled "other".

II. Overview of FCC, CPUC and SEC Financial Reporting

The financial reporting process leading to CPUC-regulated earnings is described below. An integrated flowchart of Pacific Bell's entire financial reporting process for each year of the audit period is shown in 3-4.

A. FCC, CPUC and External Reporting Formats

Pacific Bell maintains three separate sets of books for financial reporting. These include:

- MR Books - Financial Reporting for the Federal Communications Commission
- FR Books - Financial Reporting for the California Public Utilities Commission
- ER Books - Financial Reporting for shareholders and the Securities and Exchange Commission

The relationship between the general ledgers used to maintain each set of books is shown in the table below. Most transactions are initially recorded on the MR, or FCC books. The FCC books are adjusted to produce the FR, or CPUC books. During the audit period, Pacific Bell calculated dozens of "C3" adjustments to its FCC books. Finally, "C7" adjustments are calculated to obtain ER (external or SEC) results. During the audit period, many C3 adjustments were reversed by C7 adjustments, often putting FCC and SEC books in sync with one another but out of sync with CPUC books.

Table 3-3
Pacific Bell Financial Results
FCC, CPUC and External (SEC) Reporting Formats

MR (FCC) Reporting	+	MR to FR (C3) Adjustments	=	FR (CPUC Reporting)	+	FR to ER (C7) Adjustments	=	ER (SEC) Reporting

B. Total California FR Results

During the audit, Pacific Bell's FR results were consolidated with the results of Pacific Bell's subsidiaries prior to being included on the IEMR. In 1997 and years prior to the audit period, six subsidiaries were added to Pacific Bell's results to obtain consolidated results.[1] In 1998 and 1999, Pacific Bell Information Systems (PBIS) was the only subsidiary added to produce consolidated results. Pacific Bell's consolidated FR Results became the first column of the IEMR. This process is summarized below.

Table 3-4
Pacific Bell Financial Flowchart
Pacific Bell MR to "Total California" FR Results

FCC (MR) Results	+	MR to FR (C3) Adjustments	=	CPUC (FR) Results
				+
				Pacific Bell Subsidiary Results
				+
				Intercompany Eliminations (41 & 42)
				=
				Pacific Bell Consolidated CPUC Results

C. CPUC IEMR Reporting

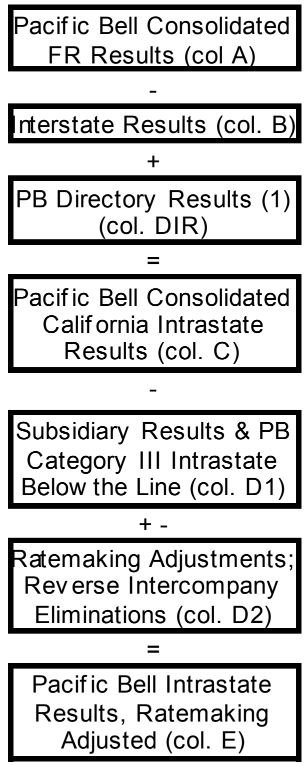
Audit period IEMR reports started with Total California (Pacific Bell Consolidated) FR Results. Part 36 separations were applied to remove interstate results measured on an MR (FCC) basis. In 1998 and 1999 PB Directory (PBD) was added (it was already in the consolidated total in 1997). This produced Pacific Bell's consolidated California *intrastate* results (plus imputed directory company results in 1998 and 1999). To get from this amount to Pacific Bell's CPUC- regulated earnings, subsidiary results were removed, inter-company eliminations were reversed, Category III below-the-line results were removed and ratemaking adjustments were applied to Pacific Bell's results. This process is summarized in the following table.

[1] PB Information Systems, PB Directory, PB Development, PB Internet, PB Network Integration & PB Mobile.

Table 3-5

Pacific Bell Financial Flowchart

Total California to Adjusted IEMR Results



(1) 1998 & 1999 only.

D. <u>General Ledger Coding</u>

The transactions associated with each of the steps discussed above are separately tracked through general ledger "corporation" codes. In effect, the transactions tracked under each corporation code represented a separate sub-ledger. Codes used during the audit period are shown below:

Table 3-6 **Corporation Codes Used to Maintain Pacific Bell Sub-Ledgers and Subsidiary Ledgers**	
CA	Pacific Bell general ledger transactions in accordance with FCC financial reporting requirements.
C3	Jurisdictional differences between FCC and CPUC reporting (as interpreted by Pacific Bell) and between FCC and SEC (GAAP) reporting for GAAP differences in effect prior to the enactment of Financial Accounting Statement (FAS) 71.[2]
C7	Pacific Bell California ER71 Adjustments - Differences between CPUC and SEC reporting, including FAS 71 adjustments and post-FAS 71 GAAP external reporting adjustments (i.e. differences between CPUC reporting and external reporting.)
DL	General ledger transactions for PB Development.
DR	General ledger transactions for PB Directory
IT	General ledger transaction for PB Internet
IS	General ledger transactions for PBIS
NT	General ledger transactions for PB Network Integration
WL	General ledger transactions for PB Mobile.
41	Subsidiary Eliminations
42	Consolidated Eliminations

CA transactions form the FCC general ledger. Combined CA and C3 transactions form the CPUC general ledger, and CA, C3 and C7 transactions, when combined, form the SEC, or external reporting general ledger. Subsidiary general ledgers and inter-company eliminations are added to produce consolidated results for Pacific Bell and subsidiaries. The ledgers and sub-ledgers combined to obtain Total California Operations (the first column in the IEMR) include:

1997 - CA, C3, DL, DR, IT, IS, NT, WL, 41 and 42

1998 & 1999 - CA, C3, IS and 42

III. Audit Period Financial Reporting Issues

A. Organizational and Financial Reporting Changes

In March, 1998, Pacific Bell transferred its ownership in four subsidiaries (Pacific Bell Directory, Pacific Bell Internet, Pacific Bell Development and Pacific Bell Mobile Services) to its parent, PTG. This change in the legal organization also caused a change in financial reporting. Beginning in 1998, the transferred subsidiaries were no longer included in Pacific Bell's consolidated financial results presented to the CPUC.

In September 1998, Pacific Bell moved accounting for Pacific Bell Network Integration (PBNI) into the Pacific Bell's MR (FCC) general ledger. Prior to this, PBNI had its own ledger (corporation code NT) and was treated as a subsidiary for financial purposes. PBNI's status as a financial reporting subsidiary ended

[2] Accounting for the Effects of Certain Types of Regulation.

with the change incorporating it into Pacific Bell's books. After the change, Pacific Bell used a tracking code to identify and separate costs associated with PBNI for placement in below-the-line accounts.[3]

Columns containing consolidated amounts on pre-1998 IEMRs cannot be directly compared with amounts on post-1997 IEMRs because they contain different groups of subsidiaries. The financial reporting changes that occurred in 1998 were not isolated or disclosed in the IEMR.

B. Calculation of IEMR Results and Related Disclosures

The IEMR is the CPUC's primary tool for monitoring Pacific Bell's intrastate financial results. During the audit period, the presentation of results on the IEMR was confused by the reporting consolidated results in some columns and the Pacific Bell stand-alone results in other columns. Consolidated results were presented in IEMR column A - "Total California Operations." Results for Pacific Bell's subsidiaries were then removed in IEMR column D1 - "As Adjusted: Intrastate Below-the-Line Services" and associated inter-company eliminations were reversed in column D2 - "As Adjusted: Intrastate Ratemaking Adjustments".

Amounts reported in the IEMR were also highly summarized. For example, the maximum detail presented for operating expenses was the expense category level (Network Support, General Support, Central Office, etc.). Results were not presented at the Part 32 account level.

C. Pacific Bell's "C3" Adjustments

The most significant adjustments to Pacific Bell's recorded financial data were the "C3" adjustments that produced the differences between FCC and CPUC-basis results. The C3s were not subject to CPUC review or approval, nor were they reflected or disclosed on the IEMR; rather, their result was already embedded in the consolidated amounts entered into the first column of the IEMR. Because three separate steps separated FCC (MR) financial data from the first column on the IEMR, even a comparison of the IEMR to FCC ARMIS reports did not reveal the existence of the C3s (see Table 3-2 above). During the audit period, Pacific Bell made 58 C3 adjustments to MR financial data, some of which were calculated by Pacific Bell at its discretion. The combined impact of these adjustments on regulated earnings reported by Pacific Bell during the audit period is summarized below.

IV. Audit Results Impact on Regulated Earnings

Pacific Bell filed their IEMR annually during 1997 through 1999. As stated above, the basis for this report is the FR (CPUC-basis) results. Throughout the chapters of this audit report, various audit findings are discussed and analyzed. These findings impact accounting transactions used in the calculation of audit adjusted IEMR results .

Attachment 3-2 shows audit period IEMRs recalculated to include the impact of the audit findings. Audit adjustments affect IEMR results in five ways:

1. Total California Operations FR Results (Column A) - Adjustments made to individual Part 32 accounts.

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[3] In response to OC-693, Pacific Bell explained the reason for the change as follows: "Network Integration was consolidated into Pacific Bell to align the sales forces of the two companies. By aligning the sales forces, a single point of contact could be provided to the customer along with a unified approach to sales."

2. Interstate Adjustments (Column B) - Adjustments made to regulated activities and their effect on Part 36 separations.

3. Pacific Bell Directory Results (Column DIR) - Adjustments to Pacific Bell Directory financial reporting results.

4. Intrastate Below-the-line Services (Column D1) - Adjustments to Category III services recorded below-the-line.

5. Intrastate Ratemaking Adjustments (Column D2) - Adjustments to calculations of Pacific Bell's intrastate ratemaking adjustments.

Attachment 3-1
Audit Calculation of Pacific Bell's Shareable Earnings
1997 - 1999

Attachment 3-1

Pacific Bell
Audit Calculation of Shareable Earnings
1997 - 1999

	1997	1998	1999
Total Intrastate Operating Revenue	7,604,120,275	8,029,208,013	8,385,003,365
Total Intrastate Operating Expense	6,064,980,502	5,813,284,589	5,838,511,312
Other Intrastate Income & Expense	12,450,866	9,500,717	7,687,494
Total IntrastateOperating Taxes	437,288,246	676,097,917	736,215,083
Net Income	1,114,302,393	1,549,326,224	1,817,964,464
Intrastate Rate Base	9,507,818,292	9,765,731,845	9,980,132,043
Rate of Return on Intrastate Rate Base	11.720%	15.865%	18.216%
Sharing Trigger	11.500%	11.500%	11.500%
Customer Share of Earnings			
ROR Above Benchmark	0.220%	4.365%	6.716%
Customer Amount	17,638,716	331,184,800	457,244,588
Between Benchmark and Ceiling			
ROR Between Benchmark and Ceiling	0.2199%	3.5000%	3.5000%
Times: Sharing Percentage	50%	50%	50%
Times: Intrastate Rate Base	9,507,818,292	9,765,731,845	9,980,132,043
Customer Amount Before Gross Up	10,451,645	170,900,307	174,652,311
Times: Tax Gross Up Factor (1/(1-40.746)	1.6876	1.6876	1.6876
Customer Amount With Gross Up	17,638,716	288,419,866	294,751,934
Above Ceiling			
ROR Above Ceiling	0.0000%	0.8649%	3.2158%
Times: Sharing Percentage	30%	30%	30%
Times: Intrastate Rate Base	9,507,818,292	9,765,731,845	9,980,132,043
Customer Amount Before Gross Up	-	25,339,934.18	96,283,397.27
Times: Tax Gross Up Factor (1/(1-40.746)	1.6876	1.6876	1.6876
Customer Amount With Gross Up	-	42,764,934	162,492,654

Attachment 3-2
Intrastate Earnings Monitoring Report as Adjusted for Audit Findings Impact

Attachment 3-2

PACIFIC BELL
INTRASTATE EARNINGS MONITORING REPORT
AUDIT ADJUSTED
1997

	Audit Adjusted: Total Califonia Operations (A.2)	Audit Adjusted: Interstate Adjustments (B.2)	Audit Adjusted Intrastate Results (C.2=A.2-B.2)	Audit Adjusted Intrastate Below The-Line Services (D1.2)	Audit Adjusted Intrastate Ratemaking Adj. (D2.2)	Audit Adjusted: Adj. RO For Intrastate Ratemaking (E.1 = C.2-D1.2-D2.2)
1 LOCAL NETWORK SERVICE	4,308,695,499	0	4,308,695,499	126,980,557	(43,579,000)	4,225,293,942
2 ACCESS REV - INTERSTATE	1,714,151,521	1,714,149,000	2,521	0	0	2,521
3 ACCESS REV - INTRASTATE	793,440,936	0	793,440,936	1	0	793,440,935
4 LONG DISTANCE SERVICES	1,183,954,214	1,109,000	1,182,845,214	0	(8,857,000)	1,191,702,214
5 MISC & OTHER	1,965,936,911	44,554,000	1,921,382,911	450,855,389	(83,681,000)	1,554,208,522
6 LESS: UNCOLLECTIBLE	191,207,460	7,063,000	184,144,460	23,616,600	0	160,527,860
7 TOTAL OPERATING REVENUE	9,774,971,622	1,752,749,000	8,022,222,622	554,219,346	(136,117,000)	7,604,120,275
8 NETWORK SUPPORT	11,995,000	2,239,000	9,756,000	469,991	62,000	9,224,009
9 GENERAL SUPPORT	448,949,179	81,441,000	367,508,179	33,197,943	(12,378,000)	346,688,236
10 CENTRAL OFFICE	434,236,439	98,386,000	335,850,439	5,217,722	0	330,632,717
11 INFORMATION ORIG/TERM	169,932,277	4,727,000	165,205,277	16,286,390	0	148,918,887
12 CABLE/WIRE FACILITIES	612,888,047	152,586,000	460,302,047	1,396,652	0	458,905,395
13 OTHER PROP, PLANT & EQPT	(60,726)	(11,000)	(49,726)	(1,346)	0	(48,379)
14 NETWORK OPERATIONS	888,991,845	159,775,000	729,216,845	82,555,347	(23,109,000)	669,770,498
15 DEPRECIATION & AMORTIZATION	2,105,622,920	402,725,000	1,702,897,920	115,848,761	2,931,000	1,584,118,159
16 MARKETING	671,648,142	72,654,000	598,994,142	287,252,257	(61,087,468)	372,829,353
17 CUSTOMER SERVICES	1,664,849,532	140,699,000	1,524,150,532	304,307,792	(4,053,000)	1,223,895,739
18 EXECUTIVE & PLANNING	95,683,434	12,273,000	83,410,434	29,619,078	2,387,412	51,403,944
19 GENERAL & ADMINSTRATIVE	1,378,695,775	212,227,000	1,166,468,775	179,792,268	118,034,564	868,641,943
20 TOTAL OPERATING EXPENSES	8,483,431,864	1,339,721,000	7,143,710,864	1,055,942,855	22,787,508	6,064,980,502
21 OTHER INC & EXP - NET	(2,061,267)	(2,049,000)	(12,267)	(12,463,133)	0	12,450,866
22 OPERATING TAXES - FED	7,172,503	73,355,000	(66,182,497)	(169,361,781)	(133,733,085)	236,912,368
23 OPERATING TAXES - ST/LCL	20,929,423	20,666,000	263,423	(46,970,490)	(3,764,418)	50,998,331
24 OPERATING TAXES - OTHER	193,753,000	40,332,000	153,421,000	3,266,045	777,410	149,377,545
25 TOTAL OPERATING TAXES	221,854,926	134,353,000	87,501,926	(213,066,226)	(136,720,093)	437,288,245
26 BALANCE NET REVENUE	1,067,623,564	276,626,000	790,997,564	(301,120,416)	(22,184,415)	1,114,302,395
27 TELECOM PLANT IN SERVICE	28,011,725,587	5,927,361,000	22,084,364,587	823,461,887	149,745,000	21,111,157,700
28 PROP HELD FOR FUTURE USE	116,407	25,000	91,407	929	0	90,478
29 TEL PLANT ACQ ADJ	(27,363)	(6,000)	(21,363)	(450)	(20,913)	(0)
30 OTHER RATE BASE ITEMS	0	0	558,697,000	77,132,037	481,432,335	132,628
31 MATERIALS & SUPPLIES	50,383,117	9,342,000	41,041,117	10,636,444	0	30,404,673
32 DEPRECIATION RESERVE	12,458,118,818	2,892,447,000	9,565,671,818	273,899,085	39,120,000	9,252,652,733
33 TAX RESERVE	2,821,733,130	0	2,331,448,130	3,244,000	(53,110,323)	2,381,314,453
34 NET RATE BASE	12,782,345,800	3,044,275,000	10,787,052,800	634,087,763	645,146,745	9,507,818,292
35 RATE OF RETURN	8.35%		7.33%			11.72%

Attachment 3-2

PACIFIC BELL
INTRASTATE EARNINGS MONITORING REPORT
AUDIT ADJUSTED
1998

	Audit Adjusted Total Califonia Operations (A.2)	Audit Adjusted Interstate Adjustments (B.2)	Audit Adjusted Directory (DIR.2)	Audit Adjusted Intrastate Results (C.2=A.2-B.2+DIR.2)	Audit Adjusted Intrastate Below The-Line Services (D1.2)	Audit Adjusted Intrastate Ratemaking Adj. (D2.2)	Audit Adjusted: Adj. RO For Intrastate Ratemaking (E.1 = C.2-D1.2-D2.2)
1 LOCAL NETWORK SERVICE	4,853,898,691	0	-	4,853,898,691	392,453,265	0	4,461,445,426
2 ACCESS REV - INTERSTATE	1,998,979,221	1,998,979,221	-	0	0	0	0
3 ACCESS REV - INTRASTATE	761,412,630	0	-	761,412,630	25	0	761,412,604
4 LONG DISTANCE SERVICES	1,194,989,656	1,369,000	-	1,193,620,656	0	(2,262,000)	1,195,882,656
5 MISC & OTHER	705,636,970	66,060,000	1,183,442,933	1,823,019,903	138,136,316	(95,879,000)	1,780,762,587
6 LESS: UNCOLLECTIBLE	149,916,813	1,595,000	32,733,516	181,055,329	10,760,068	0	170,295,260
7 TOTAL OPERATING REVENUE	9,365,000,356	2,064,813,221	1,150,709,417	8,450,896,552	519,829,539	(98,141,000)	8,029,208,013
8 NETWORK SUPPORT	21,821,052	4,647,000	-	17,174,052	166,688	0	17,007,364
9 GENERAL SUPPORT	378,817,493	75,337,000	18,386,417	321,866,910	17,820,653	0	304,046,257
10 CENTRAL OFFICE	386,578,171	77,495,000	-	309,083,171	891,341	0	308,191,830
11 INFORMATION ORIG/TERM	226,255,716	12,794,000	-	213,461,716	60,505,164	0	152,956,552
12 CABLE/WIRE FACILITIES	585,705,497	147,690,000	-	438,015,497	1,031,616	0	436,983,881
13 OTHER PROP, PLANT & EQPT	(16,695)	(4,000)	-	(12,695)	(586)	0	(12,108)
14 NETWORK OPERATIONS	970,276,332	224,744,000	-	745,532,332	23,650,364	64,891	721,817,077
15 DEPRECIATION & AMORTIZATION	2,086,146,884	436,317,000	16,050,624	1,665,880,508	41,119,919	2,079,000	1,622,681,589
16 MARKETING	522,362,465	82,514,000	-	439,848,465	211,067,239	(75,291,232)	304,072,458
17 CUSTOMER SERVICES	1,053,192,276	137,260,000	442,662,733	1,358,595,010	123,456,598	0	1,235,138,412
18 EXECUTIVE & PLANNING	46,941,323	9,210,000	-	37,731,323	2,685,981	4,522,372	30,522,970
19 GENERAL & ADMINSTRATIVE	950,578,469	209,461,000	1,865,761	742,983,230	71,429,930	(8,325,009)	679,878,308
20 TOTAL OPERATING EXPENSES	7,228,658,983	1,417,465,000	478,965,535	6,290,159,518	553,824,907	(76,949,977)	5,813,284,589
21 OTHER INC & EXP - NET	(745,138)	(290,000)	8,314,853	7,859,715	(4,002)	(1,637,000)	9,500,717
22 OPERATING TAXES - FED	455,087,651	158,242,000	210,950,904	507,796,554	(13,190,712)	136,772,927	384,214,339
23 OPERATING TAXES - ST/LCL	131,588,714	47,053,000	58,619,121	143,154,836	(3,700,360)	(6,814,816)	153,670,012
24 OPERATING TAXES - OTHER	183,106,739	43,717,000	3,015,583	142,405,322	3,420,459	771,297	138,213,566
25 TOTAL OPERATING TAXES	769,783,104	249,012,000	272,585,608	793,356,712	(13,470,613)	130,729,408	676,097,917
26 BALANCE NET REVENUE	1,365,813,131	398,046,221	407,473,127	1,375,240,036	(20,528,757)	(153,557,430)	1,549,326,223
27 TELECOM PLANT IN SERVICE	28,805,394,209	6,262,037,000	121,928,555	22,665,285,764	623,533,518	137,341,000	21,904,411,245
28 PROP HELD FOR FUTURE USE	331,448	74,000	-	257,448	268	0	257,179
29 TEL PLANT ACQ ADJ	(30,104)	(6,000)	-	(24,104)	(876)	(24,104)	876
30 OTHER RATE BASE ITEMS	0	0	-	521,544,000	41,166,000	413,314,792	67,063,208
31 MATERIALS & SUPPLIES	44,828,268	9,215,000	396,716	36,009,984	7,395,527	0	28,614,457
32 DEPRECIATION RESERVE	13,442,520,068	3,162,720,000	90,547,714	10,370,347,782	307,250,160	39,737,000	10,023,360,622
33 TAX RESERVE	2,728,658,917	497,601,000	-	2,231,057,917	31,517,000	(11,713,582)	2,211,254,499
34 NET RATE BASE	12,679,344,836	2,610,999,000	31,777,557	10,621,667,393	333,327,277	522,608,270	9,765,731,845
35 RATE OF RETURN	10.77%			12.95%			15.86%

Attachment 3-2

PACIFIC BELL
INTRASTATE EARNINGS MONITORING REPORT
AUDIT ADJUSTED
1999

	Audit Adjusted: Total Califonia Operations (A.2)	Audit Adjusted: Interstate Adjustments (B.2)	Audit Adjusted: Directory (DIR.2)	Audit Adjusted: Intrastate Results (C.2=A.2-B.2+DIR.2)	Audit Adjusted: Intrastate Below The-Line Services (D1.2)	Audit Adjusted: Intrastate Ratemaking Adj. (D2.2)	Audit Adjusted: Adj. RO For Intrastate Ratemaking (E.1 = C.2-D1.2-D2.2)
1 LOCAL NETWORK SERVICE	4,965,174,649	0	0	4,965,174,649	397,504,051	0	4,567,670,598
2 ACCESS REV - INTERSTATE	2,228,559,627	2,228,559,627	0	0	0	0	0
3 ACCESS REV - INTRASTATE	797,927,394	0	0	797,927,394	1,015,704	0	796,911,690
4 LONG DISTANCE SERVICES	1,038,574,188	1,371,000	0	1,037,203,188	7,907,793	(6,157,000)	1,035,452,396
5 MISC & OTHER	1,090,805,799	86,076,000	1,295,621,995	2,300,351,794	241,919,941	(101,878,000)	2,160,309,853
6 LESS: UNCOLLECTIBLE	152,677,271	4,640,000	58,267,809	206,305,080	30,963,908	0	175,341,172
7 TOTAL OPERATING REVENUE	9,968,364,387	2,311,366,627	1,237,354,186	8,894,351,946	617,383,581	(108,035,000)	8,385,003,365
8 NETWORK SUPPORT	16,114,154	3,154,000	0	12,960,154	306,219	0	12,653,935
9 GENERAL SUPPORT	408,049,463	71,426,000	0	336,623,463	22,699,295	0	313,924,168
10 CENTRAL OFFICE	408,723,852	90,815,000	0	317,908,852	1,317,772	0	316,591,080
11 INFORMATION ORIG/TERM	395,607,251	8,536,000	0	387,071,251	234,146,722	0	152,924,529
12 CABLE/WIRE FACILITIES	581,523,777	149,499,000	0	432,024,777	58,382	0	431,966,395
13 OTHER PROP, PLANT & EQPT	4,000,364	771,000	0	3,229,364	299,334	0	2,930,030
14 NETWORK OPERATIONS	1,106,538,073	251,632,000	0	854,906,073	60,936,937	53,176	793,915,961
15 DEPRECIATION & AMORTIZATION	1,822,131,942	413,707,000	16,737,287	1,425,162,229	46,561,038	1,690,000	1,376,911,191
16 MARKETING	491,411,184	105,663,000	0	385,748,184	93,899,127	(83,186,674)	375,035,731
17 CUSTOMER SERVICES	1,169,419,885	131,725,000	475,541,991	1,513,236,876	216,849,193	0	1,296,387,684
18 EXECUTIVE & PLANNING	36,932,463	6,744,000	0	30,188,463	2,862,307	7,231,605	20,094,550
19 GENERAL & ADMINSTRATIVE	1,155,963,365	184,726,000	0	971,237,365	169,139,859	56,921,447	745,176,059
20 TOTAL OPERATING EXPENSES	7,596,415,773	1,418,398,000	492,279,278	6,670,297,052	849,076,185	(17,290,445)	5,838,511,312
21 OTHER INC & EXP - NET	7,355,732	(1,883,000)	(1,077,148)	8,161,584	474,090	0	7,687,494
22 OPERATING TAXES - FED	398,715,498	227,316,000	232,871,184	404,270,682	(76,898,533)	45,583,571	435,585,645
23 OPERATING TAXES - ST/LCL	160,257,692	65,641,000	66,097,636	160,714,328	(21,338,674)	(2,901,540)	184,954,542
24 OPERATING TAXES - OTHER	169,841,746	55,038,000	2,061,789	116,865,535	3,596,058	(2,405,419)	115,674,896
25 TOTAL OPERATING TAXES	728,814,936	347,995,000	301,030,610	681,850,545	(94,641,149)	40,276,612	736,215,083
26 BALANCE NET REVENUE	1,650,489,410	543,090,627	442,967,150	1,550,365,933	(136,577,366)	(131,021,167)	1,817,964,465
				0			
27 TELECOM PLANT IN SERVICE	29,894,652,801	6,450,878,000	161,029,579	23,604,804,380	620,497,893	147,037,000	22,837,269,488
28 PROP HELD FOR FUTURE USE	3,849,119	865,000	0	2,984,119	25,932	0	2,958,187
29 TEL PLANT ACQ ADJ	(8,957)	(2,000)	0	(6,957)	0	(6,957)	(0)
30 OTHER RATE BASE ITEMS	-	0	0	396,639,000	54,020,000	239,566,106	103,052,894
31 MATERIALS & SUPPLIES	36,279,593	7,282,000	593,829	29,591,422	5,739,527	0	23,851,895
32 DEPRECIATION RESERVE	14,379,074,789	3,351,510,000	119,960,768	11,147,525,557	345,118,382	39,700,000	10,762,707,174
33 TAX RESERVE	2,872,162,565	514,774,500	0	2,357,388,065	44,042,000	89,052,818	2,224,293,247
34 NET RATE BASE	12,683,535,202	2,592,738,500	41,662,640	10,529,098,342	291,122,969	257,843,331	9,980,132,043
				0			
35 RATE OF RETURN	13.01%			14.72%			18.22%

Attachment 3-3
1997 - 1999 MR(FCC) and FR(CPUC)
Trial Balances with Reconciling Data

Pacific Bell

Attachment 3-3

1997 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GLMAIN	GL SUB	ACCOUNT	1997 MR (FCC-Basis) TOTALS	C3 FCC to CPUC & Regulatory Adjustments	IS (PBIS Account Balances)	DR (PB Directory Account Balances)	DL (PB Development Acct Balances)	IT (PB Internet Account Balances)	NT (PB Network Integration Acct Bal)	WL (PB Mobile Acct Balances)	41 (Subsidiary Eliminations)	42 (Consolidated Eliminations)	1997 FR (CPUC-Basis) TOTALS
			DATA RESPONSE REFERENCE	(OC-558)	(OC-556)	(OC-621)								
1000														
	1130 Total		CASH	(249,128,857)	-	-	(5,535,025)	-	-	-	4,600	-	-	(254,659,281)
	1140 Total		SPECIAL CASH DEPOSITS	-	-	-	-	-	-	-	-	-	-	-
	1150 Total		WORKING CASH ADVANCES	626,046	-	-	14,000	-	-	-	-	-	-	640,046
	1160 Total		TEMPORARY INVESTMENTS	900,000	-	-	-	-	-	-	-	-	-	900,000
	1180 Total		TELECOM ACCOUNTS RECEIVABLE	1,759,792,417	-	1,687,316	469,091,709	-	1,404,080	25,101,117	34,183,711	-	(760,040)	2,290,500,309
	1181 Total		ACCOUNTS RECEIVABLE ALLOWANCE	(150,855,745)	-	(1,161,162)	(75,533,265)	-	(362,927)	-	(8,670,904)	-	-	(236,584,003)
	1190 Total		AFFILIATE RECEIVABLES	154,169,057	-	22,310,117	57,309,516	-	4,031,062	2,099,646	(1,681,663)	(717,459)	(93,065,379)	144,454,897
	1191 Total		NONREGULATED - NONTELECOM	-	-	-	-	-	-	(261,796)	-	-	-	(261,796)
	1200 Total		NOTES RECEIVABLE-NON AFFILIATED	259,375	-	1,640,192	196,848,877	-	-	-	-	-	(1,640,192)	197,108,252
	1210 Total		INTEREST RECEIVABLE - OTHER	58,400	-	-	(0)	-	-	-	-	-	(126,657)	(68,257)
	1220 Total		MATERIALS AND SUPPLIES	40,627,574	-	-	540,253	-	-	3,268,312	10,331,767	-	-	54,767,906
	1290 Total		PREPAID RENTS	7,086,240	-	-	-	-	104,153	-	664,195	-	-	7,854,588
	1300 Total		PREPAID TAXES	3,621,641	-	-	195,550	-	-	-	-	-	-	3,817,191
	1310 Total		PREPAID INSURANCE	5,215,977	-	87,390	-	-	10,817	12,219	200,589	-	-	5,526,993
	1320 Total		PREPAID DIRECTORY EXPENSE	-	-	-	22,339,131	-	-	-	-	-	-	22,339,131
	1330 Total		OTHER PREPAYMENTS	34,639,384	-	-	-	-	112,048	1,853,376	70,000	-	-	36,674,808
	1350 Total		OTHER CURRENT ASSETS	49,184,624	41,753,663	-	333,262	-	-	-	25,087	-	-	91,296,636
	1401 Total		INVESTMENTS IN AFFILIATES	540,395,204	-	-	-	-	-	-	-	-	(540,395,204)	-
	1402 Total		INVESTMENTS IN NONAFFILIATES	7,075,443	-	-	-	-	-	-	-	-	-	7,075,443
	1406 Total		NONREGULATED INVESTMENTS	-	-	-	-	-	-	-	(11,896,387)	-	-	(11,896,387)
	1407 Total		UNAMORTIZED DEBT ISSUANCE EXPENSE	22,456,183	826,919	-	-	-	-	-	-	-	-	23,283,102
	1410 Total		OTHER NON CURRENT ASSETS	120,100	-	-	-	-	125,459	-	32,730	-	-	278,289
	1437 Total		DEFERRED TAX REGULATORY ASSET	390,667,786	414,337,930	-	-	-	-	-	-	-	-	805,005,716
	1439 Total		DEFERRED CHARGES	91,095,981	(474,087,151)	5,057,525	-	-	-	667,960	(1,219,596)	-	-	(378,485,281)
	1500 Total		OTHER JURISDICTIONAL ASSETS-NET	700,521,155	(700,521,155)	-	-	-	-	-	-	-	-	-
Total 1000			CURRENT ASSETS	3,408,527,989	(717,689,793)	29,621,377	665,604,008	-	5,424,692	32,740,833	22,044,128	(717,459)	(635,987,472)	2,809,568,303
2001	TELECOMMUNICATIONS PLANT IN SERVICE													
	2111 Total		LAND	207,854,087	-	-	-	-	-	-	-	-	-	207,854,087
	2112 Total		MOTOR VEHICLES	310,245,764	-	-	40,936	-	-	-	7,386,377	-	-	317,673,076
	2114 Total		SPECIAL PURPOSE VEHICLES	310,698	-	-	-	-	-	-	-	-	-	310,698
	2115 Total		GARAGE WORK EQUIPMENT	17,578,896	-	-	-	-	-	-	-	-	-	17,578,896
	2116 Total		OTHER WORK EQUIPMENT	222,337,945	-	349,634	-	-	233,503	-	-	-	-	222,921,082
	2121 Total		BUILDINGS	2,460,167,151	-	-	-	-	-	-	-	-	-	2,460,167,151
	2122 Total		FURNITURE	47,241,904	-	353,298	23,649,970	-	632,066	1,071,000	6,704,405	-	-	79,652,643
	2123 Total		OFFICE EQUIPMENT	115,575,390	-	6,050,191	14,676,417	-	53,851	279,489	3,888,644	-	-	140,523,982
	2124 Total		GENERAL PURPOSE COMPUTERS	1,696,054,980	-	5,708,348	92,261,572	-	2,460,840	6,876,141	24,476,181	-	-	1,827,838,063
	2211 Total		ANALOG ELECTRONIC SWITCHING	726,549,127	-	-	-	-	-	-	-	-	-	726,549,127
	2212 Total		DIGITAL ELECTRONIC SWITCHING	4,433,381,133	-	143,801,451	-	-	31,462,548	479,708	-	-	-	4,609,124,839
	2215 Total		ELECTROMECHANICAL SWITCHING	28,490	-	-	-	-	-	-	-	-	-	28,490
	2220 Total		OPERATOR SYSTEMS	97,845,932	-	-	-	-	-	-	-	-	-	97,845,932
	2231 Total		RADIO	117,111,821	-	-	-	-	-	-	501,009,953	-	-	618,121,773
	2232 Total		CIRCUIT EQUIPMENT	4,790,923,065	-	-	-	-	-	-	-	-	-	4,790,923,065
	2341 Total		LARGE PRIVATE BRANCH EXCHANGES	4,586,054	-	-	-	-	-	-	-	-	-	4,586,054
	2351 Total		PUBLIC TELEPHONE TERMINAL EQUIPMENT	154,861,702	-	-	-	-	-	-	-	-	-	154,861,702
	2362 Total		ST TPUC - OTHER TERMINAL EQUIPMENT	371,926,711	-	-	-	-	-	-	-	-	-	371,926,711
	2411 Total		POLES	580,637,872	-	-	-	-	-	-	-	-	-	580,637,872
	2421 Total		AERIAL CABLE	2,407,680,329	-	-	-	-	-	-	-	-	-	2,407,680,329
	2422 Total		UNDERGROUND CABLE	3,968,970,434	-	-	-	-	-	-	-	-	-	3,968,970,434
	2423 Total		BURIED CABLE	2,017,625,041	-	-	-	-	-	-	-	-	-	2,017,625,041
	2424 Total		SUBMARINE CABLE	7,744,311	-	-	-	-	-	-	-	-	-	7,744,311
	2426 Total		INTRABUILDING NETWORK CABLE	271,497,940	-	-	-	-	-	-	-	-	-	271,497,940
	2431 Total		AERIAL WIRE	16,603,918	-	-	-	-	-	-	-	-	-	16,603,918
	2441 Total		CONDUIT SYSTEMS	2,296,236,478	-	-	-	-	-	-	-	-	-	2,296,236,478
	2681 Total		CAPITAL LEASES	39,126,345	-	-	-	-	-	-	-	-	-	39,126,345
	2682 Total		LEASEHOLD IMPROVEMENTS	204,874,775	-	4,168,092	12,873,860	-	2,362,549	1,485,404	120,801,941	-	-	346,566,621
	2690 Total		PATENT RIGHTS	20,000	-	-	-	-	-	-	-	-	-	20,000
	2001 C3 Adj. Total			-	265,605,670	-	-	-	-	-	-	-	-	265,605,670
Total 2001			TELECOM PLANT IN SERVICE	27,585,598,293	265,605,670	160,431,014	143,502,756	-	37,205,357	10,191,742	664,267,500	-	-	28,866,802,332
2002	TELECOM PLANT HELD FOR FUTURE USE													
	2111 Total		LAND	2,029	-	-	-	-	-	-	-	-	-	2,029
	2232 Total		CIRCUIT EQUIPMENT	326,774	-	-	-	-	-	-	-	-	-	326,774

Pacific Bell
1997 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GLMAIN	GL SUB	ACCOUNT	1997 MR (FCC-Basis) TOTALS	C3 FCC to CPUC & Regulatory Adjustments	IS (PBIS Account Balances)	DR (PB Directory Account Balances)	DL (PB Development Acct Balances)	IT (PB Internet Account Balances)	NT (PB Network Integration Acct Bal)	WL (PB Mobile Acct Balances)	41 (Subsidiary Eliminations)	42 (Consolidated Eliminations)	1997 FR (CPUC-Basis) TOTALS
	2422 Total		UNDERGROUND CABLE	5	-	-	-	-	-	-	-	-	-	5
	2002 C3 Adj. Total			-	9,923,902	-	-	-	-	-	-	-	-	9,923,902
Total 2002			TELECOM PLANT HELD FOR FUTURE USE	328,808	9,923,902	-	-	-	-	-	-	-	-	10,252,710
2003	SHORT TERM TPUC													
	2115 Total		GARAGE WORK EQUIPMENT	1,383	-	-	-	-	-	-	-	-	-	1,383
	2116 Total		OTHER WORK EQUIPMENT	699,746	-	-	-	-	-	-	-	-	-	699,746
	2121 Total		BUILDINGS	47,207,945	-	-	-	-	-	-	-	-	-	47,207,945
	2122 Total		ST TPUC - FURNITURE	43,971	-	7,762	-	-	-	-	-	-	-	51,734
	2123 Total		OFFICE EQUIPMENT	(668,038)	-	236,167	-	-	-	-	-	-	-	(431,871)
	2124 Total		GENERAL PURPOSE COMPUTERS	23,989,170	-	93,288	-	-	-	-	-	-	-	24,082,458
	2211 Total		ANALOG ELECTRONIC SWITCHING	513,475	-	-	-	-	-	-	-	-	-	513,475
	2212 Total		DIGITAL ELECTRONIC SWITCHING	136,894,197	-	13,443,614	-	-	-	-	-	-	-	150,337,811
	2220 Total		OPERATOR SYSTEMS	8,908,142	-	-	-	-	-	-	-	-	-	8,908,142
	2231 Total		RADIO	2,110,947	-	-	-	-	-	-	-	-	-	2,110,947
	2232 Total		CIRCUIT EQUIPMENT	143,588,539	-	-	-	-	-	-	-	-	-	143,588,539
	2341 Total		LARGE PRIVATE BRANCH EXCHANGES	28,203	-	-	-	-	-	-	-	-	-	28,203
	2351 Total		PUBLIC TELEPHONE TERMINAL EQUIPMENT	60,000	-	-	-	-	-	-	-	-	-	60,000
	2362 Total		OTHER TERMINAL EQUIPMENT	15,831,710	-	-	-	-	-	-	-	-	-	15,831,710
	2411 Total		POLES	246,963	-	-	-	-	-	-	-	-	-	246,963
	2421 Total		AERIAL CABLE	7,117,414	-	-	-	-	-	-	-	-	-	7,117,414
	2422 Total		UNDERGROUND CABLE	34,379,915	-	-	-	-	-	-	-	-	-	34,379,915
	2423 Total		BURIED CABLE	8,644,793	-	-	-	-	-	-	-	-	-	8,644,793
	2426 Total		INTRABUILDING NETWORK CABLE	5	-	-	-	-	-	-	-	-	-	5
	2441 Total		CONDUIT SYSTEMS	15,947,935	-	-	-	-	-	-	-	-	-	15,947,935
	2681 Total		CAPITAL LEASES	-	-	-	-	-	-	-	-	-	-	-
	2682 Total		LEASEHOLD IMPROVEMENTS	3,065,707	-	269,864	-	-	-	-	-	-	-	3,335,571
Total 2003			SHORT TERM TPUC	448,612,123	-	14,050,695	-	-	-	-	-	-	-	462,662,818
2004	LONG TERM TPUC													
	2121 Total		BUILDINGS	9,594,681	-	-	-	-	-	-	14,316,975	-	-	23,911,657
	2124 Total		GENERAL PURPOSE COMPUTERS	846,523	-	-	-	-	-	-	-	-	-	846,523
	2211 Total		ANALOG ELECTRONIC SWITCHING	582,243	-	-	-	-	-	-	-	-	-	582,243
	2212 Total		DIGITAL ELECTRONIC SWITCHING	53,472,966	-	-	-	-	-	-	-	-	-	53,472,966
	2220 Total		OPERATOR SYSTEMS	11,535,493	-	-	-	-	-	-	-	-	-	11,535,493
	2231 Total		RADIO	615,392	-	-	-	-	-	-	62,093,698	-	-	62,709,090
	2232 Total		CIRCUIT EQUIPMENT	71,284,243	-	-	-	-	-	-	-	-	-	71,284,243
	2341 Total		LARGE PRIVATE BRANCH EXCHANGES	171,383	-	-	-	-	-	-	-	-	-	171,383
	2362 Total		OTHER TERMINAL EQUIPMENT	3,343,758	-	-	-	-	-	-	-	-	-	3,343,758
	2411 Total		POLES	331,074	-	-	-	-	-	-	-	-	-	331,074
	2421 Total		AERIAL CABLE	3,934,590	-	-	-	-	-	-	-	-	-	3,934,590
	2422 Total		UNDERGROUND CABLE	24,838,700	-	-	-	-	-	-	-	-	-	24,838,700
	2423 Total		BURIED CABLE	1,613,036	-	-	-	-	-	-	-	-	-	1,613,036
	2426 Total		INTRABUILDING NETWORK CABLE	309	-	-	-	-	-	-	-	-	-	309
	2441 Total		CONDUIT SYSTEMS	15,929,292	-	-	-	-	-	-	-	-	-	15,929,292
	2681 Total		CAPITAL LEASES	-	-	-	-	-	-	-	64,881,782	-	-	64,881,782
	2682 Total		LEASEHOLD IMPROVEMENTS	(157,931)	-	-	-	-	-	-	-	-	-	(157,931)
	2004 C3 Adj. Total			-	1,463,147	-	-	-	-	-	-	-	-	1,463,147
Total 2004			LONG TERM TPUC	197,935,754	1,463,147	-	-	-	-	-	141,292,455	-	-	340,691,356
2005	TELECOMMUNICATIONS PLANT ADJUSTMENT													
	2005 Total		TELECOMMUNICATIONS PLANT ADJ.	(27,363)	-	-	-	-	-	-	-	-	-	(27,363)
Total 2005			TELECOMMUNICATIONS PLANT ADJ.	(27,363)	-	-	-	-	-	-	-	-	-	(27,363)
2006	NON-OPERATING PLANT													
	2111 Total		LAND	14,373,108	-	-	-	-	-	-	-	-	-	14,373,108
	2121 Total		BUILDINGS	14,932,464	-	-	-	-	-	-	-	-	-	14,932,464
	2124 Total		GENERAL PURPOSE COMPUTERS	6,774,849	-	-	-	-	-	-	-	-	-	6,774,849
	2211 Total		ANALOG ELECTRONIC SWITCHING	1,855	-	-	-	-	-	-	-	-	-	1,855
	2212 Total		DIGITAL ELECTRONIC SWITCHING	11,183,086	-	-	-	-	-	-	-	-	-	11,183,086
	2220 Total		OPERATOR SYSTEMS	4,020,019	-	-	-	-	-	-	-	-	-	4,020,019
	2231 Total		RADIO	76,842	-	-	-	-	-	-	-	-	-	76,842
	2232 Total		CIRCUIT EQUIPMENT	5,740,696	-	-	-	-	-	-	-	-	-	5,740,696
	2341 Total		LARGE PRIVATE BRANCH EXCHANGES	48,631	-	-	-	-	-	-	-	-	-	48,631
	2362 Total		ST TPUC - OTHER TERMINAL EQUIPMENT	865,845	-	-	-	-	-	-	-	-	-	865,845
	2411 Total		POLES	9,533	-	-	-	-	-	-	-	-	-	9,533
	2421 Total		AERIAL CABLE	157,033	-	-	-	-	-	-	-	-	-	157,033

Pacific Bell
1997 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GLMAIN	GL SUB	ACCOUNT	1997 MR (FCC-Basis) TOTALS	C3 FCC to CPUC & Regulatory Adjustments	IS (PBIS Account Balances)	DR (PB Directory Account Balances)	DL (PB Development Acct Balances)	IT (PB Internet Account Balances)	NT (PB Network Integration Acct Bal)	WL (PB Mobile Acct Balances)	41 (Subsidiary Eliminations)	42 (Consolidated Eliminations)	1997 FR (CPUC-Basis) TOTALS
	2422 Total		UNDERGROUND CABLE	2,560,039	-	-	-	-	-	-	-	-	-	2,560,039
	2423 Total		BURIED CABLE	205,539	-	-	-	-	-	-	-	-	-	205,539
	2426 Total		INTRABUILDING CABLE NETWORK	7,891	-	-	-	-	-	-	-	-	-	7,891
	2431 Total		AERIAL WIRE	-	-	-	-	-	-	-	-	-	-	-
	2441 Total		CONDUIT SYSTEMS	1,095,418	-	-	-	-	-	-	-	-	-	1,095,418
	2682 Total		LEASEHOLD IMPROVEMENTS	318,638	-	-	-	-	-	-	-	-	-	318,638
Total 2006			NON-OPERATING PLANT	62,371,487	-	-	-	-	-	-	-	-	-	62,371,487
3000														
	3100 Total		ACCUMULATED DEPRECIATION-OPERATING	(13,139,905,543)	677,496,340	(114,980,530)	(87,954,472)	-	(9,820,261)	(2,664,972)	(45,062,188)	-	-	(12,722,891,626)
	3300 Total		ACCUMULATED DEPRECIATION NON-OPERA	(4,710,931)	-	-	-	-	-	-	-	-	-	(4,710,931)
	3410 Total		ACCUMULATED AMORTIZATION - CAPITAL	(15,548,017)	-	-	-	-	-	-	-	-	-	(15,548,017)
	3420 Total		ACCUMULATED AMORTIIZATION - LEASEHO	(151,493,709)	(2,916,629)	(1,567,522)	(10,956,417)	-	(751,815)	(514,419)	(9,979,826)	-	-	(178,180,338)
	3500 Total		ACCUMULATED AMORTIZATION - INTANGIBL	(19,333)	-	-	-	-	-	-	-	-	-	(19,333)
Total 3000			ACCUMULATED DEPRECIATION & AMORTIZA	(13,311,677,533)	674,579,711	(116,548,052)	(98,910,890)	-	(10,572,076)	(3,179,391)	(55,042,014)	-	-	(12,921,350,245)
4000														
	4010 Total		ACCOUNTS PAYABLE	(1,360,639,237)	(7,700,569)	(43,261,845)	(76,366,328)	-	(9,219,254)	(23,310,064)	(153,220,919)	677,518	92,519,944	(1,580,520,754)
	4020 Total		NOTES PAYABLE-AFFILIATES	(566,846,800)	-	25,544,920	(304,297,424)	-	(501,311)	(3,001,038)	(29,123,636)	-	1,640,192	(876,585,097)
	4030 Total		ADVANCE BILLINGS & PAYMENTS	(217,313,301)	-	(7,701,074)	-	-	(162,208)	(16,365,136)	-	-	-	(241,541,718)
	4040 Total		CUSTOMER DEPOSITS	(58,512,345)	-	-	-	-	(47,836)	-	(2,495,596)	-	-	(61,055,777)
	4050 Total		CURRENT MATURITIES-LONG TERM DEBT	-	-	-	-	-	-	-	-	-	-	-
	4060 Total		CURRENT MATURITIES-CAPITAL LEASES	(3,687,764)	-	-	-	-	-	-	(32,312,008)	-	-	(35,999,772)
	4070 Total		INCOME TAXES-ACCRUED	(313,168,445)	-	(9,013,201)	(84,206,881)	47,158	6,639,094	2,108,822	72,040,104	-	-	(325,553,348)
	4080 Total		OTHER TAXES-ACCRUED	540,424	(13,000,000)	(407,749)	(1,139,760)	-	(69,417)	(682,568)	(149,665)	-	-	(14,908,735)
	4100 Total		NET CURRENT DEFERRED OPERATING INCO	136,150,942	164,916,238	1,823,211	(73,260,824)	65,045	1,559,671	225,455	(14,602,976)	-	-	216,876,761
	4110 Total		NET CURRENT DEFERRED NON-OPERATING	38,607,863	(53,371,479)	-	-	-	-	-	-	-	-	(14,763,616)
	4120 Total		OTHER ACCRUED LIABILITIES	(396,327,236)	(11,000,000)	(1,670,918)	(13,819,900)	-	(567,986)	(1,071,547)	(14,524,915)	-	-	(438,982,501)
	4130 Total		OTHER CURRENT LIABILITIES	(117,381,007)	(87,693,047)	(580,922)	(4,393,127)	-	(9,198,511)	-	(8,866,308)	-	-	(228,112,922)
	4210 Total		FUNDED DEBT	(5,445,000,000)	-	-	-	-	-	-	-	-	-	(5,445,000,000)
	4220 Total		PREMIUM ON LONG-TERM DEBT	(175,303)	-	-	-	-	-	-	-	-	-	(175,303)
	4230 Total		DISCOUNT ON LONG-TERM DEBT	205,753,005	190,802,270	-	-	-	-	-	-	-	-	396,555,274
	4250 Total		OBLIGATIONS UNDER CAPITAL LEASES	(20,861,402)	-	-	-	-	-	-	(230,367,189)	-	-	(251,228,591)
	4310 Total		OTHER RESERVES	(982,664,448)	524,000,321	(6,318,609)	(43,711,180)	-	(632,632)	(455,704)	(1,407,008)	-	-	(511,189,260)
	4320 Total		UNAMORTIZED OPERATING ITC-NET	(298,782,637)	(17,261,332)	-	22,849	-	-	-	-	-	-	(316,021,120)
	4340 Total		NET NONCURRENT DEFERRED OPERATING I	(2,128,536,486)	(499,281,840)	10,562,663	27,354,384	106,914	(2,346)	1,296,915	(24,425,583)	-	-	(2,612,925,378)
	4341 Total		NET DEFERRED TAX LIAB ADJ-NONCURR FR	163,894,660	(139,927,553)	-	-	-	-	-	-	-	-	23,967,107
	4350 Total		NONCURRENT DEFERRED NONOPERATING	(25,256,548)	161,384,922	-	-	-	-	-	-	-	-	136,128,374
	4360 Total		OTHER DEFERRED CREDITS	(289,583,937)	(395,075,061)	(1,273,744)	(2,958,485)	-	-	39,193	-	156,210	1,318,644	(687,377,181)
	4361 Total		DEFERRED REGULATORY LIABILITY	(554,562,446)	(116,351,594)	-	-	-	-	-	-	-	-	(670,914,040)
	4370 Total		OTHER JURISDICTIONAL LIABILITIES AND CI	62,124,857	(62,124,857)	-	-	-	-	-	-	-	-	-
	4510 Total		CAPITAL STOCK	(224,504,982)	-	(60,349,403)	(157,826,493)	-	-	-	-	-	218,175,896	(224,504,982)
	4520 Total		ADDITIONAL PAID IN CAPITAL	(6,256,875,348)	-	-	19,225,761	(3,468,375)	(89,007,182)	(16,991,665)	(652,564,485)	-	742,805,945	(6,256,875,348)
	4550 Total		DIVIDENDS & RETAINED EARNINGS	228,622,677	-	29,082,301	307,759,825	2,979,839	29,200,307	7,456,004	62,593,864	-	(439,074,921)	228,619,897
Total 4000			LIABILITIES & STOCKHOLDERS EQUITY	(18,424,985,244)	(361,683,582)	(63,564,369)	(407,617,582)	(269,419)	(72,009,611)	(50,751,333)	(1,029,426,318)	833,728	617,385,700	(19,792,088,030)
5000														
	5001 Total		BASIC AREA REVENUE	(3,184,462,671)	1,659,384	-	-	-	-	-	-	-	9,227,579	(3,173,575,708)
	5002 Total		EXTENDED AREA REVENUE	(55,801,952)	367,403	-	-	-	-	-	-	-	-	(55,434,549)
	5004 Total		OTHER MOBILE SERVICES REVENUE	(95,453,006)	53,160	-	-	-	-	-	-	-	-	(95,399,846)
	5010 Total		PUBLIC TELEPHONE REVENUE	(170,326,317)	6,202,171	-	-	-	-	-	-	-	-	(164,124,146)
	5040 Total		LOCAL PRIVATE LINE REVENUE	(69,620,335)	761,284	-	-	-	-	-	-	-	-	(68,859,050)
	5050 Total		CUSTOMER PREMISE REVENUE	(16,072,448)	398	-	-	-	-	-	-	-	-	(16,072,050)
	5060 Total		OTHER LOCAL EXCHANGE REVENUE	(782,629,449)	39,209,940	-	-	-	-	-	-	-	34,351,846	(709,067,664)
	5069 Total		OTHER LOCAL EXCHANGE REV-SETTLEMEN	(23,073)	-	-	-	-	-	-	-	-	-	(23,073)
	5081 Total		END USER ACCESS REVENUE	(722,252,875)	501,944	-	-	-	-	-	-	-	1,254,989	(720,495,942)
	5082 Total		SWITCHED ACCESS REVENUE	(647,034,614)	33,286,507	-	-	-	-	-	-	-	-	(613,748,107)
	5083 Total		SPECIAL ACCESS REVENUE-DSL	(386,905,741)	6,998,269	-	-	-	-	-	-	-	-	(379,907,472)
	5084 Total		STATE ACCESS REVENUE	(793,122,946)	3,566,506	-	-	-	-	-	-	-	-	(789,556,440)
	5100 Total		LONG DISTANCE MESSAGE REVENUE	(1,163,719,444)	357,801	-	-	-	-	-	-	-	12,488,743	(1,150,872,900)
	5111 Total		LONG DISTANCE INWARD ONLY REVENUE	(76,845,972)	450,520	-	-	-	-	-	-	-	-	(76,395,452)
	5112 Total		LONG DISTANCE OUTWARD ONLY REVENUE	(1,467,761)	365	-	-	-	-	-	-	-	-	(1,467,396)
	5121 Total		SUBVOICE GRADE LONG DISTANCE	(950)	-	-	-	-	-	-	-	-	-	(950)
	5122 Total		VOICE GRADE LONG DISTANCE-PRIVATE	(13,901,363)	26,642	-	-	-	-	-	-	-	-	(13,874,722)
	5123 Total		AUDIO PROGRAM GRADE LONG DISTANCE	(835,866)	-	-	-	-	-	-	-	-	-	(835,866)
	5125 Total		DIGITAL TRANSMISSION LONG DISTANCE	(61,905,021)	119,345	-	-	-	-	-	-	-	-	(61,785,676)
	5128 Total		OTHER LONG DISTANCE PRIVATE NETWORK	(513,765)	-	-	-	-	-	-	-	-	-	(513,765)

Pacific Bell

Attachment 3-3

1997 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GLMAIN	GL SUB	ACCOUNT	1997 MR (FCC-Basis) TOTALS	C3 FCC to CPUC & Regulatory Adjustments	IS (PBIS Account Balances)	DR (PB Directory Account Balances)	DL (PB Development Acct Balances)	IT (PB Internet Account Balances)	NT (PB Network Integration Acct Bal)	WL (PB Mobile Acct Balances)	41 (Subsidiary Eliminations)	42 (Consolidated Eliminations)	1997 FR (CPUC-Basis) TOTALS
	5129 Total		OTHER LONG DISTANCE PVT NTWK SETTLE	5,983	-	-	-	-	-	-	-	-	-	5,983
	5160 Total		OTHER LD REVENUE	115,578,486	16,647,626	-	-	-	-	-	-	-	-	132,226,112
	5230 Total		DIRECTORY REVENUE	(35,949,556)	5,322	-	(1,089,853,036)	-	-	-	-	-	77,640	(1,125,719,630)
	5240 Total		RENT REVENUE	(29,889,927)	-	-	-	-	-	-	-	-	-	(29,889,927)
	5250 Total		CORPORATE OPERATIONS REVENUE	(1,033,343)	-	-	-	-	-	-	-	-	-	(1,033,343)
	5261 Total		SPECIAL BILLING ARRANGEMENTS REVENU	(15,041,366)	92,303	-	-	-	-	-	-	-	-	(14,949,063)
	5262 Total		CUSTOMER OPERATIONS REVENUE	(14,102,652)	-	-	-	-	-	-	-	-	-	(14,102,652)
	5264 Total		OTHER INCIDENTAL REGULATED REVENUE	(160,706,767)	(10,168,602)	-	(4,091,709)	-	-	(7,166,368)	-	3,666,411	64,983,219	(113,483,816)
	5270 Total		CARRIER BILLING & COLLECTION	(84,128,425)	-	-	-	-	-	-	-	-	-	(84,128,425)
	5280 Total		NONREGULATED OPERATING REVENUE	(171,075,805)	(7,634,922)	(198,990,773)	-	-	(29,836,668)	(46,408,356)	(150,044,402)	3,047,027	18,313,844	(582,630,055)
	5301 Total		UNCOLLECTIBLE TELECOM	178,782,602	-	-	45,908,692	-	31,311	-	-	-	-	224,722,605
	5302 Total		UNCOLLECTIBLE REVENUE-OTHER	220,941	-	4,598,013	-	-	3,178,407	433,291	11,587,206	-	-	20,017,857
Total 5000			TOTAL OPERATING REVENUE	(8,460,235,399)	92,503,368	(194,392,760)	(1,048,036,053)	-	(26,626,950)	(53,141,433)	(138,457,196)	6,713,437	140,697,859	(9,680,975,128)
6000														
	6112 Total		MOTOR VEHICLE EXPENSE	7,968,601	-	-	-	-	79	-	157,541	-	-	8,126,221
	6113 Total		AIRCRAFT EXPENSE	77,033	-	-	-	-	-	-	-	-	-	77,033
	6114 Total		SPECIAL PURPOSE VEHICLE EXPENSE	32,382	-	-	-	-	-	-	-	-	-	32,382
	6115 Total		GARAGE WORK EQUIPMENT EXPENSE	674,462	-	-	-	-	-	-	-	-	-	674,462
	6116 Total		OTHER WORK EQUIPMENT EXPENSE	2,986,056	62,435	-	-	-	-	35,918	-	-	-	3,084,409
	6121 Total		LAND AND BUILDING EXPENSE	156,840,535	(9,102,398)	4,035,682	15,158,895	-	4,098,646	1,060,435	15,200,993	-	-	187,292,788
	6122 Total		FURNITURE AND ARTWORK	14,656,152	(285,955)	63,909	1,316,688	-	14,212	-	-	-	-	15,765,005
	6123 Total		OFFICE EQUIPMENT EXPENSE	37,731,637	(450,224)	252,774	1,885,071	-	-	-	-	-	-	39,419,258
	6124 Total		GENERAL PURPOSE COMPUTERS EXPENSE	213,940,946	(2,812,170)	110,235	30,327	-	262,614	-	-	-	-	211,531,952
	6211 Total		ANALOG ELECTRIC EXPENSE	54,080,428	(200,290)	-	-	-	-	-	-	-	-	53,880,138
	6212 Total		DIGITAL ELECTRONIC EXPENSE	311,841,191	208,043	-	-	-	-	-	-	-	-	312,049,234
	6215 Total		ELECTROMECHANICAL EXPENSE	47,610	-	-	-	-	-	-	-	-	-	47,610
	6220 Total		OPERATOR SYSTEMS EXPENSE	34,736,555	-	-	-	-	-	-	-	-	-	34,736,555
	6231 Total		RADIO SYSTEMS EXPENSE	2,931,467	-	-	-	-	-	-	-	-	-	2,931,467
	6232 Total		CIRCUIT EQUIPMENT EXPENSE	100,357,460	(636,879)	-	-	-	-	-	-	-	-	99,720,581
	6311 Total		STATION APPARATUS EXPENSE	188,390	-	-	-	-	-	-	-	-	-	188,390
	6351 Total		PUBLIC TELEPHONE TEMRINAL EQUIPMENT	19,337,009	-	-	-	-	-	-	-	-	-	19,337,009
	6362 Total		OTHER TERMINAL EQUIPMENT EXPENSE	154,960,892	5,395,972	-	-	-	-	-	-	-	-	160,356,864
	6411 Total		POLES EXPENSE	7,527,757	-	-	-	-	-	-	-	-	-	7,527,757
	6421 Total		AERIAL CABLE EXPENSE	252,063,906	20,647,944	-	-	-	-	-	-	-	-	272,711,850
	6422 Total		UNDERGROUND CABLE EXPENSE	167,049,112	6,736,492	-	-	-	-	-	-	-	-	173,785,604
	6423 Total		BURIED CABLE EXPENSE	167,219,245	7,768,217	-	-	-	-	-	-	-	-	174,987,462
	6424 Total		SUBMARINE CABLE EXPENSE	38,281	-	-	-	-	-	-	-	-	-	38,281
	6426 Total		INTRABUILDING NETWORK CABLE EXPENSE	272,254	-	-	-	-	-	-	-	-	-	272,254
	6431 Total		AERIAL WIRE EXPENSE	1,136,724	-	-	-	-	-	-	-	-	-	1,136,724
	6441 Total		CONDUIT SYSTEMS EXPENSE	12,166,704	-	-	-	-	-	-	-	-	-	12,166,704
	6512 Total		PROVISIONING EXPENSE	(60,726)	-	-	-	-	-	-	-	-	-	(60,726)
	6531 Total		POWER EXPENSE	49,610,073	-	-	-	-	-	-	-	-	-	49,610,073
	6532 Total		NETWORK ADMINISTRATION EXPENSE	27,898,181	-	-	-	-	312,418	-	-	-	-	28,210,599
	6533 Total		TESTING EXPENSE	180,294,030	6,679,285	-	-	-	-	-	-	-	-	186,973,315
	6534 Total		PLANT OPERATIONS ADMIN EXPENSE	301,258,693	5,134,718	-	-	-	-	-	-	-	-	306,393,411
	6535 Total		NETWORK ENGINEERING EXPENSE	208,926,122	(12,912,930)	-	-	-	17,032,489	(65,351)	36,889,558	-	-	249,869,888
	6540 Total		ACCESS EXPENSE	119,719,255	-	-	-	-	-	-	-	-	-	119,719,255
	6561 Total		DEPRECIATION EXPENSE-TELECOMM	1,878,925,686	92,215,291	19,677,688	19,421,408	18,203	3,019,559	4,438,545	70,909,502	-	-	2,088,625,882
	6563 Total		AMORTIZATION EXPENSE-TANGIBLE	20,260,025	441,622	-	-	3,389	3,846,884	909,997	477,312	-	-	25,939,229
	6564 Total		AMORTIZATION EXPENSE-INTANGIBLE	4,000	-	-	-	-	-	-	-	-	-	4,000
	6565 Total		AMORTIZATION EXPENSE-OTHER	-	26,025,494	-	-	-	-	-	-	-	-	26,025,494
	6611 Total		PRODUCT MANAGEMENT EXPENSE	113,336,490	2,916,320	112,319,479	-	-	(3,273,749)	2,701,488	39,308,270	(668,476)	(56,576,183)	210,063,640
	6612 Total		SALES EXPENSE	238,447,209	15,347,948	-	-	-	1,689,859	50,311,323	54,676,123	-	(4,362,389)	356,110,073
	6613 Total		PRODUCT ADVERTISING EXPENSE	111,303,974	-	2,003,966	-	-	9,057,186	181,029	-	-	-	122,546,155
	6621 Total		CALL COMPLETION SERVICES	53,016,934	(52,120)	-	-	-	-	-	136,458,939	-	-	189,423,752
	6622 Total		NUMBER SERVICES	162,027,006	15,197,033	-	525,535,033	-	-	-	-	(9,878)	(8,472,069)	694,277,125
	6623 Total		CUSTOMER SERVICES	705,222,268	41,240,406	3,508,718	-	-	15,319,892	2,831	71,972,718	-	-	837,266,834
	6711 Total		EXECUTIVE	50,986,874	(298,213)	-	-	-	(765,072)	673,467	28,533,701	-	34,583	79,165,341
	6712 Total		PLANNING EXPENSE	15,675,078	457,525	-	-	1,906	(339,408)	-	-	-	-	15,795,100
	6721 Total		ACCOUNTING AND FINANCE	54,149,064	(1,137,071)	-	-	-	3,958,572	687,115	17,325,873	-	-	74,983,553
	6722 Total		EXTERNAL RELATIONS	62,206,453	(1,986,401)	-	-	-	-	-	2,050,282	-	-	62,270,334
	6723 Total		HUMAN RESOURCES EXPENSE	110,789,988	1,390,929	-	5,127	-	1,192,975	689,931	2,897,969	-	-	116,966,920
	6724 Total		INFORMATION MANAGEMENT	680,597,458	(21,086,433)	10,712,284	-	-	4,028,830	2,506,437	-	-	-	676,758,576
	6725 Total		LEGAL EXPENSE	36,252,235	-	-	-	-	54,000	-	-	-	-	36,306,235
	6726 Total		PROCUREMENT EXPENSE	16,417,407	(63,971)	-	-	-	-	778	25,000	-	-	16,379,213
	6727 Total		RESEARCH AND DEVELOPMENT EXPENSE	(940,563)	44,400,000	-	-	-	-	-	-	-	-	43,459,437

Pacific Bell

Attachment 3-3

1997 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GLMAIN	GL SUB	ACCOUNT	1997 MR (FCC-Basis) TOTALS	C3 FCC to CPUC & Regulatory Adjustments	IS (PBIS Account Balances)	DR (PB Directory Account Balances)	DL (PB Development Acct Balances)	IT (PB Internet Account Balances)	NT (PB Network Integration Acct Bal)	WL (PB Mobile Acct Balances)	41 (Subsidiary Eliminations)	42 (Consolidated Eliminations)	1997 FR (CPUC-Basis) TOTALS
	6728 Total		OTHER GENERAL AND ADMIN EXPENSE	398,102,714	123,396,741	796,731	(468,997)	387,324	27,096,267	5,547,512	57,837,091	(6,151,352)	(71,205,501)	535,338,530
Total 6000			OPERATING EXPENSE	7,315,288,716	364,637,359	153,481,467	562,883,551	410,821	86,606,252	69,681,455	534,720,873	(6,829,706)	(140,581,559)	8,940,299,229
7000														
	7110 Total		INCOME FROM CUSTOMER WORK	(740,191)	-	-	-	-	-	-	-	-	-	(740,191)
	7150 Total		GAINS /LOSSES FROM DISPOSITION OF LANI	(2,646,439)	(3,421,971)	-	-	-	-	-	-	-	-	(6,068,410)
	7160 Total		OTHER OPERATING GAINS AND LOSSES	18,380,768	-	-	(2,913,603)	-	-	-	8,798,383	-	-	24,265,548
	7210 Total		OPERATING INVESTMENT TAX CREDIT-NET	(41,550,793)	(6,078,737)	-	(652,992)	-	-	-	-	-	-	(48,282,522)
	7220 Total		OPERATING FEDERAL INCOME TAX	156,440,263	-	3,781,980	122,130,312	(1,735,167)	(17,774,260)	(4,721,246)	(180,809,649)	-	-	77,312,233
	7230 Total		OPERATING STATE AND LOCAL TAXES	27,134,385	-	2,682,078	25,095,984	(208,586)	(1,184,462)	(218,964)	(41,929,873)	-	-	11,370,562
	7240 Total		OPERATING OTHER TAXES	176,555,010	13,000,000	1,296,026	2,614,559	-	286,961	-	-	-	-	193,752,556
	7250 Total		PROV. FOR DEFERRED OPERATING INCOME	(16,228,633)	(180,261,683)	9,457,142	55,961,818	1,732,906	(4,005,534)	(1,620,120)	55,492,669	-	-	(79,471,435)
	7310 Total		DIVIDEND INCOME-OTHER	(4,453,040)	-	537,291	-	-	-	-	-	-	-	(3,915,749)
	7320 Total		INTEREST INCOME	(7,045,518)	-	(81)	(10,482,231)	-	-	-	(671,210)	-	10,340,550	(7,858,489)
	7340 Total		AFUDC-INTEREST	(36,514,348)	(9,838,480)	-	-	-	-	-	-	-	-	(46,352,828)
	7350 Total		GAINS/LOSSES DISPOSITION OF CERTAIN	266,431	-	222,110	-	-	58,225	-	-	-	-	546,766
	7360 Total		OTHER NONOPERATING INCOME	143,171,312	218,097,677	11,750	-	-	1,179	-	-	-	18,485,503	379,767,420
	7370 Total		SPECIAL CHARGES EXPENSE	15,589,187	-	5,917	42,102	-	12,573	12,635	-	-	-	15,662,414
	7420 Total		NONOPERATING FEDERAL INCOME TAXES	(119,444,820)	-	-	-	-	-	-	-	-	-	(119,444,820)
	7430 Total		NONOPERATING STATE & LOCAL INCOME TA	(29,379,278)	-	-	-	-	-	-	-	-	-	(29,379,278)
	7440 Total		NONOPERATING OTHER TAXES	901,813	-	-	-	-	-	-	-	-	-	901,813
	7450 Total		PROV. FOR DEF NONOP INCOME TAX	83,147,983	(87,859,412)	-	-	-	-	-	-	-	-	(4,711,429)
	7510 Total		INTEREST ON FUNDED DEBT	374,048,644	6,630,278	-	-	-	-	-	-	-	-	380,678,922
	7520 Total		INTEREST EXPENSE-CAPITAL LEASES	1,938,000	-	-	-	-	-	-	17,444,342	-	-	19,382,342
	7530 Total		AMORTIZATION OF DEBT ISSUANCE EXPENS	1,107,946	4,777	-	-	-	-	-	-	-	-	1,112,723
	7540 Total		OTHER INTEREST DEDUCTIONS	100,573,465	24,340,034	(597,741)	1,657,734	69,445	2,609,115	1,026,468	(10,705,771)	-	(10,340,582)	108,632,168
	7610 Total		EXTRAORDINARY INCOME CREDITS	(676,167,845)	-	(551,783)	-	-	(36,482)	(23,588)	(38,762)	-	-	(676,818,460)
	7620 Total		EXTRAORDINARY INCOME CHARGES	93,060,081	547,695,954	75,941	(10,879,474)	-	5,021	2,941	13,020,444	-	-	642,980,908
	7640 Total		PROV DEF INCOME TAXES-EXTRAORDINARY	239,079,753	(224,560,927)	-	-	-	-	-	-	-	-	14,518,826
	7910 Total		JURISDICTIONAL RATEMAKING DIFFERENCE	681,038,232	(681,038,232)	-	-	-	-	-	-	-	-	-
Total 7000			OTHER INCOME	1,178,262,370	(383,290,722)	16,920,629	182,574,209	(141,402)	(20,027,664)	(5,541,874)	(139,399,427)	-	18,485,472	847,841,591
	8701 Total			-	29,119,500	-	-	-	-	-	-	-	-	29,119,500
Total 8000				-	29,119,500	-	-	-	-	-	-	-	-	29,119,500
	Grand Total			(0)	(24,831,440)	(0)	-	0	0	-	(0)	-	-	(24,831,440)

Pacific Bell
1998 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT		GLACCT	ACCOUNT	1998 MR (FCC-Basis) Trial Balance Totals	C3 FCC to CPUC Accounting & Regulatory Adjs.	IS (PBIS Account Balances)	42 (Consolidated Eliminations)	1998 FR (CPUC-Basis) Trial Balance Totals
			DATA RESPONSE REFERENCE	(OC-558)	(OC-556)	(OC-621)	(OC-621)	
1000								
	1130		CASH	(155,328,473)	-	(87)	-	(155,328,560)
	1140		SPECIAL CASH DEPOSITS	-	-	-	-	-
	1150		WORKING CASH ADVANCES	454,291	-	-	-	454,291
	1160		TEMPORARY INVESTMENTS	-	-	-	-	-
	1180		TELECOM ACCOUNTS RECEIVABLE	1,868,343,027	-	1,765,715	-	1,870,108,742
	1181		ACCOUNTS RECEIVABLE ALLOWANCE -	(156,697,986)	(1,386,687)	(1,317,453)	-	(159,402,125)
	1190		AFFILIATE RECEIVABLES	315,065,315	-	23,974,988	(33,288,165)	305,752,138
	1191		NONREGULATED - NONTELECOM	(1,306,515)	-	-	-	(1,306,515)
	1200		NOTES RECEIVABLE - NONAFFILIATED	115,000	-	-	-	115,000
	1210		INTEREST RECEIVABLE-OTHER	4,175	-	-	-	4,175
	1220		MATERIALS AND SUPPLIES	36,877,546	-	-	-	36,877,546
	1290		PREPAID RENTS	6,682,312	-	-	-	6,682,312
	1300		PREPAID TAXES	16,819,206	-	39,506	-	16,858,712
	1310		PREPAID INSURANCE	7,202,732	-	0	-	7,202,732
	1330		OTHER PREPAYMENTS	59,271,282	-	419,801	-	59,691,083
	1350		OTHER CURRENT ASSETS	40,999,662	49,706,378	(3,509)	-	90,702,531
	1401		INVESTMENTS IN AFFILIATES	5,781,001	-	-	(5,272,429)	508,571
	1402		INVESTMENTS IN NONAFFILIATES	8,812,987	-	-	-	8,812,987
	1406		NONREGULATED INVESTMENTS	-	-	-	-	-
	1407		UNAMORTIZED DEBT ISSUANCE EXPENSE	20,034,306	821,803	-	-	20,856,109
	1410		OTHER NON CURRENT ASSETS	68,549,267	-	-	-	68,549,267
	1437		DEFERRED TAX REGULATORY ASSET	411,214,485	397,524,069	-	-	808,738,554
	1439		DEFERRED CHARGES	85,888,066	(694,691,898)	1,222,656	-	(607,581,176)
	1500		OTHER JURISDICTIONAL ASSETS -NET	518,976,287	(518,976,287)	-	-	-
	Total 1000			3,157,757,972	(767,002,621)	26,101,618	(38,560,594)	2,378,296,374
2001	TELECOM PLANT IN SERVICE							
	2111		LAND	212,238,055	-	-	-	212,238,055
	2112		MOTOR VEHICLES	339,541,055	-	-	-	339,541,055
	2114		SPECIAL PURPOSE VEHICLES	310,698	-	-	-	310,698
	2115		GARAGE WORK EQUIPMENT	18,101,281	-	-	-	18,101,281
	2116		OTHER WORK EQUIPMENT	243,432,764	-	349,634	-	243,782,398
	2121		BUILDINGS	2,555,064,550	-	-	-	2,555,064,550
	2122		FURNITURE	49,039,964	-	648,515	-	49,688,479
	2123		OFFICE EQUIPMENT	117,696,560	-	9,557,626	-	127,254,186
	2124		GENERAL PURPOSE COMPUTERS	1,553,538,642	-	6,636,508	-	1,560,175,150
	2211		ANALOG ELECTRONIC SWITCHING	562,786,287	-	-	-	562,786,287
	2212		DIGITAL ELECTRONIC SWITCHING	4,835,730,706	-	150,205,579	-	4,985,936,286
	2215		ELECTROMECHANICAL SWITCHING	25,463	-	-	-	25,463
	2220		OPERATOR SYSTEMS	99,990,070	-	-	-	99,990,070
	2231		RADIO	118,498,471	-	-	-	118,498,471
	2232		CIRCUIT EQUIPMENT	5,357,771,383	-	-	-	5,357,771,383
	2341		LARGE PRIVATE BRANCH EXCHANGES	5,674,450	-	-	-	5,674,450
	2351		PUBLIC TELEPHONE TERMINAL	140,749,981	-	-	-	140,749,981
	2362		ST TPUC - OTHER TERMINAL EQUIPMENT	459,005,087	-	-	-	459,005,087
	2411		POLES	597,576,499	-	-	-	597,576,499
	2421		AERIAL CABLE	2,489,890,260	-	-	-	2,489,890,260
	2422		UNDERGROUND CABLE	4,178,210,611	-	-	-	4,178,210,611
	2423		BURIED CABLE	2,087,056,896	-	-	-	2,087,056,896
	2424		SUBMARINE CABLE	7,744,311	-	-	-	7,744,311
	2426		INTRABUILDING NETWORK CABLE	4,341,651	-	-	-	4,341,651
	2431		AERIAL WIRE	43,176,932	-	-	-	43,176,932
	2441		CONDUIT SYSTEMS	2,381,422,965	-	-	-	2,381,422,965
	2681		CAPITAL LEASES	28,681,464	-	-	-	28,681,464
	2682		LEASEHOLD IMPROVEMENTS	211,065,662	-	7,758,404	-	218,824,065
	2690		PATENT RIGHTS	-	-	-	-	-
	C3 Adj Total Total			-	278,515,127	-	-	278,515,127
	Total 2001		TELECOM PLANT IN SERVICE	28,698,362,719	278,515,127	175,156,266	-	29,152,034,113
2002	TELECOM PLANT HELD FOR FUTURE USE							
	2111		LAND	2,029	-	-	-	2,029
	2212		DIGITAL ELECTRONIC SWITCHING	-	-	-	-	-
	2232		CIRCUIT EQUIPMENT	332,054	-	-	-	332,054
	2422		UNDERGROUND CABLE	5	-	-	-	5
	Total 2002		TELECOM PLANT HELD FOR FUTURE USE	334,087	-	-	-	334,087
2005	TELECOMMUNICATIONS PLANT ADJ.							
	2005		TELCOMMUNICATIONS PLANT ADJ.	(32,844)	-	-	-	(32,844)
2003	SHORT TERM TPUC							
	2111		LAND	-	-	-	-	-
	2112		MOTOR VEHICLES	-	-	-	-	-
	2115		GARAGE WORK EQUIPMENT	-	-	-	-	-
	2116		OTHER WORK EQUIPMENT	1,334,043	-	-	-	1,334,043

Pacific Bell
1998 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT		GLACCT	ACCOUNT	1998 MR (FCC-Basis) Trial Balance Totals	C3 FCC to CPUC Accounting & Regulatory Adjs.	IS (PBIS Account Balances)	42 (Consolidated Eliminations)	1998 FR (CPUC-Basis) Trial Balance Totals
	2121		BUILDINGS	36,545,963	-	-	-	36,545,963
	2122		ST TPUC - FURNITURE	-	-	19,414	-	19,414
	2123		OFFICE EQUIPMENT	-	-	67,130	-	67,130
	2124		GENERAL PURPOSE COMPUTERS	14,354,672	-	109,887	-	14,464,558
	2211		ANALOG ELECTRONIC SWITCHING	5,901,637	-	-	-	5,901,637
	2212		DIGITAL ELECTRONIC SWITCHING	123,009,047	-	4,098,943	-	127,107,990
	2220		OPERATOR SYSTEMS	(855,304)	-	-	-	(855,304)
	2231		OPERATOR SYSTEMS	6,421,066	-	-	-	6,421,066
	2232		CIRCUIT EQUIPMENT	147,818,338	-	-	-	147,818,338
	2341		LARGE PRIVATE BRANCH EXCHANGES	77,188	-	-	-	77,188
	2351		PUBLIC TELEPHONE TERMINAL	-	-	-	-	-
	2362		ST TPUC - OTHER TERMINAL EQUIPMENT	20,258,875	-	-	-	20,258,875
	2411		POLES	704,519	-	-	-	704,519
	2421		AERIAL CABLE	9,410,147	-	-	-	9,410,147
	2422		UNDERGROUND CABLE	53,245,221	-	-	-	53,245,221
	2423		BURIED CABLE	8,448,661	-	-	-	8,448,661
	2424		SUBMARINE CABLE	-	-	-	-	-
	2426		INTRABUILDING NETWORK CABLE	-	-	-	-	-
	2431		AERIAL WIRE	3,374	-	-	-	3,374
	2441		CONDUIT SYSTEMS	18,673,612	-	-	-	18,673,612
	2682		LEASEHOLD IMPROVEMENTS	2,993,051	-	271,669	-	3,264,721
	2003 C3 Adj. Total Total			-	12,848,065	-	-	12,848,065
	Total 2003		SHORT TERM TPUC	448,344,108	12,848,065	4,567,043	-	465,759,216
2004	LONG TERM TPUC							
	2111		LAND	-	-	-	-	-
	2121		BUILDINGS	13,215,331	-	-	-	13,215,331
	2123		OFFICE EQUIPMENT	-	-	-	-	-
	2124		GENERAL PURPOSE COMPUTERS	360,997	-	-	-	360,997
	2211		ANALOG ELECTRONIC SWITCHING	247,177	-	-	-	247,177
	2212		DIGITAL ELECTRONIC SWITCHING	111,164,214	-	-	-	111,164,214
	2220		OPERATOR SYSTEMS	4,594,676	-	-	-	4,594,676
	2231		RADIO	2,040,050	-	-	-	2,040,050
	2232		CIRCUIT EQUIPMENT	55,487,524	-	-	-	55,487,524
	2341		LARGE PRIVATE BRANCH EXCHANGES	-	-	-	-	-
	2362		ST TPUC - OTHER TERMINAL EQUIPMENT	7,140,703	-	-	-	7,140,703
	2411		POLES	296,712	-	-	-	296,712
	2421		AERIAL CABLE	4,974,814	-	-	-	4,974,814
	2422		UNDERGROUND CABLE	31,708,259	-	-	-	31,708,259
	2423		BURIED CABLE	4,946,585	-	-	-	4,946,585
	2426		INTRABUILDING NETWORK CABLE	27	-	-	-	27
	2431		AERIAL WIRE	5	-	-	-	5
	2441		CONDUIT SYSTEMS	20,270,561	-	-	-	20,270,561
	2682		LEASEHOLD IMPROVEMENTS	-	-	-	-	-
	2004 C3 Adj Total Total			-	1,463,107	-	-	1,463,107
	Total 2004		LONG TERM TPUC	256,447,637	1,463,107	-	-	257,910,744
2006	NONOPERATING PLANT							
	2111		LAND	13,349,860	-	-	-	13,349,860
	2121		BUILDINGS	16,467,221	-	-	-	16,467,221
	2124		GENERAL PURPOSE COMPUTERS	-	-	-	-	-
	2211		ANALOG ELECTRONIC SWITCHING	1,469	-	-	-	1,469
	2212		DIGITAL ELECTRONIC SWITCHING	8,497,333	-	-	-	8,497,333
	2220		OPERATOR SYSTEMS	15,710,663	-	-	-	15,710,663
	2231		RADIO	5,196	-	-	-	5,196
	2232		CIRCUIT EQUIPMENT	9,203,928	-	-	-	9,203,928
	2341		LARGE PRIVATE BRANCH EXCHANGES	-	-	-	-	-
	2362		ST TPUC - OTHER TERMINAL EQUIPMENT	801,869	-	-	-	801,869
	2411		POLES	6,298	-	-	-	6,298
	2421		AERIAL CABLE	253,198	-	-	-	253,198
	2422		UNDERGROUND CABLE	1,721,771	-	-	-	1,721,771
	2423		BURIED CABLE	349,625	-	-	-	349,625
	2426		INTRABUILDING NETWORK CABLE	6,819	-	-	-	6,819
	2431		AERIAL WIRE	-	-	-	-	-
	2441		CONDUIT SYSTEMS	667,872	-	-	-	667,872
	2682		LEASEHOLD IMPROVEMENTS	28,707	-	-	-	28,707
	Total 2006		NON-OPERATING PLANT	67,071,828	-	-	-	67,071,828
3000								
	3100		ACCUM. DEPRECIATION - OPERATING	(14,145,462,217)	585,659,649	(109,850,824)	-	(13,669,653,392)
	3200		ACCUM. DEP - HOLD FOR FUTURE USE	-	-	-	-	-
	3300		ACCUM. DEPRECIATION - NON-OP	(5,722,461)	-	-	-	(5,722,461)
	3410		ACCUM AMORT - CAPITAL LEASES	(15,465,402)	-	-	-	(15,465,402)
	3420		ACCUM AMORT - LH IMPROVEMTS	(168,935,038)	(3,298,982)	(2,909,479)	-	(175,143,499)
	3500		ACCUM. AMORTIZATION - INTANGIBLES	-	-	-	-	-
	Total 3000		ACCUM DEPRECIATION & AMORTIZATION	(14,335,585,118)	582,360,667	(112,760,303)	-	(13,865,984,754)

Pacific Bell
1998 MR (FCC) and FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT		GLACCT	ACCOUNT	1998 MR (FCC-Basis) Trial Balance Totals	C3 FCC to CPUC Accounting & Regulatory Adjs.	IS (PBIS Account Balances)	42 (Consolidated Eliminations)	1998 FR (CPUC-Basis) Trial Balance Totals
4000								
	4010		ACCOUNTS PAYABLE	(1,408,723,577)	-	(44,410,722)	33,288,165	(1,419,846,134)
	4020		NOTES PAYABLE-AFFILIATES	(1,579,741,964)	-	(11,645,731)	-	(1,591,387,694)
	4030		ADVANCE BILLING AND PAYMENTS	(290,526,088)	-	(9,033,084)	-	(299,559,172)
	4040		CUSTOMER DEPOSITS	(59,171,308)	-	-	-	(59,171,308)
	4050		CURRENT MATURIITES - LONG TERM	(100,000,000)	-	-	-	(100,000,000)
	4060		CURRENT MATURITIES - CAPITAL LEASES	(2,216,590)	-	-	-	(2,216,590)
	4070		INCOME TAXES ACCRUED	(103,923,975)	-	635,498	-	(103,288,476)
	4080		OTHER TAXES ACCRUED	(1,033,660)	(13,000,000)	(1,397,163)	-	(15,430,823)
	4100		NET CURRENT DEFERRED OPERATING	74,175,402	150,548,902	2,673,289	-	227,397,593
	4110		NET CURRENT DEFERRED NONOPER.	46,837,815	(56,786,836)	-	-	(9,949,021)
	4120		OTHER ACCRUED LIABILITIES	(563,583,154)	(11,000,000)	(17,838,485)	-	(592,421,639)
	4130		OTHER CURRENT LIABILITIES	(44,918,441)	(72,371,500)	(501,930)	-	(117,791,871)
	4210		FUNDED DEBT	(4,686,012,000)	-	-	-	(4,686,012,000)
	4220		PREMIUM ON LONG-TERM DEBT	(76,057)	-	-	-	(76,057)
	4230		DISCOUNT ON LONG-TERM DEBT	178,642,776	189,788,018	-	-	368,430,794
	4250		OBLIGATIONS UNDER CAPITAL LEASES	(11,872,577)	-	-	-	(11,872,577)
	4310		OTHER RESERVES	(736,949,187)	602,666,805	(5,947,158)	-	(140,229,541)
	4320		UNAMORTIZED OPERATING ITC -NET	(262,797,462)	(14,656,507)	-	-	(277,453,969)
	4340		NET NONCURRENT DEFERRED OPER.	(2,234,534,998)	(429,721,148)	5,431,925	-	(2,658,824,220)
	4341		NET DFRD TAX LIAB ADJ-NCURR-FR ONLY	117,383,387	(150,199,778)	-	-	(32,816,391)
	4350		NONCURRENT DEFERRED	(25,547,670)	162,346,646	-	-	136,798,976
	4360		OTHER DEFERRED CREDITS	(361,886,638)	(235,572,729)	(5,758,634)	-	(603,218,002)
	4361		DEFERRED REGULATORY LIABILITY	(528,597,872)	(247,324,291)	-	-	(775,922,163)
	4370		OTHER JURISDICATIONAL LIABILITIES	98,185,264	(98,185,264)	-	-	-
	4510		CAPITAL STOCK	(224,504,982)	-	(60,349,403)	60,349,403	(224,504,982)
	4520		ADDITIONAL PAID IN CAPITAL	(4,972,496,406)	-	54,192,781	(54,192,781)	(4,972,496,406)
	4550		DIVIDENDS & RETAINED EARNINGS	68,434,673	-	26,895,637	(26,895,637)	68,434,673
	Total 4000			(17,615,455,288)	(223,467,682)	(67,053,181)	12,549,150	(17,893,427,000)
5000								
	5001		BASIC AREA REVENUE	(3,323,046,643)	244,445	-	-	(3,322,802,198)
	5002		EXTENDED AREA REVENUE	(45,045,363)	43,115	-	-	(45,002,248)
	5004		OTHER MOBILE SERVICES REVENUE	(120,450,290)	22,898	-	-	(120,427,392)
	5010		PUBLIC TELEPHONE REVENUE	(177,848,550)	-	-	-	(177,848,550)
	5040		LOCAL PRIVATE LINE REVENUE	(59,691,171)	104,929	-	-	(59,586,242)
	5050		CUSTOMER PREMISES REVENUE	(14,908,566)	70	-	-	(14,908,496)
	5060		OTHER LOCAL EXCHANGE REVENUE	(903,744,948)	4,846,149	(214,412,420)	-	(1,113,311,219)
	5069		OTHER LOCAL EXCH REV SETTLEMTS	(12,345)	-	-	-	(12,345)
	5081		END USER ACCESS REVENUE	(923,225,191)	85,053	-	-	(923,140,138)
	5082		SWITCHED ACCESS REVENUE	(567,878,639)	(10,396,753)	-	-	(578,275,392)
	5083		SPECIAL ACCESS REVENUE	(495,666,746)	(1,896,946)	-	-	(497,563,692)
	5084		STATE ACCESS REVENUE	(762,691,537)	1,278,908	-	-	(761,412,630)
	5100		LONG DISTANCE MESSAGE REV	(1,128,482,252)	51,802	-	2,262,161	(1,126,168,288)
	5111		LONG DISTANCE INWARD ONLY REV	(80,389,187)	81,241	-	-	(80,307,947)
	5112		LONG DISTANCE OUTWARD ONLY REV	1,064,253	-	-	-	1,064,253
	5121		SUBVOICE GRADE LONG DISTANCE	(879)	-	-	-	(879)
	5122		VOICE GRADE LD PVT NETWORK	(13,246,448)	3,465	-	-	(13,242,983)
	5123		AUDIO PROGRAM GRADE LONG DISTANCE	(895,661)	-	-	-	(895,661)
	5125		DIGITAL TRANSM. LD REV	(79,858,240)	19,323	-	-	(79,838,917)
	5128		OTHER LD PRIVATE NETWK REV	(63,552)	-	-	-	(63,552)
	5129		INTERSTATE	-	-	-	-	-
	5160		OTHER LD REVENUE	102,408,702	2,055,616	-	-	104,464,318
	5230		DIRECTORY REVENUE	(37,053,190)	576	-	0	(37,052,614)
	5240		RENT REVENUE	(24,328,176)	-	-	-	(24,328,176)
	5250		CORPORATE OPERATIONS REVENUE	(233,706)	-	-	-	(233,706)
	5261		SPECIAL BILLING ARRANGEMENTS	(10,184,205)	11,815	-	-	(10,172,390)
	5262		CUSTOMER OPERATIONS REVENUE	(13,826,829)	-	-	-	(13,826,829)
	5264		OTHER INCIDENTAL REGULATED	(199,004,676)	(67,569,438)	-	81,077,359	(185,496,754)
	5270		CARRIER BILLING AND COLLECTION	(111,018,158)	-	-	-	(111,018,158)
	5280		NONREGULATED OPERATING REVENUE	(314,988,947)	1,673,820	(17,534,186)	14,801,881	(316,047,431)
	5301		UNCOLLECTIBLE TELECOM	141,427,771	-	-	-	141,427,771
	5302		UNCOLLECTIBLE REVENUE OTHER	4,103,427	-	4,385,614	-	8,489,041
	Total 5000		TOTAL OPERATING REVENUE	(9,158,779,940)	(69,339,913)	(227,560,992)	98,141,402	(9,357,539,443)
6000								
	6112		MOTOR VEHICLE EXPENSE	7,667,239	-	-	-	7,667,239
	6113		AIRCRAFT EXPENSE	-	-	-	-	-
	6114		SPECIAL PURPOSE VEHICLE EXPENSE	12,298	-	-	-	12,298
	6115		GARAGE WORK EQUIPMENT EXPENSE	622,841	-	-	-	622,841
	6116		OTHER WORK EQUIPMENT EXPENSE	13,517,511	-	1,163	-	13,518,673
	6121		LAND AND BUILDING EXPENSE	133,745,124	-	3,677,435	-	137,422,559
	6122		FURNITURE AND ARTWORK EXPENSE	11,755,444	-	-	-	11,755,444
	6123		OFFICE EQUIPMENT EXPENSE	38,366,477	-	301,213	-	38,667,691
	6124		GENERAL PURPOSE COMPUTERS	190,345,167	1,374,012	281,597	-	192,000,776
	6211		ANALOG ELECTRIC EXPENSE	48,778,686	-	-	-	48,778,686
	6212		DIGITAL ELECTRONIC EXPENSE	233,916,718	-	-	-	233,916,718

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	6215		ELECTROMECHANICAL EXPENSE	33,990	-	-	-	33,990
	6220		OPERATOR SYSTEMS EXPENSE	15,192,049	-	-	-	15,192,049
	6231		RADIO SYSTEMS EXPENSE	2,357,306	-	-	-	2,357,306
	6232		CIRCUIT EQUIPMENT EXPENSE	108,292,835	-	-	-	108,292,835
	6311		STATION APPARATUS EXPENSE	5,264,714	-	-	-	5,264,714
	6341		LARGE PRIVATE BRANCH EXCHANGE	1,605,432	-	-	-	1,605,432
	6351		PUBLIC TELEPHONE TERMINAL	16,038,370	-	-	-	16,038,370
	6362		OTHER TERMINAL EQUIPMENT EXPENSE	203,807,176	2,739,075	-	-	206,546,251
	6411		POLES EXPENSE	2,473,923	-	-	-	2,473,923
	6421		AERIAL CABLE EXPENSE	235,886,320	14,998,097	-	-	250,884,417
	6422		UNDERGROUND CABLE EXPENSE	155,748,372	6,727,549	-	-	162,475,921
	6423		BURIED CABLE EXPENSE	168,630,995	7,822,818	-	-	176,453,813
	6424		SUBMARINE CABLE EXPENSE	2,170	-	-	-	2,170
	6426		INTRABUILDING NETWORK CABLE	248,798	-	-	-	248,798
	6431		AERIAL WIRE EXPENSE	901,137	-	-	-	901,137
	6441		CONDUIT SYSTEMS EXPENSE	10,021,926	-	-	-	10,021,926
	6512		PROVISIONING EXPENSE	(16,695)	-	-	-	(16,695)
	6531		POWER EXPENSE	48,902,360	-	-	-	48,902,360
	6532		NETWORK ADMINISTRATION EXPENSE	30,228,706	-	12,829,053	-	43,057,759
	6533		TESTING EXPENSE	187,758,833	9,687,434	-	-	197,446,267
	6534		PLANT OPERATIONS ADMIN EXPENSE	265,121,139	15,194,793	-	-	280,315,932
	6535		NETWORK ENGINEERING EXPENSE	131,003,885	-	-	-	131,003,885
	6540		ACCESS EXPENSE	295,841,820	-	-	-	295,841,820
	6561		DEPRECIATION EXPENSE - TELECOMM.	1,955,383,497	94,121,680	15,292,676	-	2,064,797,853
	6563		AMORTIZATION EXP - TANGIBLE PLANT	22,112,070	433,893	-	-	22,545,963
	6564		AMORTIZATION EXP - INTANGIBLES	667	-	-	-	667
	6565		AMORTIZATION EXP _ OTHER	19,842,046	15,181,531	-	-	35,023,577
	6611		PRODUCT MANAGEMENT EXPENSE	86,191,265	1,199,031	123,996,794	(83,339,521)	128,047,569
	6612		SALES EXPENSE	298,061,177	19,065,708	-	-	317,126,885
	6613		PRODUCT ADVERTISING EXPENSE	84,052,934	-	573,638	-	84,626,572
	6621		CALL COMPLETION SERVICES	48,607,257	-	-	-	48,607,257
	6622		NUMBER SERVICES	156,860,411	17,036,792	-	-	173,897,203
	6623		CUSTOMER SERVICES	799,525,798	55,049,693	4,153,501	-	858,728,992
	6711		EXECUTIVE EXPENSE	36,692,877	945,090	-	-	37,637,967
	6712		PLANNING EXPENSE	10,866,888	1,241,778	-	-	12,108,666
	6721		ACCOUNTING AND FINANCE EXPENSE	61,635,014	1,073,248	367,569	-	63,075,832
	6722		EXTERNAL RELATIONS EXPENSE	75,664,275	41,875	-	-	75,706,150
	6723		HUMAN RESOURCES EXPENSE	176,848,688	1,209,964	-	-	178,058,652
	6724		INFORMATION MANAGEMENT EXPENSE	525,534,602	7,460,628	13,287,609	-	546,282,839
	6725		LEGAL EXPENSE	67,133,370	-	-	-	67,133,370
	6726		PROCUREMENT EXPENSE	21,921,778	460,353	-	-	22,382,131
	6727		RESEARCH AND DEVELOPMENT EXPENSE	461,519	-	-	-	461,519
	6728		OTHER GENERAL & ADMIN EXPENSE	171,658,349	(71,155,130)	8,131,452	(14,801,881)	93,832,789
	Total 6000		TOTAL 6000 OPERATING EXPENSE	7,183,127,548	201,909,912	182,893,700	(98,141,402)	7,469,789,758
7000								
	7110		INCOME FROM CUSTOM WORK	2,201,482	-	-	-	2,201,482
	7150		GAINS & LOSSES- DISPOSITION OF LAND	362,693	59,480	-	-	422,173
	7160		OTHER OPERATING GAINS AND LOSSES	(1,878,518)	-	-	-	(1,878,518)
	7210		OPERATING INVESTMENT TAX CREDIT -	(35,985,175)	(2,604,825)	-	-	(38,590,000)
	7220		OPERATING FEDERAL INCOME TAXES	363,287,585	-	1,942,856	-	365,230,441
	7230		OPERATING STATE AND LOCAL TAXES	95,618,941	-	2,380,019	-	97,998,960
	7240		OPERATING OTHER TAXES	181,794,991	-	1,311,749	-	183,106,739
	7250		PROV. FOR DEFERRED OPERATING	143,920,971	(29,557,505)	13,540,493	-	127,903,959
	7310		DIVIDEND INCOME	-	-	-	-	-
	7320		INTEREST INCOME	(2,668,847)	-	101,549	-	(2,567,298)
	7340		AFUDC-INTEREST	(35,178,375)	(17,649,444)	-	-	(52,827,819)
	7350		GAINS/LOSSES DISPOSITION OF CERTAIN	-	-	6,958	-	6,958
	7360		OTHER NONOPERATING INCOME	54,557,251	(8,239,531)	-	26,011,444	72,329,164
	7370		SPECIAL CHARGES EXPENSE	17,035,336	(47)	5,201	-	17,040,490
	7420		NONOPERATING FEDERAL INCOME TAXES	(25,493,188)	-	-	-	(25,493,188)
	7430		NONOP STATE/LOCAL INCOME TAX	(9,460,084)	-	-	-	(9,460,084)
	7440		NONOPERATING OTHER TAXES	807,303	-	-	-	807,303
	7450		PROV FOR DEF NONOP INCOME TAX	(7,938,830)	2,570,498	-	-	(5,368,332)
	7510		INTEREST ON FUNDED DEBT	380,457,276	1,014,252	-	-	381,471,527
	7520		INTEREST EXPENSE -CAPITAL LEASES	2,089,066	-	-	-	2,089,066
	7530		AMORTIZATON OF DEBT ISSUANCE	1,323,210	5,116	-	-	1,328,326
	7540		OTHER INTEREST DEDUCTIONS	67,076,987	15,791,618	(632,978)	0	82,235,627
	7610		EXTRAORDINART INCOME CREDITS	-	-	-	-	-
	7620		EXTRAORDINARY INCOME CHARGES	-	-	-	-	-
	7640		PROV DEF INCOME TAXES -EXTRAORD	-	-	-	-	-
	7910		JURISD. RATEMAKING DIFFERENCES	106,477,219	(106,477,219)	-	-	-
	Total 7000			1,298,407,292	(145,087,607)	18,655,847	26,011,444	1,197,986,976
	Grand Total			(0)	(127,800,945)	(0)	(0)	(127,800,945)

Pacific Bell

1999 MR (FCC) AND FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GL ACC	ACCOUNT	1999 MR Trial Balance (FCC Basis)	C3 Trial Balance	PBIS (IS) Trial Balance	Elimin (42) Trial Balance	Total FR Trial Balance (CPUC Basis)
			(OC-558)	(OC-556)	(OC-621)	(OC-621)	
1000							
	1130	CASH	(25,301,490)	-	-	-	(25,301,490)
	1140	SPECIAL CASH DEPOSITS	(130)	-	-	-	(130)
	1150	WORKING CASH ADVANCES	687,383	-	-	-	687,383
	1160	TEMPORARY INVESTMENTS	-	-	-	-	-
	1180	TELECOM ACCOUNTS RECEIVABLE	1,807,815,096	(20,704,911)	1,705,306	-	1,788,815,490
	1181	ACCOUNTS RECEIVABLE ALLOWANCE -	(142,126,852)	(16,164,647)	(1,029,749)	-	(159,321,247)
	1190	AFFILIATE RECEIVABLES	298,286,850	609,814	24,467,546	(31,680,001)	291,684,209
	1191	NONREGULATED - NONTELECOM	-	-	-	-	-
	1200	NOTES RECEIVABLE - NONAFFILIATED	115,000	-	-	-	115,000
	1210	INTEREST RECEIVABLE-OTHER	-	-	-	-	-
	1220	MATERIALS AND SUPPLIES	35,778,104	-	-	-	35,778,104
	1290	PREPAID RENTS	2,546,460	-	-	-	2,546,460
	1300	PREPAID TAXES	2,139,280	-	-	-	2,139,280
	1310	PREPAID INSURANCE	4,126,259	-	-	-	4,126,259
	1330	OTHER PREPAYMENTS	87,104,904	-	288,921	-	87,393,825
	1350	OTHER CURRENT ASSETS	13,604,384	57,695,500	27,710	-	71,327,594
	1401	INVESTMENTS IN AFFILIATES	20,563,626	-	-	(20,055,055)	508,571
	1402	INVESTMENTS IN NONAFFILIATES	10,011,508	-	-	-	10,011,508
	1407	UNAMORTIZED DEBT ISSUANCE	18,758,009	816,325	-	-	19,574,334
	1410	OTHER NON CURRENT ASSETS	109,593,271	-	-	-	109,593,271
	1437	DEFERRED TAX REGULATORY ASSET	237,953,708	45,807,798	-	-	283,761,506
	1439	DEFERRED CHARGES	88,277,030	(519,710,692)	(4,049,507)	-	(435,483,169)
	1500	OTHER JURISDICTIONAL ASSETS -NET	(38,098,320)	38,098,320	-	-	-
	Total 1000		2,531,834,080	(413,552,492)	21,410,226	(51,735,056)	2,087,956,758
2001	TELECOM PLANT IN SERVICE						
	2111	LAND	213,708,382	-	-	-	213,708,382
	2112	MOTOR VEHICLES	393,833,240	-	-	-	393,833,240
	2114	SPECIAL PURPOSE VEHICLES	435,742	-	-	-	435,742
	2115	GARAGE WORK EQUIPMENT	18,257,209	-	-	-	18,257,209
	2116	OTHER WORK EQUIPMENT	285,230,509	-	-	-	285,230,509
	2121	BUILDINGS	2,615,858,020	-	-	-	2,615,858,020
	2122	FURNITURE	50,266,588	-	-	-	50,266,588
	2123	OFFICE EQUIPMENT	151,285,083	-	-	-	151,285,083
	2124	GENERAL PURPOSE COMPUTERS	1,305,902,084	-	-	-	1,305,902,084
	2211	ANALOG ELECTRONIC SWITCHING	302,972,060	-	-	-	302,972,060
	2212	DIGITAL ELECTRONIC SWITCHING	5,232,837,549	-	216,266,092	-	5,449,103,642
	2215	ELECTROMECHANICAL SWITCHING	25,463	-	-	-	25,463
	2220	OPERATOR SYSTEMS	48,065,216	-	-	-	48,065,216
	2231	RADIO	125,369,656	-	-	-	125,369,656
	2232	CIRCUIT EQUIPMENT	5,995,112,877	-	-	-	5,995,112,877
	2341	LARGE PRIVATE BRANCH EXCHANGES	6,097,077	-	-	-	6,097,077
	2351	PUBLIC TELEPHONE TERMINAL	130,424,364	-	-	-	130,424,364
	2362	ST TPUC - OTHER TERMINAL EQUIPMENT	550,404,242	-	-	-	550,404,242
	2411	POLES	616,087,902	-	-	-	616,087,902
	2421	AERIAL CABLE	2,576,199,882	-	-	-	2,576,199,882
	2422	UNDERGROUND CABLE	4,434,182,581	-	-	-	4,434,182,581
	2423	BURIED CABLE	2,151,951,705	-	-	-	2,151,951,705
	2424	SUBMARINE CABLE	7,748,110	-	-	-	7,748,110
	2426	INTRABUILDING NETWORK CABLE	4,235,240	-	-	-	4,235,240
	2431	AERIAL WIRE	45,480,160	-	-	-	45,480,160
	2441	CONDUIT SYSTEMS	2,477,810,488	-	-	-	2,477,810,488
	2681	CAPITAL LEASES	28,131,223	-	-	-	28,131,223
	2682	LEASEHOLD IMPROVEMENTS	68,943,930	-	-	-	68,943,930
	2690	PATENT RIGHTS	-	-	8,661,416	-	8,661,416
	Total C3 Adj Total		-	306,170,546	-	-	306,170,546
	Total 2001	TELECOM PLANT IN SERVICE	29,836,856,584	306,170,546	224,927,508	-	30,367,954,638
2002	TELECOM PLANT HELD FOR FUTURE USE						
	2111	LAND	5,360,060	-	-	-	5,360,060
	2212	DIGITAL ELECTRONIC SWITCHING	12,031,111	-	-	-	12,031,111
	2232	CIRCUIT EQUIPMENT	-	-	-	-	-
	2422	CIRCUIT EQUIPMENT	-	-	-	-	-
	Total 2002	USE	17,391,171	-	-	-	17,391,171

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Attachment 3-3

1999 MR (FCC) AND FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GL ACC	ACCOUNT	1999 MR Trial Balance	C3 Trial Balance	PBIS (IS) Trial Balance	Elimin (42) Trial Balance	Total FR Trial Balance
2003	SHORT TERM TPUC						
	2111	LAND	2,768,873	-	-	-	2,768,873
	2112	MOTOR VEHICLES	6,089,050	-	-	-	6,089,050
	2115	GARAGE WORK EQUIPMENT	-	-	-	-	-
	2116	OTHER WORK EQUIPMENT	1,916,398	-	-	-	1,916,398
	2121	BUILDINGS	63,954,813	-	-	-	63,954,813
	2122	ST TPUC - FURNITURE	-	-	-	-	-
	2123	OFFICE EQUIPMENT	6,499	-	-	-	6,499
	2124	GENERAL PURPOSE COMPUTERS	3,908,432	-	-	-	3,908,432
	2211	ANALOG ELECTRONIC SWITCHING	112,935	-	-	-	112,935
	2212	DIGITAL ELECTRONIC SWITCHING	65,716,790	-	-	-	65,716,790
	2215	ELECTROMECHANICAL SWITCHING	-	-	-	-	-
	2220	OPERATOR SYSTEMS	957,591	-	-	-	957,591
	2231	RADIO	(630,242)	-	-	-	(630,242)
	2232	CIRCUIT EQUIPMENT	186,933,476	-	-	-	186,933,476
	2341	LARGE PRIVATE BRANCH EXCHANGES	(55,674)	-	-	-	(55,674)
	2351	PUBLIC TELEPHONE TERMINAL	-	-	-	-	-
	2362	ST TPUC - OTHER TERMINAL EQUIPMENT	22,856,401	-	-	-	22,856,401
	2411	POLES	2,670,416	-	-	-	2,670,416
	2421	AERIAL CABLE	10,937,940	-	-	-	10,937,940
	2422	UNDERGROUND CABLE	60,996,491	-	-	-	60,996,491
	2423	BURIED CABLE	15,226,525	-	-	-	15,226,525
	2424	SUBMARINE CABLE	-	-	-	-	-
	2426	INTRABUILDING NETWORK CABLE	-	-	-	-	-
	2431	AERIAL WIRE	100,741	-	-	-	100,741
	2441	CONDUIT SYSTEMS	26,630,771	-	-	-	26,630,771
	2682	LEASEHOLD IMPROVEMENTS	9,041,517	-	-	-	9,041,517
	Total C3 Adj Total		-	10,753,804	-	-	10,753,804
	Total 2003	SHORT TERM TPUC	480,139,744	10,753,804	-	-	490,893,548
2004	LONG TERM TPUC						
	2005	TELCOMMUNICATIONS PLANT	-	1,456,181	-	-	1,456,181
	2111	LAND	705,812	-	-	-	705,812
	2121	BUILDINGS	16,456,947	-	-	-	16,456,947
	2123	OFFICE EQUIPMENT	-	-	-	-	-
	2124	GENERAL PURPOSE COMPUTERS	(87,661)	-	-	-	(87,661)
	2211	ANALOG ELECTRONIC SWITCHING	329,499	-	-	-	329,499
	2212	DIGITAL ELECTRONIC SWITCHING	91,402,121	-	-	-	91,402,121
	2220	OPERATOR SYSTEMS	1,421,274	-	-	-	1,421,274
	2231	RADIO	4,953,984	-	-	-	4,953,984
	2232	CIRCUIT EQUIPMENT	66,849,646	-	-	-	66,849,646
	2341	LARGE PRIVATE BRANCH EXCHANGES	61,067	-	-	-	61,067
	2362	PUBLIC TELEPHONE TERMINAL	5,469,722	-	-	-	5,469,722
	2411	POLES	773,302	-	-	-	773,302
	2421	AERIAL CABLE	5,460,001	-	-	-	5,460,001
	2422	UNDERGROUND CABLE	40,721,927	-	-	-	40,721,927
	Total	BURIED CABLE	2,663,737	-	-	-	2,663,737
	2426	INTRABUILDING NETWORK CABLE	-	-	-	-	-
	2431	AERIAL WIRE	-	-	-	-	-
	2441	CONDUIT SYSTEMS	19,839,499	-	-	-	19,839,499
	2682	LEASEHOLD IMPROVEMENTS	986	-	-	-	986
	Total 2004	LONG TERM TPUC	257,021,863	1,456,181	-	-	258,478,044
2006	NON-OPERATING PLANT						
	2111	LAND	11,756,309	-	-	-	11,756,309
	2121	BUILDINGS	16,544,744	-	-	-	16,544,744
	2124	GENERAL PURPOSE COMPUTERS	-	-	-	-	-
	2211	ANALOG ELECTRONIC SWITCHING	9	-	-	-	9
	2212	DIGITAL ELECTRONIC SWITCHING	10,172,921	-	-	-	10,172,921
	2220	OPERATOR SYSTEMS	4,022,932	-	-	-	4,022,932
	2231	RADIO	27,369	-	-	-	27,369
	2232	CIRCUIT EQUIPMENT	12,692,272	-	-	-	12,692,272
	2341	LARGE PRIVATE BRANCH EXCHANGES	61,392	-	-	-	61,392
	2362	ST TPUC - OTHER TERMINAL EQUIPMENT	1,218,394	-	-	-	1,218,394
	2411	POLES	85,515	-	-	-	85,515
	2421	AERIAL CABLE	842,595	-	-	-	842,595
	2422	UNDERGROUND CABLE	2,684,707	-	-	-	2,684,707
	2423	BURIED CABLE	2,372,853	-	-	-	2,372,853

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1999 MR (FCC) AND FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GL ACC	ACCOUNT	1999 MR Trial Balance	C3 Trial Balance	PBIS (IS) Trial Balance	Elimin (42) Trial Balance	Total FR Trial Balance
	2426	INTRABUILDING NETWORK CABLE	6,819	-	-	-	6,819
	2431	AERIAL WIRE	-	-	-	-	-
	2441	CONDUIT SYSTEMS	739,591	-	-	-	739,591
	2682	LEASEHOLD IMPROVEMENTS	-	-	-	-	-
	Total 2006	NON-OPERATING PLANT	63,228,421	-	-	-	63,228,421
3000							
	3100	ACCUM. DEPRECIATION - OPERATING	(14,967,257,403)	53,726,509	(129,237,332)	-	(15,042,768,227)
	3200	ACCUM DEP.-HELD FOR FUTURE	-	-	-	-	-
	3300	ACCUMULATED DEPRECIATION -	(4,827,227)	-	-	-	(4,827,227)
	3410	ACCUMULATED AMORTIZATION -CAPITAL	(16,628,877)	-	-	-	(16,628,877)
	3420	ACCUM. AMORTIZATION -LEASEHOLD	(42,351,711)	1,345,818	-	-	(41,005,894)
	3500	ACCUM. AMORTIZATION - INTANGIBLES	-	-	(840,569)	-	(840,569)
	Total 3000	AMORTIZATION	(15,031,065,219)	55,072,326	(130,077,901)	-	(15,106,070,794)
4000							
	4010	ACCOUNTS PAYABLE	(1,243,214,916)	-	(34,865,380)	31,680,001	(1,246,400,295)
	4020	NOTES PAYABLE-AFFILIATES	(1,595,279,528)	-	(27,826,404)	-	(1,623,105,932)
	4030	ADVANCE BILLING AND PAYMENTS	(397,832,053)	-	-	-	(397,832,053)
	4040	CUSTOMER DEPOSITS	(49,145,316)	-	-	-	(49,145,316)
	4050	CURRENT MATURITIES - LONG TERM	(125,000,000)	-	-	-	(125,000,000)
	4060	CURRENT MATURITIES - CAPITAL	(2,364,205)	-	-	-	(2,364,205)
	4070	INCOME TAXES ACCRUED	(134,509,082)	-	-	-	(134,509,082)
	4080	INCOME TAXES ACCRUED	1,259,074	(8,959,051)	(12,917,204)	-	(20,617,181)
	4100	NET CURRENT DEFERRED OPERATING	185,204,284	(114,532,458)	-	-	70,671,826
	4110	NET CURRENT DEFERRED NONOPER.	62,218,203	-	-	-	62,218,203
	4120	OTHER ACCRUED LIABILITIES	(670,173,633)	(6,014,607)	(8,058,584)	-	(684,246,824)
	4130	OTHER CURRENT LIABILITIES	(200,506,779)	(33,506,500)	-	-	(234,013,279)
	4210	FUNDED DEBT	(4,561,012,000)	-	-	-	(4,561,012,000)
	4220	PREMIUM ON LONG-TERM DEBT	(15,771)	-	-	-	(15,771)
	4230	DISCOUNT ON LONG-TERM DEBT	170,625,676	183,110,182	-	-	353,735,858
	4250	OBLIGATIONS UNDER CAPITAL LEASES	(9,524,740)	-	-	-	(9,524,740)
	4310	OTHER RESERVES	(1,170,853,833)	625,081,593	(17,823,729)	-	(563,595,970)
	4320	UNAMORTIZED OPERATING ITC -NET	(232,407,282)	(12,456,679)	-	-	(244,863,961)
	4340	NET NONCURRENT DEFERRED OPER.	(2,546,411,898)	249,390,348	5,286,523	-	(2,291,735,026)
	4341	NET DFRD TAX LIAB ADJ-NCURR-FR	280,884,809	(268,562,516)	-	-	12,322,293
	4350	NONCURRENT DEFERRED	100,726,153	-	-	-	100,726,153
	4360	OTHER DEFERRED CREDITS	(318,994,665)	(201,251,960)	-	-	(520,246,625)
	4361	DEFERRED REGULATORY LIABILITY	(518,838,517)	(225,583,360)	-	-	(744,421,877)
	4370	OTHER JURISDICATIONAL LIABILITIES	159,021,668	(159,021,668)	-	-	-
	4510	CAPITAL STOCK	(224,504,982)	-	(60,349,403)	60,349,403	(224,504,982)
	4520	ADDITIONAL PAID IN CAPITAL	(4,225,877,406)	-	38,192,781	(38,192,781)	(4,225,877,406)
	4550	DIVIDENDS & RETAINED EARNINGS	(663,580,428)	-	32,502,193	(32,502,193)	(663,580,428)
	Total 4000	LIABILITIES & STOCKHOLDERS EQUITY	(17,930,107,166)	27,693,323	(85,859,207)	21,334,430	(17,966,938,620)

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1999 MR (FCC) AND FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GL ACC	ACCOUNT	1999 MR Trial Balance	C3 Trial Balance	PBIS (IS) Trial Balance	Elimin (42) Trial Balance	Total FR Trial Balance
5000							
	5001	BASIC AREA REVENUE	(3,348,614,092)	(193,461)	-	-	(3,348,807,553)
	5002	EXTENDED AREA REVENUE	(40,645,460)	(33,361)	-	-	(40,678,821)
	5004	OTHER MOBILE SERVICES REVENUE	(109,243,567)	(21,175)	-	-	(109,264,742)
	5010	PUBLIC TELEPHONE REVENUE	(121,898,790)	-	-	-	(121,898,790)
	5040	LOCAL PRIVATE LINE REVENUE	(71,779,351)	(43,686)	-	-	(71,823,037)
	5050	CUSTOMER PREMISES REVENUE	(7,537,969)	(61)	-	-	(7,538,030)
	5060	OTHER LOCAL EXCHANGE REVENUE	(972,436,803)	(32,875,317)	(259,839,210)	-	(1,265,151,330)
	5069	OTHER LOCAL EXCH REV SETTLEMENTS	(12,345)	-	-	-	(12,345)
	5081	END USER ACCESS REVENUE	(1,050,165,756)	(72,088)	-	-	(1,050,237,844)
	5082	SWITCHED ACCESS REVENUE	(522,447,019)	-	-	-	(522,447,019)
	5083	SPECIAL ACCESS REVENUE	(655,837,206)	(37,558)	-	-	(655,874,765)
	5084	STATE ACCESS REVENE	(792,729,816)	(5,197,578)	-	-	(797,927,394)
	5100	LONG DISTANCE MESSAGE REVENUE	(921,689,737)	(47,494)	-	6,157,368	(915,579,863)
	5111	LONG DISTANCE INWARD ONLY REV	(76,357,508)	(62,847)	-	-	(76,420,355)
	5112	LONG DISTANCE OUTWARD ONLY	595,313	(2,517)	-	-	592,796
	5121	SUBVOICE GRADE LONG DISTANCE	(813)	-	-	-	(813)
	5122	VOICE GRADE LONG DISTANCE PRIVATE	(6,177,724)	-	-	-	(6,177,724)
	5123	AUDIO PROGRAM GRADE LONG	(683,417)	-	-	-	(683,417)
	5125	DIGITAL TRANSMISSION LONG DISTANCE	(90,970,428)	(15,368)	-	-	(90,985,796)
	5128	OTHER LONG DISTANCE PRIVATE	-	-	-	-	-
	5129	OTHER LD PVT NETWORK SETTLEMENTS	-	-	-	-	-
	5160	OTHER LD REVENUE	58,514,537	(7,833,553)	-	-	50,680,984
	5230	DIRECTORY REVENUE	(38,846,789)	(453)	-	-	(38,847,242)
	5240	RENT REVENUE	(85,769,569)	-	-	-	(85,769,569)
	5250	CORPORATE OPERATIONS REVENUE	(53,818)	-	-	-	(53,818)
	5261	SPECIAL BILLING ARRANGEMENTS	(14,885,459)	(11,104)	-	-	(14,896,562)
	5262	CUSTOMER OPERATIONS REVENUE	(13,494,978)	-	-	-	(13,494,978)
	5264	OTHER INCIDENTAL REGULATED	(280,557,406)	(31,421,873)	-	85,623,948	(226,355,332)
	5270	CARRIER BILLING AND COLLECTION	(110,151,061)	-	-	-	(110,151,061)
	5280	NONREGULATED OPERATING REVENUE	(532,831,414)	(572,378)	-	16,253,719	(517,150,073)
	5301	UNCOLLECTIBLE TELECOM	129,637,827	16,164,647	-	-	145,802,474
	5302	UNCOLLECTIBLE REVENUE OTHER	(120,901)	-	6,995,698	-	6,874,797
	Total 5000	TOTAL OPERATING REVENUE	(9,677,191,521)	(62,277,224)	(252,843,512)	108,035,034	(9,884,277,224)
6000							
	6112	MOTOR VEHICLE EXPENSE	7,691,471	-	-	-	7,691,471
	6113	AIRCRAFT EXPENSE	-	-	-	-	-
	6114	SPECIAL PURPOSE VEHICLE EXPENSE	2,126	-	-	-	2,126
	6115	GARAGE WORK EQUIPMENT EXPENSE	690,082	-	-	-	690,082
	6116	OTHER WORK EQUIPMENT EXPENSE	7,730,474	-	-	-	7,730,474
	6121	LAND AND BUILDING EXPENSE	127,234,560	-	-	-	127,234,560
	6122	FURNITURE AND ARTWORK EXPENSE	20,881,328	-	-	-	20,881,328
	6123	OFFICE EQUIPMENT EXPENSE	37,818,181	-	-	-	37,818,181
	6124	GENERAL PURPOSE COMPUTERS	223,923,315	185,455	-	-	224,108,770
	6211	ANALOG ELECTRIC EXPENSE	51,489,838	-	-	-	51,489,838
	6212	DIGITAL ELECTRONIC EXPENSE	294,376,069	(1,050,000)	-	-	293,326,069
	6215	ELECTROMECHANICAL EXPENSE	19,778	-	-	-	19,778
	6220	OPERATOR SYSTEMS EXPENSE	11,929,854	-	-	-	11,929,854
	6231	RADIO SYSTEMS EXPENSE	2,928,312	-	-	-	2,928,312
	6232	CIRUIT EQUIPMENT EXPENSE	113,565,067	-	-	-	113,565,067
	6311	STATION APPARATUS EXPENSE	6,489,621	-	-	-	6,489,621
	6341	LARGE PRIVATE BRANCH EXCHANGE	1,303,517	-	-	-	1,303,517
	6351	PUBLIC TELEPHONE TERMINAL	13,445,523	-	-	-	13,445,523
	6362	OTHER TERMINAL EQUIPMENT EXPENSE	382,586,884	238,811	-	-	382,825,695
	6411	POLES EXPENSE	2,051,998	-	-	-	2,051,998
	6421	AERIAL CABLE EXPENSE	227,863,475	13,403,804	-	-	241,267,279
	6422	UNDERGROUND CABLE EXPENSE	163,549,614	8,643,626	-	-	172,193,240
	6423	BURIED CABLE EXPENSE	176,779,166	8,953,151	-	-	185,732,317
	6424	SUBMARINE CABLE EXPENSE	11,009	-	-	-	11,009
	6426	INTRABUILDING NETWORK CABLE	136,280	-	-	-	136,280
	6431	AERIAL WIRE EXPENSE	689,112	-	-	-	689,112
	6441	CONDUIT SYSTEMS EXPENSE	11,558,030	-	-	-	11,558,030
	6512	PROVISIONING EXPENSE	4,000,364	-	-	-	4,000,364
	6531	POWER EXPENSE	53,728,888	-	-	-	53,728,888
	6532	NETWORK ADMINISTRATION EXPENSE	35,898,519	-	38,451,080	-	74,349,600
	Total	TESTING EXPENSE	205,019,244	11,652,007	-	-	216,671,251
	6534	PLANT OPERATIONS ADMIN EXPENSES	288,362,508	19,816,948	-	-	308,179,456
	6535	NETWORK ENGINEERING EXPENSE	177,384,102	344,140	-	-	177,728,242
	6540	ACCESS EXPENSE	318,271,652	(7,800,000)	-	-	310,471,652
	6561	DEPRECIATION EXPENSE - TELECOMM.	1,838,932,179	535,695,113	15,911,491	-	2,390,538,783
	6563	AMORTIZATION EXP - TANGIBLE PLANT	23,781,597	386,055	-	-	24,167,652

Pacific Bell
1999 MR (FCC) AND FR (CPUC) Trial Balances with Reconciling Data

MAJ ACCT	GL ACC	ACCOUNT	1999 MR Trial Balance	C3 Trial Balance	PBIS (IS) Trial Balance	Elimin (42) Trial Balance	Total FR Trial Balance
	6564	AMORTIZATION EXP - INTANGIBLES	-	-	1,407,163	-	1,407,163
	6565	AMORTIZATION EXPENSE - OTHER	20,183,526	1,507,489	-	-	21,691,015
	6611	PRODUCT MANAGEMENT EXPENSE	58,995,036	416,776	20,235,309	(91,781,316)	(12,134,195)
	6612	SALES EXPENSE	379,238,323	38,793,509	-	-	418,031,832
	6613	PRODUCT ADVERTISING EXPENSE	101,475,077	-	-	-	101,475,077
	6621	CALL COMPLETION SERVICES	39,960,411	-	-	-	39,960,411
	6622	NUMBER SERVICES	143,627,953	17,483,055	-	-	161,111,008
	6623	CUSTOMER SERVICES	884,939,463	87,711,880	47,678,426	-	1,020,329,768
	6711	EXECUTIVE EXPENSE	27,207,958	84,745	-	-	27,292,703
	Total	PLANNING EXPENSE	10,118,557	89,050	-	-	10,207,607
	6721	ACCOUNTING AND FINANCE EXPENSE	66,615,602	328,130	1,580,554	-	68,524,286
	6722	EXTERNAL RELATIONS EXPENSE	71,581,437	34,008	-	-	71,615,445
	6723	HUMAN RESOURCES EXPENSE	180,735,164	315,161	-	-	181,050,325
	6724	INFORMATION MANAGEMENT EXPENSE	518,997,498	44,913,447	-	-	563,910,945
	6725	LEGAL EXPENSE	49,059,144	-	-	-	49,059,144
	6726	PROCUREMENT EXPENSE	20,765,256	123,525	-	-	20,888,781
	6727	RESEARCH & DEVELOPMENT EXPENSE	(26,438)	-	-	-	(26,438)
	6728	OTHER GENERAL & ADMIN EXPENSE	212,230,639	(16,883,446)	73,720,214	(16,253,719)	252,813,687
	Total 6000	TOTAL OPERATING EXPENSE	7,617,828,343	765,386,439	198,984,237	(108,035,034)	8,474,163,985
7000							
	7110	INCOME FROM CUSTOM WORK	(236,661)	-	-	-	(236,661)
	7150	GAINS AND LOSSES FROM DISPOSITION	(6,258,297)	2,048,901	-	-	(4,209,396)
	7160	OTHER OPERATING GAINS AND LOSSES	(2,809,675)	-	(100,000)	-	(2,909,675)
	7210	OPERATING INVESTMENT TAX CREDIT -	(30,390,180)	(2,199,828)	-	-	(32,590,008)
	7220	OPERATING FEDERAL INCOME TAXES	309,783,634	-	16,519,718	-	326,303,352
	7230	OPERATING STATE AND LOCAL TAXES	108,407,124	-	4,586,323	-	112,993,447
	7240	OPERATING OTHER TAXES	180,212,132	(4,040,949)	1,003,916	-	177,175,099
	7250	PROV. FOR DEFERRED OPERATING	187,691,522	(302,534,544)	-	-	(114,843,022)
	7310	DIVIDEND INCOME	-	-	-	-	-
	7320	INTEREST INCOME	(5,127,578)	-	1,008,235	-	(4,119,343)
	7340	AFUDC-INTEREST	(33,264,783)	(12,932,333)	-	-	(46,197,116)
	7350	GAINS/LOSSES DISPOSITION OF	-	-	-	-	-
	7360	OTHER NONOPERATING INCOME	(18,434,224)	(7,989,122)	-	30,400,626	3,977,280
	7370	SPECIAL CHARGES	39,302,507	3,640	-	-	39,306,147
	7420	NONOPERATING FEDERAL INCOME	(7,813,941)	-	-	-	(7,813,941)
	7430	NONOPERATING STATE AND LOCAL	(1,653,292)	-	-	-	(1,653,292)
	7440	NONOPERATING OTHER TAXES	825,342	-	-	-	825,342
	7450	PROV. FOR DEFERRED NONOPER.	(3,946,921)	7,220,714	-	-	3,273,793
	7510	INTEREST ON FUNDED DEBT	331,245,928	6,677,836	-	-	337,923,764
	7520	INTEREST EXPENSE -CAPITAL LEASES	807,872	-	-	-	807,872
	7530	AMORTIZATON OF DEBT ISSUANCE	1,276,297	5,478	-	-	1,281,775
	7540	OTHER INTEREST DEDUCTIONS	107,116,542	(15,140,393)	28,500	-	92,004,650
	7610	EXTRAORDINARY INCOME CREDITS	-	-	722,553	-	722,553
	7620	EXTRAORDINARY INCOME CHARGES	337,932,000	-	(310,596)	-	337,621,404
	7640	PROV. DEF INCOME TAXES-	(137,707,290)	-	-	-	(137,707,290)
	7910	JURISDICTIONAL RATEMAKING	477,105,642	(477,105,642)	-	-	-
	Total 7000	OTHER INCOME	1,834,063,700	(805,986,241)	23,458,649	30,400,626	1,081,936,734
8000							
	8701 Total		-	-	-	-	-
	Grand Total		(0)	(115,283,337)	0	0	(115,283,337)

Attachment 3-4
Financial Reporting Structure

Pacific Bell
Financial Reporting Structure
1997

FCC Reporting

MR Results(Corp Code CA)

Part 64 Allocations

Regulated | Nonregulated

Part 36 Separations

Intrastate Regulated MR | Interstate Regulated MR Results (IEMR

CPUC Reporting

MR Results (Corp Code CA)

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C3 Adjustments (Corp Code C3)

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Subsidiary Results:

1. PB Information Services (Corp Code IS)
2. PB Directory (Corp Code DR)
3. PB Development (Corp Code DL)
4. PB Internet Services (Corp Code IT)
5. PB Network Integration (Corp Code NT)
6. PB Mobile Serices (Corp Code WL)
7. Subsidiary Eliminations (Corp Code 41)
8. Consolidated Eliminations (Corp Code 42)

equals

Total California FR Results (CA+C3+Sub Results) (IEMR Row 1)

Part 64 Allocations

Category I & II Results | Category III Results

P-CASS Allocations

Above the Line Cat. III | Below the Line Cat. III

Line Cat. III (IEMR Row 3) | Interstate Below the Line Cat. III

Note 1

SEC Reporting

MR Results (Corp Code CA)

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C3 Adjustments (Corp Code C3)

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C7 Adjustments (Corp Code C7)

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Subsidiary Results

equals

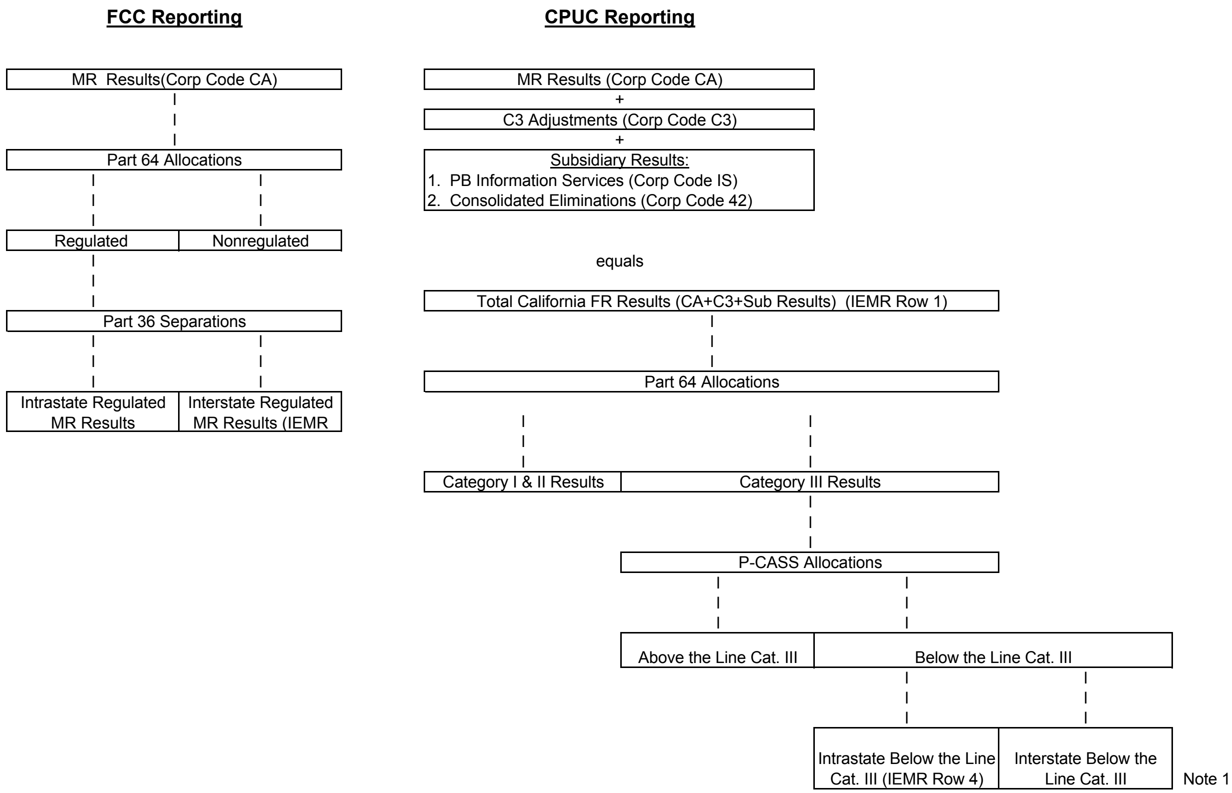
ER California Results

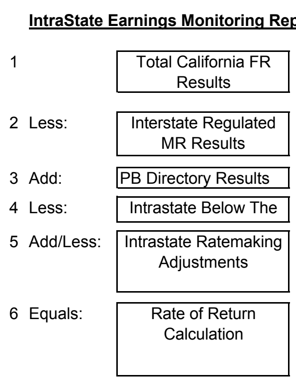
IntraState Earnings Monitoring Report

1		Total California FR Results
2	Less:	Interstate Regulated MR
3	Less:	Intrastate Below The Line Cat. III
4	Add/Less	Intrastate Ratemaking Adjustments
5	Equals:	Rate of Return Calculation

Note 1: Below-the-line Category III costs are further divided due to differences in product treatment between the FCC and the CPUC. For products that are regulated for FCC purposes and non-regulated for CPUC purposes, FCC regulated amounts already removed from Total California FR Results in FCC Part 36 Separations process (column B of IEMR) are removed from total below-the-line Category III costs to avoid double elimination of costs in the IEMR calculation.

Pacific Bell
Financial Reporting Structure
1998





Note 1: Below-the-line Category III costs are further divided due to differences in product treatment between the FCC and the CPUC. For products that are regulated for FCC purposes and non-regulated for CPUC purposes, FCC regulated amounts already removed from Total California FR Results in FCC Part 36 Separations process (column B of IEMR) are removed from total below-the-line Category III costs to avoid double elimination of costs in the IEMR calculation.

Pacific Bell
Financial Reporting Structure
1999

FCC Reporting

MR Results(Corp Code CA)

Part 64 Allocations

Regulated	Nonregulated

Part 36 Separations

Intrastate Regulated MR Results	Interstate Regulated MR Results (IEMR

CPUC Reporting

MR Results (Corp Code CA)

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C3 Adjustments (Corp Code C3)

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Subsidiary Results:
1. PB Information Services (Corp Code IS)
2. Consolidated Eliminations (Corp Code 42)

equals

Total California FR Results (CA+C3+Sub Results) (IEMR Row 1)

Part 64 Allocations

Category I & II Results	Category III Results

P-CASS Allocations

Above the Line Cat. III	Below the Line Cat. III

Intrastate Below the Line Cat. III (IEMR Row 4)	Interstate Below the Line Cat. III

Note 1

SEC Reporting

MR Results (Corp Code CA)

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C3 Adjustments (Corp Code C3)

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C7 Adjustments (Corp Code C7)

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Subsidiary Results

equals

ER California Results

IntraState Earnings Monitoring Report

1		Total California FR Results
2	Less:	Interstate Regulated MR Results
3	Add:	PB Directory Results
4	Less:	Intrastate Below The Line Cat. III
5	Add/Less:	Intrastate Ratemaking Adjustments
6	Equals:	Rate of Return Calculation

Note 1: Below-the-line Category III costs are further divided due to differences in product treatment between the FCC and the CPUC. For products that are regulated for FCC purposes and non-regulated for CPUC purposes, FCC regulated amounts already removed from Total California FR Results in FCC Part 36 Separations process (column B of the IEMR) are removed from total below-the-line Category III costs to avoid double elimination of costs in the IEMR calculation