

## Notes to Consolidated Financial Statements

Dollars in millions except per share amounts

### NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** Throughout this document, AT&T Inc. is referred to as "AT&T," "we" or the "Company." The consolidated financial statements include the accounts of the Company and our majority-owned subsidiaries and affiliates. Our subsidiaries and affiliates operate in the communications services industry throughout the U.S. and internationally, providing wireless and wireline telecommunications services and equipment as well as directory advertising and publishing services. On December 29, 2006, we acquired 100% of the outstanding common shares of BellSouth Corporation (BellSouth). BellSouth is a wholly-owned subsidiary, and the results of BellSouth's operations have been included in our consolidated financial statements after the December 29, 2006 acquisition date. For a detailed discussion of our acquisition, see Note 2.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships, joint ventures, and less-than-majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Prior to the closing of the BellSouth acquisition on December 29, 2006, we accounted for our joint ventures with BellSouth under the equity method since we shared control equally. Thus, for 2006 we recorded as equity income our proportionate share of economic ownership in these joint ventures, namely, 60% of AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC, and 66% of YELLOWPAGES.COM (YPC). AT&T Mobility and YPC became wholly-owned subsidiaries of AT&T on December 29, 2006. Earnings from certain foreign equity investments accounted for using the equity method are included for periods ended within up to one month of our year end (see Note 7).

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimates of probable losses and expenses. Actual results could differ from those estimates.

**FAS 159** In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (FAS 159). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value, providing the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FAS 159 is effective for fiscal years beginning after November 15, 2007. We elected not to adopt the fair value option for valuation of those assets and liabilities which are eligible, therefore there is no impact on our financial position and results of operations.

**FAS 160** In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" (FAS 160). FAS 160 requires noncontrolling interests held by parties other than the parent in subsidiaries be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity. FAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact FAS 160 will have on our financial position and results of operations.

**FAS 141(R)** In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations" (FAS 141(R)). FAS 141(R) is a revision of FAS 141 and requires that costs incurred to effect the acquisition (i.e., acquisition-related costs) be recognized separately from the acquisition. In addition, in accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), restructuring costs that the acquirer expected but was not obligated to incur, which included changes to benefit plans, were recognized as if they were a liability assumed at the acquisition date. FAS 141(R) requires the acquirer to recognize those costs separately from the business combination. We are currently evaluating the impact that FAS 141(R) will have on our accounting for acquisitions prior to the effective date of the first fiscal year beginning after December 15, 2008.

**FIN 48** We adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." The interpretation prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken within an income tax return. For each tax position, the enterprise must determine whether it is more likely than not that the position will be sustained upon examination based on the technical merits of the position, including resolution of any related appeals or litigation. A tax position that meets the more likely than not recognition threshold is then measured to determine the amount of benefit to recognize within the financial statements. No benefits may be recognized for tax positions that do not meet the more likely than not threshold. As required by FIN 48, on January 1, 2007, we reclassified deferred income tax liabilities of \$6,225 from our "Deferred income taxes" for unrecognized tax benefits, of which \$6,100 was included in "Other noncurrent liabilities" and \$175 was included in "Accrued taxes" on our consolidated balance sheets and the remaining \$50 was recorded as a reduction to the beginning-of-year retained earnings to reflect the cumulative effect of adoption of FIN 48 in the first quarter. In May 2007, the FASB issued further guidance on whether a tax position is effectively settled, the adoption of which did not have a material impact on our financial position.

**EITF 06-11** In June 2007, the Emerging Issues Task Force (EITF) ratified the consensus on EITF 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." EITF 06-11 provides that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for nonvested equity-classified share-based awards and equity-classified outstanding share options should be recognized as an increase to additional paid-in capital rather than a reduction of income tax expense. EITF 06-11 applies prospectively to the income tax benefits that result from dividends on equity-classified employee share-based payment awards that are declared in fiscal periods beginning after December 15, 2007. EITF 06-11 will not have a material impact on our financial position and results of operations.

**Reclassifications** We have reclassified certain amounts in prior-period financial statements to conform to the current period's presentation. Included among these, as a result of

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integration activities following our December 2006 acquisition of BellSouth, we revised our segment reporting in 2007 (see Note 4).

**Income Taxes** As discussed previously in this footnote, we adopted FIN 48 on January 1, 2007. Prior to our adoption of FIN 48, we provided deferred income taxes for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. With our adoption of FIN 48, we provide deferred income taxes for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax basis of assets and liabilities computed pursuant to FIN 48. Under FIN 48, the tax bases of assets and liabilities are based on amounts that meet the FIN 48 recognition threshold and are measured pursuant to the measurement requirement in FIN 48. To the extent allowed by GAAP, we provide valuation allowances against the deferred tax assets for which the realization is uncertain. We review these items regularly in light of changes in federal and state tax laws and changes in our business.

Investment tax credits earned prior to their repeal by the Tax Reform Act of 1986 are amortized as reductions in income tax expense over the lives of the assets, which gave rise to the credits. Additionally, we report taxes imposed by governmental authorities on revenue-producing transactions between us and our customers in the income statement on a net basis.

**Cash Equivalents** Cash and cash equivalents include all highly-liquid investments with original maturities of three months or less and the carrying amounts' approximate fair value. At December 31, 2007, we held \$889 in cash and \$1,081 in money market funds and other cash equivalents.

**Investment Securities** Investments in securities principally consist of available-for-sale instruments. Short-term and long-term investments in money market securities are carried as held-to-maturity securities. Available-for-sale securities consist of various debt and equity securities that are long term in nature. Unrealized gains and losses, net of tax, on available-for-sale securities are recorded in accumulated other comprehensive income. Our investment securities maturing within one year are recorded in "Other current assets" and instruments with maturities of more than one year are recorded in "Other Assets" on the consolidated balance sheets.

**Revenue Recognition** Revenues derived from wireless, local telephone, long-distance, data and video services are recognized when services are provided. This is based upon either usage (e.g., minutes of traffic processed), period of time (e.g., monthly service fees) or other established fee schedules. Our wireless service revenues are billed either in advance, arrears or are prepaid. Our wireless Rollover<sup>®</sup> rate plans include a feature whereby unused anytime minutes do not expire each month but rather are available, under certain conditions, for future use for a period not to exceed one year from the date of purchase. Using historical subscriber usage patterns, we defer these revenues based on an estimate of the portion of unused minutes expected to be utilized prior to expiration.

We record an estimated revenue reduction for future adjustments to customer accounts, other than a provision for doubtful accounts, at the time revenue is recognized based on historical experience. Service revenues also include billings to our customers for various regulatory fees imposed on us by governmental authorities. Cash incentives given to customers are recorded as a reduction of revenue. When required as part

of providing service, revenues and associated expenses related to nonrefundable, upfront service activation and setup fees are deferred and recognized over the associated service contract period. If no service contract exists, those fees are recognized over the average customer relationship period. Associated expenses are deferred only to the extent of such deferred revenue. For contracts that involve the bundling of services, revenue is allocated to the services based on their relative fair value. We record the sale of equipment to customers as gross revenue when we are the primary obligor in the arrangement, when title is passed and when the products are accepted by customers. For agreements involving the resale of third-party services in which we are not considered the primary obligor of the arrangement, we record the revenue net of the associated costs incurred. For contracts where we provide customers with an indefeasible right to use network capacity, we recognize revenue ratably over the stated life of the agreement.

We recognize revenues and expenses related to publishing directories on the amortization method, which recognizes revenues and expenses ratably over the life of the directory title, typically 12 months.

**Traffic Compensation Expense** We use various estimates and assumptions to determine the amount of traffic compensation expenses recognized during any reporting period. Switched traffic compensation costs are accrued utilizing estimated rates by product, formulated from historical data and adjusted for known rate changes and volume levels. Such estimates are adjusted monthly to reflect newly-available information, such as rate changes and new contractual agreements. Bills reflecting actual incurred information are generally not received until three to nine months subsequent to the end of the reporting period, at which point a final adjustment is made to the accrued switched traffic compensation expense. Dedicated traffic compensation costs are estimated based on the number of circuits and the average projected circuit costs. These costs are adjusted to reflect actual expenses over the three months following the end of the reporting period as bills are received.

**Allowance for Uncollectibles** We maintain an allowance for doubtful accounts for estimated losses that result from the failure or inability of our customers to make required payments. When determining the allowance, we consider the probability of recoverability of accounts receivable based on past experience, taking into account current collection trends as well as general economic factors, including bankruptcy rates. Credit risks are assessed based on historical write-offs, net of recoveries, as well as an analysis of the aged accounts receivable balances with reserves generally increasing as the receivable ages. Accounts receivable may be fully reserved for when specific collection issues are known to exist, such as pending bankruptcy or catastrophes. The analysis of receivables is performed monthly, and the bad-debt allowances are adjusted accordingly.

**Inventory** Inventories are included in "Other current assets" on our consolidated balance sheet and were \$1,119 and \$756 at December 31, 2007 and 2006, respectively. Wireless handsets and accessories, which are valued at the lower of cost or market value (determined using current replacement cost) amount to \$836 and \$467 for the years 2007 and 2006. The remainder of our inventory includes new

and reusable supplies and network equipment of our local telephone operations, which are stated principally at average original cost, except that specific costs are used in the case of large individual items. Inventories of our other subsidiaries are stated at the lower of cost or market.

**Property, Plant and Equipment** Property, plant and equipment is stated at cost, except for assets acquired using purchase accounting, which are recorded at fair value (see Note 2). The cost of additions and substantial improvements to property, plant and equipment is capitalized. The cost of maintenance and repairs of property, plant and equipment is charged to operating expenses. Property, plant and equipment is depreciated using straight-line methods over their estimated economic lives. Certain subsidiaries follow composite group depreciation methodology; accordingly, when a portion of their depreciable property, plant and equipment is retired in the ordinary course of business, the gross book value is reclassified to accumulated depreciation; no gain or loss is recognized on the disposition of this plant.

Property, plant and equipment is reviewed for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss shall be recognized only if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset.

The fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. In periods subsequent to initial measurement, period-to-period changes in the liability for an asset retirement obligation resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows are recognized. The increase in the carrying value of the associated long-lived asset is depreciated over the corresponding estimated economic life.

**Software Costs** It is our policy to capitalize certain costs incurred in connection with developing or obtaining internal-use software. Capitalized software costs are included in "Property, Plant and Equipment" on our consolidated balance sheets and are primarily amortized over a three-year period. Software costs that do not meet capitalization criteria are expensed immediately.

**Goodwill and Other Intangible Assets** Goodwill represents the excess of consideration paid over the fair value of net assets acquired in business combinations. Goodwill and other indefinite-lived intangible assets are not amortized but are tested at least annually for impairment. We have completed our annual impairment testing for 2007 and determined that no impairment exists. The significant increase in the carrying amount of our goodwill in 2006 primarily resulted from our acquisition of BellSouth.

Intangible assets that have finite useful lives are amortized over their useful lives, a weighted average of 7.4 years. Customer relationships are amortized using primarily the sum-of-the-months-digits method of amortization over the expected period in which those relationships are expected to contribute to our future cash flows based in such a way as to allocate it as equitably as possible to periods during which we expect to benefit from those relationships.

A significant portion of intangible assets in our wireless segment are Federal Communications Commission (FCC) licenses that provide us with the exclusive right to utilize certain radio frequency spectrum to provide wireless communications services. While FCC licenses are issued for a fixed time, renewals of FCC licenses have occurred routinely and at nominal cost. Moreover, we have determined that there are currently no legal, regulatory, contractual, competitive, economic or other factors that limit the useful lives of our FCC licenses, and therefore the FCC licenses are an indefinite-lived intangible asset under the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

In accordance with EITF No. 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets," we test FCC licenses for impairment on an aggregate basis, consistent with the management of the business on a national scope. We utilize a fair value approach, incorporating discounted cash flows, to complete the test. This approach determines the fair value of the FCC licenses and, accordingly, incorporates cash flow assumptions regarding the investment in a network, the development of distribution channels and other inputs for making the business operational. As these inputs are included in determining free cash flows of the business, the present value of the free cash flows is attributable to the licenses. The discount rate applied to the cash flows is consistent with our weighted-average cost of capital. During the fourth quarter of 2007, we completed the annual impairment tests for indefinite-lived FCC licenses. These annual impairment tests resulted in no impairment of indefinite-lived FCC licenses.

**Advertising Costs** Advertising costs for advertising products and services or for promoting our corporate image are expensed as incurred.

**Foreign Currency Translation** Our foreign investments and foreign subsidiaries generally report their earnings in their local currencies. We translate our share of their foreign assets and liabilities at exchange rates in effect at the balance sheet dates. We translate our share of their revenues and expenses using average rates during the year. The resulting foreign currency translation adjustments are recorded as a separate component of accumulated other comprehensive income in the accompanying consolidated balance sheets. Gains and losses resulting from exchange-rate changes on transactions denominated in a currency other than the local currency are included in earnings as incurred.

We have also entered into foreign currency contracts to minimize our exposure to risk of adverse changes in currency exchange rates. We are subject to foreign exchange risk for foreign currency-denominated transactions, such as debt issued, recognized payables and receivables and forecasted transactions. At December 31, 2007, our foreign currency exposures were principally Euros, British pound sterling, Danish krone and Japanese yen.

**Derivative Financial Instruments** We record derivatives on the balance sheet at fair value. We do not invest in derivatives for trading purposes. We use derivatives from time to time as part of our strategy to manage risks associated with our contractual commitments. These derivatives are designated as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or a hedge of a forecasted transaction or of

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the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). Our derivative financial instruments primarily include interest rate swap agreements and foreign currency exchange contracts. For example, we use interest rate swaps to manage our exposure to changes in interest rates on our debt obligations (see Note 9). We account for our interest rate swaps using mark-to-market accounting and include gains or losses from interest rate swaps when paid or received in interest expense in our consolidated statements of income. Amounts paid or received on interest rate forward contracts are amortized over the period of the related interest payments.

All other derivatives are not formally designated for accounting purposes (undesignated). These derivatives, although undesignated for accounting purposes, are entered into to hedge economic risks.

We record changes in the fair value of fair value hedges, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. Gains or losses upon termination of our fair value hedges are recognized as interest expense when the hedge instrument is settled.

We record changes in the fair value of cash flow hedges, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk, in "Accumulated other comprehensive income," which is a component of Stockholders' Equity. The settlement gains or costs on our cash flow hedges are amortized as interest expense over the term of the interest payments of the related debt issuances.

Changes in the fair value of undesignated derivatives are recorded in other income (expense), net, along with the change in fair value of the underlying asset or liability, as applicable.

Cash flows associated with derivative instruments are presented in the same category on the consolidated statements of cash flows as the item being hedged.

When hedge accounting is discontinued, the derivative is adjusted for changes in fair value through other income (expense), net. For fair value hedges, the underlying asset or liability will no longer be adjusted for changes in fair value, and any asset or liability recorded in connection with the hedging relationship (including firm commitments) will be removed from the balance sheet and recorded in current-period earnings. For cash flow hedges, gains and losses that were accumulated in other comprehensive income as a component of stockholders' equity in connection with hedged assets or liabilities or forecasted transactions will be recognized in other income (expense) – net, in the same period the hedged item affects earnings.

**Employee Separations** In accordance with Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits," (FAS 112) we establish obligations for expected termination benefits provided under existing plans to former or inactive employees after employment but before retirement. These benefits include severance payments, workers' compensation, disability, medical continuation coverage and other benefits. At December 31, 2007, we had severance accruals under FAS 112 of \$153, of which \$99 was established as merger-related severance accruals. At December 31, 2006, we had severance accruals of \$286.

**Pension and Postretirement Benefits** See Note 11 for a comprehensive discussion of our pension and postretirement benefit expense, including a discussion of the actuarial assumptions.

## NOTE 2. ACQUISITIONS, DISPOSITIONS, VALUATION AND OTHER ADJUSTMENTS

### Acquisitions

**Dobson** In November 2007, we acquired Dobson Communications Corporation (Dobson) for approximately \$2,500. Under the purchase method of accounting, the transaction was valued, for accounting purposes, at \$2,580. Our December 31, 2007 consolidated balance sheet includes the preliminary valuation of the fair value of Dobson's assets and liabilities, including goodwill of \$2,623, licenses of \$2,230, customer lists of \$517 and other intangible assets totaling \$8 associated with this transaction. The values of the assets and liabilities are subject to adjustment as additional information becomes available. When finalized, material adjustments to goodwill may result.

Dobson marketed wireless services under the Cellular One brand and had provided roaming services to AT&T subsidiaries since 1990. Dobson had 1.7 million subscribers across 17 states, mostly in rural and suburban areas with a population covered of more than 12.6 million people. Dobson's operations were incorporated into our wireless operations following the date of acquisition.

**BellSouth Corporation** In December 2006, we acquired BellSouth, issuing 2.4 billion shares. BellSouth was the leading communications service provider in the southeastern U.S., providing wireline communications services, including local exchange, network access, long-distance services and Internet services to substantial portions of the population across nine states. BellSouth also provided long-distance services to enterprise customers throughout the country.

We and BellSouth jointly owned AT&T Mobility and the Internet-based publisher YPC. In the AT&T Mobility joint venture, we held a 60% economic interest and BellSouth held a 40% economic interest, and in the YPC joint venture, we held a 66% economic interest and BellSouth held a 34% economic interest. For each joint venture, control was shared equally. We and BellSouth each accounted for the joint ventures under the equity method of accounting, recording the proportional share of AT&T Mobility's and YPC's income as equity in net income of affiliates on the respective consolidated statements of income and reporting the ownership percentage of AT&T Mobility's net assets as "Investments in and Advances to AT&T Mobility" and the ownership percentage of YPC's net assets as "Investments in Equity Affiliates" on the respective consolidated balance sheets. After the BellSouth acquisition, BellSouth, AT&T Mobility and YPC became wholly-owned subsidiaries of AT&T, and the operational results of these companies have been included in our consolidated financial statements since the December 29, 2006 acquisition date.

Under the purchase method of accounting, the transaction was valued, for accounting purposes, at approximately \$66,800. We conducted an appraisal of the assets and liabilities of BellSouth and AT&T Mobility for inclusion in the

balance sheet, adjusting 100% of BellSouth's and 40% of AT&T Mobility's values. Long-lived assets such as property, plant and equipment reflect a value of replacing the assets, which takes into account changes in technology, usage, and relative obsolescence and depreciation of the assets, sometimes referred to as a "Greenfield approach." This approach often results in differences, sometimes material, from recorded book values even if, absent the acquisition, the assets would not be impaired. In addition, assets and liabilities that would not normally be recorded in ordinary operations (i.e., customer relationships) were recorded at their acquisition values. Debt instruments and investments were valued in relation to current market conditions and other assets and liabilities were valued based on the acquiring company's estimates. After all values were assigned to assets and liabilities, the remainder of the purchase price was recorded as goodwill.

The following table summarizes the preliminary estimated fair values of the BellSouth assets acquired and liabilities assumed and related deferred income taxes as of the acquisition date and final adjustments made thereto.

	BellSouth Purchase Price Allocation		
	As of 12/31/06	Adjust- ments	As of 12/29/07
<b>Assets acquired</b>			
Current assets	\$ 4,875	\$ 6	\$ 4,881
Property, plant and equipment	18,498	225	18,723
Intangible assets not subject to amortization:			
Trademark/name	330	—	330
Licenses	214	100	314
Intangible assets subject to amortization:			
Customer lists and relationships	9,230	(25)	9,205
Patents	100	—	100
Trademark/name	211	—	211
Investments in AT&T Mobility	32,759	2,039	34,798
Other investments	2,446	(3)	2,443
Other assets	11,211	(168)	11,043
Goodwill	26,467	(1,554)	24,913
<b>Total assets acquired</b>	<b>106,341</b>	<b>620</b>	<b>106,961</b>
<b>Liabilities assumed</b>			
Current liabilities, excluding current portion of			
long-term debt	5,288	(427)	4,861
Long-term debt	15,628	(4)	15,624
Deferred income taxes	10,318	(89)	10,229
Postemployment benefit obligation	7,086	163	7,249
Other noncurrent liabilities	1,223	941	2,164
<b>Total liabilities assumed</b>	<b>39,543</b>	<b>584</b>	<b>40,127</b>
<b>Net assets acquired</b>	<b>\$ 66,798</b>	<b>\$ 36</b>	<b>\$ 66,834</b>

Adjustments were primarily related to finalization of participant count estimates used in the opening balance sheet valuation for the pension and postretirement plans, a gain on a contingency related to an insurance claim recovery for Hurricane Katrina damages, AT&T Mobility's purchase accounting adjustments and tax impacts related thereto, the valuation of certain licenses and a decrease in the estimate of relative obsolescence of property, plant and equipment resulting in an increase in value and longer average remaining economic life. Deferred tax adjustments are associated with the above-mentioned items.

BellSouth's 40% economic ownership of AT&T Mobility was recorded above as "Investment in AT&T Mobility" and was eliminated on our consolidated balance sheets. We recorded the consolidation of AT&T Mobility as a step acquisition, retaining 60% of AT&T Mobility's prior book value and adjusting the remaining 40% to fair value. The following table summarizes the preliminary estimated fair values (40%) and historical book values (60%) of the AT&T Mobility assets acquired and liabilities assumed and related deferred income taxes as of the acquisition date and final adjustments made thereto.

	Fair Value Adjustments AT&T Mobility		
	As of 12/31/06	Adjust- ments	As of 12/29/07
<b>Assets acquired</b>			
Current assets	\$ 6,988	\$ (1)	\$ 6,987
Property, plant and equipment	19,687	(569)	19,118
Intangible assets not subject to amortization:			
Licenses	33,979	887	34,866
Intangible assets subject to amortization:			
Customer lists and relationships	7,583	479	8,062
Trademark/names	343	(127)	216
Other	176	(44)	132
Other assets	1,086	13	1,099
Goodwill	27,429	1,989	29,418
<b>Total assets acquired</b>	<b>97,271</b>	<b>2,627</b>	<b>99,898</b>
<b>Liabilities assumed</b>			
Current liabilities, excluding current portion of			
long-term debt	7,014	647	7,661
Intercompany debt	9,043	—	9,043
Long-term debt	12,559	—	12,559
Deferred income taxes	5,459	(1)	5,458
Postemployment benefit obligation	301	93	394
Other noncurrent liabilities	2,007	(106)	1,901
<b>Total liabilities assumed</b>	<b>36,383</b>	<b>633</b>	<b>37,016</b>
<b>Net assets acquired</b>	<b>\$60,888</b>	<b>\$1,994</b>	<b>\$62,882</b>

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Adjustments were primarily related to valuation estimates that, due to the proximity of the merger to year-end, were based on data from periods prior to the close of the December 29, 2006 acquisition. Using the December 29, 2006 data, purchase price allocations decreased the opening balance sheet values of property, plant and equipment, trademark/names and other intangibles, offset by an increased value of licenses and customer lists and relationships acquired. Deferred tax adjustments are associated with the above-mentioned items.

Substantially all of the licenses acquired have an indefinite life, and accordingly, are not subject to amortization. The majority of customer relationship intangible assets are being amortized over a weighted-average period of 6.4 years using the sum-of-the-months-digits method. This method best reflects the estimated pattern in which the economic benefits will be consumed. Other intangible assets and other noncurrent liabilities include lease and sublease contracts, which are amortized over the remaining terms of the underlying leases and have a weighted-average amortization period of 6.4 years.

**AT&T Corp.** In November 2005, we acquired ATTC in a transaction accounted for under FAS 141, issuing 632 million shares. ATTC was one of the nation's leading business service communications providers, offering a variety of global communications services, including large domestic and multinational businesses, small and medium-size businesses and government agencies, and operated one of the leading telecommunications networks in the U.S. ATTC also provided domestic and international long-distance and usage-based-communications services to consumer customers. ATTC is now a wholly-owned subsidiary of AT&T and the results of ATTC's operations have been included in our consolidated financial statements after the November 18, 2005 acquisition date.

Under the purchase method of accounting, the transaction was valued, for accounting purposes, at \$15,517 and the assets and liabilities of ATTC were recorded at their respective fair values as of the date of the acquisition.

**Other Acquisitions** During 2007, we acquired Interwise®, a global provider of voice, Web and video conferencing services to businesses for \$122 and Ingenio®, a provider of Pay Per Call® technology for directory and local search business for \$195, net of cash. We recorded \$304 of goodwill related to these acquisitions.

During 2006, we acquired Comergent Technologies, Nistevo Corporation and USinternetworking, Inc., for a combined \$500, recording \$333 in goodwill. The acquisitions of these companies are designed to enhance our service offerings for Web hosting and application management. In January 2005, we acquired Yantra Corporation (Yantra) for \$169 in cash and recorded goodwill of \$98. Yantra is a provider of distributed order management and supply-chain fulfillment services.

### Dispositions

In May 2007, we sold to Clearwire Corporation (Clearwire), a national provider of wireless broadband Internet access, education broadband service spectrum and broadband radio service spectrum valued at \$300. Sale of this spectrum was required as a condition to the approval of our acquisition of BellSouth.

### Valuation and Other Adjustments

As ATTC and BellSouth stock options that were converted at the time of the respective acquisitions are exercised, the tax effect on those options may further reduce goodwill. During 2007, we recorded \$9 in related goodwill reductions for ATTC and \$33 for BellSouth.

Included in the current liabilities reported on our consolidated balance sheet are accruals established under EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination" (EITF 95-3). The liabilities include accruals for severance, lease terminations and equipment removal costs associated with our acquisitions of ATTC and BellSouth.

Included in the liabilities valued for the December 2006 acquisition of BellSouth was accrued severance of \$535 for BellSouth employees and \$44 for AT&T Mobility employees, all of which will be paid from company cash. In addition, we also reviewed, confirmed and developed plans affecting the integration of retail stores, administrative space and networks, including those acquired in AT&T Mobility's acquisition of AT&T Wireless Services, Inc. When these acquisition plans were finalized during 2007, we recorded additional accruals for severance, lease terminations and equipment removal costs at AT&T Mobility.

Following is a summary of the accruals recorded at December 31, 2006, cash payments made during 2007 and the purchase accounting adjustments thereto, for the acquisitions of ATTC and BellSouth.

	12/31/06 Balance	Cash Payments	Additional Accruals	Adjustments	12/31/07 Balance
Severance accruals paid from:					
Company funds	\$ 986	\$(417)	\$ 42	\$ (71)	\$ 540
Pension and postemployment benefit plans	183	(54)	—	—	129
Lease terminations	146	(149)	422	6	425
Equipment removal and other related costs	117	(125)	214	(45)	161
<b>Total</b>	<b>\$1,432</b>	<b>\$(745)</b>	<b>\$678</b>	<b>\$(110)</b>	<b>\$1,255</b>

### NOTE 3. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for the years ended December 31, 2007, 2006 and 2005 are shown in the table below:

Year Ended December 31,	2007	2006	2005
<b>Numerators</b>			
Numerator for basic earnings per share:			
Net Income	\$11,951	\$7,356	\$4,786
Dilutive potential common shares:			
Other stock-based compensation	8	7	10
Numerator for diluted earnings per share	\$11,959	\$7,363	\$4,796
<b>Denominators (000,000)</b>			
Denominator for basic earnings per share:			
Weighted-average number of common shares outstanding	6,127	3,882	3,368
Dilutive potential common shares:			
Stock options	24	4	1
Other stock-based compensation	19	16	10
Denominator for diluted earnings per share	6,170	3,902	3,379
<b>Basic earnings per share</b>	<b>\$ 1.95</b>	<b>\$ 1.89</b>	<b>\$ 1.42</b>
<b>Diluted earnings per share</b>	<b>\$ 1.94</b>	<b>\$ 1.89</b>	<b>\$ 1.42</b>

At December 31, 2007, 2006 and 2005, we had issued and outstanding options to purchase approximately 231 million, 309 million and 277 million shares of AT&T common stock. The exercise prices of options to purchase a weighted-average of 93 million, 201 million and 257 million shares in 2007, 2006, and 2005 exceeded the average market price of AT&T stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective periods. At December 31, 2007, the exercise prices of 162 million share options were below market price.

### NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. We analyze our various operating segments based on segment income before income taxes. Interest expense, interest income and other income (expense) – net are managed only on a total company basis and are, accordingly, reflected only in consolidated results. The wireless segment includes minority interest reported as other income (expense) – net in the consolidated statements of income. Therefore, these items are not included in the calculation of each segment's percentage of our consolidated results. As a result of the December 29, 2006 acquisition of BellSouth, we have revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segments. The customers and long-lived assets of our reportable segments are predominantly in the United States. We have four reportable segments: (1) wireless, (2) wireline, (3) advertising & publishing and (4) other.

The wireless segment provides voice, data and other wireless communications services, and includes 100% of the results of AT&T Mobility, which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. Prior to the acquisition, we analyzed AT&T Mobility's revenues and expenses under the wireless segment, and we eliminated the wireless segment in our consolidated financial statements. In our 2006 and prior consolidated financial statements, we reported our 60% proportionate share of AT&T Mobility's results as equity in net income of affiliates.

The wireline segment provides both retail and wholesale landline communications services, including local and long-distance voice, switched access, Internet protocol and Internet access data, messaging services, managed networking to business customers, AT&T U-verse<sup>SM</sup> TV service (U-verse) and satellite television services through our agency agreements with EchoStar Communications Corp. (EchoStar) and the DIRECTV Group, Inc.

The advertising & publishing segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. This segment also includes the results of YPC, which was a joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. For segment reporting disclosure, we have carried forward the deferred revenue and deferred cost balances for BellSouth at the acquisition date in order to reflect how the segment is managed. This is different for consolidated reporting purposes as under FAS 141, BellSouth deferred revenue and expenses from directories published during the 12-month period ending with the December 29, 2006 acquisition date, are not recognized and therefore were not included in the opening balance sheet. For management reporting purposes, we continue to amortize these balances over the life of the directory. Thus, our advertising & publishing segment results in 2007 include revenue of \$964 and expenses of \$308, related to directories published in the Southeast region during 2006, prior to our acquisition of BellSouth. These amounts are eliminated in the consolidations and eliminations column in the reconciliation below.

The other segment includes results from Sterling Commerce, Inc., customer information services and all corporate and other operations. This segment includes our portion of the results from our international equity investments. Prior to December 29, 2006, this segment also included our results from AT&T Mobility as equity in net income of affiliates, as discussed above.

In the following tables, we show how our segment results are reconciled to our consolidated results reported in accordance with GAAP. The Wireless, Wireline, Advertising & Publishing and Other columns represent the segment results of each such operating segment. The Consolidation and Elimination column adds in those line items that we manage on a consolidated basis only: interest expense, interest income and other income (expense) – net. This column also eliminates any intercompany transactions included in each segment's results as well as the advertising & publishing revenue and expenses in 2007 related to directories published in the Southeast region during 2006, mentioned previously. In 2006, since our 60% share of the results from AT&T Mobility is already included in the Other column, the Wireless Elimination column removes the non-consolidated results shown in the wireless segment.

**Notes to Consolidated Financial Statements (continued)**

Dollars in millions except per share amounts

Segment results, including a reconciliation to AT&amp;T consolidated results, for 2007, 2006 and 2005 are as follows:

At December 31, 2007 or for the year ended	Wireless	Wireline	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	\$ 42,574	\$ 69,565	\$ 5,771	\$ 1,982	\$ (964)	\$ 118,928
Intersegment revenues	110	2,012	80	252	(2,454)	—
Total segment operating revenues	42,684	71,577	5,851	2,234	(3,418)	118,928
Operations and support expenses	28,585	46,394	3,066	1,664	(2,762)	76,947
Depreciation and amortization expenses	7,079	13,411	924	163	—	21,577
Total segment operating expenses	35,664	59,805	3,990	1,827	(2,762)	98,524
Segment operating income	7,020	11,772	1,861	407	(656)	20,404
Interest expense	—	—	—	—	3,507	3,507
Equity in net income of affiliates	16	—	—	676	—	692
Minority interest	(198)	—	—	—	198	—
Other income (expense) – net	—	—	—	—	615	615
Segment income before income taxes	\$ 6,838	\$ 11,772	\$ 1,861	\$ 1,083	\$ (3,350)	\$ 18,204
Segment assets	\$105,953	\$168,048	\$14,910	\$183,075	\$(196,342)	\$275,644
Investment in equity method investees	13	—	—	2,257	—	2,270
Expenditures for additions to long-lived assets	3,745	13,693	25	254	—	17,717

At December 31, 2006 or for the year ended	Wireless	Wireline	Advertising & Publishing	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	\$37,537	\$ 57,473	\$ 3,634	\$ 1,702	\$ —	\$(37,291)	\$ 63,055
Intersegment revenues	—	5	51	176	(232)	—	—
Total segment operating revenues	37,537	57,478	3,685	1,878	(232)	(37,291)	63,055
Operations and support expenses	26,503	39,878	1,737	1,318	(233)	(26,343)	42,860
Depreciation and amortization expenses	6,462	9,676	3	167	—	(6,401)	9,907
Total segment operating expenses	32,965	49,554	1,740	1,485	(233)	(32,744)	52,767
Segment operating income	4,572	7,924	1,945	393	1	(4,547)	10,288
Interest expense	—	—	—	—	1,843	—	1,843
Equity in net income (loss) of affiliates	40	—	(17)	2,020	—	—	2,043
Minority interest	(169)	—	—	—	4	165	—
Other income (expense) – net	—	—	—	—	393	—	393
Segment income before income taxes	\$ 4,443	\$ 7,924	\$ 1,928	\$ 2,413	\$ (1,445)	\$ (4,382)	\$ 10,881
Segment assets	\$98,563	\$166,178	\$14,791	\$166,187	\$(175,085)	\$ —	\$270,634
Investment in equity method investees	3	—	—	1,992	—	—	1,995
Expenditures for additions to long-lived assets	7,039	8,147	2	171	—	(7,039)	8,320

At December 31, 2005 or for the year ended	Wireless	Wireline	Advertising & Publishing	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	\$34,468	\$ 38,454	\$ 3,625	\$ 1,650	\$ —	\$(34,433)	\$ 43,764
Intersegment revenues	—	—	59	81	(140)	—	—
Total segment operating revenues	34,468	38,454	3,684	1,731	(140)	(34,433)	43,764
Operations and support expenses	26,033	27,339	1,685	1,066	(137)	(26,033)	29,953
Depreciation and amortization expenses	6,608	7,426	5	182	(2)	(6,576)	7,643
Total segment operating expenses	32,641	34,765	1,690	1,248	(139)	(32,609)	37,596
Segment operating income	1,827	3,689	1,994	483	(1)	(1,824)	6,168
Interest expense	—	—	—	—	1,456	—	1,456
Equity in net income (loss) of affiliates	(11)	—	(5)	629	—	(4)	609
Minority interest	(103)	—	—	—	2	101	—
Other income (expense) – net	—	—	—	—	397	—	397
Segment income before income taxes	\$ 1,713	\$ 3,689	\$ 1,989	\$ 1,112	\$ (1,058)	\$ (1,727)	\$ 5,718

## NOTE 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is summarized as follows at December 31:

	Lives (years)	2007	2006
Land	—	\$ 1,860	\$ 1,925
Buildings	35-45	23,670	23,481
Central office equipment	3-10	70,632	63,997
Cable, wiring and conduit	10-50	68,676	64,483
Other equipment	5-15	32,606	33,448
Software	3-5	9,298	11,678
Under construction	—	3,776	3,137
		<b>210,518</b>	202,149
Accumulated depreciation and amortization		<b>114,628</b>	107,553
Property, plant and equipment – net		<b>\$ 95,890</b>	\$ 94,596

Our depreciation expense was \$15,625 in 2007, \$8,874 in 2006 and \$7,372 in 2005.

## NOTE 6. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amounts of goodwill, by segment, for the years ended December 31, 2007 and 2006, are as follows:

	Wireless	Wireline	Advertising & Publishing	Other	Total
Balance as of January 1, 2006	\$ —	\$ 12,795	\$ 8	\$ 1,252	\$ 14,055
Goodwill acquired:					
BellSouth acquisition	27,429	20,939	5,528	—	53,896
Other	—	197	128	139	464
Goodwill adjustment related to ATTC acquisition	—	(989)	—	—	(989)
Other	681	—	—	(450)	231
Balance as of December 31, 2006	28,110	32,942	5,664	941	67,657
Goodwill acquired	2,623	133	171	—	2,927
Goodwill adjustment related to BellSouth acquisition	1,989	(1,554)	—	—	435
Settlement of IRS audit	—	(123)	—	—	(123)
Goodwill adjustments for prior-year acquisitions and FIN 48	—	(44)	(51)	(32)	(127)
Other	(9)	(53)	4	2	(56)
<b>Balance as of December 31, 2007</b>	<b>\$32,713</b>	<b>\$31,301</b>	<b>\$5,788</b>	<b>\$ 911</b>	<b>\$70,713</b>

Goodwill is tested annually for impairment, with any impairments being expensed in that period's income statement. Due to the proximity of our acquisition of BellSouth to year-end 2006, we originally recorded all BellSouth assets, including goodwill, in our other segment. In 2007, in conjunction with our segment realignment (see Note 4) we moved the initial BellSouth goodwill to our wireline and advertising & publishing segments. During our allocation period, we completed purchase accounting adjustments to the AT&T Mobility and BellSouth goodwill (see Note 2). Other changes to goodwill include adjustments totaling \$42 for the tax effect of stock options exercised.

Certain facilities and equipment used in operations are leased under operating or capital leases. Rental expenses under operating leases were \$2,566 for 2007, \$869 for 2006, and \$473 for 2005. The future minimum rental payments under noncancelable operating leases for the years 2008 through 2012 are \$2,088, \$1,850, \$1,629, \$1,399 and \$1,223, with \$6,958 due thereafter. Capital leases are not significant.

### American Tower Corp. Agreement

In August 2000, we reached an agreement with American Tower Corp. (American Tower) under which we granted American Tower the exclusive rights to lease space on a number of our communications towers. In exchange, we received a combination of cash and equity instruments as complete prepayment of rent with the closing of each leasing agreement. The value of the prepayments was recorded as deferred revenue and recognized in income as revenue over the life of the leases. The balance of deferred revenue was \$539 in 2007, \$568 in 2006, and \$598 in 2005.

## Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

Our other intangible assets are summarized as follows:

	December 31, 2007		December 31, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Other Intangible Assets</b>				
Amortized intangible assets:				
Customer lists and relationships:				
AT&T Mobility	\$10,526	\$4,549	\$ 9,530	\$1,948
BellSouth	9,205	2,205	9,230	—
ATTC	3,050	1,653	3,050	1,082
Other	429	298	395	253
Subtotal	23,210	8,705	22,205	3,283
Other	1,873	1,191	1,973	714
<b>Total</b>	<b>\$25,083</b>	<b>\$9,896</b>	<b>\$24,178</b>	<b>\$3,997</b>
Indefinite life intangible assets not subject to amortization:				
Licenses	\$37,985		\$34,252	
Trade name	5,230		5,307	
<b>Total</b>	<b>\$43,215</b>		<b>\$39,559</b>	

Amortized intangible assets are definite-life assets, and as such, we record amortization expense based on a method that most appropriately reflects our expected cash flows from these assets with a weighted-average amortization period of 7.4 years (7.3 years for customer lists and relationships and 9.6 years for other). Amortization expense for definite-life intangible assets was \$5,952, \$1,033 and \$271 for the years ended December 31, 2007, 2006 and 2005, respectively. Amortization expense is estimated to be \$4,430 in 2008, \$3,540 in 2009, \$2,740 in 2010, \$1,820 in 2011 and \$1,200 in 2012.

Licenses include FCC licenses of \$37,948 that provide us with the exclusive right to utilize certain radio frequency spectrum to provide wireless communications services. While FCC licenses are issued for a fixed time, renewals of FCC licenses have occurred routinely and at nominal cost. Moreover, we have determined that there are currently no legal, regulatory, contractual, competitive, economic or other factors that limit the useful lives of our FCC licenses and therefore, treat the FCC licenses as an indefinite-lived intangible asset.

### NOTE 7. EQUITY METHOD INVESTMENTS

Investments in partnerships, joint ventures, and less-than-majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Until our acquisition of BellSouth in December 2006 (see Note 2), we accounted for our 60% economic interest in AT&T Mobility under the equity method since we shared control equally with BellSouth, our 40% economic partner. We had equal voting rights and representation on the board of directors that controlled AT&T Mobility. As a result of the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary of AT&T and is reported in our wireless segment and our consolidated statements of income.

**AT&T Mobility** As of December 29, 2006, we report AT&T Mobility as a wholly-owned subsidiary.

The following table presents summarized operating results for AT&T Mobility prior to the December 29, 2006 BellSouth acquisition:

	2006	2005
<b>Income Statements</b>		
Operating revenues	\$37,291	\$34,433
Operating income	4,547	1,824
Net income	2,513	333

**Equity Method Investments** Our investments in equity affiliates include primarily international investments. As of December 31, 2007, our investments in equity affiliates included a 9.3% interest in Teléfonos de México, S.A. de C.V. (Telmex), Mexico's national telecommunications company, and an 8.2% interest in América Móvil S.A. de C.V. (América Móvil), primarily a wireless provider in Mexico, with telecommunications investments in the United States and Latin America. We are a member of a consortium that holds all of the class AA shares of Telmex stock, representing voting control of the company. Another member of the consortium, Carso Global Telecom, S.A. de C.V., has the right to appoint a majority of the directors of Telmex. We also are a member of a consortium that holds all of the class AA shares of América Móvil stock, representing voting control of the company. Another member of the consortium, Americas Telecom S.A. de C.V., has the right to appoint a majority of the directors of América Móvil. On November 14, 2007, Telmex's board of directors approved a strategic initiative to divide the company into two separate companies. The initiative calls for Telmex to split off all of its Latin American businesses and its Mexican yellow pages business to a new holding company, Telmex Internacional. The spin-off was approved by shareholders on December 21, 2007. The proposed spin-off will be subject to compliance with the regulatory requirements in Mexico and other jurisdictions.

The following table is a reconciliation of our investments in equity affiliates as presented on our consolidated balance sheets:

	2007	2006
Beginning of year	\$1,995	\$2,031
Additional investments	8	5
Equity in net income of affiliates	692	535
Dividends received	(395)	(97)
Currency translation adjustments	(18)	(22)
Other adjustments	(12)	(457)
End of year	\$2,270	\$1,995

Undistributed earnings from equity affiliates were \$2,335 and \$2,038 at December 31, 2007 and 2006, respectively. The currency translation adjustment for 2007 and 2006 primarily reflects the effect of exchange rate fluctuations on our investments in Telmex and América Móvil. "Other adjustments" for 2006 consisted primarily of \$375 representing the consolidation of Cellular Communications of Puerto Rico, YPC and other domestic wireless investments as wholly-owned subsidiaries of AT&T as a result of the BellSouth acquisition and \$75 representing purchase accounting revaluation of equity investments in ATTC.

The fair value of our investment in Telmex, based on the equivalent value of Telmex L shares at December 31, 2007, was \$3,315. The fair value of our investment in América Móvil, based on the equivalent value of América Móvil L shares at December 31, 2007, was \$8,808.

## NOTE 8. DEBT

Long-term debt of AT&T and its subsidiaries, including interest rates and maturities, is summarized as follows at December 31:

	2007	2006	
Notes and debentures			
Interest Rates		Maturities	
4.03% – 5.98%	2007 – 2054	\$23,324	\$18,571
6.00% – 7.88%	2007 – 2097	29,282	24,685
8.00% – 9.10%	2007 – 2031	7,114	8,626
Other		136	141
Fair value of interest rate swaps		88	(80)
	59,944	51,943	
Unamortized premium, net of discount	2,049	2,323	
Total notes and debentures	61,993	54,266	
Capitalized leases	201	211	
Total long-term debt, including current maturities	62,194	54,477	
Current maturities of long-term debt	(4,939)	(4,414)	
Total long-term debt	\$57,255	\$50,063	

On December 29, 2006, we included on our balance sheet \$28,321 in long-term debt and capital leases related to our acquisition of BellSouth (see Note 2). The debt of AT&T Mobility was included in that amount since it is now a subsidiary of AT&T. BellSouth's and AT&T Mobility's long-term debt included both fixed and floating interest rates with a weighted-average rate of 6.7% (ranging from 4.2% to 8.8%)

and had maturities ranging from 2007 to 2097. Included in our "Total notes and debentures" balance in the table above was the face value of acquired debt from BellSouth and AT&T Mobility of \$25,234, which had a carrying amount of \$26,968 at December 31, 2006.

Included in the table above at December 31, 2006, was \$1,734 representing the remaining excess of the fair value over the recorded value of debt in connection with the acquisition of BellSouth and AT&T Mobility. The excess is amortized over the remaining lives of the underlying debt obligations.

We have debt instruments that may require us to repurchase the debt or which may alter the interest rate associated with that debt. We have \$1,000 of Puttable Reset Securities (PURS) at 4.2% maturing in 2021 with an annual put option by the holder. If the holders of our PURS do not require us to repurchase the securities, the interest rate will be reset based on current market conditions. Since these securities can be put to us annually, the balance is included in current maturities of long-term debt in our balance sheet.

Beginning in May 2009, our \$500 zero-coupon puttable note may be presented for redemption by the holder at specified dates, but not more frequently than annually, excluding 2011. If the note is held to maturity in 2022, the redemption amount will be \$1,030.

As of December 31, 2007 and 2006, we were in compliance with all covenants and conditions of instruments governing our debt. Substantially all of our outstanding long-term debt is unsecured. Excluding capitalized leases and the effect of interest rate swaps, the aggregate principal amounts of long-term debt and the corresponding weighted-average interest rate scheduled for repayment are as follows:

	2008	2009	2010	2011	2012	There-after
Debt repayments	\$4,926	\$5,965	\$3,766	\$7,534	\$4,894	\$32,771
Weighted-average interest rate	5.5%	4.9%	6.2%	7.1%	6.6%	6.4%

## Financing Activities

**Debt** During 2007, debt repayments totaled \$10,183 and consisted of:

- \$3,871 related to debt repayments with a weighted-average interest rate of 6.1%, which included the early redemption of debt related to a put exercise on \$1,000 of our 4.2% PURS and called debt of \$500 with an interest rate of 7.0%.
- \$3,411 related to repayments of commercial paper and other short-term bank borrowings.
- \$1,735 related to the early redemption of Dobson debt acquired with a par value of \$1,599 and a weighted-average interest rate of 9.1%.
- \$904 related to the early repayment of a Dobson long-term credit facility.
- \$218 related to the early redemption of a convertible note held by Dobson.
- \$44 related to scheduled principal payments on other debt and repayments of other borrowings.

## Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

During 2007, we received net proceeds of \$11,367 from the issuance of \$11,499 in long-term debt. Debt proceeds were used for general corporate purposes, and parts of the proceeds were used for repurchases of our common stock. Long-term debt issuances consisted of:

- \$2,000 of 6.3% global notes due in 2038.
- \$2,000 of 6.5% global notes due in 2037.
- €1.25 billion of 4.375% notes due in 2013 (equivalent to U.S. \$1,641 when issued).
- \$1,500 of floating-rate notes due in 2010.
- \$1,200 of 6.375% retail notes due in 2056.
- £600 million of 5.5% notes due in 2027 (equivalent to U.S. \$1,158 when issued).
- \$1,000 of 4.95% notes due in 2013.
- \$500 of 5.625% notes due in 2016.
- \$500 of zero-coupon puttable notes due in 2022.

In February 2008, we received net proceeds of \$3,972 from the issuance of \$4,000 in long-term debt. The long-term debt issued consisted of the following:

- \$2,500 of 5.5% global notes due in 2018.
- \$750 of 4.95% global notes due in 2013.
- \$750 of 6.3% global notes due in 2038.

Debt maturing within one year consists of the following at December 31:

	2007	2006
Commercial paper	\$1,859	\$5,214
Current maturities of long-term debt	4,939	4,414
Bank borrowings <sup>1</sup>	62	105
Total	\$6,860	\$9,733

<sup>1</sup>Primarily represents borrowings, the availability of which is contingent on the level of cash held by some of our foreign subsidiaries.

The weighted-average interest rate on commercial paper debt at December 31, 2007 and 2006 was 4.2% and 5.3%, respectively.

**Credit Facility** We have a five-year \$10,000 credit agreement with a syndicate of investment and commercial banks, which we have the right to increase up to an additional \$2,000, provided no event of default under the credit agreement has occurred. The current agreement will expire in July 2011. We also have the right to terminate, in whole or in part, amounts committed by the lenders under this agreement in excess of any outstanding advances; however, any such terminated commitments may not be reinstated. Advances under this agreement may be used for general corporate purposes, including support of commercial paper borrowings and other short-term borrowings. There is no material adverse change provision governing the drawdown of advances under this credit agreement. This agreement contains a negative pledge covenant, which requires that, if at any time we or a subsidiary pledge assets or otherwise permits a lien on its properties, advances under this agreement will be ratably secured, subject to specified exceptions. We must maintain a debt-to-EBITDA (earnings before interest, income taxes, depreciation and amortization, and other modifications described in the agreement) financial ratio covenant of not more than three-to-one as of the last day of each fiscal quarter for the four quarters then ended. We comply with all covenants under the agreement. We had no borrowings outstanding under committed lines of credit as of December 31, 2007 or 2006.

Defaults under the agreement, which would permit the lenders to accelerate required payment, include nonpayment of principal or interest beyond any applicable grace period; failure by AT&T or any subsidiary to pay when due other debt above a threshold amount that results in acceleration of that debt (commonly referred to as “cross-acceleration”) or commencement by a creditor of enforcement proceedings within a specified period after a money judgment above a threshold amount has become final; acquisition by any person of beneficial ownership of more than 50% of AT&T common shares or a change of more than a majority of AT&T’s directors in any 24-month period other than as elected by the remaining directors (commonly referred to as a “change-of-control”); material breaches of representations in the agreement; failure to comply with the negative pledge or debt-to-EBITDA ratio covenants described above; failure to comply with other covenants for a specified period after notice; failure by AT&T or certain affiliates to make certain minimum funding payments under Employee Retirement Income Security Act of 1974, as amended (ERISA); and specified events of bankruptcy or insolvency.

### NOTE 9. FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of our long-term debt, including current maturities, and other financial instruments, are summarized as follows at December 31:

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	\$61,993	\$62,544	\$54,266	\$54,566
Commercial paper	1,859	1,859	5,214	5,214
Bank borrowings	62	62	105	105
Available-for-sale equity securities	2,735	2,735	2,731	2,731
EchoStar note receivable	491	489	478	467

The fair values of our notes and debentures were estimated based on quoted market prices, where available, or on the net present value method of expected future cash flows using current interest rates. The carrying value of debt with an original maturity of less than one year approximates market value.

The fair value of our EchoStar note receivable was estimated based on a valuation. The carrying amount of this note was based on the present value of cash and interest payments, which will be accreted on the note up to the face value of \$500 on a straight-line basis through August 2008.

Our available-for-sale equity securities are carried at fair value, and realized gains and losses on these equity securities were included in “Other income (expense) – net” in the consolidated statements of income. The fair value of our available-for-sale equity securities was principally determined based on quoted market prices, and the carrying amount of the remaining securities approximates fair value.

Our short-term investments, other short-term and long-term held-to-maturity investments and customer deposits are recorded at amortized cost, and the carrying amounts approximate fair values. We held other short-term marketable securities of \$1 at December 31, 2007 compared to \$477 at December 31, 2006.

**Derivatives** We use interest rate swaps, interest rate forward contracts and foreign currency exchange contracts to manage our market risk changes in interest rates and foreign exchange rates. We do not use financial instruments for trading or speculative purposes. Each swap matches the exact maturity dates of the underlying debt to which they are related, allowing for perfectly-effective hedges. Each utilized forward contract matches the interest payments of the underlying debt to which they are related, allowing for perfectly-effective hedges.

**Interest Rate Swaps** We had fair value interest rate swaps with a notional value of \$3,250 at December 31, 2007, and \$5,050 at December 31, 2006, with a net carrying and fair value asset of \$88 and liability of \$80, respectively. The net fair value liability at December 31, 2006 was comprised of a liability of \$86 and an asset of \$6. Included in the fair value interest rate swap notional amount for 2006 were interest rate swaps with a notional value of \$1,800, which were acquired as a result of our acquisition of BellSouth on December 29, 2006. These swaps were unwound in January 2007.

**Interest Rate Foreign Currency Swaps** We have combined interest rate foreign currency swap agreements for Euro-denominated debt and British pound sterling-denominated debt, which hedge our risk to both interest rate and currency movements. In March 2007, we entered into fixed-to-fixed cross-currency swaps on foreign-currency-denominated debt instruments with a U.S. dollar notional value of \$2,799 to hedge our exposure to changes in foreign currency exchange rates. These hedges include initial and final exchanges of principal from fixed foreign denominations to fixed U.S.-denominated amounts, to be exchanged at a specified rate, which was determined by the market spot rate upon issuance. They also include an interest rate swap of a fixed foreign-denominated rate to a fixed U.S.-denominated interest rate. These derivatives have been designated at inception and qualify as cash flow hedges with a net fair value of \$114 at December 31, 2007. These swaps are valued using current market quotes, which were obtained from dealers.

In November 2006, we repaid the notional amount of a foreign currency swap of \$636. Upon repayment we unwound our swap asset of \$284. Additionally, we repaid the collateral associated with the swap contract of \$150, which was received by us over the term of the swap agreement.

**Interest Rate Locks** We entered into interest rate forward contracts to partially hedge interest expense related to our debt issuances. During 2008, we expect to reclassify into earnings net settlement expenses of approximately \$8 to \$9, net of tax. The following table summarizes our interest rate lock activity:

Rate Lock Execution Period	Notional Amount	Utilized Notional Amount	Settlement Gain/(Cost)	Settlement Gain/(Cost) – net of tax
2007	\$1,800	\$1,800	\$ (8)	\$ (5)
2006	750	600	4	3
2005	500	500	(2)	(1)
2004	5,250	5,250	(302)	(196)

**Foreign Currency Forward Contracts** We enter into foreign currency forward contracts to manage our exposure to

changes in currency exchange rates related to foreign-currency-denominated transactions. At December 31, 2007 and 2006, our foreign exchange contracts consisted principally of Euros, British pound sterling, Danish krone and Japanese yen. At December 31, 2007, the notional amounts under contract were \$345, of which none were designated as net investment hedges. At December 31, 2006, the notional amounts under contract were \$440, of which \$6 were designated as net investment hedges. The remaining contracts in both periods were not designated for accounting purposes. At December 31, 2007 and 2006, these foreign exchange contracts had a net carrying and fair value liability of less than \$2. These contracts were valued using current market quotes, which were obtained from independent sources.

#### NOTE 10. INCOME TAXES

Significant components of our deferred tax liabilities (assets) are as follows at December 31:

	2007	2006
Depreciation and amortization	\$17,004	\$21,016
Intangibles (nonamortizable)	1,990	2,271
Equity in foreign affiliates	231	515
Employee benefits	(6,121)	(9,667)
Currency translation adjustments	(287)	(261)
Allowance for uncollectibles	(388)	(385)
Net operating loss and other carryforwards	(2,838)	(2,981)
Investment in wireless partnership	13,997	12,580
Other – net	(1,763)	300
Subtotal	21,825	23,388
Deferred tax assets valuation allowance	1,070	984
Net deferred tax liabilities	\$22,895	\$24,372
Net long-term deferred tax liabilities	\$24,939	\$27,406
Less: Net current deferred tax assets	(2,044)	(3,034)
Net deferred tax liabilities	\$22,895	\$24,372

At December 31, 2007, we had combined net operating and capital loss carryforwards (tax effected) for federal, and for state and foreign income tax purposes of \$1,289 and \$1,207, respectively, expiring through 2026. The federal net operating loss carryforward primarily relates to the acquisitions of AT&T Wireless Services, Inc. in 2004 and Dobson in 2007. Additionally, we had federal and state credit carryforwards of \$100 and \$242, respectively, expiring primarily through 2024.

We recognize a valuation allowance if, based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of a deferred tax asset will not be realized. Our valuation allowances at December 31, 2006 and 2007 relate primarily to state net operating loss carryforwards. The net increase in the valuation allowance for 2007 results from the acquisition of Dobson and the generation of additional state net operating losses, the ultimate realization of which are not more-likely-than-not. Future adjustments (prior to the effective date of FAS 141(R)) to the valuation allowance attributable to the ATTC, BellSouth, AT&T Mobility, and Dobson opening balance sheet items may be required to be allocated to goodwill and other purchased intangibles. After the effective date of FAS 141(R), changes to these valuation allowances may be reflected in income tax expense.

## Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

On January 1, 2007, we adopted FIN 48 (see Note 1) and, as required, we reclassified \$6,225 from net deferred tax liabilities to unrecognized tax benefits. As a result of the implementation of FIN 48, we recognized a \$50 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. A reconciliation of the change in our unrecognized tax benefits (UTB) balance from January 1, 2007 to December 31, 2007, is as follows:

	Federal, State and Foreign Tax	Accrued Interest and Penalties	Gross Unrecognized Income Tax Benefits	Deferred Federal and State Income Tax Benefits	Unrecognized Income Tax Benefits, Net of Deferred Federal and State Benefits
Balance at January 1, 2007	\$ 4,895	\$ 1,380	\$ 6,275	\$ (846)	\$ 5,429
Increases for tax positions related to the current year	429	—	429	(30)	399
Increases for tax positions related to prior years	1,324	606	1,930	(315)	1,615
Decreases for tax positions related to prior years	(478)	(298)	(776)	93	(683)
Settlements	(269)	(10)	(279)	17	(262)
Balance at December 31, 2007	5,901	1,678	7,579	(1,081)	6,498
Less: tax attributable to timing items included above	(3,911)	—	(3,911)	189	(3,722)
Less: UTB included above that relate to acquired entities that would impact goodwill if recognized	(623)	(174)	(797)	216	(581)
<b>Total UTB that, if recognized, would impact the effective income tax rate as of December 31, 2007</b>	<b>\$ 1,367</b>	<b>\$ 1,504</b>	<b>\$ 2,871</b>	<b>\$ (676)</b>	<b>\$ 2,195</b>

In the fourth quarter of 2007, we made a deposit of \$1,000 related to the AT&T Inc. 2000 – 2002 IRS examination cycle. This deposit is not included in the reconciliation above but reduces our unrecognized tax benefits balance. Net of this deposit, our unrecognized tax benefits balance at December 31, 2007, was \$6,579, of which \$5,894 was included in “Other noncurrent liabilities” and \$685 was included in “Accrued taxes” on our consolidated balance sheets. We expect to pay \$685 within one year, but we cannot reasonably estimate the timing or amounts of additional cash payments, if any, at this time.

A portion of our unrecognized tax benefits relates to pre-acquisition uncertain tax positions of ATTC, BellSouth and AT&T Mobility. Future adjustments (prior to the effective date of FAS 141(R)) to these unrecognized tax benefits may be required to be allocated to goodwill and other purchased intangibles. After the effective date of FAS 141(R), adjustment of these unrecognized tax benefits may be reflected in income tax expense.

We record interest and penalties related to federal, state and foreign unrecognized tax benefits in income tax expense. Accrued interest and penalties included in unrecognized tax benefits were \$1,380 and \$1,678 as of January 1, 2007 and December 31, 2007, respectively. Interest and penalties included in our consolidated statements of income were \$303 for both December 31, 2007 and 2006.

The Company and our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. Our income tax returns are regularly audited and reviewed by the IRS as well as by state and foreign taxing authorities.

The IRS has completed field examinations of AT&T’s tax returns through 2002, and all audit periods prior to 1998 are closed for federal purposes. We were unable

to reach agreement with the IRS on one issue related to our 1998 and 1999 tax returns and, as a result, we have filed a refund suit in U.S. District Court. We are engaged with the IRS Appeals Division (Appeals) in settling our 2000 – 2002 returns and may reach a resolution of this examination cycle during the next 12 months. At this time, we are not able to determine the impact that resolution may have on our unrecognized tax benefits. The IRS is currently examining the AT&T 2003 – 2005 tax returns, and we expect their fieldwork to be completed during 2008.

The IRS has completed the examination of all acquired entity tax returns through 2003 (ATTC through 2004) and, with the exception of BellSouth, all years through 2001 are closed. We expect to settle the ATTC 2005 examination within the next 12 months with an immaterial impact on our unrecognized tax benefits. Appeals has issued BellSouth an assessment for years 1999 – 2001, which was paid during the second quarter, and we are reviewing our options with this case.

The components of income tax expense are as follows:

	2007	2006	2005
Federal:			
Current	\$5,903	\$3,344	\$1,385
Deferred – net	(413)	(139)	(681)
Amortization of investment tax credits	(31)	(28)	(21)
	<b>5,459</b>	<b>3,177</b>	<b>683</b>
State, local and foreign:			
Current	621	295	226
Deferred – net	173	53	23
	<b>794</b>	<b>348</b>	<b>249</b>
Total	<b>\$6,253</b>	<b>\$3,525</b>	<b>\$ 932</b>

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate (35%) to income before income taxes, income from discontinued operations, extraordinary items and cumulative effect of accounting changes is as follows:

	2007	2006	2005
Taxes computed at federal statutory rate	\$6,371	\$3,809	\$2,001
Increases (decreases) in income taxes resulting from:			
State and local income taxes – net of federal income tax benefit	549	234	176
Effects of international operations	(178)	(200)	(70)
Medicare reimbursements	(120)	(123)	(95)
Equity in net income of affiliates	—	(218)	(35)
Tax settlements	—	—	(902)
Other – net	(369)	23	(143)
<b>Total</b>	<b>\$6,253</b>	<b>\$3,525</b>	<b>\$ 932</b>
<b>Effective Tax Rate</b>	<b>34.4%</b>	<b>32.4%</b>	<b>16.3%</b>

In December 2005, we reached an agreement with the IRS to settle certain claims, principally related to the utilization of capital losses and tax credits for years 1997 – 1999. Included in the settlement was relief from previous assessments and agreement on multiple items challenged by the IRS in the course of routine audits. As we had previously paid the assessments in full and filed refund claims with the IRS, the settlement resulted in our recognition of approximately \$902 of reduced income tax expense in 2005.

Effects of international operations include items such as foreign tax credits, sales of foreign investments and the effects of undistributed earnings from international operations. We do not provide deferred taxes on the undistributed earnings of subsidiaries operating outside the United States that have been or are intended to be permanently reinvested. The amount of undistributed earnings for which we have not recorded deferred taxes is not material.

## NOTE 11. PENSION AND POSTRETIREMENT BENEFITS

### Pension Benefits

Substantially all of our U.S. employees are covered by one of our noncontributory pension and death benefit plans. Many of our management employees participate in pension plans that have a traditional pension formula (i.e., a stated percentage of employees' adjusted career income) and a frozen cash balance or defined lump sum formula. In 2005, the management pension plan for those employees was amended to freeze benefit accruals previously earned under a cash balance formula. Each employee's existing cash balance continues to earn interest at a variable annual rate. After this change, those management employees, at retirement, may elect to receive the portion of their pension benefit derived under the cash balance or defined lump sum as a lump sum or an annuity. The remaining pension benefit, if any, will be paid as an annuity if its value exceeds a stated monthly amount. Management employees of former ATTC, BellSouth and AT&T Mobility participate in cash balance pension plans. Nonmanagement employees' pension benefits are generally calculated using one of two formulas: benefits are based on

a flat dollar amount per year according to job classification or are calculated under a cash balance plan that is based on an initial cash balance amount and a negotiated annual pension band and interest credits. Most nonmanagement employees can elect to receive their pension benefits in either a lump sum payment or an annuity.

In April 2007, we announced a one-time increase to certain retiree pension annuity payments, an average increase of 3.2% by group of retiree count. This pension adjustment is for pre-1996 retirees and is reflected below as a plan amendment.

At December 31, 2007, defined pension plans formerly sponsored by Ameritech Publishing Ventures and AT&T Mobility were merged in the AT&T Pension Benefit Plan. At December 31, 2006, certain defined pension plans formerly sponsored by ATTC and AT&T Mobility were also merged into the AT&T Pension Benefit Plan.

### Postretirement Benefits

We provide a variety of medical, dental and life insurance benefits to certain retired employees under various plans and accrue actuarially-determined postretirement benefit costs as active employees earn these benefits.

### Obligations and Funded Status

For defined benefit pension plans, the benefit obligation is the "projected benefit obligation," the actuarial present value, as of our December 31 measurement date, of all benefits attributed by the pension benefit formula to employee service rendered to that date. The amount of benefit to be paid depends on a number of future events incorporated into the pension benefit formula, including estimates of the average life of employees/survivors and average years of service rendered. It is measured based on assumptions concerning future interest rates and future employee compensation levels.

For postretirement benefit plans, the benefit obligation is the "accumulated postretirement benefit obligation," the actuarial present value as of a date of all future benefits attributed under the terms of the postretirement benefit plan to employee service rendered to that date.

In conjunction with the 2006 BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary. BellSouth and AT&T Mobility sponsored noncontributory defined benefit pension plans covering the majority of their U.S. employees. In accordance with GAAP, when an employer is acquired as part of a merger, any excess of projected benefit obligation over the plan assets is recognized as a liability and any excess of plan assets over the projected benefit obligation is recognized as a plan asset. The recognition of a new liability or a new asset by the acquirer, at the date of the merger, results in the elimination of any (a) previously existing unrecognized net gain or loss, (b) unrecognized prior service cost and (c) unrecognized net transition obligation. In addition, the accumulated postretirement benefit obligations are to be measured using actuarial assumptions and terms of the substantive plans, as determined by the purchaser. As such, and consistent with our practice, we did not account for the annual dollar value cap of medical and dental benefits in the value of the accumulated postretirement benefit obligation for the BellSouth or AT&T Mobility post-retirement benefit plans (i.e., we assumed the cap would be waived in the future). All other significant weighted-average assumptions used were determined based on our policies that are discussed below in "Assumptions."

## Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

Our December 31, 2006, obligations and funded status include benefit obligations of \$11,013 for pension benefits and \$11,461 for postretirement benefits, and plan assets of \$17,628 and \$5,269, respectively, related to BellSouth. Additionally, our December 31, 2006, obligations and funded status include benefit obligations of \$635 for pension benefits and \$209 for postretirement benefits, and plan assets of \$548 and \$0, respectively, related to AT&T Mobility.

The following table presents this reconciliation and shows the change in the projected benefit obligation for the years ended December 31:

	Pension Benefits		Postretirement Benefits	
	2007	2006	2007	2006
Benefit obligation at beginning of year	\$55,949	\$46,176	\$44,137	\$35,225
Service cost – benefits earned during the period	1,257	1,050	511	435
Interest cost on projected benefit obligation	3,220	2,507	2,588	1,943
Amendments	246	—	—	—
Actuarial loss (gain)	(2,044)	(1,499)	(4,752)	(3,386)
Special termination benefits	56	25	7	2
Settlements	(15)	—	—	—
Benefits paid	(5,312)	(3,958)	(2,316)	(1,772)
Transferred from AT&T Mobility	—	635	—	209
Transferred from BellSouth	—	11,013	—	11,461
Other	165	—	210	20
Benefit obligation at end of year	\$53,522	\$55,949	\$40,385	\$44,137

The following table presents the change in the value of plan assets for the years ended December 31 and the plans' funded status at December 31:

	Pension Benefits		Postretirement Benefits	
	2007	2006	2007	2006
Fair value of plan assets at beginning of year	\$69,284	\$48,755	\$ 17,145	\$ 11,417
Actual return on plan assets	6,833	6,311	1,209	1,379
Benefits paid <sup>1</sup>	(5,312)	(3,958)	(1,694)	(920)
Contributions	—	—	255	—
Transferred from AT&T Mobility	—	548	—	—
Transferred from BellSouth	—	17,628	—	5,269
Other	5	—	84	—
Fair value of plan assets at end of year	\$70,810	\$69,284	\$ 16,999	\$ 17,145
Funded (unfunded) status at end of year <sup>2</sup>	\$17,288	\$13,335	\$(23,386)	\$(26,992)

<sup>1</sup>At our discretion, certain postretirement benefits are paid from AT&T cash accounts and do not reduce Voluntary Employee Beneficiary Association (VEBA) assets. Future benefit payments may be made from VEBA trusts and thus reduce those asset balances.

<sup>2</sup>Funded status is not indicative of our ability to pay ongoing pension benefits nor of our obligation to fund retirement trusts. Required pension funding is determined in accordance with ERISA regulations.

Amounts recognized on our consolidated balance sheets at December 31 are listed below:

	Pension Benefits		Postretirement Benefits	
	2007	2006	2007	2006
Postemployment benefit	\$17,288	\$13,335	\$ —	\$ 772
Current portion employee benefit obligation <sup>1</sup>	—	—	(249)	(973)
Employee benefit obligation <sup>2</sup>	—	—	(23,137)	(26,791)
Net amount recognized	\$17,288	\$13,335	\$(23,386)	\$(26,992)

<sup>1</sup>Included in "Accounts payable and accrued liabilities."

<sup>2</sup>Included in "Postemployment benefit obligation."

Amounts included in our accumulated other comprehensive income that have not yet been recognized in net periodic benefit cost at December 31 are listed below:

	Pension Benefits		Postretirement Benefits	
	2007	2006	2007	2006
Net loss	\$ 661	\$4,271	\$ 1,125	\$ 6,124
Prior service cost (benefit)	722	624	(2,355)	(2,669)
Total	\$1,383	\$4,895	\$(1,230)	\$ 3,455

The accumulated benefit obligation for our pension plans represents the actuarial present value of benefits based on employee service and compensation as of a certain date and does not include an assumption about future compensation levels. The accumulated benefit obligation for our pension plans was \$51,357 at December 31, 2007, and \$53,662 at December 31, 2006.

## Net Periodic Benefit Cost and Other Amounts Recognized in Other Comprehensive Income

Our combined net pension and postretirement cost recognized in our consolidated statements of income was \$1,078, \$1,635 and \$1,336 for the years ended December 31, 2007, 2006 and 2005.

The following tables present the components of net periodic benefit obligation cost and other changes in plan assets and benefit obligations recognized in other comprehensive income:

### Net Periodic Benefit Cost

	Pension Benefits			Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Service cost – benefits earned during the period	\$ 1,257	\$ 1,050	\$ 804	\$ 511	\$ 435	\$ 390
Interest cost on projected benefit obligation	3,220	2,507	1,725	2,588	1,943	1,496
Expected return on plan assets	(5,468)	(3,989)	(2,736)	(1,348)	(935)	(781)
Amortization of prior service cost (benefit) and transition asset	142	149	186	(359)	(359)	(344)
Recognized actuarial loss	241	361	156	294	473	440
<b>Net pension and postretirement cost (benefit)<sup>1</sup></b>	<b>\$ (608)</b>	<b>\$ 78</b>	<b>\$ 135</b>	<b>\$ 1,686</b>	<b>\$1,557</b>	<b>\$1,201</b>

<sup>1</sup>During 2007, 2006 and 2005, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 reduced postretirement benefit cost by \$342, \$349 and \$304. This effect is included in several line items above.

### Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income

	Pension Benefits			Postretirement Benefits		
	2007	2006	2005 <sup>1</sup>	2007	2006	2005 <sup>1</sup>
Net loss (gain)	\$ (2,131)	\$2,650	\$ —	\$ (2,525)	\$ 3,404	\$ —
Prior service cost (credit)	139	387	—	(28)	(1,655)	—
Amortization of net loss (gain)	154	—	—	181	—	—
Amortization of prior service cost	78	—	—	(223)	—	—
<b>Total recognized in net pension and postretirement cost other comprehensive income</b>	<b>\$ (1,760)</b>	<b>\$3,037</b>	<b>\$ —</b>	<b>\$ (2,595)</b>	<b>\$ 1,749</b>	<b>—</b>

<sup>1</sup>FAS 158 required prospective application for fiscal years ending after December 15, 2006.

The estimated net loss and prior service cost for pension benefits that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$7 and \$134, respectively. The estimated prior service benefit for postretirement benefits that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is \$360.

### Assumptions

In determining the projected benefit obligation and the net pension and postemployment benefit cost, we used the following significant weighted-average assumptions:

	2007	2006	2005
Discount rate for determining projected benefit obligation at December 31	6.50%	6.00%	5.75%
Discount rate in effect for determining net cost (benefit) <sup>1</sup>	6.00%	5.75%	6.00%
Long-term rate of return on plan assets	8.50%	8.50%	8.50%
Composite rate of compensation increase for determining projected benefit obligation and net pension cost (benefit)	4.00%	4.00%	4.00%

<sup>1</sup>Discount rate in effect for determining net cost (benefit) of BellSouth and AT&T Mobility pension and postretirement plans for the two-day period ended December 31, 2006, was 6.00%. The discount rate in effect for determining net cost (benefit) of ATTC pension and postretirement plans for the 43-day period ended December 31, 2005 was 5.75%.

Approximately 10% of pension and postretirement costs are capitalized as part of construction labor, providing a small reduction in the net expense recorded. While we will continue our cost-control efforts, certain factors, such as investment returns, depend largely on trends in the U.S. securities markets and the general U.S. economy. In particular, uncertainty in the securities markets and U.S. economy could result in investment returns less than those assumed and a decline in the value of plan assets used in pension and postretirement calculations, which under GAAP we will recognize over the next several years. Should the securities markets decline or medical and prescription drug costs increase at a rate greater than assumed, we would expect increasing annual combined net pension and postretirement costs for the next several years. Additionally, should actual experience differ from actuarial assumptions, combined net pension and postretirement cost would be affected in future years.

**Discount Rate** Our assumed discount rate of 6.50% at December 31, 2007 reflects the hypothetical rate at which the projected benefit obligations could be effectively settled or paid out to participants on that date. We determined our discount rate based on a range of factors, including a yield curve comprised of the rates of return on high-quality, fixed-income corporate bonds available at the measurement date and the related expected duration for the obligations. For the year ended December 31, 2007, we increased our discount rate by 0.50%, resulting in a decrease in our pension plan benefit obligation of \$2,353 and a decrease in our

## Notes to Consolidated Financial Statements (continued)

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postretirement benefit obligation of \$2,492. For the year ended December 31, 2006, we increased our discount rate by 0.25%, resulting in a decrease in our pension plan benefit obligation of \$1,040 and a decrease in our postretirement benefit obligation of \$1,030. Should actual experience differ from actuarial assumptions, the projected pension benefit obligation and net pension cost and accumulated postretirement benefit obligation and postretirement benefit cost would be affected in future years.

**Expected Long-Term Rate of Return** Our expected long-term rate of return on plan assets of 8.50% for 2008 and 2007 reflects the average rate of earnings expected on the funds invested, or to be invested, to provide for the benefits included in the projected benefit obligations. We consider many factors that include, but are not limited to, historical returns on plan assets, current market information on long-term returns (e.g., long-term bond rates) and current and target asset allocations between asset categories. The target asset allocation is determined based on consultations with external investment advisors. This assumption, which is based on our long-term expectations of market returns in future years, is one of the most significant of the weighted-average assumptions used to determine our actuarial estimates of pension and postretirement benefit expense. If all other factors were to remain unchanged, we expect that a 1% decrease in the expected long-term rate of return would cause 2008 combined pension and postretirement cost to increase \$814 over 2007.

**Composite Rate of Compensation Increase** Our expected composite rate of compensation increase of 4% reflects the long-term average rate of salary increases.

**Health Care Cost Trend** Our health care cost trend assumptions are developed based on historical cost data, the near-term outlook and an assessment of likely long-term trends. Additionally, to recognize the disproportionate growth in prescription drug costs, we have developed separate trend assumptions for medical and prescription drugs. In addition to the health care cost trend, we assume an annual 3% growth in administrative expenses and an annual 3% growth in dental claims. Due to benefit design changes in recent years (e.g., increased co-pays and deductibles for prescription drugs and certain medical services), we continue to experience better than expected claims experience. The following table provides our assumed average health care cost trend based on the demographics of plan participants.

	2008	2007
Health care cost trend rate assumed for current year		
Retirees 64 and under	5.76%	6.43%
Retirees 65 and over	6.36%	7.50%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that rate reaches the ultimate trend rate	2010	2010

A one percentage-point change in the assumed combined medical and dental cost trend rate would have the following effects:

	One Percentage-Point Increase	One Percentage-Point Decrease
Increase (decrease) in total of service and interest cost components	\$ 438	\$ (351)
Increase (decrease) in accumulated postretirement benefit obligation	4,314	(3,583)

For the majority of our labor contracts that contain an annual dollar value cap for the purpose of determining contributions required from nonmanagement retirees who retire during the term of the labor contract, we have waived the cap during the relevant contract periods and thus not collected contributions from those retirees, and we have similarly waived the cap for nonmanagement retirees who retired prior to inception of the labor contract. Therefore, in accordance with the substantive plan provisions required in accounting for postretirement benefits under GAAP, we do not account for the cap in the value of our accumulated postretirement benefit obligation (i.e., for GAAP purposes, we assumed the cap would be waived for all future contract periods).

### Plan Assets

Plan assets consist primarily of private and public equity, government and corporate bonds, and real estate. The asset allocations of the pension plans are maintained to meet ERISA requirements. Any plan contributions, as determined by ERISA regulations, are made to a pension trust for the benefit of plan participants. We maintain VEBA trusts to partially fund postretirement benefits; however, there are no ERISA or regulatory requirements that these postretirement benefit plans be funded annually.

The principal investment objectives are: to ensure the availability of funds to pay pension and postretirement benefits as they become due under a broad range of future economic scenarios; to maximize long-term investment return with an acceptable level of risk based on our pension and postretirement obligations; and to be broadly diversified across and within the capital markets to insulate asset values against adverse experience in any one market. Each asset class has a broadly diversified style. Substantial biases toward any particular investing style or type of security are sought to be avoided by managing the aggregation of all accounts with portfolio benchmarks. Asset and benefit obligation forecasting studies are conducted periodically, generally every two to three years, or when significant changes have occurred in market conditions, benefits, participant demographics or funded status. Decisions regarding investment policy are made with an understanding of the effect of asset allocation on funded status, future contributions and projected expenses. The current asset allocation policy for the pension plan is based on a study completed during 2007. The asset allocation policy for the VEBA assets is based on our legacy operations, and the pre-acquisition allocation policies of ATTC and BellSouth. It is our intention to complete an asset allocation study during 2008.

The plans' weighted-average asset target and actual allocations as a percentage of plan assets, including the notional exposure of future contracts by asset categories at December 31 are as follows:

	Pension Assets			Postretirement (VEBA) Assets		
	Target	2007	2006	Target	2007	2006
Equity securities						
Domestic	35% – 45%	<b>39%</b>	38%	38% – 58%	<b>49%</b>	51%
International	13% – 23%	<b>18</b>	19	7% – 27%	<b>24</b>	22
Debt securities	22% – 32%	<b>27</b>	26	13% – 23%	<b>17</b>	18
Real estate	5% – 11%	<b>9</b>	8	0% – 10%	<b>2</b>	2
Other	4% – 10%	<b>7</b>	9	7% – 17%	<b>8</b>	7
<b>Total</b>		<b>100%</b>	100%		<b>100%</b>	100%

At December 31, 2007, AT&T securities represented less than 0.5% of assets held by our pension plans and VEBA trusts.

### Estimated Future Benefit Payments

Expected benefit payments are estimated using the same assumptions used in determining our benefit obligation at December 31, 2007. Because benefit payments will depend on future employment and compensation levels, average years employed and average life spans, among other factors, changes in any of these factors could significantly affect these expected amounts. The following table provides expected benefit payments under our pension and postretirement plans:

	Pension Benefits	Postretirement Benefits	Medicare Subsidy Receipts
2008	\$ 4,964	\$ 2,520	\$ (120)
2009	4,841	2,636	(130)
2010	4,864	2,733	(140)
2011	4,857	2,815	(150)
2012	4,853	2,843	(164)
Years 2013 – 2017	23,393	14,389	(1,047)

### Supplemental Retirement Plans

We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. While these plans are unfunded, we have assets in a designated nonbankruptcy remote trust that are used to provide for these benefits. These plans include supplemental pension benefits as well as compensation deferral plans, some of which include a corresponding match by us based on a percentage of the compensation deferral.

We use the same significant assumptions for the discount rate and composite rate of compensation increase used in determining the projected benefit obligation and the net pension and postemployment benefit cost. The following tables provide the plans' benefit obligations and fair value of assets at December 31 and the components of the supplemental retirement pension benefit cost. The net amounts recorded as "Other noncurrent liabilities" on our consolidated balance sheets at December 31, 2007 and 2006 were \$2,301 and \$2,470, respectively.

The following table provides information for our supplemental retirement plans with accumulated benefit obligations in excess of plan assets:

	2007	2006
Projected benefit obligation	<b>\$(2,301)</b>	\$(2,470)
Accumulated benefit obligation	<b>(2,155)</b>	(2,353)
Fair value of plan assets	—	—

The following tables present the components of net periodic benefit cost and other changes in plan assets and benefit obligations recognized in other comprehensive income:

<b>Net Periodic Benefit Cost</b>	2007	2006
Service cost – benefits earned during the period	<b>\$ 16</b>	\$ 15
Interest cost on projected benefit obligation	<b>147</b>	108
Amortization of prior service cost	<b>6</b>	4
Recognized actuarial loss	<b>27</b>	29
<b>Net supplemental retirement pension cost</b>	<b>\$196</b>	\$156

<b>Other Changes Recognized in Other Comprehensive Income<sup>1</sup></b>	2007	2006
Net loss (gain)	<b>\$ (60)</b>	\$233
Prior service cost (credit)	<b>11</b>	7
Amortization of net loss (gain)	<b>15</b>	—
Amortization of prior service cost	<b>3</b>	—
<b>Total recognized in net supplemental pension cost and other comprehensive income</b>	<b>\$ (31)</b>	\$240

<sup>1</sup>FAS 158 required prospective application for fiscal years ending after December 15, 2006.

In addition to the net supplemental retirement pension cost in the table above, we recorded charges of \$32 due to accelerated benefit expenses and settlement charges related to retirements during 2007.

The estimated net loss and prior service cost for our supplemental retirement plan benefits that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$18 and \$6, respectively.

## Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

Deferred compensation expense was \$106 in 2007, \$39 in 2006 and \$46 in 2005. Our deferred compensation liability, included in "Other noncurrent liabilities," was \$1,116 at December 31, 2007 and \$996 at December 31, 2006.

### Non-U.S. Plans

As part of our ATTC acquisition, we acquired certain non-U.S. operations that have varying types of pension programs providing benefits for substantially all of their employees and, to a limited group, postemployment benefits. As described earlier and in accordance with FAS 87, we eliminated previously-existing unrecognized net gains or losses, unrecognized prior service costs and unrecognized net transition obligations. The following table provides the plans' benefit obligations and fair value of assets and a statement of the funded status at December 31.

The net amounts recorded as "Postemployment benefit obligation" on our consolidated balance sheets at December 31, 2007 and 2006 were \$(48) and \$158, respectively.

	2007	2006
Benefit obligations at end of year	<b>\$(1,016)</b>	\$(1,016)
Fair value of plan assets	<b>1,064</b>	858
(Unfunded) benefit obligation	<b>\$ 48</b>	\$ (158)

The following table provides information for certain non-U.S. defined-benefit pension plans with accumulated benefit obligations in excess of plan assets:

	2007	2006
Projected benefit obligation	<b>\$1,015</b>	\$1,016
Accumulated benefit obligation	<b>892</b>	874
Fair value of plan assets	<b>1,064</b>	858

In determining the projected benefit obligation for certain non-U.S. defined-benefit pension plans, we used the following significant weighted-average assumptions:

	2007	2006
Discount rate for determining projected benefit obligation at December 31	<b>5.57%</b>	4.86%
Discount rate in effect for determining net cost (benefit)	<b>4.86%</b>	4.55%
Long-term rate of return on plan assets	<b>6.15%</b>	6.09%
Composite rate of compensation increase for determining projected benefit obligation at December 31	<b>4.25%</b>	4.36%
Composite rate of compensation increase for determining net pension cost	<b>4.36%</b>	4.25%

The following tables present the components of net periodic benefit cost and other changes in plan assets and benefit obligations recognized in other comprehensive income:

Net Periodic Benefit Cost	2007	2006
Service cost – benefits earned during the period	<b>\$ 25</b>	\$ 27
Interest cost on projected benefit obligation	<b>52</b>	45
Expected return on assets	<b>(54)</b>	(43)
Amortization of prior service cost	<b>(1)</b>	—
Net pension cost	<b>\$ 22</b>	\$ 29

Other Changes Recognized in Other Comprehensive Income <sup>1</sup>	2007	2006
Net loss (gain)	<b>\$(105)</b>	\$ 40
Amortization of net loss (gain)	<b>(2)</b>	—
Amortization of prior service cost	<b>—</b>	—
Total recognized in net pension cost and other comprehensive income	<b>\$(107)</b>	\$ 40

<sup>1</sup>FAS 158 required prospective application for fiscal years ending after December 15, 2006.

The estimated net gain that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is \$3.

### Contributory Savings Plans

We maintain contributory savings plans that cover substantially all employees. Under the savings plans, we match in cash or company stock a stated percentage of eligible employee contributions, subject to a specified ceiling. There are no debt-financed shares held by the Employee Stock Ownership Plans, allocated or unallocated.

Our match of employee contributions to the savings plans is fulfilled with purchases of our stock on the open market or company cash. Benefit cost is based on the cost of shares or units allocated to participating employees' accounts and was \$633, \$412 and \$334 for the years ended December 31, 2007, 2006 and 2005.

### NOTE 12. STOCK-BASED COMPENSATION

We account for stock-based compensation using FAS 123(R). By using the modified retrospective method to adopt FAS 123(R), we increased the amount of excess tax benefits we had previously recorded on our consolidated balance sheets. Our accounting under FAS 123(R) may affect our ability to fully realize the value shown on our balance sheet of deferred tax assets associated with compensation expense. Full realization of these deferred tax assets requires stock options to be exercised at a price equaling or exceeding the sum of the strike price plus the fair value of the option at the grant date. The provisions of FAS 123(R) do not allow a valuation allowance to be recorded unless the company's future taxable income is expected to be insufficient to recover the asset. Accordingly, there can be no assurance that the current stock price of our common shares will rise to levels sufficient to realize the entire tax benefit currently reflected in our balance sheet. However, to the extent that additional tax benefits are generated in excess of the deferred taxes associated with compensation expense previously recognized, the potential future impact on income would be reduced.

At December 31, 2007, we had various stock-based compensation plans, which are described below. The compensation cost recognized for those plans for the years ended December 31 was \$720 in 2007, \$301 in 2006 and \$143 in 2005 and is included in "Selling, general and administrative" in our consolidated statements of income. The total income tax benefit recognized in the consolidated statements of income for stock-based compensation arrangements for the years ended December 31, 2007, 2006 and 2005 was \$275, \$116 and \$54.

Under our various plans, senior and other management and nonmanagement employees and nonemployee directors have received stock options, performance stock units and other nonvested stock units. Stock options issued through December 31, 2007 carry exercise prices equal to the market price of our stock at the date of grant. Beginning in 1994 and ending in 1999, certain employees of AT&T Teleholdings, Inc. (formerly known as Ameritech) were awarded grants of nonqualified stock options with dividend equivalents. During 2006, we amended our stock option plan to vest upon the date of grant. Prior to 2006, depending on the grant, stock options vesting could occur up to five years from the date of grant, with most options vesting ratably over three years. Performance stock units, which are nonvested stock units, are granted to key employees based upon the stock price at the date of grant and are awarded in the form of common stock and cash at the end of a three-year period, subject to the achievement of certain performance goals. Other nonvested stock units are valued at the market price of our stock at the date of grant and vest over a three- to five-year period. As of December 31, 2007, we were authorized to issue up to 133 million shares of stock (in addition to shares that may

be issued upon exercise of outstanding options or upon vesting of performance stock units or other nonvested stock units) to officers, employees and directors pursuant to these various plans.

The compensation cost that has been charged against income for our stock-based compensation plans is as follows:

	2007	2006	2005
Performance stock units	\$620	\$282	\$116
Restricted stock	68	6	6
Stock option expense	14	13	19
Other	18	—	2
<b>Total</b>	<b>\$720</b>	<b>\$301</b>	<b>\$143</b>

The estimated fair value of the options when granted is amortized to expense over the options' vesting or required service period. The fair value for these options was estimated at the date of grant based on the expected life of the option and historical exercise experience, using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2007	2006	2005
Risk-free interest rate	5.01%	4.94%	4.15%
Dividend yield	3.65%	4.75%	5.38%
Expected volatility factor	20.75%	21.79%	22.47%
Expected option life in years	7.00	8.00	8.00

A summary of option activity as of December 31, 2007, and changes during the period then ended, is presented below (shares in millions):

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value <sup>1</sup>
Outstanding at January 1, 2007	309	\$37.96		
Granted	2	38.99		
Exercised	(68)	29.76		
Forfeited or expired	(12)	45.00		
<b>Outstanding at December 31, 2007</b>	<b>231</b>	<b>\$40.03</b>	<b>3.10</b>	<b>\$1,266</b>
<b>Exercisable at December 31, 2007</b>	<b>229</b>	<b>\$40.04</b>	<b>3.05</b>	<b>\$1,261</b>

<sup>1</sup>Aggregate intrinsic value includes only those options with intrinsic value (options where the exercise price is below the market price).

The weighted-average fair value of each option granted during the year ended December 31 was \$7.71 in 2007, \$4.78 in 2006 and \$3.39 in 2005. The total intrinsic value of options exercised during the year was \$667 in 2007, \$134 in 2006 and \$24 in 2005.

It is our policy to satisfy share option exercises using our treasury shares. The actual tax benefit realized for the tax deductions from option exercises from these arrangements for the years ended December 31, 2007, 2006 and 2005 totaled \$77, \$28 and \$9.

A summary of the status of our nonvested stock units, which includes performance stock units as of December 31, 2007, and changes during the year then ended is presented as follows (shares in millions):

Nonvested Stock Units	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2007	25	\$24.03
Granted	17	36.78
Vested	(14)	25.00
Forfeited	(1)	30.17
Other	9	24.68
<b>Nonvested at December 31, 2007</b>	<b>36</b>	<b>\$29.49</b>

As of December 31, 2007, there was \$422 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted. That cost is expected to be recognized over a weighted-average period of 1.58 years. The total fair value of shares vested during the years ended December 31, 2007, 2006 and 2005 was \$345, \$246 and \$38.

## Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

### NOTE 13. STOCKHOLDERS' EQUITY

From time to time, we repurchase shares of common stock for distribution through our employee benefit plans or in connection with certain acquisitions. In December 2007, the Board of Directors authorized the repurchase of up to 400 million shares of our common stock. This authorization replaced previous authorizations and will expire on December 31, 2009. As of December 31, 2007, we had not repurchased any shares under this program.

### NOTE 14. ADDITIONAL FINANCIAL INFORMATION

Balance Sheets	December 31,	
	2007	2006
Accounts payable and accrued liabilities:		
Accounts payable	\$ 7,059	\$ 6,919
Accrued rents and other	4,321	3,957
Accrued payroll and commissions	3,419	3,974
Deferred directory revenue	2,348	1,721
Accrued interest	1,149	915
Compensated future absences	637	759
Current portion of employee benefit obligation	249	973
Other	2,217	2,888
Total accounts payable and accrued liabilities	\$21,399	\$22,106
Deferred compensation (included in Other noncurrent liabilities)	\$ 2,141	\$ 2,064

Statements of Income	2007	2006	2005
Advertising expense	\$3,430	\$1,530	\$ 812
Interest expense incurred	\$3,678	\$1,916	\$1,492
Capitalized interest	(171)	(73)	(36)
Total interest expense	\$3,507	\$1,843	\$1,456

Statements of Cash Flows	2007	2006	2005
Cash paid during the year for:			
Interest	\$3,445	\$1,666	\$1,395
Income taxes, net of refunds	4,013	2,777	2,038

Statements of Stockholders' Equity	2007	2006	2005
Accumulated other comprehensive income (loss) is comprised of the following components, net of taxes, at December 31:			
Foreign currency translation adjustment	\$ (469)	\$ (488)	\$ (505)
Unrealized gains on securities	375	345	340
Unrealized (losses) on cash flow hedges	(226)	(172)	(189)
Defined benefit postretirement plan	(59)	(4,999)	—
Other	(1)	—	(2)
Accumulated other comprehensive (loss)	\$ (380)	\$ (5,314)	\$ (356)

No customer accounted for more than 10% of consolidated revenues in 2007, 2006 or 2005.

### NOTE 15. TRANSACTIONS WITH AT&T MOBILITY

Prior to our December 29, 2006 acquisition of BellSouth (see Note 2), we and BellSouth, the two owners of AT&T Mobility, each made a subordinated loan to AT&T Mobility (shareholder loans) and entered into a revolving credit agreement with AT&T Mobility to provide short-term financing for operations. Following the BellSouth acquisition both our shareholder loan and revolving credit agreement with AT&T Mobility were consolidated and do not appear on our consolidated balance sheets at December 31, 2007 and 2006. The shareholder loan carries an annual 6.0% interest rate and we earned interest income on this loan of \$246 during 2006 and \$311 in 2005.

Prior to our BellSouth acquisition, we generated revenues of \$1,466 in 2006 and \$869 in 2005 for services sold to AT&T Mobility. These revenues were primarily from access and long-distance services sold to AT&T Mobility on a wholesale basis and commissions revenue related to customers added through AT&T sales sources.

### NOTE 16. CONTINGENT LIABILITIES

In addition to issues specifically discussed elsewhere, we are party to numerous lawsuits, regulatory proceedings and other matters arising in the ordinary course of business. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," in evaluating these matters on an ongoing basis, we take into account amounts already accrued on the balance sheet. In our opinion, although the outcomes of these proceedings are uncertain, they should not have a material adverse effect on our financial position, results of operations or cash flows.

We have contractual obligations to purchase certain goods or services from various other parties. Our purchase obligations are expected to be approximately \$2,461 in 2008, \$2,237 in total for 2009 and 2010, \$1,197 in total for 2011 and 2012 and \$471 in total for years thereafter.

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**NOTE 17. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

The following table represents our quarterly financial results:

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Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Basic Earnings Per Share <sup>1</sup>	Diluted Earnings Per Share <sup>1</sup>	Stock Price		
						High	Low	Close
<b>2007</b>								
First	\$ 28,969	\$ 4,664	\$ 2,848	\$0.46	\$0.45	\$39.86	\$33.20	\$39.43
Second	29,478	4,944	2,904	0.47	0.47	41.54	38.38	41.50
Third	30,132	5,304	3,063	0.50	0.50	42.97	36.53	42.31
Fourth	30,349	5,492	3,136	0.52	0.51	42.79	36.25	41.56
Annual	\$118,928	\$20,404	\$11,951	1.95	1.94			
<b>2006</b>								
First	\$ 15,756	\$ 2,191	\$ 1,445	\$ 0.37	\$ 0.37	\$ 28.82	\$ 24.24	\$ 27.04
Second	15,770	2,604	1,808	0.47	0.46	28.03	24.72	27.89
Third	15,638	2,917	2,165	0.56	0.56	33.76	26.35	32.56
Fourth	15,891	2,576	1,938	0.50	0.50	36.21	31.57	35.75
Annual	\$ 63,055	\$ 10,288	\$ 7,356	1.89	1.89			

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<sup>1</sup>Quarterly earnings per share impacts may not add to full-year earnings per share impacts due to the difference in weighted-average shares for the quarters versus the weighted-average shares for the year.

## Report of Management

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The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles. The integrity and objectivity of the data in these financial statements, including estimates and judgments relating to matters not concluded by year-end, are the responsibility of management, as is all other information included in the Annual Report, unless otherwise indicated.

The financial statements of AT&T Inc. (AT&T) have been audited by Ernst & Young LLP, Independent Registered Public Accounting Firm. Management has made available to Ernst & Young LLP all of AT&T's financial records and related data, as well as the minutes of stockholders' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP during its audit were valid and appropriate.

Management maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by AT&T is recorded, processed, summarized, accumulated and communicated to its management, including its principal executive and principal financial officers, to allow timely decisions regarding required disclosure, and reported within the time periods specified by the Securities and Exchange Commission's rules and forms.

Management also seeks to ensure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility and by communication programs aimed at ensuring that its policies, standards and managerial authorities are understood throughout the organization.

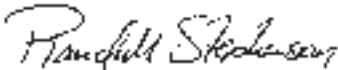
The Audit Committee of the Board of Directors meets periodically with management, the internal auditors and the independent auditors to review the manner in which they are performing their respective responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have access to the Audit Committee at any time.

### Assessment of Internal Control

The management of AT&T is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) or 15d-15(f) under the Securities Exchange Act of 1934. AT&T's internal control system was designed to provide reasonable assurance to the company's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

AT&T management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on its assessment, AT&T management believes that, as of December 31, 2007, the Company's internal control over financial reporting is effective based on those criteria.

Ernst & Young LLP, the independent registered public accounting firm that audited the financial statements included in this Annual Report, has issued an attestation report on the company's internal control over financial reporting. The attestation report is included on Page 82.



Randall Stephenson  
Chairman of the Board,  
Chief Executive Officer and President



Richard G. Lindner  
Senior Executive Vice President and  
Chief Financial Officer

## Report of Independent Registered Public Accounting Firm

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The Board of Directors and Stockholders  
AT&T Inc.

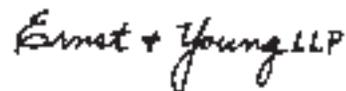
We have audited the accompanying consolidated balance sheets of AT&T Inc. (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2007 the Company changed its method of accounting for income taxes.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 14, 2008 expressed an unqualified opinion thereon.

The signature of Ernst & Young LLP is written in a cursive, handwritten style in black ink.

San Antonio, Texas  
February 14, 2008

## Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

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The Board of Directors and Stockholders  
AT&T Inc.

We have audited AT&T Inc.'s (the Company) internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report of Management. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

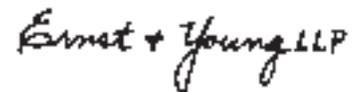
A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007, of the Company and our report dated February 14, 2008, expressed an unqualified opinion thereon.

San Antonio, Texas  
February 14, 2008

The signature of Ernst & Young LLP is written in a cursive, handwritten style in black ink.