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 both domestically and internationally providing wireline and wireless 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 of the Company 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, including AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC (Cingular), and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Until the BellSouth acquisition, 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. After the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary of AT&T. 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 6).

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.

FIN 48 In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), an interpretation of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." FIN 48 changes the accounting for uncertainty in income taxes by prescribing a recognition threshold for tax positions taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Our evaluation of the impact FIN 48 will have on our financial position and results of operations is ongoing. See Note 9 for further discussion.

EITF 06-3 In June 2006, the Emerging Issues Task Force (EITF) ratified the consensus on EITF 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement" (EITF 06-3). EITF 06-3 provides that taxes imposed by a governmental authority on a revenue producing transaction between a seller and a customer should be shown in the income statement on either a gross or a net basis, based on the entity's accounting policy, which should be disclosed pursuant to Accounting Principles Board Opinion No. 22, "Disclosure of Accounting Policies." Amounts that are allowed to be charged to customers as an offset to taxes owed by a company are not considered taxes collected and remitted. If such taxes are significant, and are presented on a gross basis, the amounts of those taxes should be disclosed. EITF 06-3 will be effective for interim and annual reporting periods beginning after December 15, 2006. We are currently evaluating the impact EITF 06-3 will have, but do not expect a material impact on our financial position and results of operations.

FAS 157 In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, "Fair Value Measurements" (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurement. FAS 157 does not require any new fair value measurements and we do not expect the application of this standard to change our current practice. FAS 157 requires prospective application for fiscal years ending after November 15, 2007.

FAS 158 In September 2006, the FASB issued Statement of Financial Accounting Standard No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)" (FAS 158). FAS 158 required us to recognize the funded status of defined benefit pension, including supplemental retirement and savings plans, and postemployment plans as an asset or liability in our statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. This standard has no effect on our expense or benefit recognition, nor will it affect the funding requirements imposed under the Employee Retirement Income Security Act of 1974, as amended (ERISA). FAS 158 requires prospective application for fiscal years ending after December 15, 2006. The table below illustrates the incremental impact on our Consolidated Balance Sheet of applying FAS 158 at December 31, 2006.

	Before Application of FAS 158	Adjustments	After Application of FAS 158
Postemployment Benefit	$ 19,118	$(4,890)	$ 14,228
Other Assets	7,003	(138)	6,865
Postretirement benefit obligation	25,485	3,416	28,901
Noncurrent deferred income taxes	31,100	(3,694)	27,406
Other noncurrent liabilities	8,020	41	8,061
Additional minimum pension liability adjustment – net of tax	(208)	208	—
Accumulated other comprehensive income – net of tax	(315)	(4,999)	(5,314)
Total Stockholders' Equity	120,331	(4,791)	115,540

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 integration activities following our November 2005 acquisition of AT&T Corp. (ATTC), we revised our segment reporting in 2006 (see Note 4). In addition, we revised the product categories reported in operating revenue as follows: long distance is now reported in voice revenue; the majority of customer premises equipment and integration services

revenue, previously reported as voice and data revenue are now reported in other revenue; and directory revenue now reflects our traditional directory segment revenue. Operating income remained unchanged by these reclassifications.

Income Taxes Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. To the extent allowed by GAAP, we provide valuation allowances against the deferred tax assets for amounts when the realization is uncertain. Management reviews these items regularly in light of changes in tax laws and court rulings at both federal and state levels.

Our income tax returns are regularly audited and reviewed by the Internal Revenue Service (IRS) and state taxing authorities. The IRS has completed examinations for all tax years through 2002. In 2005, we reached a settlement with the IRS regarding almost all issues included in 1997-1999 claims. The 1997-1999 IRS settlement resulted in an income tax benefit that was recognized during 2005. During 2006 the IRS completed the field examination for the 2000-2002 periods. Settlement meetings with the IRS Appeals Division related to the disputed issues will begin during 2007. We do not expect a decision during 2007 from the IRS relating to the 2000-2002 disputed issues. The completion of the 2000-2002 examination is not expected to have an adverse impact on the financial statements. The IRS also began its field examination of our 2003-2005 federal tax returns during 2006. We do not expect the IRS to complete the field examination during 2007.

Additionally, during the first quarter of 2006, we received Joint Committee approval of the IRS audit for ATTC's 1997-2001 federal income tax returns. The closing of this audit resulted in a reduction to goodwill and a corresponding reduction in our net deferred tax liability, as required by the purchase accounting rules, of approximately $385.

The IRS has completed field examinations for BellSouth's tax years through 2001 and all years through 1998 are settled and closed. The IRS has issued assessments challenging the timing and amounts of various deductions for the 1999-2001 periods. Settlement discussions with the IRS Appeals Division regarding the 1999-2001 periods continue. Additionally, we anticipate that the IRS will complete its examination for the 2002-2003 periods during 2007 and we project that settlement meetings with the IRS Appeals Division will begin during 2007. The IRS' field examination of BellSouth's 2004-2005 federal tax returns began in 2006 and is not likely to be completed during 2007. We do not expect the resolution of these audits to have an adverse impact on the financial statements.

The IRS has completed field examinations for all AT&T Mobility tax years through 2003. The IRS has issued assessments challenging the timing and amounts of various deductions for the 2002-2003 periods. We anticipate that we will begin settlement meetings with the IRS Appeals Division related to AT&T Mobility's 2002-2003 disputed issues during 2007. The IRS' field examination of AT&T Mobility's 2004-2005 federal tax returns is expected to begin during 2007. We do not expect the resolution of these audits to have an adverse impact on the financial statements.

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.

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, 2006, we held $1,324 in cash, $357 in money market funds and $737 in other cash equivalents.

Investment Securities Investments in securities principally consist of held-to-maturity or 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 local telephone, long-distance and data 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. Service revenues also include billings to our customers for various regulatory fees imposed on us by governmental authorities. 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. 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 set-up 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 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 adjusted accordingly.

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 are 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 amortized over a period not to exceed five years. 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 2006 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, and in 2005, primarily resulted from our acquisition of ATTC.

Intangible assets that have finite useful lives are amortized over their useful lives, which range from 6 months to 18 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 AT&T Mobility's intangible assets are Federal Communications Commission (FCC) licenses that provide them 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, AT&T Mobility has determined that there are currently no legal, regulatory, contractual, competitive, economic or other factors that limit the useful lives of its FCC licenses and therefore treats the FCC licenses as 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," AT&T Mobility tests its licenses for impairment on an aggregate basis, consistent with its management of the business on a national scope. AT&T Mobility utilizes 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 AT&T Mobility's weighted-average cost of capital.

During the fourth quarter of 2006, AT&T Mobility completed its annual impairment tests for goodwill and indefinite-lived FCC licenses. These annual impairment tests resulted in no impairment of AT&T Mobility's goodwill or 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, 2006, 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 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 8). 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 on 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," we establish obligations for expected termination benefits provided to former or inactive employees after employment but before retirement. These benefits include severance payments, workers' compensation, disability, medical continuation coverage and other benefits. In accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), severance accruals recorded for the BellSouth and ATTC acquisition related to the acquired employees were included in the purchase price allocation (see Note 2). At December 31, 2006, we had severance accruals of $263, of which $240 was established as merger-related severance accruals. In accordance with FAS 141, severance accruals for BellSouth employees were included in the purchase price allocation (see Note 2). At December 31, 2005, we had severance accruals of $410.

Pension and Postretirement Benefits See Note 10 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

BellSouth Corporation In December 2006, we acquired BellSouth in a transaction accounted for under FAS 141. BellSouth was the leading communications service provider in the southeastern U.S., providing wireline communications services, including local exchange, network access, intraLATA 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.

Under the merger agreement, each share of BellSouth common stock was exchanged for 1.325 shares of our common stock. We issued 2.4 billion shares to BellSouth shareholders, giving them an approximate 39% stake in the combined company, based on common shares outstanding. Based on the $35.75 per share closing price of our common stock on the New York Stock Exchange (NYSE) on December 29, 2006, the last trading session before the closing of the merger, consideration received by BellSouth shareholders was approximately $86,900.

Based on the average closing price of our common stock on the NYSE for the two days prior to, including, and two days subsequent to the public announcement of the merger (March 5, 2006) of $27.32, capitalized merger-transaction costs and other items, the transaction was valued, for accounting purposes, at $66,798.

We and BellSouth jointly owned AT&T Mobility and the Internet-based publisher YELLOWPAGES.COM (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.

We paid a premium (i.e., goodwill) over the fair value of the net tangible and identified intangible assets acquired for a number of reasons, including the following:

AT&T Mobility

- Ownership of 100% of AT&T Mobility will permit us to better integrate AT&T Mobility offerings with our other communication offerings. We expect that this will create enhanced marketing opportunities, significant network synergies resulting from the combination of multiple Internet Protocol (IP) networks and the ability to more rapidly develop and make available advanced products and services. The ownership change in AT&T Mobility will also improve the speed and focus of decision making, which should help to develop and deliver more quickly the new products and services customers desire.

Network Integration

- The merger will allow for the ability to integrate IP networks of AT&T, BellSouth and AT&T Mobility into a single fully-integrated wireless and wireline IP network and will not only offer substantial cost-saving opportunities, but should also allow us to offer the desired products and services demanded by customers.
- The addition of the BellSouth wireline network, which already includes a substantial build-out of fiber-optic cable to points near end-users, will complement our existing plans to deploy IPTV to existing wireline service areas and to increase the number of potential customers for our IPTV product.

The application of purchase accounting under FAS 141, requires that the total purchase price be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date, with amounts exceeding the fair values being recorded as goodwill. The acquisition of BellSouth's portion of AT&T Mobility has been accounted for as a step acquisition. In accordance with purchase accounting rules, BellSouth's investment in AT&T Mobility has been adjusted to its fair value through purchase accounting adjustments.

The assets and liabilities of BellSouth and AT&T Mobility have been appraised, based on third-party valuations, 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 will 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 will be recorded at their acquisition values (i.e., customer relationships that were developed by the acquired company). Debt instruments and investments are valued in relation to current market conditions and other assets and liabilities are valued based on the acquiring company's estimates. After all values have been assigned to assets and liabilities, the remainder of the purchase price is recorded as goodwill. These values are subject to adjustment for one year after the close of the transaction as additional information is obtained.

The allocation process requires an analysis of acquired fixed assets, contracts, customer lists and relationships, contractual commitments, legal contingencies and brand value to identify and record the fair value of all assets acquired and liabilities assumed. In valuing acquired assets and assumed liabilities, fair values were based on, but not limited to: future expected discounted cash flows for customer relationships; current replacement cost for similar capacity and obsolescence for certain fixed assets; comparable market rates for contractual obligations and certain investments, real estate and liabilities, including pension and postretirement benefits; expected settlement amounts for litigation and contingencies; and appropriate discount rates and growth rates.

The assets and liabilities of BellSouth were recorded at their respective fair values as of the date of the acquisition, December 29, 2006. Additionally, we recorded BellSouth's ownership percentage, or 40%, of AT&T Mobility's assets and liabilities at their respective fair values and our ownership percentage, or 60%, of AT&T Mobility's assets and liabilities at their historical, or book value. We recorded goodwill of $54,024 as a result of the BellSouth acquisition. We have obtained preliminary third-party valuations; however, because of the proximity of this transaction to year-end, the values of certain assets and liabilities are based on preliminary valuations and are subject to adjustment as additional information is obtained. Such additional information includes, but is not limited to: valuations and physical counts of property, plant and equipment, valuation of investments and the involuntary separation of employees. We will have 12 months from the closing of the acquisition to finalize our valuations. Changes to the valuation of property, plant and equipment may result in adjustments to the fair value of certain identifiable intangible assets acquired. When finalized, material adjustments to goodwill may result.

We have not identified any material unrecorded pre-acquisition contingencies where the related asset, liability or impairment is probable and the amount can be reasonably estimated. Prior to the end of the one-year purchase price allocation period, if information becomes available that would indicate it is probable that such events had occurred and the amounts can be reasonably estimated, such items will be included in the final purchase price allocation and may adjust 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 acquisition date. Included in the liabilities assumed at the acquisition was $535 for accrued severance.

	BellSouth
Assets acquired	
Current assets	$ 4,875
Property, plant and equipment	18,498
Intangible assets not subject to amortization	
Trademark/name	330
Licenses	214
Intangible assets subject to amortization	
Customer lists and relationships	9,230
Patents	100
Trademark/name	211
Investment in AT&T Mobility	32,759
Other investments	2,446
Other assets	11,211
Goodwill	26,467
Total assets acquired	106,341
Liabilities assumed	
Current liabilities, excluding current portion of long-term debt	5,288
Long-term debt	15,628
Deferred income taxes	10,318
Postemployment benefit obligation	7,086
Other noncurrent liabilities	1,223
Total liabilities assumed	39,543
Net assets acquired	$ 66,798

Goodwill of $26,467 resulting from the acquisition of BellSouth was assigned to the other segment. In addition, BellSouth's investment in AT&T Mobility's and YPC's goodwill was recorded as a result of this acquisition. However, as part of the final valuation of the acquisition, we will determine to which reporting units and to what extent the benefit of the acquisition applies, and as required by GAAP, record the appropriate goodwill to each reporting unit. Goodwill includes a portion of value for assembled workforce which is not separately classified from goodwill in accordance with FAS 141. The purchased intangibles and goodwill are not deductible for tax purposes. However, purchase accounting allows for the establishment of deferred tax liabilities on purchased intangibles (other than goodwill), which will be reflected as a tax benefit on our future Consolidated Statements of Income in proportion to and over the amortization period of the related intangible asset.

Substantially all of the licenses acquired have an indefinite life, and accordingly, are not subject to amortization. The customer relationship intangible assets will be amortized over the following weighted periods using the sum-of-the-months-digits method of amortization: 5 years for consumer customers, 9.6 years for business customers and 7 years for directory customers. This sum-of-the-months-digits method of amortization best reflects the estimated pattern in which the economic benefits will be consumed.

BellSouth's 40% economic ownership of AT&T Mobility has been recorded above as "Investment in AT&T Mobility," and has been eliminated in our Consolidated Balance Sheets. We have 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 as shown below.

	AT&T Mobility		
	60% at Book Value	40% at Fair Value	Total
Assets acquired			
Current assets	$ 4,218	$ 2,770	$ 6,988
Property, plant and equipment	14,118	5,569	19,687
Intangible assets not subject to amortization			
Licenses	15,952	18,027	33,979
Intangible assets subject to amortization			
Customer lists and relationships	1,028	6,555	7,583
Trademark/name	7	336	343
Other	79	97	176
Other assets	439	647	1,086
Goodwill	13,078	14,351	27,429
Total assets acquired	48,919	48,352	97,271
Liabilities assumed			
Current liabilities, excluding current portion of long-term debt	4,224	2,790	7,014
Intercompany debt	5,504	3,539	9,043
Long-term debt	7,570	4,989	12,559
Deferred income taxes	2,298	3,161	5,459
Postemployment benefit obligation	163	138	301
Other noncurrent liabilities	1,031	976	2,007
Total liabilities assumed	20,790	15,593	36,383
Net assets acquired	$28,129	$32,759	$60,888

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.

The following unaudited pro forma consolidated results of operations assume that the acquisition of BellSouth was completed as of January 1 for each of the fiscal years shown below.

Year Ended December 31,	**2006**	2005
Revenues	**$116,300**	$116,144
Net Income (Loss)	**9,226**	7,687
Earnings Per Common Share	**$ 1.46**	$ 1.22
Earnings Per Common Share – Assuming Dilution	**$ 1.46**	$ 1.22

Pro forma data may not be indicative of the results that would have been obtained had these events actually occurred at the beginning of the periods presented, nor does it intend to be a projection of future results.

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 largest business service communications providers, offering a variety of global communications services, including large domestic and multinational businesses, small and medium-sized businesses and government agencies, and operated one of the largest 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. At the time of the acquisition, we obtained preliminary third-party valuations of property, plant and equipment, intangible assets (including the AT&T trade name), debt and certain other assets and liabilities. Because of the proximity of this transaction to year-end, the values of certain assets and liabilities at December 31, 2005 were based on preliminary valuations and were subject to adjustment as additional information was obtained. Such additional information included, but was not limited to: valuations and physical counts of property, plant and equipment, valuation of investments and the involuntary termination of employees.

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

	Purchase Price Allocation		
	As of 12/31/05	Adjs.	As of 11/18/06
Assets acquired			
Current assets	$ 6,295	$ 358	$ 6,653
Property, plant and equipment	10,921	(489)	10,432
Intangible assets not subject to amortization:			
Trade name	4,900	—	4,900
Licenses	40	—	40
Intangible assets subject to amortization:			
Customer lists and relationships	3,050	—	3,050
Patents	150	—	150
Brand licensing agreements	70	—	70
Investments in unconsolidated subsidiaries	160	(90)	70
Other assets	4,247	167	4,414
Goodwill	12,343	(976)	11,367
Total assets acquired	42,176	(1,030)	41,146
Liabilities assumed			
Current liabilities, excluding current portion of long-term debt	6,740	(176)	6,564
Long-term debt	8,293	—	8,293
Deferred income taxes	531	(173)	358
Postemployment benefit obligation	8,807	(520)	8,287
Other noncurrent liabilities	2,288	(161)	2,127
Total liabilities assumed	26,659	(1,030)	25,629
Net assets acquired	$15,517	$ —	$15,517

Adjustments were primarily related to property, plant and equipment, head-count assumptions associated with payments for involuntary employee separations, pension asset valuations and the adjustment for certain tax items. Reductions in the value of property, plant and equipment primarily reflect the reduction of estimated real estate values of property in use as well as a more comprehensive look at our fixed asset portfolio. In addition to the deferred tax impacts associated with valuation adjustments, a net reduction in deferred taxes was recorded as a result of modifications to various pre-merger tax estimates and the resolution of an ATTC IRS audit (an adjustment of $385 for the years 1997-2001).

As ATTC stock options that were converted at the time of the merger are exercised, the tax effect on those options may further reduce goodwill. As of December 31, 2006, we had recorded $13 in related reductions.

ATTC maintained change-in-control provisions with its employees that required enhanced severance and benefit payments be paid to employees of ATTC if a change-in-control occurred. Included in the liabilities assumed at acquisition, was $1,543 accrued for such enhanced severance and benefits. As part of the opening balance sheet adjustments, a revised number of expected employee separations that will result in payments resulted in a decline in the change-in-control severance and benefits accrual of $616, included in "Adjustments" below. Following is a summary of the accrual recorded at December 31, 2005, cash payments made during 2006 and the purchase accounting adjustments thereto.

	Balance at 12/31/05	Cash Payments for the Year Ended 2006	Adjustments	Balance at 12/31/06
Paid out of:				
Company funds	$ 870	$(279)	$(184)	$407
Pension and Postemployment benefit plans	673	(58)	(432)	183
Total	$1,543	$(337)	$(616)	$590

The following unaudited pro forma consolidated results of operations assume that the acquisition of ATTC was completed as of January 1 for each of the fiscal years shown below.

Year Ended December 31,	2005	2004[1]
Revenues	$65,789	$69,165
Net Income (Loss)	6,167	(74)
Earnings Per Common Share	$ 1.59	$ (0.02)
Earnings Per Common Share – Assuming Dilution	$ 1.59	$ (0.02)

[1]ATTC's 2004 results include an impairment charge on property, plant and equipment of $11,400. Since the triggering event for assessing impairment of long-lived assets occurred in July 2004, it is not adjusted in the pro forma consolidated results.

Pro forma data may not be indicative of the results that would have been obtained had these events actually occurred at the beginning of the periods presented, nor does it intend to be a projection of future results.

As part of the process of coordinating benefits, we changed our management vacation-pay policy for legacy SBC Communications Inc. (SBC) employees so that vacation is earned ratably throughout the year rather than at the end of the preceding year. As a result, we recognized a decrease in operating expenses of $330 in 2006.

Other 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

Net proceeds from the 2004 dispositions of our international investments were generally used to fund, in part, our share of the purchase price paid by AT&T Mobility to acquire AT&T Wireless (AWE).

Directory advertising In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana to R.H. Donnelley Corporation (Donnelley) for net proceeds of $1,397. The sale included our interest in the DonTech II Partnership, a partnership between us and Donnelley that was the exclusive sales agent for Yellow Pages advertising in those two areas. This transaction closed in the third quarter of 2004 and we recorded a gain of $1,357 ($827 net of tax) in our third-quarter 2004 financial results. During the third quarter of 2004, we changed our reporting for this portion of the directory business to discontinued operations (see Note 15).

TDC A/S During 2004, we sold our investment in Danish telecommunications provider TDC A/S (TDC) for $2,864 in cash. We reported a net loss of $138 ($66 net of tax).

Telkom S.A. Limited During 2004, we also sold our investment in South African telecommunications provider Telkom S.A. Limited for $1,186 in cash. We reported a loss of $82 ($55 net of tax).

Belgacom S.A. In March 2004, in connection with Belgacom S.A.'s (Belgacom) initial public offering (IPO), we disposed of our entire investment in Belgacom. Both our investment and TDC's investment in Belgacom were held through Belgacom's minority stockholder, ADSB Telecommunications B.V. In a series of transactions culminating with the IPO, we reported a combined direct and indirect net gain of $1,067 ($715 net of tax) in our 2004 financial results, with $235 of this pretax gain reported as equity income, reflecting our indirect ownership though TDC (which also disposed of its interest). We received $2,063 in cash from the disposition of our direct interest.

NOTE 3. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for income from continuing operations for the years ended December 31, 2006, 2005 and 2004 are shown in the table below:

Year Ended December 31,	2006	2005	2004
Numerators			
Numerator for basic earnings per share:			
Income from continuing operations	**$7,356**	$4,786	$4,979
Dilutive potential common shares:			
Other stock-based compensation	**7**	10	9
Numerator for diluted earnings per share	**$7,363**	$4,796	$4,988
Denominators (000,000)			
Denominator for basic earnings per share:			
Weighted average number of common shares outstanding	**3,882**	3,368	3,310
Dilutive potential common shares:			
Stock options	**4**	1	2
Other stock-based compensation	**16**	10	10
Denominator for diluted earnings per share	**3,902**	3,379	3,322
Basic earnings per share			
Income from continuing operations	**$ 1.89**	$ 1.42	$ 1.50
Income from discontinued operations	**—**	—	0.28
Net income	**$ 1.89**	$ 1.42	$ 1.78
Diluted earnings per share			
Income from continuing operations	**$ 1.89**	$ 1.42	$ 1.50
Income from discontinued operations	**—**	—	0.27
Net income	**$ 1.89**	$ 1.42	$ 1.77

At December 31, 2006, 2005 and 2004, we had issued and outstanding options to purchase approximately 309 million, 277 million and 214 million shares of AT&T common stock. The exercise prices of options to purchase a weighted-average of 201 million, 257 million and 191 million shares in 2006, 2005 and 2004, 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, 2006, the exercise price of 111 million share options were below market price; of these options, 38 million will expire by the end of 2011.

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. As a result of our November 18, 2005 acquisition of ATTC we revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segments. Due to the proximity of our BellSouth acquisition to year-end, we have reported the two days of results from BellSouth in the other segment even though there may be some overlap in the products and services provided by that segment and our wireline segment. Under GAAP segment reporting rules, we analyze our various operating segments based on segment income before income taxes. Substantially all of our interest expense, interest income, other income (expense) – net and income tax expense are managed on a total company basis and are, accordingly, reflected only in consolidated results. The customers and long-lived assets of our reportable segments are predominantly in the United States. We have four reportable segments that reflect the current management of our business: (1) wireline, (2) wireless, (3) directory and (4) other.

The wireline segment provides both retail and wholesale landline telecommunications services, including local and long-distance voice, switched access, IP and Internet access data, messaging services, managed networking to business customers, our U-verse[SM] video service and satellite television services through our agreement with EchoStar Communications Corp. (EchoStar).

The wireless segment reflects 100% of the results reported by 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. Although we analyze AT&T Mobility's revenues and expenses under the wireless segment, we eliminate all results from the wireless segment prior to the acquisition in our consolidated financial statements and report our 60% proportionate share of AT&T Mobility's results from that period as equity in net income of affiliates. For segment reporting, we report this equity in net income of affiliates in our other segment. The results from the wireless segment for the two days following the acquisition are now included in our Consolidated Statements of Income and have not been eliminated.

The directory segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. This segment does not include BellSouth's directory operations for the two days following the December 29, 2006 acquisition, which are recorded in the other segment. Results for this segment are shown under the amortization method, which means that revenues and direct expenses are recognized ratably over the life of the directory title, typically 12 months. Results reflect the September 2004 sale of our interest in the directory advertising business in Illinois and northwest Indiana to Donnelley (see Note 2). Our portion of the results from YPC is recorded in this segment as equity in net income of affiliates. YPC became a wholly-owned subsidiary of AT&T following the December 29, 2006 acquisition of BellSouth.

The other segment includes results from BellSouth for the two days following the December 29, 2006 acquisition, as well as results from Sterling Commerce Inc. (Sterling) and from all corporate and other operations. In addition, the other segment contains our portion of the results from our international equity investments and from AT&T Mobility, 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 Wireline, Wireless, Directory and Other columns represent the segment results of each such operating segment. The Wireline column includes revenues from services sold to AT&T Mobility (see Note 14). Since we accounted for AT&T Mobility using the equity method of accounting prior to the December 29, 2006 acquisition, these revenues were not eliminated upon consolidation and as such, remain in consolidated revenue. The Consolidation and Elimination column includes 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. Since our 60% share of the results from AT&T Mobility is already included in the Other column for the period prior to the December 29, 2006 acquisition of BellSouth, the Wireless Elimination column removes the results of our wireless business shown in the Wireless segment for that period. In the balance sheet section of the tables below, we included goodwill and other intangibles from the acquisition of BellSouth in the "Segment assets" line item in the Other column and included our investment in AT&T Mobility of $26,989 in 2005 in the "Investment in equity method investees" line item in the Other column. Because of the BellSouth acquisition, AT&T Mobility and YPC are fully consolidated subsidiaries at December 31, 2006, and 100% of their assets are included in the "Segment assets" line item in the Wireless and Directory columns, respectively.

Segment results, including a reconciliation to AT&T consolidated results, for 2006, 2005 and 2004 are as follows:

At December 31, 2006 or for the year ended	Wireline	Wireless	Directory	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	**$ 58,441**	**$37,506**	**$3,621**	**$ 778**	**$ —**	**$(37,291)**	**$ 63,055**
Intersegment revenues	**35**	**—**	**81**	**176**	**(292)**	**—**	**—**
Total segment operating revenues	**58,476**	**37,506**	**3,702**	**954**	**(292)**	**(37,291)**	**63,055**
Operations and support expenses	**40,511**	**26,503**	**1,760**	**721**	**(292)**	**(26,343)**	**42,860**
Depreciation and amortization expenses	**9,614**	**6,436**	**3**	**256**	**(1)**	**(6,401)**	**9,907**
Total segment operating expenses	**50,125**	**32,939**	**1,763**	**977**	**(293)**	**(32,744)**	**52,767**
Segment operating income	**8,351**	**4,567**	**1,939**	**(23)**	**1**	**(4,547)**	**10,288**
Interest expense	**—**	**1,186**	**—**	**—**	**1,836**	**(1,179)**	**1,843**
Interest income	**—**	**20**	**—**	**—**	**377**	**(20)**	**377**
Equity in net income of affiliates	**—**	**—**	**(17)**	**2,060**	**—**	**—**	**2,043**
Other income (expense) – net	**—**	**(159)**	**—**	**—**	**16**	**159**	**16**
Segment income before income taxes	**8,351**	**3,242**	**1,922**	**2,037**	**(1,442)**	**(3,229)**	**10,881**
Segment assets	**102,891**	**97,634**	**4,107**	**288,103**	**(222,101)**	**—**	**270,634**
Investment in equity method investees	**—**	**1**	**—**	**1,994**	**—**	**—**	**1,995**
Expenditures for additions to long-lived assets	**8,147**	**7,039**	**2**	**171**	**—**	**(7,039)**	**8,320**

At December 31, 2005 or for the year ended	Wireline	Wireless	Directory	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	$ 39,475	$ 34,433	$ 3,625	$ 664	$ —	$ (34,433)	$ 43,764
Intersegment revenues	30	—	89	81	(200)	—	—
Total segment operating revenues	39,505	34,433	3,714	745	(200)	(34,433)	43,764
Operations and support expenses	27,857	26,034	1,715	577	(196)	(26,034)	29,953
Depreciation and amortization expenses	7,426	6,575	5	215	(3)	(6,575)	7,643
Total segment operating expenses	35,283	32,609	1,720	792	(199)	(32,609)	37,596
Segment operating income	4,222	1,824	1,994	(47)	(1)	(1,824)	6,168
Interest expense	—	1,260	—	—	1,456	(1,260)	1,456
Interest income	—	49	—	—	383	(49)	383
Equity in net income of affiliates	—	5	(5)	614	—	(5)	609
Other income (expense) – net	—	(87)	—	—	14	87	14
Segment income before income taxes	4,222	531	1,989	567	(1,060)	(531)	5,718
Segment assets	105,880	79,319	4,041	129,257	(93,546)	(79,319)	145,632
Investment in equity method investees	—	7	64	28,956	—	(7)	29,020
Expenditures for additions to long-lived assets	5,418	7,475	2	156	—	(7,475)	5,576

For the year ended December 31, 2004	Wireline	Wireless	Directory	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	$36,418	$19,565	$3,665	$650	$ —	$(19,565)	$40,733
Intersegment revenues	31	—	94	56	(181)	—	—
Total segment operating revenues	36,449	19,565	3,759	706	(181)	(19,565)	40,733
Operations and support expenses	25,233	14,960	1,644	567	(176)	(14,960)	27,268
Depreciation and amortization expenses	7,322	3,077	9	236	(3)	(3,077)	7,564
Total segment operating expenses	32,555	18,037	1,653	803	(179)	(18,037)	34,832
Segment operating income	3,894	1,528	2,106	(97)	(2)	(1,528)	5,901
Interest expense	—	900	—	—	1,023	(900)	1,023
Interest income	—	12	—	—	492	(12)	492
Equity in net income of affiliates	—	(415)	—	873	—	415	873
Other income (expense) – net	—	(82)	—	—	922	82	922
Segment income before income taxes	3,894	143	2,106	776	389	(143)	7,165

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

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

	Lives (years)	**2006**	2005
Land	—	**$ 1,925**	$ 1,169
Buildings	35-45	**23,481**	15,557
Central office equipment	3-10	**63,997**	57,254
Cable, wiring and conduit	10-50	**64,483**	55,858
Other equipment	5-15	**33,448**	12,111
Software	3-5	**11,678**	5,539
Under construction	—	**3,137**	1,750
		202,149	149,238
Accumulated depreciation and amortization		**107,553**	90,511
Property, plant and equipment – net		**$ 94,596**	$ 58,727

Our depreciation expense was $8,874 in 2006, $7,372 in 2005 and $7,447 in 2004.

Certain facilities and equipment used in operations are leased under operating or capital leases. Rental expenses under operating leases were $869 for 2006, $473 for 2005 and $479 for 2004. At December 31, 2006, the future minimum rental payments under noncancelable operating leases for the years 2007 through 2011 were $1,961, $1,718, $1,488, $1,295 and $1,087, with $6,747 due thereafter. Capital leases were not significant.

During 2005, we had impairments in our wireline segment of $349 on assets for which we do not believe we will recover their value due to the acquisition of ATTC. The impairments primarily consisted of $237 due to the write-down of out-of-region assets to current market value and write-offs of $45 of collocation assets and $43 of software. The impairments are reflected as an operating expense in the “Selling, general and administrative” line on our Consolidated Statements of Income.

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 were recorded as deferred revenue and recognized in income as revenue over the life of the leases. The balance of deferred revenue was $568 in 2006, $598 in 2005 and $628 in 2004.

NOTE 6. EQUITY METHOD INVESTMENTS

Investments in partnerships, joint ventures, including AT&T Mobility, and less-than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Until the December 29, 2006 BellSouth acquisition (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 The following table is a reconciliation of our investments in and advances to AT&T Mobility as presented on our Consolidated Balance Sheets:

	2006	2005
Beginning of year	**$ 31,404**	$33,687
Equity in net income	**1,508**	200
Other adjustments	**(32,912)**	(2,483)
End of year	**$ —**	$31,404

Undistributed earnings from AT&T Mobility were $4,219 prior to the BellSouth acquisition at December 29, 2006, and $2,711 at December 31, 2005. “Other adjustments” in 2006 primarily represents the consolidation of AT&T Mobility as a wholly-owned subsidiary of AT&T as a result of the BellSouth acquisition. “Other adjustments” in 2005 included the net activity of $2,442 under our revolving credit agreement with AT&T Mobility, reflecting a repayment of their shareholder loan of $1,747 and a net repayment of their revolving credit balance of $695 (see Note 14).

The following table presents summarized financial information for AT&T Mobility at December 31 or for the year then ended:

	2006	2005	2004
Income Statements			
Operating revenues	**$37,506**	$34,433	$19,565
Operating income	**4,567**	1,824	1,528
Net income	**2,523**	333	201
Balance Sheets			
Current assets	**$ 7,196**	$ 6,049	
Noncurrent assets	**90,438**	73,270	
Current liabilities	**10,317**	10,008	
Noncurrent liabilities	**26,318**	24,333	

Other Equity Method Investments Our investments in equity affiliates include primarily international investments. As of December 31, 2006, our investments in equity affiliates included an 8.9% interest in Teléfonos de México, S.A. de C.V. (Telmex), Mexico's national telecommunications company, and an 8.0% 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.

The following table is a reconciliation of our investments in equity affiliates as presented on our Consolidated Balance Sheets:

	2006	2005
Beginning of year	**$2,031**	$1,798
Additional investments	**5**	6
Equity in net income of affiliates	**535**	409
Dividends received	**(97)**	(158)
Currency translation adjustments	**(22)**	66
Dispositions	**—**	(228)
Other adjustments	**(457)**	138
End of year	**$1,995**	$2,031

Undistributed earnings from equity affiliates were $2,038 and $1,615 at December 31, 2006 and 2005. The currency translation adjustment for 2006 and 2005 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 the 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.

Dispositions for 2005 primarily reflect the dissolution of a wireless partnership. "Other adjustments" for 2005 include equity investment balances at December 31, 2005, acquired as part of our acquisition of ATTC totaling $135, which includes our 49% economic interest in Alestra S. de R.L. de C.V., a telecommunications company in Mexico.

The fair value of our investment in Telmex, based on the equivalent value of Telmex L shares at December 31, 2006, was $2,543. The fair value of our investment in América Móvil, based on the equivalent value of América Móvil L shares at December 31, 2006, was $6,488.

NOTE 7. DEBT

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

		2006	2005
Notes and debentures			
Interest Rates	Maturities		
4.13% – 5.98%	2006 – 2054	**$18,571**	$12,284
6.00% – 7.88%	2006 – 2097	**24,685**	12,700
8.13% – 9.75%	2006 – 2031	**8,626**	4,417
Other		**141**	3
Fair value of interest rate swaps		**(80)**	(16)
		51,943	29,388
Unamortized premium, net of discount		**2,323**	639
Total notes and debentures		**54,266**	30,027
Capitalized leases		**211**	115
Total long-term debt, including current maturities		**54,477**	30,142
Current maturities of long-term debt		**(4,414)**	(4,027)
Total long-term debt		**$50,063**	$26,115

On December 29, 2006, we assumed $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 the amount assumed now that it is 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 two issues of $1,000 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.

On November 18, 2005, we consolidated $8,293 in long-term debt, including capital leases, related to our acquisition of ATTC. ATTC's debt included both fixed and floating interest rates with a weighted-average rate of 8.6% (ranging from 3.87% to 9.75%) and had maturities ranging from 2006 to 2054. Included in our "Total notes and debentures" balance in the table above was the face value of acquired debt from ATTC of $6,910, which had a carrying amount of $7,694 at December 31, 2005.

Included in the table above at December 31, 2005, was $784 representing the remaining excess of the fair value over the recorded value of debt in connection with the acquisition of ATTC, of which $747 was included in our "Unamortized net premium (discount)" and $37 was included in our "Current maturities of long-term debt." The excess is amortized over the remaining lives of the underlying debt obligations.

At December 31, 2006, the aggregate principal amounts of long-term debt and the corresponding weighted-average interest rate scheduled for repayment for the years 2007 through 2011, excluding capitalized leases and the effect of interest rate swaps, were $4,400 (5.5%), $3,895 (5.5%), $5,919 (4.9%), $2,253 (6.3%) and $7,485 (7.5%) with $27,911 (7.0%) due thereafter. As of December 31, 2006 and 2005, we were in compliance with all covenants and conditions of instruments governing our debt. Substantially all of our outstanding long-term debt is unsecured.

Financing Activities

Debt During 2006, debt repayments totaled $4,244 and consisted of:

- $4,040 related to debt repayments with interest rates ranging from 5.75% to 9.50%, which included $284 associated with unwinding an interest rate foreign currency swap on our Euro-denominated debt (see Note 8).
- $148 related to called and put debt with interest rates ranging from 6.35% to 9.5%.
- $56 related to scheduled principal payments on other debt and repayments of other borrowings.

In May 2006, we received net proceeds of $1,491 from the issuance of $1,500 of long-term debt consisting of $900 of two-year floating rate notes and $600 of 6.80%, 30-year bonds maturing in 2036.

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

	2006	2005
Commercial paper	**$5,214**	$ 320
Current maturities of long-term debt	**4,414**	4,027
Bank borrowings[1]	**105**	108
Total	**$9,733**	$4,455

[1]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, 2006 and 2005 was 5.31% and 4.31%, respectively.

In February 2007, we issued $3,200 of long-term debt consisting of $1,500 principal amount of floating-rate notes due in 2010, $1,200 principal amount of 6.375% notes due in 2056 and $500 principal amount of 5.625% notes notes due in 2016.

Credit Facility In July 2006, we replaced our three-year $6,000 credit agreement with a five-year $6,000 credit agreement with a syndicate of investment and commercial banks. The current agreement will expire in July 2011. The available credit under this agreement increased by an additional $4,000 when we completed our acquisition of BellSouth. This incremental available credit is intended to replace BellSouth's $3,000 credit facility, which was terminated in January 2007. We have the right to request the lenders to further increase their commitments (i.e., raise the available credit) up to an additional $2,000, provided no event of default under the credit agreement has occurred. 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 are in compliance with all covenants under the agreement. We had no borrowings outstanding under committed lines of credit as of December 31, 2006 or 2005.

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 ERISA; and specified events of bankruptcy or insolvency.

NOTE 8. 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:

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	**$54,266**	**$54,566**	$30,027	$30,735
Commercial paper	**5,214**	**5,214**	320	320
Bank borrowings	**105**	**105**	108	108
AT&T Mobility shareholder loan	**—**	**—**	4,108	4,108
Available-for-sale equity securities	**2,731**	**2,731**	648	648
EchoStar note receivable	**478**	**467**	465	447
Preferred stock of subsidiaries	**43**	**43**	43	43

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.

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). Following the BellSouth acquisition, our shareholder loan with AT&T Mobility was consolidated and does not appear on our Consolidated Balance Sheet at December 31, 2006. At December 31, 2005, our shareholder loan to AT&T Mobility was recorded at face value, and the carrying amounts approximate fair values.

The fair value of our EchoStar note receivable was estimated based on a third-party 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" on 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. Gross realized gains on our available-for-sale equity securities were $10 in 2006, $110 in 2005 and $323 in 2004. Gross realized losses on these securities were $0 in 2006, $1 in 2005 and $191 in 2004. These gains and losses were determined using the specific identification method. Our proceeds from the sales of our available-for-sale equity securities were $10 in 2006, $125 in 2005 and $3,188 in 2004.

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 held-to-maturity securities of $477 at December 31, 2006, compared to $3 at December 31, 2005.

Preferred Stock Issuances In November 2005, we issued 768,391.4 shares of Perpetual Cumulative Preferred Stock (AT&T preferred stock), par value $1 per share. The AT&T preferred stock was issued to replace each share of ATTC preferred stock that was issued and outstanding prior to the November 18, 2005 acquisition and is held by a subsidiary of ATTC.

Preferred Stock Issuances by Subsidiaries In 2002, we restructured our holdings in certain investments, including Sterling. As part of this restructuring, a newly created subsidiary issued $43 of preferred stock, which was included in "Other noncurrent liabilities" on the Consolidated Balance Sheets. The preferred stock will accumulate dividends at an annual rate of 5.79% and can be converted, at the option of the holder, to common stock (but not a controlling interest) of the subsidiary at any time.

In 2005, we redeemed $350 of an AT&T subsidiary-issued preferred stock private placement and repaid $378 of preferred securities previously issued by an AT&T subsidiary, which was related to an internal restructuring of our ownership in several investments.

Letters of Credit Letters of credit are guarantees we purchase, which ensure our performance or payment to third parties in accordance with specified terms and conditions. Management has determined that our letters of credit do not create additional risk to us. The notional amounts outstanding were $478 at December 31, 2006, and $623 at December 31, 2005, and the fair values of the letters of credit, based on the fees paid to obtain the obligations, for both periods were $1.

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 $5,050 at December 31, 2006 and $4,250 at December 31, 2005, with a net carrying and fair value liability of $80 and $16, respectively. In 2006, we had $1,000 of swaps mature in 2006 related to our repayment of the underlying security. The net fair value liability at December 31, 2006, was comprised of a liability of $86 and an asset of $6. The net fair value liability at December 31, 2005, was comprised of a liability of $33 and an asset of $17.

Included in the above fair value interest rate swap notional value for 2006 was interest rate swaps with a notional amount of $1,800 acquired as a result of our acquisition of BellSouth on December 29, 2006. These swaps were unwound in January 2007.

Interest Rate Locks In May 2006, we entered into an interest rate forward contract with a notional amount of $750 to partially hedge interest expense related to our debt issuance in 2006. In 2006, we utilized a notional amount of $600 of this forward contract and incurred settlement gains of $4. In November 2005, we entered into an interest rate forward contract with a notional amount of $500 to partially hedge interest expense related to refinancing a portion of our debt maturities in 2006. In November 2005, we utilized the notional amount of this interest rate forward contract and incurred settlement costs of $2. During 2004, we utilized a notional amount of $1,500 of interest rate forward contracts and incurred settlement costs of $302 ($196 net of tax benefit). During 2007, we expect to reclassify into earnings between $8 to $9, net of tax, of the previously mentioned settlement expenses.

Interest Rate Foreign Currency Swaps We had combined interest rate foreign currency swap agreements for Euro-denominated debt, which hedge our risk to both interest rate and currency movements. In November 2006, we repaid the notional amount of our 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.

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, 2006 and 2005, our foreign exchange contracts consisted principally of Euros, British pound sterling, Danish krone and Japanese Yen. At December 31, 2006, the notional amounts under contract were $440, of which $6 were designated as net investment hedges. At December 31, 2005, the notional amounts under contract were $623, of which $18 were designated as net investment hedges. The remaining contracts in both periods were not designated for accounting purposes. There was no ineffectiveness recognized in earnings for these contracts during 2006 and 2005. At December 31, 2006, these foreign exchange contracts had a net carrying and fair value asset of $1, comprised of an asset of $4 and a liability of $3. At December 31, 2005, these foreign exchange contracts had a net carrying and fair value liability of $8, comprised of an asset of $5 and a liability of $13. These contracts were valued using current market quotes, which were obtained from independent sources.

NOTE 9. INCOME TAXES

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

	2006	2005
Depreciation and amortization	**$21,016**	$13,921
Intangibles (nonamortizable)	**2,271**	1,874
Equity in foreign affiliates	**515**	727
Employee benefits	**(9,667)**	(4,897)
Currency translation adjustments	**(261)**	(272)
Allowance for uncollectibles	**(385)**	(351)
Unamortized investment tax credits	**(68)**	(79)
Net operating loss and other carryforwards	**(2,981)**	(838)
Investment in wireless partnership	**12,580**	2,597
Other – net	**368**	387
Subtotal	**23,388**	13,069
Deferred tax assets valuation allowance	**984**	627
Net deferred tax liabilities	**$24,372**	$13,696
Net long-term deferred tax liabilities	**$27,406**	$15,713
Less: Net current deferred tax assets	**(3,034)**	(2,011)
Less: Other assets	**—**	(6)
Net deferred tax liabilities	**$24,372**	$13,696

At December 31, 2006 and 2005, net deferred tax liabilities include a deferred tax asset of $456 and $542 relating to compensation expense under Statement of Financial Accounting Standards No. 123(R) "Share-Based Payment" (FAS 123(R)). Full realization of this deferred tax asset 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), however, 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 stock price of AT&T common shares will rise to levels sufficient to realize the entire tax benefit currently reflected in our balance sheet.

At December 31, 2006, we had net operating and capital loss carryforwards (tax effected) for federal, state and foreign income tax purposes of $1,507, $1,138 and $13 respectively expiring through 2025. The federal net operating loss carryforward primarily relates to AT&T Mobility's acquisition of AWE in 2004. Additionally, we had federal and state credit carryforwards of $71 and $252 respectively expiring primarily through 2024.

The change in the valuation allowance for 2006 is primarily the result of the acquisition of ATTC, BellSouth and AT&T Mobility. Other changes are the result of an evaluation of the uncertainty associated with the realization of certain deferred tax assets unrelated to FAS 123(R). Future adjustments to the valuation allowance attributable to the ATTC, BellSouth and AT&T Mobility opening balance sheet items may be required to be allocated to goodwill and other purchased intangibles.

In June 2006, the FASB issued FIN 48, which changes the accounting for uncertainty in income taxes by prescribing a recognition threshold for tax positions taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Our evaluation of the impact FIN 48 will have on our financial position and results of operations is ongoing.

The components of income tax expense are as follows:

	2006	2005	2004
Federal:			
Current	**$3,344**	$1,385	$1,145
Deferred – net	**(139)**	(681)	843
Amortization of investment tax credits	**(28)**	(21)	(32)
	3,177	683	1,956
State, local and foreign:			
Current	**295**	226	427
Deferred – net	**53**	23	(197)
	348	249	230
Total	**$3,525**	$ 932	$2,186

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:

	2006	2005	2004
Taxes computed at federal statutory rate	**$3,809**	$2,001	$2,508
Increases (decreases) in income taxes resulting from:			
State and local income taxes – net of federal income tax benefit	**234**	176	213
Effects of international operations	**(200)**	(70)	(222)
Medicare reimbursements	**(123)**	(95)	(89)
Equity in net income of affiliates	**(218)**	(35)	—
Tax settlements	**—**	(902)	(65)
Other – net	**23**	(143)	(159)
Total	**$3,525**	$ 932	$2,186

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. Deferred taxes are not provided on the undistributed earnings of subsidiaries operating outside the United States that have been or are intended to be permanently reinvested.

NOTE 10. PENSION AND POSTRETIREMENT BENEFITS

We acquired BellSouth on December 29, 2006, and ATTC on November 18, 2005. In conjunction with the BellSouth merger, AT&T Mobility became a wholly-owned subsidiary and its pension plan was combined with AT&T's. BellSouth, AT&T Mobility and ATTC sponsored noncontributory defined benefit pension plans covering the majority of their U.S. employees. In accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (FAS 87) and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (FAS 106), 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 ATTC, BellSouth or AT&T Mobility postretirement 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."

Due to the proximity of the BellSouth transaction to the end of the year, we have presented below the reconciliation of the December 31, 2006 expected funded status of BellSouth's plans, excluding supplemental retirement plans and excluding the acquisition by AT&T, and status of those plans subsequent to the acquisition.

	Pension Benefits		Postretirement Benefits	
	Pre-merger	Post-merger	Pre-merger	Post-merger
Benefit obligations	$(11,622)	$(11,013)	$(10,803)	$(11,461)
Fair value of plan assets	17,628	17,628	5,269	5,269
Funded (unfunded) benefit obligation	6,006	6,615	(5,534)	(6,192)
Unrecognized net (gain) loss	(661)	—	1,377	—
Unrecognized net obligation	—	—	49	—
Unrecognized prior service cost (benefit)	(280)	—	2,535	—
Net amount recorded	$ 5,065	$ 6,615	$ (1,573)	$ (6,192)

The acquisition of BellSouth's portion of AT&T Mobility will be accounted for as a step acquisition. In accordance with purchase accounting rules, BellSouth's investment in AT&T Mobility will be adjusted to its fair value through purchase accounting adjustments. Accordingly, we have recognized a new liability for 40% of AT&T Mobility's pension and postretirement benefit plans. Prior to the merger, we recorded our investment in AT&T Mobility as an equity investment and did not account for our 60% economic interest of AT&T Mobility's pension and postretirement plans. We have included our historical 60% ownership interest in the table below.

We have presented below the reconciliation of the December 31, 2006 expected funded status of AT&T Mobility's plans, excluding supplemental retirement plans and excluding the acquisition by AT&T, and status of those plans subsequent to the acquisition.

	Pension Benefits		Postretirement Benefits	
	Pre-merger	Post-merger	Pre-merger	Post-merger
Benefit obligations	$(679)	$(635)	$(153)	$(209)
Fair value of plan assets	548	548	—	—
Funded (unfunded) benefit obligation	(131)	(87)	(153)	(209)
Unrecognized net (gain) loss	(20)	(38)	26	—
Unrecognized prior service cost (benefit)	8	4	(6)	45
Net amount recorded	$(143)	$(121)	$(133)	$(164)

The reconciliation of the December 31, 2004 funded status of ATTC's U.S. plans, excluding supplemental retirement plans, and status of those plans subsequent to the merger are as follows:

	Pension Benefits		Postretirement Benefits	
	Pre-merger	Post-merger	Pre-merger	Post-merger
Benefit obligations	$(16,178)	$(16,942)	$(5,813)	$(9,129)
Fair value of plan assets	18,510	18,917	2,313	2,429
Funded (unfunded) benefit obligation	2,332	1,975	(3,500)	(6,700)
Unrecognized net loss	949	—	1,298	—
Unrecognized prior service cost	356	—	53	—
Net amount recorded	$ 3,637	$ 1,975	$(2,149)	$(6,700)

In subsequent periods, net periodic pension and postemployment cost for BellSouth, BellSouth's 40% economic interest in AT&T Mobility and ATTC will exclude any amortization of either the unrecognized loss or the unrecognized prior service cost existing at the date of the merger. However, the funding of these plans is not directly affected by the mergers. The basis of funding, over time, will reflect the past amendments and losses that underlie those amounts. As they are reflected in the funding process, contributions will, in some periods, exceed the net pension cost, and that will reduce the liability (unfunded accrued pension cost) recognized at the date of acquisition.

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. Effective January 15, 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. ATTC, BellSouth and AT&T Mobility management employees 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.

At December 31, 2006, certain defined pension plans formerly sponsored by ATTC and AT&T Mobility were merged in to the AT&T Pension Benefit Plan.

Postretirement Benefits

We provide certain 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 the 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.

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	
	2006	2005	**2006**	2005
Benefit obligation at beginning of year	**$46,176**	$28,189	**$35,225**	$25,114
Service cost – benefits earned during the period	**1,050**	804	**435**	390
Interest cost on projected benefit obligation	**2,507**	1,725	**1,943**	1,496
Amendments	**—**	(2)	**—**	(442)
Actuarial loss (gain)	**(1,499)**	1,182	**(3,386)**	613
Special termination benefits	**25**	15	**2**	2
Curtailments	**—**	—	**—**	(77)
Benefits paid	**(3,958)**	(2,679)	**(1,772)**	(1,234)
Transferred from AT&T Mobility	**635**	—	**209**	—
Transferred from BellSouth	**11,013**	—	**11,461**	—
Transferred from ATTC	**—**	16,942	**—**	9,129
Other	**—**	—	**20**	234
Benefit obligation at end of year	**$55,949**	$46,176	**$44,137**	$35,225

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	
	2006	2005	**2006**	2005
Fair value of plan assets at beginning of year	**$48,755**	$29,813	**$ 11,417**	$ 8,692
Actual return on plan assets	**6,311**	2,704	**1,379**	677
Benefits paid[1]	**(3,958)**	(2,679)	**(920)**	(381)
Transferred from AT&T Mobility	**548**	—	**—**	—
Transferred from BellSouth	**17,628**	—	**5,269**	—
Transferred from ATTC	**—**	18,917	**—**	2,429
Fair value of plan assets at end of year	**$69,284**	$48,755	**$ 17,145**	$ 11,417
Funded (unfunded) status at end of year[2]	**$13,335**	$ 2,579	**$(26,992)**	$(23,808)

[1]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.

[2]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.

Included in "Postemployment benefit obligation" on our Consolidated Balance Sheets at December 31, 2004, was a reduction in the liability associated with the "1983 Unfunded Postretirement Benefits Cost Sharing Agreement" and "1983 Force Adjustment Cost-Reimbursement and Indemnification Agreement" (Agreements). Under the Agreements, the Bell System Companies (RBOCs) (which included the former SBC and BellSouth) agreed to provide postemployment benefits to those employees of ATTC who retired prior to the 1983 reorganization that divided ATTC. As part of the Agreements, ATTC agreed to reimburse RBOCs for postemployment benefits paid to these retirees. Since ATTC agreed to provide reimbursement, the accumulated postemployment benefits recorded on our Consolidated Balance Sheets prior to the November 18, 2005 acquisition of ATTC did not include these expected payments. After the ATTC merger, we no longer will receive third-party reimbursement for these liabilities and accordingly increased our benefit obligation by $234 in 2005 for the ATTC merger. ATTC maintains the Agreements with the remaining RBOCs and we include estimated amounts subject to reimbursement on our Consolidated Balance Sheets as "Other noncurrent liabilities."

Also included in "Postemployment benefit obligation" on our Consolidated Balance Sheets at December 31, 2004, were phone concessions for out-of-region retirees. The out-of-region phone concession, which is not part of the pension plan and not subject to ERISA, allowed for out-of-region retirees to receive reimbursements for phone services provided by another carrier. During 2005, we notified out-of-region retirees of changes which allowed us to reduce this obligation by $96.

Effective January 1, 2006, medical coverage for most management participants was amended to provide a high-deductible plan. Additionally, effective January 1, 2005, medical coverage for nonmanagement retirees was amended to increase co-pays and deductibles for prescription drugs and certain medical services.

During 2004, we agreed to new five-year labor agreements for nonmanagement employees. The agreements provided that, prior to expiration of the agreement, we would contribute $2,000 to a VEBA trust to partially fund current and future retiree health care, $1,000 of which was contributed during 2004.

Amounts recognized on our Consolidated Balance Sheets at December 31 are listed below:

	Pension Benefits		Postretirement Benefits	
	2006	2005	**2006**	2005
Postemployment benefit	**$13,335**	$12,699	**$ 772**	$ —
Current portion employee benefit obligation[1]	**—**	—	**(973)**	(1,505)
Employee benefit obligation[2]	**—**	(1,548)	**(26,791)**	(14,953)
Net amount recognized	**$13,335**	$11,151	**$(26,992)**	$(16,458)

[1]Included in "Accounts payable and accrued liabilities."
[2]Included in "Postemployment benefit obligation."

As required by FAS 158, we recognized the funded status of defined benefit pension, including supplemental retirement and savings plans, and postemployment plans as an asset or liability in our statement of financial position and will recognize changes in that funded status in the year in which the changes occur through comprehensive income. This standard has no effect on our expense or benefit recognition nor will it affect the funding requirements imposed under ERISA. FAS 158 requires prospective application for fiscal years ending after December 15, 2006. At December 31, 2006, we decreased our net postretirement assets $4,891, increased our postemployment benefits $3,459 and decreased our other comprehensive income $4,786 (net of deferred taxes of $3,564). (See Note 1)

Amounts recognized in our accumulated other comprehensive income at December 31 are listed below:

	Pension Benefits		Postretirement Benefits	
	2006	2005	**2006**	2005
Net loss	**$4,271**	$ —	**$ 6,124**	$ —
Prior service cost (benefit)	**624**	—	**(2,669)**	—
Total	**$4,895**	$ —	**$ 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 $53,662 at December 31, 2006, and $44,139 at December 31, 2005.

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 $1,635, $1,336 and $1,287 for the years ended December 31, 2006, 2005 and 2004. The following table presents the components of net periodic benefit obligation cost (gains are denoted with parentheses and losses are not):

	Pension Benefits			Postretirement Benefits		
	2006	2005	2004	**2006**	2005	2004
Service cost – benefits earned during the period	**$ 1,050**	$ 804	$ 818	**$ 435**	$ 390	$ 383
Interest cost on projected benefit obligation	**2,507**	1,725	1,642	**1,943**	1,496	1,495
Expected return on plan assets	**(3,989)**	(2,736)	(2,684)	**(935)**	(781)	(720)
Amortization of prior service cost (benefit) and transition asset	**149**	186	188	**(359)**	(344)	(349)
Recognized actuarial loss	**361**	156	44	**473**	440	470
Net pension and postretirement cost[1]	**$ 78**	$ 135	$ 8	**$1,557**	$1,201	$1,279

[1]During 2006, 2005 and 2004, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) reduced postretirement benefit cost by $349, $304 and $255. This effect is included in several line items above.

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 $248 and $127, respectively. The estimated net loss and 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 are $293 and $355.

Assumptions

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

	2006	2005	2004
Discount rate for determining projected benefit obligation at December 31	**6.00%**	5.75%	6.00%
Discount rate in effect for determining net cost (benefit)[1]	**5.75%**	6.00%	6.25%
Long-term rate of return on plan assets	**8.50%**	8.50%	8.50%
Composite rate of compensation increase for determining projected benefit obligation at December 31	**4.00%**	4.00%	4.00%
Composite rate of compensation increase for net pension cost (benefit)	**4.00%**	4.00%	4.25%

[1]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-cutting 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 6.00% at December 31, 2006 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 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, 2006, we increased our discount rate by 0.25%, resulting in a decrease in our pension plan benefit of $1,040 and a decrease in our postretirement benefit obligation of $1,030. For the year ended December 31, 2005, we reduced our discount rate by 0.25%, resulting in an increase in our pension plan benefit obligation of $609 and an increase in our postretirement benefit obligation of $844. 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 2007 and 2006 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 2007 combined pension and postretirement cost to increase $802 over 2006.

Composite Rate of Compensation Increase Our expected composite rate of compensation increase of 4% for 2006 and 2005 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. 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.

	2007	2006
Health care cost trend rate assumed for current year		
Retirees 64 and under	**6.43%**	7.00%
Retirees 65 and over	**7.50%**	8.00%
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**	2009

Due to multiple years of better than assumed experience on dental claims, we reduced our assumed annual dental cost trend from 5% to 3% in 2007. 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	$ 351	$ (279)
Increase (decrease) in accumulated postretirement benefit obligation	4,891	(4,040)

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 is based on our legacy operations, ATTC and BellSouth asset weighted allocation and forecasting studies that have been conducted within the last few years for the postretirement benefit plans.

The following table presents the asset targets by asset category and does not reflect updated targets for the December 29, 2006 acquisition of BellSouth due to the proximity of that transaction to year-end. It is our intention to perform forecasting studies during 2007 that will establish appropriate investment strategies for all AT&T plan assets.

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	**2006**	2005	Target	**2006**	2005
Equity securities						
Domestic	35% – 45%	**38%**	41%	45% – 55%	**51%**	51%
International	15% – 25%	**19**	17	10% – 20%	**22**	16
Debt securities	20% – 30%	**26**	29	12% – 22%	**18**	28
Real estate	5% – 10%	**8**	6	3% – 9%	**2**	1
Other	5% – 10%	**9**	7	9% – 15%	**7**	4
Total		**100%**	100%		**100%**	100%

At December 31, 2006, the pension assets included 4.3 million shares of AT&T common stock with a fair value of $152 and AT&T bonds with a notional amount of $62 and fair value of $68. As a result of our acquisition of BellSouth, pension assets increased by 2.4 million shares of AT&T stock with a fair value of $86 and AT&T bonds with a notional value of $16 and fair value of $17. During 2006, the pension plans purchased $19 and sold $19 of AT&T bonds. Additionally, during 2006, the pension plan purchased and sold AT&T common stock of $22 and $38, respectively. Pension plan holdings in AT&T securities represented 0.3% of total plan assets at December 31, 2006.

At December 31, 2006, the VEBA assets included 1.6 million shares of AT&T common stock with a fair value of $56 and AT&T bonds with a notional amount and fair value of $5. As a result of our acquisition of BellSouth, the VEBA assets increased by 949,000 shares of AT&T stock with a fair value of $34 and AT&T bonds with a notional and fair value of $3. During 2006, the VEBAs purchased $1 of AT&T bonds and $8 of AT&T common stock. VEBA holdings in AT&T securities represented 0.4% of total plan assets at December 31, 2006.

Estimated Future Benefit Payments

Expected benefit payments are estimated using the same assumptions used in determining our benefit obligation at December 31, 2006. 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
2007	$ 4,920	$ 2,531	$ (120)
2008	4,711	2,652	(132)
2009	4,824	2,768	(143)
2010	4,840	2,859	(154)
2011	4,854	2,947	(164)
Years 2012 – 2016	23,705	15,022	(1,074)

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, 2006 and 2005 were $2,470 and $1,381, respectively.

At December 31, 2006 we increased our other noncurrent liabilities $386 ($375 for net losses and $11 for prior service costs) and decreased our other comprehensive income $240 (net of deferred taxes of $146) for the adoption of FAS 158 (see Note 1). Prior to our adoption of FAS 158, at December 31, 2005 we had recorded an additional minimum pension liability as a direct charge to equity of $217 (net of deferred taxes of $134), as the accumulated benefit obligation of certain plans exceeded the recorded liability.

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

	2006	2005
Projected benefit obligation	**$(2,470)**	$(1,800)
Accumulated benefit obligation	**(2,353)**	(1,730)
Fair value of plan assets	**—**	—

The following table presents the components of net periodic benefit cost (gains are denoted with parentheses and losses are not):

	2006	2005
Service cost – benefits earned during the period	**$ 15**	$ 8
Interest cost on projected benefit obligation	**108**	73
Amortization of prior service cost	**4**	9
Recognized actuarial loss	**29**	23
Net supplemental retirement pension cost	**$156**	$113

Deferred compensation expense was $39 in 2006, $46 in 2005 and $44 in 2004. Our deferred compensation liability, included in "Other noncurrent liabilities," was $996 at December 31, 2006 and $574 at December 31, 2005.

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. As described earlier and in accordance with FAS 106, 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, 2006 and 2005 were $158 and $236, respectively.

	2006	2005
Benefit obligations at end of year	**$(1,016)**	$(906)
Fair value of plan assets	**858**	650
(Unfunded) benefit obligation	**(158)**	(256)

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

	2006	2005
Projected benefit obligation	**$1,016**	$906
Accumulated benefit obligation	**874**	765
Fair value of plan assets	**858**	650

We recognized a net loss of $64 in our accumulated other comprehensive income at December 31, 2006. The estimated net loss that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $3.

The following table presents the components of net periodic benefit cost (gains are denoted with parentheses and losses are not):

	2006	2005
Service cost – benefits earned during the period	**$ 27**	$ 3
Interest cost on projected benefit obligation	**45**	5
Expected return on assets	**(43)**	(4)
Net pension cost	**$ 29**	$ 4

The December 31, 2006, benefit obligations were determined using a weighted-average discount rate of 4.86% and a weighted-average rate of compensation increase of 4.36%. Net periodic pension cost was $29 for the year ended December 31, 2006, and was determined using the following weighted-average assumptions: discount rate of 4.55%, compensation increase of 4.25% and expected return on plan assets of 6.09%.

The December 31, 2005, benefit obligations were determined using a weighted-average discount rate of 4.55% and a weighted-average rate of compensation increase of 4.25%. Net periodic pension cost was $4 for the 43 days ended December 31, 2005, and was determined using the following weighted-average assumptions: discount rate of 4.90%, compensation increase of 4.25% and expected return on plan assets of 6.15%.

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.

In December 2006, we completed our acquisition of BellSouth, thereby acquiring AT&T Mobility; and in November 2005, we acquired ATTC. We currently intend to maintain coverage of employees in savings plans, which provide for a match of a percentage of employee contributions up to certain limits.

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 $412, $334 and $316 for the years ended December 31, 2006, 2005 and 2004.

NOTE 11. STOCK-BASED COMPENSATION

In September 2005, we adopted FAS 123(R), which is a revision of FAS 123. FAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and amends Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows" using the modified retrospective method.

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.

In connection with the December 2006 acquisition of BellSouth, all outstanding BellSouth stock-based compensation plans were restructured based on the 1.325 per share conversion rate and subsequently issued in AT&T shares of stock or stock units. We converted and recorded 83 million stock options.

In connection with the November 2005 acquisition of ATTC, all outstanding ATTC stock-based compensation plans were restructured based on the 0.77942 per share conversion rate and the special dividend, and subsequently issued in AT&T shares of stock or stock units. We converted and recorded 86 million stock options.

At December 31, 2006, 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 $293 in 2006, $143 in 2005 and $153 in 2004 and is included in "Selling, general and administrative" on our Consolidated Statements of Income. The total income tax benefit recognized on the Consolidated Statements of Income for stock-based compensation arrangements for the years ended December 31, 2006, 2005 and 2004 was $113, $54 and $58.

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, 2006 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 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, 2006, we were authorized to issue up to 143 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:

	2006	2005	2004
Performance stock units	**$274**	$116	$ 65
Stock option expense	**13**	19	75
Other	**6**	8	13
Total	**$293**	$143	$153

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:

	2006	2005	2004
Risk-free interest rate	**4.94%**	4.15%	4.21%
Dividend yield	**4.75%**	5.38%	5.00%
Expected volatility factor	**21.79%**	22.47%	23.78%
Expected option life in years	**8.00**	8.00	7.00

A summary of option activity as of December 31, 2006, 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[1]
Outstanding at January 1, 2006	277	$39.74		
Granted	2	28.01		
Converted from BellSouth[2]	83	30.40		
Exercised	(24)	24.73		
Forfeited or expired	(29)	42.79		
Outstanding at December 31, 2006	309	$37.96	2.95	$941
Exercisable at December 31, 2006	307	$38.03	2.90	$923

[1]Aggregate intrinsic value includes only those options with intrinsic value (options where the exercise price is below the market price).
[2]Options converted from BellSouth used the following weighted-average assumptions: risk-free interest rate of 4.84%, dividend yield of 5.20%, expected volatility factor of 19.05% and had an expected option life of up to 4 years. The weighted-average fair value of each option converted was $2.02.

The weighted-average fair value of each option granted during the year ended December 31 was $4.78 in 2006, $3.39 in 2005 and $4.06 in 2004. The total intrinsic value of options exercised during the year was $134 in 2006, $24 in 2005 and $33 in 2004.

A summary of the status of our nonvested stock units, which includes performance stock units as of December 31, 2006, and changes during the period then ended is presented below (shares in millions):

Nonvested Stock Units	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	15	$24.91
Granted	15	25.45
Converted from BellSouth	6	21.54
Vested	(10)	25.95
Forfeited	(1)	25.18
Nonvested at December 31, 2006	25	$24.03

As of December 31, 2006, there was $230 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 1.75 years. The total fair value of shares vested during the years ended December 31, 2006, 2005 and 2004 was $246, $38 and $24.

Cash received from option exercises under all stock-based payment arrangements for the years ended December 31 was $614 in 2006, $192 in 2005 and $234 in 2004. The actual tax benefit realized for the tax deductions from option exercises from these arrangements for the years ended December 31, 2006, 2005 and 2004 totaled $28, $9 and $12.

It is our policy to satisfy share option exercises using our treasury shares.

NOTE 12. 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 March 2006, 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, 2008. As of December 31, 2006, we had repurchased approximately 84 million shares under the program.

NOTE 13. ADDITIONAL FINANCIAL INFORMATION

Balance Sheets	December 31, 2006	December 31, 2005
Accounts payable and accrued liabilities:		
Accounts payable	**$ 6,919**	$ 4,466
Accrued rents and other	**5,013**	1,015
Advance billing and customer deposits	**3,402**	1,717
Accrued payroll	**3,111**	2,104
Deferred directory revenue	**1,721**	1,832
Current portion of employee benefit obligation	**973**	1,505
Compensated future absences	**759**	875
Accrued interest	**722**	473
Other	**2,888**	3,101
Total accounts payable and accrued liabilities	**$25,508**	$17,088
Deferred compensation (included in Other noncurrent liabilities)	**$ 2,064**	$ 1,127

Statements of Income	2006	2005	2004
Advertising expense	**$ 1,530**	$ 812	$ 862
Interest expense incurred	**$ 1,916**	$ 1,492	$ 1,054
Capitalized interest	**(73)**	(36)	(31)
Total interest expense	**$ 1,843**	$ 1,456	$ 1,023

Statements of Cash Flows	2006	2005	2004
Cash paid during the year for:			
Interest	**$ 1,666**	$ 1,395	$ 1,043
Income taxes, net of refunds	**2,777**	2,038	506

Statements of Stockholders' Equity	2006	2005	2004
Accumulated other comprehensive income is comprised of the following components, net of taxes, at December 31:			
Foreign currency translation adjustment	**$ (488)**	$ (505)	$ (555)
Unrealized gains on securities	**345**	340	391
Unrealized (losses) on cash flow hedges	**(172)**	(191)	(196)
Defined benefit postretirement plan	**(4,999)**	—	—
Accumulated other comprehensive (loss)	**$(5,314)**	$ (356)	$ (360)

No customer accounted for more than 10% of consolidated revenues in 2006, 2005 or 2004.

Goodwill and Other Intangible Assets

Changes in the carrying amounts of goodwill for the years ended December 31, 2006 and 2005 are as follows:

	Wireline Segment	Wireless Segment	Directory Segment	Other Segment	Total
Balance as of January 1, 2005	$ 724	$ —	$ 8	$ 893	$ 1,625
Goodwill acquired	12,071	—	—	370	12,441
Goodwill written off related to sale of business unit	—	—	—	(11)	(11)
Balance as of December 31, 2005	12,795	—	8	1,252	14,055
Goodwill acquired	197	27,429	128	26,606	54,360
Goodwill adjustment related to ATTC acquisition	(989)	—	—	—	(989)
Other	—	155	—	76	231
Balance as of December 31, 2006	**$12,003**	**$27,584**	**$136**	**$27,934**	**$67,657**

Goodwill is tested annually for impairment, with any impairments being expensed in that period's income statement. Goodwill recorded in 2005 to our ATTC segment related to our November 2005 acquisition of ATTC was reallocated in 2006 primarily to our wireline segment and was further reduced in 2006 by $976 upon completion of purchase accounting adjustments and by $13 for the tax effect of stock options exercised (see Note 2). Goodwill recorded in 2006 to our wireless and other segments primarily relates to our December 2006 acquisition of BellSouth and, as allowed by GAAP, is subject to adjustment for one-year as we finalize the valuations of assets acquired and liabilities assumed in that transaction. As part of the final valuation we will determine to which entities and to what extent the benefit of the acquisition applies, and will record the appropriate goodwill to that entity, which may affect our segment presentation.

Our other intangible assets are summarized as follows:

	December 31, 2006		December 31, 2005	
Other Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer lists and relationships:				
AT&T Mobility	**$ 9,530**	**$ 1,948**	$ —	$ —
BellSouth	**9,230**	**—**	—	—
ATTC	**3,050**	**1,082**	3,050	184
Other	**395**	**253**	380	213
Subtotal	**22,205**	**3,283**	3,430	397
Other	**1,973**	**714**	1,100	589
Total	**$24,178**	**$3,997**	$4,530	$986
Indefinite life intangible assets not subject to amortization:				
Licenses	**$34,252**		$ 59	
Trade name	**5,307**		4,900	
Total	**$39,559**		$4,959	

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 7.1 years (7.2 years for customer lists and relationships and 5.8 years for other). Amortization expense for definite-life intangible assets was $1,033, $271 and $117 for the years ended December 31, 2006, 2005 and 2004, respectively. Amortization expense is estimated to be $5,870 in 2007, $4,190 in 2008, $3,340 in 2009, $2,550 in 2010 and $1,680 in 2011.

Licenses includes FCC licenses of $33,979 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 14. 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). Our shareholder loan to AT&T Mobility totaled $4,108 at December 31, 2005. This loan carried an annual 6.0% interest rate. We and BellSouth also entered into a revolving credit agreement with AT&T Mobility to provide short-term financing for operations. Our share of advances to AT&T Mobility under the revolving credit agreement was $307 at December 31, 2005, and is reflected in "Investments in and Advances to AT&T Mobility" on our Consolidated Balance Sheet. During 2005, AT&T Mobility repaid $1,747 to reduce the balance of its shareholder loan in accordance with the terms of the revolving credit agreement. Following the BellSouth acquisition, mentioned above, both our shareholder loan and our revolving credit agreement with AT&T Mobility were consolidated and do not appear on our Consolidated Balance Sheet at December 31, 2006. We earned interest income on our shareholder loan of $246 during 2006, $311 in 2005 and $354 in 2004.

Prior to our December 29, 2006 acquisition of BellSouth, we generated revenues of $1,466 in 2006, $869 in 2005 and $602 in 2004 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. The offsetting expense amounts were recorded by AT&T Mobility, and 60% of these expenses were included in our "Equity in net income of affiliates" line on our Consolidated Statements of Income when we reported our 60% proportionate share of AT&T Mobility's results.

NOTE 15. DISCONTINUED OPERATIONS

In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana to Donnelley and received net proceeds of $1,397. As part of this transaction we recorded a gain of $1,357 ($827 net of tax) in our 2004 results.

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets," we have reclassified the results from our directory advertising business in Illinois and northwest Indiana as discontinued operations, restating previously reported results to reflect the reclassification on a comparable basis. The operational results and the gain associated with the sale of this business are presented in the "Income From Discontinued Operations, net of tax" line item on our Consolidated Statements of Income. Prior to the reclassification, these results were reported in our directory segment.

Summarized financial information for the Illinois and northwest Indiana directory advertising business is as follows:

Year ended December 31,	**2006**	2005	2004
Operating revenues	**$ —**	$ —	$311
Operating income	**—**	—	132
Income taxes	**—**	—	51
Net income from operations	**—**	—	81
Gain on disposal, net of tax	**—**	—	827

The assets and liabilities of the discontinued operations were $0 as of December 31, 2006 and 2005.

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 $2,564 in 2007, $2,100 in total for 2008 and 2009, $802 in total for 2010 and 2011 and $331 in total for years thereafter.

NOTE 17. SUBSEQUENT EVENT

As part of the dissolution of AT&T Mobility's joint venture agreement with T-Mobile USA (T-Mobile), both parties were required to exchange certain spectrum licenses and we committed to purchase a minimum number of minutes on T-Mobile's California/Nevada and New York networks during a specified transition period. In January 2007, we received 10 MHz of spectrum in the New York market; T-Mobile received 5 MHz of spectrum in each of nine markets in California, the largest of which is San Diego. T-Mobile also notified us of its intent to exercise its option to purchase an additional 10 MHz of spectrum in the San Diego market, with the transaction closing expected during the second quarter of 2007. Concurrent with T-Mobile's notification to purchase the San Diego spectrum, T-Mobile communicated to us that it will not exercise its option to purchase 10 MHz of spectrum in the Los Angeles market.

We expect to record a net gain in connection on these transactions, estimated to be between $150 to $250 net of tax, principally due to the value of the New York spectrum received. The gain is net of $55 of costs previously deferred, which related to parts of the dissolution transaction completed in prior periods. This gain is subject to valuation revisions of the assets exchanged and the resolution of remaining business matters governed by the dissolution agreement.

NOTE 18. SUBSIDIARY FINANCIAL INFORMATION

We have fully and unconditionally guaranteed a 2006 debt issuance of BellSouth, which is a wholly-owned subsidiary of AT&T as of December 29, 2006. (See Note 2)

In accordance with Securities and Exchange Commission (SEC) rules, we are providing the following condensed consolidating financial information. The Parent column presents investments in all subsidiaries under the equity method of accounting. We have listed BellSouth separately because we have guaranteed securities that are legal obligations of BellSouth that would otherwise require SEC periodic reporting for 2006. In the following Condensed Consolidating Statements of Income and the Condensed Consolidating Statements of Cash Flows, the BellSouth column represents 100% of the results from BellSouth for the two days following the December 29, 2006 acquisition. All other wholly-owned subsidiaries are presented in the Other column. The consolidating adjustments column (Adjs.) eliminates the intercompany balances and transactions between our subsidiaries.

Condensed Consolidating Statements of Income
For the Twelve Months Ended December 31, 2006

	Parent	BellSouth	Other	Adjs.	Total
Total operating revenues	**$ —**	**$113**	**$71,845**	**$(8,903)**	**$63,055**
Total operating expenses	**(184)**	**82**	**61,772**	**(8,903)**	**52,767**
Operating Income	**184**	**31**	**10,073**	**—**	**10,288**
Interest expense	**1,019**	**6**	**3,521**	**(2,703)**	**1,843**
Equity in net income of affiliates	**5,874**	**4**	**2,511**	**(6,346)**	**2,043**
Other income (expense) – net	**2,926**	**3**	**(253)**	**(2,283)**	**393**
Income Before Income Taxes	**7,965**	**32**	**8,810**	**(5,926)**	**10,881**
Income taxes	**609**	**10**	**2,906**	**—**	**3,525**
Net Income	**$7,356**	**$ 22**	**$ 5,904**	**$(5,926)**	**$ 7,356**

Condensed Consolidating Statements of Income
For the Twelve Months Ended December 31, 2005

	Parent	BellSouth	Other	Adjs.	Total
Total operating revenues	$ —	$ —	$49,563	$(5,799)	$43,764
Total operating expenses	(142)	—	43,537	(5,799)	37,596
Operating Income	142	—	6,026	—	6,168
Interest expense	868	—	2,590	(2,002)	1,456
Equity in net income of affiliates	2,634	—	711	(2,736)	609
Other income (expense) – net	2,407	—	(81)	(1,929)	397
Income Before Income Taxes	4,315	—	4,066	(2,663)	5,718
Income taxes	(471)	—	1,403	—	932
Net Income	$4,786	$ —	$ 2,663	$(2,663)	$ 4,786

Condensed Consolidating Statements of Income
For the Twelve Months Ended December 31, 2004

	Parent	BellSouth	Other	Adjs.	Total
Total operating revenues	$ —	$ —	$45,650	$(4,917)	$40,733
Total operating expenses	(182)	—	39,931	(4,917)	34,832
Operating Income	182	—	5,719	—	5,901
Interest expense	417	—	1,255	(649)	1,023
Equity in net income of affiliates	5,035	—	1,714	(5,876)	873
Other income (expense) – net	1,039	—	183	192	1,414
Income Before Income Taxes	5,839	—	6,361	(5,035)	7,165
Income taxes	(48)	—	2,234	—	2,186
Income from Continuing Operations	5,887	—	4,127	(5,035)	4,979
Income from Discontinued Operations, net of tax	—	—	908	—	908
Net Income	$5,887	$ —	$ 5,035	$(5,035)	$ 5,887

Condensed Consolidating Balance Sheets
December 31, 2006

	Parent	BellSouth	Other	Adjs.	Total
Cash and cash equivalents	**$ 225**	**$ 408**	**$ 1,785**	**$ —**	**$ 2,418**
Accounts receivable – net	**47,544**	**3,602**	**39,841**	**(74,793)**	**16,194**
Other current assets	**406**	**887**	**5,666**	**(18)**	**6,941**
Total current assets	**48,175**	**4,897**	**47,292**	**(74,811)**	**25,553**
Property, plant and equipment – Net	**191**	**18,498**	**75,907**	**—**	**94,596**
Goodwill	**349**	**26,467**	**40,841**	**—**	**67,657**
Intangible Assets – Net	**—**	**10,085**	**49,655**	**—**	**59,740**
Investments in Equity Affiliates	**109,916**	**32,824**	**45,072**	**(185,817)**	**1,995**
Other Assets	**1,591**	**13,592**	**16,006**	**(10,096)**	**21,093**
Total Assets	**$160,222**	**$106,363**	**$274,773**	**$(270,724)**	**$270,634**
Debt maturing within one year	**$ 25,614**	**$ 2,770**	**$ 51,718**	**$ (70,369)**	**$ 9,733**
Other current liabilities	**3,227**	**4,043**	**30,247**	**(6,768)**	**30,749**
Total current liabilities	**28,841**	**6,813**	**81,965**	**(77,137)**	**40,482**
Long-term debt	**14,264**	**14,103**	**28,994**	**(7,298)**	**50,063**
Other noncurrent liabilities	**1,577**	**18,627**	**44,461**	**(116)**	**64,549**
Total stockholders' equity	**115,540**	**66,820**	**119,353**	**(186,173)**	**115,540**
Total Liabilities and Stockholders' Equity	**$160,222**	**$106,363**	**$274,773**	**$(270,724)**	**$270,634**

Condensed Consolidating Balance Sheets
December 31, 2005

	Parent	BellSouth	Other	Adjs.	Total
Cash and cash equivalents	$ 220	$ —	$ 1,004	$ —	$ 1,224
Accounts receivable – net	45,076	—	34,475	(70,200)	9,351
Other current assets	341	—	3,738	—	4,079
Total current assets	45,637	—	39,217	(70,200)	14,654
Property, plant and equipment – Net	129	—	58,598	—	58,727
Goodwill	349	—	13,706	—	14,055
Intangible Assets – Net	15	—	8,488	—	8,503
Investments in Equity Affiliates	43,115	—	14,214	(55,298)	2,031
Investments in and Advances to AT&T Mobility	4,415	—	48,581	(21,592)	31,404
Other Assets	2,365	—	15,173	(1,280)	16,258
Total Assets	$96,025	$ —	$197,977	$(148,370)	$145,632
Debt maturing within one year	$22,397	$ —	$ 69,742	$ (87,684)	$ 4,455
Other current liabilities	3,171	—	23,512	(5,720)	20,963
Total current liabilities	25,568	—	93,254	(93,404)	25,418
Long-term debt	13,841	—	12,863	(589)	26,115
Other noncurrent liabilities	1,926	—	36,248	1,235	39,409
Total stockholders' equity	54,690	—	55,612	(55,612)	54,690
Total Liabilities and Stockholders' Equity	$96,025	$ —	$197,977	$(148,370)	$145,632

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2006

	Parent	BellSouth	Other	Adjs.	Total
Net cash from operating activities	**$ 5,017**	**$ 22**	**$ 7,104**	**$ 3,472**	**$15,615**
Net cash from investing activities	**(1,435)**	**386**	**(7,244)**	**—**	**(8,293)**
Net cash from financing activities	**(3,577)**	**—**	**921**	**(3,472)**	**(6,128)**
Net Increase in Cash	**$ 5**	**$408**	**$ 781**	**$ —**	**$ 1,194**

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2005

	Parent	BellSouth	Other	Adjs.	Total
Net cash from operating activities	$ 4,969	$ —	$10,567	$ (2,562)	$ 12,974
Net cash from investing activities	2,849	—	(3,823)	—	(974)
Net cash from financing activities	(8,227)	—	(5,561)	2,562	(11,226)
Net increase (decrease) in cash from continuing operations	(409)	—	1,183	—	774
Net increase (decrease) in cash from discontinued operations	—	—	(310)	—	(310)
Net Increase (Decrease) in Cash	$ (409)	$ —	$ 873	$ —	$ 464

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2004

	Parent	BellSouth	Other	Adjs.	Total
Net cash from operating activities	$(14,941)	$ —	$ 1,830	$24,061	$ 10,950
Net cash from investing activities	(407)	—	(20,340)	—	(20,747)
Net cash from financing activities	11,367	—	17,304	(24,061)	4,610
Net increase (decrease) in cash from continuing operations	(3,981)	—	(1,206)	—	(5,187)
Net increase in cash from discontinued operations	—	—	1,141	—	1,141
Net Increase (Decrease) in Cash	$ (3,981)	$ —	$ (65)	$ —	$ (4,046)

NOTE 19. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table represents our quarterly financial results:

						Stock Price		
Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Basic Earnings Per Share[1]	Diluted Earnings Per Share[1]	High	Low	Close
2006								
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**			
2005								
First	$10,234	$1,556	$885	$0.27	$0.27	$25.98	$22.99	$23.69
Second	10,317	1,518	1,000	0.30	0.30	24.33	22.78	23.75
Third	10,304	1,962	1,246	0.38	0.38	24.97	23.20	23.97
Fourth	12,909	1,132	1,655	0.46	0.46	25.60	21.75	24.49
Annual	$43,764	$6,168	$4,786	1.42	1.42			

[1]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

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.

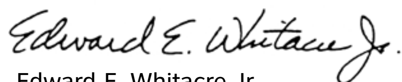
The Audit Committee of the Board of Directors meets periodically with management, the internal auditors and the independent auditors to review the manner in which they are performing their respective responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. 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, 2006. 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*. We have excluded from the scope of our assessment of internal control over financial reporting the operations and related assets of BellSouth and AT&T Mobility, which we acquired on December 29, 2006. At December 31, 2006 and for the period from December 29 through December 31, 2006, total assets and total revenues subject to BellSouth's internal control over financial reporting represented 27% and 0.2% of AT&T's consolidated total assets and total revenues as of and for the year ended December 31, 2006 and total assets and total revenues subject to AT&T Mobility's internal control over financial reporting represented 36% and 0.3% of AT&T's consolidated total assets and total revenues as of and for the year ended December 31, 2006. Based on its assessment, AT&T management believes that, as of December 31, 2006, the Company's internal control over financial reporting is effective based on those criteria.

Ernst & Young LLP, an independent registered public accounting firm, has issued an attestation report on management's assessment of the company's internal control over financial reporting. The attestation report is included on Page 82.



Edward E. Whitacre Jr.
Chairman of the Board and
Chief Executive Officer

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

Report of Independent Registered Public Accounting Firm

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, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. 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, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in 2006 the Company changed its method of accounting for pension and other postretirement benefits.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, 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 15, 2007, expressed an unqualified opinion thereon.

Ernst + Young LLP

San Antonio, Texas
February 15, 2007

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

The Board of Directors and Stockholders
AT&T Inc.

We have audited management's assessment as described in the "Assessment of Internal Control," included in the accompanying Report of Management, that AT&T Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2006, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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.

As indicated in the accompanying "Assessment of Internal Control," management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of BellSouth Corporation (BellSouth) or AT&T Mobility LLC (formerly Cingular Wireless LLC), which were acquired on December 29, 2006, and are included in the 2006 consolidated financial statements of the Company. At December 31, 2006, and for the period from December 29 through December 31, 2006, total assets and total revenues subject to BellSouth's internal control over financial reporting represented 27% and 0.2% of the Company's consolidated total assets and total revenues as of and for the year ended December 31, 2006, and total assets and total revenues subject to AT&T Mobility LLC's internal control over financial reporting represented 36% and 0.3% of the Company's consolidated total assets and total revenues as of and for the year ended December 31, 2006. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of BellSouth or AT&T Mobility LLC.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, 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, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006, of the Company and our report dated February 15, 2007, expressed an unqualified opinion thereon.

Ernst + Young LLP

San Antonio, Texas
February 15, 2007