Dollars in millions except per share amounts

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

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

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

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

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

| | **2007** | 2006 |
|---|---|---|
| Commercial paper | **$1,859** | $5,214 |
| Current maturities of long-term debt | **4,939** | 4,414 |
| Bank borrowings[1] | **62** | 105 |
| Total | **$6,860** | $9,733 |

[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, 2007 and 2006 was 4.2% and 5.3%, respectively.

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

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

## NOTE 9. FINANCIAL INSTRUMENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

## NOTE 10. INCOME TAXES

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

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

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

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

Dollars in millions except per share amounts

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

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

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

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

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

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

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

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

The components of income tax expense are as follows:

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

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

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

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

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

## NOTE 11. PENSION AND POSTRETIREMENT BENEFITS

### Pension Benefits

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

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

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

### Postretirement Benefits

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

### Obligations and Funded Status

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

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

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

Dollars in millions except per share amounts

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

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

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

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

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

[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.

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

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| Postemployment benefit | **$17,288** | $13,335 | **$ —** | $ 772 |
| Current portion employee benefit obligation[1] | **—** | — | **(249)** | (973) |
| Employee benefit obligation[2] | **—** | — | **(23,137)** | (26,791) |
| Net amount recognized | **$17,288** | $13,335 | **$(23,386)** | $(26,992) |

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

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

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

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

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

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

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

**Net Periodic Benefit Cost**

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

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

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

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

[1]FAS 158 required prospective application for fiscal years ending after December 15, 2006.

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

**Assumptions**

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

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

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

*Discount Rate* Our assumed discount rate of 6.50% at December 31, 2007 reflects the hypothetical rate at which the projected benefit obligations could be effectively settled or paid out to participants on that date. We determined our discount rate based on a range of factors, including a yield curve comprised of the rates of return on high-quality, fixed-income corporate bonds available at the measurement date and the related expected duration for the obligations. For the year ended December 31, 2007, we increased our discount rate by 0.50%, resulting in a decrease in our pension plan benefit obligation of $2,353 and a decrease in our postretirement benefit obligation of $2,492. For the year ended December 31, 2006, we increased our discount rate by 0.25%, resulting in a decrease in our pension plan benefit obligation of $1,040 and a decrease in our postretirement benefit obligation of $1,030. Should actual experience differ from actuarial assumptions, the projected pension benefit obligation and net pension cost and accumulated postretirement benefit obligation and postretirement benefit cost would be affected in future years.

Dollars in millions except per share amounts

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

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

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

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

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

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

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

**Plan Assets**

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

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

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

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

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

**Estimated Future Benefit Payments**

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

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

**Supplemental Retirement Plans**

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

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

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

| | **2007** | 2006 |
|---|---|---|
| Projected benefit obligation | **$(2,301)** | $(2,470) |
| Accumulated benefit obligation | **(2,155)** | (2,353) |
| Fair value of plan assets | **—** | — |

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

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

| **Other Changes Recognized in Other Comprehensive Income**[1] | **2007** | 2006 |
|---|---|---|
| Net loss (gain) | **$ (60)** | $233 |
| Prior service cost (credit) | **11** | 7 |
| Amortization of net loss (gain) | **15** | — |
| Amortization of prior service cost | **3** | — |
| Total recognized in net supplemental pension cost and other comprehensive income | **$ (31)** | $240 |

[1]FAS 158 required prospective application for fiscal years ending after December 15, 2006.

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

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

Dollars in millions except per share amounts

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

### Non-U.S. Plans

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

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

| | 2007 | 2006 |
|---|---|---|
| Benefit obligations at end of year | **$(1,016)** | $(1,016) |
| Fair value of plan assets | **1,064** | 858 |
| (Unfunded) benefit obligation | **$ 48** | $ (158) |

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

| | 2007 | 2006 |
|---|---|---|
| Projected benefit obligation | **$1,015** | $1,016 |
| Accumulated benefit obligation | **892** | 874 |
| Fair value of plan assets | **1,064** | 858 |

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

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

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

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

| Other Changes Recognized in Other Comprehensive Income[1] | 2007 | 2006 |
|---|---|---|
| Net loss (gain) | **$(105)** | $ 40 |
| Amortization of net loss (gain) | **(2)** | — |
| Amortization of prior service cost | **—** | — |
| Total recognized in net pension cost and other comprehensive income | **$(107)** | $ 40 |

[1]FAS 158 required prospective application for fiscal years ending after December 15, 2006.

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

### Contributory Savings Plans

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

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

## NOTE 12. STOCK-BASED COMPENSATION

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

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

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

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

| | **2007** | 2006 | 2005 |
|---|---|---|---|
| Performance stock units | **$620** | $282 | $116 |
| Restricted stock | **68** | 6 | 6 |
| Stock option expense | **14** | 13 | 19 |
| Other | **18** | — | 2 |
| Total | **$720** | $301 | $143 |

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

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

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

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

[1]Aggregate intrinsic value includes only those options with intrinsic value (options where the exercise price is below the market price).

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

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

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

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

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