

Verizon Communications
2005 Annual Report



We never stop working for you.

Verizon Communications

With more than \$75 billion in annual revenues in 2005, Verizon Communications is one of the world's leading providers of communications services.

- \$22 billion in Cash Flows From Operations
- Reported earnings of \$2.65 per diluted share
- 105.3 million total customer connections (wireline, wireless and broadband)
- #1 in customer satisfaction for Verizon Wireless, American Customer Satisfaction Index
- Top-ranked “major communications performer” in J.D. Power Customer Satisfaction Survey
- Numerous awards and “best of” lists, including Latina Style, DiversityInc, CIO Magazine, Hispanic Magazine, and Frost & Sullivan Product Innovation Awards

Domestic Telecom

Provider of wireline and other telecommunications services, including broadband

- Revenues of \$37.6 billion
- Serving nearly 30 million wireline households throughout the United States
- 5.1 million broadband connections
- Deploying the most advanced broadband network, including video, in the U.S.

Verizon Wireless

Leading wireless services provider with the nation's most reliable wireless network

- Revenues of \$32.3 billion
- 51.3 million customers across the United States
- Industry leader in customer loyalty, profitability and customer growth
- Leading innovator in wireless services, including broadband, video and music

Information Services

Provider of print, Internet and wireless yellow pages directories and related shopping information

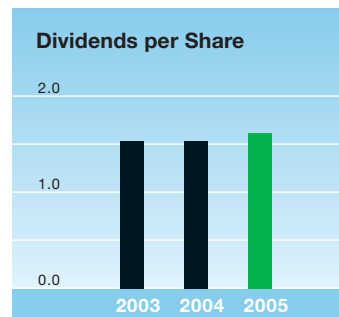
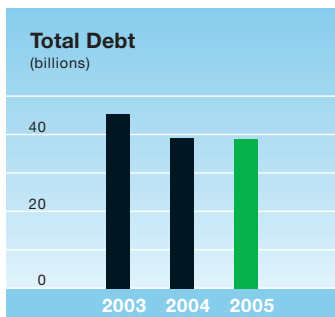
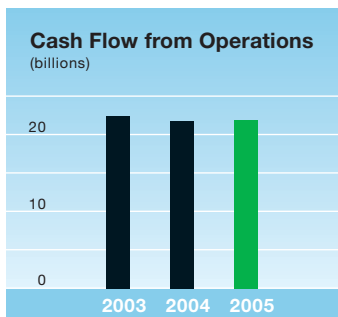
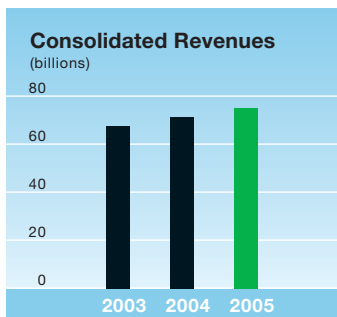
- Revenues of \$3.5 billion
- Publishes more than 1,300 Verizon directory titles with a total circulation of approximately 121 million copies in the U.S., and 8 million internationally
- Verizon Superpages.com is an advanced Internet directory and online shopping resource
- In December 2005, Verizon announced that it is exploring divesting Verizon Information Services through a spin-off, sale or other strategic transaction

International

Wireline and wireless operations and investments in the Americas and Europe

- Revenues of \$2.2 billion
- Ownership and management interests in:
 - Verizon Dominicana
 - Puerto Rico Telephone
 - CANTV
 - Vodafone Omnitel

(all data as of December 31, 2005)



In keeping with Verizon's commitment to protecting the environment, this Annual Report is printed on recycled paper. Information about our environmental initiatives – including energy conservation, reducing greenhouse gas emissions, waste reduction and recycling – can be found on our website (www.verizon.com) by clicking on “About Verizon” and selecting “Verizon and the Environment.”



putting our **customers** first

At Verizon, we believe that the power of communications can have a profound effect on people's lives. That's why our highly skilled and dedicated workforce is motivated to put our customers first by delivering all the benefits of the wireless, wireline and multimedia services that consumers and businesses demand. We want our customers to enjoy a seamless communications experience, at home, in the office and on the road, that connects them to the things that matter most – wherever they are and whenever they want.

Verizon has 105 million customer connections – the total of our switched access lines, broadband connections and wireless subscribers – that provide the richer, deeper and broader

experiences that customers are demanding from their communications providers. Our long history of service and reliability makes us the customer's trusted guide in this new and constantly changing world of communications, and we believe that the best way to deliver long-term shareowner value is to first deliver a superior customer experience.

Providing great service to customers is our number-one priority. It's who we are and why we exist. We come to work every day trying to do our job better than we did yesterday. Our slogan, "we never stop working for you," expresses the central spirit of Verizon's philosophy of total accountability for satisfying our customers.

delivering growth through transformation

Fellow shareowners:

When we created Verizon in 2000, we had at our core a belief that investing in technology was the key to creating value in communications. As services like video, photos, data, music and games converged onto broadband networks, we knew that businesses and consumers would demand access to this surge of digital content – creating huge new markets for companies whose networks could transport all those bits and bytes, make them work together and help make customers' lives simpler, richer and more productive.



Ivan Seidenberg,
Chairman and Chief Executive Officer

We built our company to stand at the center of that digital marketplace.

Verizon is investing in the technology we need to compete and grow. We are using that technology to expand our revenue base and produce real innovation for customers. Our strategy is to create our future in the digital world – and in 2005, we saw that strategy take root.

Preparing to Lead in the Digital World

We are using technology investment to position each of our major businesses to benefit from the growth trends that are transforming our industry.

At Verizon Wireless, we moved ahead of the rest of the industry to gain a national footprint and invested early on in a network that gave us an edge in quality and efficiency. We also were a first mover in wireless broadband, launching our high-speed network ahead of the rest of the industry and carving out a premium position in the fast-growing markets for wireless data, video and music. Our wireless broadband network now covers half the United States. The result of this approach is that, rather than slowing down as competition in wireless ramps up, we have accelerated our momentum – gaining market share, improving profitability and turning in quarter after quarter of industry-leading results.

As we've done in wireless, we are using technology transformation to create competitive advantage in our wired

network. Over the years, we have invested steadily in fiber backbones, digital switching, and higher-bandwidth capabilities such as DSL, which have given us a growing foothold in broadband. In 2005, we took another big step to transform this business by deploying a unique fiber architecture to the home that enables us to provide super-high-speed Internet access and enter the video market. This fiber network now passes 3 million customers, with another 3 million targeted for 2006.

The power of networks also underlies our approach to the business and government market, where we dramatically improved our competitive position through our acquisition of MCI. This transaction gives us the global reach, Internet backbone, customer relationships and product portfolio to be a truly major player in this marketplace. We closed this transaction in January 2006 and immediately launched our new Verizon Business unit, which is poised to become one of the premier global service providers in the marketplace.

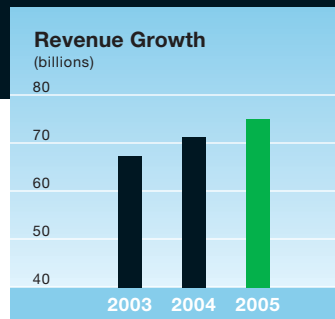
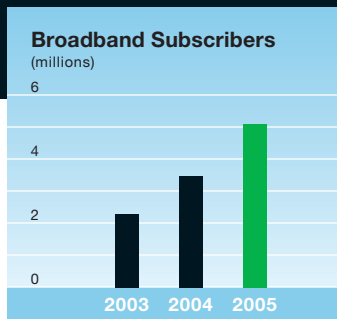
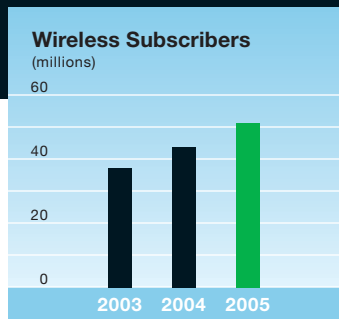
Verizon now has the technology base to grow the way other high-tech companies do: through innovation. We are introducing more new products in the market today than at any time in our history – from broadband products for every market niche, to Internet voice services, to new wireless video and music products, to on-line games, and more.

The good news is, customers are responding and our operating and financial results are strong.

2005 Operating and Financial Results

Revenues were \$75 billion in 2005, up 5.4 percent over 2004. In the last four years, we have expanded our revenue base by \$8.6 billion through our focus on growth businesses such as wireless, consumer broadband and high-speed business data products. Leading the way was Verizon Wireless, which grew revenues by 16.8 percent – an extraordinary performance for a business with more than \$30 billion in revenues. We saw strong growth in consumer broadband and high-speed data services in our Telecom business, which is helping us manage the impact of technology substitution and competition in our traditional business.

We also turned in a solid financial performance in 2005. Reported earnings for the year were \$7.4 billion, or \$2.65 per diluted share. After adjustments for one-time and special items, earnings grew 1.6 percent over 2004. Our operating businesses generated \$22 billion in cash for the year, which enabled us to invest \$15.3 billion in capital, reduce debt by \$300 million, and pay \$4.4 billion in dividends to shareowners. In the last five years, we have reduced total debt by \$18.8 billion, making our balance sheet as strong today as at any time in our history.



In 2005, we added millions of new customers across our business. Verizon Wireless had another record-setting year, adding 7.5 million new customers, for a total of 51.3 million. We also had a record-setting year in broadband, adding 1.7 million customers, for a total of 5.1 million.

We continue to focus on what matters to customers. Verizon Wireless set new

The bottom line is that we entered 2006 in a strong financial position, with consistent revenue growth, solid margins and cash flows, and a strong balance sheet.

Unfortunately, 2005 was a difficult year for Verizon's stock. Our total return for the year was down 22.2 percent. This is both disappointing and frustrating for us. Investors have told us that they

Putting Customers First

Of course, the way to make a company more valuable to investors is by making it more valuable to customers – not just through its products, but also through its people, reputation and commitment to service. In 2005 we formalized our “customer first” commitment and aligned our employees around our core values of integrity, respect, performance excellence and accountability.

Our employees are proud to be part of a company that's taking charge of its own future. They are passionate about putting customers first. They hold one another – and themselves – accountable for delivering outstanding service with the highest of ethical standards. And just as they've done throughout our history, our people came through for their neighbors in times of crisis. Whether it was responding to the tsunami in Asia or Hurricane Katrina on the Gulf Coast, Verizon employees continue to demonstrate the moral fiber and can-do spirit that is built into the foundation of our company.

We are grateful to the members of our Board of Directors, who have steadfastly supported our investments in technology. We're confident in our pathway to the future. We're excited about getting on the right side of the big ideas that are pushing our industry forward. And with every step we take toward becoming the premier broadband, wireless and multi-media company in the industry, we know we are creating a better future for our people and a more valuable company for our shareowners.

Ivan G. Seidenberg
Chairman and Chief Executive Officer

Verizon now has the technology base to grow the way other high-tech companies do: through innovation.

standards of excellence for the wireless industry, leading the league in customer loyalty, network reliability and quality. Both our landline and wireless companies rank tops in our categories in American Customer Satisfaction and J. D. Power surveys, and our brand is regularly named by consumers as number one in our industry.

Looking ahead, we will continue to focus our resources on our network businesses. To that end, we announced that we are exploring the divestiture of our valuable Verizon Information Services unit. We also are making some tough choices to secure our place in the future. For example, in 2005 we announced that we are making changes to retirement benefits for management employees, which will be effective July 1, 2006. These changes (which do not affect pensions or benefits for current retirees) will help align benefit plans for management employees across the company, address unpredictable and escalating costs, and put Verizon on a more stable competitive footing going forward.

are concerned with the effect of competition and technology substitution in our traditional business, the heavy capital investment we're making in broadband, and the potential uncertainty created in 2005 by the pending MCI transaction.

2006 will be an important year for us to demonstrate that we can use our capital to produce results in the marketplace and growth for shareowners. Our people are up to the challenge. In fact, as I visit employees around Verizon, I am struck by their commitment to our strategy and their conviction that our technology investments are creating a more valuable company.

Together, we will marshal that conviction to deliver results that will build that same kind of confidence and optimism among investors.



giving customers more choice

Around the block or around the globe, the power and intelligence of Verizon's high-tech networks give customers more choice of communications services, both now and in the future. Our networks touch more customers in a day than many companies do in an entire year. We will begin 2006 serving more than 51 million wireless customers, nearly 30 million wireline households, 134,000 large business customers, and thousands of schools, libraries, universities and government offices all over the United States and the world.

Verizon is the industry leader in wireless, broadband and global communications networks because we continue to invest in the advanced infrastructure necessary to deliver supe-

rior products and services to customers with a growing appetite for innovation.

Innovative products and great customer service helped Verizon Wireless add a record 7.5 million new subscribers last year, with the highest customer loyalty in the industry. Our subscribers enjoy the most reliable wireless network in the country, as well as the most widely available wireless broadband network in the country.

In the residential market, Verizon is giving customers a better choice for broadband and video services. Our new state-of-the-art fiber network, which takes fiber-optic technology all the way to customers' homes and businesses, is the most



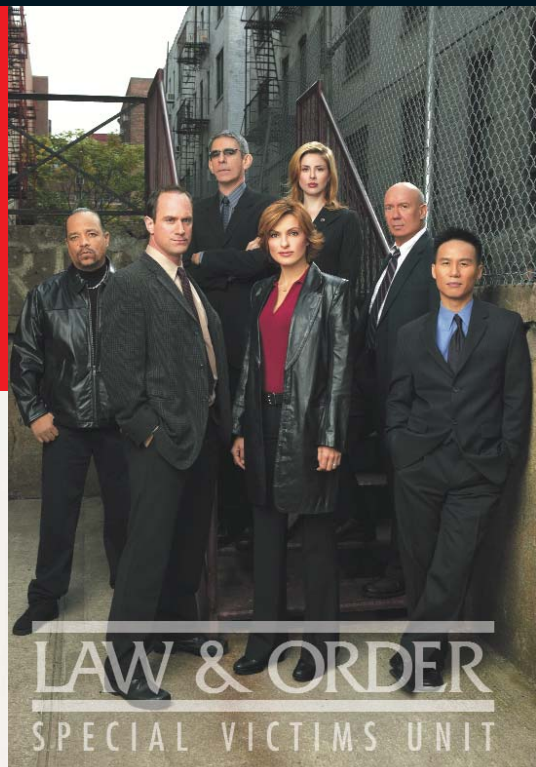
in communications services

advanced broadband network being deployed in America today. Our fiber network provides customers with blazing fast Internet connections and over 400 channels of 100 percent digital video.

In addition, our merger with MCI earlier this year has made Verizon a leading global provider of advanced communications solutions to the business and government marketplace. We own and operate one of the most expansive end-to-end global Internet Protocol (IP) networks. This infrastructure includes over 270,000 domestic and 360,000 international route miles of fiber-optic cable, provides next-generation IP network services to medium and large businesses and government customers, and offers access to over 140 countries.

Our investments in fiber, wireless broadband and global IP networks have made us a strong competitor in the converged communications marketplace. But what really sets us apart is our ability to integrate these network strengths to improve efficiencies and provide better value to our customers.

As technology and competition continue to evolve, our customers will find new and exciting ways to connect with each other. To satisfy the needs of a constantly changing marketplace, we're focused on delivering the best customer experience possible. Our quality networks, innovative products, reliable service and great value will continue to make Verizon the first choice in communications.



creating the nation's most advanced

The growth of the Internet has created a digital world of movies, photos, music and other data that can now be carried over broadband networks and delivered to a wide variety of electronic devices. Verizon is at the center of this converging marketplace. As a result of Verizon's investment in advanced broadband networks, we can capture this digital content, make it all work together and then deliver it to whatever device the customer wants.

Verizon has created the best all-around value in broadband today. We offer a speed for every need, a price for every budget, along with unsurpassed content and applications for today's digital household. We put customers first with excellent

service and a continuously growing portfolio of broadband services delivered over reliable, advanced networks.

Verizon offers a choice of high-speed DSL Internet service plans, and Verizon Online DSL customers also have a choice of Web portals featuring a wide array of content, such as online security, entertainment and multiple mail accounts.

In 2004, Verizon began rolling out our groundbreaking fiber network, featuring an advanced technology that uses fiber-optics instead of copper wire as the direct connection to homes and businesses. By the end of 2005, Verizon's fiber network passed 3 million homes and was deployed in close to 800 communities in more than half the states that we serve. We



Verizon Online DSL

broadband networks

plan to pass an additional 3 million homes by the end of 2006, covering around 20 percent of our residential customer base.

Verizon FiOS is the new suite of broadband services offered over this network. It gives customers a broad array of voice and data applications and delivers Internet access at blazing fast speeds of up to 30 megabits per second, with even greater speeds possible in the future.

But FiOS is more than just a super-fast Internet connection. We've harnessed the speed and capacity of broadband with the power of broadcast to create a revolutionary new entertainment experience. FiOS TV offers a simple, compelling and affordable package, and is designed to be a superior alter-

native to cable and satellite TV. We offer over 400 all-digital channels, more than 20 high-definition channels and 2,000 video-on-demand titles. Delivered over our high-speed fiber network, FiOS TV displays amazingly sharp pictures that seem to leap from the TV screen.

FiOS Internet and FiOS TV are redefining and enriching the broadband experience for customers. Our fiber network provides unprecedented power to today's multi-tasking household and is changing the way America communicates. And for Verizon, it will be a platform for long-term growth as we transform our business around the expanding opportunities in broadband and multimedia.



providing the nation's most reliable

Verizon Wireless is committed to offering customers the most reliable service on the nation's best wireless voice and data network. We've been recognized consistently as a leader in the U.S. wireless industry for our superior network coverage, products and services, as well as for our outstanding customer support. In 2005, Verizon Wireless posted the lowest customer churn rate – an indicator of customer loyalty – among national carriers. We provide customers with the highest level of satisfaction by offering quality products and innovative services, and we proudly stand behind our motto: “we never stop working for you.”

Verizon Wireless has been a strong growth engine for the corporation and keeps getting better with time. In 2005, our

solid business fundamentals and innovative new services helped add a record number of new subscribers while delivering strong revenue growth and healthy margins. Best of all, we have a business culture that is driven to deliver continuous improvement and innovation year after year.

A major development in 2005 was Verizon's continued expansion of the largest wireless high-speed broadband network in the U.S., now available to 150 million Americans in 180 major metropolitan areas coast to coast. Mobile professionals can be more productive outside of the office with BroadbandAccess service from Verizon Wireless, which offers users DSL-comparable speeds. BroadbandAccess provides



wireless network

mobile workers access to their corporate information just as if they were attached to a high-speed wired connection, but with the freedom of true mobility.

V CAST, also available on the Verizon Wireless broadband network, is the nation's first wireless multimedia service for consumers. Launched in early 2005, V CAST delivers crystal clear on-demand content such as short broadcasts, 3D games, and music videos from news and entertainment sources and other innovative content providers.

Verizon Wireless continued its reputation for innovation by introducing the world's most comprehensive music service, V CAST Music, in early 2006. This service offers customers the

ability to download a wide variety of music over the air directly to their wireless phones or straight to their computers. V CAST Music from Verizon Wireless gives customers immediate access to songs from well-known artists and lets customers play music on their wireless phones – the same device they have come to rely upon for entertainment, information and mobile communication.

V CAST Music is the mobile music experience that consumers have been craving. It further emphasizes the leadership role Verizon plays in bringing customers the entertainment content they want and the mobility they need in today's fast-paced world.



providing innovative business solutions

The completion of the Verizon and MCI merger on January 6, 2006 created a strong competitor for advanced communications services by enhancing Verizon's ability to deliver converged communications across the country and around the world. The new unit – called Verizon Business – leverages the power of the global MCI network and the reach of Verizon's broadband and wireless networks in the U.S.

We now employ a highly trained and experienced global force of sales and service professionals in hundreds of sales offices around the world. We own and operate one of the most expansive end-to-end global IP networks. This infrastructure includes over 270,000 domestic and 360,000 international

route miles of fiber-optic cable, provides next-generation IP network services to medium and large businesses and government customers, and offers access to over 140 countries.

The launch of Verizon Business is a game-changing event, for us and our customers. Verizon now serves 94 percent of the Fortune 500 largest companies and is the leading communications provider for the federal government. In addition, we are a market leader in key industry segments including financial services, retail, manufacturing, health care, state and local government, and education. Verizon Business now enables these business and government customers to seamlessly link their offices – by means of an advanced, cost-effective high-



over our IP network

speed data and voice network – down the street, across the nation or around the world.

Verizon Business also provides the clear advantages of a single source for the full range of end-to-end services. We operate one of the world's most connected global Internet backbone networks. Our expansive IP footprint, coupled with our direct interconnections in major metropolitan areas across the country, enables customers to reach more destinations than any other carrier.

We will use our global reach, local presence and unsurpassed combination of wireless and wireline capabilities to be a single-source provider of complete local-to-global business

continuity solutions. We've introduced a new suite of services that integrate the capabilities of our wired and wireless networks to enable workforce mobility and maintain uninterrupted business operations. The new offerings demonstrate the benefits of the merger by combining the power of Verizon Wireless, America's most reliable network, with the Verizon Business global IP network.

Verizon Business is uniquely positioned to help move the industry forward. Our new innovative global network, deep IP experience and broad set of product offerings will yield new and greater possibilities for our customers around the globe to use advanced technology to achieve their business goals.



making an impact on our communities

In 2005, as Hurricanes Katrina and Rita devastated the Gulf Coast, Verizon rose to the occasion. We deployed technicians from across the country and provided communications resources to ensure continued operation of our wireline and wireless networks. We donated 10,000 wireless phones with free airtime, distributed 20,000 prepaid calling cards and staffed call centers with 10,000 volunteers to support a national telethon. In addition, we contributed more than \$10.8 million in employee donations and corporate matching gifts.

Verizon's response to these disasters is rooted in more than a century of caring about the people we serve. We foster relationships to address social and economic needs in our communities. We also partner with organizations and use tech-

nology to develop innovative programs for literacy, education, domestic violence prevention, health care and accessibility. And our volunteer program encourages employees to donate their time, money and talents to help build stronger, sustainable communities by supporting the causes they care about.

Our corporate responsibility goes far beyond the traditional definition of philanthropy. Through grassroots programs we put essential tools in the hands of people making a difference at the local level. Together, we are building a lasting foundation and are making sure people have the resources and fundamental skills to succeed.

More information about our corporate responsibility initiatives can be found at www.verizon.com/responsibility.

selected financial data

			(dollars in millions, except per share amounts)		
	2005	2004	2003	2002	2001
Results of Operations					
Operating revenues	\$ 75,112	\$ 71,283	\$ 67,468	\$ 67,056	\$ 66,513
Operating income	14,814	13,117	7,407	14,877	11,402
Income before discontinued operations, extraordinary items and cumulative effect of accounting change	7,397	7,261	3,460	4,591	545
Per common share – basic	2.67	2.62	1.26	1.68	.20
Per common share – diluted	2.65	2.59	1.25	1.67	.20
Net income	7,397	7,831	3,077	4,079	389
Net income available to common shareowners	7,397	7,831	3,077	4,079	389
Per common share – basic	2.67	2.83	1.12	1.49	.14
Per common share – diluted	2.65	2.79	1.12	1.49	.14
Cash dividends declared per common share	1.62	1.54	1.54	1.54	1.54
Financial Position					
Total assets	\$168,130	\$165,958	\$165,968	\$167,468	\$170,795
Long-term debt	31,869	35,674	39,413	44,003	44,873
Employee benefit obligations	18,819	17,941	16,754	15,392	11,895
Minority interest	26,754	25,053	24,348	24,057	21,915
Shareowners' investment	39,680	37,560	33,466	32,616	32,539

- Significant events affecting our historical earnings trends in 2003 through 2005 are described in Management's Discussion and Analysis of Results of Operations and Financial Condition.
- 2002 data includes gains on investments and sales of businesses and other special and/or non-recurring items.
- 2001 data includes losses on investments, severance benefits charges, and other special and/or non-recurring items.

management's discussion and analysis

of results of operations and financial condition

OVERVIEW

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Verizon's domestic wireline telecommunications business provides local telephone services, including broadband, in 28 states and Washington, D.C. and nationwide long-distance and other communications products and services. Verizon's domestic wireless business, operating as Verizon Wireless, provides wireless voice and data products and services across the United States using one of the most extensive wireless networks. Information Services operates directory publishing businesses and provides electronic commerce services. Verizon's International segment includes wireline and wireless communications operations and investments in the Americas and Europe. In connection with the closing of the merger with MCI, Inc. (MCI), which occurred on January 6, 2006, Verizon now owns and operates one of the most expansive end-to-end global Internet Protocol (IP) networks which includes over 270,000 domestic and 360,000 international route miles of fiber optic cable and provides access to over 140 countries worldwide. Operating as Verizon Business, we are now better able to provide next-generation IP network services to medium and large businesses and government customers. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of 250,000 employees, including Verizon Business.

The sections that follow provide information about the important aspects of our operations and investments, both at the consolidated and segment levels, and include discussions of our results of operations, financial position and sources and uses of cash. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information used by our chief operating decision makers for, among other purposes, evaluating performance and allocating resources. We also monitor several key economic indicators as well as the state of the economy in general, primarily in the United States where the majority of our operations are located, in evaluating our operating results and analyzing and understanding business trends. While most key economic indicators, including gross domestic product, impact our operations to some degree, we have noted higher correlations to housing starts, non-farm employment, personal consumption expenditures and capital spending, as well as more general economic indicators such as inflation and unemployment rates.

Our results of operations, financial position and sources and uses of cash in the current and future periods reflect Verizon management's focus on the following four key areas:

- **Revenue Growth** – Our emphasis is on revenue transformation, devoting more resources to higher growth markets such as wireless, wireline broadband connections, including digital subscriber lines (DSL) and fiber optics to the home (Verizon's FiOS data product), long distance and other data services as well as expanded services to business markets, rather than to traditional wireline voice services, where we have been experiencing access line losses. In 2005, revenues from these growth areas increased by 15% compared to 2004 and represent 58% of our total revenues, up from 53% of total revenues in 2004 and 47% in 2003. Verizon reported consolidated revenue growth of 5.4% in 2005 compared to 2004, led by 16.8% higher revenue at Domestic Wireless and 10.5% total data revenue growth at

Domestic Telecom. Verizon added 7,521,000 wireless customers, 1,659,000 broadband connections and 992,000 long distance lines. Excluding the revenues of Verizon's Hawaii wireline and directory operations, which were sold in 2005, consolidated revenue growth would have been 6.0% in 2005 compared to 2004.

- **Operational Efficiency** – While focusing resources on growth markets, we are continually challenging our management team to lower expenses, particularly through technology-assisted productivity improvements including self-service initiatives. The effect of these and other efforts, such as the 2003 labor agreements and voluntary separation plans, real estate consolidations and call center routing improvements, has been to significantly change the company's cost structure and maintain stable operating income margins. Real estate consolidations include our decision to establish Verizon Center for the leadership team. In 2005, Verizon restructured its management retirement benefit plans such that management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after receiving an 18-month enhancement of the value of their pension and retiree medical benefits, but will receive higher savings plan matching contributions. The net effect of these management benefit plan changes is expected to be a reduction in pretax benefit expenses of approximately \$3 billion over 10 years. In addition, Domestic Telecom's salary and benefits expenses have declined in 2005 and 2004 as a result of the 2003 voluntary separation plan. Workforce levels in 2005 and 2004 increased to 217,000 and 209,000, respectively, from 200,000 as of December 31, 2003 driven by wireless and wireline broadband growth markets.
- **Capital Allocation** – Verizon's capital expenditures continue to be directed toward growth markets. High-speed wireless data (Evolution-Data Optimized, or EV-DO) services, replacement of copper access lines with fiber optics to the home, as well as expanded services to business markets are examples of areas of capital expenditures in support of these growth markets. In 2005, Verizon achieved targeted increased capital expenditures of \$15,324 million compared to 2004 capital expenditures of \$13,259 million in support of growth initiatives. Approximately 69% of 2005 capital expenditures related to growth initiatives. In 2006, Verizon management expects capital expenditures to be in the range of \$15.4 billion to \$15.7 billion, excluding capital expenditures associated with MCI. Including MCI, capital expenditures are expected to be \$17.0 billion to \$17.4 billion in 2006. In addition to capital expenditures, Domestic Wireless continues to acquire wireless spectrum in support of expanding data applications and customer base. In 2005, this included participation in the Federal Communications Commission (FCC) Auction 58 and the NextWave Telecom Inc. (NextWave) and Qwest Wireless, LLC acquisitions.
- **Cash Flow Generation** – The financial statements reflect the emphasis of management on not only directing resources to growth markets, but also using cash provided by our operating and investing activities for the repayment of debt in addition to providing a competitive dividend to our shareowners. In 2005, Verizon increased its dividend by 5.2% to \$1.62 per share from \$1.54 per share in 2004. At December 31, 2005, Verizon's total debt was \$39,010 million, a decrease of \$257 million from \$39,267 million at December 31, 2004. However, Verizon's balance of cash and cash equivalents at December 31, 2005 of \$776 million declined by \$1,514 million from \$2,290 million at December 31, 2004.

management's discussion and analysis

of results of operations and financial condition continued

Supporting these key focus areas are continuing initiatives to package more effectively and add more value to our products and services. In 2004, Verizon announced a deployment expansion of FiOS in several states in our service territory. As of the end of 2005, we have met our goal of passing three million premises by the end of 2005. We have achieved a penetration rate of 9% in markets where Verizon has been actively marketing for more than six months and 14% in markets where we have been marketing for nine months, and continue to progress toward our goal of reaching 30% penetration in five years. In 2005, Verizon began offering video on the FiOS network in three markets and expects to begin offering video services in markets in New York, Massachusetts and California in the first quarter of 2006. In Keller, Texas, the first market that FiOS TV has been offered, we have achieved a 21% penetration rate in four months. FiOS TV includes a collection of all-digital programming with more than 375 channels, 47 music channels and 20 high-definition television channels. Innovative product bundles include local wireline, long distance, wireless and broadband services for consumer and general business retail customers. These efforts will also help counter the effects of competition and technology substitution that have resulted in access line losses that have contributed to declining Domestic Telecom revenues over the past several years.

Verizon Business will serve medium and large businesses and government customers from related business operations within Domestic Telecom that market communications and information technology and services to large businesses and governments and MCI's global, corporate and government customers group. Beginning in 2006, Verizon will be positioned as a global communications solutions provider. In connection with this merger, Verizon expects to achieve merger synergies with a net present value of approximately \$8 billion; annual synergies over the next three years are estimated to be \$550 million in 2006, \$825 million in 2007 and \$1,100 million in 2008. Integration costs over that same three year period are estimated to be \$400 million in 2006, \$325 million in 2007 and \$275 million in 2008 and integration capital expenditures are estimated to be between \$1.6 billion and \$1.9 billion, of which \$550 million is expected to be spent in 2006. Examples of these synergies include moving more voice and data traffic, such as long-haul long distance traffic, onto Verizon's networks rather than paying third party access providers and duplicate work force reductions.

At Domestic Wireless, we will continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business while at the same time provide new and innovative products and services for our customers. We are continuing to expand the areas where we are offering BroadbandAccess, our EV-DO service. During 2005, Domestic Wireless expanded its broadband network to 180 major metropolitan areas, covering over 150 million people across the United States. We have achieved our goal of reaching approximately one-half of the U.S. population by the end of 2005. During 2005, we launched V CAST, our consumer broadband wireless service offering, which provides customers with unlimited access to a variety of video and gaming content on EV-DO handsets. In the first year of V CAST service, customers received 11.8 million downloads. Beginning in 2006, Domestic Wireless launched V CAST Music, a comprehensive mobile music service in which customers can download music over the air directly to their wireless phones and to their personal computers.

In December 2005, Verizon announced that it is exploring divesting Information Services through a spin-off, sale or other strategic transaction. However, since this process is still ongoing, Information Services' results of operations, financial position and cash flows remain in Verizon's continuing operations.

CONSOLIDATED RESULTS OF OPERATIONS

In this section, we discuss our overall results of operations and highlight special and non-recurring items. In the following section, we review the performance of our four reportable segments. We exclude the effects of the special and non-recurring items from the segments' results of operations since management does not consider them in assessing segment performance, due primarily to their non-recurring and/or non-operational nature. We believe that this presentation will assist readers in better understanding our results of operations and trends from period to period. This section on consolidated results of operations carries forward the segment results, which exclude the special and non-recurring items, and highlights and describes those items separately to ensure consistency of presentation in this section and the "Segment Results of Operations" section.

The special and non-recurring items include operating results through the sale date of our wireline and directory businesses in Hawaii which operated approximately 700,000 switched access lines and were sold in the second quarter of 2005. These operating results are not in segment results of operations to enhance comparability. Segment results also do not include discontinued operations in segment income. See "Other Consolidated Results – Discontinued Operations" for a discussion of these results of operations. In addition, consolidated operating results include several other events and transactions that are highlighted because of their non-recurring and/or non-operational nature. See "Special Items" for additional discussion of these items.

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Consolidated Revenues

Years Ended December 31,			% Change			% Change
	2005	2004		2004	2003	
						(dollars in millions)
Domestic Telecom	\$ 37,616	\$ 38,021	(1.1)%	\$ 38,021	\$ 39,055	(2.6)%
Domestic Wireless	32,301	27,662	16.8	27,662	22,489	23.0
Information Services	3,452	3,549	(2.7)	3,549	3,763	(5.7)
International	2,193	2,014	8.9	2,014	1,949	3.3
Corporate & Other	(652)	(558)	16.8	(558)	(402)	38.8
Revenues of Hawaii operations sold	202	595	(66.1)	595	614	(3.1)
Consolidated Revenues	<u>\$ 75,112</u>	<u>\$ 71,283</u>	<u>5.4</u>	<u>\$ 71,283</u>	<u>\$ 67,468</u>	<u>5.7</u>

2005 Compared to 2004

Consolidated revenues in 2005 were higher by \$3,829 million, or 5.4% compared to 2004 revenues. This increase was primarily the result of significantly higher revenues at Domestic Wireless and higher International revenues, partially offset by lower revenues at Domestic Telecom and the sale of Hawaii operations in the second quarter of 2005.

Domestic Wireless's revenues increased by \$4,639 million, or 16.8% in 2005 compared to 2004 due to a 7.5 million, or 17.2% increase in customers to 51.3 million as of December 31, 2005 and higher equipment and other revenue, partially offset by a decrease in average revenue per customer per month. Increased equipment and other revenues was principally the result of an increase in wireless devices sold together with an increase in revenue per unit sold. Average revenue per customer per month decreased 1.5% to \$49.49 in 2005 compared to 2004, primarily due to pricing changes in early 2005, partially offset by a 71.7% increase in data revenue per customer in 2005 compared to 2004, driven by increased use of our messaging and other data services. Data revenues were \$2,243 million in 2005 compared to \$1,116 million in 2004. Average minutes of use (MOUs) per customer increased to 665, or 16.1% in 2005 compared to 2004.

Domestic Telecom's revenues in 2005 were lower than 2004 by \$405 million, or 1.1% primarily due to lower revenues from local services, partially offset by higher network access and long distance services revenues. The decline in local service revenues of \$669 million, or 3.7% in 2005 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by declines in switched access lines in service of 6.7% in 2005, driven by the effects of competition and technology substitution. Our network access revenues increased by \$159 million, or 1.3% in 2005 principally due to increased DSL and carrier special access revenues, partially offset by the impact of decreasing switched MOUs and access lines and mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. We added 1.7 million new broadband connections, for a total of 5.1 million lines in service at December 31, 2005, an increase of 47.6% compared to 3.5 million lines in service at December 31, 2004. Switched MOUs declined by 7.1% in 2005 compared to 2004 reflecting the impact of access line loss and technology substitution. Network access revenues also increased in 2005 as a result of a favorable adjustment associated with a recent regulatory decision. Long distance service revenues increased \$206 million, or 5.0% in 2005 principally as a result of customer growth from our interLATA long distance services. In 2005, we added 1.0 million long distance lines, for a total of 18.4 million long distance lines nationwide, representing a 5.7% increase from December 31, 2004. The introduction of our Freedom service plans continues to

stimulate growth in long distance services. As of December 31, 2005, approximately 53% of our local wireline customers have chosen Verizon as their long distance carrier.

Lower revenue of Hawaii operations sold of \$393 million, or 66.1% in 2005 compared to 2004 was the result of the sale during the second quarter of 2005 of our wireline and directory operations in Hawaii.

2004 Compared to 2003

Consolidated revenues in 2004 were higher by \$3,815 million, or 5.7% compared to 2003 revenues. This increase was primarily the result of significantly higher revenues at Domestic Wireless, partially offset by lower revenues at Domestic Telecom.

Domestic Wireless's revenues increased by \$5,173 million, or 23.0% in 2004 compared to 2003 as a result of 6.3 million net customer additions and higher revenue per customer per month, including higher data revenue per customer. Average revenue per customer per month was \$50.22, or 2.8% higher in 2004 compared to 2003, primarily due to a larger number of customers on higher access price plan offerings as well as an increase in data revenues per subscriber. Data revenues were \$1,116 million in 2004 compared to \$449 million in 2003. These increases were partially offset by decreased roaming revenue due to bundled pricing.

Domestic Telecom's revenues in 2004 were lower than 2003 by \$1,034 million, or 2.6% primarily due to lower local and network access services, partially offset by higher long distance revenues. The decline in local service revenues of \$916 million, or 4.8% in 2004 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a decline in switched access lines in service of 4.6% in 2004. These revenue declines were mainly driven by the effects of competition, regulatory pricing rules for unbundled network elements (UNEs) and technology substitution. Network access revenues declined by \$486 million, or 3.9% in 2004 compared to 2003 principally due to decreasing MOUs and access lines, as well as mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. Switched MOUs declined in 2004 by 5.7% compared to 2003, reflecting the impact of access line loss and wireless substitution. Domestic Telecom's long distance service revenues increased \$390 million, or 10.4% in 2004 compared to 2003, principally as a result of customer growth from our interLATA long distance services. In 2004, we added 2.3 million long distance lines, for a total of 17.7 million long distance lines nationwide, representing a 15.5% increase from December 31, 2003.

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Consolidated Operating Expenses

Years Ended December 31,	2005	2004	% Change	(dollars in millions)		
				2004	2003	% Change
Cost of services and sales	\$ 25,469	\$ 23,168	9.9%	\$ 23,168	\$ 21,701	6.8%
Selling, general and administrative expense	21,312	21,088	1.1	21,088	24,894	(15.3)
Depreciation and amortization expense	14,047	13,910	1.0	13,910	13,607	2.2
Sales of businesses, net	(530)	—	nm	—	(141)	(100.0)
Consolidated Operating Expenses	\$ 60,298	\$ 58,166	3.7	\$ 58,166	\$ 60,061	(3.2)

nm – Not meaningful

2005 Compared to 2004

Cost of Services and Sales

Cost of services and sales increased by \$2,301 million, or 9.9% in 2005 compared to 2004. This increase was principally due to increases in pension and other postretirement benefit costs, higher direct wireless network costs, increases in wireless equipment costs and higher costs associated with our wireline growth businesses.

The overall impact of pension and other postretirement benefit plan assumption changes, combined with lower asset returns over the last several years, increased net pension and postretirement benefit expenses by \$399 million in 2005 (primarily in cost of services and sales) compared to 2004. Higher direct wireless network charges resulted from increased MOUs in 2005 compared to 2004, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales was higher in 2005 due primarily to an increase in wireless devices sold together with an increase in cost per unit sold, driven by growth in customer additions and an increase in equipment upgrades in 2005. Higher costs associated with our wireline growth businesses, long distance and broadband connections, included a 2,400, or 1.7% increase in the number of Domestic Telecom employees as of December 31, 2005 compared to December 31, 2004. Costs in 2004 were impacted by lower interconnection expense charged by competitive local exchange carriers (CLECs) and settlements with carriers, including the MCI settlement recorded in 2004.

Selling, General and Administrative Expense

Selling, general and administrative expense was \$224 million, or 1.1% higher in 2005 compared to 2004. This increase was driven by increases in salary, pension and benefits costs, including an increase in the customer care and sales channel work force and sales commissions, partially offset by gains on real estate sales in 2005 and lower bad debt costs. In addition, 2004 included the favorable resolution of a 2003 Telecomunicaciones de Puerto Rico, Inc. (TELPRI) charge. Special and non-recurring items in selling, general and administrative expenses in 2005 were \$315 million compared to special and non-recurring items in 2004 of \$995 million.

Special and non-recurring items in 2005 included a pretax impairment charge of \$125 million pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties, a net pretax charge of \$98 million related to the restructuring of the Verizon management retirement benefit plans and a pretax charge of \$59 million associated with employee severance costs and severance-related activities in connection with the voluntary separation program to surplus union-represented employees. Special and non-recurring items recorded in 2004 included \$815 million related to pension settlement losses incurred in connection with the voluntary separation of approximately 21,000 employees in the fourth quarter of 2003 who received lump-sum distributions during 2004. Special

charges in 2004 also include an expense credit of \$204 million resulting from the favorable resolution of pre-bankruptcy amounts due from MCI, partially offset by a charge of \$113 million related to operating asset losses.

Depreciation and Amortization Expense

Depreciation and amortization expense increased by \$137 million, or 1.0% in 2005 compared to 2004. This increase was primarily due to the increase in depreciable assets and software, partially offset by lower rates of depreciation on telephone plant.

Sales of Businesses, Net

During the second quarter of 2005, we sold our wireline and directory businesses in Hawaii and recorded a net pretax gain of \$530 million.

2004 Compared to 2003

Cost of Services and Sales

Cost of services and sales increased by \$1,467 million, or 6.8% in 2004 compared to 2003. This increase was principally due to increased pension and other postretirement benefit costs, primarily at Domestic Telecom, higher direct wireless network charges and customer handset costs at Domestic Wireless as a result of customer base growth and higher costs at Domestic Telecom associated with growth businesses, partially offset by lower work-force levels and other cost reductions at Domestic Telecom.

The overall impact of pension and other postretirement benefit plan assumption changes, combined with lower asset returns over the last several years, increased net pension and postretirement benefit expenses by \$1,166 million in 2004 (primarily in cost of services and sales) compared to 2003. Costs increased in 2004 at Domestic Wireless primarily due to higher direct wireless network charges resulting from increased MOUs in 2004 compared to 2003 and higher cost of equipment sales due to an increase in handsets sold, driven by growth in customer additions and an increase in equipment upgrades in 2004 compared to 2003. Higher customer premises equipment and other costs associated with our growth businesses at Domestic Telecom such as long distance and DSL also contributed to the increase in cost of services and sales. These expense increases were partially offset by the effect of workforce reductions. In 2004, Domestic Telecom benefited from an average of approximately 15,000 fewer employees compared to 2003 levels. This reduction in employees was principally due to a voluntary separation plan, which was completed in November 2003. Costs in 2004 were also impacted by lower interconnection expense charged by CLECs and settlements with carriers, including the MCI settlement recorded in the second quarter of 2004.

Selling, General and Administrative Expense

Selling, general and administrative expense was \$3,806 million, or 15.3% lower in 2004 compared to 2003. This decrease was driven by lower special charges in 2004 by \$5,390 million and lower costs

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at Domestic Telecom associated with workforce reductions and by lower bad debt expense, partially offset by cost increases at Domestic Wireless and Domestic Telecom. Special charges related to severance, pension and benefits were \$4,607 million lower in 2004 compared to 2003, driven primarily by fourth quarter 2003 charges incurred in connection with the voluntary separation of approximately 21,000 employees. Lease impairment and other special charges in 2003 were \$496 million, compared to other special credits, net of \$91 million in 2004.

Domestic Wireless's salary and benefits expense increased by \$821 million, including a \$447 million increase in costs incurred in 2004 related to that segment's long-term incentive program, and by an increase in the employee base, primarily in the customer care and sales channels. Also contributing to the increase at Domestic Wireless were higher sales commissions in our direct and indirect channels primarily related to an increase in customer additions and renewals during the year. Cost increases in 2004 at Domestic Telecom included higher net pension and benefit costs, as described in costs of services and sales above, additional other employee benefit costs and higher professional and general costs.

Depreciation and Amortization Expense

Depreciation and amortization expense increased by \$303 million, or 2.2% in 2004 compared to 2003. This increase was primarily due to increased depreciation expense related to the increase in depreciable assets, partially offset by lower rates of depreciation on telephone plant.

Sales of Businesses, Net

In 2003, Information Services recorded a pretax gain of \$141 million primarily related to the sale of its European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Pension and Other Postretirement Benefits

For 2005 pension and other postretirement benefit costs, the discount rate assumption was lowered to 5.75% from 6.25% in 2004 consistent with interest rate levels at the end of 2004. The expected rate of return on pension plan assets remained 8.50% while the expected rate of return on postretirement benefit plan assets was lowered to 7.75% from 8.50% in 2004. The medical cost trend rate was 10% for 2005. For 2004 pension and other postretirement benefit costs, the discount rate assumption was lowered to 6.25% from 6.75% in 2003, consistent with interest rate levels at the end of 2003. The expected rate of return on pension and postretirement benefit plan assets was maintained at 8.50%. The medical cost trend rate assumption was 10% in 2004.

For 2006 pension and other postretirement benefit costs, we evaluated our key employee benefit plan assumptions in response to current conditions in the securities markets and medical and prescription drug cost trends. The discount rate assumption will be maintained at 5.75%, consistent with interest rate levels at the end of 2005. The expected rate of return on pension plan assets will remain 8.50% while the expected rate of return on postretirement benefit plan assets will increase to 8.25% from 7.75% in 2005. The medical cost trend rate will be 10% for 2006.

Verizon's union contracts contain health care cost provisions that limit company payments toward health care costs to specific dollar amounts (known as caps). These caps pertain to both current and future retirees, and have a significant impact on the actuarial valuation of postretirement benefits. These caps have been included in

union contracts for several years, but have exceeded the annual health care cost every year until 2003. During the negotiation of new collective bargaining agreements for union contracts covering 79,000 unionized employees in the second half of 2003, the date health care caps would become effective was extended and the dollar amounts of the caps were increased. In the fourth quarter of 2003, we began recording retiree health care costs as if there were no caps, in connection with the ratification of the union contracts. Since the caps are an assumption included in the actuarial determination of Verizon's postretirement obligation, the effect of extending and increasing the caps increased the accumulated postretirement obligation in the fourth quarter of 2003 by \$5,158 million, which increased the annual postretirement benefit expense by \$667 million in 2004.

During 2005, we recorded net pension and postretirement benefit expense of \$1,376 million (\$839 million after-tax, or \$.30 per diluted share), compared to net pension and postretirement benefit expense of \$977 million (\$596 million after-tax, or \$.21 per diluted share) in 2004 and net pension and postretirement benefit income of \$(189) million (\$115 million after-tax, or \$.04 per diluted share) in 2003.

Other Consolidated Results

Equity in Earnings of Unconsolidated Businesses

Equity in earnings of unconsolidated businesses decreased by \$1,002 million in 2005 compared to 2004. The decrease is primarily due to a pretax gain of \$787 million recorded on the sale of our 20.5% interest in TELUS Corporation (TELUS) in the fourth quarter of 2004 and the sale of another investment in 2004, lower equity income resulting from the sale of TELUS and estimated additional pension liabilities at Compañía Anónima Nacional Teléfonos de Venezuela (CANTV), partially offset by higher tax benefits and operational results at our Italian investment Vodafone Omnitel N.V. (Vodafone Omnitel).

Equity in earnings of unconsolidated businesses increased by \$413 million in 2004 compared to 2003. The increase was primarily due to a pretax gain of \$787 million recorded on the sale of our 20.5% interest in TELUS in 2004. This increase was partially offset by tax benefits in 2003 from a reorganization at Vodafone Omnitel and a contribution tax reversal benefiting Vodafone Omnitel. In early 2003, Vodafone Group Plc (Vodafone) completed the reorganization of several of its investments in Vodafone Omnitel that resulted in the consolidation of several holding companies. As a result, the intangible assets held by these holding companies were transferred to Vodafone Omnitel and became tax-deductible for Italian tax purposes. It was determined that this intangible asset was deductible over a three-year period as a customer database. At the time that the reorganization was effective, Vodafone Omnitel began recording the tax benefit associated with the newly created intangible asset in its reported income and Verizon recorded its share of that tax benefit. Separately, in September 2003, the European Court of Justice ruled that an Italian contribution tax on the use of wireless frequencies, established by Italy in 1998, was contrary to European Union law and that the Italian government must refund amounts previously paid by Italian wireless carriers. During the fourth quarter of 2003, Verizon recorded its share of the earnings impact of this favorable ruling. In 2003, we also recorded a pretax gain of \$348 million in connection with the sale of our interest in Eurotel Praha, spol. s r.o. (Eurotel Praha), a wireless joint venture in the Czech Republic.

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Income From Other Unconsolidated Businesses

Income from other unconsolidated businesses increased by \$17 million in 2005 compared to 2004 and decreased by \$256 million in 2004 compared to 2003. The decrease in 2004 was primarily driven by a \$176 million net gain recorded in 2003 as a result of a payment received in connection with the liquidation of Genuity Inc. (Genuity) and the sales of shares of investments, including Taiwan Cellular Corporation (TCC) and TelecomAsia Corporation Public Company Limited (TelecomAsia) in 2003. This decrease was partially offset by a pretax gain of \$43 million recorded in connection with the sale of our investment in Iowa Telecom preferred stock and TCC share sales in 2004.

Other Income and (Expense), Net

Years Ended December 31,	2005	(dollars in millions)	
		2004	2003
Interest income	\$ 120	\$ 116	\$ 95
Foreign exchange gains (losses), net	10	(13)	(11)
Other, net	107	(81)	(47)
Total	\$ 237	\$ 22	\$ 37

In 2005, the changes in Other Income and (Expense), Net were primarily due to other, net income in the current year compared to other, net expenses in the prior year. Other, net in 2005 includes a pretax gain on the sale of a small international business, leased asset gains and investment gains. Other, net in 2005 and 2004 include expenses of \$14 million and \$55 million, respectively, related to the early retirement of debt. The changes in Other Income and (Expense), Net in 2004 were primarily due to higher other, net expenses, partially offset by higher interest income. Other, net in 2004 and 2003 includes expenses of \$55 million and \$61 million, respectively, related to the early retirement of debt.

Interest Expense

Years Ended December 31,	2005	(dollars in millions)	
		2004	2003
Total interest expense	\$ 2,180	\$ 2,384	\$ 2,797
Capitalized interest costs	352	177	144
Total interest costs on debt balances	\$ 2,532	\$ 2,561	\$ 2,941

Average debt outstanding	\$ 39,939	\$ 42,555	\$ 49,181
Effective interest rate	6.3%	6.0%	6.0%

In 2005, the decrease in interest costs was primarily due to a reduction in average debt level of \$2,616 million compared to 2004, partially offset by higher average interest rates. Higher capital expenditures contributed to higher capitalized interest costs. In 2004, the decrease in interest costs was primarily due to a reduction in average debt level of \$6,626 million compared to 2003. Higher capital expenditures contributed to higher capitalized interest costs.

Minority Interest

Years Ended December 31,	2005	(dollars in millions)	
		2004	2003
Minority interest	\$ 3,045	\$ 2,409	\$ 1,583

The increase in minority interest expense in 2005 was primarily due to higher earnings at Domestic Wireless, which has a significant minority interest attributable to Vodafone. The increase in minority interest expense in 2004 was primarily due to higher earnings at Domestic Wireless and higher earnings at TELPRI.

Provision for Income Taxes

Years Ended December 31,	2005	(dollars in millions)	
		2004	2003
Provision for income taxes	\$ 3,210	\$ 2,851	\$ 1,213
Effective income tax rate	30.3%	28.2%	26.0%

The effective income tax rate is the provision for income taxes as a percentage of income from continuing operations before the provision for income taxes. Our effective income tax rate in 2005 was higher than 2004 due to a higher state income tax rate, lower foreign-related tax benefits and lower favorable deferred tax reconciliation adjustments. As a result of the capital gain realized in the second quarter of 2005 in connection with the sale of our Hawaii businesses, we recorded tax benefits of \$336 million primarily related to prior year investment losses, which were largely offset by a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004. The effective income tax rate in 2004 was favorably impacted from the reversal of a valuation allowance relating to investments, and tax benefits related to deferred tax balance adjustments and expense credits that are not taxable.

Our effective income tax rate in 2004 was higher than 2003 due to lower foreign-related tax benefits, particularly associated with lower equity income from our investment in Vodafone Omnitel and higher state taxes. Vodafone Omnitel income is not taxable until received in the form of dividends. The effective income tax rate in 2004 was favorably impacted by the reversal of a valuation allowance relating to investments, and tax benefits related to deferred tax balance adjustments and expense credits that are not taxable. The effective income tax rate in 2003 was favorably impacted by higher equity income from Vodafone Omnitel, a decrease in state taxes and a benefit related to a deferred tax balance adjustment.

A reconciliation of the statutory federal income tax rate to the effective rate for each period is included in Note 16 to the consolidated financial statements.

Discontinued Operations

Discontinued operations represent the results of operations of Verizon Information Services Canada Inc. for all years presented in the consolidated statements of income and Grupo Iusacell, S.A. de C.V. (Iusacell) prior to the sale of Iusacell in July 2003. During 2004, we announced our decision to sell Verizon Information Services Canada Inc. and, in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we have classified the results of operations of Verizon Information Services Canada as discontinued operations. The sale closed in the fourth quarter of 2004 and resulted in a pretax gain of \$1,017 million (\$516 million after-tax, or \$.18 per diluted share). In connection with the decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of \$957 million (\$931 million after-tax, or \$.33 per diluted share) in the second quarter of 2003.

Cumulative Effect of Accounting Change

Directory Accounting Change

During 2003, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the amortization method, revenues and direct

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expenses, primarily printing and distribution costs, are recognized over the life of the directory, which is usually 12 months. This accounting change affected the timing of the recognition of revenues and expenses. As required by generally accepted accounting principles, the directory accounting change was recorded effective January 1, 2003. The cumulative effect of the accounting change was a one-time charge of \$2,697 million (\$1,647 million after-tax, or \$.58 per diluted share).

Impact of SFAS No. 143

We adopted the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations," on January 1, 2003. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. Consequently, in connection with the initial adoption of SFAS No. 143 we reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of \$3,499 million (\$2,150 million after-tax, or \$.76 per diluted share).

SEGMENT RESULTS OF OPERATIONS

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments are Domestic Telecom, Domestic Wireless, Information Services and International. You can find additional information about our segments in Note 17 to the consolidated financial statements.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from business segment results, they are included in reported consolidated earnings. We previously highlighted the more significant of these transactions in the "Consolidated Results of Operations" section. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

Domestic Telecom

Domestic Telecom provides local telephone services, including voice, DSL, data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones in 28 states and Washington, D.C. As discussed earlier under "Consolidated Results of Operations," in the second quarter of 2005, we sold wireline properties in Hawaii representing approximately 700,000 access lines or 1% of the total Domestic Telecom switched access lines in service. For comparability purposes, the

results of operations shown in the tables below exclude the Hawaii properties that have been sold. This segment also provides long distance services, customer premises equipment distribution, video services, data solutions and systems integration, billing and collections and inventory management services.

Operating Revenues		(dollars in millions)		
Years Ended December 31,		2005	2004	2003
Local services		\$ 17,600	\$ 18,269	\$ 19,185
Network access services		12,217	12,058	12,544
Long distance services		4,347	4,141	3,751
Other services		3,452	3,553	3,575
		\$ 37,616	\$ 38,021	\$ 39,055

Local Services

Local service revenues are earned by our telephone operations from the provision of local exchange, local private line, wire maintenance, voice messaging and value-added services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting and Return Call. The provision of local exchange services not only includes retail revenues but also includes local wholesale revenues from UNEs, interconnection revenues from CLECs and wireless carriers, and some data transport revenues.

The decline in local service revenues of \$669 million, or 3.7% in 2005 and \$916 million, or 4.8% in 2004 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by declines in switched access lines in service of 6.7% in 2005 and 4.6% in 2004. These revenue declines were mainly driven by the effects of competition and technology substitution. Technology substitution affected local service revenue growth in both years, as declining demand for residential access lines resulted in 8.4% fewer lines at December 31, 2005 compared to December 31, 2004 and a reduction in lines of 5.4% during 2004, as more customers substituted wireless, broadband and cable services for traditional landline services. At the same time, basic business access lines declined by 3.5% in 2005 and 3.1% in 2004, primarily reflecting competition and a shift to high-speed, high-volume special access lines.

In the first quarter of 2005, the FCC adopted significant new unbundling rules which eliminated the requirement to unbundle mass market local switching for new orders on a nationwide basis, and provided for a one year transition period for existing UNE switching arrangements. See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – FCC Regulation" for additional information on FCC rulemakings concerning UNEs. Due to a decision by two major competitors to deemphasize their local market initiatives, wholesale voice connections (commercial local wholesale arrangements, UNE platform and resale lines) declined 1.1 million in 2005, to 5.5 million as of December 31, 2005, which reflected a 16.1% decrease compared to December 31, 2004. In 2004, prior to the adoption of these new rules, wholesale voice connections increased 0.8 million to 6.6 million as of December 31, 2004.

We continue to seek opportunities to retain and win-back customers. Our Freedom service plans offer local services with various combinations of long distance, wireless and Internet access services in a discounted bundle available on one customer bill. Since 2003, we have introduced our Freedom service plans in nearly all of our key markets. As of December 31, 2005, approximately 65% of

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Verizon's residential customers have purchased local services in combination with either Verizon long distance or Verizon DSL, or both. For small businesses, we have also introduced Verizon Freedom for Business in eleven key markets, covering approximately 86% of business access lines.

Network Access Services

Network access services revenues are earned from end-user customers and long distance and other competing carriers who use our local exchange facilities to provide usage services to their customers. Switched access revenues are derived from fixed and usage-based charges paid by carriers for access to our local network. Special access revenues originate from carriers and end-users that buy dedicated local exchange capacity to support their private networks. End-user access revenues are earned from our customers and from resellers who purchase dial-tone services. Further, network access revenues include our DSL services.

Our network access revenues increased by \$159 million, or 1.3% in 2005, and decreased \$486 million, or 3.9% in 2004. These changes were principally due to increased DSL and carrier special access revenues, partially offset in 2005, and more than offset in 2004, by the impact of decreasing switched MOUs and access lines and mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. We added 1.7 million new broadband connections, for a total of 5.1 million lines in service at December 31, 2005, an increase of 47.6% compared to 3.5 million lines in service at December 31, 2004. Total revenues for high-capacity and data services were \$8,489 million in 2005, an increase of 10.5% compared to 2004 revenues of \$7,679 million, which increased 7.1% compared to 2003. Special access revenue growth reflects continuing demand in the business market for high-capacity, high speed digital services, partially offset by lessening demand for older, low-speed data products and services and ongoing price reductions. Switched access revenues decreased due to declines in switched MOUs of 7.1% in 2005 compared to 2004 and 5.7% in 2004 compared to 2003, reflecting the impact of access line loss and technology substitution, partially offset in 2005 by a favorable adjustment associated with a recent regulatory decision.

The FCC regulates the rates that we charge long distance carriers and end-user customers for interstate access services. See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – FCC Regulation" for additional information on FCC rulemakings concerning federal access rates, universal service and unbundling of network elements and broadband services.

Long Distance Services

Long distance service revenues include both intraLATA toll services and interLATA long distance voice and data services.

Long distance service revenues increased \$206 million, or 5.0% in 2005 and \$390 million, or 10.4% in 2004, principally as a result of customer growth from our interLATA long distance services. In 2005, we added 1.0 million long distance lines, for a total of 18.4 million long distance lines nationwide, representing a 5.7% increase from December 31, 2004. In 2004, we added 2.3 million long distance lines, representing an increase of 15.5% from December 31, 2003. The introduction of our Freedom service plans continues to stimulate growth in long distance services. As of December 31, 2005, approximately 53% of our local wireline customers have chosen Verizon as their long distance carrier.

Other Services

Our other services include such services as billing and collections for long distance carriers, public (coin) telephone and customer premises equipment and supply sales. Other services revenues also include services provided by our non-regulated subsidiaries such as data solutions and systems integration businesses, and other services.

Revenues from other services declined by \$101 million, or 2.8% in 2005, and by \$22 million, or 0.6% in 2004. Revenues decreased due to the dissolution of non-strategic businesses, including the termination of a large commercial inventory management contract in 2005, and reduced business volumes related to billing and collection services and public telephone services, partially offset by increases resulting from higher sales of voice and data customer premises equipment and other services.

Operating Expenses	(dollars in millions)		
	Years Ended December 31,	2005	2004 2003
Cost of services and sales		\$ 15,604	\$ 14,830 \$ 14,512
Selling, general and administrative expense		8,419	8,621 8,363
Depreciation and amortization expense		8,801	8,910 9,107
		\$ 32,824	\$ 32,361 \$ 31,982

Cost of Services and Sales

Cost of services and sales includes the following costs directly attributable to a service or product: salaries and wages, benefits, materials and supplies, contracted services, network access and transport costs, customer provisioning costs, computer systems support and cost of products sold. Aggregate customer care costs, which include billing and service provisioning, are allocated between cost of services and sales and selling, general and administrative expense.

In 2005, our cost of services and sales increased by \$774 million, or 5.2% compared to 2004. Costs in 2005 were impacted by increased pension and other postretirement benefit costs. As of December 31, 2004, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets. The expected rate of return on pension plan assets has been maintained at 8.50%. However, the discount rate assumption has been lowered from 6.25% in 2004 to 5.75% in 2005, consistent with interest rate levels at the end of 2004. Further, there was an increase in the retiree health care cost trend rates. The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the last several years, resulted in net pension and other postretirement benefit expense (primarily in cost of services and sales) of \$1,248 million in 2005, compared to net pension and postretirement benefit expense of \$803 million in 2004. Also contributing to expense increases in cost of services and sales were higher costs associated with our growth businesses, including a 2,400, or 1.7% increase in the number of employees as of December 31, 2005 compared to December 31, 2004. Further, the expense increase was impacted by favorable adjustments to our interconnection expense in 2004, as a result of our ongoing reviews of local interconnection expense charged by CLECs and settlements with carriers, including the MCI settlement recorded in 2004.

In 2004, our cost of services and sales increased by \$318 million, or 2.2% compared to 2003. Costs in 2004 were also impacted by increased pension and other postretirement benefit costs. As of December 31, 2003, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets

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and the result of extending and increasing limits (caps) on company payments toward retiree health care costs in connection with the union contracts ratified in 2003. The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the last several years, resulted in net pension and other postretirement benefit expense (primarily in cost of services and sales) of \$803 million in 2004, as compared to pension income, net of other postretirement benefit expense of \$312 million in 2003. Higher customer premises equipment and other costs associated with our growth businesses and annual wage increases also contributed to the increase in cost of services and sales. Further, the comparison of 2004 to 2003 cost of services and sales was affected by the 2003 reduction in operating expenses (primarily cost of services and sales) of approximately \$130 million in 2003 for insurance recoveries related to the terrorist attacks on September 11, 2001.

These 2004 expense increases were partially offset by the effect of workforce reductions of an average of approximately 15,000 employees, principally due to a voluntary separation plan in November 2003. Costs in 2004 were also impacted by lower interconnection expense as a result of our ongoing reviews of local interconnection expense charged by CLECs and settlements with carriers, including the MCI settlement. Expense comparisons were also impacted by 2003 contingency costs incurred in connection with labor negotiations and other costs recorded in 2003.

See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – Interstate Access Charges and Intercarrier Compensation" for additional information on FCC rulemakings and other court decisions addressing intercarrier compensation for dial-up connections for Internet-bound traffic.

Selling, General and Administrative Expense

Selling, general and administrative expense includes salaries and wages and benefits not directly attributable to a service or product, bad debt charges, taxes other than income, advertising and sales commission costs, customer billing, call center and information technology costs, professional service fees and rent for administrative space.

Selling, general and administrative expense in 2005 decreased by \$202 million, or 2.3% compared to 2004. This decrease was attributable to gains on the sale of real estate in 2005, lower property and gross receipts taxes and reduced bad debt costs, partially offset by higher net pension and benefit costs, as described above, and a prior year gain on the sale of two small business units.

In 2004, our selling, general and administrative expense increased by \$258 million, or 3.1% compared to 2003. This increase includes higher net pension and benefit costs and higher professional and general costs, partially offset by the effect of workforce reductions and by lower bad debt expense, reduced property and gross receipts taxes, and a gain on the sale of two small business units.

Depreciation and Amortization Expense

The decreases in depreciation and amortization expense in 2005 of \$109 million, or 1.2%, and \$197 million, or 2.2% in 2004, were mainly driven by lower rates of depreciation, partially offset by higher plant, property and equipment balances and software amortization costs.

Segment Income	(dollars in millions)		
	Years Ended December 31,	2005	2004 2003
Segment Income		\$ 1,906	\$ 2,652 \$ 3,299

Segment income decreased by \$746 million, or 28.1% in 2005 and \$647 million, or 19.6% in 2004 primarily as a result of the after-tax impact of operating revenues and operating expenses described above. Special and non-recurring items of (\$168) million, \$346 million and \$1,063 million, after-tax, affected the Domestic Telecom segment but were excluded from segment income in 2005, 2004 and 2003, respectively. Special and non-recurring items in 2005 primarily included a gain on the sale of the Hawaii wireline operations, Hawaii results of operations, and a net gain on the sale of a New York City office building, partially offset by net expenses associated with changes to management retirement benefit plans, severance costs and Verizon Center relocation-related costs. Special and non-recurring items in 2004 primarily included pension settlement losses, operating asset losses, and costs associated with the early retirement of debt, partially offset by an expense credit resulting from the favorable resolution of pre-bankruptcy amounts due from MCI as well as a gain on the sale of an investment. Special and non-recurring items in 2003 primarily include the costs associated with severance activity, including retirement enhancement costs, and pension settlements, partially offset by the favorable impact of adopting SFAS No. 143.

Domestic Wireless

Our Domestic Wireless segment provides wireless voice and data services and equipment sales across the United States. This segment primarily represents the operations of the Verizon Wireless joint venture with Vodafone. Verizon owns a 55% interest in the joint venture and Vodafone owns the remaining 45%. All financial results included in the tables below reflect the consolidated results of Verizon Wireless.

Operating Revenues	(dollars in millions)		
	Years Ended December 31,	2005	2004 2003
Wireless sales and services		\$ 32,301	\$ 27,662 \$ 22,489

Domestic Wireless's total revenues of \$32,301 million were \$4,639 million, or 16.8% higher in 2005 compared to 2004. Service revenues of \$28,131 million were \$3,731 million, or 15.3% higher than 2004. The service revenue growth was primarily due to increased customers, partially offset by a decrease in average revenue per customer per month. Equipment and other revenue increased by \$908 million, or 27.8%, principally as a result of an increase in wireless devices sold together with an increase in revenue per unit sold.

Our Domestic Wireless segment ended 2005 with 51.3 million customers, an increase of 7.5 million net new customers, or 17.2% compared to December 31, 2004. Retail net additions accounted for 7.2 million, or 95.8% of the total net additions. The overall composition of our Domestic Wireless customer base as of December 31, 2005 was 92.4% retail postpaid, 3.1% retail prepaid and 4.5% resellers. The average monthly churn rate, the rate at which customers disconnect service, decreased to 1.3% in 2005 compared to 1.5% in 2004. Retail postpaid churn decreased to 1.1% in 2005 compared to 1.3% in 2004.

Average revenue per customer per month decreased 1.5% to \$49.49 in 2005 compared to 2004, primarily due to pricing changes

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to our America's Choice and Family Share plans earlier in the year. Partially offsetting the impact of these pricing changes was a 71.7% increase in data revenue per customer in 2005 compared to 2004, driven by increased use of our messaging and other data services. Data revenues were \$2,243 million and accounted for 8.0% of service revenue in 2005, compared to \$1,116 million and 4.6% of service revenue in 2004. Average MOUs per customer increased to 665, or 16.1% in 2005 compared to 2004.

Domestic Wireless's total revenues of \$27,662 million were \$5,173 million, or 23.0% higher in 2004 compared to 2003. Service revenues of \$24,400 million were \$4,064 million, or 20.0% higher than 2003. This revenue growth was largely attributable to customer additions and higher revenue per customer per month, including higher data revenue per customer. At December 31, 2004, customers totaled 43.8 million, an increase of 16.8% compared to December 31, 2003. Retail net additions accounted for 5.8 million, or 92.5% of the total net additions. Total churn decreased to 1.5% in 2004 compared to 1.8% in 2003. Average revenue per customer per month increased by 2.8% to \$50.22 in 2004 compared to 2003, primarily due to a larger number of customers on higher access price plan offerings as well as an increase in data revenues per subscriber. Data revenues were \$1,116 million in 2004 compared to \$449 million in 2003. These increases were partially offset by decreased roaming revenue due to bundled pricing. Average MOUs per customer increased to 573, or 16.5% in 2004 compared to 2003.

Operating Expenses		(dollars in millions)		
Years Ended December 31,	2005	2004	2003	
Cost of services and sales	\$ 9,393	\$ 7,747	\$ 6,460	
Selling, general and administrative expense	10,768	9,591	8,057	
Depreciation and amortization expense	4,760	4,486	3,888	
	\$ 24,921	\$ 21,824	\$ 18,405	

Cost of Services and Sales

Cost of services and sales, which are costs to operate the wireless network as well as the cost of roaming, long distance and equipment sales, increased by \$1,646 million, or 21.2% in 2005 compared to 2004. Cost of services increased primarily due to higher direct wireless network charges resulting from increased MOUs in 2005 compared to 2004, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales was higher by 23.0% in 2005, due primarily to an increase in wireless devices sold together with an increase in cost per unit sold, driven by growth in customer additions and an increase in equipment upgrades in 2005 compared to 2004.

Cost of services and sales increased by \$1,287 million, or 19.9% in 2004 compared to 2003. This increase was due primarily to increased network costs resulting from increased MOUs and an increase in cost of equipment sales driven by growth in new customer additions and increased equipment upgrades. These cost increases were partially offset by lower roaming, local interconnection and long distance rates.

Selling, General and Administrative Expense

Selling, general and administrative expense increased by \$1,177 million, or 12.3% in 2005 compared to 2004. This increase was primarily due to an increase in salary and benefits expense of \$382 million, which included a \$70 million increase in costs incurred in 2005 related to our long-term incentive program, and by an increase in the employee base, primarily in the customer care and sales channels. Also contributing to the increase were higher sales

commissions in our direct and indirect channels of \$215 million, primarily related to an increase in customer additions and renewals during the year. Costs associated with regulatory fees, primarily the universal service fund, increased by \$179 million in 2005 compared to 2004.

Selling, general and administrative expense increased by \$1,534 million, or 19.0% in 2004 compared to 2003. This increase was due primarily to higher salary and benefits expense and increased sales commissions related to the growth in customer additions and higher costs associated with our long-term incentive program.

Depreciation and Amortization Expense

Depreciation and amortization expense increased by \$274 million, or 6.1% in 2005 compared to 2004 and increased by \$598 million, or 15.4% in 2004 compared to 2003. These increases were primarily due to increased depreciation expense related to the increases in depreciable assets.

Segment Income		(dollars in millions)		
Years Ended December 31,	2005	2004	2003	
Segment Income	\$ 2,219	\$ 1,645	\$ 1,083	

Segment income increased by \$574 million, or 34.9% in 2005 compared to 2004 and increased by \$562 million, or 51.9% in 2004 compared to 2003, primarily as a result of the after-tax impact of operating revenues and operating expenses described above, partially offset by higher minority interest. There were no special items affecting this segment in 2005, 2004 or 2003.

Increases in minority interest in 2005 and 2004 were principally due to the increased income of the wireless joint venture and the significant minority interest attributable to Vodafone.

Information Services

Information Services' multi-platform business comprises yellow pages directories, SuperPages.com, our online directory and search services, and SuperPages On the Go, our directory and information services on wireless telephones. This segment's operations are principally in the United States.

We sold our directory operations in Hawaii in connection with the sale of Verizon's wireline properties in Hawaii discussed earlier under "Consolidated Results of Operations." For comparability purposes, the results of operations shown in the tables below exclude the Hawaii operations that have been sold. In 2004, Verizon sold Verizon Information Services Canada, our directory operations in Canada, to an affiliate of Bain Capital, a private investment firm, for \$1.6 billion. The sale resulted in an after-tax gain of \$516 million. This gain and current and prior years' results of operations for this business unit are classified as discontinued operations in accordance with SFAS No. 144, and are excluded from Information Services segment results.

Operating Revenues		(dollars in millions)		
Years Ended December 31,	2005	2004	2003	
Operating Revenues	\$ 3,452	\$ 3,549	\$ 3,763	

Operating revenues in 2005 decreased \$97 million, or 2.7% compared to 2004, primarily due to reduced domestic print advertising revenue, partially offset by SuperPages.com revenue growth. Verizon's domestic Internet directory service, SuperPages.com, achieved growth of 18% in gross revenues compared with 2004.

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Operating revenues in 2004 decreased \$214 million, or 5.7% compared to 2003, primarily due to reduced domestic print advertising revenue and elimination of revenue from the 2003 sale of European operations. SuperPages.com reported a 22% increase in revenue over 2003.

Operating Expenses		(dollars in millions)		
Years Ended December 31,		2005	2004	2003
Cost of services and sales	\$	593	\$ 542	\$ 554
Selling, general and administrative expense		1,107	1,319	1,387
Depreciation and amortization expense		92	87	79
Sales of businesses, net		-	-	(141)
	\$	1,792	\$ 1,948	\$ 1,879

Cost of Services and Sales

Cost of services and sales in 2005 increased \$51 million, or 9.4% compared to 2004 and decreased by \$12 million, or 2.2% in 2004 compared to 2003. The 2005 increase was primarily due to increased printing and distribution costs and higher costs associated with SuperPages.com. The decrease in 2004 was primarily due to reduced expenses related to the July 2003 sale of European operations.

Selling, General and Administrative Expense

Selling, general and administrative expenses decreased \$212 million, or 16.1% in 2005 compared to 2004. This decrease was due primarily to cost reductions, as well as reduced bad debt and legal expenses. Selling, general and administrative expenses decreased \$68 million, or 4.9% in 2004 compared to 2003. Lower bad debt expenses and reduced expenses related to the July 2003 sale of European operations were partially offset by higher domestic pension and benefit costs.

Depreciation and Amortization Expense

Depreciation and amortization expense in 2005 increased by \$5 million, or 5.7% compared to 2004 and by \$8 million, or 10.1% in 2004 compared to 2003, primarily due to increased software amortization expense.

Sales of Businesses, Net

In 2003, we recorded a net pretax gain of \$141 million primarily related to the sale of our European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Segment Income		(dollars in millions)		
Years Ended December 31,		2005	2004	2003
Segment Income	\$	1,044	\$ 968	\$ 1,128

Segment income in 2005 increased by \$76 million, or 7.9% compared to 2004 and decreased by \$160 million, or 14.2% in 2004 compared to 2003. The increase in 2005 and decrease in 2004 were primarily the result of the after-tax impact of the operating revenues and expenses described above and lower interest expense in 2005 compared to 2004.

Special and non-recurring items of \$(10) million, \$(596) million, \$1,660 million, after-tax, affected the Information Services segment but were excluded from segment income in 2005, 2004 and 2003, respectively. The special and non-recurring items in all years include the results of operations of the Hawaii directory operations. The special and non-recurring items in 2004 and 2003 include the results of operations of Verizon Information Services Canada. The special and non-recurring items in 2004 also included the gain on the sale of Verizon Information Services Canada, partially offset by pension settlement losses for employees who received lump-sum

distributions under a prior year voluntary separation plan. Special and non-recurring items in 2003 also included a loss recorded in connection with the cumulative effect of the directory accounting change from the publication-date method of recognizing revenue and expenses to the amortization method, effective January 1, 2003, and severance charges related to a voluntary separation plan.

International

Our International segment includes international wireline and wireless telecommunication operations in the Americas and Europe. Our consolidated international investments as of December 31, 2005 included Verizon Dominicana, C. por A. (Verizon Dominicana) in the Dominican Republic and TELPRI in Puerto Rico. Either the cost or the equity method is applied to those investments in which we have less than a controlling interest.

On June 13, 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell and reclassified our investment and the results of operations of Iusacell as discontinued operations. We sold our shares in Iusacell on July 29, 2003. The results of operations for this business unit in 2003 are classified as discontinued operations in accordance with SFAS No. 144, and are excluded from International segment results.

Operating Revenues		(dollars in millions)		
Years Ended December 31,		2005	2004	2003
Operating Revenues	\$	2,193	\$ 2,014	\$ 1,949

Revenues generated by our international businesses increased by \$179 million, or 8.9% in 2005 compared to 2004 and increased by \$65 million, or 3.3% in 2004 compared to 2003. The increase in 2005 was primarily due to favorable foreign exchange rates in the Dominican Republic as well as favorable wireless growth at both TELPRI and Verizon Dominicana, partially offset by a favorable adjustment to carrier access revenues at TELPRI in 2004. The increase in 2004 was primarily due to operational growth at Verizon Dominicana and a 2003 adjustment to carrier access revenues at TELPRI, partially offset by declining foreign exchange rates in the Dominican Republic.

Operating Expenses		(dollars in millions)		
Years Ended December 31,		2005	2004	2003
Cost of services and sales	\$	707	\$ 626	\$ 574
Selling, general and administrative expense		675	471	691
Depreciation and amortization expense		340	324	346
	\$	1,722	\$ 1,421	\$ 1,611

Cost of Services and Sales

Cost of services and sales increased in 2005 by \$81 million, or 12.9% compared to 2004 and by \$52 million, or 9.1% in 2004 compared to 2003. The increase in 2005 was due primarily to higher variable costs at Verizon Dominicana and at TELPRI as well as the appreciation of the Dominican Republic peso. The increase in 2004 reflected higher variable costs at Verizon Dominicana, partially offset by the decline of the Dominican Republic's foreign exchange rates.

Selling, General and Administrative Expense

Selling, general and administrative expenses increased in 2005 by \$204 million, or 43.3% compared to 2004 and decreased by \$220 million, or 31.8% in 2004 compared to 2003. The increase in 2005 reflects the favorable resolution in 2004 of a 2003 TELPRI charge recorded as a result of an adverse Puerto Rico Circuit Court of Appeals ruling on intra-island long distance access rates, the

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appreciation of the Dominican Republic peso and higher employee-related costs and commission expenses. The decrease in 2004 was primarily due to a TELPRI charge recorded in 2003 as a result of the Puerto Rico Circuit Court of Appeals ruling as well as the favorable resolution to the charge in 2004, an asset write-off in 2003, and declining foreign exchange rates in the Dominican Republic.

Depreciation and Amortization Expense

Depreciation and amortization expense increased in 2005 by \$16 million, or 4.9% compared to 2004 and decreased \$22 million, or 6.4% in 2004 compared to 2003. The increase in 2005 primarily reflects the appreciation of the Dominican Republic peso. The decrease in 2004 was due primarily to declining foreign exchange rates in the Dominican Republic and the adoption of SFAS No. 143 in 2003, offset in part by increased depreciation related to ongoing network capital expenditures in 2004.

Segment Income Years Ended December 31,	(dollars in millions)		
	2005	2004	2003
Segment Income	\$ 1,251	\$ 1,225	\$ 1,392

Segment income increased in 2005 by \$26 million, or 2.1% compared to 2004 and decreased by \$167 million, or 12.0% in 2004 compared to 2003. The increase in 2005 reflects an increase in interest income, foreign exchange gains and lower income taxes, largely offset by lower equity in earnings of unconsolidated businesses and Verizon's share (after minority interest) of the after-tax impact of the operating revenues and operating expenses previously described. The decrease in 2004 was primarily the result of the decrease in equity in earnings of unconsolidated businesses and income from other unconsolidated businesses, partially offset by Verizon's share (after minority interest) of the after-tax impact of the operating revenues and operating expenses previously described.

Equity in earnings of unconsolidated businesses decreased in 2005 by \$224 million, or 21.7% compared to 2004 and decreased by \$60 million, or 5.5% in 2004 compared to 2003. The decrease in 2005 primarily resulted from lower equity income due to the sale of our TELUS interest in 2004, estimated additional pension liabilities at CANTV and the gain on the sale of an equity investment in 2004, partially offset by higher tax benefits and operational results at Vodafone Omnitel. The decrease in 2004 was driven primarily from Italian tax benefits in 2003 arising from a reorganization and the 2003 contribution tax reversal that resulted from a favorable European Court of Justice ruling at Vodafone Omnitel, partially offset by favorable foreign currency impacts from the euro on that investment and continued operational growth, as well as a gain on the sale of an equity investment in 2004. Income from other unconsolidated businesses decreased by \$138 million, or 81.7% in 2004 compared to 2003. This decrease reflects lower gains realized from the sale of investments compared to 2003.

Special and non-recurring items of \$(112) million, \$(797) million and \$791 million, after-tax, affected the International segment but were excluded from segment income in 2005, 2004 and 2003, respectively. The special and non-recurring items in 2005 primarily related to tax benefits realized in connection with prior years' investment losses, partially offset by a net tax provision from the repatriation of foreign earnings. The special and non-recurring items in 2004 were related to the gain on sale of our investment in TELUS and tax benefits realized in connection with prior years' sales of investments, partially offset by pension settlement losses for employees that received lump-sum distributions under a voluntary separation plan.

The special and non-recurring items in 2003 include the impairment of our investment in Iusacell, partially offset by a gain on the sale of Eurotel Praha.

SPECIAL ITEMS

Discontinued Operations

During 2004, we announced our decision to sell Verizon Information Services Canada to an affiliate of Bain Capital, a global private investment firm, for \$1,540 million (Cdn. \$1,985 million). The sale closed during the fourth quarter of 2004 and resulted in a gain of \$1,017 million (\$516 million after-tax, or \$.18 per diluted share). In accordance with SFAS No. 144, we have classified the results of operations of Verizon Information Services Canada as discontinued operations in the consolidated statements of income in all years.

During 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell into a tender offer launched by Movil Access, a Mexican company. Verizon tendered its shares shortly after the tender offer commenced, and the tender offer closed on July 29, 2003. In accordance with SFAS No. 144, we have classified the results of operations of Iusacell as discontinued operations in the consolidated statements of income in all years until the sale. In connection with a comparison of expected net sale proceeds to net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of \$957 million (\$931 million after-tax, or \$.33 per diluted share).

Sales of Businesses and Investments, Net

Sales of Businesses, Net

During 2005, we sold our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operated approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services Inc. in Hawaii, to an affiliate of The Carlyle Group for \$1,326 million in cash proceeds. In connection with this sale, we recorded a net pretax gain of \$530 million (\$336 million after-tax, or \$.12 per diluted share).

Sales of Investments, Net

During 2004, we recorded a pretax gain of \$787 million (\$565 million after-tax, or \$.20 per diluted share) on the sale of our 20.5% interest in TELUS in an underwritten public offering in the U.S. and Canada. In connection with this sale transaction, Verizon recorded a contribution of \$100 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$500 million after taxes, or \$.18 per diluted share related to this transaction and the accrual of the Verizon Foundation contribution.

Also during 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of \$43 million (\$43 million after-tax, or \$.02 per diluted share). This preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

During 2003, we recorded a pretax gain of \$348 million on the sale of our interest in Eurotel Praha. Also during 2003, we recorded a net pretax gain of \$176 million as a result of a payment received in connection with the liquidation of Genuity. In connection with these sales transactions, Verizon recorded contributions of \$150 million for each of the transactions to Verizon Foundation to fund its

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charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$44 million after taxes, or \$.02 per diluted share related to these transactions and the accrual of the Verizon Foundation contributions.

Tax Matters

During 2005, we recorded a tax benefit of \$336 million (\$.12 per diluted share) in connection with capital gains and prior year investment losses. As a result of the capital gain realized in 2005 in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million (\$.09 per diluted share) related to prior year investment losses. The investment losses pertain to Iusacell, CTI Holdings, S.A. (CTI) and TelecomAsia.

Also during 2005, we recorded a net tax provision of \$206 million (\$.07 per diluted share) related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, which provides for a favorable federal income tax rate in connection with the repatriation of foreign earnings, provided the criteria described in the law is met. Two of Verizon's foreign investments repatriated earnings resulting in income taxes of \$332 million, partially offset by a tax benefit of \$126 million.

As a result of the capital gain realized in 2004 in connection with the sale of Verizon Information Services Canada, we recorded tax benefits of \$234 million (\$.08 per diluted share) in the fourth quarter of 2004 pertaining to prior year investment impairments. The investment impairments primarily related to debt and equity investments in CTI, Cable & Wireless plc and NTL Incorporated.

Facility and Employee-Related Items

During 2005, we recorded a net pretax gain of \$18 million (\$8 million after-tax, or less than \$.01 per diluted share) in connection with our planned relocation of several functions to Verizon Center, including a pretax gain of \$120 million (\$72 million after-tax, or \$.03 per diluted share) related to the sale of a New York City office building, partially offset by a pretax charge of \$102 million (\$64 million after-tax, or \$.02 per diluted share) primarily associated with relocation-related employee severance costs and related activities. Additional relocation costs are anticipated in 2006.

During 2005, we recorded a net pretax charge of \$98 million (\$59 million after-tax, or \$.02 per diluted share) related to the restructuring of the Verizon management retirement benefit plans. This pretax charge was recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and includes the unamortized cost of prior pension enhancements of \$441 million offset partially by a pretax curtailment gain of \$343 million related to retiree medical benefits. In connection with this restructuring, management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after receiving an 18-month enhancement of the value of their pension and retiree medical subsidy, but will receive a higher savings plan matching contribution.

In addition, during 2005 we recorded a charge of \$59 million (\$36 million after-tax, or \$.01 per diluted share) associated with employee severance costs and severance-related activities in connection with the voluntary separation program for surplus union-represented employees.

During 2004, we recorded pretax pension settlement losses of \$815 million (\$499 million after-tax, or \$.18 per diluted share) related to employees that received lump-sum distributions during 2004 in connection with the voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003. These charges were recorded in accordance with SFAS No. 88, which requires that settlement losses be recorded once prescribed payment thresholds have been reached.

Total pension, benefit and other costs related to severance activities were \$5,524 million (\$3,399 million after-tax, or \$1.20 per diluted share) in 2003, primarily in connection with the voluntary separation of more than 25,000 employees, as follows:

- In connection with the voluntary separation of more than 21,000 employees during the fourth quarter of 2003, we recorded a pretax charge of \$4,695 million (\$2,882 million after-tax, or \$1.02 per diluted share). This pretax charge included \$2,716 million recorded in accordance with SFAS No. 88 and SFAS No. 106, for pension and postretirement benefit enhancements and a net curtailment gain for a significant reduction of the expected years of future service resulting from early retirements. In addition, we recorded a pretax charge of \$76 million for pension settlement losses related to lump-sum settlements of some existing pension obligations. The fourth quarter pretax charge also included severance costs of \$1,720 million and costs related to other severance-related activities of \$183 million.
- We also recorded a special charge in 2003 of \$235 million (\$150 million after-tax, or \$.05 per diluted share) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees. In addition, we recorded pretax pension settlement losses of \$131 million (\$81 million after-tax, or \$.03 per diluted share) in 2003 related to employees that received lump-sum distributions during the year in connection with previously announced employee separations.
- Further, in 2003 we recorded a special charge of \$463 million (\$286 million after-tax, or \$.10 per diluted share) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

Other Special Items

During 2005, we recorded pretax charges of \$139 million (\$133 million after-tax, or \$.05 per diluted share) including a pretax impairment charge of \$125 million (\$125 million after-tax, or \$.04 per diluted share) pertaining to our leasing operations for aircraft leases involved in recent airline bankruptcy proceedings and a pretax charge of \$14 million (\$8 million after-tax, or less than \$.01 per diluted share) in connection with the early retirement of debt.

In 2004, we recorded an expense credit of \$204 million (\$123 million after-tax, or \$.04 per diluted share) resulting from the favorable resolution of pre-bankruptcy amounts due from MCI. Previously reached

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settlement agreements became fully effective when MCI emerged from bankruptcy proceedings in the second quarter of 2004.

Also during 2004, we recorded a charge of \$113 million (\$87 million after-tax, or \$.03 per diluted share) related to operating asset losses pertaining to our international long distance and data network. In addition, we recorded pretax charges of \$55 million (\$34 million after-tax, or \$.01 per diluted share) in connection with the early retirement of debt.

During 2003, we recorded other special pretax charges of \$557 million (\$419 million after-tax, or \$.15 per diluted share). These charges included \$240 million (\$156 million after-tax, or \$.06 per diluted share) primarily in connection with environmental remediation efforts relating to several discontinued businesses, including a former facility that processed nuclear fuel rods in Hicksville, New York (see "Other Factors That May Affect Future Results – Recent Developments – Environmental Matters") and a pretax impairment charge of \$184 million (\$184 million after-tax, or \$.06 per diluted share) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and for power generating facilities. These 2003 charges also include pretax charges of \$61 million (\$38 million after-tax, or \$.01 per diluted share) related to the early retirement of debt and other pretax charges of \$72 million (\$41 million after-tax, or \$.01 per diluted share).

CONSOLIDATED FINANCIAL CONDITION

Years Ended December 31,		(dollars in millions)	
	2005	2004	2003
Cash Flows Provided By (Used In)			
Operating activities	\$ 22,012	\$ 21,820	\$ 22,467
Investing activities	(18,492)	(10,343)	(12,236)
Financing activities	(5,034)	(9,856)	(10,959)
Increase (Decrease) In Cash and Cash Equivalents	\$ (1,514)	\$ 1,621	\$ (728)

We use the net cash generated from our operations to fund network expansion and modernization, repay external financing, pay dividends and invest in new businesses. Additional external financing is utilized when necessary. While our current liabilities typically exceed current assets, our sources of funds, primarily from operations and, to the extent necessary, from readily available external financing arrangements, are sufficient to meet ongoing operating and investing requirements. We expect that capital spending requirements will continue to be financed primarily through internally generated funds. Additional debt or equity financing may be needed to fund additional development activities or to maintain our capital structure to ensure our financial flexibility.

Cash Flows Provided By Operating Activities

Our primary source of funds continues to be cash generated from operations. In 2005, the increase in cash from operations compared to 2004 was primarily driven by the repatriation of \$2.2 billion of foreign earnings from unconsolidated businesses and lower severance payments in 2005, largely offset by cash income tax payments, including taxes paid in 2005 related to the 2004 sales of Verizon Information Services Canada and TELUS shares, and higher pension fund contributions.

In 2004, the decrease in cash from operations compared to 2003 was primarily driven by an increase in working capital requirements.

The increase in working capital requirements was driven by higher severance payments in 2004 compared to higher severance accruals in 2003, primarily related to the fourth quarter 2003 voluntary separation plan. In addition, a higher tax refund was recorded in the 2003 period.

Cash Flows Used In Investing Activities

Capital expenditures continue to be our primary use of capital resources and facilitate the introduction of new products and services, enhance responsiveness to competitive challenges and increase the operating efficiency and productivity of our networks. Including capitalized software, we invested \$8,267 million in our Domestic Telecom business in 2005, compared to \$7,118 million and \$6,820 million in 2004 and 2003, respectively. We also invested \$6,484 million in our Domestic Wireless business in 2005, compared to \$5,633 million and \$4,590 million in 2004 and 2003, respectively. The increase in capital spending of both Domestic Telecom and Domestic Wireless represents our continuing effort to invest in high growth areas including wireless, long distance, broadband and other wireline data initiatives.

In 2006, capital expenditures including capitalized software are expected to be in the range of \$15.4 billion to \$15.7 billion, excluding capital expenditures associated with MCI. Including MCI, capital expenditures are expected to be \$17.0 billion to \$17.4 billion in 2006.

We invested \$4,684 million in acquisitions and investments in businesses during 2005, including \$3,003 million to acquire NextWave Telecom Inc. (NextWave) personal communications services licenses, \$641 million to acquire 63 broadband wireless licenses in connection with FCC auction 58, \$419 million to purchase Qwest Wireless, LLC's spectrum licenses and wireless network assets in several existing and new markets, \$230 million to purchase spectrum from MetroPCS, Inc. and \$297 million for other wireless properties and licenses. In 2004, we invested \$1,196 million in acquisitions and investments in businesses, including \$1,052 million for wireless licenses and businesses, including the NextWave licenses covering the New York metropolitan area, and \$144 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects. In 2003, we invested \$1,162 million in acquisitions and investments in businesses, including \$762 million to acquire 50 wireless licenses and related network assets from Northcoast Communications LLC, \$242 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects and \$157 million for other wireless properties.

In 2005, we received cash proceeds of \$1,326 million in connection with the sale of Verizon's wireline and directory operations in Hawaii. In 2004, we received cash proceeds of \$1,720 million, including \$1,603 million from the sale of Verizon Information Services Canada and \$117 million from the sale of a small business unit. In 2003, we received cash proceeds of \$229 million, from the sale of our European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Our short-term investments include principally cash equivalents held in trust accounts for payment of employee benefits. In 2005, 2004 and 2003, we invested \$1,978 million, \$1,827 million and \$1,887 million, respectively, in short-term investments, primarily to pre-fund active employees' health and welfare benefits. Proceeds from the sales of all short-term investments, principally for the payment of these benefits, were \$1,634 million, \$1,727 million and \$1,767 million in the years 2005, 2004 and 2003, respectively.

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Other, net investing activities for 2005 includes a net investment of \$913 million for the purchase of 43.4 million shares of MCI common stock from eight entities affiliated with Carlos Slim Helu, offset by cash proceeds of \$713 million from property sales, including a New York City office building, and \$349 million of repatriated proceeds from the sales of European investments in prior years. Other, net investing activities for 2004 include net cash proceeds of \$1,632 million received in connection with the sale of our 20.5% interest in TELUS and \$650 million in connection with sales of our interests in various other investments, including a partnership venture with Crown Castle International Corp., EuroTel Bratislava, a.s. and Iowa Telecom preferred stock. Other, net investing activities for 2003 include net cash proceeds of \$415 million in connection with sales of our interests in various investments, primarily TCC and Crown Castle International Corp. and \$195 million in connection with the sale of our interest in Eurotel Praha, representing a portion of the total proceeds of \$525 million.

Under the terms of an investment agreement, Vodafone may require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to \$12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to \$10 billion during the 61-day period opening on June 10 and closing on August 9 in 2005, and did not exercise that right. As a result, Vodafone still has the right to require the purchase of up to \$20 billion worth of its interest, not to exceed \$10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2006 and 2007. Vodafone also may require that Verizon Wireless pay for up to \$7.5 billion of the required repurchase through the assumption or incurrence of debt.

Cash Flows Used In Financing Activities

Cash of \$303 million was used to reduce our total debt during 2005. We repaid \$1,533 million of Domestic Wireless, \$1,183 million of Domestic Telecom, \$996 million of Verizon Global Funding Corp., \$113 million of other corporate and \$93 million of International long-term debt. The Domestic Telecom debt repayment includes the early retirement of \$350 million of long-term debt and \$806 million of other long-term debt at maturity. This decrease was largely offset by the issuance by Verizon Global Funding of long-term debt with a total principal amount of \$1,500 million, resulting in total cash proceeds of \$1,478 million, net of discounts and costs, and an increase in our short-term borrowings of \$2,129 million.

Cash of \$5,467 million was used to reduce our total debt during 2004. We repaid \$2,315 million and \$2,769 million of Domestic Telecom and corporate long-term debt, respectively. The Domestic Telecom debt repayment includes the early retirement of \$1,275 million of long-term debt and \$950 million of other long-term debt at maturity. The corporate debt repayment includes \$1,984 million of zero-coupon convertible notes redeemed by Verizon Global Funding and \$723 million of other corporate long-term debt at maturity. Also, during 2004, we decreased our short-term borrowings by \$783 million and Verizon Global Funding issued \$500 million of long-term debt.

Cash of \$7,436 million was used to reduce our total debt during 2003. We repaid \$5,646 million of Verizon Global Funding, \$2,190 million of Domestic Telecom, \$1,582 million of Domestic Wireless

and \$1,239 million of other corporate long-term debt, and reduced our short-term borrowings by \$1,330 million with cash from operations and the issuance of Verizon Global Funding, Domestic Telecom and Domestic Wireless long-term debt. Verizon Global Funding, Domestic Telecom and Domestic Wireless issued long-term debt with principal amounts of \$1,500 million, \$1,653 million and \$1,525 million, respectively, resulting in total cash proceeds of \$4,591 million, net of discounts, costs and a payment related to a hedge on the interest rate for an anticipated financing.

Our ratio of debt to debt combined with shareowners' equity was 49.6% at December 31, 2005 compared to 51.1% at December 31, 2004.

As of December 31, 2005, we had \$11 million in bank borrowings outstanding. We also had approximately \$6.7 billion of unused bank lines of credit (including a \$6.0 billion three-year committed facility which expires in June 2008, a \$400 million one-year committed facility for TELPRI which expires in February 2006 and various other facilities totaling approximately \$400 million). In addition, our financing subsidiary had shelf registrations for the issuance of up to \$8.5 billion of unsecured debt securities. The debt securities of our telephone and financing subsidiaries continue to be accorded high ratings by primary rating agencies. In February 2005, both Standard & Poor's and Moody's Investors Service (Moody's) indicated that the proposed acquisition of MCI (see "Other Factors That May Affect Future Results – Recent Developments – MCI Merger") may result in downgrades in Verizon's debt ratings. At that time, Moody's placed the short-term and long-term debt of Verizon and its telephone subsidiaries on review for possible downgrade, while simultaneously changing the outlook on the A3-rated Verizon Wireless debt to stable from positive. Standard & Poor's placed the A+ long-term debt rating of Verizon and affiliates (including Verizon Wireless) on credit watch with negative implications. Fitch Ratings also placed the A+ rating of Verizon, along with the ratings of its affiliates, on ratings watch negative as a result of the proposed acquisition of MCI. In December 2005, Moody's downgraded the long-term debt rating of Verizon to A3 from A2. At the same time, the short-term debt ratings of Verizon Global Funding and Verizon Network Funding were changed to Prime-2 from Prime-1. Both outlooks were changed to stable. Moody's also placed the A3-rated long-term debt of Verizon Wireless on review for possible upgrade. These actions resolved the reviews initiated in February 2005. In January 2006, Fitch Ratings affirmed the A+ long-term debt ratings of Verizon and affiliates (including Verizon Wireless), removed them from rating watch negative, and assigned stable rating outlooks. The F1 short-term debt ratings of Verizon Global Funding and Verizon Network Funding were also affirmed. These short-term ratings had not been on rating watch negative. Also in January 2006, Standard & Poor's lowered the long-term ratings of Verizon and subsidiaries (including Verizon Wireless) to A from A+, removed them from credit watch, and assigned a negative outlook. Short-term ratings assigned by Standard & Poor's to Verizon remain at A-1.

We and our consolidated subsidiaries are in compliance with all of our debt covenants.

As in prior years, dividend payments were a significant use of capital resources. We determine the appropriateness of the level of our dividend payments on a periodic basis by considering such factors as long-term growth opportunities, internal cash requirements and the expectations of our shareowners. In 2005, Verizon increased its quar-

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terly dividend by \$.02 per share, or 5.2% to \$.405 per share. In 2004 and 2003, we declared quarterly cash dividends of \$.385 per share.

Common stock has generally been issued to satisfy some of the funding requirements of employee benefit plans. On January 19, 2006, the Board of Directors authorized the repurchase of up to 100 million common shares terminating no later than the close of business on February 28, 2008. The Board of Directors also determined that no additional common shares may be purchased under the previous program.

Increase (Decrease) In Cash and Cash Equivalents

Our cash and cash equivalents at December 31, 2005 totaled \$776 million, a \$1,514 million decrease compared to cash and cash equivalents at December 31, 2004 of \$2,290 million. The decrease in cash and cash equivalents in 2005 was primarily driven by increased capital expenditures and higher acquisitions and investments, partially offset by proceeds from the sale of businesses and lower repayments of borrowings. Our cash and cash equivalents at December 31, 2004 was \$1,621 million higher compared to December 31, 2003. The increase was driven by higher proceeds from disposition of businesses and investments and lower debt repayment activity, partially offset by higher capital expenditures.

Additional Minimum Pension Liability and Employee Benefit Plan Contributions

We evaluate each pension plan to determine whether an additional minimum pension liability is required or whether any adjustment is necessary as determined by the provisions of SFAS No. 87, "Employers' Accounting for Pensions." In 2005, we recorded a net benefit of \$59 million, primarily in Employee Benefit Obligations and Other Assets. In 2004, we recorded an additional minimum pension liability of \$587 million, primarily in Employee Benefit Obligations in the consolidated balance sheets, as a result of a lower discount rate at December 31, 2004. The changes in the assets and liabilities are recorded in Accumulated Other Comprehensive Loss, net of a tax benefit, in shareowners' investment in the consolidated balance sheets.

We operate numerous qualified and nonqualified pension plans and other postretirement benefit plans. These plans primarily relate to our domestic business units and TELPRI. The majority of Verizon's pension plans are adequately funded. We contributed \$744 million,

\$325 million and \$123 million in 2005, 2004 and 2003, respectively, to our qualified pension trusts. We also contributed \$108 million, \$118 million and \$159 million to our nonqualified pension plans in 2005, 2004 and 2003, respectively.

Federal legislation was enacted on April 10, 2004 that provides temporary pension funding relief for the 2004 and 2005 plan years. The legislation replaced the 30-year treasury rate with a higher corporate bond rate for determining the current liability. Based on the funded status of the plans at December 31, 2005, we anticipate qualified pension trust contributions of \$100 million in 2006, primarily for the TELPRI plans. Our estimate of the amount and timing of required qualified pension trust contributions for 2007 is based on current regulations including continued pension funding relief and is approximately \$1,200 million, including TELPRI plans. Nonqualified pension contributions are estimated to be approximately \$145 million and \$180 million for 2006 and 2007, respectively.

Contributions to our other postretirement benefit plans generally relate to payments for benefits primarily on an as-incurred basis since the other postretirement benefit plans do not have similar funding requirements as the pension plans. Consequently, we contributed \$1,085 million, \$1,143 million and \$1,014 million to our other postretirement benefit plans in 2005, 2004 and 2003, respectively. Contributions to our other postretirement benefit plans are estimated to be approximately \$1,180 million in 2006 and \$1,370 million in 2007, prior to anticipated receipts related to Medicare subsidies.

Leasing Arrangements

We are the lessor in leveraged and direct financing lease agreements under which commercial aircraft and power generating facilities, which comprise the majority of the portfolio, along with industrial equipment, real estate property, telecommunications and other equipment are leased for remaining terms of less than 1 year to 50 years as of December 31, 2005. Minimum lease payments receivable represent unpaid rentals, less principal and interest on third-party nonrecourse debt relating to leveraged lease transactions. Since we have no general liability for this debt, which holds a senior security interest in the leased equipment and rentals, the related principal and interest have been offset against the minimum lease payments receivable in accordance with generally accepted accounting principles. All recourse debt is reflected in our consolidated balance sheets. See "Special Items" for a discussion of lease impairment charges.

Off Balance Sheet Arrangements and Contractual Obligations

Contractual Obligations and Commercial Commitments

The following table provides a summary of our contractual obligations and commercial commitments at December 31, 2005. Additional detail about these items is included in the notes to the consolidated financial statements.

Contractual Obligations	Payments Due By Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt (see Note 11)	\$ 36,683	\$ 4,909	\$ 7,078	\$ 4,439	\$ 20,257
Capital lease obligations (see Note 10)	112	17	36	18	41
Total long-term debt	36,795	4,926	7,114	4,457	20,298
Interest on long-term debt (see Note 11)	24,973	2,219	3,587	3,116	16,051
Operating leases (see Note 10)	4,497	1,184	1,443	820	1,050
Purchase obligations (see Note 22)	669	486	151	22	10
Other long-term liabilities (see Note 15)	3,850	1,280	2,570	—	—
Total contractual obligations	\$ 70,784	\$ 10,095	\$ 14,865	\$ 8,415	\$ 37,409

(dollars in millions)

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Guarantees

In connection with the execution of agreements for the sales of businesses and investments, Verizon ordinarily provides representations and warranties to the purchasers pertaining to a variety of nonfinancial matters, such as ownership of the securities being sold, as well as financial losses.

Subsequent to the sale of Verizon Information Services Canada (see "Special Items – Discontinued Operations"), our Information Services segment continues to provide a guarantee to publish directories, which was issued when the directory business was purchased in 2001 and had a 30-year term (before extensions). The preexisting guarantee continues, without modification, following the sale of Verizon Information Services Canada. The possible financial impact of the guarantee, which is not expected to be adverse, cannot be reasonably estimated since a variety of the potential outcomes available under the guarantee result in costs and revenues or benefits that may offset. In addition, performance under the guarantee is not likely.

As of December 31, 2005, letters of credit totaling \$140 million had been executed in the normal course of business, which support several financing arrangements and payment obligations to third parties.

MARKET RISK

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes, foreign currency exchange rate fluctuations, changes in equity investment prices and changes in corporate tax rates. We employ risk management strategies using a variety of derivatives, including interest rate swap agreements, interest rate locks, foreign currency forwards and collars and equity options. We do not hold derivatives for trading purposes.

It is our general policy to enter into interest rate, foreign currency and other derivative transactions only to the extent necessary to achieve our desired objectives in limiting our exposures to the various market risks. Our objectives include maintaining a mix of fixed and variable rate debt to lower borrowing costs within reasonable risk parameters and to protect against earnings and cash flow volatility resulting from changes in market conditions. We do not hedge our market risk exposure in a manner that would completely eliminate the effect of changes in interest rates, equity prices and foreign exchange rates on our earnings. We do not expect that our net income, liquidity and cash flows will be materially affected by these risk management strategies.

Interest Rate Risk

The table that follows summarizes the fair values of our long-term debt and interest rate derivatives as of December 31, 2005 and 2004. The table also provides a sensitivity analysis of the estimated fair values of these financial instruments assuming 100-basis-point upward and downward parallel shifts in the yield curve. Our sensitivity analysis did not include the fair values of our commercial paper and bank loans because they are not significantly affected by changes in market interest rates.

		(dollars in millions)	
	Fair Value	Fair Value assuming +100 basis point shift	Fair Value assuming -100 basis point shift
At December 31, 2005			
Long-term debt and interest rate derivatives	\$ 38,052	\$ 36,123	\$ 40,202
At December 31, 2004			
Long-term debt and interest rate derivatives	\$ 42,072	\$ 39,952	\$ 44,378

Foreign Currency Translation

The functional currency for our foreign operations is the local currency. At December 31, 2005, our primary translation exposure was to the Venezuelan bolivar, Dominican Republic peso and the euro. The translation of income statement and balance sheet amounts of our foreign operations into U.S. dollars are recorded as cumulative translation adjustments, which are included in Accumulated Other Comprehensive Loss in our consolidated balance sheets. We also periodically hold cash balances in foreign currencies. The translation of foreign currency cash balances is recorded in the consolidated statements of income in Other Income and (Expense), Net. During 2005, the translation of these cash balances were not material. During 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. In accordance with the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and related amendments and interpretations, changes in the fair value of these contracts due to exchange rate fluctuations are recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment in the operation being hedged. As of December 31, 2005, our positions in the zero cost euro collars have been settled. We have not hedged our accounting translation exposure to foreign currency fluctuations relative to the carrying value of our other investments.

During 2004, we entered into foreign currency forward contracts to hedge our net investment in our Canadian operations and investments. In accordance with the provisions of SFAS No. 133, changes in the fair value of these contracts due to exchange rate fluctuations were recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment in the operations being hedged. During 2004, we sold our Canadian operations and investments. Accordingly, the unrealized losses on these net investment hedge contracts were realized in net income along with the corresponding foreign currency translation balance. We recorded realized losses of \$106 million (\$58 million after-tax) related to these hedge contracts.

Our earnings were affected by foreign currency gains or losses associated with the U.S. dollar denominated assets and liabilities at Verizon Dominicana.

Through June 30, 2003, our earnings were affected by foreign currency gains or losses associated with the unhedged portion of U. S. dollar denominated debt at Iusacell (see "Consolidated Results of Operations – Other Consolidated Results – Discontinued Operations").

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SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

Significant Accounting Policies

A summary of the significant accounting policies used in preparing our financial statements are as follows:

- Special and non-recurring items generally represent revenues and gains as well as expenses and losses that are non-operational and/or non-recurring in nature. Several of these special and non-recurring items include impairment losses. These impairment losses were determined in accordance with our policy of comparing the fair value of the asset with its carrying value. The fair value is determined by quoted market prices or by estimates of future cash flows. There is inherent subjectivity involved in estimating future cash flows, which can have a significant impact on the amount of any impairment.
- Verizon's plant, property and equipment balance represents a significant component of our consolidated assets. Depreciation expense on Verizon's telephone operations is principally based on the composite group remaining life method and straight-line composite rates, which provides for the recognition of the cost of the remaining net investment in telephone plant, less anticipated net salvage value, over the remaining asset lives. We depreciate other plant, property and equipment generally on a straight-line basis over the estimated useful life of the assets. Changes in the remaining useful lives of assets as a result of technological change or other changes in circumstances, including competitive factors in the markets where we operate, can have a significant impact on asset balances and depreciation expense.
- We maintain benefit plans for most of our employees, including pension and other postretirement benefit plans. In the aggregate, the fair value of pension plan assets exceeds benefit obligations, which contributes to pension plan income. Other postretirement benefit plans have larger benefit obligations than plan assets, resulting in expense. Significant benefit plan assumptions, including the discount rate used, the long-term rate of return on plan assets and health care trend rates are periodically updated and impact the amount of benefit plan income, expense, assets and obligations (see "Consolidated Results of Operations – Consolidated Operating Expenses – Pension and Other Postretirement Benefits"). A sensitivity analysis of the impact of changes in these assumptions on the benefit obligations and expense (income) recorded as of December 31, 2005 and for the year then ended pertaining to Verizon's pension and postretirement benefit plans is provided in the tables below. Note that some of these sensitivities are not symmetrical as the calculations were based on all of the actuarial assumptions as of year-end.

Pension Plans

(dollars in millions)

	Percentage point change	Benefit obligation increase (decrease) at December 31, 2005	Pension expense increase (decrease) for the year ended December 31, 2005
Discount rate	+ 1.00 - 1.00	\$ (4,093) 5,165	\$ (216) 173
Long-term rate of return on plan assets	+ 1.00 - 1.00	– –	(393) 393

Postretirement Plans

(dollars in millions)

	Percentage point change	Benefit obligation increase (decrease) at December 31, 2005	Postretirement benefit expense increase (decrease) for the year ended December 31, 2005
Discount rate	+ 1.00 - 1.00	\$ (3,315) 3,774	\$ (186) 221
Long-term rate of return on plan assets	+ 1.00 - 1.00	– –	(45) 45
Health care trend rates	+ 1.00 - 1.00	3,378 (2,745)	474 (352)

- Our accounting policy concerning the method of accounting applied to investments (consolidation, equity or cost) involves an evaluation of all significant terms of the investments that explicitly grant or suggest evidence of control or influence over the operations of the entity in which we have invested. Where control is determined, we consolidate the investment. If we determine that we have significant influence over the operating and financial policies of an entity in which we have invested, we apply the equity method. We apply the cost method in situations where we determine that we do not have significant influence.
- Our current and deferred income taxes, and associated valuation allowances, are impacted by events and transactions arising in the normal course of business as well as in connection with special and non-recurring items. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred income tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting related income tax balances.
- Intangible assets are a significant component of our consolidated assets. Wireless licenses of \$47,804 million represent the largest component of our intangible assets. Our wireless licenses are indefinite-lived intangible assets, and as required by SFAS No. 142, are not amortized but are periodically evaluated for impairment. Any impairment loss would be determined by comparing the fair value of the wireless licenses with their carrying value. For 2004 and 2003, we used a residual method, which determined fair value by estimating future cash flows of the wireless business. Beginning in 2005, we began using a direct value approach in accordance with a September 29, 2004 Staff Announcement from the staff of the Securities and Exchange Commission (SEC), "Use of the Residual Method to Value Acquired Assets Other Than Goodwill." The direct value approach also determines fair value by estimating future cash flows. There is inherent subjectivity involved in estimating future cash flows, which can have a material impact on the amount of any impairment.

management's discussion and analysis

of results of operations and financial condition continued

Recent Accounting Pronouncements

Stock-Based Compensation

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which revises SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense based on their fair value. Effective January 1, 2003, Verizon adopted the fair value recognition provisions of SFAS No. 123. We plan to adopt SFAS No. 123(R) effective January 1, 2006, using the modified prospective method and expect that any impact will not be material to our financial position or ongoing results of operations.

OTHER FACTORS THAT MAY AFFECT FUTURE RESULTS

Recent Developments

MCI Merger

On February 14, 2005, Verizon announced that it had agreed to acquire MCI for a combination of Verizon common shares and cash (including MCI dividends). On May 2, 2005, Verizon announced that it agreed with MCI to further amend its agreement to acquire MCI for cash and stock of at least \$26.00 per share, consisting of cash of \$5.60, which was paid as a special dividend by MCI on October 27, 2005, after the October 6, 2005 approval of the transaction by MCI shareholders, plus the greater of .5743 Verizon shares for each MCI common share or a sufficient number of Verizon shares to deliver to shareholders \$20.40 of value. Under this price protection feature, Verizon had the option of paying additional cash instead of issuing additional shares over the .5743 exchange ratio. This consideration was subject to adjustment at closing and may have been decreased based on MCI's bankruptcy claims-related experience and international tax liabilities. The merger received the required state, federal and international regulatory approvals by year-end 2005, and on January 6, 2006, Verizon and MCI closed the merger.

Under terms of the merger agreement, MCI shareholders received .5743 shares of Verizon and cash for each of their MCI shares. Verizon elected to make a supplemental cash payment of \$2.738 per MCI share, \$779 million in the aggregate, rather than issue additional shares of Verizon common stock, so that the merger consideration was equal to at least \$20.40 per MCI share. Verizon and MCI management mutually agreed that there was no purchase price adjustment related to the amount of MCI's bankruptcy claims-related experience and international tax liabilities.

Separately, on April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helu to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash plus an additional cash amount of 3% per annum from April 9, 2005 until the closing of the purchase of those shares. The transaction closed on May 17, 2005 and the additional cash payment was made through May 13, 2005. The total cash payment was \$1,121 million. Under the stock purchase agreement, Verizon will pay the Slim entities an adjustment at the end of one year in an amount per MCI share calculated by multiplying (i) .7241 by (ii) the amount, if any, by which the price of Verizon's common stock exceeds \$35.52 per share (measured over a 20-day period), subject to a maximum excess amount per Verizon share of \$26.98. After the closing of the stock purchase agreement, Verizon transferred the shares of MCI common stock it had purchased to a trust established pursuant to an agreement between Verizon and the

Department of Justice. We received the special dividend of \$5.60 per MCI share on these 43.4 million MCI shares, or \$243 million, on October 27, 2005.

Redemption of MCI Debt

On January 17, 2006, Verizon announced offers to purchase two series of MCI senior notes, MCI \$1,983 million aggregate principal amount of 6.688% Senior Notes Due 2009 and MCI \$1,699 million aggregate principal amount of 7.735% Senior Notes Due 2014, at 101% of their par value. Due to the change in control of MCI that occurred in connection with the merger with Verizon on January 6, 2006, Verizon is required to make this offer to noteholders within 30 days of the closing of the merger of MCI and Verizon. Separately, Verizon notified noteholders that MCI is exercising its right to redeem both series of Senior Notes prior to maturity under the optional redemption procedures provided in the indentures. The 6.688% Notes were redeemed on March 1, 2006, and the 7.735% Notes were redeemed on February 16, 2006.

In addition, on January 20, 2006, Verizon announced an offer to repurchase MCI \$1,983 million aggregate principal amount of 5.908% Senior Notes Due 2007 at 101% of their par value. On February 21, 2006, \$1,804 million of these notes were redeemed by Verizon. Verizon satisfied and discharged the indenture governing this series of notes shortly after the close of the offer for those noteholders who did not accept this offer.

Issuance of Debt

In February 2006, Verizon issued \$4,000 million of floating rate and fixed rate notes maturing from 2007 through 2035.

Spectrum Purchases

On February 15, 2005, the FCC's auction of broadband personal communications services licenses ended and Verizon Wireless and Vista PCS, LLC were the highest bidders for 63 licenses totaling approximately \$697 million. On May 13, 2005, the licenses won by Verizon Wireless were granted by the FCC. The licenses won by Vista PCS remain subject to FCC approval.

Sales of Businesses and Investments

Information Services

In December 2005, we announced that we are exploring divesting Information Services through a spin-off, sale or other strategic transaction. However, since this process is still ongoing, Information Services' results of operations, financial position and cash flows remain in Verizon's continuing operations.

Telephone Access Lines

We continually consider plans for a reduction in the size of our access line business, including through a spin-off mechanism or otherwise, so that we may pursue our strategy of placing greater focus on the higher growth businesses of broadband and wireless.

Environmental Matters

During 2003, under a government-approved plan, remediation commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. As a result, an additional environmental remediation expense of \$240 million was recorded in 2003, for remedial activities likely to take place over the next several years. In September 2005, the Army Corps of

management's discussion and analysis

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Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for remedial work at the Hicksville site, an adjustment to this reserve may be made. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the sites requiring remediation.

New York Recovery Funding

In August 2002, President Bush signed the Supplemental Appropriations bill that included \$5.5 billion in New York recovery funding. Of that amount, approximately \$750 million has been allocated to cover utility restoration and infrastructure rebuilding as a result of the September 11th terrorist attacks on Lower Manhattan. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 2004, we had applied for reimbursement of approximately \$266 million under Category One, although we did not record this amount as a receivable. We received advances totaling \$88 million in connection with this application process. On December 22, 2004, we applied for reimbursement of an additional \$136 million of "category 2" losses, and on March 29, 2005 we amended our application seeking an additional \$3 million. Category 2 funding is for permanent restoration and infrastructure improvement. According to the plan, permanent restoration is reimbursed up to 75% of the loss. On November 3, 2005, we received the results of preliminary audit findings disallowing all but \$44 million of our original \$266 million of costs in our Category One applications. On December 8, 2005, we provided a detailed rebuttal to the preliminary audit findings and are currently awaiting the final audit report. Our applications are pending.

Regulatory and Competitive Trends

Competition and Regulation

Technological, regulatory and market changes have provided Verizon both new opportunities and challenges. These changes have allowed Verizon to offer new types of services in this increasingly competitive market. At the same time, they have allowed other service providers to broaden the scope of their own competitive offerings. Current and potential competitors for network services include other telephone companies, cable companies, wireless service providers, foreign telecommunications providers, satellite providers, electric utilities, Internet service providers, providers of voice over the Internet, or VoIP services, and other companies that offer network services using a variety of technologies. Many of these companies have a strong market presence, brand recognition and existing customer relationships, all of which contribute to intensifying competition and may affect our future revenue growth. Many of our competitors also remain subject to fewer regulatory constraints than Verizon.

We are unable to predict definitively the impact that the ongoing changes in the telecommunications industry will ultimately have on our business, results of operations or financial condition. The financial impact will depend on several factors, including the timing, extent and success of competition in our markets, the timing and outcome of various regulatory proceedings and any appeals, and the timing, extent and success of our pursuit of new opportunities.

FCC Regulation

Our services are subject to the jurisdiction of the FCC with respect to interstate telecommunications services and other matters for which the FCC has jurisdiction under the Communications Act of 1934, as amended.

Broadband

The FCC has adopted a series of orders that recognize the competitive nature of the broadband market, and impose lesser regulatory requirements to broadband services and facilities than apply to narrowband. With respect to facilities, the FCC has determined that certain unbundling requirements that apply to narrowband facilities do not apply to broadband facilities such as fiber to the premise loops and packet switches. With respect to services, the FCC has concluded that broadband Internet access services offered by telephone companies and their affiliates qualify as largely deregulated information services. The same order also concluded that telephone companies may offer the underlying broadband transmission services that are used as an input to Internet access services through private carriage arrangements on negotiated commercial terms. The FCC's order addressing the appropriate regulatory treatment of broadband Internet access services is the subject of a pending appeal.

Video

The FCC has a body of rules that apply to cable operators under Title VI of the Communications Act of 1934, and these rules also generally apply to telephone companies that provide cable services over their networks. In addition, companies that provide cable service over a cable system generally must obtain a local cable franchise. The FCC currently is conducting a rulemaking proceeding to determine whether the local franchising process is serving as a barrier to entry for new providers of video services, like Verizon. In this proceeding, the FCC is evaluating the scope of its authority over the local franchise process and is considering adopting rules under Section 621 of the Communications Act of 1934 to ensure that the local franchising process does not undermine competitive entry.

Interstate Access Charges and Intercarrier Compensation

The current framework for interstate access rates was established in the Coalition for Affordable Local and Long Distance Services (CALLS) plan, which the FCC adopted on May 31, 2000. The CALLS plan has three main components. First, it establishes portable interstate access universal service support of \$650 million for the industry that replaces implicit support previously embedded in interstate access charges. Second, the plan simplifies the patchwork of common line charges into one subscriber line charge (SLC) and provides for de-averaging of the SLC by zones and class of customers. Third, the plan set into place a mechanism to transition to a set target of \$.0055 per minute for switched access services. Once that target rate is reached, local exchange carriers are no longer required to make further annual price cap reductions to their switched access prices. As a result of tariff adjustments which became effective in July 2003, virtually all of our switched access lines reached the \$.0055 benchmark.

The FCC currently is conducting a broad rulemaking proceeding to consider new rules governing intercarrier compensation including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. The notice seeks comments about intercarrier compensation in general, and requests input on seven specific reform proposals.

management's discussion and analysis

of results of operations and financial condition continued

The FCC also has pending before it issues relating to intercarrier compensation for dial-up Internet-bound traffic. The FCC previously found this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the Telecommunications Act of 1996. Instead, the FCC established federal rates per minute for this traffic that declined from \$.0015 to \$.0007 over a three-year period, established caps on the total minutes of this traffic subject to compensation in a state, and required incumbent local exchange carriers to offer to both bill and pay reciprocal compensation for local traffic at the same rate as they are required to pay on Internet-bound traffic. The U.S. Court of Appeals for the D.C. Circuit rejected part of the FCC's rationale, but declined to vacate the order while it is on remand. As a result, pending further action by the FCC, the FCC's underlying order remains in effect. The FCC subsequently denied a petition to discontinue the \$.0007 rate cap on this traffic, but removed the caps on the total minutes of Internet-bound traffic subject to compensation. That decision is the subject of an appeal by several parties. Disputes also remain pending in a number of forums relating to the appropriate compensation for Internet-bound traffic during previous periods under the terms of our interconnection agreements with other carriers.

The FCC also is conducting a rulemaking proceeding to address the regulation of services that use Internet protocol, including whether access charges should apply to voice or other Internet protocol services. The FCC also considered several petitions asking whether, and under what circumstances, services that employ Internet protocol are subject to access charges. The FCC previously has held that one provider's peer-to-peer Internet protocol service that does not use the public switched network is an interstate information service and is not subject to access charges, while a service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service that is subject to access charges. Another petition asking the FCC to forbear from applying access charges to voice over Internet protocol services that are terminated on switched local exchange networks was withdrawn by the carrier that filed that petition. The FCC also declared the services offered by one provider of a voice over Internet protocol service to be jurisdictionally interstate on the grounds that it was impossible to separate that carrier's Internet protocol service into interstate and intrastate components. The FCC also stated that its conclusion would apply to other services with similar characteristics. That order has been appealed.

The FCC also has adopted rules for special access services that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. More than half of special access revenues are now removed from price regulation. The FCC currently has a rulemaking proceeding underway to evaluate experience under its pricing flexibility rules, and to determine whether any changes to those rules are warranted.

Universal Service

The FCC also has a body of rules implementing the universal service provisions of the Telecommunications Act of 1996, including rules governing support to rural and non-rural high-cost areas, support for low income subscribers, and support for schools, libraries and rural health care. The FCC's current rules for support to high-cost areas served by larger "non-rural" local telephone companies were previously remanded by U.S. Court of Appeals for the Tenth Circuit, which had found that the FCC had not adequately justified these rules. The FCC has initiated a rulemaking proceeding in response to

the court's remand, but its rules remain in effect pending the results of the rulemaking. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. Any change in the current assessment mechanism could result in a change in the contribution that local telephone companies, wireless carriers or others must make and that would have to be collected from customers.

Unbundling of Network Elements

Under section 251 of the Telecommunications Act of 1996, incumbent local exchange carriers were required to provide competing carriers with access to components of their network on an unbundled basis, known as UNEs, where certain statutory standards are satisfied. The Telecommunications Act of 1996 also adopted a cost-based pricing standard for these UNEs, which the FCC interpreted as allowing it to impose a pricing standard known as "total element long run incremental cost" or "TELRIC." The FCC's rules defining the unbundled network elements that must be made available at TELRIC prices have been overturned on multiple occasions by the courts. In its most recent order issued in response to these court decisions, the FCC eliminated the requirement to unbundle mass market local switching on a nationwide basis, with the obligation to accept new orders ending as of the effective date of the order (March 11, 2005). The FCC also established a one year transition for existing UNE switching arrangements. For high capacity transmission facilities, the FCC established criteria for determining whether high capacity loops, transport or dark fiber transport must be unbundled in individual wire centers, and stated that these standards were only expected to affect a small number of wire centers. The FCC also eliminated the obligation to provide dark fiber loops and found that there is no obligation to provide UNEs exclusively for wireless or long distance service. In any instance where a particular high capacity facility no longer has to be made available as a UNE, the FCC established a similar one year transition for any existing high capacity loop or transport UNEs, and an 18 month transition for any existing dark fiber UNEs. Verizon and other parties have challenged various aspects of the new FCC rules on appeal.

As noted above, the FCC has concluded that the requirement under Section 251 of the Telecommunications Act of 1996 to provide unbundled network elements at TELRIC prices generally does not apply with respect to broadband facilities, such as fiber to the premises loops, the packet-switched capabilities of hybrid loops and packet switching. The FCC also has held that any separate unbundling obligations that may be imposed by Section 271 of the Telecommunications Act of 1996 do not apply to these same facilities. The decision with respect to Section 271 is the subject of an ongoing appeal.

management's discussion and analysis

of results of operations and financial condition continued

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition, and elsewhere in this Annual Report, we have made forward-looking statements. These statements are based on our estimates and assumptions and are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed future results of operations. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "estimates," "hopes" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The following important factors, along with those discussed elsewhere in this Annual Report, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements:

- materially adverse changes in economic and industry conditions and labor matters, including workforce levels and labor negotiations, and any resulting financial and/or operational impact, in the markets served by us or by companies in which we have substantial investments;
- material changes in available technology;
- technology substitution;
- an adverse change in the ratings afforded our debt securities by nationally accredited ratings organizations;
- the final results of federal and state regulatory proceedings concerning our provision of retail and wholesale services and judicial review of those results;
- the effects of competition in our markets;
- the timing, scope and financial impacts of our deployment of fiber-to-the-premises broadband technology;
- the ability of Verizon Wireless to continue to obtain sufficient spectrum resources;
- changes in our accounting assumptions that regulatory agencies, including the SEC, may require or that result from changes in the accounting rules or their application, which could result in an impact on earnings; and
- the extent and timing of our ability to obtain revenue enhancements and cost savings following our business combination with MCI.

report of management on internal control over financial reporting

We, the management of Verizon Communications Inc., are responsible for establishing and maintaining adequate internal control over financial reporting of the company. Management has evaluated internal control over financial reporting of the company using the criteria for effective internal control established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management has assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2005. Based on this assessment, we believe that the internal control over financial reporting of the company is effective as of December 31, 2005. In connection with this assessment, there were no material weaknesses in the company's internal control over financial reporting identified by management.

The company's financial statements included in this annual report have been audited by Ernst & Young LLP, independent registered public accounting firm. Ernst & Young LLP has also issued an attestation report on management's assessment of the company's internal control over financial reporting.



Ivan G. Seidenberg
Chairman and Chief Executive Officer



Doreen A. Toben
Executive Vice President and Chief Financial Officer



Thomas A. Bartlett
Senior Vice President and Controller

report of independent registered public accounting firm on internal control over financial reporting

To The Board of Directors and Shareowners of Verizon Communications Inc.:

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that Verizon Communications Inc. and subsidiaries (Verizon) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Verizon'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.

In our opinion, management's assessment that Verizon maintained effective internal control over financial reporting, as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Verizon maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, 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 Verizon as of December 31, 2005 and 2004, and the related consolidated statements of income, cash flows and changes in shareowners' investment for each of the three years in the period ended December 31, 2005 and our report dated February 23, 2006 expressed an unqualified opinion thereon.



Ernst & Young LLP
New York, New York

February 23, 2006

**To The Board of Directors and Shareowners of
Verizon Communications Inc.:**


We have audited the accompanying consolidated balance sheets of Verizon Communications Inc. and subsidiaries (Verizon) as of December 31, 2005 and 2004, and the related consolidated statements of income, cash flows and changes in shareowners' investment for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of Verizon'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 Verizon at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, Verizon changed its methods of accounting for directory revenues and expenses, stock-based compensation and asset retirement obligations effective January 1, 2003.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Verizon's internal control over financial reporting as of December 31, 2005, 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 23, 2006 expressed an unqualified opinion thereon.



Ernst & Young LLP
New York, New York

February 23, 2006

consolidated statements of income

Years Ended December 31,	(dollars in millions, except per share amounts)		
	2005	2004	2003
Operating Revenues	\$ 75,112	\$ 71,283	\$ 67,468
Operating Expenses			
Cost of services and sales (exclusive of items shown below)	25,469	23,168	21,701
Selling, general & administrative expense	21,312	21,088	24,894
Depreciation and amortization expense	14,047	13,910	13,607
Sales of businesses, net	(530)	—	(141)
Total Operating Expenses	60,298	58,166	60,061
Operating Income	14,814	13,117	7,407
Equity in earnings of unconsolidated businesses	689	1,691	1,278
Income from other unconsolidated businesses	92	75	331
Other income and (expense), net	237	22	37
Interest expense	(2,180)	(2,384)	(2,797)
Minority interest	(3,045)	(2,409)	(1,583)
Income Before Provision for Income Taxes, Discontinued Operations and Cumulative Effect of Accounting Change	10,607	10,112	4,673
Provision for income taxes	(3,210)	(2,851)	(1,213)
Income Before Discontinued Operations and Cumulative Effect of Accounting Change	7,397	7,261	3,460
Discontinued Operations			
Income (loss) from operations	—	1,116	(869)
Provision for income taxes	—	(546)	(17)
Income (loss) on discontinued operations, net of tax	—	570	(886)
Cumulative Effect of Accounting Change, Net of Tax	—	—	503
Net Income	\$ 7,397	\$ 7,831	\$ 3,077
Basic Earnings Per Common Share:			
Income before discontinued operations and cumulative effect of accounting change	\$ 2.67	\$ 2.62	\$ 1.26
Income (loss) on discontinued operations, net of tax	—	.21	(.32)
Cumulative effect of accounting change, net of tax	—	—	.18
Net Income⁽¹⁾	\$ 2.67	\$ 2.83	\$ 1.12
Weighted-average shares outstanding (in millions)	2,766	2,770	2,756
Diluted Earnings Per Common Share:			
Income before discontinued operations and cumulative effect of accounting change	\$ 2.65	\$ 2.59	\$ 1.25
Income (loss) on discontinued operations, net of tax	—	.20	(.31)
Cumulative effect of accounting change, net of tax	—	—	.18
Net Income⁽¹⁾	\$ 2.65	\$ 2.79	\$ 1.12
Weighted-average shares outstanding (in millions)	2,817	2,831	2,832

(1) Total per share amounts may not add due to rounding.

See Notes to Consolidated Financial Statements.

consolidated balance sheets

At December 31,	(dollars in millions, except per share amounts)	
	2005	2004
Assets		
Current assets		
Cash and cash equivalents	\$ 776	\$ 2,290
Short-term investments	2,498	2,257
Accounts receivable, net of allowances of \$1,288 and \$1,670	9,171	9,801
Inventories	1,780	1,535
Assets held for sale	—	950
Prepaid expenses and other	2,223	2,646
Total current assets	16,448	19,479
Plant, property and equipment	193,610	185,522
Less accumulated depreciation	118,305	111,398
	75,305	74,124
Investments in unconsolidated businesses	4,604	5,855
Wireless licenses	47,804	42,090
Goodwill	836	837
Other intangible assets, net	4,293	4,521
Other assets	18,840	19,052
Total assets	\$ 168,130	\$ 165,958
Liabilities and Shareowners' Investment		
Current liabilities		
Debt maturing within one year	\$ 7,141	\$ 3,593
Accounts payable and accrued liabilities	12,351	13,177
Liabilities related to assets held for sale	—	525
Other	5,571	5,834
Total current liabilities	25,063	23,129
Long-term debt	31,869	35,674
Employee benefit obligations	18,819	17,941
Deferred income taxes	22,411	22,532
Other liabilities	3,534	4,069
Minority interest	26,754	25,053
Shareowners' investment		
Series preferred stock (\$.10 par value; none issued)	—	—
Common stock (\$.10 par value; 2,774,865,381 shares issued in both periods)	277	277
Contributed capital	25,369	25,404
Reinvested earnings	15,905	12,984
Accumulated other comprehensive loss	(1,783)	(1,053)
Common stock in treasury, at cost	(353)	(142)
Deferred compensation-employee stock ownership plans and other	265	90
Total shareowners' investment	39,680	37,560
Total liabilities and shareowners' investment	\$ 168,130	\$ 165,958

See Notes to Consolidated Financial Statements.

consolidated statements of cash flows

Years Ended December 31,	2005	2004	(dollars in millions) 2003
Cash Flows from Operating Activities			
Net Income	\$ 7,397	\$ 7,831	\$ 3,077
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	14,047	13,910	13,607
Sales of businesses, net	(530)	—	(141)
(Gain) loss on sale of discontinued operations	—	(516)	931
Employee retirement benefits	1,840	1,999	3,048
Deferred income taxes	(1,059)	1,842	826
Provision for uncollectible accounts	1,290	1,181	1,789
Income from unconsolidated businesses	(781)	(1,766)	(1,609)
Cumulative effect of accounting change, net of tax	—	—	(503)
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses:			
Accounts receivable	(933)	(1,617)	(938)
Inventories	(252)	(274)	(80)
Other assets	(191)	578	101
Accounts payable and accrued liabilities	(1,034)	(1,930)	2,657
Other, net	2,218	582	(298)
Net cash provided by operating activities	22,012	21,820	22,467
Cash Flows from Investing Activities			
Capital expenditures (including capitalized software)	(15,324)	(13,259)	(11,874)
Acquisitions, net of cash acquired, and investments	(4,684)	(1,196)	(1,162)
Proceeds from disposition of businesses	1,326	117	229
Proceeds from discontinued operations	—	1,603	—
Net change in short-term and other current investments	(344)	(100)	(120)
Other, net	534	2,492	691
Net cash used in investing activities	(18,492)	(10,343)	(12,236)
Cash Flows from Financing Activities			
Proceeds from long-term borrowings	1,487	514	4,653
Repayments of long-term borrowings and capital lease obligations	(3,919)	(5,198)	(10,759)
Increase (decrease) in short-term obligations, excluding current maturities	2,129	(783)	(1,330)
Dividends paid	(4,427)	(4,262)	(4,239)
Proceeds from sale of common stock	37	320	839
Purchase of common stock for treasury	(271)	(370)	—
Other, net	(70)	(77)	(123)
Net cash used in financing activities	(5,034)	(9,856)	(10,959)
Increase (decrease) in cash and cash equivalents	(1,514)	1,621	(728)
Cash and cash equivalents, beginning of year	2,290	669	1,397
Cash and cash equivalents, end of year	\$ 776	\$ 2,290	\$ 669

See Notes to Consolidated Financial Statements.

consolidated statements of changes in shareowners' investment

Years Ended December 31,	(dollars in millions, except per share amounts, and shares in thousands)					
	2005		2004		2003	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance at beginning of year	2,774,865	\$ 277	2,772,314	\$ 277	2,751,650	\$ 275
Shares issued						
Employee plans	-	-	2,501	-	20,664	2
Shareowner plans	-	-	50	-	-	-
Shares retired	-	-	-	-	-	-
Balance at end of year	2,774,865	277	2,774,865	277	2,772,314	277
Contributed Capital						
Balance at beginning of year		25,404		25,363		24,685
Shares issued-employee and shareowner plans		(24)		2		725
Tax benefit from exercise of stock options		-		41		12
Other		(11)		(2)		(59)
Balance at end of year		25,369		25,404		25,363
Reinvested Earnings						
Balance at beginning of year		12,984		9,409		10,536
Net income		7,397		7,831		3,077
Dividends declared (\$1.62, \$1.54 and \$1.54 per share)		(4,479)		(4,265)		(4,250)
Shares issued-employee and shareowner plans		-		-		39
Other		3		9		7
Balance at end of year		15,905		12,984		9,409
Accumulated Other Comprehensive Loss						
Balance at beginning of year		(1,053)		(1,250)		(2,110)
Foreign currency translation adjustment		(755)		548		568
Unrealized gains on net investment hedges		2		-		-
Unrealized gains (losses) on marketable securities		(21)		7		1
Unrealized derivative gains (losses) on cash flow hedges		10		17		(21)
Minimum pension liability adjustment		34		(375)		312
Other comprehensive income (loss)		(730)		197		860
Balance at end of year		(1,783)		(1,053)		(1,250)
Treasury Stock						
Balance at beginning of year	(5,213)	(142)	(4,554)	(115)	(8,624)	(218)
Shares purchased	(7,859)	(271)	(9,540)	(370)	-	-
Shares distributed						
Employee plans	1,594	59	8,881	343	4,047	102
Shareowner plans	22	1	-	-	23	1
Balance at end of year	(11,456)	(353)	(5,213)	(142)	(4,554)	(115)
Deferred Compensation-ESOPs and Other						
Balance at beginning of year		90		(218)		(552)
Amortization		174		301		312
Other		1		7		22
Balance at end of year		265		90		(218)
Total Shareowners' Investment		\$ 39,680		\$ 37,560		\$ 33,466
Comprehensive Income						
Net income		\$ 7,397		\$ 7,831		\$ 3,077
Other comprehensive income (loss) per above		(730)		197		860
Total Comprehensive Income		\$ 6,667		\$ 8,028		\$ 3,937

See Notes to Consolidated Financial Statements.

notes to consolidated financial statements

NOTE 1

DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Verizon's domestic wireline telecommunications business provides local telephone services, including broadband, in 28 states and Washington, D.C. and nationwide long-distance and other communications products and services. Verizon's domestic wireless business, operating as Verizon Wireless, provides wireless voice and data products and services across the United States using one of the most extensive wireless networks. Information Services operates directory publishing businesses and provides electronic commerce services. Verizon's International segment includes wireline and wireless communications operations and investments in the Americas and Europe. We have four reportable segments, which we operate and manage as strategic business units: Domestic Telecom, Domestic Wireless, Information Services and International. For further information concerning our business segments, see Note 17.

In connection with the closing of the merger with MCI, Inc. (MCI), which occurred on January 6, 2006, Verizon now owns and operates one of the most expansive end-to-end global Internet Protocol (IP) networks which includes over 270,000 domestic and 360,000 international route miles of fiber optic cable and provides access to over 140 countries worldwide. Operating as Verizon Business, we are now better able to provide next-generation IP network services to medium and large businesses and government customers. For further information concerning the merger with MCI, see Note 24.

Consolidation

The method of accounting applied to investments, whether consolidated, equity or cost, involves an evaluation of all significant terms of the investments that explicitly grant or suggest evidence of control or influence over the operations of the investee. The consolidated financial statements include our controlled subsidiaries. Investments in businesses which we do not control, but have the ability to exercise significant influence over operating and financial policies, are accounted for using the equity method. Investments in which we do not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method. Equity and cost method investments are included in Investments in Unconsolidated Businesses in our consolidated balance sheets. Certain of our cost method investments are classified as available-for-sale securities and adjusted to fair value pursuant to Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities."

All significant intercompany accounts and transactions have been eliminated.

We have reclassified prior year amounts to conform to the current year presentation.

Discontinued Operations, Assets Held for Sale, and Sales of Businesses and Investments

We classify as discontinued operations any component of our business that we hold for sale or dispose of that has operations and cash flows that are clearly distinguishable operationally and for financial reporting purposes from the rest of Verizon. For those

components, Verizon has no significant continuing involvement after disposal and their operations and cash flows are eliminated from Verizon's ongoing operations. Sales not classified as discontinued operations are reported as either Sales of Businesses, Net, Equity in Earnings of Unconsolidated Businesses or Income From Other Unconsolidated Businesses in our consolidated statements of income.

Use of Estimates

We prepare our financial statements using generally accepted accounting principles (GAAP), which require management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of plant, property and equipment, intangible assets and other long-lived assets, valuation allowances on tax assets and pension and postretirement benefit assumptions.

Revenue Recognition

Domestic Telecom

Our Domestic Telecom segment earns revenue based upon usage of our network and facilities and contract fees. In general, fixed fees for local telephone, long distance and certain other services are billed one month in advance and recognized the following month when earned. Revenue from other products that are not fixed fee or that exceed contracted amounts is recognized when such services are provided.

We recognize equipment revenue for services, in which we bundle the equipment with maintenance and monitoring services, when the equipment is installed in accordance with contractual specifications and ready for the customer's use. The maintenance and monitoring services are recognized monthly over the term of the contract as we provide the services. Long-term contracts are accounted for using the percentage of completion method. We use the completed contract method if we cannot estimate the costs with a reasonable degree of reliability.

Customer activation fees, along with the related costs up to but not exceeding the activation fees, are deferred and amortized over the customer relationship period.

Domestic Wireless

Our Domestic Wireless segment earns revenue by providing access to and usage of our network, which includes roaming and long distance revenue. In general, access revenue is billed one month in advance and recognized when earned. Airtime and usage revenue, roaming revenue and long distance revenue are recognized when the service is rendered. Equipment sales revenue associated with the sale of wireless handsets and accessories is recognized when the products are delivered to and accepted by the customer, as this is considered to be a separate earnings process from the sale of wireless services. Customer activation fees are considered additional consideration when handsets are sold to the customers at a discount and are recorded as equipment sales revenue.

Information Services

Information Services earns revenues primarily from print and online directory publishing. This segment recognizes revenues and expenses in our print directory business using the amortization method. Under the amortization method, revenues and direct expenses, primarily printing and distribution costs, are recognized over the life of the directory, which is usually 12 months. Revenue

from our online directory, SuperPages.com, is recognized in the month it is earned.

International

The consolidated wireline and wireless businesses that comprise our International segment recognize revenue in a similar manner as our other segments. In addition, this segment holds several investments that are either accounted for under the equity or cost method of accounting. For additional detail on our accounting policy related to these investments, see "Consolidation" above.

Maintenance and Repairs

We charge the cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, principally to Cost of Services and Sales as these costs are incurred.

Earnings Per Common Share

Basic earnings per common share are based on the weighted-average number of shares outstanding during the year. Diluted earnings per common share include the dilutive effect of shares issuable under our stock-based compensation plans, an exchangeable equity interest (see Note 9), and the zero-coupon convertible notes (see Note 11), which represent the only potentially dilutive common shares.

Cash and Cash Equivalents

We consider all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents, except cash equivalents held as short-term investments. Cash equivalents are stated at cost, which approximates market value.

Short-Term Investments

Our short-term investments consist primarily of cash equivalents held in trust to pay for certain employee benefits. Short-term investments are stated at cost, which approximates market value.

Marketable Securities

We continually evaluate our investments in marketable securities for impairment due to declines in market value considered to be other than temporary. That evaluation includes, in addition to persistent, declining stock prices, general economic and company-specific evaluations. In the event of a determination that a decline in market value is other than temporary, a charge to earnings is recorded for the loss, and a new cost basis in the investment is established. These investments are included in the accompanying consolidated balance sheets in Investments in Unconsolidated Businesses or Other Assets.

Inventories

We include in inventory new and reusable supplies and network equipment of our telephone operations, which are stated principally at average original cost, except that specific costs are used in the case of large individual items. Inventories of our other subsidiaries are stated at the lower of cost (determined principally on either an average cost or first-in, first-out basis) or market.

Plant and Depreciation

We record plant, property and equipment at cost. Our telephone operations' depreciation expense is principally based on the composite group remaining life method and straight-line composite rates. This method provides for the recognition of the cost of the remaining net investment in telephone plant, less anticipated net salvage value, over the remaining asset lives. This method requires the periodic revision of depreciation rates.

The asset lives used by our telephone operations are presented in the following table:

Average Lives (in years)	
Buildings	25-42
Central office equipment	5-11
Outside communications plant	
Copper cable	13-18
Fiber cable	20
Poles and conduit	30-50
Furniture, vehicles and other	3-15

When we replace or retire depreciable plant used in our wireline network, we deduct the carrying amount of such plant from the respective accounts and charge it to accumulated depreciation (see Note 2 for additional information on the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations").

Plant, property and equipment of our other subsidiaries is generally depreciated on a straight-line basis over the following estimated useful lives: buildings, 8 to 42 years; wireless plant equipment, 3 to 15 years; and other equipment, 1 to 20 years.

When the depreciable assets of our other subsidiaries are retired or otherwise disposed of, the related cost and accumulated depreciation are deducted from the plant accounts, and any gains or losses on disposition are recognized in income.

We capitalize network software purchased or developed in connection with related plant assets. We also capitalize interest associated with the acquisition or construction of plant assets. Capitalized interest is reported as a cost of plant and a reduction in interest cost.

In connection with our ongoing review of the estimated remaining useful lives of plant, property and equipment and associated depreciation rates, we determined that, effective January 1, 2005, the remaining useful lives of three categories of telephone assets would be shortened by 1 to 2 years. These changes in asset lives were based on Verizon's plans, and progress to date on those plans, to deploy fiber optic cable to homes, replacing copper cable. While the timing and extent of current deployment plans are subject to modification, Verizon management believes that current estimates of reductions in impacted asset lives is reasonable and subject to ongoing analysis as deployment of fiber optic lines continues. The asset categories impacted and useful life changes are as follows:

Average Lives (in years)	From	To
Central office equipment		
Digital switches	12	11
Circuit equipment	9	8-9
Outside plant		
Copper cable	15-19	13-18

Computer Software Costs

We capitalize the cost of internal-use network and non-network software which has a useful life in excess of one year in accordance with Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Subsequent additions, modifications or upgrades to internal-use network and non-network software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are

expensed in the period in which they are incurred. Also, we capitalize interest associated with the development of non-network internal-use software. Capitalized non-network internal-use software costs are amortized using the straight-line method over a period of 1 to 7 years and are included in Other Intangible Assets, Net in our consolidated balance sheets. For a discussion of our impairment policy for capitalized software costs under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," see "Goodwill and Other Intangibles" below. Also, see Note 7 for additional detail of non-network internal-use software reflected in our consolidated balance sheets.

Goodwill and Other Intangible Assets

Goodwill

Goodwill is the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. Impairment testing for goodwill is performed at least annually unless indicators of impairment exist. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. Reporting units may be operating segments or one level below an operating segment, referred to as a component. Businesses for which discrete financial information is available are generally considered to be components of an operating segment. Components that are economically similar and managed by the same segment management group are aggregated and considered a reporting unit under SFAS No. 142, "Goodwill and Other Intangible Assets." Step one compares the fair value of the reporting unit (calculated using a discounted cash flow method) to its carrying value. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., fair value of reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is required to be recorded as an impairment.

Intangible Assets Not Subject to Amortization

A significant portion of our intangible assets are Domestic Wireless licenses, including licenses associated with equity method investments, that provide our wireless operations with the exclusive right to utilize designated radio frequency spectrum to provide cellular communication services. While licenses are issued for only a fixed time, generally ten years, such licenses are subject to renewal by the Federal Communications Commission (FCC). Renewals of 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 life of our wireless licenses. As a result, we treat the wireless licenses as an indefinite-lived intangible asset under the provisions of SFAS No. 142. We reevaluate the useful life determination for wireless licenses each reporting period to determine whether events and circumstances continue to support an indefinite useful life.

We have tested our Domestic Wireless licenses for impairment at least annually unless indicators of impairment exist. Beginning in 2005, we began using a direct value approach in performing our annual impairment test on our Domestic Wireless licenses. The direct value approach determines fair value using estimates of future cash flows associated specifically with the licenses. Previously, we used a residual method, which determined the fair value of the wireless business by estimating future cash flows of the wireless operations. The fair value of aggregate wireless licenses was determined by subtracting from the fair value of the wireless business the fair value of all of the other net tangible and intangible

(primarily recognized and unrecognized customer relationship intangible assets) assets of our wireless operations. We determined the fair value of our customer relationship intangible assets based on our average customer acquisition costs. We began using the direct value approach in 2005 in accordance with a September 29, 2004 Staff Announcement from the staff of the Securities and Exchange Commission (SEC), "Use of the Residual Method to Value Acquired Assets Other Than Goodwill." Under either the direct method or the residual method, if the fair value of the aggregated wireless licenses was less than the aggregated carrying amount of the licenses, an impairment would have been recognized.

Intangible Assets Subject to Amortization

Our intangible assets that do not have indefinite lives (primarily customer lists and non-network internal-use software) are amortized over their useful lives and reviewed for impairment in accordance with SFAS No. 144, which only requires testing whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If any indicators were present, we would test for recoverability by comparing the carrying amount of the asset to the net undiscounted cash flows expected to be generated from the asset. If those net undiscounted cash flows do not exceed the carrying amount (i.e., the asset is not recoverable), we would perform the next step which is to determine the fair value of the asset and record an impairment, if any. We reevaluate the useful life determination for these intangible assets each reporting period to determine whether events and circumstances warrant a revision in their remaining useful life.

For information related to the carrying amount of goodwill by segment as well as the major components and average useful lives of our other acquired intangible assets, see Note 7.

Sale of Stock By Subsidiary

We recognize in consolidation changes in our ownership percentage in a subsidiary caused by issuances of the subsidiary's stock as adjustments to Contributed Capital.

Income Taxes

Verizon and its domestic subsidiaries file a consolidated federal income tax return.

Our telephone operations use the deferral method of accounting for investment tax credits earned prior to the repeal of investment tax credits by the Tax Reform Act of 1986. We also defer certain transitional credits earned after the repeal. We amortize these credits over the estimated service lives of the related assets as a reduction to the Provision for Income Taxes.

Stock-Based Compensation

Prior to 2003, we accounted for stock-based employee compensation under Accounting Principals Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and followed the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, using the prospective method (as permitted under SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure") to all new awards granted, modified or settled after January 1, 2003. Under the prospective method, employee compensation expense in the first year will be recognized for new awards granted, modified, or settled. The options generally vest over a term of three years, therefore the expenses related to stock-based employee compensation

included in the determination of net income for 2005, 2004 and 2003 are less than what would have been recorded if the fair value method was also applied to previously issued awards (see Note 2 for additional information on the impact of adopting SFAS No. 123).

Foreign Currency Translation

The functional currency for all of our foreign operations is the local currency. For these foreign entities, we translate income statement amounts at average exchange rates for the period, and we translate assets and liabilities at end-of-period exchange rates. We record these translation adjustments in Accumulated Other Comprehensive Loss, a separate component of Shareowners' Investment, in our consolidated balance sheets. We report exchange gains and losses on intercompany foreign currency transactions of a long-term nature in Accumulated Other Comprehensive Loss. Other exchange gains and losses are reported in income.

Employee Benefit Plans

Pension and postretirement health care and life insurance benefits earned during the year as well as interest on projected benefit obligations are accrued currently. Prior service costs and credits resulting from changes in plan benefits are amortized over the average remaining service period of the employees expected to receive benefits.

In December 2005, we announced that Verizon management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006. See Note 15 for additional information.

Derivative Instruments

We have entered into derivative transactions to manage our exposure to fluctuations in foreign currency exchange rates, interest rates and equity prices. We employ risk management strategies using a variety of derivatives including foreign currency forwards and collars, equity options, interest rate swap agreements and interest rate locks. We do not hold derivatives for trading purposes.

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and related amendments and interpretations, we measure all derivatives, including derivatives embedded in other financial instruments, at fair value and recognize them as either assets or liabilities on our consolidated balance sheets. Changes in the fair values of derivative instruments not qualifying as hedges or any ineffective portion of hedges are recognized in earnings in the current period. Changes in the fair values of derivative instruments used effectively as fair value hedges are recognized in earnings, along with changes in the fair value of the hedged item. Changes in the fair value of the effective portions of cash flow hedges are reported in other comprehensive income (loss), and recognized in earnings when the hedged item is recognized in earnings.

Recent Accounting Pronouncements

Stock-Based Compensation

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which revises SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense based on their fair value. Effective January 1, 2003, Verizon adopted the fair value recognition provisions of SFAS No. 123. We plan to adopt SFAS No. 123(R) effective January 1, 2006, using the modified prospective method and expect that any impact will not be material to our financial position or ongoing results of operations.

NOTE 2

ACCOUNTING CHANGE

Directory Accounting

Effective January 1, 2003, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The cumulative effect of this accounting change resulted in a charge of \$2,697 million (\$1,647 million after-tax), recorded as of January 1, 2003.

Stock – Based Compensation

As discussed in Note 1, we adopted the fair value recognition provisions of SFAS No. 123 using the prospective method as permitted under SFAS No. 148. The following table illustrates the effect on reported net income and earnings per share if the fair value method had been applied to all outstanding and unvested options in each period.

(dollars in millions, except per share amounts)			
Years Ended December 31,	2005	2004	2003
Net Income, As Reported	\$ 7,397	\$ 7,831	\$ 3,077
Add: Stock option-related employee compensation expense included in reported net income, net of related tax effects	57	53	44
Deduct: Total stock option-related employee compensation expense determined under fair value based method for all awards, net of related tax effects	(57)	(124)	(215)
Pro Forma Net Income	\$ 7,397	\$ 7,760	\$ 2,906

Earnings Per Share

Basic – as reported	\$ 2.67	\$ 2.83	\$ 1.12
Basic – pro forma	2.67	2.80	1.05
Diluted – as reported	2.65	2.79	1.12
Diluted – pro forma	2.65	2.77	1.06

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2005, 2004 and 2003 was \$370 million, \$254 million and \$80 million, respectively.

For additional information on assumptions used to determine the pro forma amounts as well as other information related to our stock-based compensation plans, see Note 14.

Asset Retirement Obligations

We adopted the provisions of SFAS No. 143 on January 1, 2003. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. Consequently, in connection with the initial adoption of SFAS No. 143 we reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recogni-

notes to consolidated financial statements continued

tion of a gain of \$3,499 million (\$2,150 million after-tax). Additionally, on December 31, 2005, FASB Interpretation (FIN) No. 47, "Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143" became effective. There was no impact of the adoption of FIN No. 47 on Verizon's results of operations or financial position.

NOTE 3

DISCONTINUED OPERATIONS AND SALES OF BUSINESSES, NET

Discontinued Operations

Verizon Information Services Canada

During 2004, we announced our decision to sell Verizon Information Services Canada Inc. to an affiliate of Bain Capital, a global private investment firm, for \$1,540 million (Cdn. \$1,985 million). The sale closed during the fourth quarter of 2004 and resulted in a gain of \$1,017 million (\$516 million after-tax). In accordance with SFAS No. 144, we have classified the results of operations of Verizon Information Services Canada as discontinued operations in the consolidated statements of income in all years through the date of divestiture. Summarized results of operations for Verizon Information Services Canada are as follows:

	(dollars in millions)	
Years Ended December 31,	2004	2003
Income from operations of Verizon Information Services Canada before income taxes	\$ 99	\$ 88
Gain on sale of investment	1,017	–
Income tax provision	(546)	(39)
Income on discontinued operations, net of tax	<u>\$ 570</u>	<u>\$ 49</u>

Included in income from operations of Verizon Information Services Canada before income taxes in the preceding table are operating revenues of Verizon Information Services Canada prior to its sale in the fourth quarter of 2004 of \$280 million and \$284 million for the years ended December 31, 2004 and 2003, respectively.

Iusacell

Discontinued operations also include the results of operations of Grupo Iusacell, S.A. de C.V. (Iusacell) prior to the sale of Iusacell in July 2003. In connection with the decision to sell our interest in Iusacell and a comparison of expected sale proceeds, less cost to sell, to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of \$957 million (\$931 million after-tax) in the second quarter of 2003. This loss included \$317 million of goodwill.

Summarized results of operations for Iusacell, which was part of our International segment, follows:

	(dollars in millions)	
Year Ended December 31, 2003		
Loss from operations of Iusacell before income taxes	\$	–
Investment loss		(957)
Income tax benefit		22
Loss on discontinued operations, net of tax	<u>\$</u>	<u>(935)</u>

Included in loss from operations of Iusacell before income taxes in the preceding table are operating revenues of \$181 million for the year ended December 31, 2003.

Sales of Businesses, Net

Verizon Hawaii Inc.

During the second quarter of 2004, we entered into an agreement to sell our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operated approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services Inc. in Hawaii, to an affiliate of The Carlyle Group. This transaction closed during the second quarter of 2005. In connection with this sale, we received net proceeds of \$1,326 million and recorded a net pretax gain of \$530 million (\$336 million after-tax). As a result of entering into the agreement to sell the Hawaii businesses, we separately classified the assets held for sale and related liabilities in the December 31, 2004 condensed consolidated balance sheet. Additional detail related to the assets held for sale, and related liabilities, follows:

	(dollars in millions)
	At December 31, 2004
Current assets	\$ 109
Plant, property and equipment, net	820
Other non-current assets	21
Total assets	<u>\$ 950</u>
Debt maturing within one year	\$ 125
Other current liabilities	48
Long-term debt	302
Other non-current liabilities	50
Total liabilities	<u>\$ 525</u>

Other Transactions

In 2003, we recorded a net pretax gain of \$141 million (\$88 million after-tax) primarily related to the sale of our European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

NOTE 4

OTHER STRATEGIC ACTIONS

Facility and Employee-Related Items

During 2005, we recorded a net pretax gain of \$18 million (\$8 million after-tax) in connection with our planned relocation of several functions to Verizon Center, including a pretax gain of \$120 million (\$72 million after-tax) related to the sale of a New York City office building, partially offset by a pretax charge of \$102 million (\$64 million after-tax) primarily associated with relocation-related employee severance costs and related activities.

During 2005, we recorded a net pretax charge of \$98 million (\$59 million after-tax) related to the restructuring of the Verizon management retirement benefit plans. This pretax charge was recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and includes the unamortized cost of prior pension enhancements of \$441 million offset partially by a pretax curtailment gain of \$343 million related to retiree medical benefits. In connection with this

restructuring, management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after receiving an 18-month enhancement of the value of their pension and retiree medical subsidy, but will receive a higher savings plan matching contribution.

In addition, during 2005 we recorded a charge of \$59 million (\$36 million after-tax) associated with employee severance costs and severance-related activities in connection with the voluntary separation program for surplus union-represented employees.

During 2004, we recorded pretax pension settlement losses of \$815 million (\$499 million after-tax) related to employees that received lump-sum distributions during 2004 in connection with the voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003. These charges were recorded in accordance with SFAS No. 88, which requires that settlement losses be recorded once prescribed payment thresholds have been reached.

Total pension, benefit and other costs related to severance activities were \$5,524 million (\$3,399 million after-tax) in 2003, primarily in connection with the voluntary separation of more than 25,000 employees, as follows:

- In connection with the voluntary separation of more than 21,000 employees during the fourth quarter of 2003, we recorded a pretax charge of \$4,695 million (\$2,882 million after-tax). This pretax charge included \$2,716 million recorded in accordance with SFAS No. 88 and SFAS No. 106, for pension and postretirement benefit enhancements and a net curtailment gain for a significant reduction of the expected years of future service resulting from early retirements. In addition, we recorded a pretax charge of \$76 million for pension settlement losses related to lump-sum settlements of some existing pension obligations. The fourth quarter pretax charge also included severance costs of \$1,720 million and costs related to other severance-related activities of \$183 million.
- We also recorded a special charge in 2003 of \$235 million (\$150 million after-tax) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees. In addition, we recorded pretax pension settlement losses of \$131 million (\$81 million after-tax) in 2003 related to employees that received lump-sum distributions during the year in connection with previously announced employee separations.
- Further, in 2003 we recorded a special charge of \$463 million (\$286 million after-tax) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

Tax Matters

During 2005, we recorded a tax benefit of \$336 million in connection with capital gains and prior year investment losses. As a result of the capital gain realized in 2005 in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million related to prior year investment losses. The investment losses pertain to lusacell, CTI Holdings, S.A. (CTI) and TelecomAsia.

Also during 2005, we recorded a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, which provides for a favorable federal income tax rate in connection with the repatriation of foreign earnings, provided the criteria described in the law is met. Two of Verizon's foreign investments repatriated earnings resulting in income taxes of \$332 million, partially offset by a tax benefit of \$126 million.

As a result of the capital gain realized in 2004 in connection with the sale of Verizon Information Services Canada, we recorded tax benefits of \$234 million in the fourth quarter of 2004 pertaining to prior year investment impairments. The investment impairments primarily related to debt and equity investments in CTI, Cable & Wireless plc and NTL Incorporated.

Other Charges and Special Items

During 2005, we recorded pretax charges of \$139 million (\$133 million after-tax) including a pretax impairment charge of \$125 million (\$125 million after-tax) pertaining to our leasing operations for aircraft leases involved in recent airline bankruptcy proceedings and a pretax charge of \$14 million (\$8 million after-tax) in connection with the early retirement of debt.

In 2004, we recorded an expense credit of \$204 million (\$123 million after-tax) resulting from the favorable resolution of pre-bankruptcy amounts due from MCI. Previously reached settlement agreements became fully effective when MCI emerged from bankruptcy proceedings in the second quarter of 2004.

Also during 2004, we recorded a charge of \$113 million (\$87 million after-tax) related to operating asset losses pertaining to our international long distance and data network. In addition, we recorded pretax charges of \$55 million (\$34 million after-tax) in connection with the early retirement of debt.

During 2003, we recorded other special pretax charges of \$557 million (\$419 million after-tax). These charges included \$240 million (\$156 million after-tax) primarily in connection with environmental remediation efforts relating to several discontinued businesses, including a former facility that processed nuclear fuel rods in Hicksville, New York (see Note 22) and a pretax impairment charge of \$184 million (\$184 million after-tax) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and for power generating facilities. These 2003 charges also include pretax charges of \$61 million (\$38 million after-tax) related to the early retirement of debt and other pretax charges of \$72 million (\$41 million after-tax).

NOTE 5

MARKETABLE SECURITIES AND OTHER INVESTMENTS

We have investments in marketable securities which are considered "available-for-sale" under SFAS No. 115. These investments have been included in our consolidated balance sheets in Investments in Unconsolidated Businesses and Other Assets.

Under SFAS No. 115, available-for-sale securities are required to be carried at their fair value, with unrealized gains and losses (net of income taxes) that are considered temporary in nature recorded in Accumulated Other Comprehensive Loss. The fair values of our investments in marketable securities are determined based on market quotations. We continually evaluate our investments in marketable securities for impairment due to declines in market value considered to be other than temporary. That evaluation includes, in addition to persistent, declining stock prices, general economic and company-specific evaluations. In the event of a determination that a decline in market value is other than temporary, a charge to earnings is recorded in Income From Other Unconsolidated Businesses in the consolidated statements of income for all or a portion of the unrealized loss, and a new cost basis in the investment is established. As of December 31, 2005, no impairments were determined to exist.

The following table shows certain summarized information related to our investments in marketable securities:

	Cost	Gross Unrealized Gains	(dollars in millions) Gross Unrealized Losses	Fair Value
At December 31, 2005				
Investments in unconsolidated businesses	\$ 215	\$ 13	\$ (3)	\$ 225
Other assets	225	14	—	239
	\$ 440	\$ 27	\$ (3)	\$ 464
At December 31, 2004				
Investments in unconsolidated businesses	\$ 184	\$ 7	\$ (4)	\$ 187
Other assets	149	40	—	189
	\$ 333	\$ 47	\$ (4)	\$ 376

Our investments in marketable securities are primarily bonds and mutual funds.

On April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helu to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash plus an additional cash amount of 3% per annum from April 9, 2005 until the closing of the purchase of those shares. The transaction closed on May 17, 2005 and the additional cash payment was made through May 13, 2005. The total cash payment was \$1,121 million. Under the stock purchase agreement, Verizon will pay the Slim entities an adjustment at the end of one year in an amount per MCI share calculated by multiplying (i) .7241 by (ii) the amount, if any, by which the price of Verizon's common stock exceeds \$35.52 per share (measured over a 20-day period), subject to a maximum excess amount per Verizon share of \$26.98. After the closing of the stock purchase agreement, Verizon transferred the shares of MCI common stock it had purchased to a trust established pursuant to

an agreement between Verizon and the Department of Justice. We received the special dividend of \$5.60 per MCI share on these 43.4 million MCI shares, or \$243 million, on October 27, 2005. See Note 24 for additional information about the MCI merger.

During 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of \$43 million (\$43 million after-tax) included in Income From Other Unconsolidated Businesses in the consolidated statements of income. The preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

Certain other investments in securities that we hold are not adjusted to market values because those values are not readily determinable and/or the securities are not marketable. We have, however, adjusted the carrying values of these securities in situations where we believe declines in value below cost were other than temporary. During 2003, we recorded a net pretax gain of \$176 million as a result of a payment received in connection with the liquidation of Genuity, Inc. In connection with this payment, Verizon recorded a contribution of \$150 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$17 million after taxes related to this transaction and the accrual of the Verizon Foundation contribution. The carrying values for investments not adjusted to market value were \$5 million at December 31, 2005 and \$52 million at December 31, 2004.

NOTE 6

PLANT, PROPERTY AND EQUIPMENT

The following table displays the details of plant, property and equipment, which is stated at cost:

	(dollars in millions)	
At December 31,	2005	2004
Land	\$ 753	\$ 772
Buildings and equipment	16,800	16,159
Network equipment	156,719	149,261
Furniture, office and data processing equipment	12,929	13,064
Work in progress	1,651	1,719
Leasehold improvements	2,373	1,948
Other	2,385	2,599
	193,610	185,522
Accumulated depreciation	(118,305)	(111,398)
Total	\$ 75,305	\$ 74,124

NOTE 7

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

Changes in the carrying amount of goodwill are as follows:

(dollars in millions)

	Domestic Telecom	Information Services	International	Total
Balance at December 31, 2003	\$ 314	\$ 77	\$ 444	\$ 835
Goodwill reclassifications and other	1	–	1	2
Balance at December 31, 2004	315	77	445	837
Goodwill reclassifications and other	–	–	(1)	(1)
Balance at December 31, 2005	\$ 315	\$ 77	\$ 444	\$ 836

Other Intangible Assets

(dollars in millions)

	At December 31, 2005		At December 31, 2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer lists (1 to 7 years)	\$ 3,452	\$ 3,295	\$ 3,444	\$ 2,832
Non-network internal-use software (1 to 7 years)	7,504	3,427	6,866	2,997
Other (1 to 20 years)	83	24	62	22
Total	\$ 11,039	\$ 6,746	\$ 10,372	\$ 5,851
Unamortized intangible assets:				
Wireless licenses	\$ 47,804		\$ 42,090	

Intangible asset amortization expense was \$1,528 million, \$1,402 million, and \$1,397 million for the years ended December 31, 2005, 2004 and 2003, respectively. It is estimated to be \$1,183 million in 2006, \$868 million in 2007, \$702 million in 2008, \$565 million in 2009 and \$349 million in 2010, primarily related to customer lists and non-network internal-use software.

NOTE 8

INVESTMENTS IN UNCONSOLIDATED BUSINESSES

Our investments in unconsolidated businesses are comprised of the following:

(dollars in millions)

At December 31,	Ownership	2005 Investment	Ownership	2004 Investment
Equity Investees				
CANTV	28.5%	\$ 152	28.5%	\$ 199
Vodafone Omnitel	23.1	2,591	23.1	4,642
Other	Various	772	Various	876
Total equity investees		3,515		5,717
Cost Investees	Various	1,089	Various	138
Total investments in unconsolidated businesses		\$ 4,604		\$ 5,855

Dividends and repatriations of foreign earnings received from investees amounted to \$2,336 million in 2005, \$162 million in 2004 and \$198 million in 2003, respectively, and are reported in Other, Net operating activities in the consolidated statements of cash flows.

Equity Investees

CANTV

Compañía Anónima Nacional Teléfonos de Venezuela (CANTV) is Venezuela's largest full-service telecommunications provider. CANTV offers local services, national and international long distance, Internet access and wireless services in Venezuela as well as public telephone, private network, data transmission, directory and other value-added services.

Vodafone Omnitel

Vodafone Omnitel N.V. (Vodafone Omnitel) is an Italian digital cellular telecommunications company. It is the second largest wireless provider in Italy. At December 31, 2005 and 2004, our investment in Vodafone Omnitel included goodwill of \$937 million and \$1,072 million, respectively.

During 2005, we repatriated \$2,202 million of Vodafone Omnitel's earnings through the repurchase of issued and outstanding shares of its equity. Vodafone Omnitel's owners, Verizon and Vodafone Group Plc (Vodafone), participated on a pro rata basis; consequently, Verizon's ownership interest after the share repurchase remained at 23.1%.

TELUS

TELUS Corporation (TELUS) is a full-service telecommunications provider and provides subscribers with a full range of telecommunications products and services including data, voice and wireless services across Canada.

During the fourth quarter of 2004, we recorded a pretax gain of \$787 million (\$565 million after-tax) on the sale of our 20.5% interest in TELUS in an underwritten public offering in the U.S. and Canada. In connection with this sale transaction, Verizon recorded a contribution of \$100 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$500 million after taxes related to this transaction and the accrual of the Verizon Foundation contribution.

Other Equity Investees

Verizon has limited partnership investments in entities that invest in affordable housing projects, for which Verizon provides funding as a

limited partner and receives tax deductions and tax credits based on its partnership interests. At December 31, 2005 and 2004, Verizon had equity investments in these partnerships of \$652 million and \$755 million, respectively. Verizon currently adjusts the carrying value of these investments for any losses incurred by the limited partnerships through earnings.

During 2003, we recorded a pretax gain of \$348 million on the sale of our interest in Eurotel Praha, spol. s r.o. In connection with this sale transaction, Verizon recorded a contribution of \$150 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$27 million after taxes related to this transaction and the accrual of the Verizon Foundation contribution.

The remaining investments include wireless partnerships in the U.S., and several other domestic and international investments.

Cost Investees

Some of our cost investments are carried at their current market value. Other cost investments are carried at their original cost, except in cases where we have determined that a decline in the estimated market value of an investment is other than temporary as described in Note 5. Our cost investments include a variety of domestic and international investments primarily involved in providing telecommunication services.

The increase in our cost investments in unconsolidated businesses is primarily the result of the purchase of 43.4 million shares of MCI common stock from eight entities affiliated with Carlos Slim Helu (see Note 5).

NOTE 9

MINORITY INTEREST

Minority interests in equity of subsidiaries were as follows:

	(dollars in millions)	
At December 31,	2005	2004
Minority interests in consolidated subsidiaries*:		
Wireless joint venture (55%)	\$ 24,683	\$ 23,034
Cellular partnerships and other (various)	1,652	1,584
TELPRI (52%)	319	335
Preferred securities issued by subsidiaries	100	100
	<u>\$ 26,754</u>	<u>\$ 25,053</u>

*Indicated ownership percentages are Verizon's consolidated interests.

Wireless Joint Venture

The wireless joint venture was formed in April 2000 in connection with the combination of the U.S. wireless operations and interests of Verizon and Vodafone. The wireless joint venture operates as Verizon Wireless. Verizon owns a controlling 55% interest in Verizon Wireless and Vodafone owns the remaining 45%.

Under the terms of an investment agreement, Vodafone may require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to \$12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to \$10 billion during the 61-day period opening on June 10 and closing on August 9 in 2005, and did not

exercise that right. As a result, Vodafone still has the right to require the purchase of up to \$20 billion worth of its interest, not to exceed \$10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2006 and 2007. Vodafone also may require that Verizon Wireless pay for up to \$7.5 billion of the required repurchase through the assumption or incurrence of debt.

Cellular Partnerships and Other

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless in a transaction valued at approximately \$1.7 billion, including \$550 million of net debt. The resulting limited partnership is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which is exchangeable into common stock of Verizon Wireless if an initial public offering of that stock occurs, or into the common stock of Verizon on the fourth anniversary of the asset contribution date if the initial public offering of Verizon Wireless common stock does not occur prior to then. The price of the Verizon common stock used in determining the number of Verizon common shares received in an exchange is also subject to a maximum and minimum amount.

TELPRI

Telecomunicaciones de Puerto Rico, Inc. (TELPRI) provides local, wireless, long distance, paging and Internet-access services in Puerto Rico.

Preferred Securities Issued By Subsidiaries

On December 7, 2005, Verizon issued a notice to redeem \$100 million Verizon International Holdings Ltd. Series A variable term voting cumulative preferred stock on January 15, 2006 at the redemption price per share of \$100,000, plus accrued and unpaid dividends.

NOTE 10

LEASING ARRANGEMENTS

As Lessor

We are the lessor in leveraged and direct financing lease agreements under which commercial aircraft and power generating facilities, which comprise the majority of the portfolio, along with industrial equipment, real estate property, telecommunications and other equipment are leased for remaining terms of less than 1 year to 50 years as of December 31, 2005. Minimum lease payments receivable represent unpaid rentals, less principal and interest on third-party nonrecourse debt relating to leveraged lease transactions. Since we have no general liability for this debt, which holds a senior security interest in the leased equipment and rentals, the related principal and interest have been offset against the minimum lease payments receivable in accordance with GAAP. All recourse debt is reflected in our consolidated balance sheets. See Note 4 for information on lease impairment charges.

notes to consolidated financial statements continued

Finance lease receivables, which are included in Prepaid Expenses and Other and Other Assets in our consolidated balance sheets are comprised of the following:

At December 31,	2005			(dollars in millions) 2004		
	Leveraged Leases	Direct Finance Leases	Total	Leveraged Leases	Direct Finance Leases	Total
Minimum lease payments receivable	\$ 3,847	\$ 123	\$ 3,970	\$ 4,133	\$ 173	\$ 4,306
Estimated residual value	1,937	9	1,946	2,319	15	2,334
Unearned income	(2,260)	(11)	(2,271)	(2,631)	(19)	(2,650)
	<u>\$ 3,524</u>	<u>\$ 121</u>	<u>3,645</u>	<u>\$ 3,821</u>	<u>\$ 169</u>	<u>3,990</u>
Allowance for doubtful accounts			(375)			(326)
Finance lease receivables, net			<u>\$ 3,270</u>			<u>\$ 3,664</u>
Current			<u>\$ 30</u>			<u>\$ 43</u>
Noncurrent			<u>\$ 3,240</u>			<u>\$ 3,621</u>

Accumulated deferred taxes arising from leveraged leases, which are included in Deferred Income Taxes, amounted to \$3,049 million at December 31, 2005 and \$3,226 million at December 31, 2004.

The following table is a summary of the components of income from leveraged leases:

Years Ended December 31,	(dollars in millions)		
	2005	2004	2003
Pretax lease income	\$ 119	\$ 63	\$ 108
Income tax expense/(benefit)	(25)	(52)	11
Investment tax credits	4	3	3

The future minimum lease payments to be received from noncancelable leases, net of nonrecourse loan payments related to leveraged and direct financing leases in excess of debt service requirements, for the periods shown at December 31, 2005, are as follows:

Years	(dollars in millions)	
	Capital Leases	Operating Leases
2006	\$ 103	\$ 22
2007	122	7
2008	128	4
2009	187	6
2010	161	2
Thereafter	3,269	—
Total	<u>\$ 3,970</u>	<u>\$ 41</u>

As Lessee

We lease certain facilities and equipment for use in our operations under both capital and operating leases. Total rent expense from continuing operations under operating leases amounted to \$1,532 million in 2005, \$1,347 million in 2004 and \$1,334 million in 2003.

Capital lease amounts included in plant, property and equipment are as follows:

At December 31,	(dollars in millions)	
	2005	2004
Capital leases	\$ 313	\$ 596
Accumulated amortization	(137)	(412)
Total	<u>\$ 176</u>	<u>\$ 184</u>

The aggregate minimum rental commitments under noncancelable leases for the periods shown at December 31, 2005, are as follows:

Years	(dollars in millions)	
	Capital Leases	Operating Leases
2006	\$ 37	\$ 1,184
2007	28	791
2008	21	652
2009	13	504
2010	12	316
Thereafter	55	1,050
Total minimum rental commitments	166	<u>\$ 4,497</u>
Less interest and executory costs	(54)	
Present value of minimum lease payments	112	
Less current installments	(17)	
Long-term obligation at December 31, 2005	<u>\$ 95</u>	

As of December 31, 2005, the total minimum sublease rentals to be received in the future under noncancelable operating and capital subleases were \$46 million and \$1 million, respectively.

NOTE 11

DEBT

Debt Maturing Within One Year

Debt maturing within one year is as follows:

At December 31,	(dollars in millions)	
	2005	2004
Long-term debt maturing within one year	\$ 4,926	\$ 3,569
Commercial paper	2,204	—
Other short-term debt	11	24
Total debt maturing within one year	<u>\$ 7,141</u>	<u>\$ 3,593</u>

The weighted average interest rate for our commercial paper at year-end December 31, 2005 was 4.3%. There was no commercial paper outstanding at December 31, 2004.

Capital expenditures (primarily construction of telephone plant) are partially financed, pending long-term financing, through bank loans and the issuance of commercial paper payable within 12 months.

At December 31, 2005, we had approximately \$6.7 billion of unused bank lines of credit. Certain of these lines of credit contain requirements for the payment of commitment fees.

Long-Term Debt

Outstanding long-term debt obligations are as follows:

At December 31,	Interest Rates %	Maturities	(dollars in millions)	
			2005	2004
Notes payable	4.00 – 8.61	2006 – 2035	\$ 16,310	\$ 17,481
Telephone subsidiaries – debentures and first/refunding mortgage bonds	4.63 – 7.00	2006 – 2042	11,869	12,958
	7.15 – 7.65	2007 – 2032	1,725	1,825
	7.85 – 9.67	2010 – 2031	1,926	1,930
Other subsidiaries – debentures and other	4.25 – 8.75	2006 – 2028	3,410	3,480
Zero-coupon convertible notes, net of unamortized discount of \$790 and \$830	3.18	2021	1,360	1,320
Employee stock ownership plan loans: NYNEX debentures	9.55	2010	113	145
Capital lease obligations (average rate 11.9% and 9.4%)			112	138
Property sale holdbacks held in escrow, vendor financing and other	3.00 – 3.25	2006 – 2009	13	21
Unamortized discount, net of premium			(43)	(55)
Total long-term debt, including current maturities			36,795	39,243
Less: debt maturing within one year			(4,926)	(3,569)
Total long-term debt			<u>\$ 31,869</u>	<u>\$ 35,674</u>

Telephone Subsidiaries' Debt

Our first mortgage bonds of \$172 million are secured by certain telephone operations assets.

See Note 21 for additional information about guarantees of operating subsidiary debt.

Zero-Coupon Convertible Notes

In May 2001, Verizon Global Funding Corp. (Verizon Global Funding) issued approximately \$5.4 billion in principal amount at maturity of zero-coupon convertible notes due 2021, resulting in gross proceeds of approximately \$3 billion. The notes are convertible into

shares of our common stock at an initial price of \$69.50 per share if the closing price of Verizon common stock on the New York Stock Exchange exceeds specified levels or in other specified circumstances. The conversion price increases by at least 3% a year. The initial conversion price represents a 25% premium over the May 8, 2001 closing price of \$55.60 per share. The zero-coupon convertible notes are callable by Verizon Global Funding on or after May 15, 2006. In addition, the notes are redeemable at the option of the holders on May 15th in each of the years 2004, 2006, 2011 and 2016. On May 15, 2004, \$3,292 million of principal amount of the notes (\$1,984 million after unamortized discount) were redeemed by

Verizon Global Funding. As of December 31, 2005, the remaining zero-coupon convertible notes were classified as debt maturing within one year since they are redeemable at the option of the holders on May 15, 2006.

Support Agreements

All of Verizon Global Funding's debt has the benefit of Support Agreements between us and Verizon Global Funding, which give holders of Verizon Global Funding debt the right to proceed directly against us for payment of interest, premium (if any) and principal outstanding should Verizon Global Funding fail to pay. The holders of Verizon Global Funding debt do not have recourse to the stock or assets of most of our telephone operations; however, they do have recourse to dividends paid to us by any of our consolidated subsidiaries as well as assets not covered by the exclusion. Verizon Global Funding's long-term debt, including current portion, aggregated \$14,152 million at December 31, 2005. The carrying value of the available assets reflected in our consolidated balance sheets was approximately \$63.9 billion at December 31, 2005.

Verizon and NYNEX Corporation are the joint and several co-obligors of the 20-Year 9.55% Debentures due 2010 previously issued by NYNEX on March 26, 1990. As of December 31, 2005, \$113 million principal amount of this obligation remained outstanding. In addition, Verizon Global Funding has guaranteed the debt obligations of GTE Corporation (but not the debt of its subsidiary or affiliate companies) that were issued and outstanding prior to July 1, 2003. As of December 31, 2005, \$3,400 million principal amount of these obligations remained outstanding. NYNEX and GTE no longer issue public debt or file SEC reports. See Note 21 for information on guarantees of operating subsidiary debt listed on the New York Stock Exchange.

On February 1, 2006, Verizon announced the merger of Verizon Global Funding into Verizon.

Debt Covenants

We and our consolidated subsidiaries are in compliance with all of our debt covenants.

Maturities of Long-Term Debt

Maturities of long-term debt outstanding at December 31, 2005 are \$4.9 billion in 2006, \$4.7 billion in 2007, \$2.5 billion in 2008, \$1.7 billion in 2009, \$2.8 billion in 2010 and \$20.2 billion thereafter. These amounts include the debt, redeemable at the option of the holder, at the earliest redemption dates.

NOTE 12

FINANCIAL INSTRUMENTS

Derivatives

The ongoing effect of SFAS No. 133 and related amendments and interpretations on our consolidated financial statements will be determined each period by several factors, including the specific hedging instruments in place and their relationships to hedged items, as well as market conditions at the end of each period.

Interest Rate Risk Management

We have entered into domestic interest rate swaps, to achieve a targeted mix of fixed and variable rate debt, where we principally receive fixed rates and pay variable rates based on LIBOR. These swaps hedge against changes in the fair value of our debt portfolio. We record the interest rate swaps at fair value in our balance sheet as assets and liabilities and adjust debt for the change in its fair

value due to changes in interest rates. The ineffective portions of these hedges were recorded as gains in the consolidated statements of income of \$4 million and \$2 million for the years ended December 31, 2004 and 2003, respectively. During 2005, we entered into interest rate derivatives to limit our exposure to interest rate changes. In accordance with the provisions of SFAS No. 133, changes in fair value of these cash flow hedges due to interest rate fluctuations are recognized in Accumulated Other Comprehensive Loss. As of December 31, 2005, we have recorded unrealized gains of \$5 million in Other Comprehensive Income (Loss) related to these interest rate cash flow hedges.

Foreign Exchange Risk Management

Our foreign exchange risk management includes the use of foreign currency forward contracts and cross currency interest rate swaps with foreign currency forwards. These contracts are typically used to hedge short-term foreign currency transactions and commitments, or to offset foreign exchange gains or losses on the foreign currency obligations and are designated as cash flow hedges. There were no foreign currency contracts outstanding as of December 31, 2005. We record these contracts at fair value as assets or liabilities and the related gains or losses are deferred in shareowners' investment as a component of Other Comprehensive Income (Loss). We have recorded net gains of \$17 million and losses of \$21 million in Other Comprehensive Income (Loss) for the years ended December 31, 2004 and 2003, respectively.

Net Investment Hedges

During 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. In accordance with the provisions of SFAS No. 133 and related amendments and interpretations, changes in fair value of these contracts due to exchange rate fluctuations are recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment in the operation being hedged. As of December 31, 2005, our positions in the zero cost euro collars have been settled. As of December 31, 2005, we have recorded unrealized gains of \$2 million in Accumulated Other Comprehensive Loss related to these hedge contracts.

During 2004, we entered into foreign currency forward contracts to hedge our net investment in our Canadian operations and investments. In accordance with the provisions of SFAS No. 133, changes in the fair value of these contracts due to exchange rate fluctuations were recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment in the operations being hedged. During 2004, we sold our Canadian operations and investments. Accordingly, the unrealized losses on these net investment hedge contracts were realized in net income along with the corresponding foreign currency translation balance. We recorded realized losses of \$106 million (\$58 million after-tax) related to these hedge contracts.

Other Derivatives

On May 17, 2005, we purchased 43.4 million shares of MCI common stock under a stock purchase agreement that contained a provision for the payment of an additional cash amount determined immediately prior to April 9, 2006 based on the market price of Verizon's common stock (see Note 5). Under SFAS No. 133, this additional cash payment is an embedded derivative which we carry at fair value and is subject to changes in the market price of Verizon stock. Since this derivative does not qualify for hedge accounting under SFAS No. 133, changes in its fair value are recorded in the

notes to consolidated financial statements continued

consolidated statements of income in Other Income and (Expense), Net. During 2005, we recorded pretax income of \$57 million in connection with this embedded derivative.

In addition, we previously entered into several other contracts and similar arrangements that require fair value accounting under the provisions of SFAS No. 133 and related amendments and interpretations. We recorded charges of \$3 million, gains of \$4 million and charges of \$13 million as mark-to-market adjustments related to these instruments for the years ended December 31, 2005, 2004 and 2003, respectively.

Concentrations of Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of temporary cash investments, short-term and long-term investments, trade receivables, certain notes receivable including lease receivables, preferred stock and derivative contracts. Our policy is to deposit our temporary cash investments with major financial institutions. Counterparties to our derivative contracts are also major financial institutions and organized exchanges. The financial institutions have all been accorded high ratings by primary rating agencies. We limit the dollar amount of contracts entered into with any one financial institution and monitor our counterparties' credit ratings. We generally do not give or receive collateral on swap agreements due to our credit rating and those of our counterparties. While we may be exposed to credit losses due to the nonperformance of our counterparties, we consider the risk remote and do not expect the settlement of these transactions to have a material effect on our results of operations or financial condition.

Fair Values of Financial Instruments

The tables that follow provide additional information about our significant financial instruments:

Financial Instrument	Valuation Method			
Cash and cash equivalents and short-term investments	Carrying amounts			
Short- and long-term debt (excluding capital leases)	Market quotes for similar terms and maturities or future cash flows discounted at current rates			
Cost investments in unconsolidated businesses, derivative assets and liabilities and notes receivable	Future cash flows discounted at current rates, market quotes for similar instruments or other valuation models			
(dollars in millions)				
At December 31,	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Short- and long-term debt	\$ 38,898	\$ 40,313	\$ 39,129	\$ 42,231
Cost investments in unconsolidated businesses	1,089	1,089	138	138
Short- and long-term derivative assets	62	62	127	127
Notes receivable, net	80	80	81	81
Short- and long-term derivative liabilities	22	22	3	3

NOTE 13

EARNINGS PER SHARE AND SHAREOWNERS' INVESTMENT

Earnings Per Share

The following table is a reconciliation of the numerators and denominators used in computing earnings per common share:

Years Ended December 31,	(dollars and shares in millions, except per share amounts)		
	2005	2004	2003
Net Income Used For Basic Earnings Per Common Share			
Income before discontinued operations and cumulative effect of accounting change	\$ 7,397	\$ 7,261	\$ 3,460
Income (loss) on discontinued operations, net of tax	–	570	(886)
Cumulative effect of accounting change, net of tax	–	–	503
Net income	\$ 7,397	\$ 7,831	\$ 3,077

Net Income Used For Diluted Earnings Per Common Share

Income before discontinued operations and cumulative effect of accounting change	\$ 7,397	\$ 7,261	\$ 3,460
After-tax minority interest expense related to exchangeable equity interest	32	27	21
After-tax interest expense related to zero-coupon convertible notes	28	41	61
Income before discontinued operations and cumulative effect of accounting change – after assumed conversion of dilutive securities	7,457	7,329	3,542
Income (loss) on discontinued operations, net of tax	–	570	(886)
Cumulative effect of accounting change, net of tax	–	–	503
Net income – after assumed conversion of dilutive securities	\$ 7,457	\$ 7,899	\$ 3,159

Basic Earnings Per Common Share

Weighted-average shares outstanding – basic	2,766	2,770	2,756
Income before discontinued operations and cumulative effect of accounting change	\$ 2.67	\$ 2.62	\$ 1.26
Income (loss) on discontinued operations, net of tax	–	.21	(.32)
Cumulative effect of accounting change, net of tax	–	–	.18
Net income	\$ 2.67	\$ 2.83	\$ 1.12

Diluted Earnings Per Common Share⁽¹⁾

Weighted-average shares outstanding	2,766	2,770	2,756
Effect of dilutive securities:			
Stock options	5	5	5
Exchangeable equity interest	29	29	28
Zero-coupon convertible notes	17	27	43
Weighted-average shares – diluted	2,817	2,831	2,832
Income before discontinued operations and cumulative effect of accounting change	\$ 2.65	\$ 2.59	\$ 1.25
Income (loss) on discontinued operations, net of tax	–	.20	(.31)
Cumulative effect of accounting change, net of tax	–	–	.18
Net income	\$ 2.65	\$ 2.79	\$ 1.12

(1) Total per share amounts may not add due to rounding.

Certain outstanding options to purchase shares were not included in the computation of diluted earnings per common share because to do so would have been anti-dilutive for the period, including approximately 242 million shares during 2005, 253 million shares during 2004 and 248 million shares during 2003.

The diluted earnings per share calculation considers the assumed conversion of an exchangeable equity interest (see Note 9) and Verizon's zero-coupon convertible notes (see Note 11).

Shareowners' Investment

Our certificate of incorporation provides authority for the issuance of up to 250 million shares of Series Preferred Stock, \$.10 par value, in one or more series, with such designations, preferences, rights, qualifications, limitations and restrictions as the Board of Directors may determine.

We are authorized to issue up to 4.25 billion shares of common stock.

On January 22, 2004, the Board of Directors authorized the repurchase of up to 80 million common shares terminating no later than the close of business on February 28, 2006. We repurchased 7.9 million and 9.5 million common shares during 2005 and 2004, respectively.

On January 19, 2006, the Board of Directors authorized the repurchase of up to 100 million common shares terminating no later than the close of business on February 28, 2008. The Board of Directors also determined that no additional common shares may be purchased under the previous program.

NOTE 14

STOCK INCENTIVE PLANS

We determined stock-option related employee compensation expense for 2004 and 2003 using the Black-Scholes option-pricing model based on the following weighted-average assumptions:

	2004	2003
Dividend yield	4.2%	4.0%
Expected volatility	31.3	30.9
Risk-free interest rate	3.3	3.4
Expected lives (in years)	6	6

We did not grant options during 2005.

The weighted-average value of options granted during 2004 and 2003 was \$7.88 and \$8.41, respectively. Our stock incentive plans are described below:

Fixed Stock Option Plans

We have fixed stock option plans for substantially all employees. Options to purchase common stock were granted at a price equal to the market price of the stock at the date of grant. The options generally vest over three years and have a maximum term of ten years.

This table summarizes our fixed stock option plans:

	Stock Options (in thousands)	Weighted-Average Exercise Price
Outstanding, January 1, 2003	261,437	\$ 48.32
Granted	22,207	38.94
Exercised	(4,634)	31.29
Canceled/forfeited	(7,917)	47.87
Outstanding, December 31, 2003	271,093	47.86
Granted	16,824	36.75
Exercised	(10,163)	29.90
Canceled/forfeited	(6,364)	49.69
Outstanding, December 31, 2004	271,390	47.80
Granted	—	—
Exercised	(1,095)	29.74
Canceled/forfeited	(19,319)	51.36
Outstanding, December 31, 2005	250,976	47.62
Options exercisable, December 31,		
2003	233,374	48.27
2004	239,093	48.91
2005	236,158	48.27

notes to consolidated financial statements continued

The following table summarizes information about fixed stock options outstanding as of December 31, 2005:

Range of Exercise Prices	Stock Options Outstanding			Stock Options Exercisable	
	Shares (in thousands)	Weighted-Average Remaining Life	Weighted-Average Exercise Price	Shares (in thousands)	Weighted-Average Exercise Price
\$ 20.00 – 29.99	32	6.74 years	\$ 27.25	32	\$ 27.25
30.00 – 39.99	56,085	5.24	36.73	41,281	36.52
40.00 – 49.99	98,448	4.65	45.33	98,435	45.33
50.00 – 59.99	95,087	4.11	56.22	95,086	56.22
60.00 – 69.99	1,324	3.79	62.11	1,324	62.11
Total	<u>250,976</u>	4.57	47.62	<u>236,158</u>	48.27

Performance-Based Shares

In 2005, stock compensation awards consisted of performance-based stock units and restricted stock units that vest over three years. The 2005 performance-based stock units and restricted stock units will be paid in cash upon vesting. The expense associated with these awards is disclosed as part of other stock-based compensation (see Note 2).

In 2004, stock compensation awards consisted of stock options, performance-based stock units and restricted stock units that vest over three years. The 2004 performance-based stock units and restricted stock units will be paid in cash upon vesting. The expense associated with these awards is disclosed as part of other stock-based compensation (see Note 2).

In 2003, stock compensation awards consisted of stock options and performance-based stock units that vest over three years. This was the first grant of performance based shares since 2000, when certain key Verizon employees were granted restricted stock units that vest over a three to five year period.

The number of shares accrued for the performance-based share programs was 5,521,000, 5,993,000 and 6,707,000 at December 31, 2005, 2004 and 2003, respectively.

NOTE 15

EMPLOYEE BENEFITS

We maintain noncontributory defined benefit pension plans for many of our employees. The postretirement health care and life insurance plans for our retirees and their dependents are both contributory and noncontributory and include a limit on the company's share of cost for certain recent and future retirees. We also sponsor defined contribution savings plans to provide opportunities for eligible employees to save for retirement on a tax-deferred basis. We use a measurement date of December 31 for our pension and postretirement health care and life insurance plans.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits for many of our employees are subject to collective bargaining agreements. Modifications in benefits have been bargained from time to time, and we may also periodically amend the benefits in the management plans.

In December 2005, we announced that Verizon management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006. In addition, new management employees hired after December 31, 2005 are not eligible for pension benefits and managers with less than 13.5 years of service as of June 30, 2006 are not eligible for company-subsidized retiree healthcare or retiree life insurance benefits. Beginning July 1, 2006, management employees will receive an increased company match on their savings plan contributions.

The following tables summarize benefit costs, as well as the benefit obligations, plan assets, funded status and rate assumptions associated with pension and postretirement health care and life insurance benefit plans.

notes to consolidated financial statements continued

Obligations and Funded Status

(dollars in millions)

At December 31,

Change in Benefit Obligation

	2005	Pension 2004	Health Care and Life 2005	2004
Beginning of year	\$ 37,395	\$ 40,968	\$ 27,077	\$ 24,581
Service cost	721	712	373	282
Interest cost	2,070	2,289	1,519	1,479
Plan amendments	181	(65)	59	248
Actuarial loss, net	390	2,467	520	2,017
Benefits paid	(2,977)	(2,884)	(1,706)	(1,532)
Termination benefits	11	4	1	2
Settlements	(35)	(6,105)	—	—
Acquisitions and divestitures, net	(194)	—	(34)	—
Other	(1)	9	—	—
End of year	37,561	37,395	27,809	27,077

Change in Plan Assets

Beginning of year	39,106	42,776	4,549	4,467
Actual return on plan assets	4,246	4,874	348	471
Company contributions	852	443	1,085	1,143
Benefits paid	(2,977)	(2,884)	(1,706)	(1,532)
Settlements	(35)	(6,105)	—	—
Acquisitions and divestitures, net	(202)	2	—	—
End of year	40,990	39,106	4,276	4,549

Funded Status

End of year	3,429	1,711	(23,533)	(22,528)
Unrecognized				
Actuarial loss, net	4,761	5,486	7,585	7,335
Prior service cost	1,075	1,387	4,310	4,193
Transition obligation	1	1	16	18
Net amount recognized	\$ 9,266	\$ 8,585	\$ (11,622)	\$ (10,982)

Amounts recognized on the balance sheet

Prepaid pension cost (in Other Assets)	\$ 12,704	\$ 12,302	\$ —	\$ —
Assets held for sale	—	1	—	—
Other assets	478	463	—	—
Employee benefit obligation	(5,473)	(5,774)	(11,622)	(10,953)
Liabilities related to assets held for sale	—	—	—	(29)
Minority interest	168	145	—	—
Accumulated other comprehensive loss	1,389	1,448	—	—
Net amount recognized	\$ 9,266	\$ 8,585	\$ (11,622)	\$ (10,982)

Changes in benefit obligations were caused by factors including changes in actuarial assumptions (see Assumptions below), curtailments and settlements.

In 2005 as a result of our announcement regarding management retiree benefits, we recorded pre-tax expense of \$441 million for pension curtailments and pre-tax income of \$343 million for retiree medical curtailments (see Note 4 for additional information).

Verizon's union contracts contain health care cost provisions that limit company payments toward health care costs to specific dollar amounts (known as caps). These caps pertain to both current and future retirees, and have a significant impact on the actuarial valuation of postretirement benefits. These caps have been included in union contracts for several years, but have exceeded the annual health care cost every year until 2003. During the negotiation of new collective bargaining agreements for union contracts covering 79,000 unionized employees in the second half of 2003, the date health care caps would become effective was extended and the dollar amounts of the caps were increased. In the fourth quarter of 2003, we began recording retiree health care costs as if there were no caps, in connection with the ratification of the union contracts.

Since the caps are an assumption included in the actuarial determination of Verizon's postretirement obligation, the effect of extending and increasing the caps increased the accumulated postretirement obligation in the fourth quarter of 2003 by \$5,158 million.

In 2003 Verizon reduced its workforce using its employee severance plans (see Note 4). Additionally, in 2005, 2004 and 2003, several of the pension plans' lump-sum pension distributions surpassed the settlement threshold equal to the sum of service cost and interest cost requiring settlement recognition for all cash settlements for each of those years.

The accumulated benefit obligation for all defined benefit pension plans was \$36,128 million and \$35,389 million at December 31, 2005 and 2004, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets follows:

(dollars in millions)

At December 31,	2005	2004
Projected benefit obligation	\$ 13,100	\$ 12,979
Accumulated benefit obligation	12,575	12,508
Fair value of plan assets	8,605	7,816

notes to consolidated financial statements continued

Net Periodic Cost

(dollars in millions)

Years Ended December 31,	Pension			Health Care and Life		
	2005	2004	2003	2005	2004	2003
Service cost	\$ 721	\$ 712	\$ 785	\$ 373	\$ 282	\$ 176
Interest cost	2,070	2,289	2,436	1,519	1,479	1,203
Expected return on plan assets	(3,348)	(3,709)	(4,150)	(353)	(414)	(430)
Amortization of transition asset	—	(4)	(41)	2	2	2
Amortization of prior service cost	45	60	23	285	234	(9)
Actuarial loss (gain), net	146	57	(337)	278	187	130
Net periodic benefit (income) cost	(366)	(595)	(1,284)	2,104	1,770	1,072
Termination benefits	3	4	2,588	1	2	508
Termination benefits – Hawaii operations sold	8	—	—	—	—	—
Settlement loss	—	815	229	—	—	—
Settlement loss– Hawaii operations sold	80	—	—	—	—	—
Curtailment (gain) loss and other, net	441	1	65	(343)	2	(130)
Curtailment loss – Hawaii operations sold	6	—	—	—	—	—
Subtotal	538	820	2,882	(342)	4	378
Total cost	\$ 172	\$ 225	\$ 1,598	\$ 1,762	\$ 1,774	\$ 1,450

The termination benefits, settlement loss and curtailment loss amounts pertaining to the Hawaii operations sold were recorded in the consolidated statements of income in Sales of Businesses, Net.

Additional Information

We evaluate each pension plan to determine whether any additional minimum liability is required. As a result of changes in interest rates and changes in investment returns, an adjustment to the additional minimum pension liability was required for a small number of plans as indicated below. The adjustment in the liability is recorded as a charge or (credit) to Accumulated Other Comprehensive Loss, net of tax, in shareowners' investment in the consolidated balance sheets.

Years Ended December 31,			(dollars in millions)	
	2005	2004	2005	2003
Increase (decrease) in minimum liability included in other comprehensive income, before tax	\$ (59)	\$ 587	\$	(513)

Assumptions

The weighted-average assumptions used in determining benefit obligations follow:

At December 31,	Pension		Health Care and Life	
	2005	2004	2005	2004
Discount rate	5.75%	5.75%	5.75%	5.75%
Rate of future increases in compensation	4.00	5.00	4.00	4.00

The weighted-average assumptions used in determining net periodic cost follow:

Years Ended December 31,	Pension			Health Care and Life		
	2005	2004	2003	2005	2004	2003
Discount rate	5.75%	6.25%	6.75%	5.75%	6.25%	6.75%
Expected return on plan assets	8.50	8.50	8.50	7.75	8.50	8.50
Rate of compensation increase	5.00	5.00	5.00	4.00	4.00	4.00

notes to consolidated financial statements continued

In order to project the long-term target investment return for the total portfolio, estimates are prepared for the total return of each major asset class over the subsequent 10-year period, or longer. Those estimates are based on a combination of factors including the following: current market interest rates and valuation levels, consensus earnings expectations, historical long-term risk premiums and value-added. To determine the aggregate return for the pension trust, the projected return of each individual asset class is then weighted according to the allocation to that investment area in the trust's long-term asset allocation policy.

The assumed Health Care Cost Trend Rates follow:

At December 31,	Health Care and Life		
	2005	2004	2003
Health care cost trend rate assumed for next year	10.00%	10.00%	10.00%
Rate to which cost trend rate gradually declines	5.00	5.00	5.00
Year the rate reaches level it is assumed to remain thereafter	2010	2009	2008

Assumed health care trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

One-Percentage-Point	(dollars in millions)	
	Increase	Decrease
Effect on 2005 total service and interest cost	\$ 295	\$ (232)
Effect on postretirement benefit obligation as of December 31, 2005	3,378	(2,745)

Plan Assets

Pension Plans

The weighted-average asset allocations for the pension plans by asset category follow:

At December 31,	2005	2004
Asset Category		
Equity securities	63.4%	63.0%
Debt securities	17.5	18.2
Real estate	3.2	3.5
Other	15.9	15.3
Total	100.0%	100.0%

Equity securities include Verizon common stock in the amounts of \$72 million (less than 1% of total plan assets) and \$121 million (less than 1% of total plan assets) at December 31, 2005 and 2004, respectively. Other assets include cash and cash equivalents (primarily held for the payment of benefits), private equity and investments in absolute return strategies.

Health Care and Life Plans

The weighted-average asset allocations for the other postretirement benefit plans by asset category follow:

At December 31,	2005	2004
Asset Category		
Equity securities	71.9%	66.7%
Debt securities	22.1	25.6
Real estate	0.1	0.1
Other	5.9	7.6
Total	100.0%	100.0%

Equity securities include Verizon common stock in the amounts of \$4 million (less than 1% of total plan assets) and \$8 million (less than 1% of total plan assets) at December 31, 2005 and 2004, respectively.

The portfolio strategy emphasizes a long-term equity orientation, significant global diversification, the use of both public and private investments and professional financial and operational risk controls. Assets are allocated according to a long-term policy neutral position and held within a relatively narrow and pre-determined range. Both active and passive management approaches are used depending on perceived market efficiencies and various other factors.

Cash Flows

Federal legislation was enacted on April 10, 2004 that provides temporary pension funding relief for the 2004 and 2005 plan years. The legislation replaced the 30-year treasury rate with a higher corporate bond rate for determining the current liability. In 2005, we contributed \$744 million to our qualified pension trusts, \$108 million to our nonqualified pension plans and \$1,085 million to our other postretirement benefit plans. Our estimate of the amount and timing of required qualified pension trust contributions for 2006 is based on current regulations, including continued pension funding relief, and is approximately \$100 million, primarily for the TELPRI plans. We anticipate \$145 million in contributions to our non-qualified pension plans in 2006 and \$1,180 million to our other postretirement benefit plans.

Estimated Future Benefit Payments

The benefit payments to retirees, which reflect expected future service, are expected to be paid as follows:

	(dollars in millions)	
	Pension Benefits	Health Care and Life Gross of Medical Subsidy
2006	\$ 2,626	\$ 1,679
2007	2,649	1,769
2008	2,607	1,825
2009	2,887	1,853
2010	3,187	1,925
2011 – 2015	17,217	9,651

Medicare Prescription Drug subsidies expected to offset the future Health Care and Life benefit payments noted above are as follows:

	(dollars in millions)	
	Health Care and Life	
2006	\$	88
2007		93
2008		96
2009		97
2010		101
2011 – 2015		500

Savings Plan and Employee Stock Ownership Plans

We maintain four leveraged employee stock ownership plans (ESOP). Under these plans, we match a certain percentage of eligible employee contributions to the savings plans with shares of our common stock from these ESOPs. Common stock is allocated from all leveraged ESOP trusts based on the proportion of principal and interest paid on ESOP debt in a year to the remaining principal and interest due over the term of the debt. The final debt service payments and related share allocations for two of our leveraged ESOPs were made in 2004. At December 31, 2005, the number of unallocated and allocated shares of common stock was 5 million and 76

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million, respectively. All leveraged ESOP shares are included in earnings per share computations.

We recognize leveraged ESOP cost based on the modified shares allocated method for the leveraged ESOP trusts which purchased securities before December 15, 1989 and the shares allocated method for the leveraged ESOP trust which purchased securities after December 15, 1989. ESOP cost and trust activity consist of the following:

(dollars in millions)				
Years Ended December 31,	2005	2004	2003	
Compensation	\$ 39	\$ 159	\$ 148	
Interest incurred	–	12	22	
Dividends	(16)	(16)	(24)	
Net leveraged ESOP cost	23	155	146	
Additional ESOP cost	208	81	127	
Total ESOP cost	\$ 231	\$ 236	\$ 273	
Dividends received for debt service	\$ 16	\$ 62	\$ 76	
Total company contributions to leveraged ESOP trusts	\$ 259	\$ 275	\$ 306	

In addition to the ESOPs described above, we maintain savings plans for non-management employees and employees of certain subsidiaries. Compensation expense associated with these savings plans was \$254 million in 2005, \$234 million in 2004 and \$220 million in 2003.

Severance Benefits

The following table provides an analysis of our severance liability recorded in accordance with SFAS Nos. 112 and 146:

(dollars in millions)					
Year	Beginning of Year	Charged to Expense	Payments	Other	End of Year
2003	\$ 1,137	\$ 1,985	\$ (857)	\$ –	\$ 2,265
2004	2,265	–	(1,442)	(48)	775
2005	775	102	(256)	(8)	613

The remaining severance liability includes future contractual payments to employees separated as of December 31, 2005.

NOTE 16

INCOME TAXES

The components of Income Before Provision for Income Taxes, Discontinued Operations and Cumulative Effect of Accounting Change are as follows:

(dollars in millions)			
Years Ended December 31,	2005	2004	2003
Domestic	\$ 9,183	\$ 7,802	\$ 2,892
Foreign	1,424	2,310	1,781
	\$ 10,607	\$ 10,112	\$ 4,673

The components of the provision for income taxes from continuing operations are as follows:

(dollars in millions)			
Years Ended December 31,	2005	2004	2003
Current			
Federal	\$ 3,355	\$ 305	\$ 48
Foreign	195	369	72
State and local	719	335	267
	4,269	1,009	387
Deferred			
Federal	(829)	1,694	820
Foreign	(37)	33	18
State and local	(186)	123	(2)
	(1,052)	1,850	836
Investment tax credits	(7)	(8)	(10)
Total income tax expense	\$ 3,210	\$ 2,851	\$ 1,213

The following table shows the principal reasons for the difference between the effective income tax rate and the statutory federal income tax rate:

Years Ended December 31,	2005	2004	2003
Statutory federal income tax rate	35.0%	35.0%	35.0%
State and local income tax, net of federal tax benefits	3.3	2.9	3.7
Tax benefits from investment losses	(3.6)	(2.9)	(3.1)
Equity in earnings from unconsolidated businesses	(2.8)	(6.4)	(10.6)
Other, net	(1.6)	(.4)	1.0
Effective income tax rate	30.3%	28.2%	26.0%

During 2005, we recorded a tax benefit of \$336 million in connection with capital gains and prior year investment losses. As a result of the capital gain realized in 2005 in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million related to prior year investment losses. Also during 2005, we recorded a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, which provides for a favorable federal income tax rate in connection with the repatriation of foreign earnings, provided the criteria described in the law is met. Two of Verizon's foreign investments repatriated earnings resulting in income taxes of \$332 million, partially offset by a tax benefit of \$126 million.

The favorable impact on our 2004 and 2003 effective income tax rates was primarily driven by increased earnings from our unconsolidated businesses and tax benefits from valuation allowance reversals.

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Deferred taxes arise because of differences in the book and tax bases of certain assets and liabilities. Significant components of deferred tax liabilities (assets) are shown in the following table:

	(dollars in millions)	
At December 31,	2005	2004
Depreciation	\$ 9,445	\$ 10,307
Employee benefits	(1,971)	(1,704)
Leasing activity	3,001	3,212
Loss on investments	(369)	(752)
Wireless joint venture including wireless licenses	11,786	10,382
Uncollectible accounts receivable	(406)	(501)
Other – net	(505)	(837)
	<u>20,981</u>	<u>20,107</u>
Valuation allowance	815	1,217
Net deferred tax liability	<u>\$ 21,796</u>	<u>\$ 21,324</u>
Net long-term deferred tax liabilities	\$ 22,411	\$ 22,532
Less net current deferred tax assets (in Prepaid Expenses and Other)	511	1,076
Less deferred investment tax credit	104	132
Net deferred tax liability	<u>\$ 21,796</u>	<u>\$ 21,324</u>

At December 31, 2005, undistributed earnings of our foreign subsidiaries amounted to approximately \$3.0 billion. Deferred income taxes are not provided on these earnings as it is intended that the earnings are indefinitely invested outside of the U.S. It is not practical to estimate the amount of taxes that might be payable upon the remittance of such earnings.

The valuation allowance primarily represents the tax benefits of certain state net operating loss carry forwards, capital loss carry forwards and other deferred tax assets which may expire without being utilized. During 2005, the valuation allowance decreased \$402 million. This decrease primarily relates to the valuation allowance reversals relating to utilizing prior year investment losses to offset the capital gains realized on the sale of Hawaii businesses.

NOTE 17

SEGMENT INFORMATION

Reportable Segments

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from the business segment results, they are included in reported consolidated earnings. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

Our segments and their principal activities consist of the following:

Domestic Telecom

Domestic Telecom provides local telephone services, including voice, DSL, data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones in 28 states and Washington, D.C. This segment also provides long distance services, customer premises equipment distribution, video services, data solutions and systems integration, billing and collections and inventory management services.

Domestic Wireless

Domestic wireless products and services include wireless voice and data services and equipment sales across the United States. This segment primarily represents the operations of the Verizon Wireless joint venture with Vodafone. Verizon owns a 55% interest in the joint venture and Vodafone owns the remaining 45%. All financial results included in the tables below reflect the consolidated results of Verizon Wireless.

Information Services

Information Services' multi-platform business comprises yellow pages directories, SuperPages.com, our online directory and search services, and SuperPages On the Go, our directory and information services on wireless telephones. This segment's operations are principally in the United States.

International

International wireline and wireless communications operations and investments in the Americas and Europe.

notes to consolidated financial statements continued

The following table provides operating financial information for our four reportable segments:

	(dollars in millions)				
	Domestic Telecom	Domestic Wireless	Information Services	International	Total Segments
2005					
External revenues	\$ 36,628	\$ 32,219	\$ 3,452	\$ 2,159	\$ 74,458
Intersegment revenues	988	82	–	34	1,104
Total operating revenues	37,616	32,301	3,452	2,193	75,562
Cost of services and sales	15,604	9,393	593	707	26,297
Selling, general & administrative expense	8,419	10,768	1,107	675	20,969
Depreciation & amortization expense	8,801	4,760	92	340	13,993
Total operating expenses	32,824	24,921	1,792	1,722	61,259
Operating income	4,792	7,380	1,660	471	14,303
Equity in earnings of unconsolidated businesses	–	27	–	807	834
Income from other unconsolidated businesses	–	–	–	56	56
Other income and (expense), net	79	6	17	259	361
Interest expense	(1,701)	(601)	–	(127)	(2,429)
Minority interest	–	(2,995)	(7)	(44)	(3,046)
Provision for income taxes	(1,264)	(1,598)	(626)	(171)	(3,659)
Segment income	\$ 1,906	\$ 2,219	\$ 1,044	\$ 1,251	\$ 6,420
Assets	\$ 75,188	\$ 76,729	\$ 1,525	\$ 11,603	\$ 165,045
Investments in unconsolidated businesses	2	154	1	2,767	2,924
Plant, property and equipment, net	49,618	22,790	166	2,155	74,729
Capital expenditures	8,267	6,484	80	283	15,114
2004					
External revenues	\$ 37,160	\$ 27,586	\$ 3,549	\$ 1,982	\$ 70,277
Intersegment revenues	861	76	–	32	969
Total operating revenues	38,021	27,662	3,549	2,014	71,246
Cost of services and sales	14,830	7,747	542	626	23,745
Selling, general & administrative expense	8,621	9,591	1,319	471	20,002
Depreciation & amortization expense	8,910	4,486	87	324	13,807
Total operating expenses	32,361	21,824	1,948	1,421	57,554
Operating income	5,660	5,838	1,601	593	13,692
Equity in earnings of unconsolidated businesses	–	45	–	1,031	1,076
Income from other unconsolidated businesses	–	–	–	31	31
Other income and (expense), net	100	11	15	35	161
Interest expense	(1,602)	(661)	(33)	(85)	(2,381)
Minority interest	–	(2,323)	(6)	(80)	(2,409)
Provision for income taxes	(1,506)	(1,265)	(609)	(300)	(3,680)
Segment income	\$ 2,652	\$ 1,645	\$ 968	\$ 1,225	\$ 6,490
Assets	\$ 78,824	\$ 68,027	\$ 1,680	\$ 14,885	\$ 163,416
Investments in unconsolidated businesses	3	148	4	4,914	5,069
Plant, property and equipment, net	50,608	20,516	179	2,391	73,694
Capital expenditures	7,118	5,633	87	382	13,220
2003					
External revenues	\$ 38,281	\$ 22,436	\$ 3,763	\$ 1,921	\$ 66,401
Intersegment revenues	774	53	–	28	855
Total operating revenues	39,055	22,489	3,763	1,949	67,256
Cost of services and sales	14,512	6,460	554	574	22,100
Selling, general & administrative expense	8,363	8,057	1,387	691	18,498
Depreciation & amortization expense	9,107	3,888	79	346	13,420
Sales of businesses, net	–	–	(141)	–	(141)
Total operating expenses	31,982	18,405	1,879	1,611	53,877
Operating income	7,073	4,084	1,884	338	13,379
Equity in earnings (loss) of unconsolidated businesses	–	15	(1)	1,091	1,105
Income (loss) from other unconsolidated businesses	(4)	–	–	169	165
Other income and (expense), net	45	12	7	32	96
Interest expense	(1,648)	(626)	(38)	(160)	(2,472)
Minority interest	–	(1,554)	(8)	(20)	(1,582)
Provision for income taxes	(2,167)	(848)	(716)	(58)	(3,789)
Segment income	\$ 3,299	\$ 1,083	\$ 1,128	\$ 1,392	\$ 6,902
Assets	\$ 82,087	\$ 65,166	\$ 1,726	\$ 11,872	\$ 160,851
Investments in unconsolidated businesses	64	288	4	4,555	4,911
Plant, property and equipment, net	53,378	18,998	190	2,164	74,730
Capital expenditures	6,820	4,590	74	358	11,842

notes to consolidated financial statements continued

Reconciliation To Consolidated Financial Information

A reconciliation of the results for the operating segments to the applicable line items in the consolidated financial statements is as follows:

	2005	2004	(dollars in millions) 2003
Operating Revenues			
Total reportable segments	\$ 75,562	\$ 71,246	\$ 67,256
Hawaii operations	202	595	614
Corporate, eliminations and other	(652)	(558)	(402)
Consolidated operating revenues – reported	<u>\$ 75,112</u>	<u>\$ 71,283</u>	<u>\$ 67,468</u>
Operating Expenses			
Total reportable segments	\$ 61,259	\$ 57,554	\$ 53,877
Hawaii operations	124	393	478
Sales of businesses and investments, net (see Notes 3, 5, and 8)	(530)	100	300
Severance, pension and benefit charges (see Note 4)	157	815	5,523
Verizon Center relocation, net (see Note 4)	(18)	–	–
MCI exposure, lease impairment and other special items (see Note 4)	125	(91)	496
Corporate, eliminations and other	(819)	(605)	(613)
Consolidated operating expenses – reported	<u>\$ 60,298</u>	<u>\$ 58,166</u>	<u>\$ 60,061</u>
Net Income			
Segment income – reportable segments	\$ 6,420	\$ 6,490	\$ 6,902
Sales of businesses and investments, net (see Notes 3, 5 and 8)	336	1,059	44
Severance, pension and benefit charges (see Note 4)	(95)	(499)	(3,399)
Verizon Center relocation, net (see Note 4)	8	–	–
MCI exposure, lease impairment and other special items (see Note 4)	(133)	2	(419)
Iusacell charge (see Note 3)	–	–	(931)
Tax benefits (see Note 4)	336	234	–
Tax provision on repatriated earnings (see Note 4)	(206)	–	–
Income on discontinued operations (see Note 3)	–	54	46
Cumulative effect of accounting change (see Note 2)	–	–	503
Corporate and other	731	491	331
Consolidated net income – reported	<u>\$ 7,397</u>	<u>\$ 7,831</u>	<u>\$ 3,077</u>
Assets			
Total reportable segments	\$ 165,045	\$ 163,416	\$ 160,851
Reconciling items	3,085	2,542	5,117
Consolidated assets	<u>\$ 168,130</u>	<u>\$ 165,958</u>	<u>\$ 165,968</u>

Results of operations for Domestic Telecom and Information Services exclude the effects of our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operated approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services in Hawaii (see Note 3). Financial information for Information Services excludes the effects of Verizon Information Services Canada (see Note 3).

Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses such as lease financing, and asset impairments and expenses that are not allocated in assessing segment performance due to their non-recurring nature.

We generally account for intersegment sales of products and services and asset transfers at current market prices. We are not dependent on any single customer.

Geographic Areas

Our foreign investments are located principally in the Americas and Europe. Domestic and foreign operating revenues are based on the location of customers. Long-lived assets consist of plant, property and equipment (net of accumulated depreciation) and investments in unconsolidated businesses. The table below presents financial information by major geographic area:

		(dollars in millions) 2005	2004	2003
Years Ended December 31,				
Domestic				
Operating revenues	\$ 72,701	\$ 69,173	\$ 65,303	
Long-lived assets	74,978	72,668	74,346	
Foreign				
Operating revenues	2,411	2,110	2,165	
Long-lived assets	4,931	7,311	6,745	
Consolidated				
Operating revenues	75,112	71,283	67,468	
Long-lived assets	79,909	79,979	81,091	

NOTE 18

COMPREHENSIVE INCOME

Comprehensive income consists of net income and other gains and losses affecting shareowners' investment that, under GAAP, are excluded from net income.

Changes in the components of other comprehensive income (loss), net of income tax expense (benefit), are as follows:

Years Ended December 31,	2005	2004	(dollars in millions) 2003
Foreign Currency Translation Adjustments , net of taxes of \$-, \$- and \$-	\$ (755)	\$ 548	\$ 568
Unrealized Gains (Losses) on Net Investment Hedges			
Unrealized gains (losses), net of taxes of \$1, \$(48) and \$-	2	(58)	-
Less reclassification adjustments for losses realized in net income, net of taxes of \$-, \$(48) and \$-	-	(58)	-
Net unrealized gains on net investment hedges	2	-	-
Unrealized Derivative Gains (Losses) on Cash Flow Hedges			
Unrealized gains (losses), net of taxes of \$-, \$(2) and \$(1)	4	(9)	30
Less reclassification adjustments for gains (losses) realized in net income, net of taxes of \$(2), \$(2) and \$(1)	(6)	(26)	51
Net unrealized derivative gains (losses) on cash flow hedges	10	17	(21)
Unrealized Gains (Losses) on Marketable Securities			
Unrealized gains, net of taxes of \$10, \$4 and \$2	4	8	5
Less reclassification adjustments for gains realized in net income, net of taxes of \$14, \$1 and \$1	25	1	4
Net unrealized gains (losses) on marketable securities	(21)	7	1
Minimum Pension Liability Adjustment , net of taxes of \$25, \$(212) and \$201	34	(375)	312
Other Comprehensive Income (Loss)	\$ (730)	\$ 197	\$ 860

The foreign currency translation adjustment in 2005 represents unrealized losses from the decline in the functional currencies on our investments in Vodafone Omnitel, Verizon Dominicana, C. por A. (Verizon Dominicana) and CANTV. The foreign currency translation adjustment in 2004 represents unrealized gains from the appreciation of the functional currencies at Verizon Dominicana and our investment in Vodafone Omnitel as well as the reclassification of the foreign currency translation loss in connection with the sale of our 20.5% interest in TELUS (see Note 8), partially offset by unrealized losses from the decline in the functional currency on our investment in CANTV. The foreign currency translation adjustment in 2003 is primarily driven by the impact of the euro on our investment in Vodafone Omnitel and a reclassification of the foreign currency translation loss of Iusacell of \$577 million in connection with the sale of Iusacell (see Note 3), partially offset by unrealized foreign currency translation losses at Verizon Dominicana and CANTV.

During 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. As of December 31, 2005, our positions in the zero cost euro collars have been settled. During 2004, we entered into foreign currency forward contracts to

hedge our net investment in Verizon Information Services Canada and TELUS (see Note 12). In connection with the sales of these interests in the fourth quarter of 2004, the unrealized losses on these net investment hedges were realized in net income along with the corresponding foreign currency translation balance.

The changes in the minimum pension liability in 2005, 2004 and 2003 were required by accounting rules for certain pension plans based on their funded status (see Note 15).

The components of Accumulated Other Comprehensive Loss are as follows:

At December 31,	2005	(dollars in millions) 2004
Foreign currency translation adjustments	\$ (867)	\$ (112)
Unrealized gains on net investment hedges	2	-
Unrealized derivative losses		
on cash flow hedges	(27)	(37)
Unrealized gains on marketable securities	10	31
Minimum pension liability adjustment	(901)	(935)
Accumulated other comprehensive loss	\$ (1,783)	\$ (1,053)

NOTE 19

ACCOUNTING FOR THE IMPACT OF THE SEPTEMBER 11, 2001 TERRORIST ATTACKS

The primary financial statement impact of the September 11, 2001 terrorist attacks pertains to Verizon's plant, equipment and administrative office space located either in, or adjacent to the World Trade Center complex, and the associated service restoration efforts. We recorded insurance recoveries related to the terrorist attacks of \$270 million in 2003 and \$200 million in 2002, primarily offsetting fixed asset losses and expenses incurred in 2005 and preceding years. Of the amounts recorded, approximately \$130 million in 2003 and \$112 million in 2002 relate to operating expenses (primarily cost of services and sales) reported in the consolidated statements of income, and also reported by our Domestic Telecom segment. The costs and estimated insurance recoveries were recorded in accordance with EITF No. 01-10, "Accounting for the Impact of the Terrorist Attacks of September 11, 2001." As of December 31, 2005, we received insurance proceeds of \$849 million.

NOTE 20

ADDITIONAL FINANCIAL INFORMATION

The tables that follow provide additional financial information related to our consolidated financial statements:

Income Statement Information

Years Ended December 31,	2005	(dollars in millions)	
		2004	2003
Depreciation expense	\$ 12,519	\$ 12,508	\$ 12,210
Interest expense incurred	2,533	2,561	2,941
Capitalized interest	(352)	(177)	(144)
Advertising expense	1,914	1,685	1,419

Balance Sheet Information

		(dollars in millions)
At December 31,	2005	2004
<i>Accounts Payable and Accrued Liabilities</i>		
Accounts payable	\$ 2,827	\$ 2,827
Accrued expenses	3,036	3,071
Accrued vacation pay	914	842
Accrued salaries and wages	2,390	2,526
Interest payable	579	585
Accrued taxes	2,605	3,326
	\$ 12,351	\$ 13,177
<i>Other Current Liabilities</i>		
Advance billings and customer deposits	\$ 1,985	\$ 1,899
Dividends payable	1,137	1,083
Other	2,449	2,852
	\$ 5,571	\$ 5,834

Cash Flow Information

		(dollars in millions)	
Years Ended December 31,	2005	2004	2003
<i>Cash Paid</i>			
Income taxes, net of amounts refunded	\$ 4,744	\$ 597	\$ (716)
Interest, net of amounts capitalized	2,077	2,723	2,646
<i>Supplemental Investing and Financing Transactions</i>			
Assets acquired in business combinations	635	8	880
Liabilities assumed in business combinations	35	—	13
Debt assumed in business combinations	9	—	4

NOTE 21

GUARANTEES OF OPERATING SUBSIDIARY DEBT

Verizon has guaranteed the following two obligations of indirect wholly owned operating subsidiaries: \$480 million 7% debentures series B, due 2042 issued by Verizon New England Inc. and \$300 million 7% debentures series F issued by Verizon South Inc. due 2041. These guarantees are full and unconditional and would require Verizon to make scheduled payments immediately if either of the two subsidiaries failed to do so. Both of these securities were issued in denominations of \$25 and were sold primarily to retail investors and are listed on the New York Stock Exchange. SEC rules permit us to include condensed consolidating financial information for these two subsidiaries in our periodic SEC reports rather than filing separate subsidiary periodic SEC reports.

Below is the condensed consolidating financial information. Verizon New England and Verizon South are presented in separate columns. The column labeled Parent represents Verizon's investments in all of its subsidiaries under the equity method and the Other column represents all other subsidiaries of Verizon on a combined basis. The Adjustments column reflects intercompany eliminations.

(dollars in millions)						
Condensed Consolidating Statements of Income Year Ended December 31, 2005	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	\$ –	\$ 3,936	\$ 907	\$ 70,766	\$ (497)	\$ 75,112
Operating expenses	8	3,628	684	56,475	(497)	60,298
Operating Income (Loss)	(8)	308	223	14,291	–	14,814
Equity in earnings of unconsolidated businesses	6,698	23	–	276	(6,308)	689
Income from other unconsolidated businesses	35	–	–	57	–	92
Other income and (expense), net	502	(4)	6	141	(408)	237
Interest expense	(58)	(172)	(63)	(1,905)	18	(2,180)
Minority interest	–	–	–	(3,045)	–	(3,045)
Income before provision for income taxes	7,169	155	166	9,815	(6,698)	10,607
Income tax benefit (provision)	228	(40)	(62)	(3,336)	–	(3,210)
Net Income	\$ 7,397	\$ 115	\$ 104	\$ 6,479	\$ (6,698)	\$ 7,397

notes to consolidated financial statements continued

(dollars in millions)

Condensed Consolidating Statements of Income Year Ended December 31, 2004	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	\$ —	\$ 3,955	\$ 934	\$ 66,756	\$ (362)	\$ 71,283
Operating expenses	260	3,664	717	53,887	(362)	58,166
Operating Income (Loss)	(260)	291	217	12,869	—	13,117
Equity in earnings of unconsolidated businesses	7,714	59	—	1,438	(7,520)	1,691
Income from other unconsolidated businesses	—	—	—	75	—	75
Other income and (expense), net	171	8	7	38	(202)	22
Interest expense	(20)	(165)	(63)	(2,144)	8	(2,384)
Minority interest	—	—	—	(2,409)	—	(2,409)
Income before provision for income taxes and discontinued operations	7,605	193	161	9,867	(7,714)	10,112
Income tax benefit (provision)	229	(50)	(34)	(2,996)	—	(2,851)
Income Before Discontinued Operations	7,834	143	127	6,871	(7,714)	7,261
Gain (loss) on discontinued operations, net of tax	(3)	—	—	573	—	570
Net Income	\$ 7,831	\$ 143	\$ 127	\$ 7,444	\$ (7,714)	\$ 7,831

(dollars in millions)

Condensed Consolidating Statements of Income Year Ended December 31, 2003	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	\$ —	\$ 4,102	\$ 951	\$ 62,692	\$ (277)	\$ 67,468
Operating expenses	562	4,148	808	54,820	(277)	60,061
Operating Income (Loss)	(562)	(46)	143	7,872	—	7,407
Equity in earnings (loss) of unconsolidated businesses	3,176	(42)	—	1,272	(3,128)	1,278
Income (loss) from other unconsolidated businesses	(10)	—	—	341	—	331
Other income and (expense), net	75	(1)	2	(3)	(36)	37
Interest expense	(78)	(160)	(64)	(2,483)	(12)	(2,797)
Minority interest	—	—	—	(1,583)	—	(1,583)
Income (loss) before provision for income taxes, discontinued operations and cumulative effect of accounting change	2,601	(249)	81	5,416	(3,176)	4,673
Income tax benefit (provision)	476	82	(32)	(1,739)	—	(1,213)
Income (Loss) Before Discontinued Operations And Cumulative Effect Of Accounting Change	3,077	(167)	49	3,677	(3,176)	3,460
Loss on discontinued operations, net of tax	—	—	—	(886)	—	(886)
Cumulative effect of accounting change, net of tax	—	369	47	87	—	503
Net Income	\$ 3,077	\$ 202	\$ 96	\$ 2,878	\$ (3,176)	\$ 3,077

notes to consolidated financial statements continued

(dollars in millions)

Condensed Consolidating Balance Sheets At December 31, 2005

	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	\$ —	\$ —	\$ —	\$ 776	\$ —	\$ 776
Short-term investments	—	216	32	2,250	—	2,498
Accounts receivable, net	20	910	142	9,429	(1,330)	9,171
Other current assets	9,365	166	185	3,784	(9,497)	4,003
Total current assets	9,385	1,292	359	16,239	(10,827)	16,448
Plant, property and equipment, net	1	6,146	1,158	68,000	—	75,305
Investments in unconsolidated businesses	32,593	116	—	10,017	(38,122)	4,604
Other assets	532	472	390	70,609	(230)	71,773
Total Assets	\$ 42,511	\$ 8,026	\$ 1,907	\$ 164,865	\$ (49,179)	\$ 168,130
Debt maturing within one year	\$ 22	\$ 471	\$ —	\$ 16,452	\$ (9,804)	\$ 7,141
Other current liabilities	2,511	1,049	176	15,209	(1,023)	17,922
Total current liabilities	2,533	1,520	176	31,661	(10,827)	25,063
Long-term debt	92	2,702	901	28,404	(230)	31,869
Employee benefit obligations	205	1,892	254	16,468	—	18,819
Deferred income taxes	—	537	220	21,654	—	22,411
Other liabilities	1	146	27	3,360	—	3,534
Minority interest	—	—	—	26,754	—	26,754
Total shareowners' investment	39,680	1,229	329	36,564	(38,122)	39,680
Total Liabilities and Shareowners' Investment	\$ 42,511	\$ 8,026	\$ 1,907	\$ 164,865	\$ (49,179)	\$ 168,130

(dollars in millions)

Condensed Consolidating Balance Sheets At December 31, 2004

	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	\$ —	\$ —	\$ —	\$ 2,290	\$ —	\$ 2,290
Short-term investments	—	187	33	2,037	—	2,257
Accounts receivable, net	6	913	151	9,751	(1,020)	9,801
Other current assets	7,632	151	123	4,985	(7,760)	5,131
Total current assets	7,638	1,251	307	19,063	(8,780)	19,479
Plant, property and equipment, net	1	6,444	1,204	66,475	—	74,124
Investments in unconsolidated businesses	32,191	116	—	9,639	(36,091)	5,855
Other assets	408	488	374	65,460	(230)	66,500
Total Assets	\$ 40,238	\$ 8,299	\$ 1,885	\$ 160,637	\$ (45,101)	\$ 165,958
Debt maturing within one year	\$ 31	\$ 168	\$ —	\$ 11,222	\$ (7,828)	\$ 3,593
Other current liabilities	2,372	1,217	181	16,718	(952)	19,536
Total current liabilities	2,403	1,385	181	27,940	(8,780)	23,129
Long-term debt	113	2,966	901	31,924	(230)	35,674
Employee benefit obligations	160	1,940	235	15,606	—	17,941
Deferred income taxes	—	571	249	21,712	—	22,532
Other liabilities	2	253	34	3,780	—	4,069
Minority interest	—	—	—	25,053	—	25,053
Total shareowners' investment	37,560	1,184	285	34,622	(36,091)	37,560
Total Liabilities and Shareowners' Investment	\$ 40,238	\$ 8,299	\$ 1,885	\$ 160,637	\$ (45,101)	\$ 165,958

notes to consolidated financial statements continued

(dollars in millions)

Condensed Consolidating Statements of Cash Flows Year Ended December 31, 2005	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	\$ 7,605	\$ 831	\$ 284	\$ 20,229	\$ (6,937)	\$ 22,012
Net cash from investing activities	(913)	(784)	(221)	(16,343)	(231)	(18,492)
Net cash from financing activities	(6,692)	(47)	(63)	(5,400)	7,168	(5,034)
Net Decrease in Cash	\$ -	\$ -	\$ -	\$ (1,514)	\$ -	\$ (1,514)

(dollars in millions)

Condensed Consolidating Statements of Cash Flows Year Ended December 31, 2004	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	\$ 6,650	\$ 1,219	\$ 282	\$ 20,133	\$ (6,464)	\$ 21,820
Net cash from investing activities	-	(655)	(75)	(9,559)	(54)	(10,343)
Net cash from financing activities	(6,650)	(564)	(207)	(8,953)	6,518	(9,856)
Net Increase in Cash	\$ -	\$ -	\$ -	\$ 1,621	\$ -	\$ 1,621

(dollars in millions)

Condensed Consolidating Statements of Cash Flows Year Ended December 31, 2003	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	\$ 8,763	\$ 1,304	\$ 283	\$ 20,630	\$ (8,513)	\$ 22,467
Net cash from investing activities	-	(628)	(229)	(11,506)	127	(12,236)
Net cash from financing activities	(8,763)	(676)	(54)	(9,852)	8,386	(10,959)
Net Decrease in Cash	\$ -	\$ -	\$ -	\$ (728)	\$ -	\$ (728)

NOTE 22

COMMITMENTS AND CONTINGENCIES

Several state and federal regulatory proceedings may require our telephone operations to pay penalties or to refund to customers a portion of the revenues collected in the current and prior periods. There are also various legal actions pending to which we are a party and claims which, if asserted, may lead to other legal actions. We have established reserves for specific liabilities in connection with regulatory and legal actions, including environmental matters, that we currently deem to be probable and estimable. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods, including the Hicksville matters described below, will have a material effect on our financial condition, but it could have a material effect on our results of operations.

During 2003, under a government-approved plan, remediation commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. As a result, an additional environmental remediation expense of \$240 million was recorded in Selling, General and Administrative Expense in the consolidated statements of income in 2003, for remedial activities likely to take place over the next several years. In September 2005, the Army Corps of Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for remedial work at the Hicksville site, an adjustment to this reserve may be made. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the sites requiring remediation.

There are also litigation matters associated with the Hicksville site primarily involving personal injury claims in connection with alleged emissions arising from operations in the 1950s and 1960s at the Hicksville site. These matters are in various stages, and no trial date has been set.

In connection with the execution of agreements for the sales of businesses and investments, Verizon ordinarily provides representations and warranties to the purchasers pertaining to a variety of nonfinancial matters, such as ownership of the securities being sold, as well as financial losses.

Subsequent to the sale of Verizon Information Services Canada (see Note 3), our Information Services segment continues to provide a guarantee to publish directories, which was issued when the directory business was purchased in 2001 and had a 30-year term (before extensions). The preexisting guarantee continues, without modification, following the sale of Verizon Information Services Canada. The possible financial impact of the guarantee, which is not expected to be adverse, cannot be reasonably estimated since a variety of the potential outcomes available under the guarantee result in costs and revenues or benefits that may offset. In addition, performance under the guarantee is not likely.

As of December 31, 2005, letters of credit totaling \$140 million had been executed in the normal course of business, which support several financing arrangements and payment obligations to third parties.

We have several commitments primarily to purchase network services, equipment and software from a variety of suppliers totaling \$669 million. Of this total amount, \$486 million, \$110 million, \$41 million, \$18 million, \$4 million and \$10 million are expected to be purchased in 2006, 2007, 2008, 2009, 2010 and thereafter, respectively.

notes to consolidated financial statements continued

NOTE 23

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(dollars in millions, except per share amounts)

Quarter Ended	Operating Revenues	Operating Income	Income Before Discontinued Operations			Net Income
			Amount	Per Share-Basic	Per Share-Diluted	
2005						
March 31	\$ 18,179	\$ 3,382	\$ 1,757	\$.63	\$.63	\$ 1,757
June 30^(a)	18,569	4,092	2,113	.76	.75	2,113
September 30^(b)	19,038	3,633	1,869	.68	.67	1,869
December 31	19,326	3,707	1,658	.60	.59	1,658
2004						
March 31^(c)	\$ 17,056	\$ 2,466	\$ 1,183	\$.43	\$.42	\$ 1,199
June 30	17,758	3,701	1,782	.64	.64	1,797
September 30	18,206	3,597	1,779	.64	.64	1,796
December 31^(d)	18,263	3,353	2,517	.91	.90	3,039

- (a) Results of operations for the second quarter of 2005 include a \$336 million net after-tax gain on the sale of our wireline and directory businesses in Hawaii, tax benefits of \$242 million associated with prior investment losses and a net tax provision of \$232 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004.
- (b) Results of operations for the third quarter of 2005 include an impairment charge of \$125 million pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties.
- (c) Results of operations for the first quarter of 2004 include a \$446 million after-tax charge for severance and related pension settlement benefits.
- (d) Results of operations for the fourth quarter of 2004 include a \$500 million net after-tax gain on the sale of an investment and \$234 million of tax benefits associated with prior investment losses.

Income before discontinued operations per common share is computed independently for each quarter and the sum of the quarters may not equal the annual amount.

NOTE 24

SUBSEQUENT EVENTS (UNAUDITED)

MCI Merger

On February 14, 2005, Verizon announced that it had agreed to acquire MCI for a combination of Verizon common shares and cash (including MCI dividends). On May 2, 2005, Verizon announced that it agreed with MCI to further amend its agreement to acquire MCI for cash and stock of at least \$26.00 per share, consisting of cash of \$5.60, which was paid as a special dividend by MCI on October 27, 2005, after the October 6, 2005 approval of the transaction by MCI shareholders, plus the greater of .5743 Verizon shares for each MCI common share or a sufficient number of Verizon shares to deliver to shareholders \$20.40 of value. Under this price protection feature, Verizon had the option of paying additional cash instead of issuing additional shares over the .5743 exchange ratio. This consideration was subject to adjustment at closing and may have been decreased based on MCI's bankruptcy claims-related experience and international tax liabilities. The merger received the required state, federal and international regulatory approvals by year-end 2005, and on January 6, 2006, Verizon and MCI closed the merger.

Under terms of the merger agreement, MCI shareholders received .5743 shares of Verizon and cash for each of their MCI shares. Verizon elected to make a supplemental cash payment of \$2.738 per MCI share, \$779 million in the aggregate, rather than issue additional shares of Verizon common stock, so that the merger consideration was equal to at least \$20.40 per MCI share. Verizon and MCI management mutually agreed that there was no purchase price adjustment related to the amount of MCI's bankruptcy claims-related experience and international tax liabilities.

Redemption of MCI Debt

On January 17, 2006, Verizon announced offers to purchase two series of MCI senior notes, MCI \$1,983 million aggregate principal amount of 6.688% Senior Notes Due 2009 and MCI \$1,699 million aggregate principal amount of 7.735% Senior Notes Due 2014, at 101% of their par value. Due to the change in control of MCI that occurred in connection with the merger with Verizon on January 6, 2006, Verizon is required to make this offer to noteholders within 30 days of the closing of the merger of MCI and Verizon. Separately, Verizon notified noteholders that MCI is exercising its right to redeem both series of Senior Notes prior to maturity under the optional redemption procedures provided in the indentures. The 6.688% Notes were redeemed on March 1, 2006, and the 7.735% Notes were redeemed on February 16, 2006.

In addition, on January 20, 2006, Verizon announced an offer to repurchase MCI \$1,983 million aggregate principal amount of 5.908% Senior Notes Due 2007 at 101% of their par value. On February 21, 2006, \$1,804 million of these notes were redeemed by Verizon. Verizon satisfied and discharged the indenture governing this series of notes shortly after the close of the offer for those noteholders who did not accept this offer.

Issuance of Debt

In February 2006, Verizon issued \$4,000 million of floating rate and fixed rate notes maturing from 2007 through 2035.

board of directors

James R. Barker

Chairman

The Interlake Steamship Co. and
New England Fast Ferry Co.
and *Vice Chairman*
Mormac Marine Group, Inc. and
Moran Towing Corporation

Richard L. Carrión

Chairman, President and

Chief Executive Officer

Popular, Inc.

and *Chairman and*

Chief Executive Officer

Banco Popular de Puerto Rico

Robert W. Lane

Chairman and Chief Executive Officer

Deere & Company

Sandra O. Moose

President

Strategic Advisory Services LLC

Joseph Neubauer

Chairman and Chief Executive Officer

ARAMARK Corporation

Donald T. Nicolaisen

Former Chief Accountant

United States Securities and

Exchange Commission

Thomas H. O'Brien

*Retired Chairman and Chief Executive
Officer*

The PNC Financial Services Group, Inc.
and PNC Bank, N.A.

Clarence Otis, Jr.

Chairman and Chief Executive Officer

Darden Restaurants, Inc.

Hugh B. Price

Senior Fellow

Brookings Institution

Ivan G. Seidenberg

Chairman and

Chief Executive Officer

Verizon Communications Inc.

Walter V. Shipley

Retired Chairman

The Chase Manhattan Corporation

John R. Stafford

Retired Chairman of the Board

Wyeth

Robert D. Storey

Retired Partner

Thompson Hine LLP

corporate officers and executive leadership

Ivan G. Seidenberg

Chairman and

Chief Executive Officer

Lawrence T. Babbio, Jr.

Vice Chairman and President –

Domestic Telecom

Dennis F. Strigl

Executive Vice President and President

and Chief Executive Officer –

Verizon Wireless

Doreen A. Toben

Executive Vice President and

Chief Financial Officer

William P. Barr

Executive Vice President and

General Counsel

John W. Diercksen

Executive Vice President –

Strategy, Development and Planning

Marc C. Reed

Executive Vice President –

Human Resources

Thomas J. Tauke

Executive Vice President –

Public Affairs, Policy and Communications

Thomas A. Bartlett

Senior Vice President and Controller

Marianne Drost

Senior Vice President, Deputy General

Counsel and Corporate Secretary

Ronald H. Lataille

Senior Vice President – Investor Relations

Joleen D. Moden

Senior Vice President – Internal Auditing

Catherine T. Webster

Senior Vice President and Treasurer

Katherine J. Harless

President – Information Services

John F. Killian

President – Verizon Business

Daniel C. Petri

President – International

investor information

Registered Shareowner Services

Questions or requests for assistance regarding changes to or transfers of your registered stock ownership should be directed to our transfer agent, Computershare Trust Company, N.A. at:

Verizon Communications Shareowner Services
c/o Computershare
P.O. Box 43005
Providence, RI 02940-3005
Phone: 800 631-2355
Website: www.verizon.equiserve.com
Email: verizon@computershare.com

Persons outside the U.S. may call: 816 843-4284

Persons using a telecommunications device for the deaf (TDD) may call: 800 524-9955

On-line Account Access – Registered shareowners can view account information on-line at: www.verizon.equiserve.com

You will need your account number, a password and taxpayer identification number to enroll. For more information, contact Computershare.

Electronic Delivery of Proxy Materials – Registered shareowners can receive their Annual Report, Proxy Statement and Proxy Card on-line, instead of receiving printed materials by mail. Enroll at www.verizon.equiserve.com

Direct Dividend Deposit Service – Verizon offers an electronic funds transfer service to registered shareowners wishing to deposit dividends directly into savings or checking accounts on dividend payment dates. For more information, contact Computershare.

Direct Invest Stock Purchase and Ownership Plan – Verizon offers a direct stock purchase and share ownership plan. The plan allows current and new investors to purchase common stock and to reinvest the dividends toward the purchase of additional shares. To receive a Plan Prospectus and enrollment form, contact Computershare or visit their website.

Corporate Governance

Verizon's Corporate Governance Guidelines are available on our website – www.verizon.com/investor

If you would prefer to receive a printed copy in the mail, please contact the Assistant Corporate Secretary:

Verizon Communications Inc.
Assistant Corporate Secretary
140 West Street, 29th Floor
New York, NY 10007

Equal Opportunity Policy

The company maintains a long-standing commitment to equal opportunity and valuing the diversity of its employees, suppliers and customers. Verizon is fully committed to a workplace free from discrimination and harassment for all persons, without regard to race, color, religion, age, gender, national origin, sexual orientation, marital status, citizenship status, veteran status, disability or other protected classifications.

Investor Services

Investor Website – Get company information and news on our website – www.verizon.com/investor

VZ Mail – Get the latest investor information delivered directly to your computer desktop. Subscribe to VzMail at our investor information website.

Stock Market Information

Shareowners of record at December 31, 2005: 947,767

Verizon is listed on the New York Stock Exchange (ticker symbol: VZ)

Also listed on the Philadelphia, Boston, Chicago, Pacific, London, Swiss, Amsterdam and Frankfurt exchanges.

Common Stock Price and Dividend Information

	Market Price		Cash Dividend Declared
	High	Low	
2005			
First Quarter	\$ 41.06	\$ 34.38	\$ 0.405
Second Quarter	36.25	33.71	0.405
Third Quarter	34.97	31.65	0.405
Fourth Quarter	32.78	29.13	0.405
2004			
First Quarter	\$ 39.54	\$ 35.08	\$ 0.385
Second Quarter	38.20	34.25	0.385
Third Quarter	41.01	34.13	0.385
Fourth Quarter	42.27	38.26	0.385

Form 10-K

To receive a copy of the 2005 Verizon Annual Report on Form 10-K, which is filed with the Securities and Exchange Commission, contact Investor Relations:

Verizon Communications Inc.
Investor Relations
One Verizon Way
Basking Ridge, NJ 07920
Phone: 212 395-1525

Certifications Regarding Public Disclosures & Listing Standards

The 2005 Verizon Annual Report on Form 10-K filed with the Securities and Exchange Commission includes the certifications required by Section 302 of the Sarbanes-Oxley Act regarding the quality of the company's public disclosure. In addition, the annual certification of the chief executive officer regarding compliance by Verizon with the corporate governance listing standards of the New York Stock Exchange was submitted without qualification following the 2005 annual meeting of shareholders.

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New York, New York 10007
212 395-2121



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