ATTACHMENT 3

Verizon NW's response to Staff Data Request No. 207a, Verizon NW Inc. Financial Statements

Verizon Response to WUTC Staff Data Request No. 207
UT-040788

Attachment 207a

Verizon Northwest Inc.

Financial Statements
As of December 31, 2003 and 2002
and for the years then ended

Verizon Northwest Inc.

Index to Financial Statements

Verizon Northwest Inc.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareowner
Verizon Northwest Inc.

We have audited the accompanying consolidated balance sheets of Verizon Northwest Inc. (the Company) as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in shareowner's investment, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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 Northwest Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussion in Note 2 to the consolidated financial statements, Verizon Northwest Inc. changed its method of accounting for asset retirement obligations effective January 1, 2003.

Ernst + Young LLP

New York, New York

January 29, 2004

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31
(Dollars in Millions)

	2003	2002
OPERATING REVENUES	$1,163.3	$1,201.0
OPERATING EXPENSES		
Cost of services and sales (exclusive of items shown below)	344.6	319.7
Selling, general and administrative expense	420.7	315.6
Depreciation expense	237.4	249.0
TOTAL OPERATING EXPENSES	1,002.7	884.3
OPERATING INCOME	160.6	316.7
OTHER INCOME AND (EXPENSE), NET	1.1	.4
INTEREST EXPENSE	(39.3)	(44.6)
INCOME BEFORE PROVISION FOR INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	122.4	272.5
PROVISION FOR INCOME TAXES	(44.6)	(98.2)
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	77.8	174.3
CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF TAX	71.2	---
NET INCOME	$ 149.0	$ 174.3

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

ASSETS

	December 31 2003	December 31 2002
CURRENT ASSETS		
Short-term investments	$ 41.1	$ 33.9
Note receivable from affiliate	13.9	---
Accounts receivable:		
Trade and other, net of allowances for uncollectibles of $33.3 and $44.9	152.9	163.0
Affiliates	16.0	20.3
Material and supplies	14.1	11.0
Prepaid expenses	9.1	3.3
Deferred income taxes	2.1	7.3
Other	25.0	25.9
Total current assets	274.2	264.7
PLANT, PROPERTY AND EQUIPMENT	4,214.9	4,148.0
Less accumulated depreciation	2,614.3	2,600.2
	1,600.6	1,547.8
PREPAID PENSION ASSET	285.3	319.0
OTHER ASSETS	44.7	54.4
TOTAL ASSETS	$2,204.8	$2,185.9

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

LIABILITIES AND SHAREOWNER'S INVESTMENT

	December 31 2003	December 31 2002
CURRENT LIABILITIES		
Debt maturing within one year:		
Notes payable to affiliates	$ 240.5	$ 229.3
Other	.9	.9
Accounts payable and accrued liabilities:		
Affiliates	102.1	80.9
Other	92.4	87.5
Other current liabilities	90.7	77.8
Total current liabilities	526.6	476.4
LONG-TERM DEBT	563.4	563.8
EMPLOYEE BENEFIT OBLIGATIONS	87.4	72.8
DEFERRED CREDITS AND OTHER LIABILITIES		
Deferred income taxes	305.8	263.6
Other	42.8	57.7
	348.6	321.3
SHAREOWNER'S INVESTMENT		
Common stock (one share, without par value)	448.0	448.0
Contributed capital	165.8	165.8
Reinvested earnings	65.0	137.8
Total shareowner's investment	678.8	751.6
TOTAL LIABILITIES AND SHAREOWNER'S INVESTMENT	$2,204.8	$2,185.9

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNER'S INVESTMENT
For the Years Ended December 31
(Dollars in Millions)

	2003	2002
COMMON STOCK		
Balance at beginning of year	$448.0	$448.0
Balance at end of year	448.0	448.0
CONTRIBUTED CAPITAL		
Balance at beginning of year	165.8	155.9
Capital contribution from parent	—	9.9
Balance at end of year	165.8	165.8
REINVESTED EARNINGS		
Balance at beginning of year	137.8	98.5
Net income	149.0	174.3
Dividends declared	(221.8)	(135.0)
Balance at end of year	65.0	137.8
TOTAL SHAREOWNER'S INVESTMENT	$678.8	$751.6

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31
(Dollars in Millions)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before cumulative effect of accounting change	$ 77.8	$ 174.3
Adjustments to reconcile income before cumulative effect of accounting change to net cash provided by operating activities:		
Depreciation	237.4	249.0
Deferred income taxes, net	6.1	28.6
Employee retirement benefits	65.8	(8.4)
Provision for uncollectible accounts	5.2	46.2
Changes in current assets and liabilities:		
Accounts receivable	9.2	(4.6)
Material and supplies	(3.1)	4.9
Other current assets	(4.9)	2.5
Accounts payable and accrued liabilities	26.1	(44.9)
Other current liabilities	12.9	(1.9)
Other, net	(21.2)	(20.3)
Net cash provided by operating activities	411.3	425.4
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures (including capitalized network software)	(178.7)	(232.5)
Purchases of short-term investments	(41.1)	(33.9)
Proceeds from sale of short-term investments	33.9	34.2
Investment in unconsolidated business	---	(9.7)
Net change in note receivable from affiliate	(13.9)	---
Other, net	---	(.2)
Net cash used in investing activities	(199.8)	(242.1)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal repayments of borrowings and capital lease obligations	(.9)	(.9)
Net change in notes payable to affiliates	11.2	(57.4)
Dividends paid	(221.8)	(135.0)
Capital contribution from parent	---	9.9
Net cash used in financing activities	(211.5)	(183.4)
NET CHANGE IN CASH	---	(.1)
CASH, BEGINNING OF YEAR	---	.1
CASH, END OF YEAR	$ ---	$ ---

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Verizon Northwest Inc. is a wholly owned subsidiary of GTE Corporation (GTE), which is a wholly owned subsidiary of Verizon Communications Inc. (Verizon). We presently serve a territory consisting of Local Access and Transport Areas (LATAs) located in California, Idaho, Oregon and Washington. We have one reportable segment which provides domestic wireline telecommunications services. We currently provide two basic types of telecommunications services:

- *Exchange telecommunication service* is the transmission of telecommunications among customers located within a local calling area within a LATA. Examples of exchange telecommunications services include switched local residential and business services, local private line voice and data services and Centrex services. We also provide toll services within a LATA (intraLATA long distance).

- *Exchange access service* links a customer's premises and the transmission facilities of other telecommunications carriers, generally interLATA carriers. Examples of exchange access services include switched access and special access services.

The communications services we provide are subject to regulation by the state regulatory commissions of California, Idaho, Oregon and Washington with respect to intrastate rates and services and other matters. The Federal Communications Commission (FCC) regulates rates that we charge long distance carriers and end-user subscribers for interstate access services.

Basis of Presentation

We prepare our financial statements using generally accepted accounting principles 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 intangibles and other long-lived assets, valuation allowances on tax assets and pension and postretirement benefit assumptions.

The consolidated financial statements include the accounts of Verizon Northwest Inc. and its wholly owned subsidiary, Verizon West Coast Inc. All significant intercompany accounts and transactions have been eliminated.

We held an investment in Verizon Ventures III Inc. (Ventures III), an affiliated company which provided new exchange access services through a separate subsidiary, and was accounted for using the equity method of accounting. At December 31, 2003 and 2002, we had no investment in Ventures III (see Note 11).

We have reclassified certain amounts from prior periods to conform with our current presentation.

Revenue Recognition

We recognize service revenues based upon usage of our local exchange 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 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.

Maintenance and Repairs

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

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

Material and Supplies

We include in inventory new and reusable materials which are stated principally at average original cost, except that specific costs are used in the case of large individual items.

Plant and Depreciation

We record plant, property, and equipment at cost. 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 (if any), over the remaining asset lives. This method requires the periodic revision of depreciation rates. We used the following asset lives:

Average Lives (in years)	
Buildings	25 – 35
Central office equipment	5 – 12
Outside communications plant	16 – 50
Furniture, vehicles and other	3 – 15

When we replace or retire depreciable telephone plant, we deduct the carrying amount of such plant from the respective accounts and charge it to accumulated depreciation. (See "Accounting Changes – Asset Retirement Obligations" below.)

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.

Impairment of Long-Lived Assets

Our plant, property, and equipment are reviewed for impairment in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which we adopted effective January 1, 2002. Under SFAS No. 144, these assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. An impairment charge is recognized for the amount (if any) by which the carrying value of the asset exceeds its fair value.

Computer Software Costs

We capitalize the cost of internal-use 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 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.

Goodwill and Other Intangible Assets

Effective January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under prescribed conditions) for impairment in accordance with this statement. Intangible assets that do not have indefinite lives are amortized over their useful lives. The adoption of SFAS No. 142 did not impact our results of operations or financial position because we had no goodwill or indefinite-lived intangible assets at December 31, 2003 and 2002.

Advertising Costs

We expense advertising costs as they are incurred.

Stock-Based Compensation

We participate in employee compensation plans sponsored by Verizon with awards of Verizon common stock.

Prior to 2003, Verizon accounted for stock-based employee compensation under Accounting Principles Board (APB) 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, Verizon 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 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).

Employee Benefit Plans

We participate in the Verizon benefit plans. Under these 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.

Income Taxes

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

Current and deferred tax expense is determined by applying the provisions of SFAS No. 109, "Accounting for Income Taxes" to each subsidiary as if it were a separate taxpayer.

Derivative Instruments

We employ risk management strategies to manage our exposure to fluctuations in interest rates. 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 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.

Comprehensive Income

We had no comprehensive income components for the years ended December 31, 2003 and 2002. Therefore, comprehensive income is the same as net income for both years.

2. ACCOUNTING CHANGES

Stock-Based Compensation
We participate in employee compensation plans sponsored by Verizon with awards of Verizon common stock. 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 net income if the fair value method had been applied to all outstanding and unvested options in each period.

(Dollars in Millions)	Years ended December 31 2003	2002
Net Income, As Reported	$149.0	$174.3
Add: Stock option-related employee compensation expense included in reported net income, net of related tax effects	.1	---
Deduct: Total stock option-related employee compensation expense determined under fair value based method for all awards, net of related tax effects	(.4)	(2.2)
Pro Forma Net Income	$148.7	$172.1

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2003 and 2002 was not material.

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 8.

Asset Retirement Obligations
Effective January 1, 2003, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." This standard provides the accounting for the cost of legal obligations associated with the retirement of long-lived assets. 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 have determined that we do 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. These costs have increased depreciation expense and accumulated depreciation for future removal costs for existing assets. These removal costs were recorded as a reduction to accumulated depreciation when the assets were retired and removal costs were incurred.

For some assets, such as telephone poles, the removal costs exceeded salvage value. Under the provisions of SFAS No. 143, we are required to exclude costs of removal from our depreciation rates for assets for which the removal costs exceed salvage. Accordingly, in connection with the initial adoption of this standard on January 1, 2003, we have 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 $112.5 million ($71.2 million after-tax). Effective January 1, 2003, we began expensing costs of removal in excess of salvage for these assets as incurred. The ongoing impact of this change in accounting resulted in a decrease in depreciation expense and an increase in cost of services and sales, which was not material to our total operating expenses for the year ended December 31, 2003.

Debt Extinguishment
In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other things, eliminates the requirement that all gains and losses on the extinguishment of debt must be classified as extraordinary items on the income statement, thereby permitting the classification of such gains and losses as extraordinary items only if they meet the criteria of APB Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." We adopted this provision of SFAS No. 145 effective January 1, 2003 and, upon adoption, reclassified the losses on the early extinguishment of debt and related tax benefits that were previously reported in our statements of income as extraordinary items to Other income and (expense) and Provision for income taxes.

3. PLANT, PROPERTY AND EQUIPMENT

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

	December 31	
(Dollars in Millions)	**2003**	**2002**
Land	$ 12.7	$ 12.8
Buildings	295.6	286.2
Central office equipment	1,700.8	1,670.1
Outside communications plant	1,971.9	1,918.6
Furniture, vehicles and other work equipment	164.9	194.9
Construction-in-progress	22.8	18.2
Other	46.2	47.2
	4,214.9	4,148.0
Accumulated depreciation	(2,614.3)	(2,600.2)
Total	$ 1,600.6	$ 1,547.8

See "Accounting Changes – Asset Retirement Obligations" in Note 2.

4. LEASES

We lease certain facilities and equipment for use in our operations under both capital and operating leases. There were no initial capital lease obligations in 2003 and 2002.

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

	December 31	
(Dollars in Millions)	**2003**	**2002**
Capital leases	$2.0	$2.0
Accumulated amortization	(.2)	(.1)
Total	$1.8	$1.9

Total rent expense amounted to $60.8 million in 2003 and $52.8 million in 2002. Of these amounts, $39.0 million in 2003 and $27.8 million in 2002 were lease payments to affiliated companies for land and buildings.

This table displays the aggregate minimum rental commitments under noncancelable operating leases for the periods shown at December 31, 2003:

(Dollars in Millions) **Years**	
2004	$3.1
2005	2.9
2006	1.6
2007	.9
2008	.3
Thereafter	.3
Total minimum rental commitments	$9.1

5. DEBT

Debt Maturing Within One Year

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

(Dollars in Millions)	2003	2002
Notes payable to affiliates:		
VNFC	$240.5	$124.3
GTE Funding	---	105.0
Long-term debt maturing within one year	.9	.9
Total debt maturing within one year	$241.4	$230.2
Weighted average interest rate for notes payable outstanding at year-end	1.1%	1.6%

We have a contractual agreement with an affiliated company Verizon Network Funding Corp. (VNFC), for the provision of short-term financing and cash management services. VNFC issues commercial paper and obtains bank loans to fund the working capital requirements of Verizon's network services subsidiaries, including us, and invests funds in temporary investments on their behalf. During 2002 and 2003, we also obtained short-term financing from an affiliated company, GTE Funding Incorporated (GTE Funding).

Long-Term Debt

Long-term debt consists principally of debentures that we have issued. Interest rates and maturities of the amounts outstanding are as follows at December 31:

Description	Interest Rate	Maturity	2003	2002
			(Dollars in Millions)	
Ten year debenture	5.55 %	2008	$200.0	$200.0
Twelve year debenture	6.3	2010	175.0	175.0
Thirty year debenture	7.875	2026	175.0	175.0
Twenty year first mortgage bond	9.67	2010	4.9	5.7
			554.9	555.7
Unamortized premium and discount, net			9.4	9.0
Total long-term debt, including current maturities			564.3	564.7
Less maturing within one year			(.9)	(.9)
Total long-term debt			$563.4	$563.8

The aggregate principal amount of bonds and debentures that may be issued is subject to the restrictions and provisions of our indentures. None of the securities shown above were held in sinking or other special funds or pledged by us. Debt discounts and premiums on our outstanding long-term debt are amortized over the lives of the respective issues. Substantially all of our property is subject to the lien of our mortgage bond indenture securing funded debt.

We are in compliance with all of our debt covenants.

Maturities of long-term debt outstanding at December 31, 2003, excluding unamortized discount and premium are as follows:

(Dollars in Millions) Years	
2004	$ .9
2005	.9
2006	.9
2007	.9
2008	200.9
Thereafter	350.4
Total long-term debt outstanding	$554.9

6. FINANCIAL INSTRUMENTS

Derivatives

We did not have any derivatives as of December 31, 2003 and 2002. Consequently, SFAS No. 133 did not have an impact on our results of operations or financial position.

Concentrations of Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of short-term investments and trade receivables. Concentrations of credit risk with respect to trade receivables, other than those from AT&T, are limited due to the large number of customers. We generated revenues from services provided to AT&T (primarily network access and billing and collection) of $42.4 million in 2003 and $52.1 million in 2002.

While we may be exposed to credit losses due to the nonperformance of our counterparties, we consider this risk remote and do not expect the settlement of these transactions to have a material effect on our results of operations or financial position.

Note Receivable

The Financial Services Agreement between GTE Funding and us specifies that we are permitted to borrow or advance funds on a day-to-day (demand) basis to finance our ordinary business and capital requirements. Since these borrowings and advances are based on a variable interest rate and demand note basis the carrying value of the notes approximates its fair market value. As of December 31, 2003, we had a note receivable from GTE Funding for $13.9 million.

Fair Values of Financial Instruments

The table below provides additional information about our material financial instruments at December 31:

Financial Instrument	Valuation Method
Short-term note receivable from (GTE Funding)	Carrying amounts
Short-term notes payable to affiliates (VNFC and GTE Funding) and short-term investments	Carrying amounts
Debt (excluding capital leases)	Future cash flows discounted at current rates

	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in Millions)			
Short-term note receivable from (GTE Funding)	$ 13.9	$ 13.9	---	---
Debt and notes payable to affiliates	$804.8	$852.5	$794.0	$840.8

7. COMMON STOCK

On August 12, 2002, pursuant to an amendment to our Restated Articles of Incorporation, we exchanged all of our issued and outstanding shares of Common Stock, without par value, for one share of Common Stock, without par value.

8. STOCK INCENTIVE PLANS

Stock-option related employee compensation expense for 2003 grants and the pro forma amounts for prior years (see Note 2) were determined using the Black-Scholes option-pricing model based on the following weighted-average assumptions:

	2003	2002
Dividend yield	4.0%	3.2%
Expected volatility	30.9%	28.5%
Risk-free interest rate	3.4%	4.6%
Expected lives (in years)	6	6

The weighted-average value of options granted during 2003 and 2002 was $8.41 and $12.11, respectively.

Beginning in 2003, stock option grants to some levels of management were reduced, and accompanied by performance-based share awards.

The structure of Verizon's stock incentive plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2003.

9. EMPLOYEE BENEFITS

We participate in Verizon's benefit plans. Verizon maintains noncontributory defined benefit pension plans for many of our management and associate 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 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.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2003.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits for the majority of our employees are subject to collective bargaining agreements. Approximately 85% of our employees (associates) are covered by collective bargaining agreements. Modifications in benefits have been bargained from time to time, and Verizon may also periodically amend the benefits in the management plans.

Benefit Cost

			Years ended December 31	
	Pension		Health Care and Life	
(Dollars in Millions)	2003	2002	2003	2002
Net periodic benefit (income) cost	$(15.8)	$(30.2)	$19.8	$16.3
Termination benefits	32.2	.6	12.3	---
Settlement loss	18.8	4.9	---	---
Curtailment gain	(1.5)	---	---	---
Subtotal	49.5	5.5	12.3	---
Total (income) cost	$ 33.7	$(24.7)	$32.1	$16.3

As part of a Verizon workforce reduction plan, we have continued to reduce our headcount as allowed under various management and associate employee benefit plans. As a result, we recorded $44.5 million and $.6 million in 2003 and 2002, respectively, in connection with various pension and retirement benefit enhancements. In additional, we recorded pension settlement losses of $18.8 million in 2003 and $4.9 million in 2002 as lump-sum payments exceeded the threshold of service and interest costs. Further, we recorded a curtailment gain of $(1.5) million in 2003 associated with a significant reduction of the expected years of future service of present employees, which was largely impacted by employee terminations in 2003. The special termination benefits and settlement of pension obligations are recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions."

Amounts recognized in the consolidated balance sheets consist of:

				December 31
	Pension		Health Care and Life	
(Dollars in Millions)	2003	2002	2003	2002
Prepaid pension asset	$285.3	$319.0	$ ---	$ ---
Employee benefit obligations	.5	.8	77.3	60.6

The changes in the employee benefit asset and obligations from year to year were caused by a number of factors, including changes in actuarial assumptions (see Assumptions), curtailments, settlements and special termination benefits.

Assumptions

The actuarial assumptions used are based on market interest rates, past experience, and management's best estimate of future economic conditions. Changes in these assumptions may impact future benefit costs and obligations.

The weighted-average assumptions used in determining benefit obligations at December 31,

	Pension		Health Care and Life	
	2003	2002	2003	2002
Discount rate	6.25%	6.75%	6.25%	6.75%
Rate of future increases in compensation	5.00	5.00	4.00	4.00

The weighted-average assumptions used in determining net periodic cost for years ended December 31,

	Pension		Health Care and Life	
	2003	2002	2003	2002
Discount rate	6.75%	7.25%	6.75%	7.25%
Expected return on plan assets	8.50	9.25	8.00	8.00
Rate of compensation increase	5.00	5.00	4.00	4.00

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: observable current market interest rates, consensus earnings expectations, historical long-term performance and value-added, and the use of conventional long-term risk premiums. 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 projected long-term results are then also compared to the investment return earned over the previous 10 years.

The assumed health care cost trend rates at December 31,

	Health Care and Life	
	2003	2002
Health care cost trend rate assumed for next year	10.00%	11.00%
Rate to which cost trend rate gradually declines	5.00%	5.00%
Year the rate reaches level it is assumed to remain thereafter	2008	2007

Medicare Drug Act

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Drug Act) was signed into law. The Medicare Drug Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Verizon sponsors several postretirement health care plans that provide prescription drug benefits that are deemed actuarially equivalent to the Medicare Part D and has elected to recognize the impact of the federal subsidy on their accumulated postretirement benefit obligation and net postretirement benefits costs. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could impact current accounting for the effects of the Medicare Drug Act.

Savings Plans and Employee Stock Ownership Plans

Substantially all of our employees are eligible to participate in savings plans maintained by Verizon. Verizon maintains a leveraged employee stock ownership plan (ESOP) for its management employees of the former GTE Companies. Under this plan, a certain percentage of eligible employee contributions are matched with shares of Verizon's common stock. Verizon recognizes leveraged ESOP cost based on the modified shares allocated method for this leveraged ESOP that purchased securities before December 15, 1989. We recognize savings plan cost based on our matching obligation attributed to our participating management employees. In addition to the ESOP, Verizon also maintains a savings plan for non-management employees. We recorded total savings plan costs of $5.1 million in 2003 and $5.4 million in 2002.

Severance Benefits

We maintain ongoing severance plans for both management and associate employees, which provide benefits to employees that are terminated. The costs for these plans are accounted for under SFAS No. 112. We accrue for severance benefits based on the terms of our severance plan over the estimated service periods of the employees. The accruals are also based on the historical run-rate of actual severances and expectations for future severances. As a result of the Verizon workforce reduction plan in 2003 and 2002, it was determined that the severance liability was not sufficient and we recorded a special charge of $26.6 million and $3.8 million, respectively. Severance costs are included in selling, general and administrative expense in our statements of income. The following table provides an analysis of our severance liability:

(Dollars in Millions) Year	Beginning of Year	Charged to Expense (a)	Payments	Other (b)	End of Year
2002	$12.1	$ 4.1	$ (7.7)	$(1.1)	$ 7.4
2003	7.4	25.9	(19.7)	10.9	24.5

(a) Includes (1) accruals for ongoing employee severance costs, (2) special charges of $26.6 million in 2003 and $3.8 million in 2002.

(b) Includes amounts reallocated to other Verizon affiliates. From time to time, Verizon must redistribute across its subsidiaries the amount of severance liability based on actual experience at the companies.

The remaining severance liability includes future contractual payments to employees separated as of the end of the year. As of December 31, 2003, a total of over 600 employees have been separated under the 2002 and 2003 severance programs.

10. INCOME TAXES

The components of income tax expense are presented in the following table:

(Dollars in Millions)	Years ended December 31 2003	2002
Current:		
Federal	$36.2	$65.2
State and local	2.3	4.4
	38.5	69.6
Deferred:		
Federal	6.0	27.0
State and local	.1	1.6
	6.1	28.6
Total income tax expense	$44.6	$98.2

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

	Years ended December 31 2003	2002
Statutory federal income tax rate	35.0%	35.0%
State income taxes, net of federal tax benefits	1.3	1.5
Other, net	.1	(.5)
Effective income tax rate	36.4%	36.0%

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)	December 31 2003	2002
Depreciation	$216.2	$156.1
Employee benefits	88.8	105.2
Allowance for uncollectible accounts	(10.4)	(14.2)
Other, net	9.1	9.2
Net deferred tax liability	$303.7	$256.3

Employee benefits include $28.5 million deferred tax asset at December 31, 2003 and $22.6 million at December 31, 2002 related to postretirement benefit costs recognized under SFAS No. 106. This deferred tax asset will gradually be realized over the estimated lives of current retirees and employees.

11. TRANSACTIONS WITH AFFILIATES

Our financial statements include transactions with Verizon Services, (including Verizon Services Corp., Verizon Services Group, Verizon Corporate Services Group Inc. as previously described), Verizon Internet Services Inc., Verizon Global Networks Inc., Verizon Long Distance, Verizon Wireless Inc., Verizon Operating Telephone Companies, Verizon Information Services Inc., Verizon Advanced Data Inc., Verizon Data Services Inc., GTE Communication Systems Corporation, GTE Funding Incorporated, Verizon Network Funding Corp., GTE Corporation, Verizon Ventures III Inc. and other affiliates.

Transactions with affiliates are summarized as follows:

(Dollars in Millions)	Years ended December 31 2003	2002
Operating revenues:		
Verizon Internet Services Inc.	$ 37.4	$ 21.0
Verizon Global Networks Inc.	20.0	---
Verizon Long Distance	15.3	32.0
Verizon Wireless Inc.	10.2	9.4
Verizon Operating Telephone Companies	7.6	10.4
Verizon Information Services Inc.	.7	.5
Other	.2	10.7
	91.4	84.0
Operating expenses:		
Verizon Services	160.8	129.8
Verizon Data Services Inc.	63.5	52.1
Verizon Advanced Data Inc.	20.4	23.8
GTE Communication Systems Corporation	14.5	14.9
Verizon Operating Telephone Companies	1.8	1.8
Verizon Wireless Inc.	.1	.6
Verizon Information Services Inc.	.1	.3
Other	.5	.4
	261.7	223.7
Other income and (expense), net:		
Interest income from GTE Funding Incorporated	.8	---
Interest income from Verizon Services	.1	---
Interest income from GTE Corporation	---	.1
	.9	.1
Interest expense:		
Interest expense to Verizon Network Funding Corp.	3.0	.2
Interest expense to GTE Funding Incorporated	(.2)	5.4
	2.8	5.6
Plant, property and equipment:		
Purchases from GTE Communication Systems Corporation	26.8	37.0
Transfer of advanced data assets from Verizon Ventures III Inc.	---	13.2
	26.8	50.2
Equity contributed to Verizon Ventures III Inc.	---	9.7
Dividends to GTE Corporation:		
Dividends declared	221.8	135.0
Capital contribution from GTE Corporation	---	9.9

Outstanding balances with affiliates are reported in the balance sheets at December 31, 2003 and 2002 as Note Receivable from Affiliate, Accounts Receivable - Affiliates, Notes Payable to Affiliates, and Accounts Payable and Accrued Liabilities - Affiliates.

Verizon Northwest Inc.

Verizon Services

We have contractual arrangements with Verizon Services for the provision of various centralized services. These services are divided into two broad categories. The first category is comprised of network related services which generally benefit only Verizon's operating telephone subsidiaries. These services include marketing, sales, legal, accounting, finance, data processing, materials management, procurement, labor relations, and staff support for various network operations. The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, and treasury. Costs may be either directly assigned to one subsidiary or allocated to more than one subsidiary based on functional reviews of the work performed.

Verizon Internet Services Inc.

Our operating revenues include transactions with Verizon Internet Services Inc. (Verizon Internet Services) associated with the provision of network access and billing and collection services. These revenues are earned from Verizon Internet Services who utilizes our facilities to provide Internet access services to their customers.

Verizon Global Networks Inc.

Our operating revenues include transactions with Verizon Global Networks Inc. (Global Networks) associated with the provision of network access and long distance services. These revenues are earned from Global Networks who utilizes our facilities to provide access and data transport to their customers.

Verizon Long Distance

Our operating revenues include transactions with Verizon Long Distance associated with the provision of local and network access and billing and collection services. These revenues are earned from Verizon Long Distance who utilizes our facilities to provide long distance services to their customers.

Verizon Wireless Inc.

Our operating revenues include transactions with Verizon Wireless Inc. (Verizon Wireless) associated with the provision of local and network access services, billing and collection services, interconnection agreements and commission fees. These revenues are earned from Verizon Wireless who provides wireless voice and data services, paging services and equipment sales to their customers.

Our operating expenses also include transactions with Verizon Wireless. We recognize costs associated with wireless voice and data services, paging services and for interconnection agreements.

Verizon Operating Telephone Companies

Our operating revenues and expenses include transactions with other Verizon Operating Telephone Companies. Revenues associated with transactions with these affiliates are primarily earned from the rental of our facilities and equipment. In addition, we also recognize expenses associated with transactions with these affiliates. These costs primarily relate to fees associated with the termination of our customer's calls on their network.

Verizon Information Services Inc.

We have an agreement to provide subscriber lists, billing and collection and other services to Verizon Information Services Inc. (Directories). Directories bills us for printing and other costs associated with regulatory requirements included in the telephone directories, including the cost of any Extended Area Service sections in the directories. Directories also bills us for any advertising we place in the telephone directories.

Verizon Advanced Data Inc.

Our operating revenues included transactions with Verizon Advanced Data Inc. (VADI) associated with the provision of local telephone services.

We also have a contractual arrangement with VADI for the provision of various centralized services associated with advanced data services. These services are divided into two broad categories. The first category is comprised of network related services which include provisioning, maintenance, engineering, and data processing for various network operations. The second category is comprised of overhead and support services which include finance, human resources, treasury, procurement, marketing, sales, and support staffs. The costs are allocated based on advanced data services revenues.

Verizon Data Services Inc.

Verizon Data Services Inc. provides data processing services, software application development and maintenance, which generally benefit Verizon's operating telephone subsidiaries, including us. We are charged for these affiliated transactions based on proportional cost allocation methodologies.

GTE Communication Systems Corporation

GTE Communication Systems Corporation (GTE Communication Systems) provides construction and maintenance equipment, supplies and electronic repair services to us. We record these purchases and services at cost, including a return realized by GTE Communication Systems.

Verizon Network Funding Corp. and GTE Funding Incorporated

We have a contractual agreement with an affiliated company, Verizon Network Funding Corp. (VNFC), for the provision of short-term financing and cash management services. VNFC issues commercial paper and obtains bank loans to fund the working capital requirements of Verizon's network services subsidiaries, including us, and invests funds in temporary investments of their behalf. We also recognize interest expense/income associated with short-term financing through advances from an affiliated company, GTE Funding Incorporated (GTE Funding).

Other Affiliates

Other operating revenues and expenses include miscellaneous items of income and expense resulting from transactions with other affiliates. These transactions include the provision of local and network access services, billing and collection services, rental of facilities and equipment, and sales and purchases of material and supplies.

Investment in Verizon Ventures III Inc.

We acquired an ownership interest in Verizon Ventures III Inc. (Ventures III), an affiliated company which we accounted for under the equity method of accounting, as a result of the transfer of certain advanced data assets in December 2000 and throughout 2001. Ventures III was established to satisfy a condition of the Federal Communication Commission's (FCC) approval of the Bell Atlantic - GTE merger, which required the provision of advanced data services through a separate affiliate. In September 2001, the FCC issued an order eliminating this merger condition. We subsequently obtained approval from our regulatory commissions in Idaho and Oregon for the reintegration of these assets with our operations. On January 1, 2002, after state regulatory approvals were obtained, Ventures III transferred advanced data assets back to us with an aggregate net book value of $13.2 million in Washington. In consideration of the transfer of these assets, we have surrendered our common stock in Ventures III and remitted cash compensation.

In connection with this reintegration, we received a capital contribution from our parent of $9.7 million in the first quarter of 2002. This equity was immediately contributed to Ventures III. No gain or loss was recognized as a result of the reintegration of the advanced data assets to us. This reintegration did not have a material effect on our total results of operations or financial condition.

12. ADDITIONAL FINANCIAL INFORMATION

The tables below provide additional financial information related to our financial statements:

(Dollars in Millions)	Years ended December 31 2003	2002
STATEMENTS OF CASH FLOWS:		
Cash paid during the year for:		
Income taxes, net of amounts refunded	$52.8	$113.7
Interest, net of amounts capitalized	39.1	48.3
STATEMENTS OF INCOME:		
Interest expense incurred, net of amounts capitalized	39.3	44.6
Capitalized interest	.8	1.2
Advertising expense	4.6	5.2

Advertising expense includes $4.5 million in 2003 and $5.1 million in 2002 allocated to us by various affiliates.

In 2002, we recorded an impairment charge of $12.5 million driven by our financial statement exposure to WorldCom Inc. This charge was recorded in selling, general and administrative expense in our consolidated statements of income.

13. COMMITMENTS AND CONTINGENCIES

Various legal actions and regulatory proceedings are 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 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 will have a material effect on our financial condition, but it could have a material effect on our results of operations.

From time to time, state regulatory decisions require us to assure customers that we will provide a level of service performance that falls within prescribed parameters. There are penalties associated with failing to meet those service parameters and we, from time to time, pay such penalties. We do not expect these penalties to have a material effect on our financial condition, but they could have a material effect on our results of operations.

14. SEGMENT INFORMATION

We have one reportable segment, which provides domestic wireline telecommunications services. Specifically, we provide local telephone services including voice and data transport, enhanced and custom calling features, network access, directory assistance and private lines. In addition, we provide customer premises equipment distribution, billing and collection and pay telephone services.

15. SUBSEQUENT EVENT

On February 2, 2004, we declared and paid a dividend in the amount of $32.0 million to our parent, GTE.