

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, 2012. Based on this assessment, we believe that the internal control over financial reporting of the company is effective as of December 31, 2012. 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 provided an attestation report on the company's internal control over financial reporting.



Lowell C. McAdam
Chairman and Chief Executive Officer



Francis J. Shammo
Executive Vice President and Chief Financial Officer



Robert J. Barish
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 Verizon Communications Inc. and subsidiaries' (Verizon) internal control over financial reporting as of December 31, 2012, 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 included in the accompanying Report of Management on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING
FIRM ON 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, Verizon maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, 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, 2012 and 2011, and the related consolidated statements of income, comprehensive income, cash flows and changes in equity for each of the three years in the period ended December 31, 2012 of Verizon and our report dated February 26, 2013 expressed an unqualified opinion thereon.

The logo for Ernst & Young LLP, featuring the company name in a stylized, cursive script.

Ernst & Young LLP
New York, New York

February 26, 2013

**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, 2012 and 2011, and the related consolidated statements of income, comprehensive income, cash flows and changes in equity for each of the three years in the period ended December 31, 2012. 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, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Verizon's internal control over financial reporting as of December 31, 2012, 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 26, 2013 expressed an unqualified opinion thereon.

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Ernst & Young LLP
New York, New York

February 26, 2013

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31,	(dollars in millions, except per share amounts)		
	2012	2011	2010
Operating Revenues	\$ 115,846	\$ 110,875	\$ 106,565
Operating Expenses			
Cost of services and sales (exclusive of items shown below)	46,275	45,875	44,149
Selling, general and administrative expense	39,951	35,624	31,366
Depreciation and amortization expense	16,460	16,496	16,405
Total Operating Expenses	102,686	97,995	91,920
Operating Income	13,160	12,880	14,645
Equity in earnings of unconsolidated businesses	324	444	508
Other income and (expense), net	(1,016)	(14)	54
Interest expense	(2,571)	(2,827)	(2,523)
Income Before (Provision) Benefit For Income Taxes	9,897	10,483	12,684
(Provision) Benefit for income taxes	660	(285)	(2,467)
Net Income	\$ 10,557	\$ 10,198	\$ 10,217
Net income attributable to noncontrolling interest	\$ 9,682	\$ 7,794	\$ 7,668
Net income attributable to Verizon	875	2,404	2,549
Net Income	\$ 10,557	\$ 10,198	\$ 10,217
Basic Earnings Per Common Share			
Net income attributable to Verizon	\$.31	\$.85	\$.90
Weighted-average shares outstanding (in millions)	2,853	2,833	2,830
Diluted Earnings Per Common Share			
Net income attributable to Verizon	\$.31	\$.85	\$.90
Weighted-average shares outstanding (in millions)	2,862	2,839	2,833

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31,	(dollars in millions)		
	2012	2011	2010
Net Income	\$ 10,557	\$ 10,198	\$ 10,217
Other Comprehensive Income, net of taxes			
Foreign currency translation adjustments	69	(119)	(171)
Unrealized gain (loss) on cash flow hedges	(68)	30	89
Unrealized gain (loss) on marketable securities	29	(7)	29
Defined benefit pension and postretirement plans	936	316	2,451
Other comprehensive income attributable to Verizon	966	220	2,398
Other comprehensive income (loss) attributable to noncontrolling interest	10	1	(35)
Total Comprehensive Income	\$ 11,533	\$ 10,419	\$ 12,580
Comprehensive income attributable to noncontrolling interest	9,692	7,795	7,633
Comprehensive income attributable to Verizon	1,841	2,624	4,947
Total Comprehensive Income	\$ 11,533	\$ 10,419	\$ 12,580

See Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

(dollars in millions, except per share amounts)

At December 31,	2012	2011
Assets		
Current assets		
Cash and cash equivalents	\$ 3,093	\$ 13,362
Short-term investments	470	592
Accounts receivable, net of allowances of \$641 and \$802	12,576	11,776
Inventories	1,075	940
Prepaid expenses and other	4,021	4,269
Total current assets	<u>21,235</u>	<u>30,939</u>
Plant, property and equipment	209,575	215,626
Less accumulated depreciation	120,933	127,192
	<u>88,642</u>	<u>88,434</u>
Investments in unconsolidated businesses	3,401	3,448
Wireless licenses	77,744	73,250
Goodwill	24,139	23,357
Other intangible assets, net	5,933	5,878
Other assets	4,128	5,155
Total assets	<u>\$ 225,222</u>	<u>\$ 230,461</u>
Liabilities and Equity		
Current liabilities		
Debt maturing within one year	\$ 4,369	\$ 4,849
Accounts payable and accrued liabilities	16,182	14,689
Other	6,405	11,223
Total current liabilities	<u>26,956</u>	<u>30,761</u>
Long-term debt	47,618	50,303
Employee benefit obligations	34,346	32,957
Deferred income taxes	24,677	25,060
Other liabilities	6,092	5,472
Equity		
Series preferred stock (\$.10 par value; none issued)	-	-
Common stock (\$.10 par value; 2,967,610,119 shares issued in both periods)	297	297
Contributed capital	37,990	37,919
Reinvested earnings (Accumulated deficit)	(3,734)	1,179
Accumulated other comprehensive income	2,235	1,269
Common stock in treasury, at cost	(4,071)	(5,002)
Deferred compensation – employee stock ownership plans and other	440	308
Noncontrolling interest	52,376	49,938
Total equity	<u>85,533</u>	<u>85,908</u>
Total liabilities and equity	<u>\$ 225,222</u>	<u>\$ 230,461</u>

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31,	2012	2011	(dollars in millions) 2010
Cash Flows from Operating Activities			
Net Income	\$ 10,557	\$ 10,198	\$ 10,217
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	16,460	16,496	16,405
Employee retirement benefits	8,198	7,426	3,988
Deferred income taxes	(952)	(223)	3,233
Provision for uncollectible accounts	972	1,026	1,246
Equity in earnings of unconsolidated businesses, net of dividends received	77	36	2
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses			
Accounts receivable	(1,717)	(966)	(859)
Inventories	(136)	208	299
Other assets	306	86	(313)
Accounts payable and accrued liabilities	1,144	(1,607)	1,075
Other, net	(3,423)	(2,900)	(1,930)
Net cash provided by operating activities	31,486	29,780	33,363
Cash Flows from Investing Activities			
Capital expenditures (including capitalized software)	(16,175)	(16,244)	(16,458)
Acquisitions of investments and businesses, net of cash acquired	(913)	(1,797)	(652)
Acquisitions of wireless licenses, net	(3,935)	(221)	(786)
Proceeds from dispositions	-	-	2,594
Net change in short-term investments	27	35	(3)
Other, net	494	977	251
Net cash used in investing activities	(20,502)	(17,250)	(15,054)
Cash Flows from Financing Activities			
Proceeds from long-term borrowings	4,489	11,060	-
Repayments of long-term borrowings and capital lease obligations	(6,403)	(11,805)	(8,136)
Increase (decrease) in short-term obligations, excluding current maturities	(1,437)	1,928	(1,097)
Dividends paid	(5,230)	(5,555)	(5,412)
Proceeds from sale of common stock	315	241	-
Proceeds from access line spin-off	-	-	3,083
Special distribution to noncontrolling interest	(8,325)	-	-
Other, net	(4,662)	(1,705)	(2,088)
Net cash used in financing activities	(21,253)	(5,836)	(13,650)
Increase (decrease) in cash and cash equivalents	(10,269)	6,694	4,659
Cash and cash equivalents, beginning of period	13,362	6,668	2,009
Cash and cash equivalents, end of period	\$ 3,093	\$ 13,362	\$ 6,668

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(dollars in millions, except per share amounts, and shares in thousands)

Years Ended December 31,	2012		2011		2010	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance at beginning of year	2,967,610	\$ 297	2,967,610	\$ 297	2,967,610	\$ 297
Balance at end of year	2,967,610	297	2,967,610	297	2,967,610	297
Contributed Capital						
Balance at beginning of year		37,919		37,922		40,108
Telephone access line spin-off (Note 2)		–		–		(2,184)
Other		71		(3)		(2)
Balance at end of year		37,990		37,919		37,922
Reinvested Earnings (Accumulated Deficit)						
Balance at beginning of year		1,179		4,368		7,260
Net income attributable to Verizon		875		2,404		2,549
Dividends declared (\$2.03, \$1.975, \$1.925) per share		(5,788)		(5,593)		(5,441)
Balance at end of year		(3,734)		1,179		4,368
Accumulated Other Comprehensive Income (Loss)						
Balance at beginning of year attributable to Verizon		1,269		1,049		(1,372)
Telephone access line spin-off (Note 2)		–		–		23
Adjusted balance at beginning of year		1,269		1,049		(1,349)
Foreign currency translation adjustments		69		(119)		(171)
Unrealized gains (losses) on cash flow hedges		(68)		30		89
Unrealized gains (losses) on marketable securities		29		(7)		29
Defined benefit pension and postretirement plans		936		316		2,451
Other comprehensive income		966		220		2,398
Balance at end of year attributable to Verizon		2,235		1,269		1,049
Treasury Stock						
Balance at beginning of year	(133,594)	(5,002)	(140,587)	(5,267)	(131,942)	(5,000)
Employee plans (Note 15)	11,434	433	6,982	265	347	13
Shareowner plans (Note 15)	13,119	498	11	–	8	–
Other (Note 9)	–	–	–	–	(9,000)	(280)
Balance at end of year	(109,041)	(4,071)	(133,594)	(5,002)	(140,587)	(5,267)
Deferred Compensation-ESOPs and Other						
Balance at beginning of year		308		200		89
Restricted stock equity grant		196		146		97
Amortization		(64)		(38)		14
Balance at end of year		440		308		200
Noncontrolling Interest						
Balance at beginning of year		49,938		48,343		42,761
Net income attributable to noncontrolling interest		9,682		7,794		7,668
Other comprehensive income (loss)		10		1		(35)
Total comprehensive income		9,692		7,795		7,633
Distributions and other		(7,254)		(6,200)		(2,051)
Balance at end of year		52,376		49,938		48,343
Total Equity		\$ 85,533		\$ 85,908		\$ 86,912

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 or the Company) is a holding company, which acting through its subsidiaries is one of the world's leading providers of communications, information and entertainment products and services to consumers, businesses and governmental agencies with a presence in over 150 countries around the world. We have two reportable segments, Verizon Wireless and Wireline. For further information concerning our business segments, see Note 13.

Verizon Wireless provides wireless communications services across one of the most extensive wireless networks in the United States (U.S.) and has the largest third-generation (3G) and fourth-generation (4G) Long-Term Evolution technology (LTE) networks of any U.S. wireless service provider.

The Wireline segment provides communications products and services including local exchange and long distance voice service, broadband video and data, IP network services, network access and other services to consumers, small businesses and carriers in the United States, as well as to businesses and government customers both in the United States and in over 150 other countries around the world.

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. For controlled subsidiaries that are not wholly owned, the noncontrolling interest is included in Net income and Total equity. 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 the accounting standard related to debt and equity securities. All significant intercompany accounts and transactions have been eliminated.

Basis of Presentation

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

Corporate, eliminations and other during the periods presented include a non-cash adjustment of \$0.2 billion in 2010, primarily to adjust wireless service revenues. This adjustment was recorded to properly defer previously recognized wireless service revenues that were earned and recognized in future periods. The adjustment was recorded during 2010, which reduced Net income attributable to Verizon by approximately \$0.1 billion.

Use of Estimates

We prepare our financial statements using U.S. 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, the recoverability of intangible assets and other long-lived assets, unbilled revenues, fair values of financial instruments, unrecognized tax benefits, valuation allowances on tax assets, accrued expenses, pension and postretirement benefit assumptions, contingencies and allocation of purchase prices in connection with business combinations.

Revenue Recognition

Multiple Deliverable Arrangements

In both our Verizon Wireless and Wireline segments, we offer products and services to our customers through bundled arrangements. These arrangements involve multiple deliverables which may include products, services, or a combination of products and services.

On January 1, 2011, we prospectively adopted the accounting standard updates regarding revenue recognition for multiple deliverable arrangements, and arrangements that include software elements. These updates require us to allocate revenue in an arrangement using its best estimate of selling price if neither vendor specific objective evidence (VSOE) nor third party evidence (TPE) of selling price exists.

Verizon Wireless

Our Verizon Wireless segment earns revenue primarily by providing access to and usage of its network. In general, access revenue is billed one month in advance and recognized when earned. Usage revenue is generally billed in arrears and recognized when 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 providing wireless services. For agreements involving the resale of third-party services in which we are considered the primary obligor in the arrangements, we record the revenue gross at the time of the sale. For equipment sales, we currently subsidize the cost of wireless devices. The amount of this subsidy is generally contingent on the arrangement and terms selected by the customer. The equipment revenue is recognized up to the amount collected when the wireless device is sold.

Wireline

Our Wireline segment earns revenue based upon usage of its network and facilities and contract fees. In general, fixed monthly fees for voice, video, data and certain other services are billed one month in advance and recognized when earned. Revenue from services that are not fixed in amount and are based on usage is generally billed in arrears and recognized when service is rendered.

We sell each of the services offered in bundled arrangements (i.e., voice, video and data), as well as separately; therefore each product or service has a standalone selling price. For these arrangements revenue is allocated to each deliverable using a relative selling price method. Under this method, arrangement consideration is allocated to each separate deliverable based on our standalone selling price for each product or service. These services include FIOS services, individually or in bundles, and High Speed Internet.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

When we bundle equipment with maintenance and monitoring services, we recognize equipment revenue 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.

Installation related fees, along with the associated costs up to but not exceeding these fees, are deferred and amortized over the estimated customer relationship period.

For each of our segments we report taxes imposed by governmental authorities on revenue-producing transactions between us and our customers on a net basis.

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.

Advertising Costs

Costs for advertising products and services as well as other promotional and sponsorship costs are charged to Selling, general and administrative expense in the periods in which they are incurred (see Note 15).

Earnings Per Common Share

Basic earnings per common share are based on the weighted-average number of shares outstanding during the period. Where appropriate, diluted earnings per common share include the dilutive effect of shares issuable under our stock-based compensation plans.

There were a total of approximately 9 million, 6 million and 3 million stock options and restricted stock units outstanding included in the computation of diluted earnings per common share for the years ended December 31, 2012, 2011 and 2010, respectively. Outstanding options to purchase shares that were not included in the computation of diluted earnings per common share, because to do so would have been anti-dilutive for the period, were not significant for the year ended December 31, 2012 and included approximately 19 million and 73 million weighted-average shares for the years ended December 31, 2011 and 2010, respectively.

We are authorized to issue up to 4.25 billion and 250 million shares of common stock and Series Preferred Stock, respectively.

Cash and Cash Equivalents

We consider all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates quoted market value and include amounts held in money market funds.

Marketable Securities

We have investments in marketable securities, which are considered "available-for-sale" under the provisions of the accounting standard for certain debt and equity securities, and are included in the accompanying consolidated balance sheets in Short-term investments, Investments in unconsolidated businesses or Other assets. 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.

Inventories

Inventory consists of wireless and wireline equipment held for sale, which is carried 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. Plant, property and equipment of wireline and wireless operations are generally depreciated on a straight-line basis.

Leasehold improvements are amortized over the shorter of the estimated life of the improvement or the remaining term of the related lease, calculated from the time the asset was placed in service.

When the depreciable assets of our wireline and wireless operations 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 and depreciate network software purchased or developed along with related plant assets. We also capitalize interest associated with the acquisition or construction of network-related assets. Capitalized interest is reported as a reduction in interest expense and depreciated as part of the cost of the network-related assets.

In connection with our ongoing review of the estimated remaining average useful lives of plant, property and equipment at our local telephone operations, we determined that there were no changes necessary for average useful lives for 2012, 2011, and 2010. In connection with our ongoing review of the estimated remaining average useful lives of plant, property and equipment at our wireless operations, we determined that changes were necessary to the remaining estimated useful lives as a result of technology upgrades, enhancements, and planned retirements. These changes resulted in increases in depreciation expense of \$0.4 billion and \$0.3 billion in 2011 and 2010, respectively. While the timing and extent of current deployment plans are subject to ongoing analysis and modification, we believe the current estimates of useful lives are reasonable.

Computer Software Costs

We capitalize the cost of internal-use network and non-network software that has a useful life in excess of one year. 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. Planning, software maintenance and training costs are expensed in the period in which they are incurred. Also, we capitalize interest associated with the development of internal-use network and non-network software. Capitalized non-network internal-use software costs are amortized using the straight-line method over a period of 3 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, see "Goodwill and Other Intangible Assets" below. Also, see Note 3 for additional detail of internal-use non-network 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 annually in the fourth fiscal quarter. The Company has the option to perform a qualitative assessment to determine if the fair value of the entity is less than its carrying value. However, the Company may elect to perform an impairment test even if no indications of a potential impairment exist. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. We have determined that in our case, the reporting units are our operating

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

segments since that is the lowest level at which discrete, reliable financial and cash flow information is available. Step one compares the fair value of the reporting unit (calculated using a market approach and/or 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 implied fair value of goodwill is less than the carrying amount of goodwill, an impairment is recognized.

Intangible Assets Not Subject to Amortization

A significant portion of our intangible assets are wireless licenses that provide our wireless operations with the exclusive right to utilize designated radio frequency spectrum to provide wireless 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. We reevaluate the useful life determination for wireless licenses each year to determine whether events and circumstances continue to support an indefinite useful life.

We test our wireless licenses for potential impairment annually. We evaluate our licenses on an aggregate basis using a direct value approach. The direct value approach estimates fair value using a discounted cash flow analysis to estimate what a marketplace participant would be willing to pay to purchase the aggregated wireless licenses as of the valuation date. If the fair value of the aggregated wireless licenses is less than the aggregated carrying amount of the licenses, an impairment is recognized.

Interest expense incurred while qualifying activities are performed to ready wireless licenses for their intended use is capitalized as part of wireless licenses. The capitalization period ends when the development is discontinued or substantially complete and the license is ready for its intended use.

Intangible Assets Subject to Amortization and Long-Lived Assets

Our intangible assets that do not have indefinite lives (primarily customer lists and non-network internal-use software) are amortized over their useful lives. All of our intangible assets subject to amortization and long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If any indications were present, we would test for recoverability by comparing the carrying amount of the asset group to the net undiscounted cash flows expected to be generated from the asset group. If those net undiscounted cash flows do not exceed the carrying amount, 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 determinations for these intangible assets each year to determine whether events and circumstances warrant a revision in their remaining useful lives.

For information related to the carrying amount of goodwill by segment, wireless licenses and other intangible assets, as well as the major components and average useful lives of our other acquired intangible assets, see Note 3.

Fair Value Measurements

Fair value of financial and non-financial assets and liabilities is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The three-tier hierarchy for inputs used in measuring fair value, which prioritizes the inputs used in the methodologies of measuring fair value for assets and liabilities, is as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities
- Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities
- Level 3 – No observable pricing inputs in the market

Financial assets and financial liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. Our assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy.

Income Taxes

Our effective tax rate is based on pre-tax income, statutory tax rates, tax laws and regulations and tax planning strategies available to us in the various jurisdictions in which we operate.

Deferred income taxes are provided for temporary differences in the bases between financial statement and income tax assets and liabilities. Deferred income taxes are recalculated annually at tax rates then in effect. We record valuation allowances to reduce our deferred tax assets to the amount that is more likely than not to be realized.

We use a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return. The first step is recognition: we determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, we presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in one or more of the following: an increase in a liability for income taxes payable, a reduction of an income tax refund receivable, a reduction in a deferred tax asset, or an increase in a deferred tax liability.

The accounting standard relating to income taxes generated by leveraged lease transactions requires that changes in the projected timing of income tax cash flows generated by a leveraged lease transaction be recognized as a gain or loss in the year in which the change occurs.

Significant management judgment is required in evaluating our tax positions and in determining our effective tax rate.

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based compensation awards made to employees and directors based on estimated fair values. See Note 10 for further details.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Foreign Currency Translation

The functional currency of our foreign operations is generally 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 income (loss), a separate component of Equity, 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 income (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 generally amortized over the average remaining service period of the employees expected to receive benefits. Expected return on plan assets is determined by applying the return on assets assumption to the actual fair value of plan assets. Actuarial gains and losses are recognized in operating results in the year in which they occur. These gains and losses are measured annually as of December 31 or upon a remeasurement event. Verizon management employees no longer earn pension benefits or earn service towards the company retiree medical subsidy (see Note 11).

We recognize a pension or a postretirement plan's funded status as either an asset or liability on the consolidated balance sheets. Also, we measure any unrecognized prior service costs and credits that arise during the period as a component of Accumulated other comprehensive income (loss), net of applicable income tax.

Derivative Instruments

We have entered into derivative transactions primarily to manage our exposure to fluctuations in foreign currency exchange rates, interest rates, equity and commodity prices. We employ risk management strategies, which may include the use of a variety of derivatives including cross currency swaps, foreign currency and prepaid forwards and collars, interest rate and commodity swap agreements and interest rate locks. We do not hold derivatives for trading purposes.

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. Our derivative instruments are valued primarily using models based on readily observable market parameters for all substantial terms of our derivative contracts and thus are classified as Level 2. 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 and recognized in earnings when the hedged item is recognized in earnings.

Recently Adopted Accounting Standards

During the first quarter of 2012, we adopted the accounting standard update regarding the presentation of comprehensive income. This update was issued to increase the prominence of items reported in other comprehensive income. The update requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate, but consecutive statements. In connection with the adoption of this standard our consolidated financial statements include a separate statement of comprehensive income.

During the first quarter of 2012, we adopted the accounting standard update regarding fair value measurement. This update was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. This standard update also changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. The adoption of this standard update did not have a significant impact on our consolidated financial statements.

During the first quarter of 2012, we adopted the accounting standard update regarding testing of goodwill for impairment. This standard update gives companies the option to perform a qualitative assessment to first assess whether the fair value of a reporting unit is less than its carrying amount. If an entity determines it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The Company did not elect to use the qualitative assessment in 2012.

Recent Accounting Standards

In July 2012, the accounting standard update regarding testing of intangible assets for impairment was issued. This standard update allows companies the option to perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. An entity is not required to calculate the fair value of an indefinite-lived intangible asset and perform the quantitative impairment test unless the entity determines that it is more likely than not the asset is impaired. We will adopt this standard update during the first quarter of 2013. The adoption of this standard update is not expected to have a significant impact on our consolidated financial statements.

In February 2013, the accounting standard update regarding reclassifications out of accumulated other comprehensive income was issued. This standard update requires companies to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in our consolidated statements of income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. We will adopt this standard in the first quarter of 2013. The adoption of this standard update is not expected to have a significant impact on our consolidated financial statements.

NOTE 2

ACQUISITIONS AND DIVESTITURES

Verizon Wireless

Spectrum Licenses

During the third quarter of 2012, after receiving the required regulatory approvals, Verizon Wireless completed the following previously announced transactions in which we acquired wireless spectrum that will be used to deploy additional fourth-generation (4G) Long Term Evolution (LTE) capacity:

- Verizon Wireless acquired Advanced Wireless Service (AWS) spectrum in separate transactions with SpectrumCo, LLC (SpectrumCo) and Cox TMI Wireless, LLC for which it paid an aggregate of \$3.9 billion at the time of the closings. Verizon Wireless has also recorded a liability of \$0.4 billion related to a three-year service obligation to SpectrumCo's members pursuant to commercial agreements executed concurrently with the SpectrumCo transaction.
- Verizon Wireless completed license purchase and exchange transactions with Leap Wireless, Savary Island Wireless, which is majority owned by Leap Wireless, and a subsidiary of T-Mobile USA, Inc. (T-Mobile). As a result of these transactions, Verizon Wireless received an aggregate \$2.6 billion of AWS and PCS licenses at fair value and net cash proceeds of \$0.2 billion, transferred certain AWS licenses to T-Mobile and a 700 megahertz (MHz) lower A block license to Leap Wireless, and recorded an immaterial gain.

During 2011, Verizon Wireless entered into commercial agreements, modified in 2012, with affiliates of Comcast Corporation, Time Warner Cable, Bright House Networks and Cox Communications Inc. (the cable companies). Through these agreements, the cable companies and Verizon Wireless became agents to sell certain of one another's products and services and, over time, the cable companies will have the option, subject to the terms and conditions of the agreements, of selling Verizon Wireless service on a wholesale basis.

During the fourth quarter of 2012, we entered into license exchange agreements with T-Mobile and Cricket License Company, LLC, a subsidiary of Leap Wireless, to exchange certain AWS licenses. These non-cash exchanges, which are subject to approval by the Federal Communications Commission (FCC) and other customary closing conditions, are expected to close in 2013. The exchange includes a number of intra-market swaps that will result in more efficient use of the AWS band. As a result of these transactions, we expect to record an immaterial gain.

On April 18, 2012, we announced plans to initiate an open sale process for all of our 700 MHz lower A and B block spectrum licenses, subject to the receipt of acceptable bids. We acquired these licenses as part of FCC Auction 73 in 2008. On January 25, 2013, Verizon Wireless agreed to sell 39 lower 700 MHz B block spectrum licenses to AT&T Inc. (AT&T) in exchange for a payment of \$1.9 billion and the transfer by AT&T to Verizon Wireless of AWS (10 MHz) licenses in certain markets in the western United States. Verizon Wireless also agreed to sell certain lower 700 MHz B block spectrum licenses to an investment firm for a payment of \$0.2 billion. These transactions are subject to approval by the FCC and the Department of Justice (DOJ). When finalized, the sales will result in the completion of the open sale process. We expect to deploy the remaining licenses as necessary to meet our own spectrum needs.

Alltel Divestiture Markets

As a condition of the regulatory approvals to complete the acquisition of Alltel Corporation (Alltel) in January 2009, Verizon Wireless was required to divest overlapping properties in 105 operating markets in 24 states (Alltel Divestiture Markets). During the second quarter of 2010, AT&T Mobility acquired 79 of the 105 Alltel Divestiture Markets, including licenses and network assets, for approximately \$2.4 billion in cash and Atlantic Tele-Network, Inc. acquired the remaining 26 Alltel Divestiture Markets, including licenses and network assets, for \$0.2 billion in cash.

During the second quarter of 2010, we recorded a tax charge of approximately \$0.2 billion for the taxable gain associated with these transactions.

Other

During 2012, we acquired various other wireless licenses and markets for cash consideration that was not significant and recorded \$0.2 billion of goodwill as a result of these transactions.

During 2011, we acquired various other wireless licenses and markets for cash consideration that was not significant.

During 2010, Verizon Wireless acquired the net assets and related customers of six operating markets in Louisiana and Mississippi in a transaction with AT&T for cash consideration of \$0.2 billion. The purchase price allocation resulted in \$0.1 billion of wireless licenses and \$0.1 billion in goodwill.

Merger Integration Charges

During 2010, we recorded pre-tax merger integration charges of \$0.9 billion primarily related to the Alltel acquisition. These charges were primarily due to the decommissioning of overlapping cell sites, preacquisition contingencies, handset conversions and trade name amortization.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Wireline

HUGHES Telematics, Inc.

On June 1, 2012, we agreed to acquire HUGHES Telematics, Inc. (HUGHES Telematics) for approximately \$12 per share in cash for a total acquisition price of \$0.6 billion and we completed the acquisition on July 26, 2012. As a result of the transaction, HUGHES Telematics became a wholly-owned subsidiary of Verizon. The consolidated financial statements include the results of HUGHES Telematics' operations from the date the acquisition closed. Upon closing, we recorded approximately \$0.6 billion of goodwill, \$0.1 billion of other intangibles, and assumed the debt obligations of HUGHES Telematics, which were approximately \$0.1 billion as of the date of acquisition, and which were repaid by Verizon. Had this acquisition been completed on January 1, 2012 or 2011, the results of the acquired operations of HUGHES Telematics would not have had a significant impact on the consolidated net income attributable to Verizon. The acquisition has accelerated our ability to bring more telematics offerings to market for existing and new HUGHES Telematics and Verizon customers.

The acquisition of HUGHES Telematics was accounted for as a business combination under the acquisition method. The cost of the acquisition was allocated to the assets and liabilities acquired based on their fair values as of the close of the acquisition, with the excess amount being recorded as goodwill.

Terremark Worldwide, Inc.

During April 2011, we acquired Terremark Worldwide, Inc. (Terremark), a global provider of information technology infrastructure and cloud services, for \$19 per share in cash. Closing and other direct acquisition-related costs totaled approximately \$13 million after-tax. The acquisition was completed via a "short-form" merger under Delaware law through which Terremark became a wholly owned subsidiary of Verizon. The acquisition enhanced Verizon's offerings to business and government customers globally.

The consolidated financial statements include the results of Terremark's operations from the date the acquisition closed. Had this acquisition been consummated on January 1, 2011 or 2010, the results of Terremark's acquired operations would not have had a significant impact on the consolidated net income attributable to Verizon. The debt obligations of Terremark that were outstanding at the time of its acquisition by Verizon were repaid during May 2011.

The acquisition of Terremark was accounted for as a business combination under the acquisition method. The cost of the acquisition was allocated to the assets and liabilities acquired based on their fair values as of the close of the acquisition, with the excess amount being recorded as goodwill. The fair values of the assets and liabilities acquired were determined using the income and cost approaches. The income approach was primarily used to value the intangible assets, consisting primarily of customer relationships. The cost approach was used, as appropriate, for plant, property and equipment. The fair value of the majority of the long-term debt acquired was primarily valued based on redemption prices. The final purchase price allocation presented below includes insignificant adjustments from the initial purchase price to the values of certain assets and liabilities acquired.

The following table summarizes the allocation of the acquisition cost to the assets acquired, including cash acquired of \$0.1 billion, and liabilities acquired as of the acquisition date:

(dollars in millions)	Final Purchase Price Allocation
Assets	
Current assets	\$ 221
Plant, property and equipment	521
Goodwill	1,211
Intangible assets subject to amortization	410
Other assets	12
Total assets	<u>2,375</u>
Liabilities	
Current liabilities	158
Debt maturing within one year	748
Deferred income taxes and other liabilities	75
Total liabilities	<u>981</u>
Net assets acquired	<u>\$ 1,394</u>

Intangible assets subject to amortization include customer lists which are being amortized on a straight-line basis over 13 years, and other intangibles which are being amortized on a straight-line basis over a period of 5 years.

Telephone Access Line Spin-off

On July 1, 2010, after receiving regulatory approval, we completed the spin-off of the shares of a newly formed subsidiary of Verizon (Spinco) to Verizon stockholders and the merger of Spinco with Frontier Communications Corporation (Frontier). Spinco held defined assets and liabilities that were used in Verizon's local exchange businesses and related activities in 14 states. The total value of the transaction to Verizon and its stockholders was approximately \$8.6 billion. The accompanying consolidated financial statements for the year ended December 31, 2010 include these operations prior to the completion of the spin-off.

During 2010, we recorded pre-tax charges of \$0.5 billion, primarily for costs incurred related to network, non-network software and other activities to enable the divested markets in the transaction with Frontier to operate on a stand-alone basis subsequent to the closing of the transaction; professional advisory and legal fees in connection with this transaction; and fees related to the early extinguishment of debt from the use of proceeds from the transaction.

Other

In February 2012, Verizon entered into a venture with Redbox Automated Retail, LLC (Redbox), a subsidiary of Coinstar, Inc., to offer customers nationwide access to media rentals through online and mobile content streaming as well as physical media rentals through Redbox kiosks. Verizon holds a 65% majority ownership share in the venture and Redbox holds a 35% ownership share. The venture is consolidated by Verizon for reporting purposes. In December 2012, the venture introduced its product portfolio, which includes subscription services, under the name Redbox Instant by Verizon. The initial funding related to the formation of the venture is not significant to Verizon.

During 2011, we acquired a provider of cloud software technology for cash consideration that was not significant.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 3

WIRELESS LICENSES, GOODWILL AND OTHER INTANGIBLE ASSETS

Wireless Licenses

Changes in the carrying amount of Wireless licenses are as follows:

Balance at January 1, 2011	\$ 72,996
Acquisitions (Note 2)	58
Capitalized interest on wireless licenses	196
Balance at December 31, 2011	\$ 73,250
Acquisitions (Note 2)	4,544
Capitalized interest on wireless licenses	205
Reclassifications, adjustments and other	(255)
Balance at December 31, 2012	\$ 77,744

Reclassifications, adjustments, and other includes the exchanges of wireless licenses in 2012. See Note 2 ("Acquisitions and Divestitures") for additional details.

At December 31, 2012 and 2011, approximately \$7.3 billion and \$2.2 billion, respectively, of wireless licenses were under development for commercial service for which we were capitalizing interest costs.

The average remaining renewal period of our wireless license portfolio was 6.1 years as of December 31, 2012 (see Note 1, Goodwill and Other Intangible Assets – *Intangible Assets Not Subject to Amortization*).

Goodwill

Changes in the carrying amount of Goodwill are as follows:

	Verizon Wireless	Wireline	Total
Balance at January 1, 2011	\$ 17,869	\$ 4,119	\$ 21,988
Acquisitions (Note 2)	94	1,275	1,369
Balance at December 31, 2011	\$ 17,963	\$ 5,394	\$ 23,357
Acquisitions (Note 2)	209	551	760
Reclassifications, adjustments and other	-	22	22
Balance at December 31, 2012	\$ 18,172	\$ 5,967	\$ 24,139

Other Intangible Assets

The following table displays the composition of Other intangible assets, net:

At December 31,	2012			2011		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Customer lists (6 to 13 years)	\$ 3,556	\$ (2,338)	\$ 1,218	\$ 3,529	\$ (2,052)	\$ 1,477
Non-network internal-use software (3 to 7 years)	10,415	(6,210)	4,205	9,536	(5,487)	4,049
Other (2 to 25 years)	802	(292)	510	561	(209)	352
Total	\$ 14,773	\$ (8,840)	\$ 5,933	\$ 13,626	\$ (7,748)	\$ 5,878

The amortization expense for Other intangible assets was as follows:

Years	
2012	\$ 1,540
2011	1,505
2010	1,812

Estimated annual amortization expense for Other intangible assets is as follows:

Years	
2013	\$ 1,633
2014	1,176
2015	988
2016	790
2017	593

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 4

PLANT, PROPERTY AND EQUIPMENT

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

At December 31,	Lives (years)	(dollars in millions)	
		2012	2011
Land	–	\$ 859	\$ 862
Buildings and equipment	15–45	22,909	21,969
Central office and other network equipment	3–15	113,262	107,322
Cable, poles and conduit	11–50	53,761	67,190
Leasehold improvements	5–20	5,404	5,030
Work in progress	–	4,126	3,417
Furniture, vehicles and other	3–20	9,254	9,836
		209,575	215,626
Less accumulated depreciation		120,933	127,192
Total		\$ 88,642	\$ 88,434

NOTE 5

INVESTMENTS IN UNCONSOLIDATED BUSINESSES

Our investments in unconsolidated businesses are comprised of the following:

At December 31,	Ownership	(dollars in millions)	
		2012	2011
Equity Investees			
Vodafone Omnitel	23.1%	\$ 2,200	\$ 2,083
Other	Various	1,106	1,320
Total equity investees		3,306	3,403
Cost Investees			
Total investments in unconsolidated businesses	Various	95	45
		\$ 3,401	\$ 3,448

Dividends and repatriations of foreign earnings received from these investees amounted to \$0.4 billion in 2012, \$0.5 billion in 2011 and \$0.5 billion in 2010. See Note 12 regarding undistributed earnings of our foreign subsidiaries.

Equity Method Investments

Vodafone Omnitel

Vodafone Omnitel N.V. (Vodafone Omnitel) is one of the largest wireless communications companies in Italy. At December 31, 2012 and 2011, our investment in Vodafone Omnitel included goodwill of \$1.0 billion, respectively.

Other Equity Investees

We have limited partnership investments in entities that invest in affordable housing projects, for which we provide funding as a limited partner and receive tax deductions and tax credits based on our partnership interests. At December 31, 2012 and 2011, we had equity investments in these partnerships of \$0.9 billion and \$1.1 billion, respectively. We adjust the carrying value of these investments for any losses incurred by the limited partnerships through earnings.

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

Summarized Financial Information

Summarized financial information for our equity investees is as follows:

Balance Sheet

At December 31,	(dollars in millions)	
	2012	2011
Current Assets	\$ 3,516	\$ 3,720
Noncurrent Assets	8,159	8,469
Total Assets	\$ 11,675	\$ 12,189
Current liabilities	\$ 5,526	\$ 6,123
Noncurrent liabilities	5	8
Equity	6,144	6,058
Total liabilities and equity	\$ 11,675	\$ 12,189

Income Statement

Years Ended December 31,	(dollars in millions)		
	2012	2011	2010
Net revenue	\$ 10,825	\$ 12,668	\$ 12,356
Operating income	2,823	4,021	4,156
Net income	1,679	2,451	2,563

NOTE 6

NONCONTROLLING INTEREST

Noncontrolling interests in equity of subsidiaries were as follows:

At December 31,	(dollars in millions)	
	2012	2011
Noncontrolling interests in consolidated subsidiaries:		
Verizon Wireless	\$ 51,492	\$ 49,165
Wireless partnerships and other	884	773
	\$ 52,376	\$ 49,938

Wireless Joint Venture

Our Verizon Wireless segment is primarily comprised of Cellco Partnership doing business as Verizon Wireless (Verizon Wireless). Cellco Partnership is a joint venture formed in April 2000 by the combination of the U.S. wireless operations and interests of Verizon and Vodafone. Verizon owns a controlling 55% interest in Verizon Wireless and Vodafone owns the remaining 45%.

Special Distributions

In November 2012, the Board of Representatives of Verizon Wireless declared a distribution to its owners, which was paid in the fourth quarter of 2012 in proportion to their partnership interests on the payment date, in the aggregate amount of \$8.5 billion. As a result, Vodafone received a cash payment of \$3.8 billion and the remainder of the distribution was received by Verizon.

In July 2011, the Board of Representatives of Verizon Wireless declared a distribution to its owners, which was paid in the first quarter of 2012 in proportion to their partnership interests on the payment date, in the aggregate amount of \$10 billion. As a result, Vodafone received a cash payment of \$4.5 billion and the remainder of the distribution was received by Verizon.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 7

LEASING ARRANGEMENTS

As Lessor

We are the lessor in leveraged and direct financing lease agreements for commercial aircraft and power generating facilities, which comprise the majority of our leasing portfolio along with telecommunications equipment, commercial real estate property and other equipment. These leases have remaining terms of up to 38 years as of December 31, 2012. In addition, we lease space on certain of our cell towers to other wireless carriers. 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 is secured by 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.

At each reporting period, we monitor the credit quality of the various lessees in our portfolios. Regarding the leveraged lease portfolio, external credit reports are used where available and where not available we use internally developed indicators. These indicators or internal credit risk grades factor historic loss experience, the value of the underlying collateral, delinquency trends, and industry and general economic conditions. The credit quality of our lessees primarily varies from AAA to CCC+. For each reporting period the leveraged leases within the portfolio are reviewed for indicators of impairment where it is probable the rent due according to the contractual terms of the lease will not be collected. All significant accounts, individually or in the aggregate, are current and none are classified as impaired.

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,			2012			2011		
	Leveraged Leases	Direct Finance Leases	Total	Leveraged Leases	Direct Finance Leases	Total		
Minimum lease payments receivable	\$ 1,253	\$ 58	\$ 1,311	\$ 1,610	\$ 119	\$ 1,729		
Estimated residual value	923	6	929	1,202	9	1,211		
Unearned income	(654)	(10)	(664)	(874)	(19)	(893)		
Total	\$ 1,522	\$ 54	\$ 1,576	\$ 1,938	\$ 109	\$ 2,047		
Allowance for doubtful accounts			(99)			(137)		
Finance lease receivables, net			\$ 1,477			\$ 1,910		
Prepaid expenses and other			\$ 22			\$ 46		
Other assets			1,455			1,864		
			\$ 1,477			\$ 1,910		

Accumulated deferred taxes arising from leveraged leases, which are included in Deferred income taxes, amounted to \$1.2 billion at December 31, 2012 and \$1.6 billion at December 31, 2011.

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

Years Ended December 31,	(dollars in millions)		
	2012	2011	2010
Pretax income	\$ 30	\$ 61	\$ 74
Income tax expense	12	24	32

The future minimum lease payments to be received from noncancelable capital leases (direct financing and leveraged leases), net of nonrecourse loan payments related to leveraged leases and allowances for doubtful accounts, along with expected receipts relating to operating leases for the periods shown at December 31, 2012, are as follows:

Years	(dollars in millions)	
	Capital Leases	Operating Leases
2013	\$ 123	\$ 184
2014	45	162
2015	52	139
2016	122	114
2017	38	89
Thereafter	931	90
Total	\$ 1,311	\$ 778

As Lessee

We lease certain facilities and equipment for use in our operations under both capital and operating leases. Total rent expense under operating leases amounted to \$2.5 billion in 2012, 2011 and 2010, respectively.

Amortization of capital leases is included in Depreciation and amortization expense in the consolidated statements of income. Capital lease amounts included in Plant, property and equipment are as follows:

At December 31,	(dollars in millions)	
	2012	2011
Capital leases	\$ 358	\$ 362
Less accumulated amortization	158	132
Total	\$ 200	\$ 230

The aggregate minimum rental commitments under noncancelable leases for the periods shown at December 31, 2012, are as follows:

Years	(dollars in millions)	
	Capital Leases	Operating Leases
2013	\$ 86	\$ 2,038
2014	67	1,840
2015	57	1,572
2016	54	1,280
2017	44	992
Thereafter	99	4,119
Total minimum rental commitments	407	\$ 11,841
Less interest and executory costs	109	
Present value of minimum lease payments	298	
Less current installments	64	
Long-term obligation at December 31, 2012	\$ 234	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 8

DEBT

Changes to debt during 2012 are as follows:

	Debt Maturing within One Year	Long-term Debt	Total
Balance at January 1, 2012	\$ 4,849	\$ 50,303	\$ 55,152
Proceeds from long-term borrowings	-	4,489	4,489
Repayments of long-term borrowings and capital leases obligations	(6,403)	-	(6,403)
Decrease in short-term obligations, excluding current maturities	(1,437)	-	(1,437)
Reclassifications of long-term debt	7,062	(7,062)	-
Debt acquired (Note 2)	122	-	122
Other	176	(112)	64
Balance at December 31, 2012	\$ 4,369	\$ 47,618	\$ 51,987

Debt maturing within one year is as follows:

At December 31,	2012	2011
Long-term debt maturing within one year	\$ 3,869	\$ 2,915
Commercial paper	500	1,934
Total debt maturing within one year	\$ 4,369	\$ 4,849

The weighted-average interest rate for our commercial paper outstanding was 0.4% at December 31, 2012 and 2011, respectively.

Credit Facility

On August 13, 2012, we amended our credit facility to reduce fees and borrowing costs and extend the maturity date to August 12, 2016. As of December 31, 2012, the unused borrowing capacity under this \$6.2 billion four-year credit facility with a group of major financial institutions was approximately \$6.1 billion.

Long-Term Debt

Outstanding long-term debt obligations are as follows:

At December 31,	Interest Rates %	Maturities	2012	2011
Verizon Communications – notes payable and other	0.70 – 3.85	2013 – 2042	\$ 11,198	\$ 6,900
	4.35 – 5.50	2013 – 2041	7,062	7,832
	5.55 – 6.90	2016 – 2041	11,031	11,043
	7.35 – 8.95	2018 – 2039	5,017	6,642
	Floating	2014	1,000	1,000
Verizon Wireless – notes payable and other	5.55 – 8.88	2013 – 2018	8,635	9,331
Verizon Wireless – Alltel assumed notes	6.50 – 7.88	2013 – 2032	1,500	2,315
Telephone subsidiaries – debentures	4.75 – 7.00	2013 – 2033	2,045	4,045
	7.15 – 7.88	2022 – 2032	1,349	1,449
	8.00 – 8.75	2019 – 2031	880	880
Other subsidiaries – debentures and other	6.84 – 8.75	2018 – 2028	1,700	1,700
Capital lease obligations (average rate of 6.3% in 2012 and 2011, respectively)			298	352
Unamortized discount, net of premium			(228)	(271)
Total long-term debt, including current maturities			51,487	53,218
Less long-term debt maturing within one year			3,869	2,915
Total long-term debt			\$ 47,618	\$ 50,303

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *continued*

2012

On November 2, 2012, we announced the commencement of a tender offer (the Tender Offer) to purchase for cash any and all of the outstanding \$1.25 billion aggregate principal amount of 8.95% Verizon Communications Notes due 2039. In the Tender Offer that was completed November 9, 2012, \$0.9 billion aggregate principal amount of the notes was purchased at a price of 186.5% of the principal amount of the notes (see "Early Debt Redemption and Other Costs" below) and \$0.35 billion principal amount of the notes remains outstanding. Any accrued and unpaid interest on the principal purchased was paid to the date of purchase.

During November 2012, we issued \$4.5 billion aggregate principal amount of fixed rate notes resulting in cash proceeds of approximately \$4.47 billion, net of discounts and issuance costs. The issuances consisted of the following: \$1.0 billion of 0.70% Notes due 2015, \$0.5 billion of 1.10% Notes due 2017, \$1.75 billion of 2.45% Notes due 2022 and \$1.25 billion of 3.85% Notes due 2042. During December 2012, the net proceeds were used to redeem: \$0.7 billion of the \$2.0 billion of 8.75% Notes due November 2018 at a redemption price of 140.2% of the principal amount of the notes (see "Early Debt Redemption and Other Costs" below), \$0.75 billion of 4.35% Notes due February 2013 at a redemption price of 100.7% of the principal amount of the notes and certain telephone subsidiary debt (see "Telephone and Other Subsidiary Debt" below), as well as for the Tender Offer and other general corporate purposes. Any accrued and unpaid interest was paid to the date of redemption.

In addition, during 2012 we utilized \$0.2 billion under fixed rate vendor financing facilities.

2011

During March 2011, we issued \$6.25 billion aggregate principal amount of fixed and floating rate notes resulting in cash proceeds of approximately \$6.19 billion, net of discounts and issuance costs. The issuances consisted of the following: \$1.0 billion of Notes due 2014 that bear interest at a rate equal to three-month London Interbank Offered Rate (LIBOR) plus 0.61%, \$1.5 billion of 1.95% Notes due 2014, \$1.25 billion of 3.00% Notes due 2016, \$1.5 billion of 4.60% Notes due 2021 and \$1.0 billion of 6.00% Notes due 2041. The net proceeds were used for the repayment of commercial paper and other general corporate purposes, as well as for the redemption of certain telephone subsidiary debt during April 2011 (see "Telephone and Other Subsidiary Debt" below).

During November 2011, we issued \$4.6 billion aggregate principal amount of fixed rate notes resulting in cash proceeds of approximately \$4.55 billion, net of discounts and issuance costs. The issuances consisted of the following: \$0.8 billion of 1.25% Notes due 2014, \$1.3 billion of 2.00% Notes due 2016, \$1.9 billion of 3.50% Notes due 2021 and \$0.8 billion of 4.75% Notes due 2041. During November 2011, the net proceeds were used to redeem \$1.0 billion of 7.375% Verizon Communications Notes due September 2012 at a redemption price of 105.2% of principal amount of the notes, \$0.6 billion of 6.875% Verizon Communications Notes due June 2012 at a redemption price of 103.5% of principal amount of the notes and certain telephone subsidiary debt (see "Telephone and Other Subsidiary Debt" below), as well as for the repayment of commercial paper and other general corporate purposes. Any accrued and unpaid interest was paid to the date of redemption. In addition, we settled the interest rate swap with a notional value totaling \$1.0 billion related to the \$1.0 billion of 7.375% Verizon Communications Notes due September 2012.

During 2011, \$0.5 billion of 5.35% Verizon Communications Notes matured and were repaid and we utilized \$0.3 billion under fixed rate vendor financing facilities.

The debt obligations of Terremark that were outstanding at the time of its acquisition by Verizon were repaid during the second quarter of 2011.

Verizon Wireless – Notes Payable and Other

Verizon Wireless Capital LLC, a wholly owned subsidiary of Verizon Wireless, is a limited liability company formed under the laws of Delaware on December 7, 2001 as a special purpose finance subsidiary to facilitate the offering of debt securities of Verizon Wireless by acting as co-issuer. Other than the financing activities as a co-issuer of Verizon Wireless indebtedness, Verizon Wireless Capital LLC has no material assets, operations or revenues. Verizon Wireless is jointly and severally liable with Verizon Wireless Capital LLC for co-issued notes.

2012

During February 2012, \$0.8 billion of 5.25% Verizon Wireless Notes matured and were repaid. During July 2012, \$0.8 billion of 7.0% Verizon Wireless Notes matured and were repaid.

2011

During May 2011, \$4.0 billion aggregate principal amount of Verizon Wireless two-year fixed and floating rate notes matured and were repaid. During December 2011, we repaid \$0.9 billion upon maturity for the €0.7 billion of 7.625% Verizon Wireless Notes and the related cross currency swap was settled.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Telephone and Other Subsidiary Debt

2012

During January 2012, \$1.0 billion of 5.875% Verizon New Jersey Inc. Debentures matured and were repaid. During December 2012, we redeemed the \$1.0 billion of 4.625% Verizon Virginia LLC Debentures, Series A, due March 2013 at a redemption price of 101.1% of the principal amount of the debentures. Any accrued and unpaid interest was paid to the date of redemption.

In addition, during 2012, various Telephone and Other Subsidiary Debentures totaling approximately \$0.2 billion were repaid and any accrued and unpaid interest was paid to the date of payment.

2011

During April 2011, we redeemed the \$1.0 billion of 5.65% Verizon Pennsylvania Inc. Debentures due November 15, 2011 at a redemption price of 102.9% of the principal amount of the debentures; and the \$1.0 billion of 6.50% Verizon New England Inc. Debentures due September 15, 2011 at a redemption price of 102.3% of the principal amount of the debentures. Any accrued and unpaid interest was paid through the date of redemption.

During November 2011, we redeemed the following debentures: \$0.4 billion of 6.125% Verizon Florida Inc. Debentures due January 2013 at a redemption price of 106.3% of the principal amount of the debentures; \$0.5 billion of 6.125% Verizon Maryland Inc. Debentures due March 2012 at a redemption price of 101.5% of the principal amount of the debentures; and \$1.0 billion of 6.875% Verizon New York Inc. Debentures due April 2012 at a redemption price of 102.2% of the principal amount of the debentures. Any accrued and unpaid interest was paid through the date of redemption.

Early Debt Redemption and Other Costs

During November 2012, we recorded debt redemption costs of \$0.8 billion in connection with the purchase of \$0.9 billion of the \$1.25 billion of 8.95% Verizon Communications Notes due 2039 in a cash tender offer.

During December 2012, we recorded debt redemption costs of \$0.3 billion in connection with the early redemption of \$0.7 billion of the \$2.0 billion of 8.75% Verizon Communications Notes due 2018, \$1.0 billion of 4.625% Verizon Virginia LLC Debentures, Series A, due March 2013 and \$0.75 billion of 4.35% Verizon Communications Notes due February 2013, as well as \$0.3 billion of other costs.

During November 2011, we recorded debt redemption costs of \$0.1 billion in connection with the early redemption of \$1.0 billion of 7.375% Verizon Communications Notes due September 2012, \$0.6 billion of 6.875% Verizon Communications Notes due June 2012, \$0.4 billion of 6.125% Verizon Florida Inc. Debentures due January 2013, \$0.5 billion of 6.125% Verizon Maryland Inc. Debentures due March 2012 and \$1.0 billion of 6.875% Verizon New York Inc. Debentures due April 2012.

Guarantees

We guarantee the debentures and first mortgage bonds of our operating telephone company subsidiaries. As of December 31, 2012, \$4.3 billion principal amount of these obligations remain outstanding. Each guarantee will remain in place for the life of the obligation unless terminated pursuant to its terms, including the operating telephone company no longer being a wholly-owned subsidiary of Verizon.

We also guarantee the debt obligations of GTE Corporation that were issued and outstanding prior to July 1, 2003. As of December 31, 2012, \$1.7 billion principal amount of these obligations remain outstanding.

Debt Covenants

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

Maturities of Long-Term Debt

Maturities of long-term debt outstanding at December 31, 2012 are as follows:

Years	(dollars in millions)
2013	\$ 3,869
2014	6,809
2015	2,188
2016	4,146
2017	1,342
Thereafter	33,133

NOTE 9

FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

The following table presents the balances of assets measured at fair value on a recurring basis as of December 31, 2012:

	(dollars in millions)			
	Level 1 ⁽¹⁾	Level 2 ⁽²⁾	Level 3 ⁽³⁾	Total
Assets:				
Short-term investments:				
Equity securities	\$ 310	\$ –	\$ –	\$ 310
Fixed income securities	–	160	–	160
Other current assets:				
Interest rate swaps	–	7	–	7
Other assets:				
Fixed income securities	–	943	–	943
Cross currency swaps	–	153	–	153
Total	\$ 310	\$ 1,263	\$ –	\$ 1,573

(1) quoted prices in active markets for identical assets or liabilities

(2) observable inputs other than quoted prices in active markets for identical assets and liabilities

(3) no observable pricing inputs in the market

Equity securities consist of investments in common stock of domestic and international corporations measured using quoted prices in active markets.

Fixed income securities consist primarily of investments in municipal bonds that do not have quoted prices in active markets. For these securities, we use alternative matrix pricing resulting in these debt securities being classified as Level 2.

Derivative contracts are valued using models based on readily observable market parameters for all substantial terms of our derivative contracts and thus are classified within Level 2. We use mid-market pricing for fair value measurements of our derivative instruments.

We recognize transfers between levels of the fair value hierarchy as of the end of the reporting period. There were no transfers within the fair value hierarchy during 2012.

Fair Value of Short-term and Long-term Debt

The fair value of our debt is determined using various methods, including quoted prices for identical terms and maturities, which is a Level 1 measurement, as well as quoted prices for similar terms and maturities in inactive markets and future cash flows discounted at current rates, which are Level 2 measurements. The fair value of our short-term and long-term debt, excluding capital leases, was as follows:

At December 31,	(dollars in millions)			
	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Short- and long-term debt, excluding capital leases	\$ 51,689	\$ 61,552	\$ 54,800	\$ 64,485

Derivative Instruments
Interest Rate Swaps

We have entered into domestic interest rate swaps to achieve a targeted mix of fixed and variable rate debt. We principally receive fixed rates and pay variable rates based on the London Interbank Offered Rate, resulting in a net increase or decrease to Interest expense. These swaps are desig-

nated as fair value hedges and hedge against changes in the fair value of our debt portfolio. We record the interest rate swaps at fair value on our consolidated balance sheets as assets and liabilities. At December 31, 2012 the fair value of these interest rate swaps was not material, and at December 31, 2011, the fair value was \$0.6 billion, primarily included in Other assets and Long-term debt. As of December 31, 2012, the total notional amount of these interest rate swaps was \$1.3 billion. During 2012, interest rate swaps with a notional value of \$5.8 billion were settled. As a result of the settlements, we received net proceeds of \$0.7 billion, including accrued interest which is included in Other, net operating activities in the consolidated statement of cash flows. The fair value basis adjustment to the underlying debt instruments will be recognized into earnings as a reduction of Interest expense over the remaining lives of the underlying debt obligations.

Forward Interest Rate Swaps

In order to manage our exposure to future interest rate changes, during the second quarter of 2012, we entered into forward interest rate swaps with a notional value of \$1.0 billion. We designated these contracts as cash flow hedges. In November 2012, we settled these forward interest rate swaps and the pretax loss was not material.

Cross Currency Swaps

Verizon Wireless previously entered into cross currency swaps designated as cash flow hedges to exchange approximately \$1.6 billion of British Pound Sterling and Euro-denominated debt into U.S. dollars and to fix our future interest and principal payments in U.S. dollars, as well as to mitigate the impact of foreign currency transaction gains or losses. A portion of the gains and losses recognized in Other comprehensive income was reclassified to Other income and (expense), net to offset the related pretax foreign currency transaction gain or loss on the underlying debt obligations. The fair value of the outstanding swaps was not material at December 31, 2012 or December 31, 2011. During 2012 and 2011 the gains and losses with respect to these swaps were not material.

Prepaid Forward Agreement

During the first quarter of 2009, we entered into a privately negotiated prepaid forward agreement for 14 million shares of Verizon common stock at a cost of approximately \$0.4 billion. We terminated the prepaid forward agreement with respect to 5 million of the shares during the fourth quarter of 2009 and 9 million of the shares during the first quarter of 2010, which resulted in the delivery of those shares to Verizon.

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, 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. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 10

STOCK-BASED COMPENSATION

Verizon Communications Long-Term Incentive Plan

The Verizon Communications Inc. Long-Term Incentive Plan (the Plan) permits the granting of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance stock units and other awards. The maximum number of shares available for awards from the Plan is 119.6 million shares.

Restricted Stock Units

The Plan provides for grants of Restricted Stock Units (RSUs) that generally vest at the end of the third year after the grant. The RSUs granted prior to January 1, 2010 are classified as liability awards because the RSUs will be paid in cash upon vesting. The RSUs granted subsequent to January 1, 2010 are classified as equity awards because the RSUs will be paid in Verizon common stock upon vesting. The RSU equity awards are measured using the grant date fair value of Verizon common stock and are not remeasured at the end of each reporting period. Dividend equivalent units are also paid to participants at the time the RSU award is paid, and in the same proportion as the RSU award.

Performance Stock Units

The Plan also provides for grants of Performance Stock Units (PSUs) that generally vest at the end of the third year after the grant. As defined by the Plan, the Human Resources Committee of the Board of Directors determines the number of PSUs a participant earns based on the extent to which the corresponding performance goals have been achieved over the three-year performance cycle. The PSUs are classified as liability awards because the PSU awards are paid in cash upon vesting. The PSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the price of Verizon common stock as well as performance relative to the targets. Dividend equivalent units are also paid to participants at the time that the PSU award is determined and paid, and in the same proportion as the PSU award. The granted and cancelled activity for the PSU award includes adjustments for the performance goals achieved.

The following table summarizes Verizon's Restricted Stock Unit and Performance Stock Unit activity:

(shares in thousands)	Restricted Stock Units	Performance Stock Units
Outstanding January 1, 2010	19,443	29,895
Granted	8,422	17,311
Payments	(6,788)	(14,364)
Cancelled/Forfeited	(154)	(462)
Outstanding December 31, 2010	20,923	32,380
Granted	6,667	10,348
Payments	(7,600)	(12,137)
Cancelled/Forfeited	(154)	(2,977)
Outstanding December 31, 2011	19,836	27,614
Granted	6,350	20,537
Payments	(7,369)	(8,499)
Cancelled/Forfeited	(148)	(189)
Outstanding December 31, 2012	18,669	39,463

As of December 31, 2012, unrecognized compensation expense related to the unvested portion of Verizon's RSUs and PSUs was approximately \$0.4 billion and is expected to be recognized over approximately two years.

The RSUs granted in 2012 and 2011, and classified as equity awards, have weighted-average grant date fair values of \$38.67 and \$36.38 per unit, respectively. During 2012, 2011 and 2010, we paid \$0.6 billion, \$0.7 billion and \$0.7 billion, respectively, to settle RSUs and PSUs classified as liability awards.

Verizon Wireless' Long-Term Incentive Plan

The Verizon Wireless Long-Term Incentive Plan (the Wireless Plan) provides compensation opportunities to eligible employees of Verizon Wireless (the Partnership). Under the Wireless Plan, Value Appreciation Rights (VARs) were granted to eligible employees. As of December 31, 2012, all VARs were fully vested. We have not granted new VARs since 2004.

VARs reflect the change in the value of the Partnership, as defined in the Wireless Plan. Similar to stock options, the valuation is determined using a Black-Scholes model. Once VARs become vested, employees can exercise their VARs and receive a payment that is equal to the difference between the VAR price on the date of grant and the VAR price on the date of exercise, less applicable taxes. All outstanding VARs are fully exercisable and have a maximum term of 10 years. All VARs were granted at a price equal to the estimated fair value of the Partnership, as defined in the Wireless Plan, at the date of the grant.

The following table summarizes the assumptions used in the Black-Scholes model during 2012:

	End of Period
Risk-free rate	0.19%
Expected term (in years)	0.62
Expected volatility	43.27%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of the measurement date. Expected volatility was based on a blend of the historical and implied volatility of publicly traded peer companies for a period equal to the VARs expected life ending on the measurement date.

The following table summarizes the Value Appreciation Rights activity:

(shares in thousands)	VARs	Weighted-Average Grant-Date Fair Value
Outstanding rights, January 1, 2010	16,591	\$ 16.54
Exercised	(4,947)	24.47
Cancelled/Forfeited	(75)	22.72
Outstanding rights, December 31, 2010	11,569	13.11
Exercised	(3,303)	14.87
Cancelled/Forfeited	(52)	14.74
Outstanding rights, December 31, 2011	8,214	12.39
Exercised	(3,427)	10.30
Cancelled/Forfeited	(21)	11.10
Outstanding rights, December 31, 2012	4,766	13.89

During 2012, 2011 and 2010, we paid \$0.1 billion, respectively, to settle VARs classified as liability awards.

Stock-Based Compensation Expense

After-tax compensation expense for stock-based compensation related to RSUs, PSUs, and VARs described above included in Net income attributable to Verizon was \$0.7 billion, \$0.5 billion and \$0.5 billion for 2012, 2011 and 2010, respectively.

Stock Options

The Plan provides for grants of stock options to participants at an option price per share of no less than 100% of the fair market value of Verizon common stock on the date of grant. Each grant has a 10-year life, vesting equally over a three-year period, starting at the date of the grant. We have not granted new stock options since 2004.

The following table summarizes Verizon's stock option activity:

(shares in thousands)	Stock Options	Weighted-Average Exercise Price
Outstanding, January 1, 2010	107,765	\$ 44.52
Exercised	(372)	34.51
Cancelled/Forfeited	(50,549)	44.90
Outstanding, December 31, 2010	56,844	44.25
Exercised	(7,104)	35.00
Cancelled/Forfeited	(21,921)	51.06
Outstanding, December 31, 2011	27,819	41.24
Exercised	(7,447)	35.20
Cancelled/Forfeited	(17,054)	45.15
Outstanding, December 31, 2012	3,318	34.69

All stock options outstanding at December 31, 2012, 2011 and 2010 were exercisable.

The following table summarizes information about Verizon's stock options outstanding as of December 31, 2012:

Range of Exercise Prices	Stock Options (in thousands)	Weighted-Average Remaining Life (years)	Weighted-Average Exercise Price
\$ 30.00-39.99	3,273	0.8	\$ 34.58
40.00-49.99	45	0.3	42.99
Total	3,318	0.8	34.69

The total intrinsic value for stock options outstanding as of December 31, 2012 is not significant. The total intrinsic value of stock options exercised was \$0.1 billion in 2012 and the associated tax benefits were not significant in 2012, 2011 and 2010. The amount of cash received from the exercise of stock options was \$0.3 billion in 2012, \$0.2 billion in 2011 and not significant in 2010. There was no stock option expense for 2012, 2011 and 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 11

EMPLOYEE BENEFITS

We maintain non-contributory defined benefit pension plans for many of our employees. In addition, we maintain postretirement health care and life insurance plans for our retirees and their dependents, which are both contributory and non-contributory, and include a limit on our share of the cost for certain recent and future retirees. In accordance with our accounting policy for pension and other postretirement benefits, operating expenses include pension and benefit related charges based on actuarial assumptions, including projected discount rates and an estimated return on plan assets. These estimates are updated in the fourth quarter to reflect actual return on plan assets and updated actuarial assumptions. The adjustment is recognized in the income statement during the fourth quarter or upon a remeasurement event pursuant to our accounting policy for the recognition of actuarial gains/losses.

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. 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.

Obligations and Funded Status

At December 31,	(dollars in millions)			
	Pension		Health Care and Life	
	2012	2011	2012	2011
Change in Benefit Obligations				
Beginning of year	\$ 30,582	\$ 29,217	\$ 27,369	\$ 25,718
Service cost	358	307	359	299
Interest cost	1,449	1,590	1,284	1,421
Plan amendments	183	(485)	(1,826)	-
Actuarial loss, net	6,074	3,360	1,402	1,687
Benefits paid	(2,735)	(2,564)	(1,744)	(1,756)
Annuity purchase	(8,352)	-	-	-
Settlements paid	(786)	(843)	-	-
End of Year	\$ 26,773	\$ 30,582	\$ 26,844	\$ 27,369
Change in Plan Assets				
Beginning of year	\$ 24,110	\$ 25,814	\$ 2,628	\$ 2,945
Actual return on plan assets	2,326	1,191	312	63
Company contributions	3,719	512	1,461	1,376
Benefits paid	(2,735)	(2,564)	(1,744)	(1,756)
Settlements paid	(786)	(843)	-	-
Annuity purchase	(8,352)	-	-	-
End of year	\$ 18,282	\$ 24,110	\$ 2,657	\$ 2,628
Funded Status				
End of year	\$ (8,491)	\$ (6,472)	\$ (24,187)	\$ (24,741)

At December 31,	(dollars in millions)			
	Pension		Health Care and Life	
	2012	2011	2012	2011
Amounts recognized on the balance sheet				
Noncurrent assets	\$ 236	\$ 289	\$ -	\$ -
Current liabilities	(129)	(195)	(766)	(735)
Noncurrent liabilities	(8,598)	(6,566)	(23,421)	(24,006)
Total	\$ (8,491)	\$ (6,472)	\$ (24,187)	\$ (24,741)
Amounts recognized in Accumulated Other Comprehensive Income (Pretax)				
Prior Service Cost	\$ 181	\$ (3)	\$ (2,247)	\$ (510)
Total	\$ 181	\$ (3)	\$ (2,247)	\$ (510)

See Note 12 ("Taxes") for details regarding the impact of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, both of which became law in March 2010.

Beginning in 2013, as a result of federal health care reform, Verizon will no longer file for the Retiree Drug Subsidy (RDS) and will instead contract with a Medicare Part D plan on a group basis to provide prescription drug benefits to Medicare eligible retirees. This change to our Medicare Part D strategy resulted in the adoption of plan amendments during the fourth quarter of 2010 which will allow the company to be eligible for greater Medicare Part D plan subsidies over time.

During 2012, we reached agreements with the Communications Workers of America and the International Brotherhood of Electrical Workers on new, three-year contracts that cover approximately 43,000 Wireline employees. This resulted in the adoption of plan amendments which will result in lower other postretirement benefit costs in 2013 and beyond.

The accumulated benefit obligation for all defined benefit pension plans was \$26.5 billion and \$30.3 billion at December 31, 2012 and 2011, respectively.

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

At December 31,	(dollars in millions)	
	2012	2011
Projected benefit obligation	\$ 26,351	\$ 29,643
Accumulated benefit obligation	26,081	29,436
Fair value of plan assets	17,623	22,916

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Net Periodic Cost

The following table summarizes the benefit (income) cost related to our pension and postretirement health care and life insurance plans:

Years Ended December 31,	Pension			Health Care and Life		
	2012	2011	2010	2012	2011	2010
Service cost	\$ 358	\$ 307	\$ 353	\$ 359	\$ 299	\$ 305
Amortization of prior service cost (credit)	(1)	72	109	(89)	(57)	375
Subtotal	357	379	462	270	242	680
Expected return on plan assets	(1,795)	(1,976)	(2,176)	(171)	(163)	(252)
Interest cost	1,449	1,590	1,797	1,284	1,421	1,639
Subtotal	11	(7)	83	1,383	1,500	2,067
Remeasurement (gain) loss, net	5,542	4,146	(166)	1,262	1,787	758
Net periodic benefit (income) cost	5,553	4,139	(83)	2,645	3,287	2,825
Curtailement and termination benefits	–	–	860	–	–	386
Total	\$ 5,553	\$ 4,139	\$ 777	\$ 2,645	\$ 3,287	\$ 3,211

Other pre-tax changes in plan assets and benefit obligations recognized in other comprehensive (income) loss are as follows:

At December 31,	Pension		Health Care and Life	
	2012	2011	2012	2011
Prior service cost	\$ 183	\$ (485)	\$ (1,826)	\$ –
Reversal of amortization items				
Prior service cost	1	(72)	89	57
Total recognized in other comprehensive (income) loss (pretax)	\$ 184	\$ (557)	\$ (1,737)	\$ 57

The estimated prior service cost for the defined benefit pension plan that will be amortized from Accumulated other comprehensive income (loss) into net periodic benefit cost over the next fiscal year is not significant. The estimated prior service cost for the defined benefit postretirement plans that will be amortized from Accumulated other comprehensive income (loss) into net periodic benefit (income) cost over the next fiscal year is \$(0.2 billion).

Assumptions

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

At December 31,	Pension		Health Care and Life	
	2012	2011	2012	2011
Discount Rate	4.20%	5.00%	4.20%	5.00%
Rate of compensation increases	3.00	3.00	N/A	N/A

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

At December 31,	Pension			Health Care and Life		
	2012	2011	2010	2012	2011	2010
Discount Rate	5.00%	5.75%	6.25%	5.00%	5.75%	6.25%
Expected return on plan assets	7.50	8.00	8.50	7.00	6.00	8.25
Rate of compensation increases	3.00	3.00	4.00	N/A	N/A	N/A

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. Those estimates are based on a combination of factors including the current market interest rates and valuation levels, consensus earnings expectations and historical 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The assumed health care cost trend rates follow:

At December 31,	Health Care and Life		
	2012	2011	2010
Healthcare cost trend rate assumed for next year	7.00%	7.50%	7.75%
Rate to which cost trend rate gradually declines	5.00	5.00	5.00
Year the rate reaches the level it is assumed to remain thereafter	2016	2016	2016

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 2012 service and interest cost	\$ 232	\$ (187)
Effect on postretirement benefit obligation as of December 31, 2012	3,251	(2,669)

Plan Assets

Historically, our portfolio strategy emphasized a long-term equity orientation, significant global diversification, and the use of both public and private investments. In an effort to reduce the risk of our portfolio strategy and better align assets with liabilities, we have shifted our strategy to one that is more liability driven, where cash flows from investments better match projected benefit payments but result in lower asset returns. We intend to reduce the likelihood that assets will decline at a time when liabilities increase (referred to as liability hedging), with the goal to reduce the risk of underfunding to the plan and its participants and beneficiaries. Both active and passive management approaches are used depending on perceived market efficiencies and various other factors. Our diversification and risk control processes serve to minimize the concentration of risk.

While target allocation percentages will vary over time, the company's overall investment strategy is to achieve a mix of assets, which allows us to meet projected benefits payments while taking into consideration risk and return. The current target allocation for plan assets is designed so that 70% of the assets have the objective of achieving a return in excess of the growth in liabilities (comprised of public equities, private equities, real estate, hedge funds and emerging debt) and 30% of the assets are invested as liability hedging assets (typically longer duration fixed income). This allocation will shift as funded status improves to a higher allocation to liability hedging assets. Target policies will be revisited periodically to ensure they are in line with fund objectives. Due to our diversification and risks control processes, there are no significant concentrations of risk, in terms of sector, industry, geography or company names.

Pension and healthcare and life plans assets do not include significant amounts of Verizon common stock.

Pension Plans

The fair values for the pension plans by asset category at December 31, 2012 are as follows:

Asset Category	(dollars in millions)			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 1,618	\$ 1,586	\$ 32	\$ –
Equity securities	2,944	2,469	475	–
Fixed income securities				
U.S. Treasuries and agencies	1,589	1,125	464	–
Corporate bonds	2,456	35	2,225	196
International bonds	601	140	461	–
Other	210	–	210	–
Real estate	2,018	–	–	2,018
Other				
Private equity	5,039	–	–	5,039
Hedge funds	1,807	–	1,249	558
Total	\$ 18,282	\$ 5,355	\$ 5,116	\$ 7,811

The fair values for the pension plans by asset category at December 31, 2011 are as follows:

Asset Category	(dollars in millions)			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 1,215	\$ 1,184	\$ 31	\$ –
Equity securities	6,829	5,704	1,125	–
Fixed income securities				
U.S. Treasuries and agencies	1,796	1,239	557	–
Corporate bonds	2,140	65	1,886	189
International bonds	1,163	158	1,005	–
Other	359	–	359	–
Real estate	2,158	–	–	2,158
Other				
Private equity	6,109	–	54	6,055
Hedge funds	2,341	–	1,679	662
Total	\$ 24,110	\$ 8,350	\$ 6,696	\$ 9,064

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following is a reconciliation of the beginning and ending balance of pension plan assets that are measured at fair value using significant unobservable inputs:

	Corporate Bonds	Real Estate	Private Equity	Hedge Funds	Total
Balance at January 1, 2011	\$ 180	\$ 1,769	\$ 5,849	\$ 716	\$ 8,514
Actual gain (loss) on plan assets	(4)	258	477	(4)	727
Purchases and sales	48	43	(203)	(50)	(162)
Transfers in and/or out	(35)	88	(68)	-	(15)
Balance at December 31, 2011	\$ 189	\$ 2,158	\$ 6,055	\$ 662	\$ 9,064
Actual gain on plan assets	12	84	146	43	285
Purchases and sales	(14)	(224)	(1,162)	(147)	(1,547)
Transfers in	9	-	-	-	9
Balance at December 31, 2012	\$ 196	\$ 2,018	\$ 5,039	\$ 558	\$ 7,811

Health Care and Life Plans

The fair values for the other postretirement benefit plans by asset category at December 31, 2012 are as follows:

Asset Category	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 291	\$ 13	\$ 278	\$ -
Equity securities	1,753	1,004	749	-
Fixed income securities				
U.S. Treasuries and agencies	118	80	38	-
Corporate bonds	192	11	181	-
International bonds	189	72	117	-
Other	114	-	114	-
Total	\$ 2,657	\$ 1,180	\$ 1,477	\$ -

The fair values for the other postretirement benefit plans by asset category at December 31, 2011 are as follows:

Asset Category	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 281	\$ 22	\$ 259	\$ -
Equity securities	1,695	951	744	-
Fixed income securities				
U.S. Treasuries and agencies	85	58	27	-
Corporate bonds	119	26	93	-
International bonds	192	67	125	-
Other	210	-	210	-
Other	46	-	46	-
Total	\$ 2,628	\$ 1,124	\$ 1,504	\$ -

The following are general descriptions of asset categories, as well as the valuation methodologies and inputs used to determine the fair value of each major category of assets.

Cash and cash equivalents include short-term investment funds, primarily in diversified portfolios of investment grade money market instruments and are valued using quoted market prices or other valuation methods, and thus are classified within Level 1 or Level 2.

Equity securities are investments in common stock of domestic and international corporations in a variety of industry sectors, and are valued primarily using quoted market prices or other valuation methods, and thus are classified within Level 1 or Level 2.

Fixed income securities include U.S. Treasuries and agencies, debt obligations of foreign governments and domestic and foreign corporations. Fixed income also includes investments in collateralized mortgage obligations, mortgage backed securities and interest rate swaps. The fair value of fixed income securities is based on observable prices for identical or comparable assets, adjusted using benchmark curves, sector grouping, matrix pricing, broker/dealer quotes and issuer spreads, and thus is classified within Level 1 or Level 2.

Real estate investments include those in limited partnerships that invest in various commercial and residential real estate projects both domestically and internationally. The fair values of real estate assets are typically determined by using income and/or cost approaches or a comparable sales approach, taking into consideration discount and capitalization rates, financial conditions, local market conditions and the status of the capital markets, and thus are classified within Level 3.

Private equity investments include those in limited partnerships that invest in operating companies that are not publicly traded on a stock exchange. Investment strategies in private equity include leveraged buy-outs, venture capital, distressed investments and investments in natural resources. These investments are valued using inputs such as trading multiples of comparable public securities, merger and acquisition activity and pricing data from the most recent equity financing taking into consideration illiquidity, and thus are classified within Level 3.

Hedge fund investments include those seeking to maximize absolute returns using a broad range of strategies to enhance returns and provide additional diversification. The fair values of hedge funds are estimated using net asset value per share (NAV) of the investments. Verizon has the ability to redeem these investments at NAV within the near term and thus are classified within Level 2. Investments that cannot be redeemed in the near term are classified within Level 3.

Cash Flows

In 2012, we contributed \$0.9 billion to our qualified pension plans, \$0.2 billion to our nonqualified pension plans and \$1.5 billion to our other postretirement benefit plans, exclusive of the annuitization discussed below. We expect the qualified pension plan contributions in 2013 to be immaterial. We anticipate approximately \$0.1 billion in contributions to our non-qualified pension plans and \$1.5 billion to our other postretirement benefit plans in 2013.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Estimated Future Benefit Payments

The benefit payments to retirees are expected to be paid as follows:

(dollars in millions)

Year	Pension Benefits	Health Care and Life
2013	\$ 3,487	\$ 1,662
2014	2,513	1,670
2015	2,315	1,665
2016	1,782	1,614
2017	1,686	1,567
2018–2022	6,703	7,174

Savings Plan and Employee Stock Ownership Plans

We maintain four leveraged employee stock ownership plans (ESOP). Only one plan currently has unallocated shares. We match a certain percentage of eligible employee contributions to the savings plans with shares of our common stock from this ESOP. At December 31, 2012, the number of unallocated and allocated shares of common stock in this ESOP was 711,000 and 64 million, respectively. All leveraged ESOP shares are included in earnings per share computations.

Total savings plan costs were \$0.7 billion in 2012, 2011 and 2010, respectively.

Pension Annuitization

On October 17, 2012, we, along with our subsidiary Verizon Investment Management Corp., and Fiduciary Counselors Inc., as independent fiduciary of the Verizon Management Pension Plan (the Plan), entered into a definitive purchase agreement with The Prudential Insurance Company of America (Prudential) and Prudential Financial, Inc., pursuant to which the Plan would purchase a single premium group annuity contract from Prudential.

On December 10, 2012, upon issuance of the group annuity contract by Prudential, Prudential irrevocably assumed the obligation to make future annuity payments to approximately 41,000 Verizon management retirees who began receiving pension payments from the Plan prior to January 1, 2010. The amount of each retiree's annuity payment equals the amount of such individual's pension benefit. In addition, the group annuity contract is intended to replicate the same rights to future payments, such as survivor benefits, that are currently offered by the Plan.

We contributed approximately \$2.6 billion to the Plan between September 1, 2012 and December 31, 2012 in connection with the transaction so that the Plan's funding percentage would not decrease as a result of the transaction.

Severance Benefits

The following table provides an analysis of our actuarially determined severance liability recorded in accordance with the accounting standard regarding employers' accounting for postemployment benefits:

(dollars in millions)

Year	Beginning of Year	Charged to Expense	Payments	Other	End of Year
2010	\$ 1,638	\$ 1,217	\$ (1,307)	\$ 21	\$ 1,569
2011	1,569	32	(474)	(14)	1,113
2012	1,113	396	(531)	32	1,010

Severance, Pension and Benefit Charges

During 2012, we recorded net pre-tax severance, pension and benefits charges of approximately \$7.2 billion primarily for our pension and postretirement plans in accordance with our accounting policy to recognize actuarial gains and losses in the year in which they occur. The charges were primarily driven by a decrease in our discount rate assumption used to determine the current year liabilities from a weighted-average of 5% at December 31, 2011 to a weighted-average of 4.2% at December 31, 2012 (\$5.3 billion) and revisions to the retirement assumptions for participants and other assumption adjustments, partially offset by the difference between our estimated return on assets of 7.5% and our actual return on assets of 10% (\$0.7 billion). As part of this charge, we also recorded \$1.0 billion related to the annuitization of pension liabilities, as described above, as well as severance charges of \$0.4 billion primarily for approximately 4,000 management employees.

During 2011, we recorded net pre-tax severance, pension and benefits charges of approximately \$6.0 billion for our pension and postretirement plans in accordance with our accounting policy to recognize actuarial gains and losses in the year in which they occur. The charges were primarily driven by a decrease in our discount rate assumption used to determine the current year liabilities from 5.75% at December 31, 2010 to 5% at December 31, 2011 (\$5.0 billion); the difference between our estimated return on assets of 8% and our actual return on assets of 5% (\$0.9 billion); and revisions to the life expectancy of participants and other adjustments to assumptions.

During 2010, we recorded net pre-tax severance, pension and benefits charges of \$3.1 billion. The charges during 2010 included rereasurement losses of \$0.6 billion, for our pension and postretirement plans in accordance with our accounting policy to recognize actuarial gains and losses in the year in which they occur. Additionally, in 2010, we reached an agreement with certain unions on temporary enhancements to the separation programs contained in their existing collective bargaining agreements. These temporary enhancements were intended to help address a previously declared surplus of employees and to help reduce the need for layoffs. Accordingly, we recorded severance, pension and benefits charges associated with approximately 11,900 union-represented employees who volunteered for the incentive offer. These charges included \$1.2 billion for severance for the 2010 separation programs mentioned above and a planned workforce reduction of approximately 2,500 employees in 2011. In addition, we recorded \$1.3 billion for pension and postretirement curtailment losses and special termination benefits due to the workforce reductions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 12

TAXES

The components of income before provision for income taxes are as follows:

Years Ended December 31,	2012	(dollars in millions)	
		2011	2010
Domestic	\$ 9,316	\$ 9,724	\$ 11,921
Foreign	581	759	763
Total	\$ 9,897	\$ 10,483	\$ 12,684

The components of the provision (benefit) for income taxes are as follows:

Years Ended December 31,	2012	(dollars in millions)	
		2011	2010
Current			
Federal	\$ 223	\$ 193	\$ (705)
Foreign	(45)	25	(19)
State and Local	114	290	(42)
Total	292	508	(766)
Deferred			
Federal	(553)	276	2,945
Foreign	10	(38)	(24)
State and Local	(403)	(455)	316
Total	(946)	(217)	3,237
Investment tax credits	(6)	(6)	(4)
Total income tax provision (benefit)	\$ (660)	\$ 285	\$ 2,467

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,	2012	2011	2010
Statutory federal income tax rate	35.0%	35.0%	35.0%
State and local income tax rate, net of federal tax benefits	(1.9)	(1.0)	1.4
Affordable housing credit	(1.9)	(1.8)	(1.3)
Employee benefits including ESOP dividend	(1.1)	(1.4)	(1.2)
Medicare Part D subsidy charge	-	-	6.9
Equity in earnings from unconsolidated businesses	(1.4)	(1.9)	(1.6)
Noncontrolling interest	(33.7)	(23.0)	(19.5)
Other, net	(1.7)	(3.2)	(0.3)
Effective income tax rate	(6.7)%	2.7%	19.4%

The effective income tax rate for 2012 was (6.7)% compared to 2.7% for 2011. The negative effective income tax rate for 2012 and the decrease in the provision for income taxes during 2012 compared to 2011 was primarily due to lower income before income taxes as a result of higher severance, pension, and benefit charges as well as early debt redemption costs recorded in the current year.

The effective income tax rate in 2011 decreased to 2.7% from 19.4% in 2010. This decrease was primarily driven by lower income before provision for income taxes as a result of higher pension and benefit charges recorded in 2011 as well as tax benefits from state valuation allowance reversals in 2011. The decrease was also due to a one-time, non-cash income tax charge of \$1.0 billion recorded during the three months ended March 31, 2010 as a result of the enactment of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, both of which became law in March 2010 (collectively the Health Care Act). Under the Health Care Act, beginning in 2013, Verizon and other companies that receive a subsidy under Medicare Part D to provide retiree prescription drug coverage will no longer receive a federal income tax deduction for the expenses incurred in connection with providing the subsidized coverage to the extent of the subsidy received. Because future anticipated retiree prescription drug plan liabilities and related subsidies are already reflected in Verizon's financial statements, this change in law required Verizon to reduce the value of the related tax benefits recognized in its financial statements in the period during which the Health Care Act was enacted.

The amounts of cash taxes paid are as follows:

Years Ended December 31,	2012	(dollars in millions)	
		2011	2010
Income taxes, net of amounts refunded	\$ 351	\$ 762	\$ 430
Employment taxes	1,308	1,328	1,372
Property and other taxes	1,727	1,883	1,963
Total	\$ 3,386	\$ 3,973	\$ 3,765

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Deferred taxes arise because of differences in the book and tax bases of certain assets and liabilities. Significant components of deferred tax assets and liabilities are as follows:

At December 31,	(dollars in millions)	
	2012	2011
Employee benefits	\$ 13,644	\$ 13,119
Tax loss and credit carry forwards	4,819	5,170
Uncollectible accounts receivable	206	224
Other – assets	1,050	952
	19,719	19,465
Valuation allowances	(2,041)	(2,376)
Deferred tax assets	17,678	17,089
Former MCI intercompany accounts receivable basis difference	1,275	1,435
Depreciation	13,953	13,743
Leasing activity	1,208	1,569
Wireless joint venture including wireless licenses	22,171	21,778
Other – liabilities	1,320	1,233
Deferred tax liabilities	39,927	39,758
Net deferred tax liability	\$ 22,249	\$ 22,669

At December 31, 2012, undistributed earnings of our foreign subsidiaries indefinitely invested outside of the United States amounted to approximately \$1.8 billion. The majority of Verizon's cash flow is generated from domestic operations and we are not dependent on foreign cash or earnings to meet our funding requirements, nor do we intend to repatriate these undistributed foreign earnings to fund U.S. operations. Furthermore, a portion of these undistributed earnings represents amounts that legally must be kept in reserve in accordance with certain foreign jurisdictional requirements and are unavailable for distribution or repatriation. As a result, we have not provided U.S. deferred taxes on these undistributed earnings because we intend that they will remain indefinitely reinvested outside of the United States and therefore unavailable for use in funding U.S. operations. Determination of the amount of unrecognized deferred taxes related to these undistributed earnings is not practicable.

At December 31, 2012, we had net after tax loss and credit carry forwards for income tax purposes of approximately \$4.6 billion. Of these net after tax loss and credit carry forwards, approximately \$4.0 billion will expire between 2013 and 2032 and approximately \$0.6 billion may be carried forward indefinitely. The amount of net after tax loss and credit carry forwards reflected as a deferred tax asset above has been reduced by approximately \$0.1 billion at December 31, 2012 and 2011, respectively, due to federal and state tax law limitations on utilization of net operating losses.

During 2012, the valuation allowance decreased approximately \$0.3 billion. The balance of the valuation allowance at December 31, 2012 and the 2012 activity is primarily related to state and foreign tax losses and credit carry forwards.

Unrecognized Tax Benefits

A reconciliation of the beginning and ending balance of unrecognized tax benefits is as follows:

	(dollars in millions)		
	2012	2011	2010
Balance at January 1,	\$ 3,078	\$ 3,242	\$ 3,400
Additions based on tax positions related to the current year	131	111	231
Additions for tax positions of prior years	92	456	476
Reductions for tax positions of prior years	(415)	(644)	(569)
Settlements	100	(56)	(256)
Lapses of statutes of limitations	(43)	(31)	(40)
Balance at December 31,	\$ 2,943	\$ 3,078	\$ 3,242

Included in the total unrecognized tax benefits at December 31, 2012, 2011 and 2010 is \$2.1 billion, \$2.2 billion and \$2.1 billion, respectively, that if recognized, would favorably affect the effective income tax rate.

We recognized the following net after tax benefits related to interest and penalties in the provision for income taxes:

Years Ended December 31,	(dollars in millions)	
2012	\$	82
2011		60
2010		29

The after-tax accruals for the payment of interest and penalties in the consolidated balance sheets are as follows:

At December 31,	(dollars in millions)	
2012	\$	386
2011		470

Verizon and/or its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various state, local and foreign jurisdictions. As a large taxpayer, we are under audit by the Internal Revenue Service (IRS) and multiple state and foreign jurisdictions for various open tax years. The IRS commenced its examination of the Company's U.S. income tax returns for tax years 2007-2009 in the third quarter of 2012. Significant tax examinations are ongoing in Italy and New York City for tax years as early as 2000. The amount of unrecognized tax benefits will change in the next twelve months due to the resolution of various income tax matters, including the resolution of tax litigation in Canada in the first quarter of 2013. An estimate of the range of the possible change cannot be made until these tax matters are further developed or resolved. The impacts of the favorable resolution of the Canada litigation will be accounted for in the first quarter of 2013.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 13

SEGMENT INFORMATION

Reportable Segments

We have two 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 operating income, consistent with the chief operating decision maker's assessment of segment performance.

Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses, such as our investments in unconsolidated businesses, pension and other employee benefit related costs, lease financing, as well as the historical results of divested operations and other adjustments and gains and losses that are not allocated in assessing segment performance due to their 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 as these items are included in the chief operating decision maker's assessment of segment performance.

The reconciliation of segment operating revenues and expenses to consolidated operating revenues and expenses below also includes those items of a non-recurring or non-operational nature. We exclude from segment results the effects of certain items that management does not consider in assessing segment performance, primarily because of their non-recurring or non-operational nature.

In order to comply with regulatory conditions related to the acquisition of Alltel in January 2009, Verizon Wireless divested overlapping properties in 105 operating markets in 24 states during the first half of 2010. In addition, on July 1, 2010, certain of Verizon's local exchange business and related activities in 14 states were spun off (see Note 2). Accordingly, the historical Verizon Wireless and Wireline results for these operations have been reclassified to Corporate and Other to reflect comparable segment operating results.

We have adjusted prior-period consolidated and segment information, where applicable, to conform to current year presentation.

Our segments and their principal activities consist of the following:

Segment	Description
Verizon Wireless	Verizon Wireless' communications products and services include wireless voice and data services and equipment sales, which are provided to consumer, business and government customers across the United States.
Wireline	Wireline's voice, data and video communications products and enhanced services include local and long distance voice, broadband Internet access and video, corporate networking solutions, data center and cloud services and security and managed network services. We provide these products and services to consumers in the United States, as well as to carriers, businesses and government customers both in the United States and in over 150 other countries around the world.

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

	(dollars in millions)		
2012	Verizon Wireless	Wireline	Total Segments
External Operating Revenues			
Retail service	\$ 61,383	\$ -	\$ 61,383
Other service	2,290	-	2,290
Service revenue	<u>63,673</u>	-	<u>63,673</u>
Equipment	8,010	-	8,010
Other	4,096	-	4,096
Consumer retail	-	14,043	14,043
Small business	-	2,648	2,648
Mass Markets	-	<u>16,691</u>	<u>16,691</u>
Strategic services	-	8,052	8,052
Core	-	7,240	7,240
Global Enterprise	-	15,292	15,292
Global Wholesale	-	6,177	6,177
Other	-	508	508
Intersegment revenues	89	1,112	1,201
Total operating revenues	<u>75,868</u>	<u>39,780</u>	<u>115,648</u>
Cost of services and sales	24,490	22,413	46,903
Selling, general and administrative expense	21,650	8,883	30,533
Depreciation and amortization expense	7,960	8,424	16,384
Total operating expenses	<u>54,100</u>	<u>39,720</u>	<u>93,820</u>
Operating income	<u>\$ 21,768</u>	<u>\$ 60</u>	<u>\$ 21,828</u>
Assets	\$ 142,485	\$ 84,815	\$ 227,300
Plant, property and equipment, net	34,545	52,911	87,456
Capital expenditures	8,857	6,342	15,199

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

2011	Verizon Wireless	Wireline	(dollars in millions) Total Segments
External Operating Revenues			
Retail service	\$ 56,601	\$ -	\$ 56,601
Other service	2,497	-	2,497
Service revenue	59,098	-	59,098
Equipment			
Other	7,446	-	7,446
	3,517	-	3,517
Consumer retail	-	13,605	13,605
Small business	-	2,720	2,720
Mass Markets	-	16,325	16,325
Strategic services	-	7,607	7,607
Core	-	8,014	8,014
Global Enterprise	-	15,621	15,621
Global Wholesale	-	6,795	6,795
Other	-	704	704
Intersegment revenues	93	1,237	1,330
Total operating revenues	70,154	40,682	110,836
Cost of services and sales	24,086	22,158	46,244
Selling, general and administrative expense	19,579	9,107	28,686
Depreciation and amortization expense	7,962	8,458	16,420
Total operating expenses	51,627	39,723	91,350
Operating income	\$ 18,527	\$ 959	\$ 19,486
Assets	\$ 147,378	\$ 86,185	\$ 233,563
Plant, property and equipment, net	33,451	54,149	87,600
Capital expenditures	8,973	6,399	15,372

2010	Verizon Wireless	Wireline	(dollars in millions) Total Segments
External Operating Revenues			
Retail service	\$ 53,267	\$ -	\$ 53,267
Other service	2,321	-	2,321
Service revenue	55,588	-	55,588
Equipment			
Other	4,412	-	4,412
	3,341	-	3,341
Consumer retail	-	13,419	13,419
Small business	-	2,828	2,828
Mass Markets	-	16,247	16,247
Strategic services	-	6,602	6,602
Core	-	8,712	8,712
Global Enterprise	-	15,314	15,314
Global Wholesale	-	7,526	7,526
Other	-	858	858
Intersegment revenues	66	1,282	1,348
Total operating revenues	63,407	41,227	104,634
Cost of services and sales	19,245	22,618	41,863
Selling, general and administrative expense	18,082	9,372	27,454
Depreciation and amortization expense	7,356	8,469	15,825
Total operating expenses	44,683	40,459	85,142
Operating income	\$ 18,724	\$ 768	\$ 19,492
Assets	\$ 138,863	\$ 83,849	\$ 222,712
Plant, property and equipment, net	32,253	54,594	86,847
Capital expenditures	8,438	7,269	15,707

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Reconciliation to Consolidated Financial Information

A reconciliation of the segment operating revenues to consolidated operating revenues is as follows:

Years Ended December 31,	(dollars in millions)		
	2012	2011	2010
Operating Revenues			
Total reportable segments	\$ 115,648	\$ 110,836	\$ 104,634
Reconciling items:			
Deferred revenue adjustment (see Note 1)	-	-	(235)
Impact of divested operations	-	-	2,407
Corporate, eliminations and other	198	39	(241)
Consolidated operating revenues	<u>\$ 115,846</u>	<u>\$ 110,875</u>	<u>\$ 106,565</u>

A reconciliation of the total of the reportable segments' operating income to consolidated Income before provision for income taxes is as follows:

Years Ended December 31,	(dollars in millions)		
	2012	2011	2010
Operating Income			
Total segment operating income	\$ 21,828	\$ 19,486	\$ 19,492
Merger integration and acquisition related charges (see Note 2)	-	-	(867)
Access line spin-off related charges (see Note 2)	-	-	(407)
Litigation settlements (see Note 16)	(384)	-	-
Severance, pension and benefit charges (see Note 11)	(7,186)	(5,954)	(3,054)
Deferred revenue adjustment (see Note 1)	-	-	(235)
Impact of divested operations (see Note 2)	-	-	755
Other costs (see Note 8)	(276)	-	-
Corporate, eliminations and other	(822)	(652)	(1,039)
Consolidated operating income	<u>13,160</u>	<u>12,880</u>	<u>14,645</u>
Equity in earnings of unconsolidated businesses	324	444	508
Other income and (expense), net	(1,016)	(14)	54
Interest expense	(2,571)	(2,827)	(2,523)
Income Before Provision for Income Taxes	<u>\$ 9,897</u>	<u>\$ 10,483</u>	<u>\$ 12,684</u>

A reconciliation of the total of the reportable segments' assets to consolidated assets is as follows:

At December 31,	(dollars in millions)	
	2012	2011
Assets		
Total reportable segments	\$ 227,300	\$ 233,563
Corporate, eliminations and other	(2,078)	(3,102)
Total consolidated	<u>\$ 225,222</u>	<u>\$ 230,461</u>

We generally account for intersegment sales of products and services and asset transfers at current market prices. No single customer accounted for more than 10% of our total operating revenues during the years ended December 31, 2012, 2011 and 2010. International operating revenues and long-lived assets are not significant.

NOTE 14

COMPREHENSIVE INCOME

Comprehensive income consists of net income and other gains and losses affecting equity that, under GAAP, are excluded from net income. Significant changes in the components of Other comprehensive income, net of provision for income taxes are described below.

Foreign Currency Translation Adjustments

The change in Foreign currency translation adjustments during 2012, 2011 and 2010 was primarily related to our investment in Vodafone Omnitel N.V. and was primarily driven by the movements of the U.S. dollar against the Euro.

Net Unrealized Gains (Losses) on Cash Flow Hedges

During 2012, 2011 and 2010, Unrealized gains (losses) on cash flow hedges included in Other comprehensive income attributable to non-controlling interest, primarily reflect activity related to a cross currency swap (see Note 9). Reclassification adjustments for gains (losses) realized in net income were not significant.

Net Unrealized Gains (Losses) on Marketable Securities

During 2012, 2011 and 2010, reclassification adjustments on marketable securities for gains (losses) realized in net income were not significant.

Defined Benefit Pension and Postretirement Plans

The change in Defined benefit pension and postretirement plans of \$0.9 billion, net of taxes of \$0.6 billion at December 31, 2012 was primarily a result of plan amendments.

The change in Defined benefit pension and postretirement plans of \$0.3 billion, net of taxes of \$0.2 billion at December 31, 2011 was primarily a result of plan amendments.

Accumulated Other Comprehensive Income

The components of Accumulated other comprehensive income were as follows:

At December 31,	(dollars in millions)	
	2012	2011
Foreign currency translation adjustments	\$ 793	\$ 724
Net unrealized gain on cash flow hedges	88	156
Unrealized gain on marketable securities	101	72
Defined benefit pension and postretirement plans	1,253	317
Accumulated Other Comprehensive Income	\$ 2,235	\$ 1,269

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 15

ADDITIONAL FINANCIAL INFORMATION

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

Income Statement Information

Years Ended December 31,	2012	2011	(dollars in millions) 2010
Depreciation expense	\$ 14,920	\$ 14,991	\$ 14,593
Interest costs on debt balances	2,977	3,269	3,487
Capitalized interest costs	(406)	(442)	(964)
Advertising expense	2,381	2,523	2,451

Balance Sheet Information

At December 31,	2012	(dollars in millions) 2011
<i>Accounts Payable and Accrued Liabilities</i>		
Accounts payable	\$ 4,740	\$ 4,194
Accrued expenses	4,608	3,786
Accrued vacation, salaries and wages	5,006	4,857
Interest payable	632	774
Taxes payable	1,196	1,078
	\$ 16,182	\$ 14,689
<i>Other Current Liabilities</i>		
Advance billings and customer deposits	\$ 3,554	\$ 3,411
Dividends payable	1,494	1,440
Special distribution to noncontrolling interest	-	4,500
Other	1,357	1,872
	\$ 6,405	\$ 11,223

Cash Flow Information

Years Ended December 31,	2012	2011	(dollars in millions) 2010
<i>Cash Paid</i>			
Interest, net of amounts capitalized	\$ 1,971	\$ 2,629	\$ 2,433

Common stock has been used from time to time to satisfy some of the funding requirements of employee and shareowner plans, including 24.6 million common shares issued from Treasury stock during 2012, related to dividend payments, which had an aggregate value of \$1.0 billion.

NOTE 16

COMMITMENTS AND CONTINGENCIES

In the ordinary course of business Verizon is involved in various commercial litigation and regulatory proceedings at the state and federal level. Where it is determined, in consultation with counsel based on litigation and settlement risks, that a loss is probable and estimable in a given matter, the Company establishes an accrual. In none of the currently pending matters is the amount of accrual material. An estimate of the reasonably possible loss or range of loss in excess of the amounts already accrued cannot be made at this time due to various factors typical in contested proceedings, including (1) uncertain damage theories and demands; (2) a less than complete factual record; (3) uncertainty concerning legal theories and their resolution by courts or regulators; and (4) the unpredictable nature of the opposing party and its demands. We continuously monitor these proceedings as they develop and adjust any accrual or disclosure as needed. We do not expect that the ultimate resolution of any pending regulatory or legal matter in future periods, including the Hicksville matter described below, will have a material effect on our financial condition, but it could have a material effect on our results of operations for a given reporting period.

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. 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 a reserve previously established for the remediation may be made. Adjustments to the reserve may also be made based upon actual conditions discovered during the remediation at this or any other site requiring remediation.

Verizon is currently involved in approximately 50 federal district court actions alleging that Verizon is infringing various patents. Most of these cases are brought by non-practicing entities and effectively seek only monetary damages; a small number are brought by companies that sell products and seek injunctive relief as well. These cases have progressed to various degrees and a small number may go to trial in the coming 12 months if they are not otherwise resolved. In the third quarter of 2012, we settled a number of patent litigation matters, including cases with ActiveVideo Networks Inc. (ActiveVideo) and TiVo Inc. (TiVo). In connection with the settlements with ActiveVideo and TiVo, we recorded a charge of \$0.4 billion in the third quarter of 2012 and will pay and recognize over the next six years an additional \$0.2 billion.

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 indemnity from certain financial losses. From time to time, counterparties may make claims under these provisions, and Verizon will seek to defend against those claims and resolve them in the ordinary course of business.

Subsequent to the sale of Verizon Information Services Canada in 2004, we continue 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, despite the subsequent sale of Verizon Information Services Canada and the spin-off of our domestic print and Internet yellow pages directories business. The possible financial impact of the

guarantee, which is not expected to be adverse, cannot be reasonably estimated as a variety of the potential outcomes available under the guarantee result in costs and revenues or benefits that may offset each other. We do not believe performance under the guarantee is likely.

As of December 31, 2012, letters of credit totaling approximately \$0.1 billion, which were executed in the normal course of business and support several financing arrangements and payment obligations to third parties, were outstanding.

We have several commitments primarily to purchase handsets and peripherals, equipment, software, programming and network services, and marketing activities, which will be used or sold in the ordinary course of business, from a variety of suppliers totaling \$41.8 billion. Of this total amount, \$29.6 billion is attributable to 2013, \$7.5 billion is attributable to 2014 through 2015, \$4.2 billion is attributable to 2016 through 2017 and \$0.5 billion is attributable to years thereafter. These amounts do not represent our entire anticipated purchases in the future, but represent only those items that are the subject of contractual obligations. Our commitments are generally determined based on the noncancelable quantities or termination amounts. Purchases against our commitments for 2012 totaled approximately \$16 billion. Since the commitments to purchase programming services from television networks and broadcast stations have no minimum volume requirement, we estimated our obligation based on number of subscribers at December 31, 2012, and applicable rates stipulated in the contracts in effect at that time. We also purchase products and services as needed with no firm commitment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 17

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(dollars in millions, except per share amounts)

Quarter Ended	Operating Revenues	Operating Income (Loss)	Net Income (Loss) attributable to Verizon ⁽¹⁾		Net Income (Loss)
			Amount	Per Share-Basic	
2012					
March 31	\$ 28,242	\$ 5,195	\$ 1,686	\$.59	\$ 3,906
June 30	28,552	5,651	1,825	.64	4,285
September 30	29,007	5,483	1,593	.56	4,292
December 31	30,045	(3,169)	(4,229)	(1.48)	(1,926)
2011					
March 31	\$ 26,990	\$ 4,453	\$ 1,439	\$.51	\$ 3,264
June 30	27,536	4,892	1,609	.57	3,604
September 30	27,913	4,647	1,379	.49	3,542
December 31	28,436	(1,112)	(2,023)	(.71)	(212)

- Results of operations for the third quarter of 2012 include after-tax charges attributable to Verizon of \$0.2 billion related to legal settlements.
- Results of operations for the fourth quarter of 2012 include after-tax charges attributable to Verizon of \$5.3 billion related to severance, pension and benefit charges and early debt redemption and other costs.
- Results of operations for the third quarter of 2011 include after-tax charges attributable to Verizon of \$0.2 billion related to severance, pension and benefit charges.
- Results of operations for the fourth quarter of 2011 include after-tax charges attributable to Verizon of \$3.5 billion related to severance, pension and benefit charges and costs related to the early redemption of debt.

(1) Net income (loss) attributable to Verizon per common share is computed independently for each quarter and the sum of the quarters may not equal the annual amount.

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* Gregory D. Wasson was elected to the Board
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