TELEPHONE & DATA SYSTEMS INC /DE/
Form 10-Q/A
February 23, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

Amendment No. 1

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 001-14157

TELEPHONE AND DATA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-2669023**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

30 North LaSalle Street, Chicago, Illinois 60602
(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: **(312) 630-1900**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b 2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at August 31, 2006
Common Shares, $.01 par value	51,432,410 Shares
Special Common Shares, $.01 par value	57,782,076 Shares
Series A Common Shares, $.01 par value	6,445,404 Shares

Explanatory Note

Telephone and Data Systems, Inc. (TDS) is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006, which was originally filed with the Securities and Exchange Commission (SEC) on October 10, 2006 (Original Form 10-Q), to amend Part I Financial Information Item 1 Financial Statements, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A), Item 3 Quantitative and Qualitative Disclosures About Market Risk, and Item 4 Controls and Procedures, and Part II Other Information Item 6 Exhibits and Financial Statement Schedules.

As discussed in Note 1 to the Consolidated Financial Statements, TDS and its audit committee concluded on November 6, 2006, that TDS would amend its Annual Report on Form 10-K for the year ended December 31, 2005 to restate its consolidated financial statements and financial information for each of the three years in the period ended December 31, 2005, including quarterly information for 2005 and 2004, and certain selected financial data for 2002. TDS and its audit committee also concluded that TDS would amend its Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2006 and June 30, 2006 to restate the consolidated financial statements and financial information included therewith.

The restatement adjustments are described below.

- Forward contracts and related derivative instruments - In reviewing the accounting and disclosure of its prepaid forward contracts, TDS concluded that its continued designation of the embedded collars within the forward contracts as cash flow hedges of marketable equity securities was not appropriate. TDS did not contemporaneously de-designate, re-designate, and assess hedge effectiveness when the embedded collars were contractually modified for differences between the actual and expected dividend rates on the underlying securities in 2004, 2003 and 2002. As a result, the embedded collars no longer qualified for cash flow hedge accounting treatment upon the modification of the terms of the collars for changes in dividend rates and, from that point forward, must be accounted for as derivative instruments that do not qualify for cash flow hedge accounting treatment. Accordingly, all changes in the fair value of the embedded collars from the time of the contractual modification of each collar must be recognized in the statement of operations. The restatement adjustments represent reclassifications of unrealized gains or losses related to changes in the fair value of the embedded collars from other comprehensive income or loss, included in common stockholders equity, to the statement of operations.

- Expense reclassifications - Certain prior period amounts, primarily labor, maintenance, rent and utilities expenses at the competitive local exchange carriers (CLEC), previously reported in selling, general and administrative expense have been corrected to properly reflect the classification of the expenses in cost of service and products in the current period. Certain expenses, primarily universal service costs, at both the incumbent local exchange carriers (ILEC) and the CLEC previously reported in cost of service and products have been adjusted to properly reflect the classification of the expenses in selling, general and administrative expense. These adjustments did not have an effect on operating income or net income.

- Establishment of an Asset Retirement Obligation (ARO) - Upon initial implementation of Statement of Financial Accounting Standards No. 143 Accounting for Asset Retirement Obligations (SFAS No. 143) in 2003, TDS Telecom s ILEC operations concluded that it was not necessary to record an ARO asset and corresponding regulatory liability of equal amount. TDS Telecom's ILECs have their rates regulated by the respective state public utility commissions and the Federal Communications Commission (FCC), and therefore, reflect the effects of the rate-making actions of these regulatory bodies in their financial statements. In 2002, the FCC notified carriers by Order that it would not be adopting SFAS No. 143 since the FCC concluded that SFAS No. 143 conflicted with the FCC's current accounting rules that require ILECs to accrue for asset retirement obligations through prescribed depreciation rates. Upon adoption of SFAS No. 143, and pursuant to the FCC's order and the provisions of SFAS No. 71 Accounting for the Effects of Certain Types of Regulation, (SFAS No.71) the ILECs reclassified their existing remediation liabilities, previously recorded in accumulated depreciation, to an ARO liability and a separate regulatory liability. Upon further review, TDS has concluded that upon adoption of SFAS No. 143, and in accordance with SFAS No. 71, it should have recognized an ARO asset and a corresponding ARO liability, rather than establish the

ARO liability through a reclassification of its existing remediation liabilities. The adjustment did not affect previously reported revenues, operating income or net income (loss).

- Contracts with maintenance and support services   U.S. Cellular entered into certain equipment and software contracts that included maintenance and support services. In one case, U.S. Cellular did not properly allocate expenditures between equipment purchases and maintenance and support services. In other cases, U.S. Cellular did not properly record fees for maintenance and support services over the specified term of the agreement. The restatement adjustments properly record property, plant and equipment, related depreciation expense and fees for maintenance and support services in the correct periods.

- Classification of Asset Retirement Obligation on the Statement of Cash Flows   The additions to property, plant and equipment and other deferred liabilities representing additional asset retirement obligations (ARO) should be treated as non-cash items in the statement of cash flows. From 2004 through the second quarter of 2006, U.S. Cellular included additional ARO liabilities as a change in other assets and liabilities in cash flows from operating activities and the increase in the ARO asset balance as a capital expenditure in cash flows from investing activities resulting in an overstatement of cash flows from operating activities and an overstatement of cash flows required by investing activities. In the restatement, adjustments were recorded in the statement of cash flows to offset the change in ARO liabilities against the ARO asset.

- Income taxes   In the restatement, TDS adjusted its income tax expense, income taxes payable, goodwill, deferred income tax assets and liabilities and related disclosures for the years ended December 31, 2005, 2004, 2003 and 2002 for items identified based on its annual analysis reconciling its 2005 income tax expense and income tax balance sheet accounts as determined in its comparison of the 2005 year-end income tax provision to the 2005 federal and state income tax returns. These adjustments included corrections for certain accounts that had not previously been included in the financial reporting basis used in determining the cumulative temporary differences in computing deferred income tax assets and liabilities, as well as adjustments to certain cumulative temporary differences that had historically been incorrectly associated with operating license assets which, in this restatement, have been correctly classified as investments in partnership assets. Accordingly, the company has adjusted the deferred tax liabilities related to these assets. Goodwill was adjusted to record the income tax effect of the difference between the financial reporting basis and the income tax basis of certain acquisitions made prior to 2004.

TDS determined that the state deferred tax liabilities attributable to marketable equity securities, as presented in prior periods, should have been lower to reflect carryover of a higher stock basis than the federal basis for certain states that have not adopted the federal consolidated return regulations. TDS also identified a valuation allowance related to state net operating loss carry forwards for which deferred tax liabilities related to marketable equity securities provide positive evidence supporting reductions to previously established valuation allowances.

- Cash and interest income   In reviewing cash accounts, it was determined that cash and interest income were overstated in the three months ended March 31, 2006 and six months ended June 30, 2006. In the restatement, TDS corrected the overstatement by reducing cash and interest income.

- Property, plant and equipment   U.S. Cellular did not properly record certain transfers and disposals of equipment removed from service. Also, U.S. Cellular did not properly record depreciation expense for certain leasehold improvements and other equipment due to the use of incorrect asset lives. The restatement adjustments properly record equipment disposals and depreciation expense in the correct amounts and periods.

- Other items   In addition to the adjustments described above, TDS recorded a number of other adjustments to correct and record revenues, expenses and equity in earnings of unconsolidated entities in the periods in which such revenues, expenses and equity in earnings of unconsolidated entities were earned or incurred. Adjustments were also made to correct certain balance sheet amounts, including corrections to purchase price accounting for certain acquisitions prior to 2003. These individual adjustments were not material.

In connection with the restatement, TDS concluded that certain material weaknesses existed in its internal control over financial reporting. See Part I Item 4 Controls and Procedures.

For the convenience of the reader, this Form 10-Q/A sets forth the Original Form 10-Q, as amended hereby, in its entirety. However, this Form 10-Q/A amends and restates only Items 1, 2, 3, and 4 of Part I and Item 6 of Part II of the Original Form 10-Q, in each case solely as a result of and to reflect the adjustments discussed above and more fully in Note 1 of the accompanying consolidated financial statements, and no other information in the Original Form 10-Q is amended hereby. The foregoing items have not been updated to reflect other events occurring after the filing of the Original Form 10-Q, or to modify or update those disclosures affected by other subsequent events. In particular, forward-looking statements included in the Form 10-Q/A represented management s views as of the date of filing of the Original Form 10-Q for the quarterly period ended June 30, 2006 on October 10, 2006. Such forward-looking statements should not be assumed to be accurate as of any future date. TDS undertakes no duty to update such information whether as a result of new information, future events or otherwise.

As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by TDS s principal executive officer and principal financial officer are being filed with this Form 10-Q/A as Exhibits 31.1, 31.2, 32.1 and 32.2.

TELEPHONE AND DATA SYSTEMS, INC.

QUARTERLY REPORT ON FORM 10-Q/A

FOR THE PERIOD ENDED JUNE 30, 2006

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TELEPHONE AND DATA SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

	Three Months Ended June 30, 2006 (As Restated)	2005 (As Restated)	Six Months Ended June 30, 2006 (As Restated)	2005 (As Restated)
	(Dollars in thousands, except per share amounts)			
Operating Revenues	$ 1,068,687	$ 967,948	$ 2,127,764	$ 1,901,910
Operating Expenses				
Cost of services and products (exclusive of depreciation, amortization and accretion expense shown below)	369,559	341,993	745,865	685,810
Selling, general and administrative expense	411,366	352,707	803,987	697,779
Depreciation, amortization and accretion expense	180,453	167,911	363,419	338,052
Total Operating Expenses	961,378	862,611	1,913,271	1,721,641
Operating Income	107,309	105,337	214,493	180,269
Investment and Other Income (Expense)				
Equity in earnings of unconsolidated entities	22,491	17,741	42,296	32,492
Interest and dividend income	146,545	119,192	158,028	127,310
Interest expense	(59,288)	(54,532)	(117,820)	(106,388)
Fair value adjustment of derivative instruments	(11,768)	164,323	(11,738)	499,723
Gain on investments	91,418		91,418	500
Other expense	(941)	(6,802)	(1,868)	(11,076)
Total Investment and Other Income	188,457	239,922	160,316	542,561
Income Before Income Taxes and Minority Interest	295,766	345,259	374,809	722,830
Income tax expense	117,186	140,090	149,528	288,490
Income Before Minority Interest	178,580	205,169	225,281	434,340
Minority share of income	(11,821)	(11,190)	(22,525)	(16,800)
Net Income	166,759	193,979	202,756	417,540
Preferred dividend requirement	(50)	(52)	(101)	(102)
Net Income Available To Common	$ 166,709	$ 193,927	$ 202,655	$ 417,438
Basic Weighted Average Shares Outstanding (000s)	115,768	115,224	115,754	115,112
Basic Earnings Per Share (Note 7)	$ 1.44	$ 1.68	$ 1.75	$ 3.63
Diluted Weighted Average Shares Outstanding (000s)	116,640	115,959	116,576	115,926
Diluted Earnings Per Share (Note 7)	$ 1.43	$ 1.67	$ 1.73	$ 3.60

Dividends Per Share	$ 0.0925	$ 0.0875	$ 0.185	$ 0.175

The accompanying notes to consolidated financial statements are an integral part of these statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

	Six Months Ended June 30, 2006 (As Restated) (Dollars in thousands)	2005 (As Restated)
Cash Flows from Operating Activities		
Net income	$ 202,756	$ 417,540
Add (Deduct) adjustments to reconcile net income to net cash provided by operating activities		
Depreciation, amortization and accretion	363,419	338,052
Bad debts expense	26,465	17,764
Stock-based compensation expense	14,653	4,086
Deferred income taxes	(41,091)	195,198
Equity in earnings of unconsolidated entities	(42,296)	(32,492)
Distributions from unconsolidated entities	37,399	27,914
Minority share of income	22,525	16,800
Fair value adjustment of derivative instruments	11,738	(499,723)
(Gain) loss on investments	(91,418)	(500)
Noncash interest expense	10,705	10,129
Other noncash expense	3,631	5,558
Changes in assets and liabilities		
Change in accounts receivable	(41,637)	(28,171)
Change in materials and supplies	10,503	22,020
Change in accounts payable	(47,956)	(46,303)
Change in customer deposits and deferred revenues	5,346	8,339
Change in accrued taxes	67,233	76,878
Change in other assets and liabilities	(32,485)	(17,759)
	479,490	515,330
Cash Flows from Investing Activities		
Additions to property, plant and equipment	(330,294)	(304,383)
Cash received from divestitures	722	500
Cash paid for acquisitions	(18,546)	(126,033)
Sales of investments	102,549	
Other investing activities	(2,887)	(1,271)
	(248,456)	(431,187)
Cash Flows from Financing Activities		
Issuance of notes payable	195,000	310,000
Issuance of long-term debt	560	112,881
Repayment of notes payable	(225,000)	(290,000)
Repayment of long-term debt	(1,586)	(240,752)
Repayment of medium-term notes	(35,000)	(17,200)
TDS Common Shares and Special Common Shares issued for benefit plans	3,047	12,663
U.S. Cellular Common Shares issued for benefit plans	3,856	14,012
Capital (distributions) to minority partners	(7,613)	(810)
Dividends paid	(21,498)	(20,259)
Other financing activities	750	(6)
	(87,484)	(119,471)
Net Increase (Decrease) in Cash and Cash Equivalents	143,550	(35,328)

Cash and Cash Equivalents		
Beginning of period	1,095,791	1,171,105
End of period	$ 1,239,341	$ 1,135,777

The accompanying notes to consolidated financial statements are an integral part of these statements.

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CONSOLIDATED BALANCE SHEETS

ASSETS

Unaudited

	June 30, 2006 (As Restated) (Dollars in thousands)	December 31, 2005 (As Restated)
Current Assets		
Cash and cash equivalents	$ 1,239,341	$ 1,095,791
Accounts receivable		
Due from customers, less allowance of $14,033 and $15,200, respectively	339,627	332,278
Other, principally connecting companies, less allowance of $7,831 and $5,620, respectively	165,553	157,182
Marketable equity securities	272,938	
Materials and supplies	93,922	103,211
Prepaid expenses	53,688	41,746
Deferred income tax asset		13,438
Other current assets	24,458	34,774
	2,189,527	1,778,420
Investments		
Marketable equity securities	2,176,706	2,531,690
Licenses	1,370,369	1,365,063
Goodwill	886,476	882,168
Customer lists, net of accumulated amortization of $56,323 and $44,616, respectively	37,998	47,649
Investments in unconsolidated entities	222,187	217,180
Other investments, less valuation allowance of $55,144 in both periods	11,760	12,274
	4,705,496	5,056,024
Property, Plant and Equipment		
In service and under construction	7,431,878	7,131,977
Less accumulated depreciation	3,907,694	3,602,217
	3,524,184	3,529,760
Other Assets and Deferred Charges	56,231	55,830
	$ 10,475,438	$ 10,420,034

The accompanying notes to consolidated financial statements are an integral part of these statements.

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CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS EQUITY

Unaudited

	June 30, 2006 (As Restated) (Dollars in thousands)	December 31, 2005 (As Restated)
Current Liabilities		
Current portion of long-term debt	$ 203,091	$ 237,948
Forward contracts	179,832	
Notes payable	105,000	135,000
Accounts payable	312,512	359,934
Customer deposits and deferred revenues	132,362	126,454
Accrued interest	29,212	28,946
Accrued taxes	112,663	46,061
Accrued compensation	54,495	67,443
Derivative liability	50,828	
Deferred income tax liability	44,669	
Other current liabilities	74,497	63,539
	1,299,161	1,065,325
Deferred Liabilities and Credits		
Net deferred income tax liability	1,195,527	1,337,716
Derivative liability	413,054	449,192
Asset retirement obligation	200,529	190,382
Other deferred liabilities and credits	108,873	107,924
	1,917,983	2,085,214
Long-Term Debt		
Long-term debt, excluding current portion	1,632,577	1,633,519
Forward contracts	1,536,563	1,707,282
	3,169,140	3,340,801
Commitments and Contingencies (See Note 21)		
Minority Interest in Subsidiaries	566,881	546,833
Preferred Shares	3,863	3,863
Common Stockholders Equity		