

## *Indemnity Agreements*

TDS enters into agreements in the normal course of business that provide for indemnification of counterparties. These include certain asset sales and financings with other parties. The term of the indemnification varies by agreement. The events or circumstances that would require TDS to perform under these indemnities are transaction specific, however these agreements may require TDS to indemnify the counterparty for costs and losses incurred from litigation or claims arising from the underlying transaction. TDS is unable to estimate the maximum potential liability for these types of indemnifications as the amounts are dependent on the outcome of future events, the nature and likelihood of which cannot be determined at this time. Historically, TDS has not made any significant indemnification payments under such agreements.

## **APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

TDS prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. TDS's significant accounting policies are discussed in detail in Note 1 to the consolidated financial statements.

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and on various other assumptions and information that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from estimates under different assumptions or conditions.

Management believes the following reflect its more significant accounting policies and estimates used in the preparation of its consolidated financial statements. TDS's senior management has discussed the development of each of the following accounting policies and estimates and the following disclosures with the audit committee of the TDS Board of Directors.

## *Investment in Licenses and Goodwill*

TDS reported \$1,189.3 million of Wireless license costs and \$887.9 million of goodwill at December 31, 2003 as a result of the acquisition of wireless licenses and markets, and the acquisition of operating telephone companies. In addition, TDS reported \$42.0 million of Wireless license rights related to the licenses that will be received when the AT&T Wireless exchange transaction is fully completed. Included in Assets of Operations Held for Sale was \$63.6 million of license costs and \$7.6 million of goodwill at December 31, 2003.

See Note 5 – Wireless License Costs/Goodwill for a schedule of wireless license costs and goodwill activity in 2003 and 2002.

Wireless licenses and goodwill must be reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. TDS performs the annual impairment review on wireless license investments and goodwill during the second quarter. There can be no assurance that upon review at a later date material impairment charges will not be required.

The intangible asset impairment test consists of comparing the fair value of the intangible asset to the carrying amount of the intangible asset. If the carrying amount exceeds the fair value, an impairment loss is recognized for the difference. The goodwill impairment test is a two-step process. The first step compares the fair value of the reporting unit, as identified in accordance with SFAS No. 142, to its carrying value. If the carrying amount exceeds the fair value, the second step of the test is performed to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. To calculate the implied fair value of goodwill, an enterprise allocates the fair value of the reporting unit to all of the assets and liabilities of that reporting unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities of the reporting unit is the implied fair value of goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized for that difference.

The fair value of an intangible asset and reporting unit goodwill is the amount at which that asset or reporting unit could be bought or sold in a current transaction between willing parties. Therefore, quoted market prices in active markets are the best evidence of fair value and should be used when available. If quoted market prices are not available, the estimate of fair value is based on the best information available, including prices for similar assets and the use of other valuation techniques. Other valuation techniques include present value analysis, multiples of earnings or revenue or a similar performance measure. The use of these techniques involve assumptions by management about factors that are highly uncertain including future cash flows, the appropriate discount rate, and other inputs. Different assumptions for these inputs or valuation methodologies could create materially different results.

U.S. Cellular tests goodwill for impairment at the level of reporting referred to as a reporting unit. U.S. Cellular has identified seven reporting units pursuant to paragraph 30 of SFAS No. 142. The seven reporting units represent seven geographic groupings of FCC licenses, constituting seven markets or service areas. U.S. Cellular combines its FCC licenses into seven units of accounting for purposes of testing the licenses for impairment pursuant to Emerging

Issues Task Force Statement 02-7 "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets" ("EITF 02-7") and SFAS No. 142, using the same geographic groupings as its reporting units.

U.S. Cellular retained a third-party valuation firm to prepare valuations of the seven reporting units for purposes of goodwill impairment testing. A discounted cash flow approach was used to value each of the reporting units, using value drivers and risks specific to each individual geographic region. The cash flow estimates incorporate assumptions that market participants would use in their estimates of fair value. Key assumptions made in this process were the selection of a discount rate, estimated future cash flow levels, projected capital expenditures, and selection of terminal values.

U.S. Cellular also retained a third-party valuation firm to prepare valuations of the seven groupings of FCC licenses (units of accounting pursuant to EITF 02-7). The valuations were prepared using an excess earnings methodology, through the use of a discounted cash flow approach. This excess earnings methodology estimates the fair value of the intangible assets (FCC license units of accounting) by measuring the future cash flows of the license groups, reduced by charges for contributory assets such as working capital, trademarks, existing subscribers, fixed assets, assembled workforce and goodwill.

TDS Telecom has recorded goodwill primarily as a result of the acquisition of operating telephone companies. TDS Telecom has assigned goodwill to its incumbent local exchange carrier reporting unit (\$397.3 million), its competitive local exchange carrier reporting units (\$29.4 million), and a wireless investment reporting unit (\$30.9 million). The incumbent local exchange carrier reporting unit was valued using a multiple of cash flow valuation technique. The competitive local exchange carrier and wireless investment reporting units were valued using a discounted cash flow analysis.

TDS recorded an impairment loss on wireless license costs totaling \$49.6 million in 2003 related to the impairment of two reporting units. Upon adoption of SFAS No. 142 in 2002, TDS recorded an initial impairment loss on wireless license costs held by U.S. Cellular of \$10.4 million (\$20.9 million net of income taxes of \$8.2 million and minority interest of \$2.3 million) as a cumulative effect of an accounting change.

In 2003, U.S. Cellular recorded a \$3.5 million license cost impairment loss related to the investment in a non-operating market in Florida remaining after the AT&T Wireless exchange. Also in 2003, U.S. Cellular reduced the carrying value of one of its cost method investments by \$1.7 million based on a cash flow analysis of the investment. Both charges were included in Loss on marketable equity securities and other investments in the statements of operations.

There was no impairment of goodwill assigned to the incumbent local exchange carrier operations or the competitive local exchange carrier operations. The carrying value of the wireless investment

held by TDS Telecom exceeded the estimated fair value by approximately \$5.0 million, and TDS Telecom recorded an impairment loss on goodwill in this reporting unit by that amount in 2003.

### *Asset Retirement Obligations*

SFAS No. 143, "Accounting for Asset Retirement Obligations," was issued in June 2001, and became effective for TDS beginning January 1, 2003. SFAS No. 143 requires entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to retire the asset and a liability recorded is recognized in the statement of operations as a gain or loss.

The calculation of the asset retirement obligation for TDS is a critical accounting estimate because changing the factors used in calculating the obligation could result in larger or smaller estimated obligation that could have a significant impact on TDS's results of operations and financial condition. Such factors may include probabilities or likelihood of remediation, cost estimates, lease renewals and salvage values. Actual results may differ materially from estimates under different assumptions or conditions.

U.S. Cellular is subject to asset retirement obligations associated primarily with its cell sites, retail sites and office locations. Asset retirement obligations include costs to remediate leased land on which U.S. Cellular's cell sites and switching offices are located. U.S. Cellular is also required to return leased retail store premises and office space to their pre-existing conditions.

U.S. Cellular determined that it had an obligation to remove long-lived assets in its cell sites, retail sites and office locations as described by SFAS No. 143, and has recorded an initial \$54.4 million liability upon the adoption of SFAS No. 143 on January 1, 2003. Current year additions and accretion have increased the December 31, 2003 asset retirement obligation to \$64.5 million.

TDS Telecom's incumbent local exchange carriers have their rates regulated by the respective state public utility commissions and the FCC, and therefore, reflect the effects of the rate-making actions of these regulatory bodies in the financial statements of the TDS incumbent local exchange carriers. On December 20, 2002, the FCC notified carriers by Order that it will not adopt SFAS No. 143 since the FCC concluded that SFAS No. 143 conflicted with the FCC's current accounting rules that require incumbent local telephone companies to accrue for asset retirement obligations through prescribed depreciation rates. Pursuant to the FCC's order, and the

provisions of SFAS No. 71, the incumbent local telephone carriers have recorded an asset retirement obligation in accordance with the requirements of SFAS No. 143 and a regulatory liability for the amounts of costs of removal that these regulatory bodies have required to be recorded for regulatory accounting purposes which are in excess of the amounts required to be recorded in accordance with SFAS No. 143. At January 1, 2003, the TDS Telecom incumbent local telephone carriers reclassified \$29.9 million from accumulated depreciation to an asset retirement obligation in conjunction with the adoption of SFAS No. 143. Additionally, the incumbent local telephone carriers continue to accrue costs of removal as a component of depreciation expense pursuant to depreciation rates set forth by the respective state public utility commissions. Effective December 31, 2003, the TDS Telecom incumbent local exchange carriers have also reclassified \$31.8 million from accumulated depreciation to an asset retirement obligation. This amount consists of the costs of removal in excess of the asset retirement obligation as required by SFAS No. 143 that the respective state regulatory authorities have required the incumbent local exchange carriers to recognize as a regulatory liability.

The total asset retirement obligation, including the regulatory obligation at TDS Telecom was \$60.0 million at December 31, 2003. The regulatory liability included in asset retirement obligation at December 31, 2003 and at January 1, 2003 was \$28.2 million and \$25.4 million, respectively. The asset retirement obligation calculated in accordance with the provisions of SFAS No. 143 as of December 31, 2003 and January 1, 2003 was \$31.8 million and \$29.9 million, respectively.

TDS Telecom's competitive local exchange carriers adopted SFAS No. 143 effective January 1, 2003. TDS Telecom determined that its competitive local exchange carriers do not have a material legal obligation to remove long-lived assets as described by SFAS No. 143, and accordingly, adoption of SFAS No. 143 did not have a material effect on the competitive local exchange carriers' financial position or results of operations.

See the Asset Retirement Obligations section in Note 1 – Summary of Significant Accounting Policies for a schedule of the changes in asset retirement obligations in 2003.

### *Income Taxes*

The accounting for income taxes, the amounts of income tax assets and liabilities and the related income tax provision are critical accounting estimates because such amounts are significant to TDS's financial condition, changes in financial condition and results of operations.

The preparation of the consolidated financial statements requires TDS to calculate a provision for income taxes. This process involves calculating the current income tax liability together with assessing temporary differences resulting from the different treatment of items, such as depreciation expense, for tax and accounting

purposes as well as estimating the impact of potential adjustments to filed tax returns. These temporary differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. TDS must then assess the likelihood that deferred tax assets will be recovered from future taxable income and to the extent management believes that recovery is not likely, establish a valuation allowance. Management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. TDS's current net deferred tax asset was \$19.4 million as of December 31, 2003, representing primarily the deferred tax effects of the allowance for doubtful accounts on accounts receivable.

The temporary differences that gave rise to the noncurrent deferred tax assets and liabilities as of December 31, 2003 are as follows:

| December 31,                      | 2003<br>(as restated) |
|-----------------------------------|-----------------------|
| (Dollars in thousands)            |                       |
| Deferred Tax Asset                |                       |
| Net operating loss carryforwards  | \$ 82,054             |
| Derivative accounting             | 286,247               |
|                                   | <u>368,301</u>        |
| Less valuation allowance          | (67,209)              |
| Total Deferred Tax Asset          | <u>301,092</u>        |
| Deferred Tax Liability            |                       |
| Marketable equity securities      | 1,044,230             |
| Property, plant and equipment     | 312,232               |
| Partnership investments           | 24,627                |
| Licenses                          | 203,989               |
| Other                             | 1,038                 |
| Total Deferred Tax Liability      | <u>1,586,116</u>      |
| Net Deferred Income Tax Liability | <u>\$1,285,024</u>    |

The valuation allowance relates to state net operating loss carryforwards and the federal operating loss carryforwards for those subsidiaries not included in the consolidated federal income tax return since it is more likely than not that a portion will expire before such carryforwards can be utilized.

The deferred income tax liability relating to marketable equity securities of \$1,044.2 million at December 31, 2003 represents deferred income taxes calculated on the difference between the book basis and the tax basis of the marketable equity securities. Income taxes will be payable when TDS sells the marketable equity securities.

TDS is routinely subject to examination of its income tax returns by the Internal Revenue Service ("IRS") and other tax authorities. TDS periodically assesses the likelihood of adjustments to its tax liabilities resulting from these examinations to determine the adequacy of its provision for income taxes, including related

interest. Management judgment is required in assessing the eventual outcome of these examinations. Changes to such assessments affect the calculation of TDS's income tax expense. The IRS has completed audits of TDS's federal income tax returns for tax years through 1996.

In the event of an increase in the value of tax assets or a decrease in the value of tax liabilities, TDS would decrease the income tax expense or increase the income tax benefit by an equivalent amount. In the event of a decrease in the value of tax assets or an increase in the value of tax liabilities, TDS would increase the income tax expense or decrease the income tax benefit by an equivalent amount.

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The following persons are partners of Sidley Austin Brown & Wood LLP, the principal law firm of TDS and its subsidiaries: Walter C.D. Carlson, a trustee and beneficiary of a voting trust that controls TDS, the nonexecutive chairman of the board and member of the board of directors of TDS and a director of U.S. Cellular, a subsidiary of TDS; William S. DeCarlo, the General Counsel of TDS and an Assistant Secretary of TDS and certain subsidiaries of TDS; and Stephen P. Fitzell, the General Counsel of U.S. Cellular and an Assistant Secretary of certain subsidiaries of TDS. Walter C.D. Carlson does not provide legal services to TDS or its subsidiaries.

## PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 SAFE HARBOR CAUTIONARY STATEMENT

This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this Annual Report contain statements that are not based on historical fact, including the words "believes," "anticipates," "intends," "expects," and similar words. These statements constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, events or developments to be significantly different from any future results, events or developments expressed or implied by such forward-looking statements. Such factors include, but are not limited to, the following risks:

- *Increases in the level of competition in the markets in which TDS operates, or wireless for wireline substitution, could adversely affect TDS's revenues or increase its costs to compete.*
- *Consolidation in the wireless industry may create stronger competitors both operationally and financially which could adversely affect TDS's revenues and increase its costs to compete.*
- *Advances or changes in telecommunications technology, such as Voice over Internet Protocol, could render certain technologies used by TDS obsolete, could reduce TDS's revenues or could increase TDS's cost of doing business.*
- *Changes in the telecommunications regulatory environment, such as wireless number portability, local number portability and E-911 services, could adversely affect TDS's financial condition or results of operations or ability to do business.*
- *Changes in the supply or demand of the market for wireless licenses or telephone companies, adverse developments in the TDS businesses or the industries in which TDS is involved and/or other factors could result in an impairment of the value of TDS's license costs, goodwill and/or physical assets, which may require TDS to record a write-down in the value of such assets.*
- *Conversions of debt, early redemptions of debt or repurchases of debt, changes in prepaid forward contracts, operating leases, purchase obligations or other factors or developments could cause the amounts reported under Contractual Obligations to be different from the amounts presented.*
- *Changes in accounting standards or TDS's accounting policies, estimates and/or in the assumptions underlying the accounting estimates, including those described under Application of Critical Accounting Policies and Estimates, could have a material effect on TDS's financial condition, changes in financial condition and results of operations.*
- *Settlement, judgments, restraints on its current or future manner of doing business and/or legal costs resulting from pending and future litigation could have an adverse effect on TDS's financial condition, results of operations or ability to do business.*
- *Costs, integration problems or other factors associated with acquisitions/divestitures of properties and/or licenses could have an adverse effect on TDS's financial condition or results of operations.*
- *Changes in prices, the number of customers, average revenue per unit, penetration rates, churn rates, selling expenses, net customer retention costs associated with wireless number portability and local number portability, roaming rates, access minutes of use, the mix of products and services offered or other business factors could have an adverse effect on TDS's business operations.*
- *Changes in roaming partners' rates, and the ability to provide voice and data services on other carriers' networks could have an adverse effect on TDS's operations.*
- *Changes in competitive factors with national and global wireless carriers could result in product and cost disadvantages and could have an adverse effect on TDS's operations.*
- *Lack of standards and roaming agreements for wireless data products could place U.S. Cellular's data service offerings at a disadvantage to those offered by other wireless carriers with more nationwide service territories.*
- *Changes in guidance or interpretations of accounting requirements, changes in industry practice or changes in management assumptions could require amendments to or restatements of disclosures or financial information included in this or prior filings with the SEC.*