

TELESP HOLDING CO  
Form 6-K  
April 03, 2006  
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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 6-K

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Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16 of  
the Securities Exchange Act of 1934

For the month of March, 2006

Commission File Number: 001-14475

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## TELESP HOLDING COMPANY

(Translation of registrant's name into English)

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Rua Martiniano de Carvalho, 851 21andar

São Paulo, S.P.

Federative Republic of Brazil

(Address of principal executive office)

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Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F  Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes  No

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Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes  No

Indicate by check mark whether by furnishing the information contained in this Form, the Registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes  No

If  is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

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**TELESP HOLDING COMPANY**

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**Item**

1. Press Release entitled *Financial Statements - Telecomunicações de São Paulo S.A. Telesp* dated on December 31, 2005.

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*Financial Statements*

*Telecomunicações de São Paulo S.A. - TELESP*

*December 31, 2005 and 2004*

*with Report of Independent Auditors*

*(A free translation of the original report in Portuguese containing  
Financial Statements prepared in accordance with the accounting  
practices adopted in Brazil)*

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**TELECOMUNICAÇÕES DE SÃO PAULO S.A. - TELESP**

FINANCIAL STATEMENTS

December 31, 2005 and 2004

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**REPORT OF INDEPENDENT AUDITORS**

Board of Directors and Shareholders

**Telecomunicações de São Paulo S.A. - TELESP**

São Paulo - SP

1. We have audited the accompanying individual (Company) and consolidated balance sheets of Telecomunicações de São Paulo S.A. and subsidiaries as of December 31, 2005, and the related statements of income, shareholders' equity and changes in financial position for the year then ended. These financial statements are the responsibility of Company's management. Our responsibility is to express an opinion on these financial statements.
2. We conducted our audit in accordance with generally accepted auditing standards in Brazil which comprised: (a) the planning of our work, taking into consideration the materiality of balances, the volume of transactions and the accounting and internal control systems of the Company, (b) the examination, on a test basis, of the documentary evidence and accounting records supporting the amounts and disclosures in the financial statements, and (c) an assessment of the accounting practices used and significant estimates made by management of the Company and subsidiaries, as well as an evaluation of the overall financial statement presentation.
3. In our opinion, the financial statements referred to above present fairly, in all material respects, the individual and consolidated financial position of Telecomunicações de São Paulo S.A. - TELESP and subsidiaries at December 31, 2005, the related result of their operations, changes in their shareholders' equity and changes in their financial position for the year then ended, in conformity with the accounting practices adopted in Brazil.
4. The individual (Company) and consolidated financial statements for the year ended December 31, 2004, presented for comparison purposes, were reviewed by other independent auditors, who issued an unqualified opinion dated February 2, 2005.

São Paulo, January 31, 2006

ERNST & YOUNG

Auditores Independentes S.S.

CRC-2SP015199/O-6/S

Luiz Carlos Marques

Accountant CRC-1SP147693/O-5

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## BALANCE SHEETS

December 31, 2005 and 2004

(In thousands of reais)

	Company		Consolidated	
	2005	2004	2005	2004
<b>Assets</b>				
Current assets	<b>5,065,553</b>	4,098,160	<b>5,112,898</b>	4,161,865
Cash and cash equivalents	<b>440,166</b>	172,293	<b>463,456</b>	238,577
Trade accounts receivable, net	<b>2,757,297</b>	2,681,644	<b>2,783,268</b>	2,696,000
Deferred and recoverable taxes	<b>1,591,214</b>	897,546	<b>1,622,774</b>	907,819
Inventories	<b>74,896</b>	91,462	<b>75,101</b>	93,002
Other recoverable amounts	<b>46,316</b>	91,212	<b>47,465</b>	92,830
Other	<b>155,664</b>	164,003	<b>120,834</b>	133,637
Non-current assets	<b>948,564</b>	703,092	<b>1,046,075</b>	805,119
Deferred and recoverable taxes	<b>429,716</b>	325,560	<b>458,106</b>	354,382
Escrow deposits	<b>481,266</b>	333,407	<b>481,790</b>	333,893
Other	<b>37,582</b>	44,125	<b>106,179</b>	116,844
Permanent assets	<b>12,786,496</b>	13,884,589	<b>12,690,169</b>	13,784,783
Investments	<b>479,409</b>	509,745	<b>253,565</b>	284,574
Property, plant and equipment, net	<b>12,241,492</b>	13,261,463	<b>12,358,023</b>	13,369,391
Deferred charges	<b>65,595</b>	113,381	<b>78,581</b>	130,818
<b>Total assets</b>	<b>18,800,613</b>	18,685,841	<b>18,849,142</b>	18,751,767

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	Company		Consolidated	
	2005	2004	2005	2004
<b>Liabilities and shareholders' equity</b>				
Current liabilities	<b>5,402,917</b>	4,138,548	<b>5,431,401</b>	4,163,806
Loans and financing	<b>244,856</b>	526,132	<b>246,755</b>	529,930
Trade accounts payable	<b>1,476,235</b>	1,172,604	<b>1,506,971</b>	1,194,781
Taxes payable	<b>1,778,152</b>	1,155,720	<b>1,794,138</b>	1,165,734
Dividends and interest on capital	<b>903,356</b>	506,116	<b>903,356</b>	506,116
Reserve for contingencies	<b>67,733</b>	52,806	<b>67,791</b>	52,847
Payroll and related charges	<b>155,627</b>	138,628	<b>162,161</b>	143,312
Temporary losses on derivatives	<b>294,255</b>	235,918	<b>294,255</b>	235,918
Other	<b>482,703</b>	350,624	<b>455,974</b>	335,168
Non-current liabilities	<b>3,191,875</b>	3,147,047	<b>3,194,450</b>	3,170,245
Loans and financing	<b>2,150,853</b>	2,205,762	<b>2,150,853</b>	2,226,313
Taxes payable	<b>22,709</b>	26,007	<b>22,709</b>	26,007
Reserve for contingencies	<b>931,907</b>	800,244	<b>932,078</b>	800,382
Other	<b>86,406</b>	115,034	<b>88,810</b>	117,543
Deferred income			<b>17,470</b>	17,470
Shareholders' equity	<b>10,204,207</b>	11,398,632	<b>10,204,207</b>	11,398,632
Capital	<b>5,978,074</b>	5,978,074	<b>5,978,074</b>	5,978,074
Capital reserves	<b>2,686,973</b>	2,745,272	<b>2,686,973</b>	2,745,272
Legal reserves	<b>659,556</b>	659,556	<b>659,556</b>	659,556
Retained earnings	<b>879,604</b>	2,015,730	<b>879,604</b>	2,015,730
Funds for capitalization	<b>1,614</b>	1,614	<b>1,614</b>	1,614
Total liabilities and shareholders' equity	<b>18,800,613</b>	18,685,841	<b>18,849,142</b>	18,751,767

See accompanying notes.



**Table of Contents****TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

## STATEMENTS OF INCOME

Years ended December 31, 2005 and 2004

(In thousands of reais, except earnings per share)

	Company		Consolidated	
	2005	2004	2005	2004
Gross operating revenue	<b>20,068,302</b>	18,327,071	<b>20,350,920</b>	18,425,674
Telecommunications services	<b>20,068,302</b>	18,327,071	<b>20,350,920</b>	18,425,674
Revenue deductions	<b>(5,852,413)</b>	(5,102,017)	<b>(5,955,819)</b>	(5,117,044)
Net operating revenue	<b>14,215,889</b>	13,225,054	<b>14,395,101</b>	13,308,630
Cost of services provided	<b>(7,600,605)</b>	(7,449,067)	<b>(7,716,723)</b>	(7,496,010)
Gross profit	<b>6,615,284</b>	5,775,987	<b>6,678,378</b>	5,812,620
Operating expenses	<b>(2,786,991)</b>	(2,511,773)	<b>(2,842,551)</b>	(2,543,294)
Selling	<b>(1,789,100)</b>	(1,528,467)	<b>(1,810,377)</b>	(1,606,645)
General and administrative	<b>(814,258)</b>	(763,222)	<b>(863,920)</b>	(746,802)
Equity in subsidiaries	<b>(32,486)</b>	(84,932)	<b>(17,829)</b>	(461)
Other, net	<b>(151,147)</b>	(135,152)	<b>(150,425)</b>	(189,386)
Income from operations before financial expenses, net	<b>3,828,293</b>	3,264,214	<b>3,835,827</b>	3,269,326
Financial expenses, net	<b>(1,431,155)</b>	(1,285,753)	<b>(1,440,332)</b>	(1,292,808)
Operating income	<b>2,397,138</b>	1,978,461	<b>2,395,495</b>	1,976,518
Non-operating income, net	<b>37,310</b>	39,982	<b>37,799</b>	40,102
Income before taxes	<b>2,434,448</b>	2,018,443	<b>2,433,294</b>	2,016,620
Income tax and social contribution	<b>(872,501)</b>	(725,894)	<b>(871,347)</b>	(724,071)
Reversal of interest on capital	<b>980,000</b>	888,600	<b>980,000</b>	888,600
Net income	<b>2,541,947</b>	2,181,149	<b>2,541,947</b>	2,181,149
Number of shares outstanding at the balance sheet date in thousands	<b>492,030</b>	493,592,279		
Earnings per share - R\$	<b>5.1662</b>	0.0044		

See accompanying notes

**Table of Contents****TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

## STATEMENTS OF SHAREHOLDERS EQUITY

Years ended December 31, 2005 and 2004

(In thousands of reais)

	Capital reserves						Retained earnings	Total shareholders equity
	Capital	Share premium	Treasury stock	Investment grants	Tax incentives	Legal reserve		
Balances at December 31, 2003	5,978,074	2,737,087		6,756	188	550,498	2,996,457	12,269,060
Investment grants				1,241				1,241
Unclaimed dividends and interest on capital, net of taxes							45,472	45,472
Net income for the year							2,181,149	2,181,149
Proposed allocation of income:								
Dividends							(2,209,690)	(2,209,690)
Legal reserve						109,058	(109,058)	
Interest on capital							(755,310)	(755,310)
Income tax on interest on capital							(133,290)	(133,290)
Balances at December 31, 2004	<b>5,978,074</b>	<b>2,737,087</b>		<b>7,997</b>	<b>188</b>	<b>659,556</b>	<b>2,015,730</b>	<b>11,398,632</b>
Investment grants				<b>593</b>				<b>593</b>
Unclaimed dividends and interest on capital, net of taxes							<b>91,927</b>	<b>91,927</b>
Purchase of own shares after reverse split of shares			<b>(58,892)</b>					<b>(58,892)</b>
Net income for the year							<b>2,541,947</b>	<b>2,541,947</b>
Proposed allocation of income:								
Dividends							<b>(2,790,000)</b>	<b>(2,790,000)</b>
Interest on capital							<b>(833,000)</b>	<b>(833,000)</b>
Income tax on interest on capital							<b>(147,000)</b>	<b>(147,000)</b>
Balances at December 31, 2005	<b>5,978,074</b>	<b>2,737,087</b>	<b>(58,892)</b>	<b>8,590</b>	<b>188</b>	<b>659,556</b>	<b>879,604</b>	<b>10,204,207</b>

See accompanying notes.

**Table of Contents****TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

## STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 2005 and 2004

(In thousands of reais)

	Company		Consolidated	
	2005	2004	2005	2004
<b>Sources of funds</b>				
From operations				
Net income for the year	2,541,947	2,181,149	2,541,947	2,181,149
Items not affecting working capital	2,709,789	2,907,531	2,733,321	2,884,509
Depreciation and amortization	2,646,025	2,718,013	2,675,136	2,736,811
Monetary and exchange variations of noncurrent receivables and payables, net	(86,551)	1,435	(89,811)	1,445
Interest on loans and financing	12,677	6,702	18,923	12,049
Equity pickup	32,486	84,932	17,829	461
Loss (income) on disposal of fixed assets and investment	6,420	(6,372)	6,569	(6,359)
Reserve for contingencies	101,937	135,006	101,995	135,170
Tax credits	(44,872)	22,315	(44,439)	5,258
Amortization of investment goodwill	41,355	32,043	41,355	32,043
Provision for pension plans Resolution CVM 371/2000	312	(37,743)	312	(37,658)
Provision for losses Barramar credits		(48,800)	5,452	5,173
Other				116
Total funds from operations	5,251,736	5,088,680	5,275,268	5,065,658
Increase in noncurrent liabilities	335,332	1,738,731	336,327	1,729,399
Loans and financing	325,683	1,738,700	325,683	1,725,635
Related parties			609	
Other liabilities	9,649	31	10,035	3,764
Other sources	271,702	294,259	271,292	301,675
Investment grants	593	1,241	593	1,241
Transfer from noncurrent to current assets	146,233	232,997	144,864	240,264
Proceeds from sale of fixed assets	28,379	14,549	29,299	14,549
Unclaimed dividends	91,927	45,472	91,927	45,472
Other	4,570		4,609	149
Total sources of funds	5,858,770	7,121,670	5,882,887	7,096,732
<b>Uses of funds</b>				
Increase in noncurrent assets	321,101	112,438	321,124	115,006
Escrow deposits	127,516	38,187	127,539	38,337
Recoverable ICMS (State VAT)	189,266	62,141	189,266	62,141
Other	4,319	12,110	4,319	14,528
Increase in permanent assets	1,661,141	1,517,033	1,674,482	1,456,580
Investments	21,055	189,824		115,879

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Property, plant and equipment	<b>1,640,086</b>	1,327,209	<b>1,674,482</b>	1,340,697
Deferred charges				4
Other uses of funds	<b>4,173,504</b>	3,664,957	<b>4,203,843</b>	3,690,272
Interest on capital and dividends	<b>3,770,000</b>	3,098,290	<b>3,770,000</b>	3,098,290
Treasury stock - Capital reserve	<b>58,892</b>		<b>58,892</b>	
Merged working capital				2,944
Transfer from noncurrent to current liabilities	<b>344,612</b>	566,667	<b>369,225</b>	589,038
Other			<b>5,726</b>	
<b>Total uses of funds</b>	<b>6,155,746</b>	5,294,428	<b>6,199,449</b>	5,261,858
Increase (decrease) in funds	<b>(296,976)</b>	1,827,242	<b>(316,562)</b>	1,834,874
<b>Current assets</b>				
At beginning of year	<b>4,098,160</b>	4,053,622	<b>4,161,865</b>	4,121,165
At end of year	<b>5,065,553</b>	4,098,160	<b>5,112,898</b>	4,161,865
	<b>967,393</b>	44,538	<b>951,033</b>	40,700
<b>Current liabilities</b>				
At beginning of year	<b>4,138,548</b>	5,921,252	<b>4,163,806</b>	5,957,980
At end of year	<b>5,402,917</b>	4,138,548	<b>5,431,401</b>	4,163,806
	<b>1,264,369</b>	(1,782,704)	<b>1,267,595</b>	(1,794,174)
<b>Changes in working capital</b>	<b>(296,976)</b>	1,827,242	<b>(316,562)</b>	1,834,874

See accompanying notes.

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**TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

NOTES TO FINANCIAL STATEMENTS

December 31, 2005 and 2004

(In thousands of reais)

**1. Operations and Background**

a) Ownership control and operations

Telecomunicações de São Paulo S.A. - Telesp, hereinafter referred to as the Company or Telesp, is controlled by Telefónica S.A., which, on December 31, 2005, holds directly and indirectly 84.71% of the common shares and 88.90% of the preferred shares of the Company.

The Company is registered with the Brazilian Securities Commission (CVM) as a publicly held company and its shares are traded on the São Paulo Stock Exchange (BOVESPA). The Company is also registered with the US Securities and Exchange Commission (SEC) and its American Depository Shares (ADSs - level II) are traded on the New York Stock Exchange (NYSE).

The Company's activities are regulated by Brazil's telecommunications regulator (ANATEL), in accordance with the terms of the concession granted by the Brazilian Government.

The Company is a concessionaire of the fixed switch telephone service (STFC) in Region 3, which comprises the State of São Paulo, in Sectors 31, 32 and 34 established in the General Concession Plan (PGO).

The STFC Concession Agreement expired on December 31, 2005, and was renewed on December 22, 2005 for a period of 20 years, with the possibility of being amended on December 31, 2010, 2015 and 2020. This condition enables ANATEL to establish new requirements and universalization and quality targets, based on the conditions in force at the time of the renewal.

During the twenty years of the new period, publicly-traded companies must pay a renewal fee equivalent to 2% (two percent) of STFC revenues from the year previous to the payment, net of taxes and contributions.

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**TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**1. Operations and Background (Continued)**

b) Telecommunications service providers and subsidiaries

A. Telecom S.A.: new corporate name of Assist Telefônica S.A., still a wholly-owned subsidiary and privately-held corporation, including in its business purpose the rendering of services related to: electronic monitoring, including sale, rent, installation, operation and maintenance; billing and collection of voice and data communication services; automated voice services, providing access to information and services through fixed telephones, mobiles or public telephones, using voice and text recognition and authentication; administration and exploration of service stores and other similar or related services, including administration of franchises; production of furniture for equipment, devices and telecommunications and IT networks in general, in addition to installation services already rendered; operation and maintenance of telephony, data and IT internal networks; value-added services, including services related to internet content, connection and access, technology services and all necessary support referring to worldwide computer network; installation, operation and maintenance of internet, intranet and extranet solutions; sale, rent and maintenance of telecommunications and IT equipment and devices in general.

Aliança Atlântica Holding B.V.: this company headquartered in Amsterdam, Netherlands, is a 50-50 joint venture formed in 1997 between Telebrás and Portugal Telecom. With the spin-off of Telebrás in February 1998, Telebrás' equity interest in Aliança Atlântica was transferred to the Company. Currently, 50% of Aliança Atlântica is owned by the Company and 50% by Telefônica S.A.

Companhia AIX de Participações: this company is engaged in both direct and indirect development of activities related to the construction, conclusion and operation of underground fiber optic networks. Currently, Telesp holds 50% interest in this company.

Companhia ACT de Participações: on June 30, 2001, Telesp paid up an equity interest of 32% in this company. In November and December 2003, this company underwent a corporate restructuring process that increased Telesp equity interest to 50% in this company, whose business purpose is to participate in Refibra Consortium, render technical advisory services for preparation of projects for the conclusion of the Refibra Network, making the necessary studies to render them economically feasible, as well as monitoring of status of activities related to the Consortium.

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**TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**1. Operations and Background** (Continued)

b) Telecommunications service providers and subsidiaries (continued)

Santo Genovese Participações Ltda.: on December 24, 2004, the Company acquired all the units of interest of Santo Genovese Participações Ltda., a limited liability company, which holds an equity interest in Atrium Telecomunicações Ltda., a company that provides telecommunication management services for corporate clients in Brazil (industries, companies and condominiums), internet and intranet services, and sale, rent and representation of telecommunication systems and related equipment.

**2. Presentation of the Financial Statements**

The financial statements as of December 31, 2005 and 2004 were prepared in accordance with accounting practices adopted in Brazil, rules applicable to concessionaires of public telecommunications services, and accounting procedures and standards established by the Brazilian Securities Commission (CVM).

The consolidated financial statements include the accounts and transactions of the subsidiaries A.Telecom S.A. and Santo Genovese Participações Ltda., and of the jointly-owned subsidiaries Aliança Atlântica Holding B.V., Companhia AIX de Participações and Companhia ACT de Participações, which were fully or proportionally consolidated in accordance with CVM Instruction No. 247/96.

In consolidation, all assets, liabilities, revenues and expenses resulting from intercompany transactions have been eliminated.

Some accounts in the 2004 financial statements were reclassified for purposes of adequacy and consistency with the current year. However, the amounts of such reclassifications are not material to the financial statements and will therefore not be disclosed in detail.

**3. Summary of Significant Accounting Practices**

a) Cash and cash equivalents

Cash equivalents are temporary liquid investments, recorded at cost, increased by earnings accrued to the balance sheet date.

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**TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**3. Summary of Significant Accounting Practices (Continued)**

b) Trade accounts receivable, net

These are stated at the tariff amounts on the date the services were provided. Services rendered to clients who had not been billed on the balance sheet date are also included. Allowance for doubtful accounts is set up in an amount considered sufficient to cover possible losses.

c) Balances and transactions in foreign currency

Transactions in foreign currency were translated using the exchange rate at the transaction date. Assets and liabilities denominated in foreign currency are recorded at the exchange rate on the balance sheet date. Exchange variations resulting from operations in foreign currency were recognized in income.

d) Inventories

Inventories are stated at average acquisition cost, net of adjustment to realization value, and segregated into plant expansion and inventories for consumption, maintenance or resale. Inventories for use in expansion are classified as Construction in progress, in property, plant and equipment, and those for consumption, maintenance or resale are classified as Inventories in current assets.

e) Investments

In the Company, investments in subsidiaries are accounted for under the equity method. Other investments are recorded at cost, less allowance for probable losses, when considered necessary. Subsidiaries are consolidated at the base date December 31 of each year, except the subsidiary Santo Genovese, acquired in December 2004 and consolidated on the base date November 30, 2004.



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**TELECOMUNICAÇÕES DE SÃO PAULO S.A. TELESP**

NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**3. Summary of Significant Accounting Practices (Continued)**

f) Property, plant and equipment, net

Property, plant and equipment are stated at acquisition and/or construction cost, less accumulated depreciation.

Expenses incurred with maintenance and repair, when representing improvement (increase in the installed capacity or useful life), are capitalized, whereas other expenses are charged to income, observing the accrual method of accounting.

Depreciation is calculated by the straight-line method. Depreciation rates adopted are in accordance with the useful life of assets and with the Public Telecommunications Service standards. The main rates applied are shown in Note 12.

g) Deferred charges

Deferred charges comprise: (i) pre-operating expenses stated at acquisition cost and amortized over a period of 5 years; (ii) goodwill on acquisition of merged investment, amortized over a period of 5 years, the last installment having been recorded in November 2005; and (iii) goodwill on acquisition of IP network, amortized over a period of 10 years (see Note 13).

h) Income tax and social contribution

Corporate income tax and social contribution are accounted for on the accrual basis. Deferred taxes attributable to temporary differences and income tax and social contribution losses are recorded in assets, based on the assumption of future realization within the parameters established by CVM Ruling No. 371/02.

i) Reserve for contingencies

These are recognized for those cases in which an unfavorable outcome is considered probable at the balance sheet date. Provisions were conservatively set up for claims initiated by the Company, even though liabilities for such claims have been considered possible (Note 18).

j) Revenue recognition

Revenues related to services rendered are recorded on the accrual basis. Unbilled revenue from the date of the last billing to the balance sheet date is recognized in the month in which the service is rendered. Revenue from the sale of public phone cards is deferred and recognized in income as the cards are used.

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## NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**3. Summary of Significant Accounting Practices (Continued)**k) Financial expenses, net

These represent interest, monetary and exchange variations arising from financial investments, debentures, loans and financing obtained and granted, as well as the results of derivative operations (hedge).

Credited/debited interest on capital is included in this item. For presentation purposes, the amounts declared in the year were reversed from the statement of income and charged to retained earnings, in shareholders' equity.

l) Post-retirement benefit plans

The Company sponsors individual and multiemployer post-retirement and health assistance plans to its employees. Actuarial liabilities were calculated using the projected unit credit method, as provided for by CVM Ruling No. 371/00. Other considerations related to such plans are described in Note 30.

m) Derivatives

Gains or losses on derivatives are recorded monthly in income. Balances of derivative operations (exchange swaps) are described in Notes 25 and 32.

n) Earnings per share

Earnings per share are calculated based on the number of shares outstanding at the balance sheet date.

**4. Cash and Cash Equivalents**

	Company		Consolidated	
	2005	2004	2005	2004
Cash and banks	36,281	9,478	38,997	25,323
Temporary cash investments	403,885	162,815	424,459	213,254
<b>Total</b>	<b>440,166</b>	172,293	<b>463,456</b>	238,577

Temporary cash investments are liquid investments restated based on the Interbank Deposit Certificate (CDI) rate variation and are held with creditworthy banks.



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## NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**5. Trade Accounts Receivable, Net**

	Company		Consolidated	
	2005	2004	2005	2004
Billed amounts	2,178,028	2,212,569	2,204,490	2,225,833
Unbilled amounts	1,146,055	1,033,315	1,153,231	1,038,304
Gross accounts receivable	3,324,083	3,245,884	3,357,721	3,264,137
Allowance for doubtful accounts	(566,786)	(564,240)	(574,453)	(568,137)
Total	2,757,297	2,681,644	2,783,268	2,696,000
Current	2,176,410	2,145,167	2,172,579	2,148,190
Past-due 1 to 30 days	461,827	433,423	473,348	440,352
Past-due 31 to 60 days	121,943	114,127	127,630	116,478
Past-due 61 to 90 days	55,175	48,938	59,693	50,098
Past-due 91 to 120 days	35,393	34,086	40,306	34,963
Past-due more than 120 days	473,335	470,143	484,165	474,056
Total	3,324,083	3,245,884	3,357,721	3,264,137

Amounts receivable from Embratel in 2004, amounting to R\$68,258 were negotiated in 2005, with no effect on the Company's result of operations.

**6. Deferred and Recoverable Taxes**

	Company		Consolidated	
	2005	2004	2005	2004
Withholding taxes	59,874	46,070	61,484	46,980
Prepaid income tax	692,141	220,924	695,529	221,407
Prepaid social contribution	255,731	85,586	256,904	85,603
Deferred taxes	770,392	619,279	809,647	654,103
Tax loss carryforwards Income tax			20,831	21,136
Tax loss carryforwards Social contribution tax			7,500	7,610
Reserve for contingencies	326,442	276,602	326,520	276,662
Post-retirement benefit plans	15,287	15,182	15,288	15,211
Allowance for doubtful accounts	98,836	91,351	101,408	92,565
Allowance for reduction of inventory to market value	38,704	51,759	38,750	54,943
Income tax on other temporary differences	214,060	135,577	220,110	136,747

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Social contribution on other temporary differences	<b>77,063</b>	48,808	<b>79,240</b>	49,229
ICMS (state VAT) (*)	<b>227,694</b>	251,054	<b>230,859</b>	253,360
Other	<b>15,098</b>	193	<b>26,457</b>	748
<b>Total</b>	<b>2,020,930</b>	1,223,106	<b>2,080,880</b>	1,262,201
Current	<b>1,591,214</b>	897,546	<b>1,622,774</b>	907,819
Non current	<b>429,716</b>	325,560	<b>458,106</b>	354,382

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(\*) Refers mostly to tax credits derived from the purchase of fixed assets, available for offset in 48 months.

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## NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

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**6. Deferred and Recoverable Taxes (Continued)***Deferred income tax and social contribution*

Considering the existence of taxable income in the last five fiscal years and the expected generation of future taxable income discounted to present value based on a technical feasibility study, approved by the Board of Directors on November 21, 2005, as provided for in CVM Instruction No. 371/2002, the Company estimates the realization of the deferred taxes as of December 31, 2005 as follows:

Year	Company	Consolidated
2006	311,199	324,457
2007	119,165	124,716
2008	112,682	118,360
2009	81,243	87,487
Thereafter	146,103	154,627
Total	770,392	809,647

The recoverable amounts above are based on projections subject to changes in the future.

**7. Other Recoverable Amounts**

	Company		Consolidated	
	2005	2004	2005	2004
Advances to employees	5,246	5,710	5,498	6,085
Advances to suppliers	24,632	29,344	25,144	29,881
Other recoverable amounts	16,438	56,158	16,823	56,864
Total current	46,316	91,212	47,465	92,830

The balance of other recoverable amounts in 2004 comprises the amount of R\$42,597 referring to recoverable FUST Contribution for the Fund for Universal Access to Telecommunications Services, which was reversed in 2005 according to Pronouncement No. 7 issued by Anatel on December 15, 2005.

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**8. Inventories**

	Company		Consolidated	
	2005	2004	2005	2004
Consumption materials	<b>84,888</b>	104,550	<b>84,897</b>	104,599
Resale items	<b>90,010</b>	129,995	<b>90,341</b>	140,850
Public telephone prepaid cards	<b>13,200</b>	8,510	<b>13,200</b>	8,510
Scraps	<b>634</b>	641	<b>634</b>	641
Allowance for reduction to market value and obsolescence	<b>(113,836)</b>	(152,234)	<b>(113,971)</b>	(161,598)
Total current	<b>74,896</b>	91,462	<b>75,101</b>	93,002

The allowance for reduction to market value and obsolescence takes into consideration timely analyses carried out by the Company.

**9. Other Assets**

	Company		Consolidated	
	2005	2004	2005	2004
Prepaid expenses	<b>66,768</b>	56,163	<b>65,443</b>	52,587
Receivables from Barramar S.A. (*)			<b>71,041</b>	76,503
Intercompany receivables	<b>60,999</b>	115,921	<b>54,043</b>	86,225
Onlending of foreign currency loans	<b>30,996</b>	4,184	<b>1,584</b>	4,184
Tax incentives, net of allowance	<b>411</b>	411	<b>411</b>	411
Amounts linked to National Treasury securities	<b>9,028</b>	8,284	<b>9,028</b>	8,284
Receivables - sale of properties/scraps	<b>11,607</b>	16,234	<b>11,607</b>	16,234
Other assets	<b>13,437</b>	6,931	<b>13,856</b>	6,053
Total	<b>193,246</b>	208,128	<b>227,013</b>	250,481
Current	<b>155,664</b>	164,003	<b>120,834</b>	133,637
Non current	<b>37,582</b>	44,125	<b>106,179</b>	116,844

(\*) Refer to receivables from Barramar S.A., recorded by Companhia AIX de Participações, net of allowance for doubtful accounts.

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## NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**10. Escrow Deposits**

	Company		Consolidated	
	2005	2004	2005	2004
Civil litigation	71,474	36,509	71,511	36,546
Tax litigation	308,462	225,651	308,828	226,008
Labor claims	101,330	71,247	101,451	71,339
Total noncurrent	481,266	333,407	481,790	333,893

**11. Investments**

	Company		Consolidated	
	2005	2004	2005	2004
Investments carried under the equity method	297,607	313,607		
Aliança Atlântica Holding B.V.	55,583	75,704		
A. Telecom S.A.	159,386	166,195		
Companhia AIX de Participações	65,642	71,683		
Companhia ACT de Participações	26	25		
Companhia Santo Genovese Participações Ltda.	16,970			
Goodwill and negative goodwill on acquisition of investments	90,368	102,350	107,838	119,820
Negative goodwill on acquisition of shares - Companhia AIX de Participações	(17,470)	(17,470)		
Goodwill on acquisition - Santo Genovese Participações Ltda.	119,820	119,820	119,820	119,820
Amortization of goodwill - Santo Genovese Participações Ltda.	(11,982)		(11,982)	
Investments carried at cost	91,434	93,788	145,727	164,754
Portugal Telecom	75,362	75,362	129,655	146,329
Other companies	26,795	29,149	26,795	29,148
Other investments	3,360	3,360	3,360	3,360
Tax incentives	15,164	15,164	15,164	15,164
Allowance for losses	(29,247)	(29,247)	(29,247)	(29,247)
Total	479,409	509,745	253,565	284,574

The negative goodwill on the acquisition of shares of Companhia AIX de Participações recorded by the Company was allocated to Deferred Income in the consolidated balance sheet, according to Article 26 of CVM Instruction No. 247/96.

*Investment acquisition - Santo Genovese Participações Ltda.*



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On December 24, 2004, the Company acquired control of Santo Genovese Participações Ltda., parent company of Atrium Telecomunicações Ltda. ( Atrium ), which is engaged in telecommunication services management.

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**11. Investments** (Continued)*Investment acquisition Santo Genovese Participações Ltda.* (Continued)

Santo Genovese Participações Ltda. ( Santo Genovese ) is a holding company which holds 99.99% of Atrium as its only assets. The acquisition price was R\$113,440.

Such operation will allow extending the offer of higher value-added services in the domestic market, through the management of the rendering of telecommunication services.

Goodwill, based on Atrium's future profitability, is calculated as follows:

	<b>Amounts</b>
Acquisition price	113,440
Acquisition costs	2,435
(-) Book value of investment	(3,945)
 Total goodwill	 119,820

The goodwill is being amortized on a straight-line basis over 10 years, grounded on future profitability study.

The principal financial information on the subsidiaries as of December 31, 2005 and 2004 is as follows:

	<b>Aliança Atlântica</b>	<b>A. Telecom</b>	<b>2005 Companhia AIX</b>	<b>Companhia ACT</b>	<b>Santo Genovese</b>
Paid-up capital	110,763	254,000	460,929	1	76,850
Capital reserves					450
Retained earnings (accumulated deficit)	403	(94,614)	(329,644)	50	(60,330)
Shareholders' equity	111,166	159,386	131,285	51	16,970
<b>Shares (million)</b>					
Number of subscribed and paid-up shares	88	367,977	298,562	1	51,850
Number of common shares owned	44	367,977	149,281	0.5	51,850
Ownership percentage	50%	100%	50%	50%	100%

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## NOTES TO FINANCIAL STATEMENTS (Continued)

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**11. Investments** (Continued)

	Aliança Atlântica	A. Telecom	2004 Companhia AIX	Companhia ACT	Santo Genovese (a)
Paid-up capital	144,779	254,000	460,929	1	51,850
Capital reserves					450
Retained earnings (accumulated deficit)	6,630	(87,805)	(317,563)	50	(56,245)
Shareholders' equity	151,409	166,195	143,366	51	(3,945)
<b>Shares (million)</b>					
Number of subscribed and paid-up shares	88	367,977	298,562	1	51,850
Number of common shares owned	44	367,977	149,281	0.5	51,850
Ownership percentage	50%	100%	50%	50%	100%

(a) Balance sheet as of 11/30/2004. The Company recorded a provision for shareholders' deficit in the amount of R\$3,945, under the caption "Other liabilities".

The Company's equity in subsidiaries is as follows:

	2005	2004
Aliança Atlântica	(15,551)	1,415
A. Telecom	(6,809)	(26,670)
Companhia AIX de Participações	(6,041)	(59,702)
Companhia ACT de Participações	1	25
Santo Genovese	(4,086)	
Total	(32,486)	(84,932)

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## NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**12. Property, Plant and Equipment, Net**

	Annual depreciation rate %	Company						Net book value
		2005			2004			
		Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value	
Property, plant and equipment in service		<b>39,225,600</b>	<b>(27,289,214)</b>	<b>11,936,386</b>	<b>37,962,793</b>	<b>(25,004,091)</b>	<b>12,958,702</b>	
Switching and transmission equipment	12.50	<b>15,889,256</b>	<b>(12,376,889)</b>	<b>3,512,367</b>	<b>15,589,724</b>	<b>(11,434,121)</b>	<b>4,155,603</b>	
Transmission equipment, overhead, underground and building cables, teleprinters, PABX, energy equipment and furniture	10.00	<b>11,544,458</b>	<b>(8,394,522)</b>	<b>3,149,936</b>	<b>11,299,344</b>	<b>(7,786,228)</b>	<b>3,513,116</b>	
Transmission equipment - modems	20.00	<b>577,114</b>	<b>(428,013)</b>	<b>149,101</b>	<b>540,040</b>	<b>(375,265)</b>	<b>164,775</b>	
Underground and undersea cables, poles and towers	5.00 to 6.67	<b>394,124</b>	<b>(214,528)</b>	<b>179,596</b>	<b>387,765</b>	<b>(199,272)</b>	<b>188,493</b>	
Subscriber, public and booth equipment	12.50	<b>1,951,363</b>	<b>(1,184,643)</b>	<b>766,720</b>	<b>1,804,641</b>	<b>(994,303)</b>	<b>810,338</b>	
IT equipment	20.00	<b>507,769</b>	<b>(419,646)</b>	<b>88,123</b>	<b>466,266</b>	<b>(386,296)</b>	<b>79,970</b>	
Buildings and underground cables	4.00	<b>6,429,365</b>	<b>(3,392,523)</b>	<b>3,036,842</b>	<b>6,313,571</b>	<b>(3,178,563)</b>	<b>3,135,008</b>	
Vehicles	20.00	<b>55,669</b>	<b>(35,736)</b>	<b>19,933</b>	<b>49,465</b>	<b>(36,623)</b>	<b>12,842</b>	
Land		<b>253,802</b>		<b>253,802</b>	<b>257,530</b>		<b>257,530</b>	
Other	10.00 to 20.00	<b>1,622,680</b>	<b>(842,714)</b>	<b>779,966</b>	<b>1,254,447</b>	<b>(613,420)</b>	<b>641,027</b>	
Property, plant and equipment in progress		<b>305,106</b>		<b>305,106</b>	<b>302,761</b>		<b>302,761</b>	
<b>Total</b>		<b>39,530,706</b>	<b>(27,289,214)</b>	<b>12,241,492</b>	<b>38,265,554</b>	<b>(25,004,091)</b>	<b>13,261,463</b>	
Average annual depreciation rates - %		<b>10,57</b>			<b>10,49</b>			
Assets fully depreciated		<b>14,248,626</b>			<b>12,223,036</b>			

	Annual depreciation rate %	Consolidated						Net book value
		2005			2004			
		Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value	
Property, plant and equipment in service		<b>39,399,562</b>	<b>(27,358,785)</b>	<b>12,040,777</b>	<b>38,106,748</b>	<b>(25,047,625)</b>	<b>13,059,123</b>	
Switching and transmission equipment	12.50	<b>15,893,532</b>	<b>(12,377,428)</b>	<b>3,516,104</b>	<b>15,589,724</b>	<b>(11,434,120)</b>	<b>4,155,604</b>	
Transmission equipment, overhead, underground and building cables, teleprinters, PABX, energy equipment and furniture	10.00	<b>11,569,647</b>	<b>(8,397,114)</b>	<b>3,172,533</b>	<b>11,329,039</b>	<b>(7,795,144)</b>	<b>3,533,895</b>	

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Transmission equipment - modems	20.00	<b>597,184</b>	<b>(439,597)</b>	<b>157,587</b>	<b>540,040</b>	(375,265)	164,775
Underground and undersea cables, poles and towers	5.00 to 6.67	<b>407,157</b>	<b>(215,923)</b>	<b>191,234</b>	<b>400,797</b>	(199,737)	201,060
Subscriber, public and booth equipment	12.50	<b>1,951,370</b>	<b>(1,184,646)</b>	<b>766,724</b>	<b>1,804,647</b>	(994,305)	810,342
IT equipment	20.00	<b>519,422</b>	<b>(423,607)</b>	<b>95,815</b>	<b>469,549</b>	(388,256)	81,293
Buildings and underground cables	4.00	<b>6,429,416</b>	<b>(3,392,543)</b>	<b>3,036,873</b>	<b>6,313,622</b>	(3,178,578)	3,135,044
Vehicles	20.00	<b>56,154</b>	<b>(35,884)</b>	<b>20,270</b>	<b>49,731</b>	(36,716)	13,015
Land		<b>253,802</b>		<b>253,802</b>	<b>257,530</b>		257,530
Other	10.00 to 20.00	<b>1,721,878</b>	<b>(892,043)</b>	<b>829,835</b>	<b>1,352,069</b>	(645,504)	706,565
Property, plant and equipment in progress		<b>317,246</b>		<b>317,246</b>	<b>310,268</b>		310,268
<b>Total</b>		<b>39,716,808</b>	<b>(27,358,785)</b>	<b>12,358,023</b>	<b>38,417,016</b>	<b>(25,047,625)</b>	<b>13,369,391</b>
Average annual depreciation rates - %		<b>10,61</b>			<b>10,57</b>		
Assets fully depreciated		<b>14,254,336</b>			<b>12,223,036</b>		

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## NOTES TO FINANCIAL STATEMENTS (Continued)

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**12. Property, Plant and Equipment, Net (Continued)***Returnable assets*

Pursuant to the Concession Agreement, all assets pertaining to the Company's equity and indispensable to the provision of the services described in said agreement are considered returnable and are part of the concession assets. These assets will be automatically returned to ANATEL upon expiration of the Concession Agreement. As of December 31, 2005, the net book value of such returnable assets is estimated at R\$9,129,592 (R\$10,295,779 in 2004), comprised of switching and transmission equipment, public use terminals, external network equipment, energy equipment, and system and operation support equipment.

**13. Deferred Charges**

Deferred charges as of December 31, 2005 and 2004 are as follows:

	Company		Consolidated	
	2005	2004	2005	2004
Pre-operating expenses	<b>14,877</b>	26,034	<b>20,416</b>	32,527
Cost	55,788	55,788	65,279	65,279
Accumulated amortization	(40,911)	(29,754)	(44,863)	(32,752)
Merged goodwill - Ceterp S.A.		29,298		29,298
Cost	187,951	187,951	187,951	187,951
Accumulated amortization	(187,951)	(158,653)	(187,951)	(158,653)
Goodwill on acquisition of the IP network	<b>50,718</b>	58,049	<b>50,718</b>	58,049
Cost	72,561	72,561	72,561	72,561
Accumulated amortization	(21,843)	(14,512)	(21,843)	(14,512)
Other			<b>7,447</b>	10,944
Cost			12,059	14,243
Accumulated amortization			(4,612)	(3,299)
<b>Total</b>	<b>65,595</b>	113,381	<b>78,581</b>	130,818

Pre-operating expenses refer to costs incurred in the pre-operating stage of long-distance services; amortization began in May 2002, over a period of 60 months.

The goodwill paid on the acquisition of Ceterp S.A. is presented in deferred charges due to that company's merger on November 30, 2000. This goodwill, based on the expectation of future profitability, was amortized over 60 months, having been concluded in November 2005.



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## NOTES TO FINANCIAL STATEMENTS (Continued)

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**13. Deferred Charges (Continued)**

The goodwill on acquisition of the IP network in December 2002 refers to the acquisition of the assets for the Switched IP and Speedy Link services of Telefônica Empresas S.A. The portion considered as goodwill and recorded in deferred charges corresponds to the customer portfolio of the business. According to an appraisal report, the economic grounds of the goodwill are the expected future profitability, for an amortization period of 120 months.

**14. Loans and Financing**

Consolidated	Annual			Balance in 2005		
	Currency	interest rate	Maturity	Current	Noncurrent	Total
Mediocrédito	US\$	1.75%	2014	7,471	52,802	60,273
Loans in local currency		6% + 3.75%				
	R\$	spread	through 2006	1,898		1,898
Loans in foreign currency			through 2009	215,642	598,051	813,693
Debentures		103.50% of				
	R\$	CDI	through 2007	21,744	1,500,000	1,521,744
Total				246,755	2,150,853	2,397,608

Consolidated	Annual			Balance in 2004		
	Currency	interest rate	Maturity	Current	Noncurrent	Total
Mediocrédito	US\$	1.75%	2014	8,528	67,862	76,390
CIDA	CAN\$	3.00%	2005	1,565		1,565
Loans in local currency		6% + 3.75%				
		spread and				
	R\$	CDI + 0.40%	through 2006	3,599	2,119	5,718
Loans in foreign currency			through 2009	494,279	656,332	1,150,611
Debentures		103.50% of				
	R\$	CDI	through 2007	21,959	1,500,000	1,521,959
Total				529,930	2,226,313	2,756,243

Loans in foreign currency are as follows:



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<b>Consolidated</b>	<b>Currency</b>	<b>Interest rate</b>	<b>Principal</b>	<b>Interest</b>	<b>Balance in 2005</b>
Resolution 2770	US\$	5.70% to 6.90%	105,523	9,451	<b>114,974</b>
Resolution 2770	US\$	4.80%	292,928	9,983	<b>302,911</b>
Untied Loan JBIC	JPY	Libor + 1.25%	393,520	2,288	<b>395,808</b>
Total			791,971	21,722	<b>813,693</b>

<b>Consolidated</b>	<b>Currency</b>	<b>Interest rate</b>	<b>Principal</b>	<b>Interest</b>	<b>Balance in 2004</b>
Resolution 2770	US\$	2.00% to 6.90%	310,640	10,415	321,055
Resolution 2770	JPY	1.40%	79,736	34	79,770
Debt assumption	US\$	8.62% to 27.50%	61,119	23,081	84,200
Untied Loan JBIC	JPY	Libor + 1.25%	643,242	3,713	646,955
DEG Deutsche Investitions	US\$	Libor + 6%	18,432	199	18,631
Total			1,113,169	37,442	1,150,611

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## NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**14. Loans and Financing** (Continued)

Loans and financing with Mediocrédito are guaranteed by the Federal Government.

The loan from Japan Bank for International Cooperation - JBIC includes restrictive covenants related to the maintenance of certain financial indices, which to date have been met.

*Consolidated long-term debt maturities*

<b>Year</b>	<b>Amounts</b>
2007	1,605,420
2008	408,332
2009	105,420
Thereafter	31,681
<b>Total</b>	<b>2,150,853</b>

*Debentures*

On September 3, 2004, the Company announced a Securities Distribution Program ( Program ) and, under the Program, the first issue of Telesp debentures ( Offering ).

The Program amounts to R\$3.0 billion for a period of two years from the filing with the CVM and contemplates the issuance of simple nonconvertible debentures, unsecured or subordinated, and/or promissory notes.

The Offering consisted of the issue of 150,000 simple nonconvertible unsecured debentures, with a face value of R\$10 (ten thousand reais), in the total amount of R\$1,500,000 (one billion, five million reais), of a single series, maturing on September 1, 2010 (six years). The debentures bear interest with quarterly payments, equivalent to 103.5% of the DI (interbank deposit) average daily rate calculated and published by the CETIP (Clearing House for the Custody and Financial Settlement of Securities).

The adjustment to the interest rate of debentures is estimated for September 1, 2007. On a conservative basis, the Company included, in the consolidated schedule of long-term debt maturities shown above, the principal of the debentures in the year 2007, date of adjustment of interest rates.

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NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

(In thousands of reais)

**15. Taxes Payable**

	<b>Company</b>		<b>Consolidated</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Taxes on income				