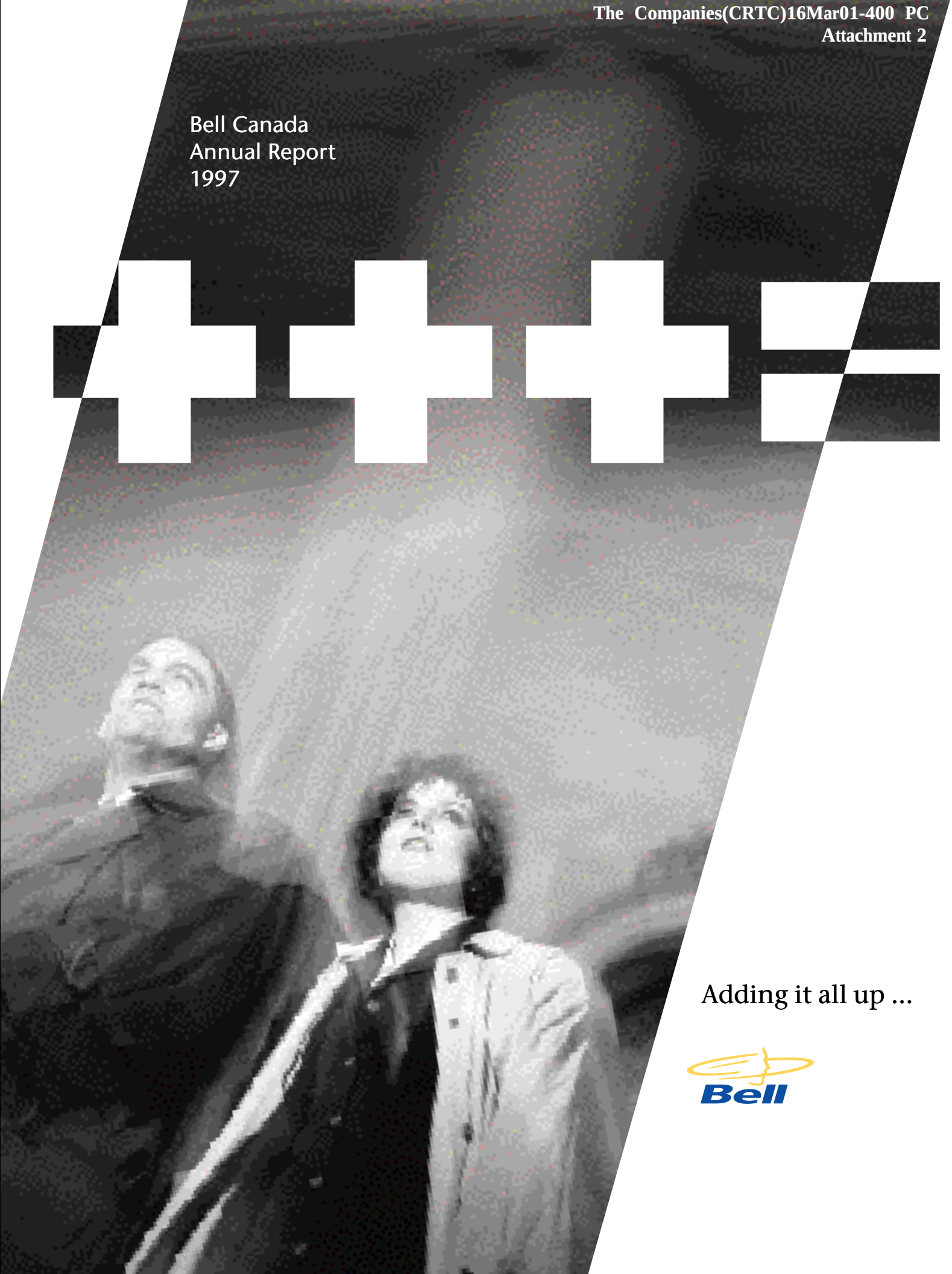
Bell Canada Annual Report 1997



Adding it all up ...

Bell

Table of contents

The 1997 review

Highlights 2
A Message from the Chairman and Chief Executive Officer 3
A Message from the President and Chief Operating Officer 5
The Vision 6
The Environment 10
The Strategy 13

Financial and corporate information

Financial review 18
Management's responsibility for financial statements 32
Auditor's report 33
Consolidated financial statements 34
Corporate governance practices 57
Directors, officers and committees of the Board 60
Selected consolidated financial and other data 64

Bell Canada, a subsidiary of BCE Inc., is Canada's largest supplier of telecommunications services. With one of the world's most robust and reliable public switched networks, Bell Canada provides advanced voice, data and image communications to more than seven million business and residence customers in Ontario and Québec. One hundred per cent of Bell Canada's network is served by digital switches.

Bell Canada is subject to the jurisdiction of the Canadian Radio-television and Telecommunications Commission (CRTC).

In 1997, Bell Canada posted consolidated total operating revenues of approximately $9.2 billion, 80 per cent of which were generated by local and long distance telecommunications services. At the end of 1997, Bell Canada provided some 10.6 million network access services, accounting for about 93 per cent of all such service supplied by telephone companies in Ontario and Québec and about 57 per cent in Canada.

Bell Canada owns a 100 per cent interest in the directory business division of Tele-Direct (Publications) Inc. This division sells telephone directory advertising and publishes white pages and Yellow Pages* directories. Bell Canada also owns 100 per cent of Bell Sygma Inc., Expertech Network Installations Inc., Progistix-Solutions Inc. and Nexacor Realty Management Inc. In addition, Bell Canada has minority common equity interest (30 per cent) in Bell-Northern Research Ltd., an industrial research and development organization.

Bell Canada is a member of Stentor, an alliance of Canada's major telecommunications companies.

* Trademark of Tele-Direct (Publications) Inc.

COMPETITIVE MOMENTUM

CUSTOMER SOLUTIONS

SKILLED AND DEDICATED PEOPLE

WORLD-CLASS CONNECTIVITY

A ROBUST NETWORK

INNOVATIVE TECHNOLOGY

DYNAMIC PARTNERSHIPS

OPERATIONAL EXCELLENCE

Bell Canada:
Your connection to what matters.

Bell Canada, a strategic member of the BCE group of companies.

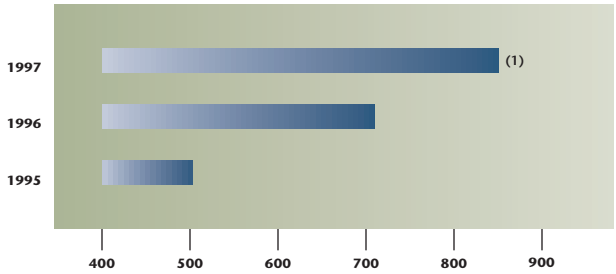
Highlights 1997

Financial Highlights ($ millions)

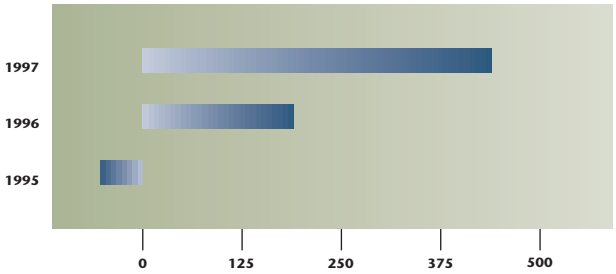
Total operating revenues	9,246
Net income applicable to common shares [1]	852
Operating cash flow	3,074
Free cash flow	438
% return on average common equity [1]	11.7

Operational Highlights

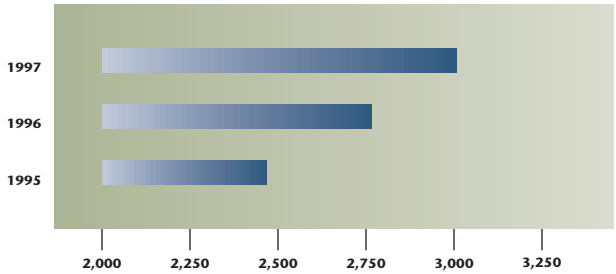
- Revenues grew by 6.3%.
- Earnings increased by 19.3%.
- Operating cash flow surpassed $3 billion for the first time in the company's history.
- Free cash flow was positive for the second year running.
- Overall operating expenses increased primarily due to an increase in depreciation and amortization expense.



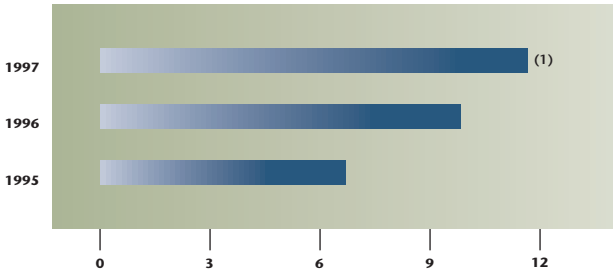
Net income applicable to common shares (millions of dollars)



Free cash flow (millions of dollars)



Operating cash flow (millions of dollars)



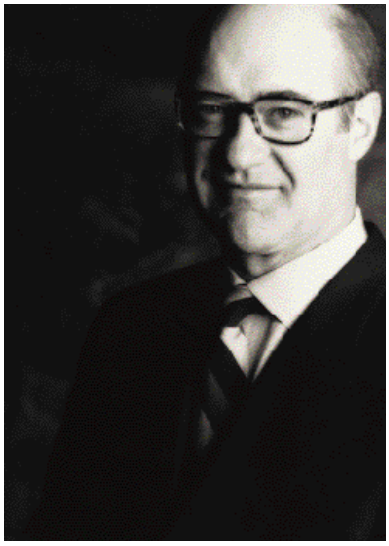
Return on average common equity (%)

[1] *before extraordinary item*

Adding it up: securing Bell Canada's future through its strong and unrelenting competitive momentum.

Bell Canada was feeling the first brunt of a radically new competitive environment when it launched its three-year transition plan in 1995 to regain shareholder confidence and restore its financial strength. Today, the results of that three-year turn-around are evident in a number of respects including Bell Canada's $852 million in net income applicable to common shares (before extraordinary item) which exceeded the target set for 1997 and yielded a dramatic 70% increase over the $502 million recorded in 1995.

Perhaps even more striking is the shift in the Bell culture. In a remarkably short time, the company has transformed itself into a highly flexible and seasoned competitor, ever-responsive to customers' changing communications needs, with the best value and solutions available.



Still, the challenges ahead are formidable. Escalating competition has eroded Bell's long distance market share to 63% and continues to drive down prices and margins. Local competition will bring more new contenders – some with an already established local base, others global in scope with substantial financial resources.

Yet even as competition for traditional revenues increases, new opportunities emerge with astonishing speed. Fuelled by the Internet and the rise of advanced wireless and broadband technologies, the Canadian communications sector is expanding at four times the rate of the total economy. As data traffic overtakes voice in the new electronic marketplace, the demand for bandwidth will continue to soar.

In this cyber landscape ripe for harvesting, Bell Canada is drawing on its close ties with customers to refashion its products and services and earn a larger share of their communications dollars. It is also actively seeking out new lines of business and keeping a constant vigil on costs.

Bell's own competitive momentum is reinforced by the synergy generated by its strong relationship with other BCE companies. Bell is using this competitive momentum to guarantee the operational excellence that is its lifeblood. First and foremost, this means ensuring the robust network connection, essential to the quality of life of consumers and to the marketing reach and productivity of business in a thriving digital economy.

In 1997, Bell launched the modernization of its information systems/information technology infrastructure which is aimed at providing improved customer service and reduced costs. In tandem with this infrastructure modernization, Bell Canada will concentrate substantial resources in 1998 on ensuring that all business-critical systems, applications and network elements are Year 2000 compliant.

In addition to retooling the existing network and operations, Bell is investing in technologies and applications for tomorrow. The creation of Bell Emergis stands out as a key event of 1997. Through co-ventures with global networking partners and Canadian and international entrepreneurs, this new business unit will encourage the development of software-based networking and interactive multimedia applications that encompass business-class Internet tools, electronic commerce and entertainment. In effect, it will be a magnet for the expertise and risk-sharing essential to sustaining homegrown leadership in communications – especially in these high-growth areas.

On the regulatory front, the May 1 decisions by the Canadian Radio-television and Telecommunications Commission (CRTC) set out the rules for total competition and effectively opened local markets. In preparation for local competition, the company has adopted a new management structure that is strengthening its regional presence with executive officers for Québec and Ontario with full marketing and sales responsibility. The continued centralization of all other operations will facilitate technological improvements, while keeping overhead costs down.

Bell people excel in difficult times – as their skill and fortitude proved once again, during the massive ice storm, when they worked ceaselessly to maintain vital communications services.

This tenacity – together with the company's other initiatives – is evidence of Bell Canada's determination to deliver excellent service and retain customer loyalty, derive new sources of revenue, hold down costs and attract the capital essential for continued growth. Augmenting Bell's abilities is the strong partnerships it generates with other key innovators such as Nortel, MCI, The CGI Group, Bell Mobility, ExpressVu, Telesat and Tele-Direct.

Yes, it does add up . . . to a Bell Canada dedicated to hard and fair competition in a deregulated environment that places all contenders on equal footing. And to a host of new opportunities that will connect Canada to the world and secure the preeminence of Canadian communications expertise on the global stage.

Jean C. Monty
Chairman and Chief Executive Officer

Bell Canada is ready – with aggressive pricing, new technology and meaningful customer solutions.

Bell Canada has a knack for rising to a challenge boldly and imaginatively. That's why – to meet the challenge of total competition – it has transformed itself into a full-service communications provider doing business on customers' terms. Bell is metaphorically moving from its customers' walls into their living rooms, just as it has travelled from the switchboards of its business customers to a seat at the management table. This transformed Bell Canada is an aggressive competitor – with one eye fixed on the demands of today's market and the other searching out new sources of growth.

In response to customers' desire for straightforward pricing, the new simplified Bell **Advantage Optimum**™ long distance plan is bringing businesses significant savings that will enable them to compete more effectively in both domestic and global markets. Residence customers will gain similar long distance economies with the January 1998 launch of the flat-rate, 10-cents-a-minute **FirstRate**† savings plan.

Customers will also gain from the long-term benefits that will derive from the modernization of Bell Canada's IS/IT infrastructure. This program will make it easier for customers to do business with Bell – be it through service self-activation, greater billing flexibility, or new electronic interfaces.

Through new technologies such as Asymmetric Digital Subscriber Line (ADSL) and Asynchronous Transfer Mode (ATM) packet switching that are enabling high-speed, high-bandwidth transmissions, the company is maximizing investment by extending the capabilities of current assets. In August 1997, Bell and MCI introduced the first ATM connection between Canada and the U.S.; in October Bell began marketing ADSL access for Internet Service Providers and large corporations that promote teleworking.

Bell Canada is also making important inroads in the delivery of the electronic commerce solutions that will characterize business transactions of the future. To support Québec's new drug insurance program, Bell worked with the Régie de l'assurance-maladie du Québec to create an electronic commerce network that links the RAMQ with 1,600 pharmacies and handles 47 million transactions a year.

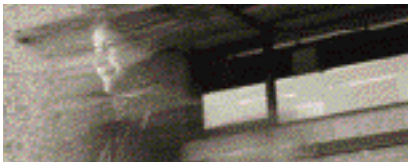
And Bell is answering customers' call for total solutions in a complex competitive environment. Through consulting expertise and a move to greater bundling of services like local, long distance, wireless and Internet, Bell Canada is forging a partnership with customers that is built on operational excellence and the delivery of tailor-made value at competitive prices.

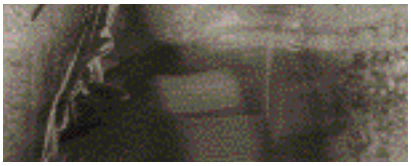
John A. MacDonald
President and Chief Operating Officer

BEGIN with a vision of world-class connectedness for all Canadians. Then incorporate the alliance-building capability this requires . . .

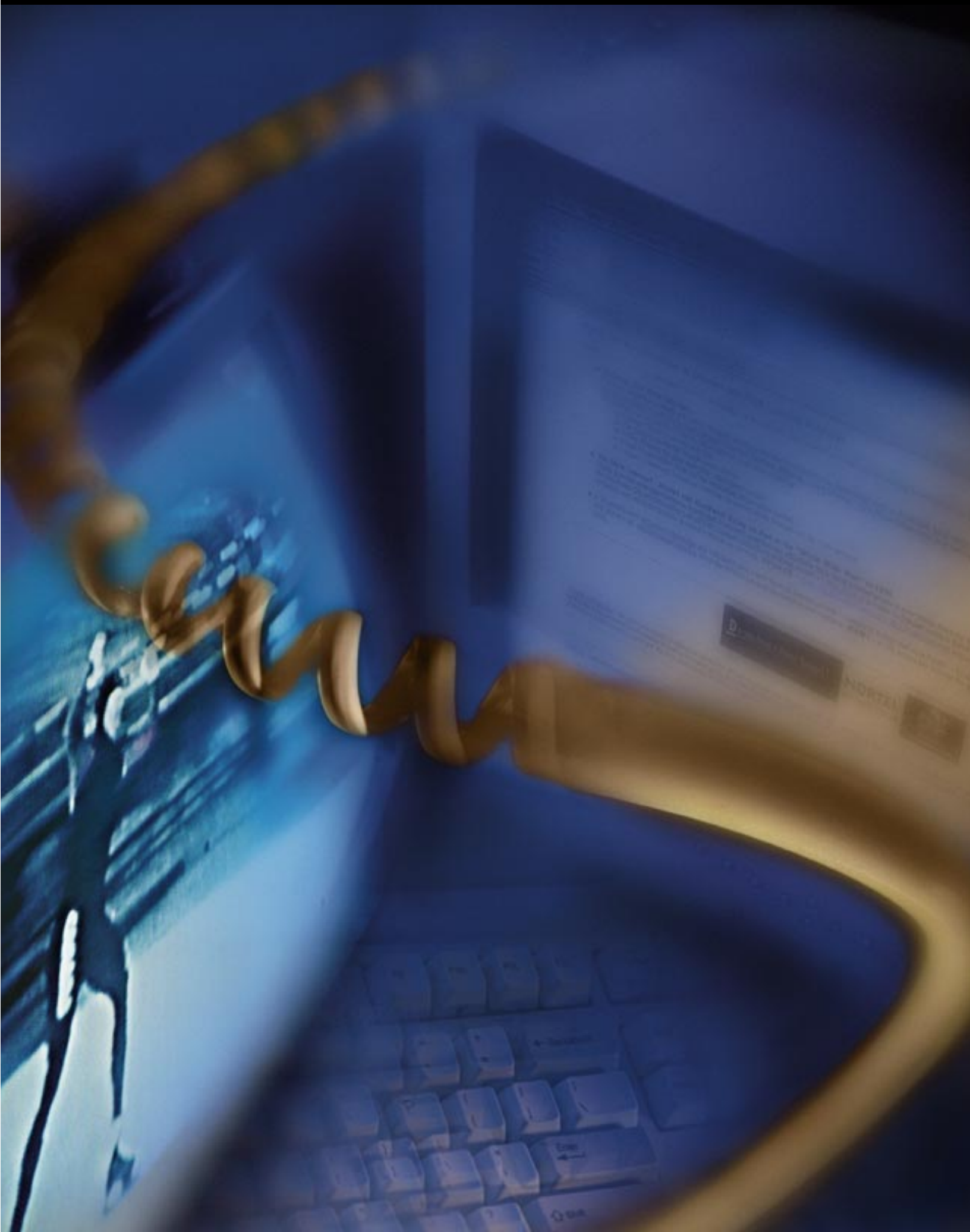
As the almost-instantaneous communication of a digitized world rapidly removes barriers of distance, place and time, the global competitiveness of Canadians stands to gain significantly. Long challenged by the economics of a relatively small population and a huge geography, ***Canadians are benefitting from a new world reach***.

Through CA*NET II, Canada's universities and R&D communities are becoming better connected to each other and the world. By providing ***a high-speed, high bandwidth R&D network*** – separate from the public Internet – CA*Net II represents the next and crucial step in the development of the Internet in Canada. CA*Net II evolved from CA*Net – the national backbone network that carries Internet traffic throughout Canada and into the United States. This past year, Bell Canada – through subsidiary Bell Advanced Communications – assumed responsibility for CA*Net from its government-sponsored originator.





*Canadian students are increasingly able to expand their learning opportunities beyond the classroom through the CA*Net II high speed Internet network.*



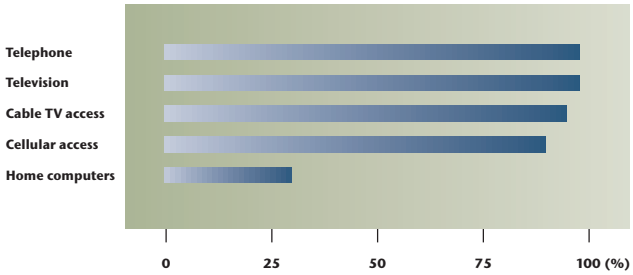
The power of CA*Net II is directly linked to the ATM switching technology that is behind it. ATM has the throughput and quality essential to run multimedia, telemedicine, CAD-CAM, three-dimensional imaging, credit card processing and financial applications that demand the transfer of huge amounts of information at extremely high speeds.

In a 1997 industry-first, Bell and MCI launched an international ATM commercial connection between Canada and the U.S. ***ATM's capacity for carrying complex data faster*** is ideal for large organizations like corporations and government agencies. Similarly, Bell's increasing deployment of ADSL technology is greatly improving the ability of its residence and small business customers to cruise the information highway. ***ADSL uses existing copper phone lines to provide Internet or other online connections at speeds 75 times faster*** than a standard 28.8 Kbps dial-up modem. Since it employs a portion of the line not usually needed customers can log on to the Internet and simultaneously use the same line to carry on a conversation or send a fax.

Since the fall, Internet service providers in Ottawa/Hull and Québec City have been offering Bell ADSL access to residence customers and companies with teleworking employees. The service will be extended to other cities in 1998.

Bell's $200-million Local Service Improvement Program will benefit millions of residence and business customers over the next four years. This program will offer similar telecommunications services to our customers no matter where they choose to live or work by expanding local calling areas, opening the door to enhanced emergency 911 service (where available), Internet and fax service, and advanced applications such as videoconferencing and telemedicine.

With telephone, cable and Internet penetration in Canada already at a higher-than-average rate, these ongoing advances will help Canadians emerge among the

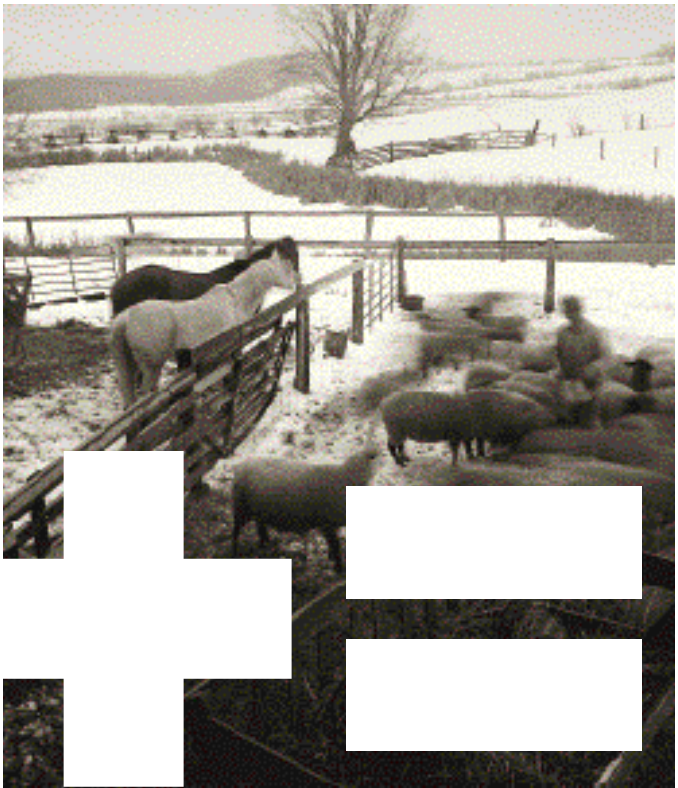


Canadians: the world's most connected people

best connected people in the world. And given such a networking environment, opportunities abound to attract and support a flourishing industry in made-in-Canada, next-generation communications software and applications, destined for both domestic and global consumption.

It was exactly this thinking that led to ***the creation of Bell Emergis as a developmental engine*** for these future products and services. In partnerships and co-ventures with small start-up companies and large international players, Bell Emergis will bring exciting, new technologies together with established marketing and distribution proficiency. Apart from attracting both homegrown and foreign expertise and research dollars to this "living laboratory" environment, Bell Emergis ***will showcase Canadian communications*** leadership to the world.

Sound investments in world-class infrastructure and in the advanced software and applications required to popularize the network – and yield a return on investment – are pivotal to Bell's continued success in a constantly evolving competitive marketplace. So is ***the company's exploration of new markets and new sources of revenue*** – like sophisticated security and other home automation systems made possible ***through computer-telephony integration***. Bell Canada is also building on existing expertise to develop new solutions for customers in areas such as banking, health care and education.



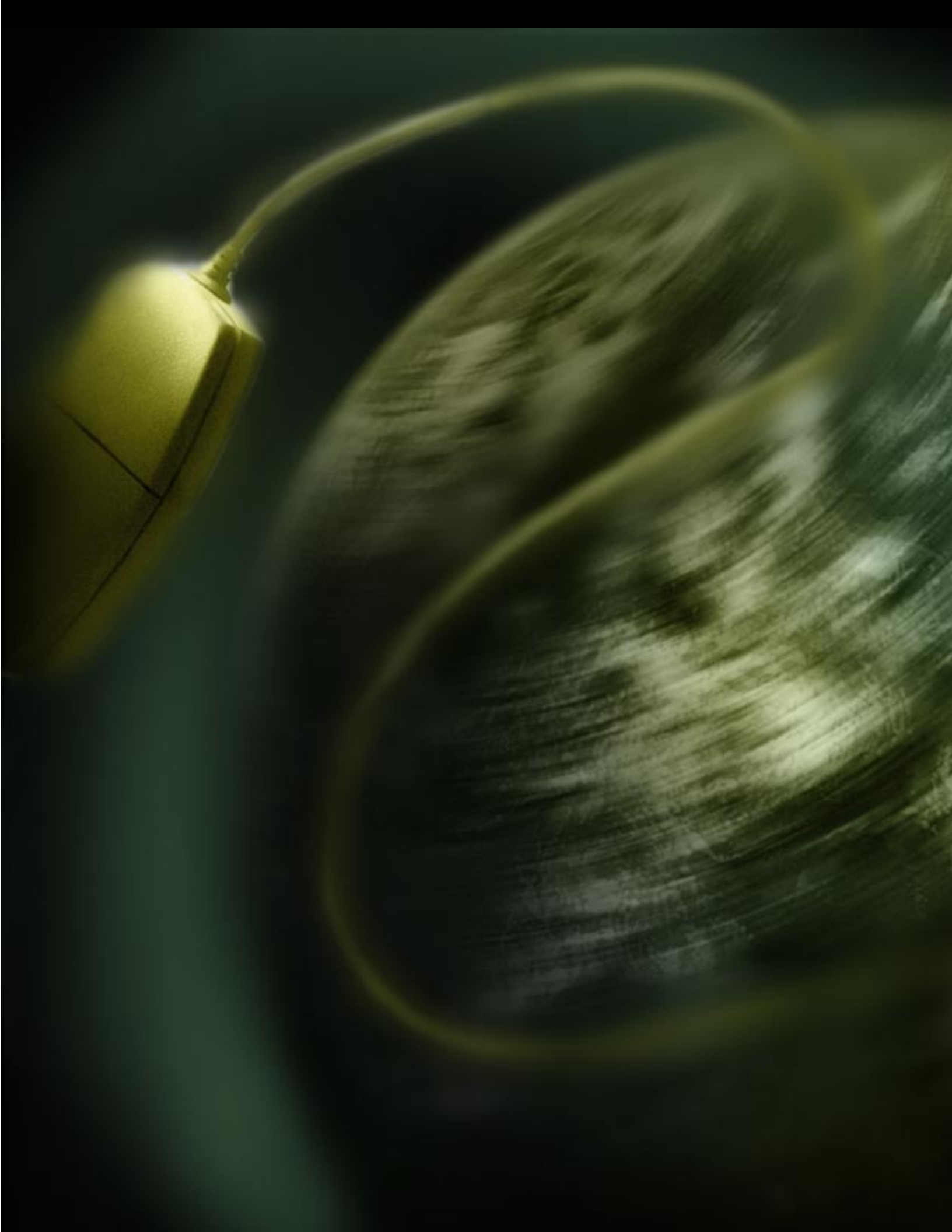
A $200 million investment in local service improvements will help millions of customers, particularly in non-urban areas, enjoy access to the advanced services of Bell's world class network.

ADD a process of renewal that for Bell Canada is never-ending – because its customers' needs continue to evolve . . .

In 1997, change in Canada's communications industry came in many forms. The CRTC's May 1 decisions laid out the ground rules for local service competition and set the related price cap structure, starting January 1, 1998. While ***this new environment of total competition*** signals that Bell Canada will now face contenders across every business segment, it also opens the door to new cable and broadcast markets for Bell.

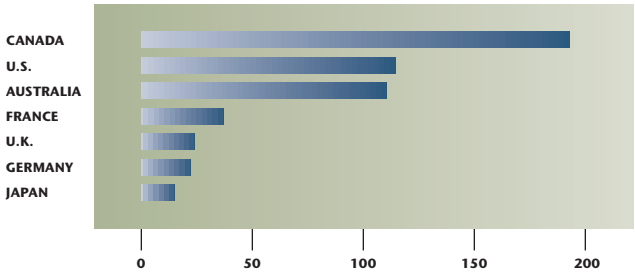
By expanding local calling areas, Bell eliminates long distance charges between affected exchanges, which among other advantages will give almost all of our customers toll-free calling to at least one Internet service provider.

Further CRTC decisions in December gave Bell Canada the go-ahead for an average $2.57 monthly increase in basic local residential rates. While short of the $2.97 increase requested, this amount will help to fund $200 million in local service improvements, and move the price of local service closer to cost. This is essential to attract the level of competition that ***will bring consumers real long-term gains***.



The CRTC's decision to refrain from regulating Bell's long distance voice services, and partially forbear from regulating inter-exchange private line services, gives Bell more flexibility to respond quickly to changing market conditions. Nevertheless, restrictions remain on certain routes for some services and the CRTC continues to regulate Bell's advanced ATM services. These ongoing restrictions impede the company's ability to compete on the same basis as its rivals, who have been free of regulatory constraints for the past three years.

If deregulation is creating a whole new level of competition, so are ascendant technologies like wireless digital personal communications systems and flat-rate marketing plans that are further commoditizing long distance voice traffic. But even if Bell Canada's share of the traditional telecommunications pie decreases, a still bigger pie is in the works. ***Customers' appetite for distinctive, tailored communications solutions is growing*** – fed by the convergence of telecommunications and computer technologies and of wireline, cable and wireless markets.



More Internet networks in Canada
(Internet networks per million population)

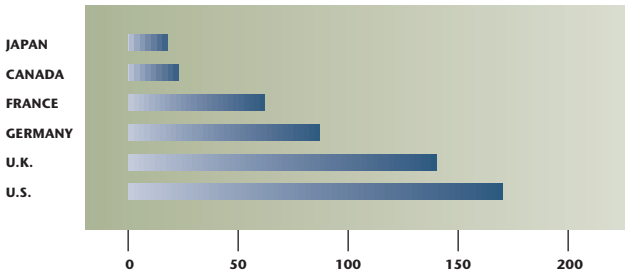
Bell's value to residential customers lies in its readiness to provide the competitive pricing and seamless service options that meet a range of personal, professional and home management expectations. ***Business customers want bandwidth*** – and the intranet, extranet and other electronic commerce solutions that will increase their access to global markets, create stronger links with customers and suppliers, and reduce costs.

Bell is proving its ability to win back customers by innovatively responding to their changing needs and maintaining its focus on the total communications solutions that they seek.

FACTOR in a vigorous core business, steeped in operational excellence, that delivers competitive value in new and imaginative ways.

As competition permeates its traditional markets, Bell Canada's determined commitment to deliver both customer and shareholder value demands a judicious and constant juggling of its price and cost structures. ***Ongoing investments in modernized information systems and information technology*** are typical of the operational excellence that is making it easier and less costly for customers to do business with Bell. These investments are permitting the smart systems and processes that will provide better integrated information, faster response times, the billing flexibility on which product/service bundling is dependent, and the ease of electronic interface that ***will improve service and reduce the cost of product delivery***.

Portable computers allow technicians to receive work assignments directly on-screen – rather than contacting control centres several times a day – giving them greater autonomy and freeing up valuable time to serve customers.



Canada's networks: robust and reliable
(number of faults per 1000 lines)

Sophisticated integrated voice response systems and continuous access via the Internet are ***examples of new electronic channels*** that are putting product information – and service – at customers' fingertips.

Operational excellence also entails having the competitive mindset and organizational flexibility and skill mix for the tasks at hand. By adding the continuous learning of business transformation to long-standing expertise, Bell employees are sparing no effort in their bid to stay well ahead of the competition.

In keeping with customers' evolving perceptions of value, Bell is streamlining its product offering and creating simplified solutions. Consumers are discovering value in Bell's ***easy-to-understand, competitively priced FirstRate long distance savings plans***. They are also taking advantage of universal messaging – the convenient new long-distance voice-mail – and the growing "call-mall" capability to retrieve information and conclude transactions over the **Vista* 350** screen-based phone.

Bell Canada is also gaining a better understanding of customer acceptance of leading-edge products and services through its **Bell TotalVision™** market trials in London, Ontario, and Repentigny, Québec. From their homes, participants are testing a Canadian-developed Interactive Program Guide and can access some 100 TV channels and FM radio stations, digital video and CD-quality audio programming, as well as high-speed interactive TV and Internet service through their PC or television.

Meanwhile, two new Bell Canada business products, launched in 1997, are consistent with the company's strategy to offer more bundled solutions. **Total Solutions *allows small- and medium-sized business customers to enhance their effectiveness*** with 12 different combinations of Bell products, services and consultative know-how – depending on their stage of business growth. And Bell's *Information Exchange* service enables these same business customers to communicate electronically with clients, partners and suppliers through a combination of Internet, fax-on-demand and **Advantage Optimum** services.

Power Networks
NORTEL
International Trade
International Offices
South American Index
Shipping Services

Rapidly shifting markets and advancing technology have made breakthrough innovation contingent upon ***the art of alliance-building***. Bell Canada's partnership with Netscape Communications is delivering the end-to-end Internet/electronic commerce solutions that will keep Canadian business competitive.

In a far-reaching inter-operability agreement – the broadest of its type in the world to date – US West, GTE and Bell have taken the lead in offering their smart card payphone customers seamless service across North America. And in another deal with MCI Communications and Concert, Bell and its Stentor partners introduced ***Canada's first global virtual network*** – supplying business with standardized, quality connections in 15 strategic countries.

The company's ability to provide convenient, ***one-stop-shopping*** is also growing. Bell's retail outlets have recently augmented their product line with such BCE group offerings as Bell Mobility cellular service and ExpressVu™ direct-to-home satellite TV.

As it retools its core business and crosses new frontiers, Bell will continue to reach out with a dynamic range of choices and value that will build customer loyalty, even in the midst of fierce competition. By any reckoning, ***Bell Canada has what it takes to sustain steady growth*** well into the next millennium.

Advantage Optimum is a trademark of Stentor Resource Centre Inc. — Bell Canada is a licensed user.
† FirstRate is a trademark of MTS NetCom Inc. used under license by Bell Canada.
** Vista is a trademark of Northern Telecom.*
ExpressVu is a trademark of ExpressVu Inc.

Financial and corporate information

For the year ended December 31, 1997

Financial review

Overview

Bell Canada's operating results for 1997 reflect revenue growth and the effect of various cost reduction programs including the three-year transition plan implemented in March 1995. Net income applicable to common shares before the extraordinary item, operating cash flow, and free cash flow all increased for 1997 compared with 1996. Bell Canada's consolidated rate of return on average common equity before extraordinary item for 1997 was 11.7% compared with 9.8% for 1996. The drawing to a close of Bell Canada's three-year transition plan coincides with significant changes to Bell Canada's regulatory and competitive environment resulting from the implementation of price cap regulation, the introduction of local service competition and decreased regulation of long distance services. These factors along with continued intense competition across all other lines of business coupled with the rapid pace of technological change are expected to significantly impact Bell Canada's results in the future (see *Outlook*).

In light of these regulatory developments, Bell Canada has determined that it no longer meets the criteria necessary for the continued application of regulatory accounting provisions. As a result, Bell Canada has recorded an after-tax extraordinary charge to income of $2,725 million to reflect adjustments made to the net carrying values of assets and liabilities as at December 31, 1997 (see *Extraordinary item*).

Operating revenues increased by $546 million for 1997 due primarily to growth in local and access service revenues and terminal, directory advertising and other revenues. Operating expenses increased by $287 million for 1997 compared with the same period of 1996 due to higher depreciation and amortization resulting primarily from adjustments to depreciation rates reflecting reduced service lives for switching equipment, transmission equipment and outside plant and increased amortization of the costs related to the business transformation and workforce reduction programs. Costs associated with volume increases, combined with increased costs related to network management services, and the provision of Internet access have been more than offset by increased pension credits, as well as the impact of process improvement projects being implemented as part of the business transformation program. Interest charges decreased by $57 million for 1997 compared with 1996 as a result of lower interest rates and lower debt levels. The number of employees decreased by 5,567 during 1997 to a level of 39,328 at December 31, 1997.

Operating cash flow increased by $317 million for 1997 compared with 1996 due mainly to higher operating revenues. Free cash flow increased by $234 million for 1997 compared with 1996 due primarily to higher operating revenues, lower working capital requirements, and the reduction of long-term receivables, partially offset by increased net capital expenditures, investments and business transformation and workforce reduction costs.

Financial highlights

(Dollars in the tables of this Financial review are in millions)

	1997	1996	Increase (Decrease)	% Change
Net income applicable to common shares before extraordinary item	**$ 852**	**$ 714**	**$ 138**	**19.3**
Extraordinary item (net of tax)	**$ (2,725)**	**–**	**$ (2,725)**	**–**
Net income (loss) applicable to common shares	**$ (1,873)**	**$ 714**	**$ (2,587)**	**–**
Operating cash flow	**$ 3,074**	**$ 2,757**	**$ 317**	**11.5**
Free cash flow	**$ 438**	**$ 204**	**$ 234**	**114.7**
Net capital expenditures	**$ 1,668**	**$ 1,621**	**$ 47**	**2.9**
Return on average common equity (%)[1]	**11.7**	**9.8**	**1.9**	**19.4**
Number of employees – as at December 31	**39,328**	**44,895**	**(5,567)**	**(12.4)**

	1996	1995	Increase (Decrease)	% Change
Net income applicable to common shares	$ 714	$ 502	$ 212	42.2
Operating cash flow	$ 2,757	$ 2,435	$ 322	13.2
Free cash flow	$ 204	$ (44)	$ 248	–
Net capital expenditures	$ 1,621	$ 1,500	$ 121	8.1
Return on average common equity (%)	9.8	6.7	3.1	46.3
Number of employees – as at December 31	44,895	48,333	(3,438)	(7.1)

1- Excludes impact of extraordinary item

The following sections provide a more detailed discussion of Bell Canada's results of operations and financial condition.

Results of operations

Operating revenues

	1997	1996	Increase	% Change
Total operating revenues	**$ 9,246**	**$ 8,700**	**$ 546**	**6.3**

	1996	1995	Increase	% Change
Total operating revenues	$ 8,700	$ 8,183	$ 517	6.3

Operating revenues increased for 1997 compared with 1996 due primarily to increased local and access service revenues and terminal, directory advertising and other revenues.

Operating revenues increased for 1996 compared with 1995 due primarily to increases in local and access service revenues and terminal, directory advertising and other revenues.

Local and access service revenues

	1997	1996	Increase	% Change
Local and access service revenues	**$ 4,324**	**$ 3,928**	**$ 396**	**10.1**
Number of network access services*†				
Business	**3,414**	**3,202**	**212**	**6.6**
Residence	**7,193**	**7,064**	**129**	**1.8**
	10,607	**10,266**	**341**	**3.3**

	1996	1995	Increase	% Change
Local and access service revenues	$ 3,928	$ 3,511	$ 417	11.9
Number of network access services*†				
Business	3,202	3,004	198	6.6
Residence	7,064	6,997	67	1.0
	10,266	10,001	265	2.6

* *As at December 31*
† *Network access services represent, approximately, the number of lines in service (thousands).*

Local and access service revenues represent 47% of total operating revenues for 1997 and are earned principally by connecting business and residence customers to Bell Canada's network and providing them with local-area service.

Local and access service revenues increased for 1997 compared with 1996 due to the $2 per month local service rate increase, moderate network access services growth, continued growth in optional services, payments made to access the local network by users of private line digital services, and the impact of the restructuring of local residential rates in December of 1996. Revenues from long distance competitors for accessing the switched local network decreased slightly for 1997 compared with the same period of 1996 as a lower contribution rate offset higher volumes.

Local and access service revenues increased for 1996 compared with 1995, due to moderate network access services growth coupled with the impact of the $2 per month local service rate increase, as well as continued growth in optional services due to concentrated sales efforts and payments made to access the local network by users of private line digital services. Revenues from long distance competitors for accessing the switched local network increased for 1996 compared with 1995, due to higher volumes and the mid-year reduction in explicit discounts, substantially offset by a lower contribution rate for 1996.

Long distance and network service revenues

	1997	**1996**	**Increase**	**% Change**
Long distance and network service revenues	**$ 3,064**	**$ 3,030**	**$ 34**	**1.1**

	1996	1995	Increase	% Change
Long distance and network service revenues	$ 3,030	$ 3,019	$ 11	0.4

Long distance and network service revenues represent 33% of total operating revenues for 1997 and are earned by carrying long distance traffic and by providing network services such as private line and business data services. Bell Canada provides these services in its territory and, jointly with other telecommunications providers, throughout Canada and the world. These revenues are subject to intensifying competition particularly from a few major competitors among the approximately 280 companies currently providing these services in Bell Canada's territory.

Long distance service revenues decreased for 1997 compared with 1996 as lower average prices and a decrease in volumes were only partially offset by the positive impact of the new Stentor settlement plan. The

lower average prices are primarily due to increased penetration of discount calling plans such as **Real Plus Extra**™, product enhancements, and special promotions.

Network service revenues increased for 1997 compared with 1996 more than offsetting the decrease in long distance revenues. The increase in network service revenues is due primarily to continued growth in digital services, **Megaplan**™ and **HyperStream**†, and **Call Answer** telemessaging services, partially offset by increased Stentor settlement payments.

Long distance service revenues decreased for 1996 compared with 1995 as higher volumes were more than offset by lower average prices, due primarily to higher caller toll-free service volume coupled with increased penetration of discount calling plans such as **Real Plus Extra**. Network service revenues increased for 1996 compared with 1995 due to continued growth in digital services such as **Megaplan** and **HyperStream**, and in **Call Answer** telemessaging services.

Conversation minutes

	1997	**1996**	**(Decrease)**	**% Change**
Conversation minutes* *(millions)*	**9,935**	**10,101**	**(166)**	**(1.6)**

	1996	1995	Increase	% Change
Conversation minutes* *(millions)*	10,101	9,933	168	1.7

* *Defined as minutes for calls originating in Bell Canada's territory for long distance services, as well as minutes for calls terminating in Bell Canada's territory for* ***Advantage Toll-free***™ *service.*

Long distance service volumes, as measured in conversation minutes decreased for 1997 compared with 1996 as the impact of intense competition in the long distance market more than offset market growth driven in part by traffic stimulation from price reductions.

Long distance service volumes, as measured in conversation minutes, increased for 1996 compared with 1995. These increases were caused by market growth driven in part by traffic stimulation from prior period price reductions.

Bell Canada estimates that during 1997 competitors gained about 6% of the volume of the long distance market, bringing Bell Canada's estimated market share to about 63% at December 31, 1997. This compares to an estimated market share of about 69% at December 31, 1996 and 74% at December 31, 1995.

Real Plus Extra, Megaplan and Advantage Toll-free are trademarks of Stentor Resource Centre Inc., Bell Canada is a licensed user.
† *Trademark of MCI Communications Corporation Inc.*

Terminal, directory advertising and other revenues

	1997	1996	Increase	% Change
Terminal, directory advertising and other revenues	**$ 1,858**	**$ 1,742**	**$ 116**	**6.7**

	1996	1995	Increase	% Change
Terminal, directory advertising and other revenues	$ 1,742	$ 1,653	$ 89	5.4

Revenues in this category represent 20% of total operating revenues for 1997 and consist of rental, sales and maintenance of terminal equipment, directory advertising, Internet access, systems integration, and network management services.

The increase in revenues for 1997 is primarily due to an increase in net sales of terminal equipment, an increase in network management services, and an increase in Internet access services, driven by the increase in customers for **Sympatico*** Internet service.

The increase in revenues for 1996 compared with 1995 is primarily due to an increase in sales of terminal equipment.

Operating expenses

Total operating expenses

	1997	1996	Increase (Decrease)	% Change
Depreciation and amortization	**$ 2,614**	**$ 2,237**	**$ 377**	**16.9**
Operating expenses	**4,307**	**4,397**	**(90)**	**(2.0)**
Total operating expenses	**$ 6,921**	**$ 6,634**	**$ 287**	**4.3**

	1996	1995	Increase (Decrease)	% Change
Depreciation and amortization	$ 2,237	$ 1,937	$ 300	15.5
Operating expenses	4,397	4,445	(48)	(1.1)
Total operating expenses	$ 6,634	$ 6,382	$ 252	3.9

* *Trademark of MediaLinx Interactive Limited Partnership.*

The depreciation and amortization expense increase for 1997 compared with 1996 was primarily due to revised depreciation rates over 1996 rates for switching equipment, transmission equipment and outside plant and increased amortization of business transformation and workforce reduction costs. The shortening of depreciable lives is consistent with the trend prevailing in the Canadian telecommunications industry.

Operating expenses (excluding depreciation and amortization) decreased for 1997 compared with 1996. Costs associated with volume increases, combined with increased costs related to network management services and the provision of Internet access, have been more than offset by increased pension credits, as well as the impact of process improvement projects implemented as part of the business transformation program. The increased pension credits reflect experience gains, the impact of changes in estimates implemented for the first time in 1996, and the workforce reduction program.

The depreciation and amortization expense increase for 1996 compared with 1995 was primarily due to revised depreciation rates over 1995 rates for switching equipment, transmission equipment and outside plant and increased amortization of business transformation and workforce reduction costs.

Operating expenses (excluding depreciation and amortization) decreased for 1996 compared with 1995. The business transformation and workforce reduction programs have enabled Bell Canada to partially offset the impact of expense increases that would normally be generated by volume increases. These costs coupled with increased sales and marketing support, have been offset by the process improvement projects implemented as part of the business transformation program and increased pension credits. The increased pension credits in 1996 reflect the 1995 experience gains, a change in estimates related to the amortization of experience gains and the workforce reduction program.

Salaries and wages

	1997	1996	(Decrease)	% Change
Telecommunications operations	**$ 1,668**	**$ 1,682**	**$ (14)**	**(0.8)**
Other operations	**295**	**369**	**(74)**	**(20.1)**
Salaries and wages expense	**1,963**	**2,051**	**(88)**	**(4.3)**
Capital and process improvement projects	**260**	**314**	**(54)**	**(17.2)**
Total salaries and wages	**$ 2,223**	**$ 2,365**	**$ (142)**	**(6.0)**

	1996	1995	(Decrease) Increase	% Change
Telecommunications operations	$ 1,682	$ 1,762	$ (80)	(4.5)
Other operations	369	333	36	10.8
Salaries and wages expense	2,051	2,095	(44)	(2.1)
Capital and process improvement projects	314	342	(28)	(8.2)
Total salaries and wages	$ 2,365	$ 2,437	$ (72)	(3.0)

*Number of employees**

	1997	1996	(Decrease)	% Change
Telecommunications operations	**33,822**	**38,859**	**(5,037)**	**(13.0)**
Other operations	**5,506**	**6,036**	**(530)**	**(8.8)**
Total	**39,328**	**44,895**	**(5,567)**	**(12.4)**

	1996	1995	(Decrease)	% Change
Telecommunications operations	38,859	42,201	(3,342)	(7.9)
Other operations	6,036	6,132	(96)	(1.6)
Total	44,895	48,333	(3,438)	(7.1)

* *As at December 31*

Salaries and wages and number of employees have decreased for 1997 compared with 1996 as a direct result of the business transformation and other workforce reduction programs. A variety of voluntary incentive measures and career transition aids were presented to employees in order to facilitate these extensive workforce reductions.

The percentage decrease of total salaries and wages, which excludes any payments made under workforce reduction programs, for 1997 compared with 1996, is less than the percentage reduction in employees. This results from the timing of workforce reduction programs in 1997, including the further workforce reductions announced in July, which occurred mostly in the second half of 1997.

Salaries and wages and number of employees decreased for 1996 compared with 1995 as a direct result of the business transformation and other workforce reduction programs. The percentage decrease of total salaries and wages, which excludes any payments made under workforce reduction programs for 1996 compared with 1995 is less than the percentage reduction in employees, as it is partially offset by increased overtime payments, wage increases, higher incentive plan payouts for 1996, and lump-sum payments which were granted primarily to represented employees under the terms of negotiated labour agreements.

Interest charges

	1997	**1996**	**(Decrease)**	**% Change**
Interest charges	**$ 602**	**$ 659**	**$ (57)**	**(8.6)**

	1996	1995	(Decrease)	% Change
Interest charges	$ 659	$ 667	$ (8)	(1.2)

Interest charges decreased for 1997 compared with 1996 as a result of lower interest rates and lower debt levels.

Interest charges decreased for 1996 compared with 1995 as a result of lower interest rates and retractable preferred share dividends, partially offset by higher average debt outstanding during the year.

Extraordinary item

Bell Canada determined that effective January 1, 1998 it no longer meets the criteria necessary for the continued application of regulatory accounting provisions as a result of the introduction of price cap regulation and the opening of the local exchange market to competition. Accordingly, Bell Canada adjusted the net carrying values of assets and liabilities as at December 31, 1997, to reflect values appropriate under generally accepted accounting principles for enterprises no longer subject to rate-of-return regulation. The adjustment resulted in an extraordinary charge of approximately $2,725 million on an after-tax basis. Included in this extraordinary charge is an adjustment to the net carrying values of capital assets and a write-off of assets and liabilities specifically recognized through the regulatory process.

The write-off related to capital assets reflects the impact of the introduction of the next generation of technologies, changes in the expected use of existing technologies, and changing market conditions.

For more details please see Bell Canada – Notes to consolidated financial statements.

Net capital expenditures

	1997	1996	Increase	% Change
Net capital expenditures	**$ 1,668**	**$ 1,621**	**$ 47**	**2.9**

	1996	1995	Increase	% Change
Net capital expenditures	$ 1,621	$ 1,500	$ 121	8.1

Net capital expenditures continue to represent one of Bell Canada's largest use of funds. Net capital expenditures increased for 1997 compared with 1996 due primarily to the replacement of analog equipment with fully modern digital equipment in small- and medium-sized communities. Net capital expenditures also increased for 1996 compared with 1995 reflecting Bell Canada's commitment to the deployment of the latest technology to meet the needs and demands of customers.

Liquidity and capital resources

The principal components of Bell Canada's cash flows include:

	1997	1996	1995
Net income before extraordinary item	**$ 888**	$ 754	$ 543
Operating cash flow	**$ 3,074**	$ 2,757	$ 2,435
Net capital expenditures	**$ (1,668)**	$ (1,621)	$ (1,500)
Dividends	**$ (858)**	$ (861)	$ (862)
Free cash flow	**$ 438**	$ 204	$ (44)
Funds provided (used) by:			
Net (repayments) borrowings	**$ (309)**	$ (304)	$ 21
(Increase) decrease in cash and other – net	**(129)**	100	23
	$ (438)	$ (204)	$ 44

Operating cash flow increased for 1997 compared with 1996 due to higher operating revenues. Free cash flow increased for 1997 compared with 1996 due primarily to higher operating revenues, lower working capital requirements, and the reduction of long-term receivables principally related to the 1996 data centre outsourcing agreement with IBM, partially offset by increased net capital expenditures, investments, and business transformation and workforce reduction costs.

Operating cash flow increased for 1996 compared with 1995 due to an increase in net operating revenues. Free cash flow increased for 1996 compared to 1995 due to higher net operating revenues and net proceeds of $91 million from the transaction relating to the outsourcing of the managed services operations of Bell Sygma Inc. to IBM, partially offset by increased business transformation and workforce reduction costs, increased net capital expenditures and the impact of working capital requirements.

On December 31, 1997, outstanding commercial paper totalled $220 million in Canadian funds. The commercial paper program is supported by lines of credit, extended by several banks, totalling $900 million.

Under an agreement effective October 14, 1997, Bell Canada sold accounts receivable for aggregate cash proceeds of $650 million. Pursuant to the agreement, the purchaser will use the funds from collections to purchase further receivables from Bell Canada until expiration of the agreement on October 6, 2002. Bell Canada is obligated to pay monthly certain predefined fees. This agreement replaced a previous agreement dated December 21,1990, pursuant to which $550 million of accounts receivable had been sold.

During 1997 Bell Canada repaid $604 million of debt comprised of $208 million of long-term debt which matured, $378 million of long-term debt which was redeemed prior to maturity, and $18 million in commercial paper. Funds required to pay this debt came from external and internal sources. Funds from external sources were obtained in 1997 principally by the public issue of $300 million of debentures in Canada for proceeds of $295 million.

Bell Canada's debt ratio was 55.6% at December 31, 1997 compared with 46.1% at December 31, 1996. The increase is due mainly to the extraordinary charge recorded in 1997 partially offset by a decrease in outstanding debt at the end of 1997 compared with 1996.

Approximately $536 million of Bell Canada long-term debt and other long-term liabilities will mature during 1998. Bell Canada's cash requirements for 1998 are expected to be met by the anticipated proceeds from the sale of certain real estate assets (see Bell Canada consolidated financial statements – note 18).

Bell Canada's current credit ratings are shown in the table below.

	Senior unsecured debt	Subordinated unsecured debt	Commercial paper	Preferred shares	Outlook
Canadian Bond Rating Service	A (high)	A (low)	A-1+	P-2 (high)	Stable
Dominion Bond Rating Service	A (high)	A (low)	R-1 (mid)	Pfd-2	Negative*
Moody's Investors Service	A2	A3	Prime-1	nr	–
Standard and Poor's Ratings Group	A+	A	nr	nr	Negative

nr = not rated
** = negative for commercial paper*

During 1997 Moody's Investors Service (Moody's) downgraded Bell Canada's senior unsecured debt from A1 to A2 and subordinated debentures from A2 to A3. The downgrade reflects Moody's concern that Bell Canada's financial performance will remain under pressure in an increasingly competitive environment. Also, during 1997 Dominion Bond Rating Service (DBRS) changed its outlook with respect to Bell Canada's commercial paper from stable to negative.

Following the announcement of Bell Canada's extraordinary item, the above credit rating agencies reaffirmed Bell Canada's credit ratings.

Outlook

This outlook, as well as certain other sections of this report, contains forward-looking statements with respect to Bell Canada. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. Bell Canada considers the assumptions on which these forward-looking statements are based to be reasonable at the time they were prepared, but cautions the reader that these assumptions regarding future events, many of which are beyond the control of Bell Canada, may ultimately prove to be incorrect.

In March 1995, Bell Canada adopted a transition plan designed to restore its financial strength over the 1995-97 period. The plan anticipated further deterioration for 1995, to be followed by progressive improvement through 1996 and 1997, with a specific goal of returning to historic levels of financial performance by the end of 1997. Bell Canada's results for 1995, 1996, and 1997 were generally in line with attainment of the overall objectives of its three-year plan as revised in February 1997.

As part of the transition plan, a business transformation program was implemented in 1995 with a significant commitment of resources aimed at a redesign of work processes to enable Bell Canada to substantially reduce its cost structure while finding better and faster ways to serve its customers. While the business transformation program has ended in 1997, Bell Canada expects to continue to realize benefits related to the program in 1998 and in subsequent years. Process improvement and cost and service competitiveness are ongoing challenges in a highly competitive marketplace and the business transformation program has been a catalyst for this need for ongoing improvement with projects such as Bell Canada's current information systems and information technology modernization program.

During 1997 the CRTC released several important decisions which set out the rules for the evolution to total competition in Canada's telecommunications industry. Included in these decisions were those related to the introduction of local service competition, the implementation of price cap regulation, and forbearance from long distance and private line service regulation. These decisions represent significant challenges and opportunities for Bell Canada.

Rate-of-return regulation of Bell Canada's services ended on December 31, 1997. Effective January 1, 1998, this was replaced by price cap regulation for certain utility services. The CRTC has determined interim "going-in" rates that provide for average basic residence local rate increases of $2.57. Bell Canada has

accordingly increased average rates effective January 1, 1998. The introduction of local service competition will increase uncertainty as to Bell Canada's local and access service revenues for 1998 and subsequent years.

The CRTC's decision to largely forbear from regulating long distance voice services and partially forbear from regulating private line services will increase Bell Canada's flexibility to respond to customers' demands and will allow Bell Canada to more effectively compete in 1998. However, the CRTC has included restrictions which continue to prevent Bell Canada from competing according to the same rules as certain competitors. Bell Canada anticipates continued pressures on long distance and network service revenues related to intense competition.

During 1998, Bell Canada will continue to pursue new sources of revenues through emerging technologies and will explore ways of integrating its businesses. As part of Bell Canada's commitment to focus on core business activities and dedicating resources to service its customers, Bell Canada will continue to pursue its strategy of divesting of non-core assets, and to that end has entered into an agreement to sell certain real estate assets (see Bell Canada consolidated financial statements – note 18).

In early January, a severe ice storm hit sections of Bell Canada's service territory causing loss of electrical power and substantial damage to Bell Canada's outside plant infrastructure. Bell Canada has responded by mobilizing its resources to keep its network operational and restore service to customers as quickly as conditions will allow. Although the overall additional cost incurred by the company is not yet finalized, initial estimates are that it will cause material reductions in our first quarter earnings and cash flow. However, the additional cost is not expected to have a material impact on full-year 1998 earnings and cash flow.

Bell Canada expects net capital expenditures to increase in 1998 compared with 1997, driven by an information systems and information technology modernization program which encompasses a portion of Bell Canada's work related to the Year 2000 issue and the introduction of new technologies. For more information concerning the Year 2000 issue please refer to pages 12-13 of the **Bell Canada Annual Information Form for the year ended December 31, 1997** under the heading "Year 2000 Issue."

As a result of Bell Canada's extraordinary charge, Bell Canada anticipates a reduction in its depreciation and amortization expense in 1998. The amount of the reduction is expected to be partially offset by increased depreciation rates for certain capital assets in 1998 reflecting changing useful lives. Capital asset lives will continue to be reviewed by Bell Canada and adjusted to reflect market conditions and technological changes within the industry. Bell Canada will continue to explore ways of improving its cost structure in 1998 in order to ensure that Bell Canada can continue to effectively compete.

Management's responsibility for financial statements

The accompanying consolidated financial statements of Bell Canada and the information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in conformity with Canadian generally accepted accounting principles. The financial statements include some amounts that are based on best estimates and judgements. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

Management, in furtherance of the integrity and objectivity of the financial statements, has developed and maintains a system of internal controls and supports an extensive program of internal audits. Management believes the internal controls provide assurance that financial records are reliable and form a proper basis for preparation of financial statements and that assets are properly accounted for and safeguarded. The internal control process includes management's communication to employees of policies which govern ethical business conduct.

The Board of Directors carries out its responsibility for the financial statements in this annual report principally through its audit committee, consisting of six members, four of whom are outside directors. The audit committee reviews Bell Canada's annual consolidated financial statements and recommends their approval to the Board of Directors. The internal and the shareholders' auditors have free and independent access to the audit committee.

These financial statements have been audited by the shareholders' auditors, Deloitte & Touche, Chartered Accountants, and their report follows.

Ronald W. Osborne
President and Chief Executive Officer

Vincent W. Salvati
Chief Financial Officer

Montréal (Québec) Canada
February 24, 1998

Auditor's report

To the shareholders of Bell Canada

We have audited the consolidated balance sheets of Bell Canada and its subsidiaries as at December 31, 1997 and 1996 and the consolidated statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1997. These consolidated financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these consolidated financial statements, based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. These standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the corporation as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1997 in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche
Chartered Accountants

Montréal (Québec) Canada
February 24, 1998

Consolidated statement of income

(millions of dollars)

For the years ended December 31	**1997**	1996	1995
Operating revenues			
Local and access services	**$ 4,324**	$ 3,928	$ 3,511
Long distance and network services	**3,064**	3,030	3,019
Terminal, directory advertising and other revenues	**1,858**	1,742	1,653
Total operating revenues	**9,246**	8,700	8,183
Operating expenses			
Depreciation and amortization	**2,614**	2,237	1,937
Operating expenses	**4,307**	4,397	4,445
Total operating expenses	**6,921**	6,634	6,382
Net operating revenues	**2,325**	2,066	1,801
Other expenses	**40**	5	48
Interest charges	**602**	659	667
Income before income taxes and extraordinary item	**1,683**	1,402	1,086
Income taxes *(note 2)*	**795**	648	543
Net income before extraordinary item	**888**	754	543
Extraordinary item, net of tax *(note 3)*	**(2,725)**	–	–
Net income (loss)	**(1,837)**	754	543
Dividends on perpetual preferred shares	**36**	40	41
Net income (loss) applicable to common shares	**$ (1,873)**	$ 714	$ 502

Consolidated statement of retained earnings

(millions of dollars)

For the years ended December 31	**1997**	1996	1995
Balance at beginning of year	**$ 2,051**	$ 2,179	$ 2,503
Net income (loss)	**(1,837)**	754	543
	214	2,933	3,046
Dividends			
Perpetual preferred shares	**(36)**	(40)	(41)
Common shares	**(822)**	(821)	(821)
	(858)	(861)	(862)
Related party adjustments *(note 16)*	**–**	(21)	–
Reclassification of premium on share capital and other items *(note 13)*	**644**	–	(5)
	(214)	(882)	(867)
Balance at end of year	**$ –**	$ 2,051	$ 2,179

Consolidated statement of changes in financial position

Cash provided from (used for)			*(millions of dollars)*
For the years ended December 31	**1997**	1996	1995
Operating activities			
Net income (loss)	**$ (1,837)**	$ 754	$ 543
Items not affecting cash			
Extraordinary item *(note 3)*	**2,725**	–	–
Depreciation and amortization	**2,614**	2,237	1,937
Deferred income taxes	**(112)**	(75)	(8)
Pension and other items	**(316)**	(159)	(37)
Operating cash flow	**3,074**	2,757	2,435
Decrease in working capital and other items	**303**	107	158
Business transformation and other workforce reduction costs (net of deferred income taxes thereon)	**(427)**	(287)	(269)
Cash flow from operations	**2,950**	2,577	2,324
Investing activities			
Capital expenditures – net	**(1,668)**	(1,621)	(1,500)
Investments, net of proceeds from asset dispositions	**(91)**	72	(16)
Long-term receivables and other items	**105**	37	10
	(1,654)	(1,512)	(1,506)
Dividends	**(858)**	(861)	(862)
Free cash flow	**438**	204	(44)
Financing activities			
Increase (decrease) in notes payable and bank advances	**(18)**	144	(169)
Proceeds from issue of long-term debt	**295**	441	716
Repayment of long-term debt	**(586)**	(733)	(416)
Redemption of retractable preferred shares	**–**	(156)	(130)
Issue of perpetual preferred shares	**–**	–	20
Other items	**40**	(1)	(13)
	(269)	(305)	8
Cash position			
Increase (decrease) during the year	**169**	(101)	(36)
At beginning of year	**(216)**	(115)	(79)
At end of year [1]	**$ (47)**	$ (216)	$ (115)
[1] ***Represented by:***			
Temporary cash investments	**$ 9**	$ –	$ 26
Cheques outstanding in excess of bank balances	**(56)**	(216)	(141)
	$ (47)	$ (216)	$ (115)

Consolidated balance sheet

Assets		*(millions of dollars)*
As at December 31	**1997**	1996
Current assets		
Accounts receivable *(note 4)*	**$ 1,116**	$ 979
Prepaid expenses	**155**	161
Other	**42**	96
	1,313	1,236
Capital assets – at cost *(notes 5 and 6)*		
Buildings, plant and equipment *(note 6)*	**28,427**	28,242
Less: accumulated depreciation	**16,839**	12,632
	11,588	15,610
Land	**111**	116
Plant under construction	**274**	274
Material and supplies	**85**	127
	12,058	16,127
Other assets		
Long-term receivables	**40**	94
Investments in associated and other companies *(note 1)*	**133**	68
Deferred charges *(notes 7 and 8)*	**1,135**	1,530
	1,308	1,692
Total assets	**$ 14,679**	$ 19,055

On behalf of the board of directors:

W. Chippindale
Director

R.F. Bennett
Director

Consolidated balance sheet

Liabilities and shareholders' equity		*(millions of dollars)*
As at December 31	**1997**	1996
Current liabilities		
Cheques outstanding in excess of bank balances (net of temporary cash investments at cost – approximates market)	**$ 47**	$ 216
Accounts payable *(note 4)*	**1,505**	1,004
Advance billing and payments	**345**	305
Dividends payable – including $ 205 ($ 205 – 1996) due to parent company	**208**	208
Taxes accrued	**115**	222
Interest accrued	**131**	142
Debt due within one year *(note 9)*	**846**	524
	3,197	2,621
Long-term debt *(note 10)*	**5,567**	6,127
Deferred credits		
Income taxes *(note 2)*	**389**	2,133
Other	**228**	181
	617	2,314
Retractable preferred shares *(note 12)*	**100**	100
Perpetual preferred shares *(note 12)*	**630**	630
Common shareholders' equity *(note 13)*		
Stated capital of common shares	**4,178**	4,178
Premium on share capital	**390**	1,034
Retained earnings	**–**	2,051
	4,568	7,263
Total liabilities and shareholders' equity	**$14,679**	$ 19,055

Notes to consolidated financial statements

1. Accounting policies

Basis of Presentation

The financial statements of Bell Canada for periods up to and including December 31, 1997 are prepared in accordance with generally accepted accounting principles (GAAP), including provisions for certain regulated companies. Bell Canada determined that, as at December 31, 1997, it no longer meets the criteria necessary for the continued application of regulatory accounting provisions as a result of the introduction of price cap regulation and the opening of the local exchange market to competition. Accordingly, Bell Canada's accounting policies, while continuing to be in accordance with GAAP, will no longer include those GAAP provisions applicable to certain regulated companies.

In 1996 the Canadian Radio-television and Telecommunications Commission (CRTC) commenced certain proceedings to implement a framework for increased competition and reduced regulation for which decisions were made in 1997. Bell Canada is now subject to competition in the local exchange market. Effective January 1, 1998, Bell Canada is no longer subject to a rate-of-return form of regulation but certain of its local services are subject to price cap regulation. Bell Canada's long distance operations have been largely forborne from regulation as have certain of Bell Canada's private line voice and data services.

Bell Canada, based on the foregoing events, has adjusted the net carrying values of assets and liabilities as at December 31, 1997, to reflect values appropriate under GAAP for enterprises no longer subject to rate-of-return regulation. The adjustment has been recorded in the December 31, 1997 financial statements as an extraordinary item, net of tax (note 3).

Bell Canada operates in a single industry segment which is telecommunications services. These services are provided in the provinces of Ontario and Québec to both business and residential customers. As used herein "Bell Canada" means Bell Canada, its subsidiaries and the directory business division of Tele-Direct (Publications) Inc.

With respect to the consolidated financial statements of Bell Canada, the important differences between Canadian and United States GAAP are described and reconciled in note 17.

Unless otherwise indicated, all amounts are in Canadian dollars. Certain previously reported amounts have been reclassified to conform with the current presentation.

Consolidation

The consolidated financial statements include the accounts of all subsidiaries (defined as companies controlled by Bell Canada) and those of the directory business division of Tele-Direct (Publications) Inc. (TD Publications). The principal subsidiary company of Bell Canada, at December 31, 1997, was Bell Sygma Inc.

TD Publications, which was a wholly owned subsidiary prior to 1989, is now a majority-owned subsidiary of BCE Inc. (BCE), the parent company of Bell Canada. Although Bell Canada does not have voting control, it retains exclusive control over and the right to earnings of the directory business division; further, it is BCE's policy that the establishment and operation of the other business activities of TD Publications will not affect Bell Canada.

The principal associated company (defined as companies under significant investor influence) of Bell Canada at December 31, 1997, was Bell-Northern Research Ltd. In its capacity as a member of Stentor, an alliance of Canada's major telecommunications companies, Bell Canada has a significant non-controlling position in Stentor Resource Centre Inc. (SRCI). Investments in associated companies are accounted for by the equity method and amounted to $53 million ($45 – 1996). Investments in other companies (defined as less than 20% owned) are accounted for at cost and amounted to $80 million ($23 – 1996).

Capital assets

Capital assets are carried at cost less accumulated depreciation, where applicable. When depreciable capital assets are retired, the carrying value of such assets is charged to accumulated depreciation. Switching machine software and certain other administrative application software is included in plant and equipment.

Prior to the discontinued application of regulatory accounting provisions, depreciation rates were reviewed and approved by the CRTC as part of the rate-setting process. Accordingly, Bell Canada's depreciation charge for 1996 and prior years reflects asset lives as approved by the CRTC. Effective January 1, 1997, Bell Canada, in anticipation of obtaining CRTC approval with respect to asset lives to be used for 1997, used shorter asset lives than those used in 1996. The CRTC subsequently ordered that for the purposes of calculating the contribution rates in 1997, the company use asset lives approved for use in 1996. Bell Canada did not adjust its 1997 depreciation expense to reflect the CRTC approved asset lives. As a result, Bell Canada's 1997 depreciation expense is approximately $335 million higher than the expense which would have resulted from the use of CRTC approved asset lives for 1997. In 1998 depreciation rates will reflect the impact of changes in market and technological conditions on the estimated useful lives of assets. Depreciation is computed on a straight-line basis.

Prior to January 1, 1998, an allowance for funds used during construction was included as an item of income and also as an addition to the cost of plant to provide for a return on total capital invested in telephone plant while under construction. Effective January 1, 1998, only interest related to plant under construction will be capitalized and will be reflected as a reduction of expenses. Amounts capitalized in 1997 were $10 million ($18 – 1996, $20 – 1995).

Research and development

All research and development costs incurred are charged to income and are reduced by related tax incentives. Research and development expenses (before deductions for tax incentives) for the year 1997 were $37 million ($75 – 1996, $58 – 1995).

Derivative financial instruments

Bell Canada does not actively trade derivative financial instruments but uses them to manage foreign currency and interest rate positions associated with its debt instruments. The costs and benefits, gains and losses, of these instruments are generally recognized in income on the same basis as the foreign exchange gains and losses on the underlying debt instruments, which is usually over the remaining life of the debt.

Translation of foreign currencies

Current assets (excluding prepaid expenses), current liabilities and long-term monetary assets and liabilities are translated at the rates in effect at the balance sheet date, whereas other assets and other liabilities are translated at rates prevailing at the respective transaction dates.

Revenues and expenses are translated at average rates prevailing during the year, except for depreciation and amortization which are translated at exchange rates prevailing when the related assets were acquired. Currency gains and losses are reflected in net income of the year except for unrealized foreign currency gains and losses on long-term monetary assets and liabilities, which are reported as deferred items and amortized over the remaining lives of the related items on a straight-line basis.

Leases

Where Bell Canada is the lessor, rental revenue from operating leases is recognized as service is rendered to customers. For leases which qualify as sales-type leases, the sales revenue is recognized at the inception of the lease. Where Bell Canada is the lessee, assets recorded under capital leases are amortized on a straight-line method using rates based on the estimated useful life of the asset or based on the lease term, as appropriate. Obligations recorded under capital leases are reduced by rental payments, net of imputed interest.

Income taxes

Bell Canada, prior to January 1, 1998, used the modified liability method of income tax allocation as directed by the CRTC. As a result of the discontinued application of regulatory accounting provisions, Bell Canada has adopted the deferred tax method of income tax allocation and has adjusted its deferred income tax balance as at December 31, 1997 to reflect the appropriate balance under the deferred tax method. The adjustment is reflected in the extraordinary item (see note 3).

Under the modified liability method, Bell Canada's tax liability was adjusted to reflect changes to statutory tax rates. The changes were reflected in the income tax provision in the year of the change in tax rates. However, under the deferred tax method, the tax liability related to prior years' results is not adjusted to reflect current statutory tax rates. Under the deferred tax method of income tax allocation, the income tax provision is based on accounting income for tax purposes included in the financial statements, regardless of when such income is subject to taxes under tax laws. The difference between taxes payable and taxes accrued is accounted for as Deferred credits – Income taxes.

Pensions and other post-retirement benefits

Bell Canada maintains defined benefit pension plans which cover substantially all of its employees. The plans provide pensions to retired employees based on years of service and best average earnings at retirement. These plans are non-contributory, with Bell Canada being responsible for contributions to adequately fund the plans.

Pension costs are determined using the projected benefit obligation method prorated over years of service and based on management's best estimates. A valuation is performed each year to determine the actuarial present value of the accrued pension benefits, including the impact of workforce reduction programs. Pension plan assets are valued at market value. Adjustments arising from plan amendments, changes in assumptions, experience gains and losses and the transition adjustment (the excess of plan assets over plan obligations) as at January 1, 1987, when the present accounting standards became effective, are amortized and recognized over the expected average remaining service life of the plan participants. The recognition in income of adjustments may be accelerated upon a significant reduction in remaining service life of the employee group or significant changes to the projected benefit obligation.

Bell Canada also provides certain health care and life insurance benefits for inactive employees. The cost of these benefits, excluding life insurance, is recorded in operating expenses as paid. Life insurance for retired employees is largely funded during their working lives.

2. *Income taxes*

A reconciliation of the combined statutory federal and provincial income tax rate in Canada to the effective income tax rate is as follows:

Year ended December 31	**1997***	1996	1995
Combined statutory income tax rate	**42.3%**	42.2%	42.2%
(i) Tax on large corporations	**1.4**	1.8	2.9
(ii) Deferred tax adjustment	**–**	1.0	–
(iii) Other	**3.5**	1.2	4.9
Effective income tax rate	**47.2%**	46.2%	50.0%

* *Excludes the impact of the extraordinary item (note 3) and the income tax benefit related to it in the amount of $1,772 million. The income tax benefit includes an adjustment made to switch from the modified liability method of income tax allocation to the deferred tax method resulting from the discontinued application of regulatory accounting provisions.*

Details of Bell Canada's income taxes are as follows:

			(millions of dollars)
Year ended December 31	**1997***	1996	1995
Income taxes			
Current	**$ 740**	$ 517	$ 453
Deferred	**55**	131	90
	$ 795	$ 648	$ 543

* *Excludes the impact of the extraordinary item (note 3) and the income tax benefit related to it in the amount of $1,772 million. The income tax benefit includes an adjustment made to switch from the modified liability method of income tax allocation to the deferred tax method resulting from the discontinued application of regulatory accounting provisions.*

Deferred income taxes result principally from deductions for tax purposes, in respect of buildings, plant and equipment, in excess of amounts charged to operations.

3. Extraordinary item

Bell Canada determined that, as at December 31, 1997, it no longer meets the criteria necessary for the continued application of regulatory accounting provisions of GAAP. As a result, Bell Canada recorded an extraordinary non-cash charge of $2,725 million, net of an income tax benefit of $1,772 million.

The operations of Bell Canada no longer meet the criteria for application of regulatory accounting provisions due to significant changes in regulation including the implementation of price cap regulation which replaced rate-of-return regulation effective January 1, 1998, and the concurrent introduction of competition in the local exchange market. Accordingly, Bell Canada adjusted the carrying values of assets and liabilities as at December 31, 1997 to reflect values appropriate under generally accepted accounting principles for enterprises no longer subject to rate-of-return regulation.

The determination by Bell Canada that it no longer meets the criteria for the continuing application of regulatory accounting provisions is the result of a review, which began in 1997, to assess the impact of the introduction of price cap regulation coupled with the introduction of competition in the local exchange market. Before the advent of these two factors, Bell Canada's accounting practices were based on a regulatory regime which provided Bell Canada with reasonable assurance of the recovery of costs through rates set by the regulator and charged to customers. These regulatory accounting provisions resulted in the recognition of certain assets and liabilities along with capital asset lives which were substantially different from enterprises not subject to rate-of-return regulation.

The extraordinary charge consists of a pre-tax charge of $3,350 million related to capital assets and a pre-tax charge of $1,147 million to adjust the carrying values of other assets and liabilities to arrive at carrying values appropriate for enterprises not subject to rate-of-return regulation. The amount of the charge related to capital assets was determined based on an estimate of the underlying cash flows using management's best estimate assumptions concerning Bell Canada's most likely course of action and other factors relating to competition, technological changes, and the evolution of products and services. The net carrying values of capital assets were adjusted primarily through an increase in accumulated depreciation. The primary component of the $1,147 million charge relates to the write-off of deferred business transformation and workforce reduction costs.

4. Accounts receivable and accounts payable

At December 31, 1997, accounts receivable are principally from customers and include $27 million ($15 – 1996) from parent, affiliated and associated companies. The majority of Bell Canada's long-term receivables are due to the data centre outsourcing agreement entered into in 1996. Accounts payable include $427 million ($183 – 1996) due to parent, affiliated and associated companies.

Under an agreement effective October 14, 1997, Bell Canada sold accounts receivable for aggregate cash proceeds of $650 million. Pursuant to the agreement, the purchaser will use the funds from collections to purchase further receivables from Bell Canada until expiration of the agreement on October 6, 2002. Bell Canada is obligated to pay monthly certain predefined fees. This agreement replaced a previous agreement dated December 21,1990, pursuant to which $550 million of accounts receivable had been sold.

5. Lease obligations

Capital assets includes property recorded under capital leases net of accumulated depreciation in the amount of $19 million as at December 31, 1997 ($14 – 1996). The future minimum lease payments under capital leases net of estimated executory costs and imputed interest, as at December 31, 1997, are $22 million.

The future minimum lease payments under operating leases that have initial non-cancellable lease terms in excess of one year as at December 31, 1997 amount to $205 million.

Rental expense applicable to all operating leases for the year 1997 was $128 million ($146 – 1996, $157 – 1995).

6. *Capital assets*

The following table provides a breakdown of the balances under buildings, plant and equipment:

(millions of dollars)

	Cost		Accumulated depreciation	
As at December 31	**1997**	1996	**1997**	1996
Buildings	**$ 2,476**	$ 2,449	**$ 1,128**	$ 985
Plant	**23,238**	23,162	**13,897**	10,319
Equipment	**2,713**	2,631	**1,814**	1,328
	$ 28,427	$ 28,242	**$ 16,839**	$ 12,632

Composite depreciation rates	**1997**	1996
Buildings	**4.09%**	4.17%
Plant	**8.12%**	7.17%
Equipment	**12.33%**	10.17%

Depreciation and amortization expense includes depreciation of $2,350 million ($2,088 – 1996, $1,874 – 1995) related to buildings, plant and equipment. Retirements charged to accumulated depreciation amounted to $1,394 million in 1997 ($667 – 1996).

As a result of the discontinued application of regulatory accounting provisions, Bell Canada charged to pre-tax income as an extraordinary item an amount of $3,350 million related to capital assets. The charge primarily relates to digital multiplex systems, outside plant (mainly copper lines), application software, transmission equipment, and inside wiring. The adjustment has been reflected primarily through an increase in accumulated depreciation. Capital asset lives are being reduced, where applicable, subject to technological change and market conditions.

Capital expenditures relating to Bell Canada's business transformation program are included in capital assets.

7. *Business transformation and workforce reduction costs*

The deferred business transformation costs include workforce reduction and process optimization costs incurred as part of the business transformation program. The deferred workforce reduction costs include costs relating to workforce reduction programs implemented prior to the implementation of the business transformation program. The costs and related amortization of Bell Canada's business transformation and workforce reduction programs are shown in the table below. Amounts related to capital assets are included in the appropriate categories in capital assets and are depreciated based on their estimated useful lives. Prior to the discontinued application of regulatory accounting provisions, deferred business transformation and workforce reduction costs were amortized to income over five years.

(millions of dollars)

	Cost		Accumulated amortization	
As at December 31	**1997**	1996	**1997**	1996
Deferred business transformation costs (*note 8*)	**$ 0**	$ 796	**$ 0**	$ 102
Capital assets (*note 6*)	**267**	174	**28**	4
Total business transformation costs	**$ 267**	$ 970	**$ 28**	$ 106
Deferred workforce reduction costs (*note 8*)	**$ 0**	$ 198	**$ 0**	$ 103

In 1997, additions to deferred business transformation costs were $593 million ($488 – 1996), additions to capital assets were $93 million, ($142 – 1996), and additions to deferred workforce reduction costs were $2 million ($6 – 1996). In 1997, the amortization of deferred business transformation and workforce reduction costs amounted to $219 million ($132 – 1996, $46 – 1995).

As a result of the discontinued application of regulatory accounting provisions, Bell Canada wrote off the remaining unamortized balance, as at December 31, 1997, of deferred business transformation and workforce reduction costs. The write-off is included in the extraordinary item (note 3).

8. Deferred charges

Bell Canada's deferred charges are as follows:

		(millions of dollars)
As at December 31	**1997**	1996
Unrealized foreign currency losses, less amortization	**$ 135**	$ 111
Cross currency contract receivables	**14**	47
Prepaid pension costs (*note 14*)	**953**	365
Deferred business transformation program and workforce reduction costs, less amortization (*notes 3 and 7*)	**–**	789
Deferred interconnection costs, less amortization	**–**	43
Other	**33**	175
	$ 1,135	$ 1,530

As a result of the discontinued application of regulatory accounting provisions, Bell Canada wrote off the remaining unamortized balance of certain deferred charges, principally deferred business transformation and workforce reduction costs, recognized and amortized in accordance with regulatory accounting provisions. The write-off is included in the extraordinary item (note 3).

9. Debt due within one year

Bell Canada's debt due within one year consists of the following:

		(millions of dollars)
As at December 31	**1997**	1996
Long-term debt – current portion	**$ 536**	$ 196
Notes payable (including $93 due to parent and affiliated companies, ($74 – 1996))	**300**	319
Bank advances	**10**	9
	$ 846	$ 524

10. Long-term debt

Long-term debt is issued at fixed interest rates, of which $875 million includes call options giving Bell Canada the right to repay such debt prior to maturity, upon payment of certain premiums in addition to the principal amount of the debt.

Bell Canada's long-term debt consists of the following:

(millions of dollars)

Total outstanding December 31	Weighted average rate of interest	1997	1996
Debentures and notes [(a)]	%		
Due 1997	8.43	$ –	$ 175
1998	8.61	475	475
1999	9.60	600	600
2000	9.38	519	533
2001	7.30	150	150
2002	7.58	300	150
2003-2012	9.90	2,440	2,805
2013-2054	9.64	1,225	1,075
		5,709	5,963
Subordinated debentures			
Due 2026-2031	8.21	275	275
Other [(b)]		119	85
Sub-total		6,103	6,323
Less: due within one year		536	196
		$ 5,567	$ 6,127

(a) Debentures and notes include U.S. $400 million maturing in 2006 and 2010; 300 million Swiss Francs, due 2003, and Canadian $380 million, due 1998 and 1999, swapped into U.S. dollar obligations as to principal and interest obligations; and 150 million German marks, due 2000, swapped into Canadian dollar obligations as to principal and interest obligations.

(b) "Other" includes $22 million in obligations under capital leases, $34 million (U.S. $24 million) under a letter of credit and indemnity and $63 million ($38 – 1996) in cross currency contract payables.

At December 31, 1997, the estimated amounts of long-term debt payable by Bell Canada in the years 1998 to 2002 are $536, $615, $521, $152 and $303 million, respectively.

11. Financial instruments

Bell Canada does not actively trade derivative financial instruments but uses them to manage foreign currency and interest rate positions associated with its debt instruments (see *note 10 Long-term debt*). The terms of these derivative contracts match the terms associated with the underlying debt instruments. These contracts are generally used to reduce financing costs and to diversify Bell Canada's access to capital markets. Bell Canada currently has five such contracts outstanding, three of which synthetically create U.S. dollar denominated debt, one contract hedges a foreign currency denominated debt back into Canadian dollars, and one interest rate swap converts fixed interest rate payments on debt to floating interest rate payments.

At December 31, 1997, Bell Canada had outstanding cross currency swaps and forward contracts to deliver foreign currency amounts of U.S. $108 million and U.S. $485 million for interest and principal payments, respectively, during the years 1998-2003 related to Canadian dollar and Swiss Franc debt instruments outstanding. Bell Canada also holds a foreign currency swap to pay Canadian dollars to hedge its 150 million German marks Series 7 notes principal and interest payments. The aggregate receivable and payable principal amounts of these cross currency contracts are reported as other deferred charges ($14 million – 1997; $47 – 1996) and other long-term debt ($62 million – 1997; $38 – 1996), respectively.

The fair value of Bell Canada's recognized financial instruments approximates carrying amounts where applicable, except as shown in the table (page 50). The fair values of the financial instruments in the table (page 50) have been estimated by management using available market information and do not necessarily represent amounts that Bell Canada could potentially realize in a current market exchange transaction between willing parties.

(millions of dollars)

	1997		1996	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Financial instrument:				
Debt [a] (*note 10*)	**$ 6,103**	**$ 7,127**	$ 6,323	$ 7,272
Cross currency contracts [b]				
(Assets) (*note 8*)	**(14)**	**(43)**	(47)	(79)
Liabilities	**62**	**57**	38	28
Retractable preferred shares (*note 12*)	**100**	**118**	100	116

(a) Includes cross currency contract liabilities

(b) (Assets) liabilities are when Bell Canada will (receive) pay a net amount.

Credit risk

Prior to the introduction of local service competition, due to the essential nature of the telecommunications services offered by Bell Canada, credit risk associated with current and long-term receivables was minimal as a percentage of total revenues. However, the introduction of competition in the local exchange market is expected to increase Bell Canada's credit risk.

Bell Canada is exposed to credit risk on its cross currency swaps and forward contract derivative financial instruments in the event of non-performance by counterparties. Non-performance by any counterparty is not anticipated. Bell Canada monitors the credit risk and credit standing of counterparties on a regular basis and has a policy in place to deal only with highly-rated financial institutions. Bell Canada manages its credit exposure so that there is no substantial concentration of credit risk resulting from cross currency swaps, forward contracts and interest rate swaps.

12. Preferred shares

Authorized

The articles of incorporation of Bell Canada provide for an unlimited number of Class A preferred shares. The articles authorize the directors of Bell Canada to issue such shares in one or more series and to fix the number of shares of each series, and the conditions attaching thereto, prior to their issue.

(dollars in millions)

Outstanding as at December 31	**1997**		1996	
	Number of shares	**Stated Capital**	Number of shares	Stated Capital
Non-convertible Class A preferred shares [a]				
Retractable preferred shares *(note 11)*				
Series 10 [b]	**4,000,000**	**$ 100**	4,000,000	$ 100
Perpetual preferred shares [c]				
Series 11	**300**	**$ 150**	300	$ 150
Series 12	**400**	**200**	400	200
Series 13	**290**	**145**	290	145
Series 14	**270**	**135**	270	135
		$ 630		$ 630

(a) All preferred shares are non-voting and redeemable at Bell Canada's option.

The holders of Cumulative Redeemable Retractable Class A Preferred Shares Series 10 are entitled to fixed cumulative annual dividends at the rate of $1.86 per share.

The holders of Perpetual Cumulative Reset Redeemable Class A Preferred Shares Series 11, 12, 13 and 14 are entitled to annual cumulative dividends at rates of 5.08%, 4.64%, 6.35% and 4.68% of the stated capital of such shares, respectively, until March 30, 1999, October 30, 2000, September 30, 1999 and September 29, 1998, respectively, at which times the dividend rates will be reset. Thereafter, the dividend rates of the series 11, 12, 13 and 14 preferred shares may be reset from time to time pursuant to the terms and conditions of each series.

(b) The series 10 preferred shares are not redeemable prior to August 15, 2000. On or after August 15, 2000, the series 10 preferred shares are redeemable at $25 per share. The series 10 preferred shares are retractable at the option of the holders on August 15, 2000, at a price of $25 per share.

(c) The series 11, 12, 13 and 14 preferred shares are redeemable at $500,000 per share any time on or after March 30, 1999, October 30, 2000, September 30, 1999 and September 29, 1998, respectively. The series 11, 12, 13 and 14 preferred shares are not retractable at the option of the holders.

During the three-year period ended December 31, 1997, Bell Canada issued for $20 million cash, 40 additional Class A Preferred Shares Series 13 on October 2, 1995 and redeemed Series 8 on December 1, 1996 and Series 9 on June 9, 1995.

13. Common shares

The articles of incorporation of Bell Canada provide for an unlimited number of common shares.

(dollars in millions)

Authorized

Outstanding as at December 31	**1997**		1996	
	Number of shares	**Stated Capital**	Number of shares	Stated Capital
	293,952,001	**$4,178**	293,952,001	$4,178

All outstanding Bell Canada common shares are owned, directly or indirectly, by its parent company, BCE. During 1997, 209,662,568 shares (209,334,598 shares – 1996) were issued to BCE and the same number of shares were acquired for cancellation. In 1996, 327,970 shares were issued to BCE as part of an inter-corporate restructure and for the acquisition of Medialinx Interactive Inc. from BCE.

The premium on share capital represents the consideration received in excess of the then par value of common shares issued before Bell Canada was continued under the Canada Business Corporations Act on April 21, 1982. Bell Canada has reclassified an amount of $644 million related to the premium paid on share capital to retained earnings on December 31, 1997.

14. Pensions

The company operates non-contributory defined benefit pension plans covering substantially all employees which provide pension benefits based on length of service and final pensionable earnings. Pension assets consist principally of Canadian and foreign equities, government and corporate bonds and real estate. Pension expense is based on management's best estimate of the long-term rate of return on the pension asset portfolio. Pension benefit obligations are determined based on management's best estimate of long-term salary escalation rates and are discounted to present value based on management's best estimate of long-term interest rates. Variances between such estimates and actual experience, which may be material, are amortized over the average remaining service lives of the employees.

The company bears the risk of experience loss and credit risk associated with the pension asset portfolio. Maximum credit risk is equal to the fair value of the accrued pension benefit obligation. Credit risk is managed by placing plan assets in trust and through the pension plan investment policy which requires that plan asset money market investments be limited to Canadian provincial and federal government paper and Canadian corporate paper rated A or better.

The company has no intention of settling its pension obligation in the near term. The fair value of the pension obligation on a settlement basis is not provided as it is not practical to do so.

Extrapolation of actuarial liabilities prepared during the year which were based on projections of employees' compensation levels to the time of retirement and management's best estimate of long-term interest rates indicate that the present value of accrued pension benefit obligations attributed to services rendered up to the balance sheet date and the net assets available to provide for these benefits are as follows:

(millions of dollars)

Year ended December 31	**1997**	1996
Pension plan assets:		
At market value	**$ 10,301**	$ 9,368
Accrued pension benefit obligations:		
Due to retirees	**4,532**	4,271
Due to active employees	**2,402**	2,261
Accrued pension benefit obligations	**6,934**	6,532
Plan assets in excess of accrued pension benefit obligations	**3,367**	2,836
Less: unrecognized items		
Unrecognized net experience gains	**(2,512)**	(2,575)
Unrecognized prior period costs	**105**	157
Unrecognized net assets existing at January 1, 1987	**(50)**	(88)
Net pension asset reflected on the consolidated balance sheet	**$ 910**	$ 330
Prepaid pension costs *(note 8)*, included in Deferred charges	**$ 953**	$ 365
Pension obligations, included in Deferred credits	**(43)**	(35)
Net pension asset	**$ 910**	$ 330

	1997	1996	1995
Total pension credit for the year	**$ (314)**	**$ (137)**	**$ (17)**

The increased pension credit in 1997 and 1996 compared with 1995 reflects experience gains related to 1995 and 1996 and a change in estimates related to the amortization of experience gains and the workforce reduction program currently in progress. The 1997 pension credit includes an $8 million ($11 – 1996) credit related to the amortization of deferred business transformation and workforce reduction costs. The unamortized balance of pension credits related to the business transformation and workforce reduction program was written off and included in the extraordinary item (see note 3).

15. Unused bank lines of credit

At December 31, 1997, Bell Canada had unused bank lines of credit, generally available at the banks' prime rate of interest or less, totalling $920 million, for general corporate purposes and to support commercial paper borrowings. $900 million of the lines of credit are binding on the financial institutions.

16. Related party transactions

During the year, Bell Canada purchased equipment and related supplies from Northern Telecom Limited (Nortel) totalling $704 million ($733 – 1996, $663 – 1995) and incurred $186 million ($202 – 1996, $211 – 1995) for services from SRCI and earned $29 million ($86 – 1996, $80 – 1995) in revenues from SRCI. Bell Canada also entered into research and development arrangements with Nortel, a subsidiary of BCE, the parent company of Bell Canada.

During 1996, Bell Canada acquired companies from related parties (BCE and other affiliated companies in the BCE group) resulting in adjustments to retained earnings of $21 million, reflecting the difference between the carrying values acquired from the related parties and the carrying values recorded by Bell Canada.

17. *Reconciliation of results reported in accordance with Canadian Generally Accepted Accounting Principles (GAAP) to United States GAAP*

The accompanying financial statements have been prepared in accordance with Canadian GAAP. The important differences between Canadian and United States GAAP affecting the consolidated financial statements of Bell Canada are reconciled in the table below. The extraordinary charge (note 3) as recorded on a Canadian GAAP basis would not be significantly different from the charge which would result on a United States GAAP basis.

(millions of dollars)

Year ended December 31	**1997**	1996	1995
Net income (loss) – Canadian GAAP	**$ (1,837)**	$ 754	$ 543
Adjustments			
Foreign exchange[(a)]	**(16)**	12	44
Pension credit[(b)]	**20**	(21)	–
Post-retirement benefit costs[(c)]	**(40)**	(42)	(46)
Post-employment benefit costs[(d)]	**(10)**	(11)	(10)
Net income (loss) – U.S. GAAP	**$ (1,883)**	$ 692	$ 531

(a) The difference arises from the method of accounting for unrealized foreign currency gains and losses on long-term debt under Canadian GAAP as opposed to the U.S. Financial Accounting Standards Board's Statement No. 52 – Foreign Currency Translation.

(b) The difference arises from variations in methodology for calculating pension expense, curtailments and settlements under Canadian GAAP as opposed to the U.S. Financial Accounting Standards Board's Statement No. 87 – Employers' Accounting for Pensions and Statement No. 88 – Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.

(c) Under the U.S. Financial Accounting Standards Board's Statement No. 106 – Employers' Accounting for Post-retirement Benefits Other Than Pensions, the expected cost of health care and other post-retirement benefits are accrued during the years employees provide service to the employer. In the absence of a similar Canadian standard, these costs are charged to income when paid.

(d) Under the U.S. Financial Accounting Standards Board's Statement No. 112 – Employers' Accounting for Post-employment Benefits, the estimated costs of benefits to former or inactive employees after employment but before retirement are accrued over applicable employee service periods or using a terminal accrual approach. In the absence of a similar Canadian standard, these costs are charged to income when paid.

18. Subsequent events

Sale of Bell Sygma Assets to The CGI Group Inc.

On January 5th, 1998, Bell Canada reached an agreement-in-principle with The CGI Group Inc. (CGI). Under the terms of the agreement-in-principle, Bell Canada will sell to CGI its systems development and maintenance operations in exchange for 8.6 million First Preferred Shares, Series 6, of CGI convertible into Class A Subordinate Voting Shares. Under terms of the agreement-in-principle, Bell Canada's required information systems and technology services would be provided by a separate wholly-owned subsidiary of CGI under a ten-year contract. The agreement-in-principle would result in the transferring of approximately 2,300 employees of Bell Canada to CGI. The agreement-in-principle is subject to due diligence, the completion of definitive agreements, regulatory and other required approvals, and is expected to close by June 30, 1998. Accordingly, the impact of this transaction on Bell Canada's financial statements is subject to uncertainty and cannot be reasonably determined at this time.

Sale of Real Estate Properties

Under an agreement dated January 13, 1998, Bell Canada will sell thirteen commercial properties to TrizecHahn Corporation (TrizecHahn). Under terms of the agreement TrizecHahn will assume property management of the buildings from Bell Canada and will lease back to Bell Canada the space currently occupied. Under the terms of the leases, Bell Canada's obligations can decrease over time. The transaction is expected to close in the first quarter of 1998 and will be reflected in the financial statements of Bell Canada at such time. The gain resulting from the transaction will be amortized over the life of the leases. Net proceeds from the sale of approximately $750 million will be used to meet outstanding debt maturities and for general corporate purposes.

Corporate governance practices

Bell Canada is a member of the BCE group of companies and seeks to maintain the high standards of corporate governance prevailing in the group. All of Bell Canada's voting shares are held by its parent company, BCE Inc. (BCE). Through its Management resources and nominating committee (MRNC), Bell Canada's Board of Directors has given detailed consideration to the corporate governance guidelines adopted by the Toronto and Montreal stock exchanges (the Guidelines) and believes that it is substantially in alignment therewith. The following describes Bell Canada's corporate governance practices as of February 25, 1998.

Mandate of the Board

The Board of Directors has overall responsibility for the management or supervision of the management of the affairs of Bell Canada. The Board has established an administrative procedure which prescribes the rules governing the approval of transactions carried out in the course of Bell Canada's operations, the delegation of authority and the signing or execution of documents on behalf of the Corporation. Any responsibility which is not delegated to management or a committee of the Board remains with the full Board. For instance, appointment of officers as well as investments and expenditures above a certain dollar threshold are subject to review and approval by the Board. In performing its responsibilities, the Board may, by a resolution, engage an outside adviser at the expense of the Corporation. In addition, a committee of the Board or an individual director may, as required, engage an outside adviser at the expense of the Corporation, subject to the approval of the Chairman of the Board, of the Chairman of the MRNC or of the Chief Executive Officer (CEO). More specifically, the Board deals with the following matters:

(i) *Strategic planning*: The Board approves Bell Canada's corporate strategy.

(ii) *Succession planning, including appointing, training and monitoring senior management:* The MRNC reviews and reports annually to the Board on succession planning and on senior management development and performance. An annual performance mandate is set by the Board early in the year which is comprised of business objectives, including service/customer satisfaction objectives, and quantifiable financial targets. The MRNC annually reviews management's performance and compensation against this set of objectives.

(iii) *Monitoring of financial performance, financial reporting and risk management*: The Audit committee reviews, reports and provides recommendations to the Board on financial management. See below, Board committees – the Audit committee for a description of the activities of the Audit committee.

(iv) *Communications policy*: Communications procedures are in place at Bell Canada addressing communications with shareholders, debtholders, financial analysts, employees, governments, regulatory authorities and the media. Procedures for receiving feedback from the investment community have also been developed. Most of Bell Canada's written communications with securityholders are reviewed by the Audit committee and by the Board prior to their publication. As well, particular issues with respect to communications with various stakeholders are addressed from time to time by the Board.

Composition of the Board

As of February 25, 1998, the Board is composed of fifteen directors of which twelve are considered by the Board to be unrelated. Eleven of the unrelated directors represent a wide variety of business sectors and the corporations to which these directors are related have had insignificant dealings with the Corporation and its subsidiaries, except in the normal course of business. In addition, Mr. J.V.R. Cyr, a former officer of Bell Canada and, more recently, of BCE, is considered by the Board to represent the interests of the shareholder and, as such, to be unrelated. Mr. R.W. Osborne, who is President and CEO of Bell Canada is an inside related director. Messrs. L.R. Wilson and J.C. Monty, by virtue of the fact that they are officers of BCE and directors of BCE subsidiary and associated companies which are major suppliers or customers of Bell Canada, may also be regarded as related directors within the meaning of the Guidelines.

The Board's objective, with respect to its composition, is to have a sufficient range of skills, expertise and experience and a reasonable geographical representation in relation to the principle service areas of Bell Canada. The directors are chosen for their ability to contribute on the broad range of issues with which the Board must deal. The MRNC reviews the qualifications of potential candidates and recommends nominees to the voting shareholder. BCE, which controls all of the common shares of Bell Canada, has the ultimate responsibility for determining both the size and the composition of the Board.

Independence of the Board

The Board has a chair separate from management. The Chairman of the Board is Mr. L.R. Wilson, who is the Chairman of the Board and CEO of BCE. Directors can add items to board agendas which are distributed in advance of meetings and agendas for committee meetings are under the responsibility of the chairmen of such committees. Furthermore, the Board meets without Mr. Osborne when the performance and compensation of the CEO is discussed. Finally, BCE's representatives on the Board informally assess the effectiveness of the Board and of its committees, as well as the contribution of individual directors. New directors are given

comprehensive information about Bell Canada, and are provided with additional information on an ad hoc basis, as required.

Board committees

There are five committees of the Board. All committees are chaired by outside directors and all are composed of outside directors except the Executive committee and the Social and environmental affairs committee (SEAC) of which Mr. Osborne is a member.

The Executive committee

The Executive committee, which did not meet in 1997, performs advisory functions determined from time to time by the Board of Directors.

The Management resources and nominating committee (MRNC)

The MRNC, which met seven times in 1997, reviews, reports and, where appropriate, provides recommendations to the Board on: candidates for election to the Board; the appointment of the CEO and other officers; existing management resources and succession plans for officers and other ranks; the performance of the CEO and other officers; the Corporation's executive compensation policy; any proposed changes in organization, or to the Corporation's pension and benefit plans; and matters of corporate governance; and directors' remuneration in relation to current compensation practices.

The Audit committee

The Audit committee, which met five times in 1997, reviews, reports and, where appropriate, provides recommendations to the Board on: the annual and interim consolidated financial statements and the integrity of the financial reporting of the Corporation; the adequacy of the Corporation's processes for identifying and managing risk; the adequacy of its internal control system; the adequacy of its processes for complying with laws and regulations; the appropriateness of and compliance with the policies and practices of the Corporation relating to business ethics; the appointment, terms of engagement and proposed fees of the shareholders' auditor; the appointment and mandate of the internal auditor.

The Pension fund policy committee (PFPC)

The PFPC, which met twice in 1997, advises the Board on policy with respect to the administration, funding and investment of Bell Canada's pension fund.

The Social and environmental affairs committee (SEAC)

The SEAC, which met twice in 1997, has the broad mandate to investigate and inform the Board of current conditions and impending developments in the social, political and physical environments which may affect Bell Canada's operations or its relationships with the individuals or the groups of people for or through which its operates.

Directors*

Ralph Mackenzie Barford
Toronto, Ontario

President of Valleydene Corporation Limited
Director since March 1996 and member of the Management resources and nominating committee. Director of BCE Inc. and Northern Telecom Limited.

Roy Frederick Bennett, F.C.A.
Etobicoke, Ontario

Chairman Bennecon Limited
Director since June 1983, Chairman of the Pension fund policy committee, member of the Audit committee, the Executive committee and the Management resources and nominating committee.

Jacques Bougie, O.C.
Outremont, Québec

President and Chief Executive Officer of Alcan Aluminium Limited
Director since May 1992 and member of the Executive committee, the Pension fund policy committee, and the Management resources and nominating committee.

Warren Chippindale, F.C.A., C.M.
Mont-Tremblant, Québec

Company director
Director since May 1987, Chairman of the Audit committee. Director of BCE Inc. and BCE Mobile Communications Inc.

Joseph Victor Raymond Cyr, O.C.
Montréal, Québec

Chairman of Telesat Canada
Director since April 1983 and member of the Executive committee, the Social and environmental affairs committee and the Management resources and nominating committee. Director of BCE Mobile Communications Inc. and Teleglobe Canada Inc.

Geno Frederick Francolini, F.C.A.
London, Ontario

President and Chief Executive Officer of Xenon Capital Corporation
Director since January 1986 and member of the Social and environmental affairs committee.

Jeannine Guillevin Wood, O.C.
Montréal, Québec

Chairman of Guillevin International Inc.
Director since February 1997 and member of the Pension fund policy committee. Director of BCE Inc.

Jean Claude Monty, C.M.
Montréal, Québec

President and Chief Operating Officer of BCE Inc.
Director since October 1997 and member of the Audit committee. Director of BCE Inc., BCE Mobile Communications Inc., Bell Canada International Inc., Cable & Wireless Communications, plc., Northern Telecom Limited, Teleglobe Inc., and Telesat Canada.

* *As of January 1, 1998*

Gordon Francis Osbaldeston, P.C., O.C.
London, Ontario

Professor Emeritus of Richard Ivey School of Business
Director since October 1988 and member of the Social and environmental affairs committee.

Ronald Walter Osborne, F.C.A.
Westmount, Québec

President and Chief Executive Officer of Bell Canada
Director since January 1995 and member of the Executive committee and the Social and environmental affairs committee. Director of ExpressVu Inc., Maritime Telegraph and Telephone Company, Limited, TMI Communciations Inc., and Telesat Canada.

John Harry Panabaker, C.M.
Waterloo, Ontario

Company director
Director since May 1986, Chairman of the Management resources and nominating committee and member of the Pension fund policy committee. Director of BCE Mobile Communications Inc.

Paul Mathias Tellier, P.C., C.C., Q.C.
Westmount, Québec

President and Chief Executive Officer of Canadian National Railway Company
Director since March 1996 and member of the Audit committee.

Paul-Gaston Tremblay, C.M., C.A.
Chicoutimi, Québec

President of Primo-Gestion Inc.
Director since August 1983, member of the Audit committee and the Pension fund policy committee.

Lynton Ronald Wilson, O.C.
Montréal, Québec

Chairman and Chief Executive Officer of BCE Inc.
Director since November 1990, Chairman of the Board, Chairman of the Executive committee, and member of the Management resources and nominating committee. Director of BCE Mobile Communications Inc., Bell Canada International Inc., Northern Telecom Limited and Teleglobe Inc.

Douglas Tyndall Wright, O.C., Ph.D.
Waterloo, Ontario

Past President of the University of Waterloo
Director since April 1985 and Chairman of the Social and environmental affairs committee.

Officers*

L.R. Wilson	*Chairman of the Board*
Ronald W. Osborne	*President and Chief Executive Officer*
John A. MacDonald	*Chief Operating Officer*
Josef J. Fridman	*Corporate Secretary*
P.André Aubin	*Executive Vice-President – President Québec*
Richard D. Barnes	*Group Vice-President – Operations Financial Management*
R. Bruce Barr	*Group Vice-President – Marketing Communications & Retail*
Gary D. Bray	*Group Vice-President – Special Assignment*
Martine Corriveau-Gougeon	*Group Vice-President – Customer Services*
Bernard A. Courtois	*Group Vice-President – Regulatory*
Peter S. Crombie	*Group Vice-President – Finance & Business Development*
David W. Drinkwater	*Chief Legal Officer*
Rudi Engel	*Group Vice-President – Business Markets & Sales*
Harold G. Giles	*Group Vice-President – Human Resources*
Terence J. Jarman	*Executive Vice-President – Corporate Development*
Sylvie Lalande	*Group Vice-President – Consumer Markets & Sales & Marketing*
H. John Lochow	*Chief Information Officer*
Guy Marier	*Executive Vice-President – Operations*
Robert D. Milne	*Group Vice-President – Corporate Markets & Sales*
Donald H. Morrison	*Group Vice-President – Consumer Markets & Sales*
Frederick D. Rucker	*Group Vice-President – Strategy*
Vincent W. Salvati	*Chief Financial Officer*
Pierre Shedleur	*Group Vice-President – Québec Public Sector Market*
John W. Sheridan	*Executive Vice-President – President Ontario*
Norman L. Simon	*Group Vice-President – Communications*
David A. Southwell	*Executive Vice-President – Chief Technology Officer*
Douglas Tipple	*Group Vice-President – Planning & Processes*
James E. Tobin	*Executive Vice-President – President Bell Emergis*

* *As of January 1, 1998*

Committees of the board*

Audit committee

W. Chippindale – *chairman*

R.F. Bennett
J.C. Monty
P.M. Tellier
P.-G. Tremblay

Pension fund policy committee

R.F. Bennett – *chairman*

J. Bougie
J. Guillevin Wood
J.H. Panabaker
P.-G. Tremblay

Management resources and nominating committee

J.H. Panabaker – *chairman*

R.M. Barford
R.F. Bennett
J. Bougie
J.V.R. Cyr
L.R. Wilson

Social and environmental affairs committee

D.T. Wright – *chairman*

J.V.R. Cyr
G.F. Francolini
G.F. Osbaldeston
R.W. Osborne

Executive committee

L.R. Wilson – *chairman*

R.F. Bennett
J. Bougie
J.V.R. Cyr
R.W. Osborne

** As of January 1, 1998*

Quarterly consolidated financial data

(millions of dollars)

(three months ended)	March 31	June 30	Sept. 30	Dec. 31
1997				
Total operating revenues	**$ 2,216**	**$ 2,275**	**$ 2,336**	**$ 2,419**
Net operating revenues	**527**	**531**	**608**	**659**
Net income before extraordinary item	**197**	**193**	**240**	**258**
Extraordinary item (net of tax)	**–**	**–**	**–**	**(2,725)**
Net income (loss) applicable to common shares	**188**	**184**	**230**	**(2,475)**
Operating cash flow	**768**	**700**	**785**	**821**
Cash flow from operations	**391**	**673**	**806**	**1,080**
Free cash flow	**(170)**	**34**	**210**	**364**
1996				
Total operating revenues	$ 2,100	$ 2,129	$ 2,210	$ 2,261
Net operating revenues	500	508	521	537
Net income	177	179	191	207
Net income applicable to common shares	167	169	181	197
Operating cash flow	675	649	652	781
Cash flow from operations	400	449	850	878
Free cash flow	(130)	(122)	283	173

Selected consolidated financial and other data

(dollars in millions)

	1997	1996	1995	1994	1993	1992
Selected consolidated financial data						
Total operating revenues	**$ 9,246**	$ 8,700	$ 8,183	$ 8,066	$ 7,957	$ 7,863
Net income before extraordinary item	**888**	754	543	765	843	978
Net income applicable to common shares before extarordinary item	**852**	714	502	722	796	931
Extraordinary item (net of tax)	**(2,725)**	–	–	–	–	–
Dividends on perpetual preferred shares	**36**	40	41	43	47	47
Dividends on common shares	**822**	821	821	821	812	811
Operating cash flow	**3,074**	2,757	2,435	2,624	2,571	2,456
Cash flow from operations	**2,950**	2,577	2,324	2,327	2,675	2,466
Free cash flow	**438**	204	(44)	(136)	(293)	(999)
Total assets[1]	**14,679**	19,055	18,986	18,953	18,979	18,439
Long-term debt (including current portion)[1]	**6,103**	6,323	6,650	6,349	6,118	5,771
Retractable preferred shares[1]	**100**	100	250	375	375	375
Perpetual preferred shares[1]	**630**	630	630	610	585	585
Common equity[1]	**4,568**	7,263	7,380	7,703	7,803	7,644
Net capital expenditures	**1,668**	1,621	1,500	1,640	2,138	2,688
Financial ratios						
Per cent return on average common equity[5]	**11.7**	9.8	6.7	9.3	10.4	12.5
Per cent return on average total capital[5]	**10.1**	9.3	8.0	9.2	9.9	11.1
Interest coverage ratio[5]	**3.80**	3.13	2.63	3.02	3.22	3.60
Interest as a per cent of total average debt[5]	**9.1**	9.5	9.5	9.6	9.8	9.9
Operating cash flow interest coverage[2][5]	**6.1**	5.2	4.6	5.0	4.9	5.0
Net operating cash flow as a per cent of net capital expenditures[3][5]	**133**	117	105	107	80	59
Net operating cash flow as a per cent of average total debt[3][5]	**33**	27	22	25	25	25
Debt as a per cent of total capital[1]	**55.6**	46.1	46.7	45.8	45.0	44.8
Credit ratings (senior unsecured debt)						
Canadian Bond Rating Service	**A(high)**	A(high)	A(high)	A+(low)	A+(low)	A+
Dominion Bond Rating Service	**A(high)**	A(high)	A(high)	AA(low)	AA(low)	AA
Moody's Investors Service	**A2**	A1	A1	A1	Aa3	Aa3
Standard & Poor's Ratings Group	**A+**	A+	A+	A+	A+	AA
Other statistics						
Network access services (thousands)[1]	**10,607**	10,266	10,001	9,727	9,462	9,229
Conversation minutes (millions)[4]	**9,935**	10,101	9,933	9,962	9,828	–
Number of employees[1]	**39,328**	44,895	48,333	51,503	50,982	52,897
Salaries and wages (excl. workforce reduction costs)	**$ 2,223**	$ 2,365	$ 2,437	$ 2,360	$ 2,481	$ 2,482

(1) As at December 31.
(2) Operating cash flow plus interest charges divided by interest charges.
(3) Net operating cash flow = operating cash flow minus dividends.
(4) Conversation minutes were calculated on statistical basis only for 1992.
(5) Excludes impact of extraordinary item

Mailing address

Bell Canada

Corporate Communications

Bureau 901

1800, avenue McGill College

Montréal (Québec)

H3A 3J6

E-mail address

forum@bell.ca

Investor Relations

Telephone: (514) 870-4561 or

1 800 371-0191

Fax: (514) 866-7143

For additional copies of the annual report, please call

(514) 391-7209

Pour obtenir un exemplaire français du rapport annuel, composez le

(514) 391-7209

Concept and design by

Momentum inc.

This report is printed on recycled paper.

... it all adds up