

Telefónica O2 Czech Republic, a.s.

**CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

**PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS**

Content	Pages
GENERAL INFORMATION	1
INDEPENDENT AUDITORS' REPORT	3
CONSOLIDATED INCOME STATEMENT	5
CONSOLIDATED BALANCE SHEET	6
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY	7
CONSOLIDATED CASH FLOW STATEMENT	9
ACCOUNTING POLICIES	10
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	37

GENERAL INFORMATION

Telefónica O2 Czech Republic, a.s. Group (the "Group") consists of Telefónica O2 Czech Republic, a.s. (the "Company") and its subsidiaries: Telefónica O2 Business Solutions, spol s r.o. (formerly Telefónica O2 Services, spol. s r.o.), SPT TELECOM (Czech Republic) Finance B.V., DELTAX Systems a.s., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH and Telefónica O2 Slovakia, s.r.o.

The Company has a form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Group is a member of the Telefónica Group of companies (the "Telefónica Group") with a parent company, Telefónica, S.A. (the "Telefónica").

The Company is the principal supplier of fixed line telecommunication services and is one of the four suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Group amounted in average to 9,258 in 2008 (2007: 9,417).

The Company's shares are traded on the Prague Stock Exchange and London Stock Exchange (GDRs).

These consolidated financial statements were approved for issue by the Company's Board of Directors on 20 February 2009.

Acquisition of DELTAX Systems a.s.

In December 2007, the purchase of 100% of the shares in DELTAX Systems a.s. was approved by the Office for the Protection of Competition. The acquisition was effective as of 1 January 2008. DELTAX Systems a.s. financial results were fully included in the Group financial statements from the effective date.

Liquidation of subsidiaries CenTrade, a.s. in liquidation and SPT TELECOM (Czech Republic) Finance B.V. in liquidation

The liquidation process of CenTrade, a.s. in liquidation was effectively terminated on 30 November 2007. As of 22 August 2008 the registration of the company was cancelled from the Commercial Register. During the fourth quarter of 2007, SPT TELECOM (Czech Republic) Finance B.V. in liquidation commenced preparatory steps for the process of voluntary liquidation. Until the end of 2008, the key legal steps for dissolution of the Company have been executed. As of 9 February 2009 the registration of the company was cancelled from the Commercial Register.

Merger of DELTAX Systems a.s. with Telefónica O2 Business Solutions, spol. s r.o.

In December 2008, the Board of Directors of the Company approved the plan to merge Telefónica O2 Business Solutions, spol. s r.o. with DELTAX Systems a.s. This merger will become effective 1 January 2009 after the fulfillment of all legal conditions expected to be performed in the first half of 2009. Telefónica O2 Business Solutions, spol. s r.o. will become the legal successor while DELTAX Systems a.s. will be dissolved without liquidation. The assets, rights and obligations including labour rights and duties will be transferred to the successor.

Provision of mobile telecommunication services in Slovakia

Telefónica O2 Slovakia, s.r.o. (Telefónica O2 Slovakia), a 100 % subsidiary company of Telefónica O2 Czech Republic, a.s., was awarded the 3rd mobile license in Slovakia in September 2006.

The license allows Telefónica O2 Slovakia to use frequencies GSM 900 MHz, GSM 1800 MHz, UMTS and FS 29 GHz for the period of 20 years for providing telecommunication services in the Slovak Republic.

The operation in Slovakia is considered as an organic expansion of the Telefónica Group business in the region and is utilizing synergies with the Company operations. The leverage of the Czech operations is expected in areas of network (development, monitoring, support), IT, procurement and back office (finance, HR, legal).

Telefónica O2 Slovakia launched its commercial service in February 2007 offering prepaid voice, SMS (Short Message Service) and GPRS (General Packet Radio Service) data in the GSM (Global System for Mobile communications) spectrum. In September 2007, Telefónica O2 Slovakia launched its postpaid services. In August 2007, Telefónica O2 Slovakia also launched its UMTS (Universal Mobile Telecommunication System) network with a limited coverage.

In 2006, Telefónica O2 Slovakia signed a national roaming agreement with T-Mobile Slovensko, a.s. It provides Telefónica O2 Slovakia with the ability to offer full network coverage to its customers immediately from commercial launch even before the construction of its own network is finished. The strategy of the Telefónica O2 Slovakia is to build own network coverage in areas where it is economically feasible.

The top priority of Telefónica O2 Slovakia has been a gradual fulfilment of the license conditions, gaining a base of active customers and aiming to provide the telecommunications market with innovations and technological advances as the first company on the market.

By the end of the year 2008, Telefónica O2 Slovakia had more than 455 thousand registered customers and put in operation more than 850 BTS and thus fulfilled the licence conditions as at 31 December 2008.

**INDEPENDENT AUDITORS' REPORT
TO THE SHAREHOLDERS OF Telefónica O2 Czech Republic, a.s.**



**Independent auditors' report to the shareholders of
Telefónica O2 Czech Republic, a.s.**

We have audited the accompanying consolidated financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

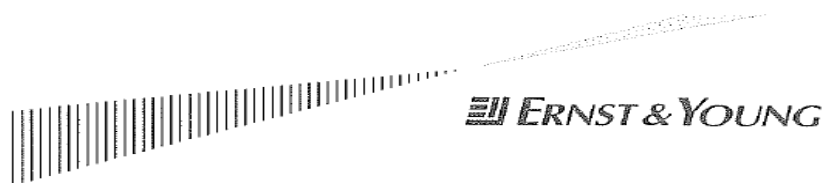
Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

A member firm of Ernst & Young Global Limited
Ernst & Young Audit, s.r.o. with 45 registered offices at Karlova náměstí 19, 120 00 Prague 2,
has been incorporated in the Commercial Register administered by the Municipal Court
in Prague, Section C, entry no. 89594, under identification No. 26704153.



Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young
Ernst & Young Audit s.r.o.
Licence No. 401
Represented by

Brian Welsh
Brian Welsh
Partner

Pavel Radek
Radek Pav
Auditor, Licence No. 2042

20 February 2009
Prague, Czech Republic

A member firm of Ernst & Young Global Limited.
Ernst & Young Audit, s.r.o. with its registered office at Karlovo náměstí 10, 120 00 Prague 2,
has been incorporated in the Commercial Register administered by the Municipal Court
in Prague, Section C, entry no. BB504, under identification No. 26704153.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2008

In CZK million	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Revenue	2	64,709	63,196
Gains from sale of non-current assets	8	855	42
Internal expenses capitalized in fixed assets	2	484	553
Operating expenses	3	(37,650)	(35,753)
Impairment loss	8, 9, 10	(86)	(5)
Depreciation and amortisation	8, 9	<u>(12,932)</u>	<u>(14,435)</u>
Operating profit		15,380	13,598
Interest income	4	449	403
Interest expense	4	(406)	(446)
Other finance expense (net)	4	<u>(75)</u>	<u>(45)</u>
Profit before income tax		15,348	13,510
Taxes on income	5	<u>(3,720)</u>	<u>(3,124)</u>
Profit for the year		11,628	10,386
Attributable to:			
Equity holders of the Company	6	11,628	10,386
Minority interest		-	-
Earnings per share (CZK) – basic*	6	36	32

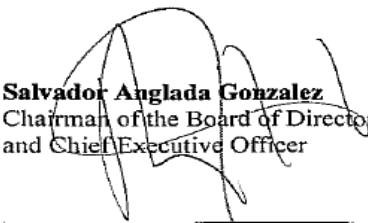
*There is no dilution of earnings as no convertible instruments have been issued by the Company.

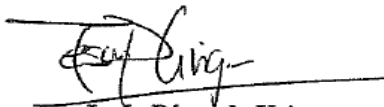
CONSOLIDATED BALANCE SHEET

As at 31 December 2008

In CZK million	Notes	31 December 2008	31 December 2007
ASSETS			
Property, plant and equipment	8	63,429	71,809
Intangible assets	9	22,348	21,805
Investment in associate	27	11	11
Other financial assets	12	378	566
Non-current assets		86,166	94,191
Inventories	11	779	853
Receivables and prepayments	12	9,240	8,577
Income tax receivable		226	-
Held-to-maturity investments	13	-	27
Cash and cash equivalents	14	7,116	9,576
Current assets		17,361	19,033
Non-current assets classified as held for sale	8	96	328
Total assets		103,623	113,552
EQUITY AND LIABILITIES			
Ordinary shares	24	32,209	32,209
Share premium		24,374	30,816
Retained earnings, funds and reserves		21,585	19,767
		78,168	82,792
Minority interest		-	-
Total equity		78,168	82,792
Long-term financial debts	16	3,098	3,062
Deferred taxes	17	3,300	3,353
Non-current provisions for liabilities and charges	19	403	2,150
Non-current other liabilities	15	176	452
Non-current liabilities		6,977	9,017
Short-term financial debts	16	98	6,207
Trade and other payables	15	17,686	13,765
Income tax liability		9	870
Provisions for liabilities and charges	19	685	901
Current liabilities		18,478	21,743
Total liabilities		25,455	30,760
Total equity and liabilities		103,623	113,552

These consolidated financial statements were approved by the Board of Directors on 20 February 2009 and were signed on its behalf by:


Salvador Anglada Gonzalez
 Chairman of the Board of Directors
 and Chief Executive Officer


Jesús Pérez de Uriguen
 Member of the Board of Directors
 and Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the year ended 31 December 2008

In CZK million	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2007		32,209	30,816	(18)	(12)	-	6,270	19,216	88,481
Fair value gains (net of tax)									
- cash flow hedges		-	-	(2)	-	-	-	-	(2)
Currency translation differences – amount arising in year		-	-	-	21	-	-	-	21
Changes in statutory reserves and other movements		-	-	-	-	-	182	(172)	10
Net income and expense recognised directly in equity		-	-	(2)	21	-	182	(172)	29
Net profit		-	-	-	-	-	-	10,386	10,386
Total income and expense for the year		-	-	(2)	21	-	182	10,214	10,415
Dividends declared in 2007	7	-	-	-	-	-	-	(16,104)	(16,104)
At 31 December 2007		32,209	30,816	(20)	9	-	6,452	13,326	82,792
At 1 January 2008		32,209	30,816	(20)	9	-	6,452	13,326	82,792
Fair value gains (net of tax)									
- cash flow hedges		-	-	20	-	-	-	-	20
Currency translation differences – amount arising in year		-	-	-	(215)	-	-	-	(215)
Net income and expense recognised directly in equity		-	-	20	(215)	-	-	-	(195)
Net profit		-	-	-	-	-	-	11,628	11,628
Total income and expense for the year		-	-	20	(215)	-	-	11,628	11,433
Equity restructuring	24	-	(6,442)	-	-	-	6,442	-	-
Transfer from reserve fund to retained earnings	24	-	-	-	-	-	(6,442)	6,442	-
Capital contribution		-	-	-	-	47	-	-	47
Dividends declared in 2008	7	-	-	-	-	-	-	(16,104)	(16,104)
At 31 December 2008		32,209	24,374	-	(206)	47	6,452	15,292	78,168

* Refer Note 24 regarding amounts not available for distribution.

Consolidated movement of gains and losses recognised in equity

In CZK million	Gains/(losses) proceeding from cash flow hedges	Translation differences	Tax effect	Total
At 1 January 2007	(22)	(12)	4	(30)
Gains/(losses) arisen in the fiscal year	(17)	21	-	4
Gains/(losses) re-classified to the profit and loss account	15	-	-	15
At 31 December 2007	(24)	9	4	(11)
Gains/(losses) arisen in the fiscal year	(52)	(215)	(4)	(271)
Gains/(losses) re-classified to the profit and loss account	76	-	-	76
At 31 December 2008	-	(206)	-	(206)

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2008

In CZK million	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Net profit		11,628	10,386
Non-cash adjustments for:			
Income tax	5	3,720	3,124
Depreciation	8	10,994	12,563
Amortisation	9	1,938	1,872
Impairment loss	8, 9, 10	86	5
Disposals of obsolete assets		114	36
Profit on sale of property, plant and equipment		(840)	(51)
Net interest and other charges		(45)	42
Foreign exchange gains (net)		(239)	(123)
Fair value changes		(15)	-
Change in provisions and allowances		<u>(828)</u>	<u>(641)</u>
Operating cash flow before working capital changes		26,513	27,213
Working capital adjustments:			
Increase in trade and other receivables		(731)	(218)
Increase in inventories		(275)	(104)
Increase in trade and other payables		<u>1,314</u>	<u>1,143</u>
Cash flows from operating activities		26,821	28,034
Interest paid		(487)	(432)
Interest received		367	375
Income tax paid		<u>(4,859)</u>	<u>(4,078)</u>
Net cash from operating activities		21,842	23,899
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,695)	(4,060)
Purchase of intangible assets		(2,221)	(1,594)
Proceeds from sales of property, plant and equipment		4,586	74
Proceeds from marketable securities		24	53
Cash purchase of financial investments		(30)	(176)
Cash acquired from purchase of financial investments		107	-
Dividends received		<u>2</u>	<u>2</u>
Net cash used in investing activities		(2,227)	(5,701)
Cash flows from financing activities			
Proceeds from borrowings		650	-
Repayment of borrowings		(6,645)	-
Dividends – paid		<u>(16,080)</u>	<u>(16,083)</u>
Net cash used in financing activities		(22,075)	(16,083)
Net (decrease) / increase in cash and cash equivalents		(2,460)	2,115
Cash and cash equivalents at beginning of year		<u>9,576</u>	<u>7,461</u>
Cash and cash equivalents at the year end	14	7,116	9,576

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

ACCOUNTING POLICIES

Index	Pages
A Basis of preparation	11
B Group accounting	14
C Foreign currencies	15
D Property, plant and equipment	16
E Intangible assets	17
F Non-current assets classified as held for sale	18
G Impairment of assets	19
H Investments and other financial assets	19
I Leases	22
J Inventories	23
K Trade receivables	23
L Cash and cash equivalents	23
M Financial debt	23
N Current and deferred income taxes	24
O Employee benefits	25
P Share-based compensation	25
Q Provisions	26
R Revenue recognition	26
S Dividend distribution	29
T Financial instruments	30
U Critical accounting estimates and judgments	34
V Change in accounting policy	36
W Operating profit	36

A Basis of preparation

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards (“IFRS”) and all applicable IFRSs adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board (“IASB”) and the International Financial Reporting Interpretations Committee (“IFRIC”).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Group to prepare its consolidated financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At the year-end, there is no difference in the policies applied by the Group between IFRS and IFRS adopted by the EU.

The consolidated financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS required the Group to use certain critical accounting estimates. It also required management to exercise its judgement in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note T.

The amounts shown in these consolidated financial statements are presented in millions Czech Crowns (“CZK”), if not stated otherwise.

Adoption of new or revised IFRS standards and interpretations (includes standards and interpretations applicable for the Group)

In 2008, the Group applied the below stated interpretation and amendment, which are relevant to its operations. Adoption of the interpretation and amendment did not have any effect on the financial performance or position of the Group:

IFRIC 11 IFRS 2 Group and Treasury Share Transactions (issued 2005, effective date 1 March 2007)

The interpretation provides guidance on whether share-based transactions involving treasury shares or involving group entities (for example, options over parents’ shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone financial statements of the parent and group companies. This interpretation does not have an impact on the Group’s financial statements.

Standards and interpretations issued and endorsed by the European Union but not early adopted by the Group (includes standards and interpretations applicable for the Group)

IFRS 8 Operating Segments (issued 2006, effective date 1 January 2009)

The standard will replace IAS 14 Segment Reporting and requires entities to disclose segment information based on the information reviewed by the entity's chief operating decision maker. The adoption of the standard will not change the current presentation of segment information.

IAS 1 Amendment (issued 2007, effective date 1 January 2009) Presentation of financial statements, Comprehensive revision including requiring a statement of comprehensive income

The amendment to the standard separates owner and non-owner changes in equity. In addition, the standard introduces a statement of comprehensive income. The Group does not expect any material effect on the Balance Sheet and the Income Statement relating to the adoption of this standard from the effective date 1 January 2009. This adoption will affect certain disclosures in the notes to the consolidated financial statements.

IAS 23 Amendment (issued 2007, effective date 1 January 2009) Borrowing Costs

The amendment requires the Group to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Since the Group has already applied this policy as an allowed alternative treatment before, no impact is expected on the financial position of the Group.

IFRIC 13 Customer Loyalty Programmes (issued 2007, effective date 1 July 2008)

This interpretation addresses the accounting by entities that provide their customers with incentives to buy goods or services by providing awards as part of the sale transaction. The interpretation requires the entity that grants the awards to account for the sales transaction that gives rise to the award credits as a multiple element transaction and allocate the fair value of the consideration received or receivable between the award credits granted and the other components of the revenue transaction.

This adoption will affect current accounting policy in respect of change of the fair value awards measurement and change in the presentation in the financial statements. This will also affect certain disclosures in the notes to the consolidated financial statements. This adoption will not have material impact on the financial results in 2009.

IFRS 2 Amendment (issued 2008, effective date 1 January 2009) Share-based Payments

The amendment clarifies the definition of a vesting condition and prescribes the treatment for an award that is cancelled. The group will apply IFRS 2 (Amendment) from 1 January 2009. This amendment will not have a material impact on the Group's financial statements.

Standards and interpretations issued but not endorsed by the European Union and neither early adopted by the Group nor effective (includes standards and interpretations applicable for the Group)

Revised IFRS 3 Business Combinations (issued 2008, effective date 1 July 2009)

The standard introduces changes in the accounting for business combination that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs and future reported results. The Group will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010.

IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate – Amendments (issued 2008, effective date 1 January 2009)

IAS 27 is amended for the following changes in respect of the holding companies separate financial statements:

- i) The deletion of the “cost method”. Making the distinction between pre-and post-acquisition profits is no longer required. All dividends will be recognized in profit or loss. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment; and
- ii) In case of reorganisations where a new parent is inserted above an existing parent of the group (subject to meeting specific requirements), the cost of the subsidiary is the previous carrying amount of its share of equity items in the subsidiary rather than its fair value.

The Group does not expect any material effect relating to the adoption of these amendments.

IAS 27 Consolidated and Separate Financial Statements - Amendment (issued 2008, effective date 1 July 2009)

The most significant changes to IAS 27 are as follows:

- i) Change in ownership interests of a subsidiary (that do not result in a loss of control) will be accounted for as an equity transaction and will have no impact on goodwill nor will it give a rise to a gain or loss.
- ii) Losses incurred by the subsidiary will be allocated between the controlling and non-controlling interests (previously referred to as “minority interests”); even if the losses exceed the non-controlling equity investment in a subsidiary.

iii) On loss of control of a subsidiary, any retained interest will be remeasured to fair value and this will impact the gain or loss recognized on disposal.

The Group does not expect any material effect relating to the adoption of this amendment.

IFRS 5 Amendment (issued 2008, effective date 1 July 2009) Non-current Assets Held for Sale and Discontinued Operations

The amendment clarifies that all of subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary, if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRS. The Group will apply the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

IAS 36 Amendment (issued 2008, effective date 1 January 2009) Impairment of Assets

Where fair value less costs to sell is calculated on the basis of discounted cash flows, disclosures equivalent to those for value-in-use calculation should be made. The Group will apply the IAS 36 (Amendment) and provide the required disclosure where applicable for impairment tests from 1 January 2009.

The Group does not intend to early adopt any of those standards and interpretations before their effective dates.

B Group accounting

Consolidation

Subsidiary undertakings, which are those companies in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations, have been consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date when the Group ceases to have control.

A business combination is accounted for using the purchase method of accounting. An acquisition is accounted for at its cost, being the amount of cash and cash equivalents paid in exchange for control over the net assets of an acquired company, plus any costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. For detail refer to Note E Intangible assets and also Note 9.

Intercompany transactions and balances between the Group companies are eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies for subsidiaries are changed, where necessary, to ensure consistency with the policies adopted by the Group and another companies within the Group.

Intercompany transactions and balances between the Group and Telefónica companies for the period after the transfer of majority ownership to Telefónica, S.A. are not eliminated. They are identified, disclosed and measured for the disclosure purposes and elimination procedures of the majority shareholder – Telefónica, S.A.

The ultimate parent company of the Telefónica O2 Czech Republic, a.s. Group is Telefónica, S.A.

C Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The consolidated financial statements are presented in Czech Crowns (“CZK”), which is the Group’s presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(iii) Group companies

The income and cash flow statements of foreign entities are translated into the Group’s reporting currency at the average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities and of borrowings and other currency instruments designated as hedges of such investments are taken to shareholders’ equity. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

D Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less impairment charges.

Property, plant and equipment acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less depreciation and impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises every expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Repairs and maintenance costs are expensed as incurred.

Items of property, plant and equipment that are retired are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is de-recognised or the date the asset is classified as held for sale.

Depreciation does not cease, when the asset becomes temporarily idle or retired from active use, unless the asset is fully depreciated.

Estimated useful lives adopted in these consolidated financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	5 to 25
Exchanges and related equipment	up to 10
Other fixed assets	2 to 10

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (refer to Note G Impairment of assets).

E Intangible assets

Intangible assets include computer software, purchased goodwill, licenses, trade names, customer base and roaming contracts. Computer software mainly represents the external acquisition costs of the Group's information systems that are intended for use within the Group. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Group and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and impairment charges and are amortised on a straight-line basis over their estimated useful lives. Customer bases are amortised over a period of the remaining average terms of the binding contracts.

Acquired licenses are recorded at cost and amortised on a straight-line basis over the remaining life of the license (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Group.

Intangible assets with an indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 9 and Note 10).

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired. Goodwill is not amortised but is tested for impairment at least annually or anytime there are indications of a decrease in its value.

The Group reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and no future economic benefits are expected or that are disposed of for any other reason are de-recognised from the balance sheet together with the corresponding accumulated amortisation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with an indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

F Non-current assets classified as held for sale

The Group classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within one year.

The Group measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Group recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as an impairment loss with impact in the income statement of the relevant period.

From the moment the asset is classified as held for sale and eventually revalued, it ceases to be depreciated/amortised and impairment is only being determined.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in the income statement.

G Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised as a reduction in the expenses in the period in which the reversal occurs.

H Investments and other financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2008 and 2007, the Group did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in equity in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Impairment of financial assets

The Group assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(2) Available-for-sale financial assets

If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) directly in equity shall be removed from equity and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from equity and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

De-recognition of financial assets

A financial asset is de-recognised when:

- a) the rights to receive cash flow from the asset have expired,
- b) the Group retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement, or
- c) the Group has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

I Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Group bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity).

The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

A sale and lease back transaction involves the sale of an asset and the leasing back of the asset. Within the Group’s operations the selling price of the asset and lease payments are independent and established at fair value. Therefore the gain from the sale of the asset and the lease payments are accounted as two separate transactions

J Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

K Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in the income statement.

L Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

M Financial debt

Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Interest costs on borrowings used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

N Current and deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date in the relevant country.

Current income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible allowances and provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Group accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

O Employee benefits

(1) Pension obligations

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Group has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to the income statement in the same period as the related salary expense. The Group also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to the income statement in the period to which the contributions relate.

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Group recognises redundancy and termination benefits when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Group recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments. The Group recognises a provision where the Group is contractually obliged or where there is a past practice that has created a constructive obligation.

P Share-based compensation

During 2006, the Group introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to shares granted are expensed over the period during which the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Group revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through the income statement for the period, if appropriate.

For the equity-settled share option plan, fair value at the grant date is measured using the binomial methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Group revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity.

Q Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

R Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Group, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. If necessary, revenue is split into separately identifiable components.

The Group offers customers free minutes for a selected price based on a chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Company is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Group recognises revenue for free minutes in the period when the related services are provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Group considers these indicators of gross revenue reporting:

- a) the Group is the primary obligor in the arrangement,
- b) the Group has general inventory risk,
- c) the Group has price latitude,
- d) the Group changes the product or performs part of the service,
- e) the Group has discretion in supplier selection,
- f) the Group is involved in the determination of product or service specifications,
- g) the Group has credit risk,
- h) the Group has the ability to set the terms of the transaction,
- i) the Group has the managerial control over the transaction.

The relative strength of each indicator is considered when concluding which accounting treatment to use for principal/agency arrangement.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised, e.g. premium rate lines.

Revenue from fixed price construction contracts (long-term contracts) is recognised on the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. An expected loss on the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues

Domestic and international call revenues are recognised in the income statement at the time the call is made.

Universal service

The Group is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. The Group follows the accounting policy of Telefónica Group and recognises the compensation of revenues attributable to the Group using the gross principle as well as recognises the compensation when CTO approves the total compensation and decides about percentage shares and absolute amounts of other operators contributions.

Subscription revenues

Revenue is recognised in the income statement in the period in which the services are rendered.

Revenues from sales of prepaid cards

Prepaid call card sales are deferred until the customer uses the stored value on the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of the degressive accounting method.

Equipment sales and other sale of goods

Revenue from the sale of telephone equipment and accessories and other sale of goods is recognised at the time of sale i.e. when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling

Revenue from access to the local loop unbundling is deferred in the income statement and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in the income statement when it occurs.

(2) Mobile business revenues

The Group earns mobile services revenue from customers usage of the Group's network, interconnection and roaming – collectively, "Mobile service revenue". The Group also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues

Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised as their airtime and other services are used. Prepaid customers recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognized as the airtime and other services are used. Upon termination of the customer contract or expiration of voucher (up to 14 months), all deferred revenue for unused airtime is recognized in income.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Equipment sales and mobile services

Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues

Mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Costs

Commissions and discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Other commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnect revenues

Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Group's network. These revenues are recognised in the income statement at the time when the call is received in the Group's network. The Group pays a proportion of the call revenue it collects from its customers to other domestic and foreign operators' for calls and other traffic that originate in the Group's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Group earns revenue from providing Internet services, IPTV and other data services. Revenue from such services is recognised at the time the service is provided.

(5) Dividend income

Dividend income is recognized when the right to receive payment is established.

(6) Interest

Revenue is recognised as interest accrues (using the effective interest method).

S Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

T Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 16.

Financial risk management

The Group's is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Group's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Group. The Group uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) to hedge certain exposures.

The Group does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board of Directors provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Group is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the Euro, partially to US Dollar and Slovak Crown:

- a) balance sheet items (such as debt, receivables, payables) denominated in foreign currency,
- b) probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency,
- c) net investment in Slovak subsidiary (functional currency differs from CZK).

The Group's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes.

The Group primarily hedges the balance sheet foreign currency exposure, mainly long term debt denominated in EUR and net payables in EUR or USD. Non-derivative instruments are currently used for hedging this kind of exposure.

Additionally, the Group uses to a certain extent derivative hedging via short term forwards to buy respective foreign currency for highly probable or committed purchase transactions, primarily up to a 6 months horizon.

(ii) Interest rate risk

The Group is exposed to interest rate risk arising from:

- a) floating interest rate bearing cash investments and debt instruments,
- b) fair value of debt on fixed interest rate.

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments are on fixed rates. The Group may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable rate debts.

(iii) Liquidity risk

The Group's essential objective of liquidity risk management is to have ready access to cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of cash instruments, marketable securities and available committed credit facilities.

The Group is particularly focusing on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) Credit risk

Concentrations of credit risk, with respect to trade accounts receivable, are limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Group does not currently foresee a dramatically higher credit risk associated with these receivables, repayment is significantly impacted by the financial stability of the national economy.

The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations of credit risk within the Group.

With respect to credit risk arising from the financial assets of the Group, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Department and is based on three main activities:

- a) monitoring of accounts receivables: regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts),
- b) prevention: scoring of new customers – checking procedures (Black Lists, External Debtors Register, other information), set up the limits or/and collection of the deposit according to customer segments, products and set up the credit limits for indirect sales partners (dealers, distributors, retailers) for purchase of our products, „securing“ of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.). Guarantees are either in cash (deposits) or there are special procedures to collect cash for the other securing tools (insurance etc.),
- c) collection: reasonable, effective and continual collection process is the additional tool of bad debts decrease and prevention as well.

New credit management activities during last years

During last years the Group introduced new credit management activities such as:

- a) implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),
- b) implementation of the credit management best practice from the merge of the fixed and mobile business in all company activities,
- c) checking of the new activation by using of fixed and mobile Black Lists,
- d) implementation of tight activation rules for all distribution channels.

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Group designates certain derivatives as either:

- a) hedge of the fair value of a recognised asset or liability (fair value hedge), or
- b) hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective are recorded in the income statement, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognised in equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the income statement and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the income statement.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Group has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the committed or forecasted transaction ultimately is recognised in the income statement. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 20. Movements on the hedging reserve in shareholder's equity are shown in Note 25.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Group's own discounted cash flow models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Group's bankers.

U Critical accounting estimates and judgments

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next year are discussed below:

(1) Income taxes and deferred taxes

The Group created a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Group expects to recover or settle the carrying amount of assets and liabilities. Where the final tax-deductible expenses are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made. As at 31 December 2008, the total amount of provision for current income taxes is CZK 3,759 million, advances paid for income taxes amount to CZK 3,976 million and the net deferred tax liability is CZK 3,300 million.

In October 2007, the new Czech legislation was enacted, by which the corporate income tax rate was reduced from 24 % to 21 %, 20 % and 19 % for the fiscal years ending in 2008, 2009 and 2010, respectively. The positive impact on the deferred tax liability amounts to CZK 798 million in 2007 (see Note 5).

(2) Goodwill

The Group tests at each reporting date goodwill for an impairment. However goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment. At 31 December 2008 the carrying amount of goodwill is CZK 13,448 million (See Note 9).

(3) Provisions and contingent liabilities

As set out in Note 21 the Group is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Group's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Group has a present obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Contingent liabilities are not recognised, because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

(4) Interconnect

The Group provides and enters into the contracts for interconnect services and the revenue is recognised on the basis of the reasonable estimation of expected amount. Such estimation is regularly reviewed, however the final agreement and invoicing can be with some operators stated on up to a yearly basis.

(5) Impairment of the fixed line business assets

The Group makes an assessment at each balance sheet date whether there is any indication that an impairment loss recognised for the fixed line business assets in prior years may no longer exist, may have decreased or may have increased. If any such indication exists, the Group estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may no longer exist, the Group considers both external and internal indicators (decline of asset's market value, changes expected in the market, including technological changes etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions about future business performance, which may, ultimately, differ from reality.

Based on the assessment performed by the Company, no increase or decrease of the previously recognised impairment of fixed line business assets was recognised in 2008 and 2007 (see Note 8 and 10).

(6) Operating lease commitments – Group as lessee

The Group changed its headquarters and moved to the new premises, where the Group has entered into the commercial property leases. The Group has determined, based on an evaluation of the terms and conditions of the arrangements, that the lessor retains all the significant risks and rewards of the ownership and therefore the Group accounts for the contract as an operating lease.

V Change in accounting policy

No significant changes in accounting policies were applied in 2008 and 2007.

W Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which include primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Index	Pages	
1	Segment information	38
2	Revenue and Internal expenses capitalized in fixed assets	40
3	Operating expenses	41
4	Interest and other finance income and expense	42
5	Income tax	42
6	Earnings per share	43
7	Dividends	43
8	Property, plant and equipment	44
9	Intangible assets	46
10	Impairment of fixed assets	49
11	Inventories	49
12	Receivables and prepayments	50
13	Held-to-maturity investments	51
14	Cash and cash equivalents	51
15	Trade and other payables	52
16	Financial debts	53
17	Deferred income taxes	55
18	Government social security and pension schemes	57
19	Provisions for liabilities and charges	58
20	Financial instruments	59
21	Contingencies	59
22	Commitments	62
23	Service concession arrangements	62
24	Share capital and reserves	65
25	Hedging reserve	66
26	Related party transactions	66
27	Principal subsidiary undertakings	68
28	Post balance sheet events	69

1 Segment information

Business segments recognised by the Group are as follows:

- Fixed - network communications services using a fixed network and IS/ICT services provided by the Company and other consolidated subsidiaries,
- Mobile - mobile communications services provided by the Company and by Telefónica O2 Slovakia

Year ended 31 December 2008 In CZK million	Fixed	Mobile	Group
Revenues	30,484	35,419	65,903
Inter-segment sales	(423)	(771)	(1,194)
Total consolidated revenues	30,061	34,648	64,709
Gains from sale of non-current assets	855	0	855
Internal expenses capitalised in fixed assets	338	146	484
Costs	(18,717)	(20,127)	(38,844)
Inter-segment purchases	771	423	1,194
Total consolidated costs	(17,946)	(19,704)	(37,650)
Impairment charge	(83)	(3)	(86)
Depreciation	(7,263)	(3,731)	(10,994)
Amortisation	(654)	(1,284)	(1,938)
Total consolidated depreciation and amortization	(7,917)	(5,015)	(12,932)
Operating profit	5,308	10,072	15,380
Interest and other financial costs (net)			(32)
Profit before tax			15,348
Tax			(3,720)
Profit after tax			11,628
Minority interest			-
Net profit			11,628
Assets (excluding goodwill and non-current assets held for sale)	37,863	52,216	90,079
Goodwill	128	13,320	13,448
Non-current assets held for sale	96	-	96
Total assets	38,087	65,536	103,623
Trade and other payables	6,199	11,487	17,686
Other liabilities	3,739	4,030	7,769
Total liabilities	9,938	15,517	25,455
Capital expenditure	4,312	3,776	8,088

Year ended 31 December 2007 In CZK million	Fixed	Mobile	Group
Revenues	30,500	33,934	64,434
Inter-segment sales	(455)	(783)	(1,238)
Total consolidated revenues	30,045	33,151	63,196
Gains from sale of non-current assets	42	-	42
Internal expenses capitalised in fixed assets	448	105	553
Costs	(16,973)	(20,018)	(36,991)
Inter-segment purchases	783	455	1,238
Total consolidated costs	(16,190)	(19,563)	(35,753)
Impairment charge	(5)	-	(5)
Depreciation	(8,521)	(4,042)	(12,563)
Amortisation	(684)	(1,188)	(1,872)
Total consolidated depreciation and amortization	(9,205)	(5,230)	(14,435)
Operating profit	5,135	8,463	13,598
Interest and other financial costs (net)			(88)
Profit before tax			13,510
Tax			(3,124)
Profit after tax			10,386
Minority interest			-
Net profit			10,386
Assets (excluding goodwill and non-current assets held for sale)	47,697	52,207	99,904
Goodwill	-	13,320	13,320
Non-current assets held for sale	328	-	328
Total assets	48,025	65,527	113,552
Trade and other payables	5,577	8,188	13,765
Other liabilities	8,166	8,829	16,995
Total liabilities	13,743	17,017	30,760
Capital expenditure	4,263	3,544	7,807

Revenue of the Group is predominantly derived from domestic trading activities and as a result, segment reporting is only shown on the basis of business segments. With respect to the issue of IFRS 8 Operating segments and the deep integration process from the past convergence of fixed and mobile operations, the Group has analysed criteria for segment identification. The adoption of the standard will not lead to a change in the reported segments in the next years.

Inter-segment sales and purchases represent sales and purchases to the Group companies belonging to another segment.

The inter-segment pricing rates applied in 2008 and 2007 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators.

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

2 Revenue and Internal expenses capitalized in fixed assets

Revenue In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Voice	23,269	23,147
Interconnection	10,428	10,625
Subscription charges	8,444	8,849
Connection charges	295	783
SMS & MMS & Value added services	5,080	4,998
Leased lines and data services	3,866	3,961
Internet	6,463	5,828
IT and business solutions	2,308	1,950
Equipment and activation fee	2,045	2,058
Other telecommunication revenues	2,253	437
Other revenues	258	560
Total revenues	64,709	63,196

Revenues from related parties are disclosed in Note 26.

The aggregate future minimum lease payments under non-cancellable operating leases, where the Company is a lessor, relating to the buildings and other telecommunication equipment are as follows:

In CZK million	31 December 2008	31 December 2007
No later than 1 year	185	244
Later than 1 year and not later than 5 years	754	868
Later than 5 years	198	237
Total	1,137	1,349

Internal expenses capitalized in fixed assets In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Material	79	138
Labour	405	415
Total	484	553

3 Operating expenses

The following items have been included into the operating expenses:

In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Wages and salaries*	5,163	4,891
Redundancy payments	160	209
Social security contributions (Note 18)	1,626	1,678
Staff welfare costs	<u>157</u>	<u>331</u>
Total staff costs	7,106	7,109
Interconnection and roaming	11,989	11,012
Cost of goods sold	3,258	3,499
Contents	220	160
Customer loyalty program	363	446
Sub-deliveries	1,213	1,217
Commissions	1,213	1,203
Other cost of sales	1,127	261
Purchases	542	645
Billing and collection	399	386
Marketing	1,908	2,237
Call centres	305	245
Network & IT repairs and maintenance	2,340	2,603
Rentals, buildings and vehicles	2,168	1,897
Utilities supplies	948	807
Consultancy and professional fees	270	338
Other external services	1,242	1,043
Provision for bad and doubtful debts and inventories	530	225
Taxes (other than income tax)	423	375
Other operating expenses	<u>86</u>	<u>45</u>
Total operating expenses	37,650	35,753

* Certain Group employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Group. The Group paid CZK 11 million in relation to such non-competition clauses in 2008 (2007: CZK 7 million).

Statutory auditor's fees as at 31 December 2008 were as follows:

In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Statutory audit	23	19
Total	23	19

Purchases from related parties are disclosed in Note 26.

4 Interest and other finance income and expense

In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Financial income		
Interest income	449	403
Gain for derivatives of fair value hedges	65	-
Other financial income	1,333	749
Total financial income	1,847	1,152
Financial expenses		
Interest expenses	(406)	(446)
Loss for derivatives of fair value hedges	-	(26)
Other financial expenses	(1,473)	(768)
Total financial expenses	(1,879)	(1,240)
Net financial cost (net)	(32)	(88)

5 Income tax

In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Total income tax expense is made up of:		
Current income tax charge	3,777	4,240
Deferred income tax credit (Note 17)	(57)	(1,116)
Taxes on income	3,720	3,124

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Group as follows:

In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Profit before tax	15,348	13,510
Income tax charge calculated at the statutory rate of 21 % (2007: 24 %)	3,223	3,242
Income not subjected to tax	-	(9)
Expenses not deductible for tax purposes	164	299
Impact of change in income tax rate	-	(798)
Tax related to prior periods	22	54
Unrecognised tax losses	311	336
Taxes on income	3,720	3,124
Effective tax rate	24 %	23 %

6 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	31 December 2008	31 December 2007
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	11,628	10,386
Basic earnings per share (CZK)	36	32

There is no dilution of earnings as no convertible instruments have been issued by the Company.

7 Dividends

In CZK million	31 December 2008	31 December 2007
Dividends declared (including withholding tax)	16,104	16,104

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2008. Approval of the 2008 profit and the decision regarding the amount of any dividend payment for the 2008 financial year will take place at the Annual General Shareholders Meeting scheduled for 3 April 2009.

8 Property, plant and equipment

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress including advances paid	Total
At 31 December 2008						
Opening net book amount	14,080	39,710	13,207	2,003	2,809	71,809
Additions	672	769	2,923	1,076	5,630	11,070
Disposals and other movements	24	-	(8)	(7)	(5,066)	(5,057)
Acquisition impact	-	-	-	2	-	2
Assets classified as held for sale	(3,285)	(25)	(6)	-	-	(3,316)
Depreciation charge	(678)	(4,206)	(4,927)	(1,183)	-	(10,994)
Impairment charge	(49)	(21)	(2)	-	(13)	(85)
Closing net book amount	10,764	36,227	11,187	1,891	3,360	63,429
At 31 December 2008						
Cost	17,718	99,982	91,788	10,486	3,385	223,359
Accumulated depreciation and impairment allowance	(6,954)	(63,755)	(80,601)	(8,595)	(25)	(159,930)
Net book amount	10,764	36,227	11,187	1,891	3,360	63,429
At 31 December 2007						
Opening net book amount	14,219	43,395	17,292	1,814	2,035	78,755
Additions	691	576	2,634	1,190	5,700	10,791
Disposals and other movements	(37)	(1)	(55)	(12)	(4,927)	(5,032)
Assets classified as held for sale	(132)	(10)	-	-	-	(142)
Depreciation charge	(656)	(4,250)	(6,664)	(989)	(4)	(12,563)
Impairment charge	(5)	-	-	-	5	-
Closing net book amount	14,080	39,710	13,207	2,003	2,809	71,809
At 31 December 2007						
Cost	22,838	99,696	93,126	10,557	2,839	229,056
Accumulated depreciation and impairment allowance	(8,758)	(59,986)	(79,919)	(8,554)	(30)	(157,247)
Net book amount	14,080	39,710	13,207	2,003	2,809	71,809

As at 31 December 2008, the carrying value of non-depreciated assets amounted to CZK 241 million (2007: CZK 472 million).

Land and buildings in the carrying value of CZK 8,280 million as of 31 December 2007 were pledged in respect of execution relating to the T-Mobile interconnect dispute. In 2008 the execution was terminated (see Note 21). No property, plant and equipment were pledged as at 31 December 2008.

No borrowing costs were capitalized during the years 2008 and 2007.

The Group reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 31 December 2008				
Opening net book amount	327	1	-	328
Disposals and other movements	(3,540)	(7)	-	(3,547)
Impairment charge	(1)	-	-	(1)
Assets re-classified as held for sale	3,310	6	-	3,316
Closing net book amount	96	-	-	96
At 31 December 2008				
Cost	789	187	6	982
Accumulated depreciation and impairment allowance	(693)	(187)	(6)	(886)
Net book amount	96	-	-	96
At 31 December 2007				
Opening net book amount	202	1	-	203
Disposals and other movements	(12)	-	-	(12)
Impairment charge	(5)	-	-	(5)
Assets re-classified as held for sale	142	-	-	142
Closing net book amount	327	1	-	328
At 31 December 2007				
Cost	1,282	199	10	1,491
Accumulated depreciation and impairment allowance	(955)	(198)	(10)	(1,163)
Net book amount	327	1	-	328

Assets intended for sale in most cases represent administration buildings with land, that became vacant due to the Group's optimization process and which the Group will not use in the future and it is expected that their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2008, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 855 million (2007: CZK 42 million) and total losses in amount CZK 59 million (2007: CZK 35 million).

In 2008 and at the beginning of 2009, the Group completed the substantial part of a real estate usage optimisation process. In 2008, as part of this process, the Group sold a portfolio of administrative and technological buildings located throughout the whole Czech Republic. Net gain from the sale of the real estate portfolio amounted to 727 million CZK. A small portion of the real estate was leased back on the long term basis. In January 2009, the Group sold a construction site and two administrative buildings of the former headquarters in Olšanská street in Prague (see Note 28).

Cost of fully depreciated property, plant and equipment was CZK 59,597 million as at 31 December 2008 (2007: CZK 62,165 million).

9 Intangible assets

In CZK million	Goodwill	Licences	Software	Other	Total
At 31 December 2008					
Opening net book amount	13,320	4,816	3,669	-	21,805
Additions	-	-	2,371	-	2,371
Disposals and other movements	-	15	(38)	-	(23)
Acquisition impact	128	-	5	-	133
Amortisation charge	-	(406)	(1,532)	-	(1,938)
Closing net book amount	13,448	4,425	4,475	-	22,348
At 31 December 2008					
Cost	13,448	6,226	24,601	-	44,275
Accumulated amortisation and impairment allowance	-	(1,801)	(20,126)	-	(21,927)
Net book amount	13,448	4,425	4,475	-	22,348
At 31 December 2007					
Opening net book amount	13,320	5,210	3,098	-	21,628
Additions	-	16	2,034	-	2,050
Disposals and other movements	-	-	(1)	-	(1)
Amortisation charge	-	(410)	(1,462)	-	(1,872)
Closing net book amount	13,320	4,816	3,669	-	21,805
At 31 December 2007					
Cost	13,320	6,209	22,955	2,829	45,313
Accumulated amortisation and impairment allowance	-	(1,393)	(19,286)	(2,829)	(23,508)
Net book amount	13,320	4,816	3,669	-	21,805

Goodwill

Goodwill in amount of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. ("Eurotel") The initially recognized goodwill of CZK 14,087 million resulted from comparison of cost of business combination of CZK 29,215 million and fair value of net assets acquired of CZK 15,128 million. Until 31 December 2004 goodwill was amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Group ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (767 million CZK). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with indefinite useful life which has been tested annually for the impairment, as well as when there are indications of impairment. There is no other intangible asset with indefinite useful life.

The Group performed impairment tests and as result of the test the Group did not recognize any impairment losses of goodwill in 2008 and 2007. The impairment test involves determining the recoverable amount of the mobile cash-generating unit, which corresponds to the value in use. Value in use is the present value of the future cash flows expected to be derived from a cash-generating unit.

Value in use is determined on the basis of an enterprise valuation model and is assessed from a Group internal perspective. Value in use is determined based on cash flow budgets, which are based on the medium-term business plan for a period of 3 years, which has been approved by the management and which is valid when the impairment test is performed. This business plan is based on the past experience, as well as on future market trends. Further, the business plan is based on general economic data derived from macroeconomic and financial studies. Cash flows beyond the three-year period are extrapolated using an appropriate growth rates. Key assumptions on which management has based its determination of business plan and growth rates include development of gross domestic product, interest rates, nominal wages, average revenue per user ("ARPU"), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and discount rates.

Any significant future changes in the market and competitive environments could have an adverse effect on the value of the cash-generating units.

The calculations of value in use for all cash-generating units are most sensitive to the following assumptions:

Estimated growth rate – the basis used to determine the value assigned to estimated growth rate is the forecast of market and regulatory environment, where the Group conduct the business.

Discount rate – discount rates reflect management's estimate of the risk specific to the cash generating unit. The basis used to determine the value assigned is weighted average of cost of capital ("WACC").

Licences

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks in the Czech Republic. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of eight years.

In 2002, Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer every internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The NMT license is currently valid for the remaining period of three years.

In December 2001, Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel was provided with deferred payment terms by the Czech Telecommunication Office (“CTO”) to finance the license acquisition. In December 2003, Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

With respect to the operation launch in 2007, the license for GSM and UMTS networks was awarded to Telefónica O2 Slovakia on 7 September 2006 for SKK 150 million (EUR 4.1 million).

Carrying value of licences:

In CZK million	31 December 2008	31 December 2007
GSM 900 license	546	619
GSM 1800 license	440	499
NMT 450 license	33	50
UMTS license	3,268	3,518
GSM and UMTS license – TO2 Slovakia	138	130
Total	4,425	4,816

No borrowing costs were capitalized during the years 2008 and 2007.

Cost of fully amortised intangible assets was CZK 16,846 million as at 31 December 2008 (2007: CZK 17,252 million).

All of the Group’s intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

10 Impairment of fixed assets

Fixed assets of the fixed line business

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up interconnection charges and other regulatory decisions in the Czech Republic led the management to assess and adjust the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the “CGU”).

Value in use has been calculated by a method of cumulated discounted cash flows for a period limited by average useful life of CGU’s key assets. Primarily, the following assumptions have been used in the impairment testing model: actual business plan, estimation of consecutive development of key indicators (revenues, margin, investments etc.) in analyzed period, discount rate derived from weighted average cost of capital.

As at 31 December 2008, the management of the Company reviewed the indicators which would indicate that the impairment allowance of fixed line business assets made in 2003 is no longer relevant and should be reversed. Upon the review, a recoverable amount of the fixed line business assets (impairment test model) was estimated. Based on this assessment performed, the management believes that the value of the existing fixed network assets is fairly stated and does not differ substantially from the assets’ recoverable amount as at 31 December 2008.

Value in use as at 31 December 2008 has been calculated using the same methodology as in the year 2003.

11 Inventories

In CZK million	31 December 2008	31 December 2007
Construction material	114	66
Cables	47	47
Other inventory including goods for resale	607	736
Finished products and work in progress	11	4
Total	<u>779</u>	<u>853</u>

The inventories noted above are stated net of an allowance of CZK 64 million (2007: CZK 96 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories at net realisable value amounts to CZK 31 million (2007: CZK 43 million). The amount of inventories recognised as an expense is CZK 4,059 million (2007: CZK 4,245 million).

12 Receivables and prepayments

In CZK million	31 December 2008	31 December 2007
Domestic trade receivables (net)	6,960	6,895
Foreign currency trade receivables (net)	834	572
Other debtors (net)	650	373
Prepayments	759	716
Other financial assets - short-term	14	17
Derivative instruments	23	4
Total	9,240	8,577

Trade receivables are stated net of an allowance for impaired receivables of CZK 3,457 million (2007: CZK 3,291 million). In order to preserve the tax-deductible status of the bad debt expense, the Group's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

Receivables from related parties are disclosed in Note 26.

Trade receivables In CZK million	Carrying amount	Neither Impaired nor overdue	Not impaired but overdue			
			Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2008	7,794	5,101	552	-	30	36
At 31 December 2007	7,467	4,491	321	50	-	-

Bad debt provisions In CZK million

At 1 January 2007	3,312
Additions	117
Retirements/amount paid	(138)
At 31 December 2007	3,291
Additions	1,057
Retirements/amount paid	(891)
At 31 December 2008	3,457

The Group's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Group's trade receivables.

As at 31 December 2008 and 2007 the Group has the following non-current balances, which are classified as other financial assets:

In CZK million	31 December 2008	31 December 2007
Long-term credits	133	112
Advance payments for long-term expenses	245	247
Other financial investment	-	207
Total	<u>378</u>	<u>566</u>

Long-term trade credits include interest bearing credit (interest 5.9 %) amounting to CZK 64 million (2007: CZK 71 million).

13 Held-to-maturity investments

Held-to-maturity investments In CZK million	31 December 2008	31 December 2007
At beginning of year	27	27
Additions	1	1
Matured	<u>(28)</u>	<u>(1)</u>
At end of year	-	27
Current	<u>-</u>	<u>27</u>
Total	-	27

Held to maturity investments category as at 31 December 2007 comprised a debt instrument – a bond held in EUR with maturity date July 2008, which was carried at amortised cost.

14 Cash and cash equivalents

In CZK million	31 December 2008	31 December 2007	Interest rate
Cash at current bank accounts	330	4,130	Floating
Cash at cash-pooling structures (inter-company)	6,344	5,107	Floating
Short-term bank deposits	442	321	Fixed
Other cash equivalents	<u>-</u>	<u>18</u>	n/a
Total cash and cash equivalents	7,116	9,576	
Financial investments (held to maturity)	-	27	Fixed

As at 31 December 2008 and 2007, the Group's cash equivalents partially consisted of short-term bank promissory notes that were economically equivalent to bank term deposits and interest bearing deposits maturing in three months or less.

Since April 2006, the Group entered into mutual Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow. The short-term deposits conditions are based on the arm's length principle. The short-term deposits are classified as cash equivalents.

At 31 December 2008, the Group had available equivalent of CZK 5,425 million (2007: CZK 12,344 million) of undrawn committed facilities.

For the purposes of the cash flow statement, the year-end cash and cash equivalents comprise the following components:

In CZK million	31 December 2008	31 December 2007
Cash and cash equivalents	7,116	9,576
Bank overdrafts and other short-term borrowings (Note 16)	<u>-</u>	<u>-</u>
Total	7,116	9,576

The amount of CZK 3,902 million kept on bank accounts was pledged as of 31 December 2007 in respect of execution relating to the T-Mobile Interconnect dispute. In 2008 the execution was terminated (Note 21). As of 31 December 2008 no cash and cash equivalents were pledged.

15 Trade and other payables

In CZK million	31 December 2008	31 December 2007
Trade creditors in local currency (net)	4,615	4,575
Trade creditors in foreign currencies (net)	2,161	1,924
Related party loans	3,249	794
Other taxes and social security	196	518
Deferred revenue	1,054	1,254
Employee wages and benefits	794	703
VAT payable	479	162
Other creditors	406	656
Accruals	<u>4,732</u>	<u>3,179</u>
Total payables	17,686	13,765
Other non-current liabilities	176	452

In 2008 and 2007 the related party loans include an intercompany loan in amount of CZK 3,194 million (2007: CZK 794 million) provided to Telefónica O2 Slovakia, s.r.o. by the company Telfisa Global, BV (see Note 26).

Other non-current liabilities include primarily deferred revenues from connection fees, which are expected to be taken to income in more than 12 months from the balance sheet date.

16 Financial debts

In CZK million	31 December 2008	31 December 2007
Bank loans in foreign currencies (a)	3,098	3,062
Bonds in local currency (b)	<u>5</u>	<u>5,998</u>
Total borrowings	3,103	9,060
Accrued interest including commitment fees	86	185
Derivatives	<u>7</u>	<u>24</u>
Other financial debt	<u>93</u>	<u>209</u>
Total financial debt	3,196	9,269
Repayable:		
Within one year	98	6,207
Between two and five years (total non-current)	<u>3,098</u>	<u>3,062</u>
Total financial debt	3,196	9,269

(a) As at 31 December 2008 the Group does not utilize bank overdrafts.

In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2008, the outstanding amount of the foreign currency loan amounts to EUR 115 million.

(b) In 2003, the Group issued CZK 6,000 million of bonds with an interest rate 3.50 % p.a. and it was fully repaid at a maturity date of 9 July 2008.

For all borrowings, interest has been charged at commercial rates.

The Group's loan interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2008	31 December 2007
At fixed rate	<u>3,103</u>	<u>9,060</u>
Total	3,103	9,060

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expects to be available to the Group at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2008	2007
Bank loans in foreign currencies	6.64 %	6.64 %
Bonds in local currency	3.50 %	3.50 %

Loans are not secured.

The table below summarizes the maturity profile of the Group's financial liabilities at 31 December 2008 based on contractual undiscounted payments.

At 31 December 2008

In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	5	206	3,715	-
Trade and other payables (except for deferred revenue)	14,796	1,836	-	-
Derivatives fair value	7	-	-	-
Total	14,808	2,042	3,715	-

At 31 December 2007

In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	-	6,413	3,875	-
Trade and other payables (except for deferred revenue)	10,655	1,856	-	-
Other financial liabilities	3	8	-	-
Derivatives fair value	22	2	-	-
Total	10,680	8,279	3,875	-

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements.

In CZK million	Carrying amount		Fair value	
	2008	2007	2008	2007
Financial assets				
Cash and cash equivalents	7,116	9,576	7,116	9,576
Financial investments (held to maturity)	-	27	-	27
Derivatives	23	4	23	4
Other financial assets	378	566	378	566
Financial liabilities				
Interest bearing loans and borrowings				
Floating rate inter-company borrowings	3,249	794	3,249	794
Fixed rate borrowings	3,184	3,148	3,503	3,348
Issued Bonds	5	6,097	5	6,049
Derivatives	7	24	7	24

Market values have been used to determine the fair value of the above mentioned issued CZK bonds. The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange rates and interest rates.

In CZK million	Effect on profit before tax	
	2008	2007
FX risk		
Value at Risk*	(395)	(95)
Stress testing*	(76)	(46)
IR risk		
Stress testing*	(114)	(176)

* The Value at Risk (VaR) Model enables the Group estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Group uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95 % reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Group in individual foreign currencies, the Group models VaR from a position of translation and transaction in EUR and USD.

FX risk used stress scenario represents immediate one-off change in the foreign exchange rates vs. CZK by 1 % in a negative direction (in the case of short open foreign currency position, this will result in a depreciation of the foreign exchange rate and vice versa).

IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1 % in an unfavourable direction. The calculation of unfavorable impact on Group cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on the floating basis within a time frame of 12 months.

Hedging

The following nominal value of foreign exchange forwards was used by the Group to hedge the currency risk:

	Nominal value		Fair value	
	In EUR million		In CZK million	
	2008	2007	2008	2007
Forward exchange contracts	19	36	16	(20)

17 Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Short-term deferred taxes were calculated at 20 % (21 % in 2007) and long-term deferred taxes were calculated at 19 % (20 % and 19 % in 2007 depending on the period of its expected realisation).

In CZK million	2008	2007
At 1 January	3,353	4,469
Income statement tax credit (Note 5)	(57)	(1,116)
Tax impact on changes in equity	4	-
At 31 December	3,300	3,353

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts, determined after offsetting, are shown in the consolidated balance sheet:

In CZK million	31 December 2008	31 December 2007
Deferred tax assets	(656)	(1,143)
Deferred tax liabilities	3,956	4,496
Total	3,300	3,353

The deferred tax asset includes CZK 423 million (2007: CZK 655 million) recoverable in less than twelve months and CZK 233 million (2007: CZK 488 million) recoverable after more than twelve months. The deferred tax liability includes CZK 494 million (2007: CZK 584 million) payable in less than twelve months and CZK 3,462 million (2007: CZK 3,912 million) payable in more than twelve months.

The deferred tax is determined by these components:

In CZK million	Consolidated balance sheet		Consolidated income statement	
	2008	2007	2008	2007
Temporary differences relating to:				
- property, plant and equipment and intangible assets	3,926	4,496	(570)	(575)
- trade receivables, inventories and other differences	(626)	(1,139)	513	231
Revaluations of cash flow hedges	-	(4)	-	-
Amount relating to unrecognised tax loss	-	-	-	26
Amount relating to changes in tax rates	-	-	-	(798)
Total	3,300	3,353	(57)	(1,116)

Deferred income tax related to items charged or credited directly to equity are as follows:

In CZK million	31 December 2008	31 December 2007
Revaluation of cash flow hedges	4	-
Total	4	-

Reduction of the corporate income tax rate resulted in a positive impact on deferred tax liability of CZK 798 million in 2007.

18 Government social security and pension schemes

The Group is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2008 and 2007, the Group paid contributions at a rate of 35 % of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,622 million in 2008 (2007: CZK 1,678 million) (Note 3). Employees contribute 12.5 % (2007: 12.5 %) of their gross salaries.

The Group has a voluntary pension plan for employees under which the Group makes contributions on behalf of the Group's employees to approved pension plan providers, under defined contribution schemes. The Group's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Group made contributions of CZK 59 million (2007: CZK 58 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2008 relating to employee retirement amounted to CZK 0.1 million (2007: CZK 0.2 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

19 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Benefit loyalty provision	Sale of real estate portfolio provision	Other	Total
At 1 January 2008	2,110	3	303	627	0	8	3,051
Additions during the year	66	73	151	43	495	31	859
Utilised during the year	(1,781)	(63)	(287)	(418)	(235)	(13)	(2,797)
Transfers	-	-	(25)	-	-	-	(25)
At 31 December 2008	395	13	142	252	260	26	1,088
Short-term Provisions 2008	-	13	134	252	260	26	685
Long-term Provisions 2008	395	-	8	-	-	-	403
	395	13	142	252	260	26	1,088
Short-term Provisions 2007	-	3	263	627	-	8	901
Long-term Provisions 2007	2,110	-	40	-	-	-	2,150
	2,110	3	303	627	-	8	3,051

With the exception of the regulatory and court decisions and other small items for which the expected timing of payments is not certain all other provisions are expected to be utilised within next twelve months from the balance sheet date.

Benefit loyalty provision

Benefit loyalty provision covers the cost of equipment, accessories, gifts and services provided to participants in the mobile segment's loyalty program in exchange for credits awarded primarily for airtime minutes spent. The provision has been recognized based on past experience of the usage of these credits by loyalty program participants. Expected outflow of provided benefits is CZK 252 million within one year (2007: CZK 347 million within one year and CZK 280 million from one year to three years).

The future obligation of the expenditures expected to be required amounting to CZK 252 million (2007: CZK 657 million) is fully covered by the amount of the provision in its present value.

Employee-related costs

Provisions for employee-related costs include expected costs associated with performance bonuses and provision for termination payments.

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Group companies (see Note 21).

20 Financial instruments

Net fair values of derivative financial instruments

At the balance sheet date, the total net fair values of derivative financial instruments were as follows:

Forward foreign exchange contracts In CZK million	31 December 2008	31 December 2007
Cash flow hedges		
- with positive fair value	-	4
- with negative fair value	-	(24)
Instruments not qualifying as hedges		
- with positive fair value	23	-
- with negative fair value	(7)	-
Total (Note 16)	16	(20)

21 Contingencies

The Company is involved in several court proceedings which have arisen from the ordinary course of business. Significant legal matters involving the Company are listed below:

Interconnect arrangements

I. The Company has not yet agreed a 2001 price amendment to an agreement with T-Mobile Czech Republic a.s. governing interconnect arrangements. Despite the fact that in December 2003 the Czech Telecommunication Office (CTO) effectively ruled in favor of the mobile operator (i.e. CZK 899 million for T-Mobile Czech Republic a.s., the outstanding amount is bearing interest of 0.05 % per day), the management believes that the amounts are not substantiated and are without merit. The Company has subsequently brought a legal action against the decision and obtained the suspension of the executability of the decision.

Meanwhile the question of jurisdiction between the civil courts and the administrative courts has arisen. As a result of the question of jurisdiction the suspension of the executability of the CTO decision temporarily expired. T-Mobile Czech Republic a.s., initiated the execution and claimed the remuneration of the litigable amount. The Company did not agree with the execution and used all its legal instruments to the termination of the execution. After 11 months of the execution it was evident that the burden of execution will continue for another several months, therefore the management decided to pay the executed amount in April 2008 and decided to continue in the legal action, in which the executed amount is claimed. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

II. On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) brought a legal action at the Municipal Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The Company is alleged to have failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements.

The High Court in Prague confirmed the Company's conclusion that CTO has already issued the final decision in favour of the Company and that the company Vodafone Czech Republic, a.s. has not respected this decision. The Municipal Court in Prague therefore terminated the legal action in September 2008. Based on the current situation the Company believes that the High Court in Prague will confirm the decision and will terminate the appeal proceedings. The management is confident that all risks, which may arise as a result of the litigation, are adequately provided for in the financial statements.

Office for the Protection of Economic Competition proceedings

The Company was subject to administrative proceeding before the Office for the Protection of Economic Competition (UOHS) relating to the alleged abuse of the dominant position by creation of unfair barriers against development on the market through the application of certain specific price plans for residential customers. UOHS rendered resolution dated 20 April 2005 imposing a fine to the Company in the total amount of CZK 210 million, which was consequently, after the Company completed and filed a protest, reduced to CZK 205 million.

The Company lodged a legal action in January 2006 and while the suspension of the executability was not granted the fine was paid. The Regional court in Brno refused the legal action and therefore the Company lodged a complaint to the Supreme Administrative Court on 19 October 2006.

Other legal matters

I. The Company is a defendant in a case filed by TELE 2 s.r.o. on 3 February 2005 asserting causes for alleged breach of act on protection of the competition by the Company in connection by offering certain pricing plans from September 2002 to December 2004. The amount of the claim is CZK 2,142 million with appurtenances.

The Company provided to the court extensive defense along with proposed items of evidence proving the legal imperfectness of the sued court's conduct. The management is convinced that the matter is adequately reflected in the financial statements and does not believe the resolution of this legal proceeding will have a material adverse effect on net income exceeding the amount of provision already made in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

II. The Company is prosecuted by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances relating to the years 1995 – 2001. AUGUSTUS spol. s r.o. claims that the Company illegitimately cancelled a contract for issue of phone cards, which was signed for unlimited period of time. Based on court decision, the Company paid an amount of the principal of CZK 83 million and the corresponding interest in August 2006 (total approximately CZK 139 million). Both parties subsequently filed an extraordinary appeal against the court judgment. The management believes that all risks, which may arise as a result of this litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

III. Subsequently AUGUSTUS spol. s r.o. filed another action against the Company regarding the amount of approximately CZK 294 million (status in April 2008). The legal action is based on the contract on phone cards issuing signed between Telefónica O2 Czech Republic, a.s. and AUGUSTUS spol. s r.o. that was terminated 13 years ago. AUGUSTUS spol. s r.o. evokes various new requirements in the prosecution that are not underpinned by the law or contradict each other eventually. The prosecution does not enable to sum the individual claims to be able to specify the total amount. Telefónica O2 Czech Republic, a.s. takes all steps in the lawsuit to defend thoroughly this unlawful claim and believes in success in this lawsuit. However, with respect to the claimed amount the lawsuit is disclosed separately.

IV. Furthermore, the Company is a defendant in a case filed by Vodafone Czech Republic, a.s. in May 2004 asserting causes for alleged breach of the act on protection of the competition by former Eurotel Praha, spol. s r.o. (damages amounting to CZK 1,043 million). Both parties filed their expert opinions to the court. The management believes that all risks, which may arise as a result of Vodafone Czech Republic, a.s. litigations, are adequately provided for in the financial statements. Decision of the Office for the Protection of Economic Competition (UOHS) on which Vodafone Czech Republic, a.s. based its claim was on 11 July 2007 cancelled by the Constitutional court. The Municipal court in Prague dismissed the claim on 21 August 2008. Vodafone Czech Republic, a.s. appealed against that decision on the High court in Prague. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is a defendant in several other legal cases. The total amount of those individual cases exceeding CZK 5 million amounts to CZK 233 million. The management believes that the risk of losing these cases is less than probable and no provision was made in the financial statements.

22 Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2008	31 December 2007
No later than 1 year	1,451	1,287
Later than 1 year and not later than 5 years	4,524	4,112
Later than 5 years	<u>6,067</u>	<u>3,208</u>
Total	12,042	8,607

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2008 were CZK 1,320 million (2007: CZK 1,201 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Group's consolidated results of operations, financial position, or cash flow and therefore are not accounted for.

In 2004 the Group entered into a sale and lease back transaction and now leases the majority of its car fleet under operating leases. There are no contingent rent obligations. The lease arrangements include an option to renew the lease after the initial period. Lease payments are fixed and determinable, however they may be increased to reflect inflation and other market conditions such as interest rates changes (e.g. an increase in PRIBOR by more than 2 % over a half year). There are no significant restrictions imposed by these lease arrangements, such as those concerning dividends, additional debt and further leasing. Total future lease payments relating to this contract in 2008 were CZK 395 million (2007: CZK 458 million).

Capital and other commitments

In CZK million	31 December 2008	31 December 2007
Capital and other expenditure contracted but not provided for in the financial statements	646	1,877

The majority of contracted amounts relate to the telecommunications network and service contracts.

23 Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2 and 516/3.

The communication activities include (territory of the Czech Republic):

- a) public fixed network of electronic communications,
- b) public network for the transfer of radio and TV signal,
- c) public fixed telephone network,
- d) public mobile telephone network,
- e) publicly accessible telephone services,
- f) other voice services - service is provided as publicly available,
- g) rent of circuits - service is provided as publicly available,
- h) transmission of radio and TV signal - service is provided as publicly available,
- i) transfers of data - service is provided as publicly available,
- j) internet access services - service is provided as publicly available,
- k) other voice services - service is not provided as publicly available.

The Company provides mobile services of electronic communications in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (“GSM”) standard on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2100 MHz frequency band under the Universal Mobile Telecommunications System (“UMTS”) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access - “CDMA”), where on the basis of radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these radio frequency assignments in the future.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Provision of electronic communications services in Slovakia

In 2006 Telefónica O2 Slovakia was granted a licence for providing of electronic communications services by the means of the public electronic communications network – GSM and UMTS mobile telephone network within the area of the Slovak Republic. The licence has been granted for 20 years, i.e. until 2026. Validity of the licence is possible to prolong for next period on the basis of application submitted to the Telecommunication Office of the Slovak Republic.

The following obligations were part of the licence:

- a) putting into operation the 800 GSM base stations and to cover 45 % of population by the own network,
- b) launch services in respect of welcome melodies and lease of phones.

These obligations were fulfilled in year 2008.

Imposition of obligations related to provision of universal service

During the year 2008, the Company provided the partial services within CTO imposed obligations to provide universal service:

- a) periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories*,
- b) information service on the numbers of participants of the publicly accessible telephone service*,
- c) public pay telephones services,
- d) access for disabled to the public telephone,
- e) supplementary services to service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location:
 - phased payment of the price for the establishment of connection to the public telephone network for consumer,
 - free selective barring of outgoing calls for the subscribers, and
 - free itemised billing of the price for consumer,
- f) special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

*) Services listed under letter a) and b) above are excluded from the universal service regime on the basis of CTO decision since 22th of December 2008. Providing of these services continues in commercial regime out of universal service.

24 Share capital and reserves

	31 December 2008	31 December 2007
Nominal value per ordinary bearer share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (in CZK million)	32,209	32,209

* One share owned by the National Property Fund of the Czech Republic bore special decision-making rights in accordance with the statutes of the Company. These special rights included namely decisions regarding the liquidation of the Company, changes in its activities, sale or lease of the Company or of its assets. This share was assigned to Telefónica, S.A. within the transferred 51.1 % stake in the Company. From this date, the share has not borne special decision-making rights.

Shareholdings in the Company were as follows:

	31 December 2008	31 December 2007
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2007: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve is not distributable.

On 21 April 2008 the Annual General Shareholders Meeting approved the restructuring of equity in the form of transfer of CZK 6,442 million from share premium to statutory reserve fund. Further the opening balance of the statutory reserve fund of CZK 6,442 million was transferred to retained earnings and used for distribution of dividend.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

- a) to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and
- b) to comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Company is to focus investment activities on pro-growth areas, i.e. broadband internet, IPTV, mobile services and corporate ICT solutions and on the expansion of the mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash. In the following periods, the Board of Directors will continue to evaluate and carry out an in-depth analysis of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

No changes were made in the objectives, policies or processes during the years 2008 and 2007.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2008	31 December 2007
Capital	78,121	82,812
Equity settled share based payment reserve	47	-
Net unrealized gains reserve (cash flow hedge)	-	(20)
Total	78,168	82,792

25 Hedging reserve

In CZK million	
Balance at 1 January 2007	(18)
Fair value losses in period	(17)
Fair value losses transfer to net profit	15
Balance at 31 December 2007	(20)
Fair value losses in period	24
Fair value losses transfer to net profit	(4)
Balance at 31 December 2008	-

26 Related party transactions

The Group provides services to all related parties on normal commercial terms. Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest free (excl. financial assets used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and no allowance or write off was incurred.

The following transactions were carried out with related parties:

I. Parent company:

In CZK million	31 December 2008	31 December 2007
Dividend paid to Telefónica, S.A.	11,179	11,179
Royalty fees (Telefónica, S.A)	626	9

II. Other related parties – Telefónica Group:

In CZK million	31 December 2008	31 December 2007
a) Sales of services and goods	704	651
b) Purchases of services and goods	597	443
c) Capital purchases	5	1
d) Receivables	111	45
e) Payables	4,011	838
f) Short-term receivables (interest)	14	17
g) Interest income	374	315
h) Interest expense	92	7
i) Cash equivalents	6,344	5,107

As at 31 December 2008 the payables include a loan in amount of CZK 3,194 million (2007: CZK 798 million) provided to Telefónica O2 Slovakia, s.r.o. by the company Telfisa Global, BV. The loan bears a floating interest based on 1M BRIBOR. In 2008 the total interest expense was CZK 91 million (2007: CZK 7 million). The loans conditions are based on the arm's length principle.

The list of the Telefónica companies with which the Group had any transaction in 2008 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., O2 Germany GmbH & CO.OHG, Telefónica Deutschland GmbH, O2 (UK) Ltd., O2 Communications (Ireland) Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Manx Telecom Ltd., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A, Telefónica Móviles Columbia, S.A., Telefónica S. de Informática y Comunicaciones de España, S.A.U., Telefónica Investigación y Desarrollo, S.A., Médi Telecom, S.A., Portugal Telecom, S.G.P.S., S.A., Telfisa Global, BV., Telefónica International Wholesale Services, S.L., Telefónica Gestión de Servicios Compartidos, S.A., Telefónica Factoring E.F.C., S.A., Atento Chequia, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A, Telefónica Móviles del Uruguay, S.A, Telefónica Móviles Peru, S.A, Telefónica Venezuela, S.A., Telefónica O2 Business Solutions, spol. s r.o, DELTAX Systems a.s., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica O2 Slovakia, s.r.o.

III. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Telefónica O2 Czech Republic, a.s., were provided with benefits as follows:

In CZK million	31 December 2008	31 December 2007
Salaries and other short-term benefits	123	153
Personal indemnification insurance	7	9
Total	130	162

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2008 and 2007.

No other loan was provided to related parties by the Group.

27 Principal subsidiary undertakings

Subsidiaries	Group's interest	Cost of investment In CZK million	Country of incorporation	Activity
1. Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o.)	100 %	30	Czech Republic	Network and consultancy services in telecommunications
2. SPT TELECOM (Czech Republic) Finance B.V. (in liquidation)	100 %	1	Netherlands	Financing other entities in the Group
3. CZECH TELECOM Germany GmbH	100 %	29	Germany	Data transmission services
4. CZECH TELECOM Austria GmbH	100 %	11	Austria	Data transmission services
5. Telefónica O2 Slovakia, s.r.o.	100 %	1,219	Slovakia	Mobile telephony, internet and data transmission services
6. DELTAX Systems a.s.	100 %	207	Czech Republic	IT/ICT services
Associates				
7. První certifikační autorita, a.s.	23 %	10	Czech Republic	Rendering of certification services
8. AUGUSTUS, spol. s r.o.	40 %	-	Czech Republic	Sales by auctions and advisory services

On 30 November 2007 the voluntary liquidation process of the subsidiary CenTrade, a.s., in liquidation was effectively terminated. The Group received the liquidation surplus of CZK 32 million. The cancellation of the registration from the Commercial Register was performed as of 22 August 2008.

During the fourth quarter of 2007, SPT TELECOM (Czech Republic) Finance B.V. in liquidation commenced preparatory steps for the process of voluntary liquidation. Until the end of 2008, the key legal steps for dissolution of the company have been executed. The cancellation of the registration from the Commercial Register was performed as of 9 February 2008.

In December 2008, the Board of Directors of the Company approved the plan to merge Telefónica O2 Business Solutions, spol. s r.o. with DELTAX Systems a.s. This merger will become effective 1 January 2009 after the fulfillment of all legal conditions expected to be performed in the first half of 2009. Telefónica O2 Business Solutions, spol. s r.o. will become the legal successor while DELTAX Systems a.s. will be dissolved without liquidation. The assets, rights and obligations including labour rights and duties will be transferred to the successor.

28 Post balance sheet events

In January 2009, the Group sold a construction site and two administrative buildings of the former headquarters in Olšanská Street in Prague (see Note 8). Net gain from the sale of the real estates amounted to CZK 342 million. The assets did not meet criteria for classification as assets held for sale as at 31 December 2008.

In January 2009, the Telefónica Group won a tender for providing a complete portfolio of services for DHL throughout Europe. The entire project will be managed by the dedicated Service Management Centre in Prague and is expected to start in summer 2009.

There were no other events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2008.