Telefónica O2 Czech Republic, a.s.

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008

PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS

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GENERAL INFORMATION

Telefónica O2 Czech Republic, a.s. (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 Company 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 Company amounted in average to 8,542 in 2008 (2007: 9,004).

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

These 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.

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.

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 financial statements of Telefónica O2 Czech Republic, a.s. ("the Company"), which comprise the balance sheet as at 31 December 2008 and the income statement, statement of changes in equity and 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.

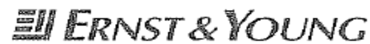
Auditor's responsibility

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 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. 88504, under Identification No. 26704153.



Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company 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 Audit s.r.o.
Licence No. 401
Represented by

Brian Welsh
Partner

Radek Pav
Auditor, Licence No. 2042

20 February 2009
Prague, Czech Republic

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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	63,613	63,035
Gains from sale of non-current assets	8	855	43
Internal expenses capitalized in fixed assets	2	341	470
Operating expenses	3	(35,232)	(34,158)
Impairment loss	8, 9,10	(85)	(5)
Depreciation and amortisation	8, 9	(12,714)	(14,375)
Operating profit		16,778	15,010
Interest income	4	446	402
Interest expense	4	(313)	(438)
Other finance (expense)/income (net)	4	(121)	3
Profit before income tax		16,790	14,977
Taxes on income	5	(3,697)	(3,083)
Profit for the year		**13,093**	**11,894**
Earnings per share (CZK) – basic*	6	41	37

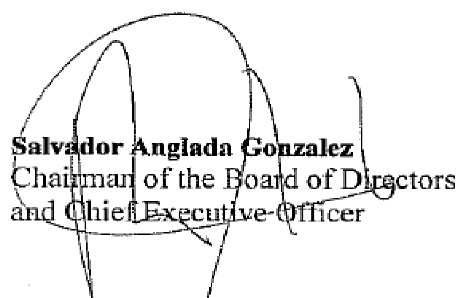
*There is no dilution of earnings as no convertible instruments have been issued by the Company.

BALANCE SHEET

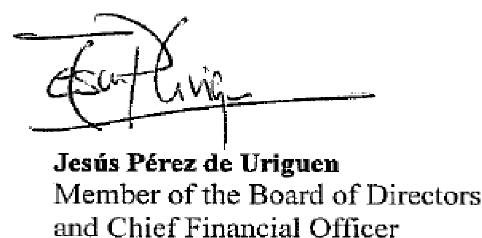
As at 31 December 2008

In CZK million	**Notes**	**31 December 2008**	**31 December 2007**
ASSETS			
Property, plant and equipment	8	61,198	70,799
Intangible assets	9	21,702	21,467
Investment in subsidiaries and associates	27	1,507	1,300
Other financial assets	12	377	565
Non-current assets		**84,784**	**94,131**
Inventories	11	743	743
Receivables and prepayments	12	9,248	8,387
Income tax receivable		225	-
Held-to-maturity investments	13	-	27
Cash and cash equivalents	14	6,972	9,521
Current assets		**17,188**	**18,678**
Non-current assets classified as held for sale	8	**96**	**328**
Total assets		**102,068**	**113,137**
EQUITY AND LIABILITIES			
Ordinary shares	24	32,209	32,209
Share premium		24,374	30,816
Retained earnings, funds and reserves		24,896	21,400
Total equity		**81,479**	**84,425**
Long-term financial debts	16	3,098	3,062
Deferred taxes	17	3,299	3,353
Non-current provisions for liabilities and charges	19	402	2,146
Non-current other liabilities	15	175	452
Non-current liabilities		**6,974**	**9,013**
Short-term financial debts	16	98	6,207
Trade and other payables	15	12,838	11,732
Income tax liability		-	859
Provisions for liabilities and charges	19	679	901
Current liabilities		**13,615**	**19,699**
Total liabilities		**20,589**	**28,712**
Total equity and liabilities		**102,068**	**113,137**

These 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

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)**	**(5)**	**-**	**6,269**	**19,344**	**88,615**
Fair value gains (net of tax) - cash flow hedges		-	-	(2)	-	-	-	-	(2)
Currency translation differences – amount arising in year		-	-	-	5	-	-	-	5
Changes in statutory reserves and other movements		-	-	-	-	-	181	(164)	17
Net income and expense recognised directly in equity		-	-	(2)	5	-	181	(164)	20
Net profit		-	-	-	-	-	-	11,894	11,894
Total income and expense for the year		**-**	**-**	**(2)**	**5**	**-**	**181**	**11,730**	**11,914**
Dividends declared in 2007	7	-	-	-	-	-	-	(16,104)	(16,104)
At 31 December 2007		**32,209**	**30,816**	**(20)**	**-**	-	**6,450**	**14,970**	**84,425**
At 1 January 2008		**32,209**	**30,816**	**(20)**	**-**	**-**	**6,450**	**14,970**	**84,425**
Fair value gains (net of tax) - cash flow hedges		-	-	20	-	-	-	-	20
Net income and expense recognised directly in equity		-	-	20	-	-	-	-	20
Net profit		-	-	-	-	-	-	13,093	13,093
Total income and expense for the year		**-**	**-**	**20**	**-**	**-**	**-**	**13,093**	**13,113**
Equity restructuring	24	-	(6,442)	-	-	-	6,442	-	-
Transfer from reserve fund to retained earnings	24	-	-	-	-	-	(6,442)	6,442	-
Capital contribution		-	-	-	-	45	-	-	45
Dividends declared in 2008	7	-	-	-	-	-	-	(16,104)	(16,104)
At 31 December 2008		**32,209**	**24,374**	**-**	**-**	**45**	**6,450**	**18,401**	**81,479**

* Refer Note 24 regarding amounts not available for distribution.

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)**	**(5)**	**4**	**(23)**
Gains/(losses) arisen in the fiscal year	(17)	5	-	(12)
Gains/(losses) re-classified to the profit and loss account	15	-	-	15
At 31 December 2007	**(24)**	**-**	**4**	**(20)**
Gains/(losses) arisen in the fiscal year	(52)	-	(4)	(56)
Gains/(losses) re-classified to the profit and loss account	76	-	-	76
At 31 December 2008	**-**	**-**	**-**	**-**

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		13,093	11,894
Non-cash adjustments for:			
Income tax	5	3,697	3,083
Depreciation	8	10,838	12,522
Amortisation	9	1,876	1,853
Impairment loss	8, 9, 10	85	5
Disposals of obsolete assets		109	37
Profit on sale of property, plant and equipment		(840)	(52)
Net interest and other charges		(133)	36
Foreign exchange losses/(gains) (net)		39	(147)
Fair value changes		(15)	-
Change in provisions and allowances		(781)	(1,258)
Operating cash flow before working capital changes		27,968	27,973
Working capital adjustments:			
(Increase)/decrease in trade and other receivables		(836)	100
(Increase)/decrease in inventories		(279)	14
(Decrease)/increase in trade and other payables		(885)	55
Cash flows from operating activities		25,968	28,142
Interest paid		(392)	(428)
Interest received		367	375
Income tax paid		(4,833)	(4,074)
Net cash from operating activities		**21,110**	**24,015**
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,070)	(3,688)
Purchase of intangible assets		(2,100)	(1,505)
Proceeds from sales of property, plant and equipment		4,585	71
Proceeds from marketable securities		24	53
Proceeds from discontinued operations		-	32
Cash purchase of financial investments		(30)	(836)
Dividends received		7	7
Grant of loan		(40)	(1,426)
Repayment of loan		40	1,583
Net cash used in investing activities		**(1,584)**	**(5,709)**
Cash flows from financing activities			
Proceeds from borrowings		650	-
Repayment of borrowings		(6,645)	-
Dividends – paid		(16,080)	(16,083)
Net cash used in financing activities		**(22,075)**	**(16,083)**
Net (decrease)/increase in cash and cash equivalents		**(2,549)**	**2,223**
Cash and cash equivalents at beginning of year		9,521	7,298
Cash and cash equivalents at the year end	14	**6,972**	**9,521**

ACCOUNTING POLICIES

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A Basis of preparation

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

The 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 Company to prepare its 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 Company between IFRS and IFRS adopted by the EU.

The financial statements are the separate financial statements of the Company and meet requirements of IFRS with respect to the preparation of parent's separate financial statements. The Company also issued consolidated financial statements prepared for the same period in accordance with IFRS, which were approved for issue by the Board of Directors on 20 February 2009.

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

The amounts shown in these 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 Company)

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

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 Company's financial statements.

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

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 Company 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 financial statements.

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

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

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 sales 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 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 Company will apply IFRS 2 (Amendment) from 1 January 2009. This amendment will not have a material impact on the Company's financial statements.

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

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 Company 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 Company 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 Company 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 Company 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 Company will apply the IAS 36 (Amendment) and provide the required disclosure where applicable for impairment tests from 1 January 2009.

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

B Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates ("the functional currency"). The financial statements are presented in Czech Crowns ("CZK"), which is the Company's functional and 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.

C 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 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 then its estimated recoverable amount (refer to Note F Impairment of assets).

D 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 Company's information systems that are intended for use within the Company. 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 Company 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 Company.

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 Company 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.

E Non-current assets classified as held for sale

The Company 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 Company 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 Company 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.

F 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.

G Investments and other financial assets

The Company 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 Company 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 Company 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 Company 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 Company 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 Company 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 Company 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 Company 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.

H 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 Company 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 Company'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.

I 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.

J 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 Company 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.

K 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.

L 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 Company 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.

M 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 Company 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.

N 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 Company 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 Company 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 Company 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 Company 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 Company recognises a provision where the Company is contractually obliged or where there is a past practice that has created a constructive obligation.

O Share-based compensation

During 2006, the Company 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 Company 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 binominal methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Company 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.

P Provisions

Provisions are recognised when the Company 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 Company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Q Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Company, 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 Company. If necessary, revenue is split into separately identifiable components.

The Company 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 Company 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 Company considers these indicators of gross revenue reporting:

a) the Company is the primary obligor in the arrangement,
b) the Company has general inventory risk,
c) the Company has price latitude,
d) the Company changes the product or performs part of the service,
e) the Company has discretion in supplier selection,
f) the Company is involved in the determination of product or service specifications,
g) the Company has credit risk,
h) the Company has the ability to set the terms of the transaction,
i) the Company 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 Company is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. The Company follows the accounting policy of Telefónica Group and recognises the compensation of revenues attributable to the Company 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 in 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 Company 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 Company earns mobile services revenue from customers usage of the Company's network, interconnection and roaming – collectively, "Mobile service revenue". The Company 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 Company's network. These revenues are recognised in the income statement at the time when the call is received in the Company's network. The Company 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 Company'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 Company 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).

R Dividend distribution

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

S 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 Company'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 Company's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Company. The Company uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) to hedge certain exposures.

The Company 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 Company 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 Company'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 Company 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 Company 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 Company 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 Company'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 Company may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable rate debts.

(iii) Liquidity rate risk

The Company'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 Company 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 Company 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 Company trades only with recognized, creditworthy third parties. It is the Company'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 Company'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 Company.

With respect to credit risk arising from the financial assets of the Company, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Company'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 Company 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 Company 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 Company's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Company 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 Company 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 Company 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 Company'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 Company's bankers.

T Critical accounting estimates and judgments

The Company 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 Company 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 Company 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 3,737 million, advances paid for income taxes amount to CZK 3,962 million and the net deferred tax liability is CZK 3,299 million.

In October 2007, the new Czech legislation was enacted, by which the corporate income tax rate will be 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 Company 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 13,320 million (See Note 9).

(3) Provisions and contingent liabilities

As set out in Note 21 the Company is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Company'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 Company 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 Company. 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 Company 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 Company 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 Company 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 Company 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 – Company as lessee

The Company changed its headquarters and moved to the new premises, where the Company has entered into the commercial property leases. The Company 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 Company accounts for the contract as an operating lease.

U Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Company, which means that the Company has the power to govern the financial and operating policies so as to obtain benefits from its activities.

An associated undertaking is an enterprise where the Company has significant influence, which is the power to participate in the financial and operating policy decisions, but not exercise control.

Equity investments in subsidiaries and associates are recorded at cost less an allowance for diminution in value.

No consolidation of subsidiaries or associates has been performed as these financial statements are presented on a stand-alone basis. In accordance with the requirements of the Act on Accounting, the Company prepares consolidated financial statements in accordance with IFRS.

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 FINANCIAL STATEMENTS

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1 Segment information

Business segments recognised by the Company are as follows:

- Fixed - network communications services using a fixed network and IS/ICT services,
- Mobile - mobile communications services.

Year ended 31 December 2008	**Fixed**	**Mobile**	**Company**
In CZK million			
Revenues	30,220	34,587	64,807
Inter-segment sales	(423)	(771)	(1,194)
Total revenues	29,797	33,816	63,613
Gains from sale of non-current assets	855	-	855
Internal expenses capitalised in fixed assets	261	80	341
Costs	(18,432)	(17,994)	(36,426)
Inter-segment purchases	771	423	1,194
Total costs	(17,661)	(17,571)	(35,232)
Impairment charge	(83)	(2)	(85)
Depreciation	(7,255)	(3,583)	(10,838)
Amortisation	(650)	(1,226)	(1,876)
Total depreciation and amortization	(7,905)	(4,809)	(12,714)
Operating profit	5,264	11,514	16,778
Interest and other financial income (net)			12
Profit before tax			16,790
Tax			(3,697)
Net profit			**13,093**
Assets (excluding goodwill and non-current assets held for sale)	37,880	50,772	88,652
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	-	13,320	13,320
Non-current assets held for sale	96	-	96
Total assets	**37,976**	**64,092**	**102,068**
Trade and other payables	6,163	6,675	12,838
Other liabilities	3,720	4,031	7,751
Total liabilities	**9,883**	**10,706**	**20,589**
Capital expenditure	**4,271**	**2,474**	**6,745**

Year ended 31 December 2007 **In CZK million**	**Fixed**	**Mobile**	**Company**
Revenues	30,490	33,783	64,273
Inter-segment sales	(455)	(783)	(1,238)
Total revenues	30,035	33,000	63,035
Gains from sale of non-current assets	43	-	43
Internal expenses capitalised in fixed assets	448	22	470
Costs	(16,990)	(18,406)	(35,396)
Inter-segment purchases	783	455	1,238
Total costs	(16,207)	(17,951)	(34,158)
Impairment charge	(5)	-	(5)
Depreciation	(8,515)	(4,007)	(12,522)
Amortisation	(683)	(1,170)	(1,853)
Total depreciation and amortization	(9,198)	(5,177)	(14,375)
Operating profit	5,116	9,894	15,010
Interest and other financial costs (net)			(33)
Profit before tax			14,977
Tax			(3,083)
Net profit			**11,894**
Assets (excluding goodwill and non-current assets held for sale)	47,689	51,800	99,489
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	-	13,320	13,320
Non-current assets held for sale	328	-	328
Total assets	**48,017**	**65,120**	**113,137**
Trade and other payables	5,631	6,101	11,732
Other liabilities	8,150	8,830	16,980
Total liabilities	**13,781**	**14,931**	**28,712**
Capital expenditure	**4,255**	**2,331**	**6,586**

Revenue of the Company 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 Company 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.

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	22,714	22,839
Interconnection	10,128	10,625
Subscription charges	8,444	8,849
Connection charges	326	783
SMS & MMS & Value added services	4,958	4,934
Leased lines and data services	3,866	3,961
Internet	6,459	5,824
IT and business solutions	2,107	1,934
Equipment and activation fee	1,928	2,070
Other telecommunication revenues	2,182	436
Other revenues	501	780
Total revenues	63,613	63,035

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	30	138
Labour	311	332
Total	341	470

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*	4,703	4,621
Redundancy payments	160	208
Social security contributions (Note 18)	1,504	1,612
Staff welfare costs	148	323
Total staff costs	6,515	6,764
Interconnection and roaming	11,408	10,649
Cost of goods sold	2,972	3,225
Contents	235	160
Customer loyalty program	363	446
Sub-deliveries	1,335	1,401
Commissions	1,167	1,179
Other cost of sales	1,109	258
Purchases	506	672
Billing and collection	399	386
Marketing	1,496	1,818
Call centres	305	231
Network & IT repairs and maintenance	2,345	2,608
Rentals, buildings and vehicles	1,973	1,802
Utilities supplies	909	790
Consultancy and professional fees	211	337
Other external services	1,163	854
Provision for bad and doubtful debts and inventories	352	171
Taxes (other than income tax)	384	362
Other operating expenses	85	45
Total operating expenses	35,232	34,158

*Certain Company 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 Company. The Company paid CZK 11 million in relation to such non-competition clauses in 2008 (2007: CZK 7 million).

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	446	402
Gain for derivatives of fair value hedges (net)	65	-
Other financial income	1,306	753
Total financial income	1,817	1,155
Financial expenses		
Interest expenses	(313)	(438)
Loss for derivatives of fair value hedges (net)	-	(26)
Other financial expenses	(1,492)	(724)
Total financial expenses	(1,805)	(1,188)
Net financial income/(cost) (net)	12	(33)

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	3,755	4,224
Deferred income tax credit (Note 17)	(58)	(1,141)
Taxes on income	3,697	3,083

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

In CZK million	Year ended 31 December 2008	Year ended 31 December 2007
Profit before tax	16,790	14,977
Income tax charge calculated at the statutory rate of 21 % (2007: 24 %)	3,526	3,594
Income not subjected to tax	-	(9)
Expenses not deductible for tax purposes	149	242
Impact of change in income tax rate	-	(798)
Tax related to prior periods	22	54
Taxes on income	3,697	3,083
Effective tax rate	22 %	21 %

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)	13,093	11,894
Basic earnings per share (CZK)	41	37

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

7 Dividends

In CZK million	2008	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	14,013	39,710	12,711	1,931	2,434	70,799
Additions	508	769	2,339	1,015	4,500	9,131
Disposals and other movements	-	-	(104)	(15)	(4,375)	(4,494)
Assets classified as held for sale	(3,285)	(25)	(6)	-	-	(3,316)
Depreciation charge	(667)	(4,206)	(4,823)	(1,142)	-	(10,838)
Impairment charge	(49)	(21)	(1)	-	(13)	(84)
Closing net book amount	10,520	36,227	10,116	1,789	2,546	61,198
At 31 December 2008						
Cost	17,459	99,982	90,504	10,315	2,573	220,833
Accumulated depreciation and impairment allowance	(6,939)	(63,755)	(80,388)	(8,526)	(27)	(159,635)
Net book amount	10,520	36,227	10,116	1,789	2,546	61,198

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 2007						
Opening net book amount	14,219	43,395	17,283	1,803	1,986	78,686
Additions	622	576	2,124	1,112	4,738	9,172
Disposals and other movements	(37)	(1)	(58)	(8)	(4,291)	(4,395)
Assets classified as held for sale	(132)	(10)	-	-	-	(142)
Depreciation charge	(654)	(4,250)	(6,638)	(976)	(4)	(12,522)
Impairment charge	(5)	-	-	-	5	-
Closing net book amount	14,013	39,710	12,711	1,931	2,434	70,799
At 31 December 2007						
Cost	22,769	99,696	92,541	10,470	2,464	227,940
Accumulated depreciation and impairment allowance	(8,756)	(59,986)	(79,830)	(8,539)	(30)	(157,141)
Net book amount	14,013	39,710	12,711	1,931	2,434	70,799

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 Company 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 Company's optimisation process and which the Company 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 Company achieved a total gain from the sale of the above fixed assets amounting to CZK 855 million (2007: CZK 43 million) and total losses in amount CZK 58 million (2007: CZK 34 million).

In 2008 and at the beginning of 2009, the Company completed the substantial part of a real estate usage optimisation process. In 2008, as part of this process, the Company 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 Company 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 59,556 million as at 31 December 2008 (2007: CZK 62,143 million).

9 Intangible assets

In CZK million	Goodwill	Licences	Software	Other	Total
At 31 December 2008					
Opening net book amount	13,320	4,686	3,461	-	21,467
Additions	-	-	2,184	-	2,184
Disposals and other movements	-	-	(73)	-	(73)
Amortisation charge	-	(399)	(1,477)	-	(1,876)
Closing net book amount	13,320	4,287	4,095	-	21,702
At 31 December 2008					
Cost	13,320	6,073	24,137	-	43,530
Accumulated amortisation and impairment allowance	-	(1,786)	(20,042)	-	(21,828)
Net book amount	13,320	4,287	4,095	-	21,702
At 31 December 2007					
Opening net book amount	13,320	5,090	3,098	-	21,508
Additions	-	-	1,814	-	1,814
Disposals and other movements	-	-	(2)	-	(2)
Amortisation charge	-	(404)	(1,449)	-	(1,853)
Closing net book amount	13,320	4,686	3,461	-	21,467
At 31 December 2007					
Cost	13,320	6,073	22,734	2,829	44,956
Accumulated amortisation and impairment allowance	-	(1,387)	(19,273)	(2,829)	(23,489)
Net book amount	13,320	4,686	3,461	-	21,467

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"). From the effective date of merger with Český Telecom, a.s. this goodwill is presented in the standalone financial statements of the Company. 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 Company 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 Company performed impairment tests and as result of the test the Company 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 Company 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 Company 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, former 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, former 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, former Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, former Eurotel was provided with deferred payment terms by the Czech Telecommunication Office ("CTO") to finance the license acquisition. In December 2003, former 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, former 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.

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
Total	4,287	4,686

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

Cost of fully amortised intangible assets was CZK 16,829 million as at 31 December 2008 (2007: CZK 16,947 million).

All of the Company'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	578	626
Finished products and work in progress	4	4
Total	743	743

The inventories noted above are stated net of an allowance of CZK 57 million (2007: CZK 89 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 24 million (2007: CZK 18 million). The amount of inventories recognised as an expense is CZK 3,708 million (2007: CZK 4,130 million).

12 Receivables and prepayments

In CZK million	31 December 2008	31 December 2007
Domestic trade receivables (net)	6,901	6,782
Foreign currency trade receivables (net)	1,061	618
Other debtors (net)	563	300
Prepayments	686	666
Other financial assets - short-term	14	17
Derivative instruments	23	4
Total	9,248	8,387

Trade receivables are stated net of an allowance for impaired receivables of CZK 3,241 million (2007: CZK 3,277 million). In order to preserve the tax-deductible status of the bad debt expense, the Company'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.

			Not impaired but overdue			
Trade receivables In CZK million	**Carrying amount**	**Neither impaired nor overdue**	Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2008	7,962	5,134	607	60	139	80
At 31 December 2007	7,400	4,491	321	50	-	-

Bad debt provisions In CZK million	
At 1 January 2007	3,345
Additions	103
Retirements/amount paid	(171)
At 31 December 2007	3,277
Additions	855
Retirements/amount paid	(891)
At 31 December 2008	3,241

The Company'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 Company's trade receivables.

As at 31 December 2008 and 2007 the Company 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	244	246
Other financial investment	-	207
Total	377	565

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	(28)	(1)
At end of year	-	27
Current	-	27
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	218	4,076	Floating
Cash at cash-pooling structures (inter-company)	6,344	5,107	Floating
Short-term bank deposits	410	321	Fixed
Other cash equivalents	-	17	n/a
Total cash and cash equivalents	6,972	9,521	
Financial investments (held to maturity)	-	27	Fixed

As at 31 December 2008 and 2007, the Company'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 Company 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 Company had available equivalent of CZK 4,850 million (2007: CZK 11,453 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	6,972	9,521
Bank overdrafts and other short-term borrowings (Note 16)	-	-
Total	6,972	9,521

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)	4,817	4,724
Trade creditors in foreign currencies (net)	1,324	1,235
Other taxes and social security	184	516
Deferred revenue	977	1,195
Employee wages and benefits	712	657
VAT payable	464	154
Other creditors	404	654
Accruals	3,956	2,597
Total payables	12,838	11,732
Other non-current liabilities	175	452

Payables to related parties are disclosed in 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)	5	5,998
Total borrowings	3,103	9,060
Accrued interest including commitment fees	86	185
Derivatives	7	24
Other financial debt	93	209
Total financial debt	3,196	9,269
Repayable:		
Within one year	98	6,207
Between two and five years (total non-current)	3,098	3,062
Total financial debt	3,196	9,269

(a) As at 31 December 2008 the Company 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 Company 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 Company'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	3,103	9,060
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 Company 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 Company's financial liabilities at 31 December 2008 based on contractual undiscounted payments.

At 31 December 2008	**Less than 3 months**	**3 to 12 months**	**1 to 5 years**	**> 5years**
In CZK million				
Interest bearing loans and borrowings	5	206	3,715	-
Trade and other payables (excluding deferred revenue)	10,456	1,405	-	-
Derivatives fair value	7	-	-	-
Total	10,468	1,611	3,715	-

At 31 December 2007	**Less than 3 months**	**3 to 12 months**	**1 to 5 years**	**> 5years**
In CZK million				
Interest bearing loans and borrowings	-	6,413	3,875	-
Trade and other payables (excluding deferred revenue)	9,236	1,301	-	-
Other financial liabilities	3	8	-	-
Derivatives fair value	22	2	-	-
Total	9,261	7,724	3,875	-

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Company'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	6,972	9,521	6,972	9,521
Financial investments (held to maturity)	-	27	-	27
Derivatives	23	4	23	4
Other financial assets	377	565	377	565

In CZK million	**Carrying amount**		**Fair value**	
	2008	**2007**	**2008**	**2007**
Financial liabilities				
Interest bearing loans and borrowings				
Floating rate borrowings	-	-	-	-
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*	(277)	(95)
Stress testing*	(52)	(46)
IR risk		
Stress testing*	(161)	(176)

* The Value at Risk (VaR) Model enables the Company 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 Company 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 Company in individual foreign currencies, the Company 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 unfavorable direction. The calculation of unfavorable impact on Company 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 Company to hedge the currency risk:

	Nominal value In EUR million		Fair value 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	4,494
Income statement tax credit (Note 5)	(58)	(1,141)
Tax on fair value gains	4	-
At 31 December	3,299	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 balance sheet:

In CZK million	**31 December 2008**	**31 December 2007**
Deferred tax assets	(656)	(1,143)
Deferred tax liabilities	3,955	4,496
Total	3,299	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 493 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	**Balance sheet**		**Income statement**	
	2008	**2007**	**2008**	**2007**
Temporary differences relating to:				
- property, plant and equipment and intangible assets	3,925	4,496	(571)	(574)
- trade receivables, inventories and other differences	(626)	(1,139)	513	231
Revaluations of cash flow hedges	-	(4)	-	-
Amount relating to changes in tax rates	-	-	-	(798)
Total	3,299	3,353	(58)	(1,141)

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

In CZK million	**2008**	**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 Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2008 and 2007, the Company 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 1,504 million in 2008 (2007: CZK 1,612 million) (see Note 3). Employees contribute 12.5 % (2007: 12.5 %) of their gross salaries.

The Company has a voluntary pension plan for employees under which the Company makes contributions on behalf of the Company's employees to approved pension plan providers, under defined contribution schemes. The Company's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Company made contributions of CZK 58 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	Other	Total
At 1 January 2008	2,110	3	298	627	-	9	3,047
Additions during the year	66	73	136	43	495	31	844
Utilised during the year	(1,781)	(63)	(275)	(418)	(235)	(13)	(2,785)
Transfers	-	-	(25)	-	-	-	(25)
At 31 December 2008	**395**	**13**	**134**	**252**	**260**	**27**	**1,081**
Short-term provisions 2008	-	13	127	252	260	27	679
Long-term provisions 2008	395	-	7	-	-	-	402
	395	**13**	**134**	**252**	**260**	**27**	**1,081**
Short-term provisions 2007	-	3	262	627	-	9	901
Long-term provisions 2007	2,110	-	36	-	-	-	2,146
	2,110	**3**	**298**	**627**	**-**	**9**	**3,047**

With the exception of the regulatory and court decisions provision 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 up 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 Company (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	**31 December 2008**	**31 December 2007**
In CZK million		
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 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. evocates 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 by 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 by 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. by Vodafone Czech Republic, a.s. appealed against that decision to 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	1,275	1,196
Later than 1 year and not later than 5 years	3,963	3,809
Later than 5 years	5,720	2,976
Total	10,958	7,981

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2008 were CZK 1,253 million (2007: CZK 1,112 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 Company's results of operations, financial position, or cash flow and therefore are not accounted for.

In 2004 the Company 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 356 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	1,671

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.

Imposition of obligations related to provision of universal service

During the whole 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 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	81,434	84,445
Equity settled share based payment reserve	45	-
Net unrealized gains reserve (cash flow hedge)	-	(20)
Total	81,479	84,425

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 Company 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	1,012	982
b)	Purchases of services and goods	1,041	817
c)	Capital purchases	5	1
d)	Receivables	480	159
e)	Payables	4,336	1,001
f)	Short-term receivables (interest)	14	17
g)	Interest income	375	330
h)	Cash equivalents	6,344	5,107

The list of the Telefónica companies with which the Company had any transaction in 2008 includes the following entities: Telefónica S.A., Telefónica de Espaňa, 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 Espana, S.A.U., Telefónica Investigación y Desrrollo, 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 Company.

27 Principal subsidiary undertakings

Subsidiaries	Company'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 telecommunicati ons
2. SPT TELECOM (Czech Republic) Finance B.V. (in liquidation)	100 %	1	Netherlands	Financing other entities in the Company
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 Company 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 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 Company 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 the company 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 events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2008.