Telefónica O2 Czech Republic, a.s.

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010

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 7,511 in 2010 (2009: 8,282).

The Company's shares are traded on the Prague Stock Exchange.

These financial statements were approved for issue by the Company's Board of Directors on 18 February 2011.

Restructuring and network outsourcing (Field Line Maintenance)

During 2010, the Company pursued the strategy of continuous efficiency and cost optimization by introducing new projects in various areas of its business. Restructuring projects resulted in transfer of some activities to outsourcing partners. During the restructuring process more than 1,000 employees were made redundant and the Company incurred restructuring costs of CZK 422 million (see Note 3).

As a result of network operation optimization Field Line Maintenance including fail rectification and supportive technological maintenance are being outsourced to a strategic partner of the Company.

Impairment of fixed line segment assets

As of 30 June 2010 and 31 December 2010, the management of the Company reviewed the indicators which could have indicated that previously recognised impairment loss of fixed line segment assets which constitute cash generating unit (CGU) made in 2003 may no longer be relevant.

Based on a detailed impairment analysis performed as of 30 June 2010 the Company has reversed previously recognised impairment loss of CZK 4,344 million attributable to the fixed line segment assets constituting the CGU.

As of 31 December 2010, the Company assessed whether there is any indication that the CGU may be impaired. Assessment carried out as of 31 December 2010 confirmed that no such indicator exists and the value of the existing CGU is fairly stated.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF TELEFÓNICA O2 CZECH REPUBLIC, A.S.

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 2010, and the statement of total comprehensive income, statement of changes in equity and statement of cash flows 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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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 the Act on Auditors and International Standards on Auditing as amended by 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 auditor's judgment, including an 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.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2010, and 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.
License No. 401
Represented by

Brian Welsh
Partner

Petr Vácha
Auditor, License No. 1948

18 February 2011
Prague, Czech Republic

STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2010

In CZK million	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Revenue	2	53,159	58,054
Gains from sale of non-current assets	8	91	422
Internal expenses capitalized in fixed assets	2	568	660
Operating expenses	3	(30,878)	(31,661)
Impairment reversal/(loss)	8, 9 ,10	4,325	(23)
Depreciation and amortisation	8, 9	(11,421)	(11,688)
Operating profit		15,844	15,764
Interest income	4	86	165
Interest expense	4	(240)	(229)
Other finance income (expense)	4	39	(89)
Profit before income tax		15,729	15,611
Taxes on income	5	(3,033)	(3,197)
Profit for the year		**12,696**	**12,414**
Other comprehensive income			
Other comprehensive income, net of tax		-	-
Total comprehensive income, net of tax		**12,696**	**12,414**
Profit attributable to:			
Equity holders of the Parent	6	12,696	12,414
Total comprehensive income attributable to:			
Equity holders of the Parent		12,696	12,414
Earnings per share (CZK) – basic*	6	39	39

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

BALANCE SHEET
As at 31 December 2010

In CZK million	Notes	31 December 2010	31 December 2009
ASSETS			
Property, plant and equipment	8	54,516	55,186
Intangible assets	9	20,735	21,677
Investment in subsidiaries and associates	24	6,396	5,351
Other financial assets	12	165	1,311
Non-current assets		**81,812**	**83,525**
Inventories	11	577	585
Receivables and prepayments	12	8,641	9,140
Income tax receivable		443	694
Cash and cash equivalents	13	4,781	1,241
Current assets		**14,442**	**11,660**
Non-current assets classified as held for sale	8	**12**	**95**
Total assets		**96,266**	**95,280**
EQUITY AND LIABILITIES			
Ordinary shares	22	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		21,026	21,207
Total equity		**77,609**	**77,790**
Long-term financial debts	15	2,883	3,044
Deferred taxes	16	3,936	3,333
Non-current provisions for liabilities and charges	18	51	23
Non-current other liabilities	14	21	19
Non-current liabilities		**6,891**	**6,419**
Short-term financial debts	15	141	87
Trade and other payables	14	11,468	10,710
Provisions for liabilities and charges	18	157	274
Current liabilities		**11,766**	**11,071**
Total liabilities		**18,657**	**17,490**
Total equity and liabilities		**96,266**	**95,280**

These financial statements were approved by the Board of Directors on 18 February 2011 and were signed on its behalf by:

Luis Antonio Malvido
Chairman of the Board of Directors
Chief Executive Officer

Jesús Pérez de Uriguen
1st Vice Chairman of the Board of Directors
Vice-President, Finance Division

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

In CZK million	Notes	Share capital	Share premium	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2009		**32,209**	**24,374**	**45**	**6,450**	**18,401**	**81,479**
Net profit		-	-	-	-	12,414	12,414
Total comprehensive income		**-**	**-**	**-**	**-**	**12,414**	**12,414**
Capital contribution and other transfers		-	-	(9)	-	10	1
Dividends declared in 2009	7	-	-	-	-	(16,104)	(16,104)
At 31 December 2009		**32,209**	**24,374**	**36**	**6,450**	**14,721**	**77,790**
At 1 January 2010		**32,209**	**24,374**	**36**	**6,450**	**14,721**	**77,790**
Net profit		-	-	-	-	12,696	12,696
Total comprehensive income		**-**	**-**	**-**	**-**	**12,696**	**12,696**
Capital contribution and other transfers		-	-	(2)	-	9	7
Dividends declared in 2010	7	-	-	-	-	(12,884)	(12,884)
At 31 December 2010		**32,209**	**24,374**	**34**	**6,450**	**14,542**	**77,609**

* Refer to Note 22 regarding amounts not available for distribution.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

Until 2009, the Company used indirect method for reporting cash flow from operating activities. Since year 2010, the Company presents cash flows from operating activities using the direct method as changed presentation is more appropriate. For cash flow from investing activities and cash flow from financing activities, direct method was used for both years 2009 and 2010.

In CZK million	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Cash from operating activities			
Cash received from operations		56,679	61,629
Cash paid to suppliers and employees		(32,877)	(36,010)
Dividends received		111	11
Net interest and other financial expenses paid		(211)	(134)
Taxes paid		(2,178)	(3,632)
Net cash from operating activities		**21,524**	**21,864**
Cash flow from investing activities			
Proceeds on disposals of property, plant and equipment and intangible assets		224	891
Payments on investments in property, plant and equipment and intangible assets		(5,019)	(7,270)
Payments made on financial investments		(1,048)	(3,889)
Net cash used in investing activities		**(5,843)**	**(10,268)**
Cash flow from financing activities			
Dividends paid		(12,876)	(16,087)
Proceeds on loans, borrowings and promissory notes		1,214	60
Cancellation of debentures and bonds		-	(5)
Repayments of loans, borrowings and promissory notes		(472)	(1,077)
Net cash used in financing activities		**(12,134)**	**(17,109)**
Effect of foreign exchange rate changes on collections and payments		**(7)**	**(218)**
Net increase / (decrease) in cash and cash equivalents during the period		**3,540**	**(5,731)**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**13**	**1,241**	**6,972**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**13**	**4,781**	**1,241**
BALANCE AT THE BEGINNING OF THE PERIOD	**13**	**1,241**	**6,972**
Cash on hand and at banks		1,224	6,554
Other cash equivalents		17	418
BALANCE AT THE END OF THE PERIOD	**13**	**4,781**	**1,241**
Cash on hand and at banks		4,762	1,224
Other cash equivalents		19	17

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 18 February 2011.

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 2010, the Company applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Company:

Revised IFRS 3 Business Combinations (effective 1 July 2009)

The standard introduces changes in the accounting for business combinations that will have an impact on the amount of goodwill recognised, the reported results in the period that

an acquisition occurs and on future reported results. The Company applies IFRS 3 (Revised) to all business combinations from 1 January 2010.

IAS 27 Consolidated and Separate Financial Statements - Amendment (effective 1 July 2009)

The most significant changes to IAS 27 are as follows:

i) Changes in the ownership interest of a subsidiary (that do not result in a loss of control) are accounted for as an equity transaction and have no impact on goodwill nor give rise to a gain or loss.

ii) Losses incurred by the subsidiary are allocated between the controlling and non-controlling interests (previously referred to as "minority interest"); even if the losses exceed the non-controlling equity investment in a subsidiary.

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

There was not any material effect relating to the adoption of this amendment on the Company financial statements.

IFRS 2 Amendment (effective date 1 January 2010) Share-based Payments

The amendment is concerning the accounting for group cash-settled share-based payment transactions. The amendment clarifies how an individual subsidiary in a group should account for some share-based payment arrangements in its own financial statements. In these arrangements, the subsidiary receives goods or services from employees or suppliers but its parent or another entity in the group must pay those suppliers.

This amendment didn’t have material impact on the Company financial statements.

IFRS 5 Amendment (effective 1 January 2010) Non-current Assets Held for Sale and Discontinued Operations - Disclosure

This amendment was issued in order to clarify the disclosure requirements in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Also clarifies that the general requirements of IAS 1 still apply.

There weren’t any material changes to the disclosure in the notes to the financial statements.

IFRS 8 Amendment (effective 1 January 2010) Operating Segments - Disclosure

Minor textual amendment to the standard and amendment to the basis for conclusions, to clarify that an entity is required to disclose a measure of segment assets only if that measure is regularly reported to the chief operating decision-maker. There weren't any material changes to the disclosure in the notes to the financial statements resulting from this amendment.

IAS 1 Amendment (effective 1 January 2010) Presentation of Financial Statements

The amendment specifies current / non-current classification of convertible instruments and clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.

This amendment did not have any material impact on the Company financial statements.

IAS 7 Amendment (effective 1 January 2010) Statement of Cash Flows

Amendment to require that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities. This amendment had no impact on the Company financial statements, since this treatment was already applied by the Company.

IAS 36 Amendment (effective 1 January 2010) Impairment of Assets

Amendment to clarify that the largest cash-generating unit (or groups of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment as defined by par. 5 of IFRS 8 Operating Segments. There was no significant impact of the application of this amendment on the Company financial statements.

IAS 38 Amendments (effective 1 January 2010) Intangible Assets

The first amendment clarifies the effect of the decision in IFRS 3 (Revised) on the accounting for intangible assets acquired in a business combination.

The second amendment clarifies the description in IAS 38, 40 and 41 of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

The Company applies IAS 38 Amendments together with IFRS 3 (Revised) prospectively to all business combination from 1 January 2010.

IFRS 5 Amendment (effective 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 applies the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

New IFRS and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) not effective as of 31 December 2010 (includes standards and interpretations applicable for the Group)

At the date of preparation of the accompanying financial statements, the following IFRS and IFRIC interpretations had been published, but their application was not mandatory. The Company intends to adopt those standards when they become effective.

Standards and amendments, Interpretations		**Mandatory application: annual periods beginning on or after**
IAS 24	Related Party Disclosures (Amendment)	1 January 2011
IAS 32	Financial Instruments: Presentation – Classification of Rights Issues (Amendment)	1 February 2010
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRIC 14	Prepayments of a minimum funding requirement (Amendment)	1 January 2011
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010
Improvements to IFRSs		**Mandatory application: annual periods beginning on or after**
IFRS 3	Business Combinations	1 July 2010 or 1 January 2011
IFRS 7	Financial Instruments: Disclosures	
IAS 1	Presentation of Financial Statements	
IAS 27	Consolidated and Separate Financial Statements	
IFRIC 13	Customer Loyalty Programmes	

The Company is currently assessing the impact of the application of these standards, amendments and interpretations. Based on the analyses made to date, the Company estimates that their adoption will not have a significant impact on the financial statements in the initial period of application. Changes introduced by IFRS 9 may affect financial assets and future transactions with financial assets carried out on or after 1 January 2013.

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 profit or loss, except when deferred in other comprehensive income 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.

Subsequent costs are recognised as property, plant and equipment only if it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably.

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	10 to 25
Exchanges and related equipment	up to 25
Other fixed assets	up to 20

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 profit or loss 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 profit or loss.

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 assumptions 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 in profit or loss in the period in which the reversal occurs.

The Company makes an assessment at least at each balance sheet date whether there is any indication that an impairment loss 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 sources of information (asset's market value, changes expected in the market, including technological, economic or legal changes, market interest rates, significant changes with effect on the Company in the extent to which, or manner in which, the assets are used or are expected to be used, evidence available from internal reporting indicating economic performance of assets etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions used.

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 2010 and 2009, 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 profit or loss 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 other comprehensive income 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 other comprehensive income is recognised in profit or loss.

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 profit or loss.

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 profit or loss 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) in other comprehensive income shall be removed from other comprehensive income 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 other comprehensive income 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 profit or loss 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 profit or loss 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 the 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 profit or loss.

K Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the statement of cash flows, 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 profit or loss 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.

Income tax relating to items recognised in other comprehensive income is recognised in other comprehensive income and not in profit or loss.

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 profit or loss, any related tax effects are also recognised in profit or loss. 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 profit or loss 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 profit or loss 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 profit or loss 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 profit or loss 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. Until March 2008, the Company recognised revenues using netto principle and recognised revenues when the contribution was received. From April 2008 until June 2009 the Company reported revenue using gross principle and recognised the compensation when CTO approved the total compensation and decided about percentage shares and absolute amounts of other operators contributions. As a result of further favourable development in smoothing of the recovery process and associated environment, since July 2009 the Company started to recognise the compensation of revenues attributable to the Company on standard accrual basis while keeping the gross principle of recording.

Subscription revenues

Revenue is recognised in profit or loss 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 profit or loss over the estimated average customer relationship period.

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 profit or loss 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 profit or loss 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. An estimate of unused airtime is recognised in Statement of comprehensive income and spread over an average top up life cycle at the moment of every top up. For calculation of the estimate, the Group applies a percentage of expiry rate calculated from historical experience of expired airtime.

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

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. 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 profit or loss 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).

(7) Instalment sales

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, 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 15.

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 and partially to US Dollar:

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. Just plain-vanilla instruments are currently used for hedging this kind of exposure.

(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 generated cash position (maintained in quickly liquid instruments), and committed credit facilities arranged with banks.

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 Unit 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 by other securing tools (receivables insurance etc.),

c) Credit Management cooperate with Customer Care on set up of reasonable, effective and continual collection process. Collection process competence is divided. Collection of active customers is in competence of Customer Care unit, following collection process after contract cancellation is in responsibility of Credit Management.

Credit management activities during last years

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

a) implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),

b) implementation of the integrated system solution RMCA for scoring, maintenance and collection of receivables (fixed and mobile) and reporting,

c) use of integrated Black Lists of fixed and mobile debtors during activation process,

d) implementation of strict activation rules for all distribution channels, especially for Indirect Sales partners.

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 profit or loss, 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 other comprehensive income. 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 other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in other comprehensive income are

transferred to profit or loss and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects profit or loss.

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 profit or loss.

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 other comprehensive income at that time remains in other comprehensive income and is recognised in profit or loss when the committed or forecasted transaction ultimately is recognised in profit or loss. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to profit or loss.

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.

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 flows models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Company's bankers.

T Use of estimates, assumptions and judgements

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-non-deductible/non-taxable items 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 2010, the total amount of provision for current income taxes is CZK 2,478 million, advances paid for income taxes amount to CZK 2,921 million and the net deferred tax liability is CZK 3,936 million.

(2) Property, plant and equipment, intangible assets and goodwill

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in the income statement for the period. The decision to recognize an impairment loss involves estimates of the timing and amount of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Group evaluates its cash-generating units' performance regularly to identify potential impairments. Determining the recoverable amount of the cash-generating units also entails the use of assumptions and estimates and requires a significant element of judgment. The Group assess at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, The Group estimates the recoverable amount where an impairment loss recognised in prior periods shall be subject to the reversal (See Note 11).

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 2010, the carrying amount of goodwill is CZK 13,320 million (See Note 9).

(3) Provisions and contingent liabilities

As set out in Note 19 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. At 31 December 2010 the carrying amount of the provision for regulatory and court decisions is CZK 126 million (see Note 18).

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 2010 and 2009.

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.

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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 2010 **In CZK million**	**Fixed**	**Mobile**	**Company**
Revenues	24,662	29,293	53,955
Inter-segment sales	(345)	(451)	(796)
Total revenues	24,317	28,842	53,159
Gains from sale of non-current assets	91	-	91
Internal expenses capitalised in fixed assets	350	218	568
Costs	(15,425)	(16,249)	(31,674)
Inter-segment purchases	451	345	796
Total costs	(14,974)	(15,904)	(30,878)
Impairment reversal	4,325	-	4,325
Depreciation	(6,675)	(2,522)	(9,197)
Amortisation	(1,034)	(1,190)	(2,224)
Total depreciation and amortization	(7,709)	(3,712)	(11,421)
Operating profit	6,400	9,444	15,844
Interest and other financial income (net)			(115)
Profit before tax			15,729
Tax			(3,033)
Net profit			**12,696**
Assets (excluding goodwill and non-current assets held for sale)	52,576	30,358	82,934
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	-	13,320	13,320
Non-current assets held for sale	12	-	12
Total assets	**52,588**	**43,678**	**96,266**
Trade and other payables	5,561	5,907	11,468
Other liabilities	3,486	3,703	7,189
Total liabilities	**9,047**	**9,610**	**18,657**
Capital expenditure	**2,843**	**2,539**	**5,382**

Year ended 31 December 2009 **In CZK million**	**Fixed**	**Mobile**	**Company**
Revenues	27,239	31,813	59,052
Inter-segment sales	(394)	(604)	(998)
Total revenues	26,845	31,209	58,054
Gains from sale of non-current assets	422	-	422
Internal expenses capitalised in fixed assets	456	204	660
Costs	(15,204)	(17,455)	(32,659)
Inter-segment purchases	604	394	998
Total costs	(14,600)	(17,061)	(31,661)
Impairment charge	(17)	(6)	(23)
Depreciation	(7,031)	(2,727)	(9,758)
Amortisation	(842)	(1,088)	(1,930)
Total depreciation and amortization	(7,873)	(3,815)	(11,688)
Operating profit	5,233	10,531	15,764
Interest and other financial costs (net)			(153)
Profit before tax			15,611
Tax			(3,197)
Net profit			**12,414**
Assets (excluding goodwill and non-current assets held for sale)	51,570	30,295	81,865
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	-	13,320	13,320
Non-current assets held for sale	95	-	95
Total assets	**51,665**	**43,615**	**95,280**
Trade and other payables	4,938	5,772	10,710
Other liabilities	3,126	3,654	6,780
Total liabilities	**8,064**	**9,426**	**17,490**
Capital expenditure	**3,229**	**2,622**	**5,851**

Revenue of the Company is predominantly derived from domestic trading activities. 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. As a result of the analysis, concept of fix and mobile segment is most appropriate for segment recognition.

The inter-segment pricing rates applied in 2010 and 2009 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 2010**	**Year ended** **31 December 2009**
Voice - outgoing	10,745	12,578
Interconnection and other wholesale services	8,244	9,380
Monthly and one-off charges from voice services	13,321	15,032
Connection charges	7	192
SMS & MMS & Value added services	4,374	4,669
Leased lines and fixed data services	3,132	3,509
Internet (including monthly and one-off charges), mobile data	8,278	7,376
IT and business solutions	2,407	2,609
Equipment and activation fee	1,409	1,492
Other telecommunication revenues	850	901
Other revenues	392	316
Total revenues	53,159	58,054

Revenues from related parties are disclosed in Note 23.

The aggregate future minimum lease payments under non-cancellable operating leases, where the Company is a lessor and give rise to future revenues consist of the buildings and other telecommunication equipment rentals as follows:

In CZK million	**31 December 2010**	**31 December 2009**
No later than 1 year	100	142
Later than 1 year and not later than 5 years	338	593
Later than 5 years	89	156
Total	527	891

Internal expenses capitalized in fixed assets **In CZK million**	**Year ended** **31 December 2010**	**Year ended** **31 December 2009**
Material	-	15
Labour	568	645
Total	568	660

3 Operating expenses

The following items have been included into the operating expenses:

Operating expenses **In CZK million**	**Year ended** **31 December 2010**	**Year ended** **31 December 2009**
Wages and salaries*	4,363	4,592
Redundancy payments	454	161
Social security contributions (Note 17)	1,481	1,510
Staff welfare costs	214	228
Total staff costs	6,512	6,491
Interconnection and roaming	9,386	10,650
Cost of goods sold	1,833	2,225
Contents	299	270
Customer loyalty program	-	74
Sub-deliveries	1,003	1,453
Commissions	1,122	1,116
Telecom services	186	205
Other cost of sales	451	583
Billing and collection	366	413
Marketing	958	1,220
Call centres	517	426
Network & IT repairs and maintenance	2,486	2,401
Rentals, buildings and vehicles	1,995	1,952
Utilities supplies	1,017	1,037
Consultancy and professional fees	156	156
Other external services	1,577	98
Provision for bad and doubtful debts and inventories	578	472
Taxes (other than income tax)	402	386
Other operating expenses	34	33
Total operating expenses	30,878	31,661

* 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 4 million in relation to such non-competition clauses in 2010 (2009: CZK 14 million).

Categories of costs were rearranged in order to improve the presentation of costs.

An appropriately approved restructuring plan covering both employees and members of management has been introduced by the Company during 2010. As a result of the restructuring process the Company incurred restructuring costs of CZK 422 million during the period ended 31 December 2010 that have been recognised for the redundancy payments.

Purchases from related parties are disclosed in Note 23.

4 Interest and other finance income and expense

In CZK million	**Year ended 31 December 2010**	**Year ended 31 December 2009**
Financial income		
Interest income	86	165
Gain on fair value adjustments of financial instruments	-	71
Other financial income	371	1,055
Total financial income	457	1,291
Financial expenses		
Interest expenses	(240)	(229)
Loss on fair value adjustments of financial instruments	(175)	-
Other financial expenses	(157)	(1,215)
Total financial expenses	(572)	(1,444)
Net financial loss/income	(115)	(153)

5 Income tax

In CZK million	**Year ended 31 December 2010**	**Year ended 31 December 2009**
Total income tax expense is made up of:		
Current income tax charge	2,430	3,163
Deferred income tax charge (Note 16)	603	34
Taxes on income	3,033	3,197

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 2010**	**Year ended 31 December 2009**
Profit before tax	15,729	15,611
Income tax charge calculated at the statutory rate of 19 % (2009: 20 %)	2,989	3,122
Not taxable income	(21)	-
Expenses not deductible for tax purposes	129	144
Tax related to prior periods	(64)	(69)
Taxes on income	3,033	3,197
Effective tax rate	19 %	20 %

6 Earnings per share

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

	31 December 2010	31 December 2009
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	12,696	12,414
Basic earnings per share (CZK)	39	39

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

7 Dividends

In CZK million	2010	2009
Dividends declared (including withholding tax)	12,884	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 2010. Approval of the 2010 profit and the decision regarding the amount of any dividend payment for the 2010 financial year will take place at the Annual General Shareholders Meeting.

Dividend per share for the years ended 31 December were as follows:

In CZK	Year ended 31 December 2010	Year ended 31 December 2009
Dividend per share (nominal value of 100 CZK)	40	50

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 2010						
Opening net book amount	10,794	33,141	7,095	1,661	2,495	55,186
Additions	294	968	2,240	531	4,099	8,132
Disposals and other movements	(3)	(4)	37	(1)	(3,966)	(3,937)
Assets classified as held for sale	(3)	(1)	-	-	-	(4)
Depreciation charge	(662)	(4,634)	(3,079)	(822)	-	(9,197)
Impairment charge	(1)	-	7	-	(14)	(8)
Impairment reversal	366	3,783	192	3	-	4,344
Closing net book amount	10,785	33,253	6,492	1,372	2,614	54,516
At 31 December 2010						
Cost	19,452	102,037	87,308	8,085	2,652	219,534
Accumulated depreciation and impairment allowance	(8,667)	(68,784)	(80,816)	(6,713)	(38)	(165,018)
Net book amount	10,785	33,253	6,492	1,372	2,614	54,516
At 31 December 2009						
Opening net book amount	10,520	36,227	10,116	1,789	2,546	61,198
Additions	322	759	2,074	856	3,924	7,935
Disposals and other movements	813	396	(1,133)	(101)	(3,963)	(3,988)
Assets classified as held for sale	(185)	(3)	-	-	-	(188)
Depreciation charge	(676)	(4,238)	(3,961)	(883)	-	(9,758)
Impairment charge	-	-	(1)	-	(12)	(13)
Closing net book amount	10,794	33,141	7,095	1,661	2,495	55,186
At 31 December 2009						
Cost	19,264	101,172	86,987	9,464	2,527	219,414
Accumulated depreciation and impairment allowance	(8,470)	(68,031)	(79,892)	(7,803)	(32)	(164,228)
Net book amount	10,794	33,141	7,095	1,661	2,495	55,186

As at 31 December 2010, the carrying value of non-depreciated assets amounted to CZK 215 million (2009: CZK 214 million).

No property, plant and equipment were pledged as at 31 December 2010.

No borrowing costs were capitalized during the years 2010 and 2009.

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 2010				
Opening net book amount	95	-	-	95
Disposals and other movements	(76)	-	-	(76)
Impairment charge	(11)	-	-	(11)
Assets re-classified as held for sale	4	-	-	4
Closing net book amount	12	-	-	12
At 31 December 2010				
Cost	502	86	69	657
Accumulated depreciation and impairment allowance	(490)	(86)	(69)	(645)
Net book amount	12	-	-	12
At 31 December 2009				
Opening net book amount	96	-	-	96
Disposals and other movements	(179)	-	-	(179)
Impairment charge	(10)	-	-	(10)
Assets re-classified as held for sale	188	-	-	188
Closing net book amount	95	-	-	95
At 31 December 2009				
Cost	804	120	76	1,000
Accumulated depreciation and impairment allowance	(709)	(120)	(76)	(905)
Net book amount	95	-	-	95

Assets intended for sale in most cases represent buildings with land, 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 2010, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 91 million (2009: CZK 422 million) and total losses in amount CZK 16 million (2009: CZK 14 million).

At the beginning of 2009, the Company completed the substantial part of a real estate usage optimisation process and sold a construction site and two administrative buildings of the former headquarters at Olšanská street in Prague with a net gain exceeding CZK 300 million.

Cost of fully depreciated property, plant and equipment was CZK 71,491 million as at 31 December 2010 (2009: CZK 69,826 million).

9 Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2010				
Opening net book amount	13,320	3,901	4,456	21,677
Additions	-	-	1,282	1,282
Disposals and other movements	-	-	-	-
Amortisation charge	-	(387)	(1,837)	(2,224)
Closing net book amount	13,320	3,514	3,901	20,735
At 31 December 2010				
Cost	13,320	6,073	26,655	46,048
Accumulated amortisation and impairment allowance	-	(2,559)	(22,754)	(25,313)
Net book amount	13,320	3,514	3,901	20,735
At 31 December 2009				
Opening net book amount	13,320	4,287	4,095	21,702
Additions	-	-	1,906	1,906
Disposals and other movements	-	-	(1)	(1)
Amortisation charge	-	(386)	(1,544)	(1,930)
Closing net book amount	13,320	3,901	4,456	21,677
At 31 December 2009				
Cost	13,320	6,073	25,776	45,159
Accumulated amortisation and impairment allowance	-	(2,172)	(21,310)	(23,482)
Net book amount	13,320	3,901	4,456	21,677

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 (CZK 767 million). 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 2010 and 2009. 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 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 the market and regulatory environment, where the Company conducts its 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 six years.

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

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

Carrying value of licences:

In CZK million	**31 December 2010**	**31 December 2009**
GSM 900 license	402	474
GSM 1800 license	324	382
NMT 450 license	19	26
UMTS license	2,769	3,019
Total	3,514	3,901

No borrowing costs were capitalized during the years 2010 and 2009.

Cost of fully amortised intangible assets was CZK 19,003 million as at 31 December 2010 (2009: CZK 16,381 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").

As of 30 June 2010 and 31 December 2010, the management of the Company reviewed the indicators which could have indicated that a previously recognised impairment loss of fixed line segment assets which constitute a cash generating unit made in 2003 may no longer be relevant. The Company considered both external and internal sources of information.

Value in use has been calculated by a method of cumulated discounted cash flows generated by the CGU in future. Primarily, the following key elements have been used in the impairment testing model: latest version of four-year business plan (revenues, operating expenses, capital expenditures, etc.), estimation of consecutive development of key indicators (estimated growth rates applied on revenues, margin, investments, etc.), terminal value, discount rate derived from weighted average cost of capital.

As at 30 June 2010, the management of the Company performed a detailed impairment review. As a result of the review, the recoverable amount of the fixed line segment assets (impairment test model) was estimated. While performing the review, the Company considered all relevant external and internal sources of information when determining the recoverable amount.

The Company has taken into account certain favourable effects like improvements and efficiencies occurred, changes during the period and further expected in the near future in the technological, market and economic environment that will have favourable effect, manner in which assets are used and are expected to be used, economic performance of assets. The Company has taken into account primarily following effects – continuously implemented measures to improve cost efficiency of operations, demand for complex ICT solutions as well as a generally increasing demand on capacity for data transfers (driven by Broadband Internet, IP-TV, Very High Speed DSL), providing of a large variety of data services besides traditional fixed line voice services, etc.

Impairment test has proved the recoverable amount is sufficient to reverse the previously recognised impairment loss. Based on the impairment test performed as of 30 June 2010 the Company reversed the previously recognised impairment loss of CZK 4,344 million (as limited by recoverable amount) attributable to the CGU's assets. Carrying amount of CGU's assets was increased to the recoverable amount. Increased amount did not exceed the carrying

amount that would have been determined, net of depreciation, had no impairment loss been recognised in prior years.

Carrying amount of identifiable assets (subject to reversal) before reversal was CZK 34 billion, after reversal CZK 38 billion. The value of assets at costs (subject to reversal) was CZK 111 billion.

Reversal of previously recognised impairment loss led to increased carrying amount of assets, hence prospective increase of depreciation charge as well.

As at 31 December 2010, the management of the Company reviewed the indicators which could have indicated whether the CGU's assets may be impaired. Assessment carried out as of 31 December 2010 confirmed that no such indicator exists and the value of the existing assets are fairly stated.

11 Inventories

In CZK million	**31 December 2010**	**31 December 2009**
Telecommunication material	231	153
Cables	20	31
Other inventory including goods for resale	312	387
Finished products and work in progress	14	14
Total	577	585

The inventories noted above are stated net of an allowance of CZK 59 million (2009: CZK 65 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 67 million (2009: CZK 55 million). The amount of inventories recognised as an expense is CZK 2,345 million (2009: CZK 2,630 million).

12 Receivables and prepayments

In CZK million	**31 December 2010**	**31 December 2009**
Trade receivables (net)	7,291	7,910
Other debtors (net)	289	389
Prepayments	768	733
Other financial assets - short-term	284	-
Derivative instruments	9	108
Total	8,641	9,140

Trade receivables are stated net of a bad debt provision of CZK 3,604 million (2009: CZK 3,448 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 23.

Trade receivables In CZK million	Carrying amount	Neither impaired nor overdue	Not impaired but overdue Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2010	7,291	3,308	273	25	30	119
At 31 December 2009	7,910	3,361	309	20	26	55

Bad debt provisions **In CZK million**	
At 1 January 2009	3,241
Additions	3,421
Retirements/amount paid	(3,214)
At 31 December 2009	3,448
Additions	3,474
Retirements/amount paid	(3,318)
At 31 December 2010	3,604

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 2010, the Company presented non-current assets of CZK 165 million (2009: CZK 1,311 million) consisting of other long-term credits and advance payments for long-term expenses, which are classified as other financial assets (2009: a long-term loan of CZK 1,032 million to Telefónica O2 Slovakia, s.r.o. presented in other financial assets).

13 Cash and cash equivalents

In CZK million	31 December 2010	31 December 2009	Interest rate
Cash at current bank accounts	203	141	Floating
Cash at cash-pooling structures (inter-company)	4,578	1,100	Floating
Total cash and cash equivalents	4,781	1,241	

As at 31 December 2010 and 2009 cash equivalents of the Group comprise interest bearing deposits with maximum maturity of three months.

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.

At 31 December 2010, the Company had available equivalent of CZK 4,135 million (2009: CZK 4,056 million) of undrawn committed facilities.

For the purposes of the statement of cash flows, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2010	31 December 2009
Cash and cash equivalents	4,781	1,241

As of 31 December 2010 and 2009 no cash and cash equivalents were pledged.

14 Trade and other payables

In CZK million	31 December 2010	31 December 2009
Trade creditors	5,062	3,642
Other taxes and social security	180	182
Deferred revenue	884	926
Employee wages and benefits	706	678
VAT payable	341	575
Other creditors	279	296
Accruals	4,016	4,411
Total payables	11,468	10,710
Other non-current liabilities	20	19

Payables to related parties are disclosed in Note 23.

As at 31 December 2010 and 2009 other non-current liabilities include primarily principals and liabilities with maturity in more than 12 months.

15 Financial debt

In CZK million	31 December 2010	31 December 2009
Bank loans in foreign currencies	2,883	3,044
Accrued interest including commitment fees	80	84
Derivatives	61	3
Other financial debt	141	87
Total financial debt	3,024	3,131
Repayable:		
Within one year	141	87
Between two and five years (total non-current)	2,883	3,044
Total financial debt	3,024	3,131

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 2010, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2010 and 2009 the Company does not utilize bank overdrafts.

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

In CZK million	**31 December 2010**	**31 December 2009**
At fixed rate	2,883	3,044

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	**2010**	**2009**
Bank loans in foreign currencies	6.64 %	6.64 %

Loans are not secured over any assets of the Company.

The table below summarizes the maturity profile of the Company's financial and trade liabilities at 31 December 2010 based on contractual undiscounted payments.

At 31 December 2010 **In CZK million**	**Less than 3 months**	**3 to 12 months**	**1 to 5 years**	**> 5 years**
Interest bearing loans and borrowings	-	191	3,074	-
Trade and other payables (excluding deferred revenue)	9,252	1,332	-	-
Derivatives (net)	61	-	-	-
Total	9,313	1,523	3,074	-
Non-current other liabilities	-	-	15	5

At 31 December 2009 **In CZK million**	**Less than 3 months**	**3 to 12 months**	**1 to 5 years**	**> 5years**
Interest bearing loans and borrowings	-	202	3,448	-
Trade and other payables (excluding deferred revenue)	8,763	1,021	-	-
Derivatives (net)	3	-	-	-
Total	8,766	1,223	3,448	-
Non-current other liabilities	-	-	12	7

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	
	2010	2009	2010	2009
Financial assets				
Cash and cash equivalents	4,781	1,241	4,781	1,241
Long-term loans	-	1,032	-	1,032
Short-term loans (incl. accrued interest)	284	-	284	-
Derivatives	9	108	9	108
Other financial assets	165	279	165	279

In CZK million	Carrying amount		Fair value	
	2010	2009	2010	2009
Financial liabilities				
Interest bearing loans and borrowings:				
Fixed rate borrowings (incl. accrued interest)	2,963	3,129	3,169	3,432
Derivatives	61	3	61	3

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

As of 31 December 2009 the Company provided a long-term loan in the amount of EUR 39 million (CZK 1,032 million) to Telefónica O2 Slovakia, s.r.o.

As of 31 December 2010 the Company provided a short-term loan in the amount of EUR 11.2 million (CZK 281 million) to Telefónica O2 Slovakia, s.r.o.

Fair value hierarchy

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

As at 31 December 2010 and 31 December 2009, the Company held only the foreign exchange contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2010, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

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**	
	2010	**2009**
FX risk		
Value at Risk*	(163)	(298)
Stress testing*	(52)	(56)
IR risk		
Stress testing*	(110)	(82)

* 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 the immediate loss caused by one-off change in the foreign exchange rate by 1 % in a negative direction

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 unfavourable 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.

Financial derivatives

The following nominal value of foreign exchange contracts was used by the Company to manage the currency risk:

	Nominal value In EUR million		Fair value In CZK million	
	2010	**2009**	**2010**	**2009**
Foreign exchange contracts	136	171	(52)	105

16 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 and long-term deferred taxes were calculated at 19% for both years 2009 and 2010.

In CZK million	**2010**	**2009**
At 1 January	3,333	3,299
Income statement tax charge / (credit) (Note 5)	603	34
At 31 December	3,936	3,333

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset 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 2010**	**31 December 2009**
Deferred tax assets	(248)	(316)
Deferred tax liabilities	4,184	3,649
Total	3,936	3,333

The deferred tax asset includes CZK 220 million (2009: CZK 289 million) recoverable in less than twelve months and CZK 28 million (2009: CZK 27 million) recoverable after more than twelve months. The deferred tax liability includes CZK 452 million (2009: CZK 378 million) payable in less than twelve months and CZK 3,732 million (2009: CZK 3,271 million) payable in more than twelve months.

The deferred tax is determined by these components:

In CZK million	**Balance sheet**		**Profit or loss**	
	2010	**2009**	**2010**	**2009**
Temporary differences relating to:				
- property, plant and equipment and intangible assets	4,162	3,621	541	(304)
- trade receivables, inventories and other differences	(226)	(288)	62	338
Total	3,936	3,333	603	34

17 Government social security and pension schemes

The Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2010 and 2009, the Company paid contributions at a rate of 34 % 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 1,481 million in 2010 (2009: CZK 1,509 million) (see Note 3). Employees contribute 11 % 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 51 million (2009: CZK 56 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 2010 relating to employee retirement amounted to CZK 0.2 million (2009: CZK 0.1 million) and were charged as an operating expense.

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

18 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Sale of real estate portfolio provision	Other	Total
At 1 January 2010	37	11	91	139	19	297
Additions during the year	120	422	112	23	29	706
Utilised during the year	(31)	(429)	(168)	(130)	(37)	(795)
At 31 December 2010	**126**	**4**	**35**	**32**	**11**	**208**
Short-term provisions 2010	84	4	26	32	11	157
Long-term provisions 2010	42	-	9	-	-	51
	126	**4**	**35**	**32**	**11**	**208**
Short-term provisions 2009	21	11	84	139	19	274
Long-term provisions 2009	16	-	7	-	-	23
	37	**11**	**91**	**139**	**19**	**297**

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 the next twelve months from the balance sheet date.

Employee related costs

Provisions for employee-related costs include expected costs associated with untaken holiday compensation and share plans.

Sale of real estate portfolio

The provision was established to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold (see Note 8).

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 19).

19 Contingencies

The Company is involved in a number of legal disputes arising from standard business interactions. Throughout 2010 the Company continued the successful trend of defending itself against law-suits filed by third parties in the past. Major legal disputes and other proceedings relating to the Company are shown below. The Company's management team is convinced that all potential risks arising from the below disputes are sufficiently reflected in the financial statements. The publication of other details on the disputes is not deemed by the Company as appropriate as this could anticipate the position of the Company on these matters:

Vodafone Czech Republic, a.s. Interconnect agreement dispute

On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) filed a legal action with the Municipal Court in Prague against the Company for damages worth CZK 538 million with interests and the return of unjust enrichment of CZK 117 million with interests. The Company allegedly did not transit the traffic to a network operated by the mobile operator in compliance with relevant interconnect agreements. The High Court in Prague confirmed the conclusion of the Company that this case had already been decided before the Czech Telecommunication Office in favour of the Company and that Vodafone Czech Republic, a.s. was seeking only to by-pass this court decision. In the light of the above, in September 2008 the Municipal Court in Prague terminated the proceeding. The High Court in Prague partly confirmed this decision. Subsequently the Municipal Court in Prague by its verdict of 30 September 2009 dismissed the remaining part of the legal action as groundless. The Company, based on the evolution so far, believes that the High Court will confirm this verdict in appeal proceedings. The hearing in this case is scheduled for February 2011.

ÚOHS (Office for Protection of Economic Competition)

I. Preliminary investigation

The Office for the Protection of Economic Competition (ÚOHS) has been conducting so called "preliminary investigation" since November 2008 to determine whether the Company had not abused its dominant position in the broadband market. The investigation was also commented in the media. The Company cooperated with the Office while repeatedly stating and proving that it had not held a dominant position in the market and, as such, no abuse could have been committed. Although the extent of information and documents required by the Office during more than a two-year long investigation immensely grew, the Company was never allowed to inspect the file to check its content and control how the information was interpreted by the Office. In the light of the above, the Company requested for court protection by legal action filed to the Regional Court in Brno. In December 2010, the Regional Court in Brno preliminarily banned the Office from the continuation of the preliminary investigation and, in February 2011, issued a verdict stating that the preliminary investigation has to be stopped immediately.

II. Proceedings for CZK 81.7 million

In December 2009, the Regional Court in Brno cancelled the decision of the Office over the penalty of CZK 81.7 million imposed in December 2003 on the Company in the proceedings on the alleged abuse of the dominant position in the fixed voice services market. As a consequence of the dismissal, the Company asked the Office for returning the penalty including interests. Although the principal was returned by the Office, before it was decided on the returning of interests, the Supreme Administrative Court in the meantime had cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. In reaction to this evolution, the Company has created a provision in a relevant amount to cover all eventualities (even only for an interim period of time) to return the penalty to the Office's account.

Other legal disputes

I. AUGUSTUS, spol. s r.o. has been sued the Company for an alleged loss of profit in the period from 1995 to 2001 in the amount of CZK 183 million with interests. AUGUSTUS, spol. s r.o. claims that the Company has illegally terminated the contract for the issue and distribution of phone cards signed for an open period of time. Based on the decision of the High court in Prague, in August 2006, the Company paid a sum of CZK 83 million plus relevant interests (total of CZK 139 million). Later on, we could see a positive turn in the proceedings in favour of the Company when the Supreme Court based on the Company's appeal cancelled the previous verdicts in June 2009 and the Municipal Court in Prague ultimately dismissed the lawsuit in April 2010. AUGUSTUS, spol. s r.o. filed an appeal but has not even paid the court charges until now. The Company in its reaction to the dismissal of the verdict and the subsequent dismissal of the lawsuit, filed a suit against AUGUSTUS, spol. s r.o. to return the amount of CZK 139 million. It turned out that at least CZK 94 million had been transferred to third parties based on agreements with the statutory representative. The Company is taking all legal steps to secure the property and to avoid additional losses.

II. AUGUSTUS, spol. s r.o. subsequently filed another legal action against the Company for the amount of CZK 294 million. Again, the action is based on the contract for the issue of phone cards which ended in 1995. AUGUSTUS, spol. s r.o. is trying in this suit to present some other claims that have no legal grounds and are even in the mutual contradiction. The Company is taking all steps leading to a consistent defence from this illegitimate claim and believes in full success in these proceedings. Given the sued amount, the Company also publishes information about this suit. With respect to the judicature of the Supreme Court and the evolution of the proceedings, the Company's management team is confident in winning this case.

III. MEDIATEL, a.s., cooperating with the Company since 1992 on the publishing of the phone directory distributed to all telecommunications subscribers (known under brand name "Zlaté stránky") filed a legal action against the Company for the compensation of an alleged damage exceeding CZK 359 million in December 2009. After the delivery of the legal action in January 2010, the Company presented its position with a detailed

analysis of the groundlessness of the suit. The hearing has not been scheduled so far. The Company is convinced of taking into account all potential risks of this suit.

IV. In 2009, the employees of CNS, a.s., dealing with the development and updates of IT applications and the employees of Telefónica O2 Business Solutions, spol. s r.o. were having negotiations over the potential collaboration relating to the operation of data boxes. However, no agreement was signed between the parties and, due to commercial reasons, the project was never materialised. CNS, a.s. filed in August 2010 a legal action against the Company for the compensation of damage and lost profit worth CZK 137.2 million for not signing any contract. The Company regards this claim as fabricated and the amount evidently exaggerated which can be demonstrated by the fact that in accordance with the annual profit and loss statement 2009, CNS, a.s. generated a yearly profit of less than CZK 5.5 million. The Company has expressed its comments on the suit being convinced of taking fully into account all potential risks of this suit.

V. The Company is involved in other legal disputes. The aggregate value of all disputes over CZK 5 million not closed with a verdict in 2010 totals to nearly CZK 30 million. The annual profit and loss statement takes also into account some minor disputes, however, with risks of lesser importance.

20 Commitments

Operating leases

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

In CZK million	31 December 2010	31 December 2009
No later than 1 year	1,311	1,352
Later than 1 year and not later than 5 years	4,431	4,684
Later than 5 years	4,079	4,710
Total	9,821	10,746

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2010 were CZK 1,425 million (2009: CZK 1,396 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.

The Company leases the majority of its car fleet under operating leases. Total future lease payments relating to these operating leases in 2010 were CZK 369 million (2009: CZK 344 million).

Capital and other commitments

In CZK million	31 December 2010	31 December 2009
Capital and other expenditure contracted but not provided for in the financial statements	4, 699	5, 422

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

21 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 mobile network of electronic communications,
c) public network for the transfer of radio and TV signal,
d) public fixed telephone network,
e) public mobile telephone network,
f) publicly accessible telephone services,
g) other voice services - service is provided as publicly available,
h) rent of circuits - service is provided as publicly available,
i) transmission of radio and TV signal - service is provided as publicly available,
j) transfers of data - service is provided as publicly available,
k) internet access services - service is provided as publicly available,
l) other voice services - service is not provided as publicly available,
m) rent of circuits – service is not provided as publicly available,
n) transmission of radio and TV signal – service is not provided as publicly available,
o) transfers of data – service is not provided as publicly available,
p) internet access 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 year 2010 and 2009, the Company provided the following selective services under CTO imposed obligations to provide universal service:

a) public pay telephones services,

b) access for disabled to the public telephone,

c) 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*,

d) 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 c) above are excluded from the universal service regime on the basis of CTO decision since 30 July 2009. Providing of these services continues in commercial regime out of universal service.

22 Share capital and reserves

	31 December 2010	31 December 2009
Nominal value per ordinary registered 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

* By the decision of the Extraordinary General Meeting held on 10 September 2010, the form of ordinary shares with a nominal value of CZK 100 issued as bearer shares was transformed in registered shares. The change in the form of shares was recorded in the Commercial Register on 13 September 2010. Change of the shares form has no impact on existing rights of the shareholders.

Shareholdings in the Company were as follows:

	31 December 2010	31 December 2009
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2009: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve is not distributable.

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 direct investment activities in pro-growth areas, i.e. fixed and mobile broadband internet and data IPTV, mobile services, corporate and public administration ICT solutions and further in the expansion and development of the mobile services in Slovakia.

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

There is no other specific objective.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2010	31 December 2009
Capital	77,575	77,754
Equity settled share based payment reserve	34	36
Total	77,609	77,790

23 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 and liabilities 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	For the period ended 31 December 2010	For the period ended 31 December 2009
Dividend paid to Telefónica, S.A.	8,943	11,179
Royalty fees (Telefónica, S.A.)	844	754
Management fees (Telefónica, S.A.)	205	-

Balance sheet In CZK million	31 December 2010	31 December 2009
a) Receivables	1	4
b) Payables	1,072	764

II. Other related parties – Telefónica Group:

Balance sheet In CZK million	31 December 2010	31 December 2009
a) Receivables	594	652
b) Payables	406	404
c) Short-term receivables (interest)	3	-
d) Cash equivalents (Note 13)	4,578	1,100
e) Short-term loans (Note 13)	281	-
f) Long-term loans (Note 13)	-	1,032

Profit or loss In CZK million	For the period ended 31 December 2010	For the period ended 31 December 2009
a) Sales of services and goods	1,145	1,306
b) Purchases of services and goods	1,157	1,049
c) Interest income	60	151
d) Interest expense	-	10

There were capital purchases of CZK 25 million carried out with related parties for the period ended 31 December 2010 (for the period ended 31 December 2009 capital purchases amounted to CZK 101 million).

The list of the Telefónica companies with which the Company had any transaction in 2010 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica O2 Germany GmbH& CO.OHG, Telefónica O2 UK Ltd., Telefónica O2 Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Telefónica Deutschland GmbH, Telefónica Soluciones, ALTAIR ASSURANCES S.A., Telecom Italia Sparkle S.p.A., 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 Investigación y Desrrollo, S.A., Portugal Telecom, Telecom Italia S.p.A., Telfisa Global, BV., Telefónica Finanzas, S.A., Telefónica International Wholesale Services, Telefónica International Wholesale Services II, 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., China Unicom (Hong Kong) Limited, Telefónica O2 Business Solutions, spol. s r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica O2 Slovakia, s.r.o., Telefónica Global Roaming GmbH.

III. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

In CZK million	**31 December 2010**	**31 December 2009**
Salaries and other short-term benefits	110	122
Personal indemnification insurance	5	5
Total	115	127

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2010 and 2009.

As at 31 December 2010 the Company provided a short-term loan of CZK 281 million (EUR 11 million) to Telefónica O2 Slovakia, s.r.o. presented in other financial assets short-term (Note 12). The loan bears a floating interest based on 1M EURIBOR. The loan conditions are based on the arm’s length principle.

As at 31 December 2009 the Company provided a long-term loan of CZK 1,032 million (EUR 39 million) to Telefónica O2 Slovakia, s.r.o. presented under other financial assets. The loan bears a floating interest based on 1M EURIBOR The loan conditions are based on the arm’s length principle.

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

24 Principal subsidiary undertakings

As at 31 December 2010

	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., merged with DELTAX Systems a.s.)	100 %	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100 %	10	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100 %	11	Austria	Data transmission services
4.	Telefónica O2 Slovakia, s.r.o.	100 %	6,116	Slovakia	Mobile telephony, internet and data transmission services
Associates					
5.	První certifikační autorita, a.s.	23 %	9	Czech Republic	Rendering of certification services
6.	AUGUSTUS, spol. s r.o.	40 %	-	Czech Republic	Sales by auctions and advisory services
7.	MOPET CZ a.s.	14 %	13	Czech Republic	Real time payment services via mobile phones

As at 31 December 2009

	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., merged with DELTAX Systems a.s.)	100 %	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100 %	13	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100 %	11	Austria	Data transmission services
4.	Telefónica O2 Slovakia, s.r.o.	100 %	5,081	Slovakia	Mobile telephony, internet and data transmission services
Associates					
5.	První certifikační autorita, a.s.	23 %	9	Czech Republic	Rendering of certification services
6.	AUGUSTUS, spol. s r.o.	40 %	-	Czech Republic	Sales by auctions and advisory services

In May 2010, the Board of Directors approved increase of the registered capital of Telefónica O2 Slovakia, s.r.o. by a monetary investment in the amount of EUR 40 million from the amount of the registered capital of EUR 200 million to the amount of the registered capital of EUR 240 million. Effective date of increase of the registered capital was 6 May 2010.

The Company and six other shareholders have founded the company MOPET CZ a.s. The purpose of the company MOPET CZ a.s. is a launch of new services which would enable paying in real time for goods and services, paying bills and invoices, sending money or paying for purchases on the Internet using a mobile telephone.

25 Post balance sheet events

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 2010.