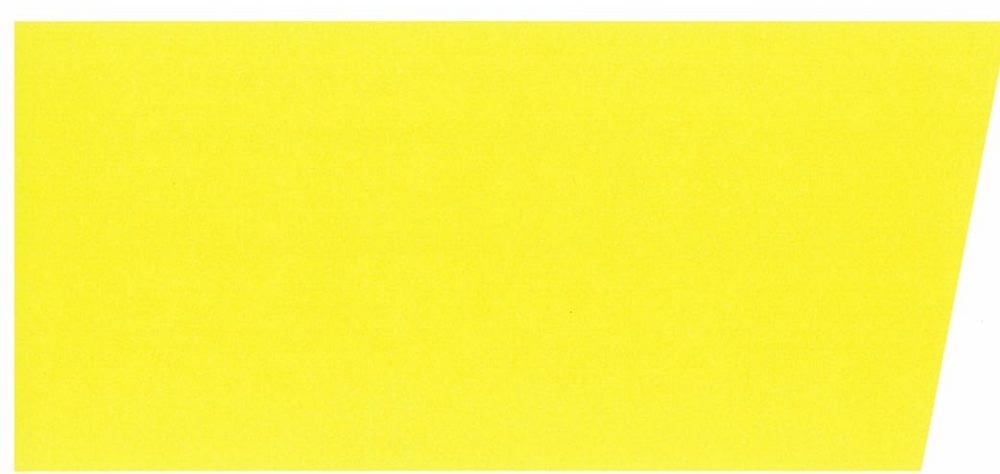


Telefónica Czech Republic, a.s.

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011**

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



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GENERAL INFORMATION

Telefónica 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 6,734 in 2011 (2010: 7,511).

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 17 February 2012.

Corporate name change

Effective from 16 May 2011 the Company changed its name Telefónica O2 Czech Republic, a.s. to Telefónica Czech Republic, a.s. and the new corporate name is entered in the Commercial Register. The Company will continue to operate under its O2 brand for its clients and all customers.

The 3G network sharing

The Company and T-Mobile Czech Republic a.s. signed an agreement on sharing the 3G network. The agreement concerns currently unserved areas and will accelerate construction of the network and significantly expand the 3G coverage of both operators. The pilot commercial operation has been launched in the second quarter of the 2011. The Company's high speed data service presently covers 73% of the Czech population.

Joint network monitoring

The Company and Telefónica Germany signed contracts regulating a joint project implementing Fixed and Mobile Networks Management for Telefónica networks in both countries. The project includes the integration of monitoring of several Telefónica Group networks in the Czech Republic, Slovakia and Germany - contributing to a more efficient use of resources and considerable operating costs savings. The entire project fits within the global Telefónica Group strategy, resulting in considerable annual savings.

Restructuring

During 2010, the Company restructured its activities mainly in Field Line Management areas of its business. Restructuring projects resulted in transfer of some activities to outsourcing partners.

During 2011, the Company went on achieving efficiency and cost optimization by introducing new projects in various areas of its business. Restructuring projects focused among others on call center consolidation and optimization. During the restructuring process more than 500 employees were made redundant and the Company incurred restructuring costs of CZK 173 million (see Note 2).

Branch of Telefónica Global Technology

On 1 December 2011, a Czech branch of Telefónica Global Technology started to operate. The branch employs for more than 200 people, mostly assigned from the Company. Telefónica Global Technology S.A.U. (a parent company of Telefónica Global Technology, S.A., branch) is a 100% owned subsidiary of Telefónica S.A. and was founded with the aim to provide IT services to individual operating departments of Telefónica Group. One of the two new European data centers is going to be build in the Czech Republic, where IT infrastructure for the Czech Republic, Slovakia and Germany will be located and operated.

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Telefónica Czech Republic, a.s.:

We have audited the accompanying financial statements of Telefónica Czech Republic, a.s. ("the Company"), which comprise the balance sheet as at 31 December 2011, 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 2011, 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.

A handwritten signature in blue ink that reads 'Ernst & Young'.

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

A handwritten signature in blue ink, likely belonging to Brian Welsh.

Brian Welsh
Partner

A handwritten signature in blue ink, likely belonging to Petr Vácha.

Petr Vácha
Auditor, License No. 1948

17 February 2012
Prague, Czech Republic

STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2011

In CZK million	Notes	Year ended 31 December 2011	Year ended 31 December 2010
Revenues from voice services	2	15,923	18,989
Monthly charges		12,412	13,328
Data services	2	11,275	11,410
Other revenues	2	9,253	9,265
Revenues		48,863	52,992
Other income	2	488	258
Interconnection and roaming expenses		(8,179)	(9,386)
Cost of goods sold		(2,087)	(1,833)
Other direct cost of sales	2	(3,215)	(3,061)
Other expenses	2	(9,184)	(9,518)
Staff costs	2	(5,690)	(6,512)
Impairment reversal/(loss)		(9)	4,325
Operating income before depreciation and amortization ("OIBDA")		20,987	27,265
Depreciation and amortisation	7, 8	(11,207)	(11,421)
Operating profit		9,780	15,844
Finance income	3	626	457
Finance costs	3	(744)	(572)
Profit before tax		9,662	15,729
Corporate income tax	4	(2,014)	(3,033)
Profit for the year		7,648	12,696
Other comprehensive income			
Other comprehensive income, net of tax		-	-
Total comprehensive income, net of tax		7,648	12,696
Profit attributable to:			
Equity holders of the Company	5	7,648	12,696
Total comprehensive income attributable to:			
Equity holders of the Company		7,648	12,696
Earnings per share (CZK) – basic*	5	24	39

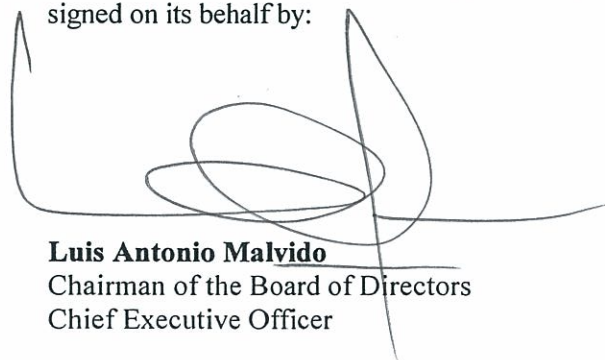
*There is no dilution of earnings as no convertible instruments have been issued by the Company.

BALANCE SHEET


As at 31 December 2011

In CZK million	Notes	31 December 2011	31 December 2010
ASSETS			
Property, plant and equipment	7	49,276	54,516
Intangible assets	8	19,795	20,735
Investment in subsidiaries and associates	22	6,446	6,396
Other financial assets	11	145	165
Non-current assets		75,662	81,812
Inventories	10	446	577
Receivables and prepayments	11	7,905	8,641
Income tax receivable	4	162	443
Cash and cash equivalents	12	6,941	4,781
Current assets		15,454	14,442
Non-current assets classified as held for sale	7	1	12
Total assets		91,117	96,266
EQUITY AND LIABILITIES			
Ordinary shares	20	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		15,809	21,026
Total equity		72,392	77,609
Long-term financial debts	14	-	2,883
Deferred tax liability	15	3,735	3,936
Non-current provisions for liabilities and charges	16	25	51
Non-current other liabilities	13	88	21
Non-current liabilities		3,848	6,891
Short-term financial debts	14	3,060	141
Trade and other payables	13	11,761	11,468
Provisions for liabilities and charges	16	56	157
Current liabilities		14,877	11,766
Total liabilities		18,725	18,657
Total equity and liabilities		91,117	96,266

These financial statements were approved by the Board of Directors on 17 February 2012 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 2011

In CZK million	Notes	Share capital	Share premium	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2010		32,209	24,374	36	6,450	14,721	77,790
Profit for the year		-	-	-	-	12,696	12,696
Total comprehensive income		-	-	-	-	12,696	12,696
Capital contribution and other transfers		-	-	(2)	-	9	7
Dividends declared in 2010	6	-	-	-	-	(12,884)	(12,884)
At 31 December 2010		32,209	24,374	34	6,450	14,542	77,609
At 1 January 2011		32,209	24,374	34	6,450	14,542	77,609
Profit for the year		-	-	-	-	7,648	7,648
Total comprehensive income		-	-	-	-	7,648	7,648
Capital contribution and other transfers		-	-	19	-	-	19
Dividends declared in 2011	6	-	-	-	-	(12,884)	(12,884)
At 31 December 2011		32,209	24,374	53	6,450	9,306	72,392

* Refer to Note 20 regarding amounts not available for distribution.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

In CZK million	Notes	Year ended 31 December 2011	Year ended 31 December 2010
Cash from operating activities			
Cash received from operations		53,271	56,679
Cash paid to suppliers and employees		(31,249)	(32,877)
Dividends received		7	111
Net interest and other financial expenses paid		(97)	(211)
Taxes paid		<u>(1,935)</u>	<u>(2,178)</u>
Net cash from operating activities		19,997	21,524
Cash flow from investing activities			
Proceeds on disposals of property, plant and equipment and intangible assets		609	224
Payments on investments in property, plant and equipment and intangible assets		(5,725)	(5,019)
Payments made on financial investments		<u>(77)</u>	<u>(1,048)</u>
Net cash used in investing activities		(5,193)	(5,843)
Cash flow from financing activities			
Dividends paid		(12,878)	(12,876)
Proceeds on loans, borrowings and promissory notes		342	1,214
Repayments of loans, borrowings and promissory notes		<u>(130)</u>	<u>(472)</u>
Net cash used in financing activities		(12,666)	(12,134)
Effect of foreign exchange rate changes on collections and payments			
		22	(7)
Net increase / (decrease) in cash and cash equivalents during the period		2,160	3,540
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD			
		4,781	1,241
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD			
	12	6,941	4,781
BALANCE AT THE BEGINNING OF THE PERIOD			
		<u>4,781</u>	<u>1,241</u>
Cash on hand and at banks		4,762	1,224
Other cash equivalents		19	17
BALANCE AT THE END OF THE PERIOD			
	12	<u>6,941</u>	<u>4,781</u>
Cash on hand and at banks		6,922	4,762
Other cash equivalents		19	19

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 IFRS Interpretations Committee (formerly called 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 IFRS policies applied by the Company 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 17 February 2012.

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 2011, 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:

IAS 24 – Related Party Transactions – Amendment (effective 1 January 2011)

The IASB issued an amendment to IAS 24 that clarifies the definitions of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarifies the circumstances in which persons and key management personnel affect related party

relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity.

The adoption of the amendment did not have any impact on the financial position or performance of the Company.

IAS 32 – Financial instruments: Presentation - Amendment (effective 1 February 2010)

The amendments address the classification of certain rights issues denominated in a foreign currency as either equity instruments or as financial liabilities. Under the amendments, rights, options or warrants issued by an entity for the holders to acquire a fixed number of the entity's equity instruments for a fixed amount of any currency are classified as equity instruments in the financial statements of the entity provided that the offer is made pro rata to all of its existing owners of the same class of its non-derivative equity instruments. Before the amendments to IAS 32, rights, options or warrants to acquire a fixed number of an entity's equity instruments for a fixed amount in foreign currency were classified as derivatives. The amendments require retrospective application.

The application of the amendments had no effect on the amounts reported in the current and prior years because the Company did not issue instruments of this nature.

IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments (effective 1 July 2010)

The Interpretation provides guidance on the accounting for the extinguishment of a financial liability by the issue of equity instruments. Specifically, under IFRIC 19, equity instruments issued under such arrangement will be measured at their fair value, and any difference between the carrying amount of the financial liability extinguished and the consideration paid will be recognised in profit or loss.

The application of IFRIC 19 has had no effect on the amounts reported in the current and prior years because the Company has not entered into any transactions of this nature.

Amendments to IFRIC 14 – Prepayments of a Minimum Funding Requirements (effective 1 January 2011)

The amendments correct an unintended consequence of IFRIC 14 - IAS 19 the Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. Without the amendments, in some circumstances entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. This was not intended when IFRIC 14 was issued, and the amendments correct the problem. The amendments must be applied retrospectively to the earliest comparative period presented.

There were not any material changes to the disclosure in the notes to the financial statements.

Improvements to IFRSs

IFRS 3 – Business Combinations (applicable to annual periods beginning on or after 1 July 2010)

a) Measurement of non-controlling interests

Specifies that the option to measure non-controlling interests either at fair value or at the proportionate share of the acquiree's net identifiable assets at the acquisition date under IFRS 3 (2008) applies only to non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the acquiree's net assets in the event of liquidation. All other components of non-controlling interests should be measured at their acquisition date fair value, unless another measurement basis is required by IFRSs.

b) Un-replaced and voluntary replaced share-based payment awards

Specifies that the current requirement to measure awards of the acquirer that replace acquiree share-based payment transactions in accordance with IFRS 2 at the acquisition date applies also to share-based payment transactions of the acquiree that are not replaced.

Specifies that the current requirement to allocate the market-based measure of replacement awards between the considerations transferred for the business combination and post-combination remuneration applies to all replacement awards regardless of whether the acquirer is obliged to replace the awards or does so voluntarily.

c) Transitional requirements for contingent consideration from a business combination that occurred before the effective date of IFRS 3 (2008)

Clarifies that IAS 32 – Financial Instruments: Presentation, IAS 39 – Financial Instruments: Recognition and Measurement and IFRS 7 – Financial Instruments: Disclosures do not apply to contingent consideration that arose from business combinations whose acquisition dates preceded the application of IFRS 3 (2008).

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

IFRS 7 – Financial instruments: Disclosures (effective 1 January 2011)

Encourages qualitative disclosures in the context of the quantitative disclosure required to help users to form an overall picture of the nature and extent of risks arising from financial instruments.

Clarifies the required level of disclosure around credit risk and collateral held and provides relief from disclosure of renegotiated loans.

There were not any material changes to the disclosure in the notes to the financial statements.

IAS 1 – Presentation of Financial Statements (effective 1 January 2011)

Clarifies that an entity may present the analysis of other comprehensive income by item either in the statement of changes in equity or in the notes to the financial statements.

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

IAS 27 – Consolidated and Separate Financial Statements (effective for annual periods beginning on or after 1 July 2010)

Clarifies that the amendments made to IAS 21 The Effects of Changes in Foreign Rates, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures as a result of IAS 27 (2008) should be applied prospectively (with the exception of paragraph 35 of IAS 28 and paragraph 46 of IAS 31, which should be applied retrospectively).

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

IAS 34 – Interim Financial Reporting (effective 1 January 2011)

Emphasises the principle in IAS 34 that the disclosure about significant events and transactions in interim periods should update the relevant information presented in the most recent annual financial report.

Clarifies how to apply this principle in respect of financial instruments and their fair values.

There were no material changes to the disclosure in the notes to the financial statements.

**New IFRS of the IFRS Interpretations Committee not effective as at 31 December 2011
(includes standards and interpretations applicable for the Company)**

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
IFRS 7	Disclosures - Transfers of Financial Assets (Amendment)	1 July 2011
IAS 1	Presentation of Items of Other Comprehensive Income (Amendment)	1 July 2012
IAS 12	Deferred Tax - Recovery of Underlying Assets (Amendment)	1 January 2012
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2013
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 19	Employee benefits (Amendment)	1 January 2013
IAS 27	Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28	Investments in Associates and Joint Ventures (as revised in 2011)	1 January 2013

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 consolidated financial statements in the initial period of application.

The Company is currently monitoring the development in the area of IFRSs being prepared regarding to leases and revenue recognition which are planned to be submitted in 2012.

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 either de-recognised or at 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 than its estimated recoverable amount (refer to Note F Impairment of assets).

D Intangible assets

Intangible assets include computer software, purchased goodwill, licenses and customer bases. 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 from 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 8 and Note 9).

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 is reviewed only from impairment point of view.

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 2011 and 2010, 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 profit or loss.

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 of interest. 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.

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 section of the balance sheet.

L Financial debt

Borrowings are recognised initially as 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 provision for 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 either 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 granted shares 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 either present legal or constructive obligation resulting from past events, and it is probable that an outflow of resources will be required to settle the obligation assuming that 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 while deciding the accounting treatment.

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.

Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from 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. Relevant costs are compensated by the Czech Telecommunication Office (CTO). The Company recognises the compensation using gross principle on standard accrual basis of revenue recognition.

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, if material, 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, accessories and other 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.

Audiotex

Revenues from audiotex, service offering content to which a special tariff applies and enables to transfer money and to pay for goods or services from the third parties, are recognised using netto principle.

Information and communication technologies services

Information and communication technologies services (ICT) include complex customer solutions and managed services, mainly system integration, outsourcing services, project solutions, software development. Revenue recognition of such services reflects substance of the provided services.

(2) Mobile business revenues

The Company earns mobile services revenue from customers usage of the Company's network, interconnection and roaming. 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 recognised 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 Company applies a percentage of expiry rate based on historical experience of expired airtime.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime 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.

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

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.

Premium SMS

Revenues from premium SMS, short text messages that enable customers to use their mobile phones to send money transfer requests and pay for goods and services from third parties, are recognised using netto principle.

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 14.

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 interest rates.

(iii) Liquidity rate risk

The Company's essential objective of liquidity risk management is having access to the 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

Credit risk concentration, with respect to trade accounts receivable, is 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 a particular national economy.

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers wishing to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the resulting into the non significant Company's exposure to bad debts. The maximum exposure is the carrying amount as disclosed in Note 11. There is no significant concentration 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 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). Those activities are processed in the integrated system solution for scoring, maintenance and collection of receivables called RMCA.
- 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) collection process: 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.

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 (See Note 4 and Note 15).

(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 profit or loss. The decision to recognize an impairment loss involves estimates of 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 Company 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 Company assesses 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 Company estimates the recoverable amount where an impairment loss recognised in prior periods shall be subject to the reversal (see Note 9).

The Company tests goodwill for an impairment at each reporting date. 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 (see Note 8).

(3) Provisions and contingent liabilities

As set out in Note 17 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 to settle the obligation will be required and a reliable estimate of the amount of the obligation can be made (see Note 16). 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.

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 2011 and 2010.

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 includes primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

NOTES TO THE FINANCIAL STATEMENTS

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1 Segment information

Business segments recognised by the Company are as follows:

- fixed - network communication services using a fixed network and IS/ICT services
- mobile - mobile communication services

Year ended 31 December 2011	Fixed	Mobile	Company
In CZK million			
Revenues from voice services	6,725	9,863	16,588
Monthly charges	4,298	8,114	12,412
Data services	8,776	2,499	11,275
Other revenues	2,942	6,311	9,253
Revenues incl. inter-segment sales	22,741	26,787	49,528
Inter-segment sales	(318)	(347)	(665)
Total revenues	22,423	26,440	48,863
Other income	481	7	488
Total costs	(14,043)	(14,312)	(28,355)
Impairment charge	(9)	-	(9)
Depreciation	(7,150)	(1,826)	(8,976)
Amortisation	(889)	(1,342)	(2,231)
Total depreciation and amortization	(8,039)	(3,168)	(11,207)
Operating income	813	8,967	9,780
Net financial loss			(118)
Profit before tax			9,662
Corporate income tax			(2,014)
Profit for the year			7,648
Assets (excluding goodwill)	40,507	37,290	77,797
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	-	13,320	13,320
Total assets	40,507	50,610	91,117
Trade and other payables	5,825	5,936	11,761
Other liabilities	3,449	3,515	6,964
Total liabilities	9,274	9,451	18,725
Capital expenditure	3,198	2,007	5,205

Year ended 31 December 2010 In CZK million	Fixed	Mobile	Company
Revenues from voice services	7,375	12,410	19,785
Monthly charges	5,133	8,195	13,328
Data services	9,107	2,303	11,410
Other revenues	2,906	6,359	9,265
Revenues incl. inter-segment sales	24,521	29,267	53,788
Inter-segment sales	(345)	(451)	(796)
Total revenues	24,176	28,816	52,992
Other income	232	26	258
Total costs	(14,624)	(15,686)	(30,310)
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 income	6,400	9,444	15,844
Net financial loss			(115)
Profit before tax			15,729
Corporate income tax			(3,033)
Profit for the year			12,696
Assets (excluding goodwill)	52,588	30,358	82,946
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	-	13,320	13,320
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

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 still valid and most appropriate for segment recognition.

The inter-segment pricing rates applied in 2011 and 2010 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 Revenues and costs

Revenues from voice services	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
Voice – outgoing	8,964	10,745
Interconnection and other wholesale services	6,959	8,244
Total revenues from voice services	15,923	18,989
Data services	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
Leased lines and fixed data services	2,837	3,132
Internet (including monthly and one-off charges)	5,428	5,384
Mobile data	2,499	2,303
IPTV	511	591
Total revenues from data services	11,275	11,410
Other revenues	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
SMS & MMS & PRMS and Contents	4,219	4,374
Equipment and activation charges	1,593	1,409
ICT and business solutions	2,226	2,407
Other telecommunication revenues	1,215	1,075
Total other revenues	9,253	9,265
Other income	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
Rental and non-telco income	105	112
Gains from fixed assets disposal	340	91
Indemnities, penalties and similar income	43	55
Total other income	488	258

Revenues from related parties are disclosed in Note 21.

Other direct cost of sales	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
Telco services, Contents and other cost of sales	(612)	(936)
Sub-deliveries	(1,134)	(1,003)
Commissions	(1,469)	(1,122)
Total other direct cost of sales	(3,215)	(3,061)
Other expenses	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
Billing and collection, provision for bad and doubtful debts	(792)	(905)
Network & IT repairs and maintenance	(2,581)	(2,486)
Rentals, buildings and vehicles	(1,906)	(1,995)
Utilities supplies	(1,057)	(1,017)
Marketing and call centers	(1,334)	(1,475)
Consultancy and professional fees and other external services	(571)	(684)
Royalties and management fees	(1,065)	(1,049)
Administrative fees and other operating expenses	(494)	(475)
Capitalized own expense on fixed assets	616	568
Total other expenses	(9,184)	(9,518)
Staff costs	Year ended	Year ended
In CZK million	31 December 2011	31 December 2010
Wages and salaries	(3,935)	(4,363)
Redundancy payments	(173)	(454)
Health and Social security contributions	(1,331)	(1,481)
Staff welfare costs	(251)	(214)
Total staff costs	(5,690)	(6,512)

Company does not participate in any pension plan.

A restructuring plan covering both employees and members of management was approved and subsequently implemented by the Company during 2010 and 2011. As a result of the restructuring process the Company incurred restructuring costs of CZK 173 million during the year ended 31 December 2011 that have been recognised for the redundancy payments (2010: CZK 422 million).

Statutory auditor's fees were as follows:

In CZK million	Year ended	Year ended
	31 December 2011	31 December 2010
Auditor's fees	21	22

Purchases from related parties are disclosed in Note 21.

3 Financial income and costs

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Financial income		
Interest income	119	86
Gain on fair value adjustments of financial instruments	185	-
Other financial income*	322	371
Total financial income	<u>626</u>	<u>457</u>
Financial costs		
Interest expenses	(224)	(240)
Loss on fair value adjustments of financial instruments	-	(175)
Other financial costs*	(520)	(157)
Total financial costs	<u>(744)</u>	<u>(572)</u>
Net financial loss	(118)	(115)

* Vast majority consists of gains/(losses) arising from foreign exchange differences

4 Income tax

In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
Total income tax expense is made up of:		
Current income tax charge	2,215	2,430
Deferred income tax charge (Note 15)	(201)	603
Taxes on income	<u>2,014</u>	<u>3,033</u>

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 2011	Year ended 31 December 2010
Profit before tax	9,662	15,729
Income tax charge calculated at the statutory rate of 19 % (2010: 19 %)	1,836	2,989
Not taxable income	-	(21)
Expenses not deductible for tax purposes	120	129
Tax related to prior periods	58	(64)
Taxes on income	<u>2,014</u>	<u>3,033</u>
Effective tax rate	21 %	19 %

As at 31 December 2011, the total amount of provision for current income taxes is CZK 2,205 million (2010: CZK 2,478 million), advances paid for income taxes amount to CZK 2,367 million (2010: CZK 2,921 million) and the net deferred tax liability is CZK 3,735 million (2010: CZK 3,936 million).

5 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 2011	31 December 2010
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	7,648	12,696
Basic earnings per share (CZK)	24	39

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

6 Dividends

In CZK million	31 December 2011	31 December 2010
Dividends declared (including withholding tax)	12,884	12,884

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2011. Approval of the 2011 profit and the decision regarding the amount of any dividend payment for the 2011 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 2011	Year ended 31 December 2010
Dividend per share (nominal value of 100 CZK)	40	40

7 Property, plant and equipment

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Communication technology and related equipment	Other fixed assets	Total
At 31 December 2011					
Opening net book amount	10,945	33,685	8,108	1,778	54,516
Additions	269	818	2,401	441	3,929
Disposals and other movements	(22)	(4)	43	-	17
Assets classified as held for sale	(199)	(2)	-	-	(201)
Depreciation charge	(876)	(4,858)	(2,458)	(784)	(8,976)
Impairment charge	-	-	(9)	-	(9)
Closing net book amount	10,117	29,639	8,085	1,435	49,276
At 31 December 2011					
Cost	19,125	102,990	88,458	7,986	218,559
Accumulated depreciation and impairment allowance	(9,008)	(73,351)	(80,373)	(6,551)	(169,283)
Net book amount	10,117	29,639	8,085	1,435	49,276
At 31 December 2010					
Opening net book amount	10,976	33,539	8,660	2,011	55,186
Additions	265	926	2,297	611	4,099
Disposals and other movements	2	74	45	(25)	96
Assets classified as held for sale	(3)	(1)	-	-	(4)
Depreciation charge	(660)	(4,636)	(3,079)	(822)	(9,197)
Impairment charge	(1)	-	(7)	-	(8)
Impairment reversal	366	3,783	192	3	4,344
Closing net book amount	10,945	33,685	8,108	1,778	54,516
At 31 December 2010					
Cost	19,612	102,470	88,962	8,490	219,534
Accumulated depreciation and impairment allowance	(8,667)	(68,785)	(80,854)	(6,712)	(165,018)
Net book amount	10,945	33,685	8,108	1,778	54,516

The net book amount at 31 December 2011 includes 1,569 million CZK of assets in the course of construction (31 December 2010: 2,614 million CZK) and assets in the course of

construction are spread in all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2011, the carrying value of non-depreciated assets amounted to CZK 191 million (2010: CZK 215 million).

No property, plant and equipment were pledged as at 31 December 2011.

No borrowing costs were capitalized during the years 2011 and 2010.

Classes of property, plant and equipment can be broken down into main categories as follows:

Land, buildings and construction In CZK million	Closing balance	
	31 December 2011	31 December 2010
Buildings*	5,590	6,056
* Majority of buildings are buildings for telecommunication technologies.		
Ducts, cables and related plant In CZK million	Closing balance	
	31 December 2011	31 December 2010
Twin cables	21,539	24,735
Terrestrial optic fibre	5,159	5,618
Communication technology and related equipment In CZK million	Closing balance	
	31 December 2011	31 December 2010
Exchanges	1,235	1,095
Transmission equipment	1,196	1,170
IP technology, routers, modems	941	989
Other fixed assets In CZK million	Closing balance	
	31 December 2011	31 December 2010
Information process equipment	1,098	1,160

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

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Other fixed assets	Total
At 31 December 2011				
Cost	6	-	-	6
Accumulated depreciation and impairment allowance	(5)	-	-	(5)
Net book amount	1	-	-	1
At 31 December 2010				
Cost	502	86	69	657
Accumulated depreciation and impairment allowance	(490)	(86)	(69)	(645)
Net book amount	12	-	-	12

Assets intended for sale in most cases represent buildings with lands that have become idle and ready to be sold. It is expected that the sale will take place within one year. Spaces in sold buildings were partially leased by the Company.

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

In 2011, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 340 million (2010: CZK 91 million) and total losses in amount CZK 42 million (2010: CZK 16 million).

In 2011, the Company conducted a copper project, which consisted of sale of unused copper cables (twin cables) achieving total gain CZK 223 million.

Cost of fully depreciated property, plant and equipment was CZK 70,290 million as at 31 December 2011 (2010: CZK 71,491 million).

8 Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2011				
Opening net book amount	13,320	3,514	3,901	20,735
Additions	-	-	1,276	1,276
Disposals and other movements	-	-	15	15
Amortisation charge	-	(386)	(1,845)	(2,231)
Closing net book amount	13,320	3,128	3,347	19,795
At 31 December 2011				
Cost	13,320	6,073	25,669	45,062
Accumulated amortisation and impairment allowance	-	(2,945)	(22,322)	(25,267)
Net book amount	13,320	3,128	3,347	19,795
At 31 December 2010				
Opening net book amount	13,320	3,901	4,456	21,677
Additions	-	-	1,283	1,283
Disposals and other movements	-	(1)	-	(1)
Amortisation charge	-	(386)	(1,838)	(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

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.

The Company performed impairment tests resulting into no impairment losses of goodwill were being recognised in 2011 and 2010. 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, have been approved by the management and are 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 the 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 a weighted average of cost of capital ("WACC").

There is no other intangible asset with indefinite useful life except for goodwill.

Licences

Acquired licences are represented by rights to operate cellular networks in the Czech Republic, the UMTS (Universal Mobile Telecommunication System, the third generation mobile cellular technology for networks), GSM (Global System for Mobile Communication, the second generation technology) and NMT (Nordic Mobile Telephone, the first generation technology).

In the course of 2012, the Czech Telecommunication Office is expected to announce a tender for licences to operate cellular network. These licences concern rights to operate the 1800MHz, 800 MHz (Digital dividend), 2.6GHz FDD and 2.6 GHz TDD spectrums.

The Company participates in a public discussion about tender conditions that should occur during the first half of 2012 with a consecutive tender process to be called later by the Czech Telecommunication Office.

All considered spectrums will be offered in one tender.

Carrying value of licences:

In CZK million	Force by	31 December 2011	31 December 2010
GSM 900 license	2016	330	402
GSM 1800 license	2016	266	324
NMT 450 license	2013	13	19
UMTS license	2022	<u>2,519</u>	<u>2,769</u>
Total		3,128	3,514

No borrowing costs were capitalized during the years 2011 and 2010.

Cost of fully amortised intangible assets was CZK 18,015 million as at 31 December 2011 (2010: CZK 19,003 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.

9 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 at 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 at 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 a consequence of June's impairment reversal the management of the Company reviewed again the indicators by 31 December 2010 as well as 31 December 2011, which could have indicated whether the CGU's assets might be impaired. Assessment carried out as at 31 December 2010 and 2011 confirmed that no such indicator exists and the values of the existing assets are fairly stated.

10 Inventories

In CZK million	31 December 2011	31 December 2010
Telecommunication material	124	251
Goods and work in progress	322	326
Total	446	577

The inventories noted above are stated net of an allowance of CZK 41 million (2010: CZK 59 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 47 million (2010: CZK 67 million). The amount of inventories recognised as an expense is CZK 2,611 million (2010: CZK 2,345 million).

11 Receivables and prepayments

In CZK million	31 December 2011	31 December 2010
Trade receivables from the third parties (net)	6,413	6,696
Group trade receivables	463	595
Prepayments	515	768
Other debtors (net)	514	582
Total	7,905	8,641

Trade receivables and other debtors are stated net of a bad debt provision of CZK 3,539 million (2010: CZK 3,604 million). In order to preserve the tax-deductible status of the bad debt expense, the Company's trade receivables have been fully provided for, however not derecognised from the primary books and records until certain statutory collection requirements are satisfied.

As at 31 December 2011, other debtors contained restricted cash of CZK 22 million (2010: CZK 0 million).

Receivables from related parties are disclosed in Note 21.

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 2011	6,876	3,449	210	16	32	59
At 31 December 2010	7,291	3,308	273	25	30	119
Bad debt provisions						
In CZK million						
At 1 January 2010						3,448
Additions						3,474
Retirements/amount paid						<u>(3,318)</u>
At 31 December 2010						3,604
Additions						2,492
Retirements/amount paid						<u>(2,557)</u>
At 31 December 2011						3,539

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 2011, the Company presented non-current assets of CZK 145 million (2010: CZK 165 million) consisting of other long-term credits and advance payments for long-term expenses, which are classified as other financial assets. As at 31 December 2011, non-current financial assets contained restricted cash of CZK 20 million (2010: CZK 0 million) resulting for the Company from legal requirements set by Czech National Bank Authority for payment services providers.

12 Cash and cash equivalents

In CZK million	31 December 2011	31 December 2010	Interest rate
Cash at current bank accounts	178	203	Floating
Cash at cash-pooling structures (inter-company)	<u>6,763</u>	<u>4,578</u>	Floating
Total cash and cash equivalents	6,941	4,781	

As at 31 December 2011 and 2010, cash equivalents of the Group comprised interest bearing deposits with maximum maturity of three months.

Since April 2006, the Company has been taking part in Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective cash flow management.

At 31 December 2011, the Company had available equivalent of CZK 1,802 million (2010: CZK 4,135 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 2011	31 December 2010
Cash and cash equivalents	6,941	4,781

As at 31 December 2011 and 2010 no cash and cash equivalents were pledged.

13 Trade and other payables

In CZK million	31 December 2011	31 December 2010
Trade creditors (net)	9,605	9,078
Tax and social security liability	597	613
Other deferred revenue	371	480
Prepaid cards	409	404
Employee wages and benefits	487	546
Other creditors	<u>292</u>	<u>347</u>
Total payables	11,761	11,468
Other non-current liabilities	88	21

Payables to related parties are disclosed in Note 21.

As at 31 December 2011 and 2010, other non-current liabilities were made up primarily of deposits placed by recharging partners for prepaid cards and liabilities with due date in more than 12 months.

14 Financial debt

In CZK million	31 December 2011	31 December 2010
Bank loans in foreign currencies	2,968	2,883
Interest obligation and derivatives	<u>92</u>	<u>141</u>
Total financial debt	3,060	3,024
Repayable:		
Within one year	3,060	141
Between two and five years (total non-current)	<u>-</u>	<u>2,883</u>
Total financial debt	3,060	3,024

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 2011, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2011 and 2010, the Company did 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 2011	31 December 2010
At fixed rate	2,968	2,883

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate estimated by the management of the Company as reachable at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2011	2010
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 2011 based on contractual undiscounted payments.

At 31 December 2011	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
In CZK million				
Interest bearing loans and borrowings	-	3,165	-	-
Trade and other payables (excluding deferred revenue and prepaid cards)	9,654	1,327	-	-
Total	9,654	4,492	-	-
Non-current other liabilities	-	-	82	6
At 31 December 2010	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
In CZK million				
Interest bearing loans and borrowings	-	191	3,074	-
Trade and other payables (excluding deferred revenue and prepaid cards)	9,252	1,332	-	-
Total	9,252	1,523	3,074	-
Non-current other liabilities	-	-	16	5

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	
	2011	2010	2011	2010
Financial assets				
Cash and cash equivalents	6,941	4,781	6,941	4,781
Short-term loans (incl. accrued interest)	67	284	67	284
Derivatives	101	9	101	9
Other financial assets	145	165	145	165
In CZK million				
Financial liabilities				
Interest bearing loans and borrowings:				
Fixed rate borrowings (incl. accrued interest)	3,051	2,963	3,115	3,169
Derivatives	9	61	9	61

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

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 that have a significant effect on the recorded fair value and that are not based on observable market data.

As at 31 December 2011 and 31 December 2010, the Company held only the foreign currency forward and swap contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2011, 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	
	2011	2010
FX risk		
Value at Risk*	(149)	(163)
Stress testing*	(47)	(52)
IR risk		
Stress testing*	(91)	(110)

* 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	
	2011	2010	2011	2010
Foreign exchange contracts	165	136	92	(52)

15 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 2010 and 2011.

In CZK million	2011	2010
At 1 January	3,936	3,333
Profit or loss tax charge / (credit) (Note 4)	<u>(201)</u>	<u>603</u>
At 31 December	3,735	3,936

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

In CZK million	31 December 2011	31 December 2010
Deferred tax assets	(218)	(248)
Deferred tax liabilities	<u>3,953</u>	<u>4,184</u>
Total	3,735	3,936

The deferred tax asset includes CZK 196 million (2010: CZK 220 million) recoverable in less than twelve months and CZK 22 million (2010: CZK 28 million) recoverable after more than twelve months. The deferred tax liability includes CZK 494 million (2010: CZK 452 million) payable in less than twelve months and CZK 3,459 million (2010: CZK 3,732 million) payable in more than twelve months.

The deferred tax is determined by these components:

In CZK million	Balance sheet		Profit or loss	
	2011	2010	2011	2010
Temporary differences relating to:				
Property, plant and equipment and intangible assets	3,852	4,162	(310)	541
Trade receivables, inventories and other differences	<u>(117)</u>	<u>(226)</u>	<u>109</u>	<u>62</u>
Total	3,735	3,936	(201)	603

16 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2011	126	82	208
Additions during the year	16	374	390
Utilised during the year	(120)	(397)	(517)
At 31 December 2011	22	59	81
Short-term provisions 2011	3	53	56
Long-term provisions 2011	19	6	25
	22	59	81
Short-term provisions 2010	84	73	157
Long-term provisions 2010	42	9	51
	126	82	208

With the exception of the regulatory and court decision provisions and other small provisions 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.

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 17).

Other provisions

Other provisions consist mainly of expected costs associated with untaken holiday compensation, share plans and provision to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold.

17 Contingencies

The Company is involved in a number of legal disputes arising from standard business interactions. Throughout 2011 the Company continued the successful trend of defending itself against law-suits filed by the third parties in the past. The only new lawsuit against the Company was brought by VOLNÝ, a.s. During 2011, an official administrative proceeding has been opened by Office for Protection of Economic Competition (see II). Major legal disputes and other proceedings relating to the Company are shown below.

I. 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 dismissed the remaining part of the legal action as groundless by its verdict of 30 September 2009. The High Court confirmed this verdict in appeal proceeding in February 2011 and the proceeding is legally closed. Though, Vodafone Czech Republic a.s. filed extraordinary appeal regarding CZK 26 million claiming that the decision is incorrect in this extent. The Supreme Court has not decided on extraordinary appeal yet.

II. ÚOHS (Office for Protection of Economic Competition)

i. Administrative proceeding on alleged abuse of dominant position on fix broadband market

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 abused its dominant position in the broadband market. 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 grew immensely, 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. This verdict was later confirmed by Supreme Administrative Court in September 2011. The Office reacted by opening official administrative proceeding on dominant position on fix broadband market by ADSL technology in March 2011. The Company filed its statement proving that the Office incorrectly defines relevant market on which Company would allegedly hold dominant position and moreover even abuse it. Company's statement about strong competition between

technological platforms such as xDSL, cable and Wi-Fi in the Czech Republic was repeatedly confirmed by the Czech Telecommunication Office and European Commission. The Company also provided the Office with numerous documents proving that all steps of the Company were correct. More records are continuously filed into the file. The Company cannot estimate when the proceeding will be closed due to extreme length and volume of information. As at the date of the financial statements approval it was not possible to make a reliable estimate of the financial impact of this administrative proceeding.

ii. Proceeding 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 proceeding 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 had in the meantime cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. After all in March 2011 the Regional Court in Brno cancelled the decision regarding the penalty and returned the case back to the Office where the Office should in compliance with law justify the penalty in relation to the judged period.

III. Disputes with AUGUSTUS spol. s r.o. company

i. AUGUSTUS spol. s r.o. had 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 proceeding 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. The High Court finally confirmed this dismissal in August 2011. In reaction to this the Company filed a lawsuit against AUGUSTUS spol. s r.o. to return the amount of CZK 139 million. The Municipal Court in Prague granted the claim in September 2011. AUGUSTUS spol. s r.o. filed an appeal. Meanwhile 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 was based on the contract for the issue of phone cards which ended in 1995. Claims had no legal grounds and in the light of development in the main case indefensible. The proceeding was finally terminated due to the non-payment of the court fee in January 2011.

IV. MEDIATEL, spol. s r.o. – dispute on CZK 359 million

MEDIATEL, spol. s r.o., which was cooperating with the Company on the publishing of the phone directory distributed to all telecommunications subscribers since 1992 (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 lawsuit. The Court in the first hearing pointed out deficiencies in the legal action and burden of proof (claim is not satisfactory justified). Next hearing will take place in 2012.

V. CNS a.s. – dispute on CZK 137 million

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 hearing will take place during the year 2012.

VI. VOLNÝ, a.s. – dispute on CZK 4 billion

On 28 March 2011, VOLNÝ, a.s. filed a legal action with the Municipal Court in Prague against the Company for an amount exceeding CZK 4 billion for an alleged abuse of a dominant position on the market of Internet broadband connection provided to households via ADSL. The amount is meant to represent the lost profit for years 2004 to 2010. VOLNÝ, a.s. claims to have had 30% share on the dial-up Internet market in 2003 and thus implies in its legal action that it should automatically have the same result on the broadband market, which it does not. Allegedly, it is due to the margin squeeze applied by the Company on the fix broadband market. The Company replied to the petition in July 2011 by noting that both the claim and the calculations submitted by the plaintiff were unsubstantiated and by pointing at discrepancies in the petition claims. The lawsuit has not been heard by the Court yet. Oral hearing could be expected during 2012.

The Company is involved in other legal disputes. The aggregate value of all disputes over CZK 5 million not closed with a verdict in 2011 totals to nearly CZK 12 million. The annual profit and loss statement takes into account also some minor disputes, however, with risks of less importance.

The Company considers disclosing other information regarding the said litigations not advisable, as it could endanger the strategy of the Company in these cases.

The Company is convinced that all risks relating to the litigations have been duly reflected in the financial statements.

18 Commitments

Operating leases - lessee

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

In CZK million	31 December 2011	31 December 2010
No later than 1 year	1,303	1,311
Later than 1 year and not later than 5 years	4,498	4,431
Later than 5 years	3,966	4,079
Total	9,767	9,821

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2011 were CZK 1,362 million (2010: CZK 1,425 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 2011 were CZK 313 million (2010: CZK 369 million).

Operating leases - lessor

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 2011	31 December 2010
No later than 1 year	104	100
Later than 1 year and not later than 5 years	391	338
Later than 5 years	90	89
Total	585	527

Capital and other commitments

In CZK million	31 December 2011	31 December 2010
Capital and other expenditure contracted but not provided for in the financial statements	1,881	4,699

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

19 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, 516/3, 516/4 and 516/5.

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 individual authorisation to use radio frequencies issued by CTO and valid until 30 November 2013 is provided broadband mobile access to Internet.

Validity of radio frequency license 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.

Imposition of obligations related to provision of universal service

During 2011 and 2010, 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) 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.

Until 2009, universal service was reimbursed by electronic communication market participants. Since 2010, the Czech Telecommunication Office has received funding from the state budget, which is without delay transferred to Company's account. Positive effect of this change is a decrease of direct expenses due to zero of Company's share, full reimbursement of Company's costs faster process of settlement and lower internal cost resulting from disputes concerning participant's contributions.

20 Share capital and reserves

	31 December 2011	31 December 2010
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

Shareholdings in the Company were as follows:

	31 December 2011	31 December 2010
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2010: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve amounted CZK 53 million (2010: CZK 34 million) 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. development and improvement of fixed and mobile broadband internet and data networks, mobile services, corporate and public administration ICT solutions and further in the expansion and development of the mobile services (including data) in Slovakia. IT systems renewal and upgrade are among other investment activities with the aim to simplify and improve processes that will lead to better operational effectiveness.

At present, the approach that the Company follows is not to retain surplus cash and distribute it to shareholders. In the following periods, the Board of Directors will continue to carry out and evaluate 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.

With regards to dividend capacity (capped by retained earnings from previous years and profit for the current year) which will be lower than surplus cash amount, in 2011 the Company has been undertaking out an analysis of other options, which might allow to distribute other available funds. These options comprise:

- a) distribution of share premium
- b) share capital reduction through a decrease in nominal value of shares
- c) share buy back

Equity structure of the Company as at 31 December 2011:

In CZK million	31 December 2011
Share capital	32,209
Share premium	24,374
Funds and reserves	6,503
Retained earnings from previous years	1,658
Net income for current year	7,648
Total	72,392

21 Related party transactions

The Telefónica Group has been reorganized in 2011 into four divisions – two geographic and two global ones.

Two geographic divisions are Telefónica Europe and Telefónica Latin America while the Company belongs to the former.

Two global cross-business divisions are Telefónica Digital and Telefónica Global Resources. Telefónica Digital seeks to strengthen the role of Telefónica in the digital world and exploit all growth opportunities while strengthening the portfolio of products and services. Telefónica Global Resources was created to increase the profitability by using all benefits of global exposure.

The Company operates in roaming, interconnection and telecommunications services in regional divisions. In the area of support services, the Company uses cooperation within global divisions.

The Company cooperates with Telefónica Global Services GmbH in performing centralized demand aggregation, negotiation activities related to the purchases of selected product categories and services and carrying out centralized commercial supplier management.

The Company cooperates with Telefónica Global Roaming GmbH in managing wholesale roaming business, negotiaton and execution of roaming discounts agreements with roaming partners which enables the Company to be granted discounts by the roaming partners and to grant discounts to the roaming partners.

The Company provides services to all related parties on regular 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 neither allowance nor write off were incurred.

The following transactions were carried out with related parties:

I. Parent company:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	6	1
b) Payables	798	1,072
Profit or loss In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
a) Sales of services and goods	-	4
b) Purchases of services and goods (excl. Royalty fees)	38	32

The total amount of dividend paid as at 31 December 2011 to Telefónica, S.A. was CZK 8,943 million (31 December 2010: CZK 8,943 million).

For the period ended 31 December 2011 the royalty fees to Telefónica, S.A. amounted to CZK 768 million (for the period ended 31 December 2010: 844 CZK million).

II. Other related parties – Company’s subsidiaries and associates:

Balance sheet In CZK million	31 December 2011	31 December 2010
a) Receivables	143	173
b) Payables	206	155
c) Short-term loans (Note 14)	62	281
Profit or loss In CZK million	Year ended 31 December 2011	Year ended 31 December 2010
a) Sales of services and goods	479	356
b) Purchases of services and goods	341	393
c) Interest income	2	7

III. Other related parties – Telefónica Group:

Balance sheet	31 December 2011	31 December 2010
In CZK million		
a) Receivables	314	421
b) Payables*	2,034	1,531
c) Short-term receivables - interest (Note 14)	5	3
d) Cash equivalents (Note 12)	6,763	4,578

* As at 31 December 2011 payables to TELEFÓNICA FACTORING E.F.C., S.A. of CZK 1,348 million were included (2010: CZK 1,280 million).

Profit or loss	For the period ended	For the period ended
In CZK million	31 December 2011	31 December 2010
a) Sales of services and goods	806	786
b) Purchases of services and goods	768	731
c) Management fees	297	205
d) Interest income	76	53

There were capital expenditures of CZK 37 million carried out with related parties for the period ended 31 December 2011 (for the period ended 31 December 2010 capital expenditures amounted to CZK 25 million).

The list of the Telefónica companies with which the Company had any transaction in 2011 and 2010 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica Germany GmbH& CO.OHG, Telefónica UK Ltd., Telefónica Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., O2 Holdings Ltd., Telefónica Deutschland GmbH, ALTAIR ASSURANCES S.A., 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 Desarrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., S.A., Atento Chequia, Portugal Telecom, 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 Global Roaming GmbH, Vivo, S.A., Telefónica Europe People Services Limited, Jajah Ltd., Telefónica USA, Telefonica Global Technology Chequia, Telefonica Global Technology, Telefonica Global Services GmbH, MOPET CZ a.s., TELEFÓNICA FACTORING E.F.C., S.A., Telefónica O2 Business Solutions, spol. s r.o., Internethome, s.r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica Slovakia, s.r.o.

Liabilities to TELEFÓNICA FACTORING E.F.C., S.A. represent due balances arising from the assigned receivables by the suppliers using Group factoring and are considered as a due amount to the associate company.

IV. 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 2011	31 December 2010
Salaries and other short-term benefits	109	110
Personal indemnification insurance	<u>4</u>	<u>5</u>
Total	113	115

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2011 and 2010.

As at 31 December 2011 the Company provided a short-term loan of CZK 19 million (2010: CZK 281 million) to Telefónica Slovakia, s.r.o. presented in short-term loans (Note 14). 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 2011 the Company provided a short-term loan of CZK 43 million to Internethome, s.r.o. presented in short-term loans (Note 14). The loan bears a floating interest based on 1M PRIBOR. The loan conditions are based on the arm's length principle.

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

22 Principal subsidiary undertakings and associates

As at 31 December 2011

Subsidiaries	Company's interest	Cost of investment in CZK million	Country of incorporation	Activity
1. Telefónica O2 Business Solutions, spol. s r.o.	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 %	6	Austria	Data transmission services
4. Telefónica Slovakia, s.r.o.	100 %	6,116	Slovakia	Mobile telephony, internet and data transmission services
5. Internethome, s.r.o.	100 %	55	Czech Republic	Providing of internet access on WiFi technology
Associates				
6. První certifikační autorita, a.s.	23 %	9	Czech Republic	Rendering of certification services
7. AUGUSTUS, spol. s r.o.	40 %	-	Czech Republic	Sales by auctions and advisory services
8. MOPET CZ a.s.	14 %	13	Czech Republic	Real time payment services via mobile phones

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.	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

In 2011, the Company became the sole shareholder of the new subsidiary with registered capital of 200 thousand CZK. The company Internethome, s.r.o., was established by demerging by spin-off of Telefónica O2 Business Solutions, spol. s.r.o. The change was recorded in the Commercial Register on 1 October 2011.

In December 2011, the Board of Directors approved increase of the other equity funds of Internethome, s.r.o. by CZK 55 million in the form of cash contribution. Effective date of increase of the other equity funds was 16 December 2011.

23 Post balance sheet events

On 1 January 2012 the subsidiary Informační linky, a.s. was founded by registration in the Commercial Register. The company was established by a non monetary investment of the part of enterprise running its core business in call-based information and on-line business catalogue. By preparation of these financial statements the Company had been in progress with reaching an Agreement for the sale and purchase of shares with Hapalo Estates s.r.o. As a result this contract 80% of shares of the subsidiary Informační linky, a.s. are to be sold and revenues from this transaction are to be recognised in profit or loss. The buyer will receive an option for acquisition of the remaining 20% of shares and it is highly probable that the buyer will execute this option. Remaining 20% of shares will not constitute substantial influence, it will be recognised in financial investments in costs, it will not be included in consolidation.

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 2011.

