Registered Number: 5310128

O2 plc

Annual Report and Financial Statements
for the 10 months ended 31 January 2006

O2 plc
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Company information

Directors

César Alierta Izuel
Sir David Arculus
Peter Erskine
David Finch
Danuta Gray
Rudolf Gröger
Matthew Key
Julio Linares Lopez
Sohail Qadri
Jaime Smith Basterra
Andrew Sukawaty
Antonio Viana-Baptista

Secretary and registered office

Philip Bramwell

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O2 plc
Directors' report

The Directors have pleasure in presenting to shareholders their report and the audited financial statements of O2 plc for the 10 months ended 31 January 2006.

Corporate structure

O2 plc is a public limited company registered in England and Wales under the number 5310128. The registered address is Wellington Street, Slough, Berkshire SL1 1YP.

As part of the implementation of the Scheme of Arrangement undertaken by the O2 Group last year, and as referred to in the Company's 2005 Annual Report and Financial Statements, the Company filed on 29 September 2005 for de-registration of its ordinary shares of 0.1 pence each from the Securities and Exchange Commission ("SEC") following the exercise of the compulsory transfer provisions in the Company's Articles of Association and subsequent reduction in the number of US Resident Shareholders to below the 300 limit specified by the SEC. This de-registration became effective 90 days later in accordance with the SEC regulations.

On 31 October 2005, the Boards of Telefónica and O2 jointly announced that they had agreed the terms of a recommended cash offer to be made on behalf of Telefónica for the entire issued and to be issued share capital of O2. Shareholders were offered £2 cash or a Loan Note Alternative for every one O2 Share which they held in the Company. The Telefónica Offer was declared wholly unconditional on 23 January 2006 at which time Telefónica became the Company's ultimate holding company.

Post balance sheet events

Following the Telefónica Offer being declared wholly unconditional, Telefónica procured O2 to apply to the Financial Services Authority for the cancellation of the listing of its shares on the Official List and to the London Stock Exchange for the cancellation of the admission to trading of O2 Shares on the London Stock Exchange's market for listed securities. The cancellation of O2's listing and admission to trading became effective on 7 March 2006 and the Company's audit, nomination and governance, and remuneration committees were dissolved with effect from this date and the responsibilities of these committees were subsumed into those of Telefónica. On 21 March 2006, the Board established a Compensation Committee, for setting financial performance targets in relation to annual O2 Group employee bonus plans, and approved the formation of an Assurance Committee, amongst other things, to co-ordinate implementation and follow up of Telefónica Group financial policies and procedures.

The Company has changed its accounting reference date from 31 March to 31 January.

On 20 June 2006, O2 purchased the entire issued share capital of Be Un Limited for £50 million, thereby acquiring a leading broadband capability in the UK, and a platform for developing future converged services that integrate mobile and the internet.

On 21 June 2006, O2 announced that that it was in exclusive negotiations regarding the acquisition by O2 (UK) Limited of DSG Retail Limited's 60% stake in The Link Stores Limited, and had reached commercial agreement in principle, subject to agreement of legally binding documentation and other terms and conditions, for a cash sum of approximately £30 million.

Principal activity

The principal activity of the O2 Group continues to be the provision of mobile communications services in Europe and it continues to trade through its wholly-owned subsidiaries in the UK, Germany, Ireland and the Isle of Man. The Group also provides a nationwide mobile radio service designed to serve the needs of the police and other emergency services in England, Wales and

Scotland through O2 Airwave. O2 UK has a 50 per cent interest in a joint venture, Tesco Mobile, to sell exclusively Tesco branded mobile services in Tesco stores across the UK, using O2's technology and network. In addition, O2 Germany has a 50 per cent interest in Tchibo Mobilfunk, a joint venture with Tchibo GmbH, which sells O2 mobile services in Germany. It is also a founding member of the Starmap Mobile Alliance, a group of independent mobile phone operators who have joined forces in readiness for the international roll-out of UMTS services. Following the acquisition of O2, Telefónica announced that the O2 Group would be run as a business division of the Telefónica Group and that O2 should also be responsible for the management of Telefónica Deutschland GmbH and the ČESKÝ TELECOM Group. The financial statements for O2 for the 10 month period ended 31 January 2006 do not, however, reflect the results of those businesses for that period.

Business review

The Group's mobile businesses in the UK, Germany and Ireland have continued to trade strongly during the 10 months ended 31 January 2006, with growth in the number of both pre-pay and contract customers in each business. The growth in customer numbers was driven by both the acquisition of new customers and the improved retention of existing customers. A detailed operating review for each of the Group's main trading businesses is provided below.

The Group's joint ventures also continued to trade successfully. In the UK, the Tesco Mobile joint venture performed well, reporting that its active customer base reached one million in December 2005 and in Germany customers acquired through the Tchibo Mobilfunk joint-venture distribution channel had reached 593,000 by December 2005.

The Group announced on 1 April 2005 that O2 Airwave had completed the nationwide network to provide every police force in England, Scotland and Wales with state of the art, secure digital communications. The five-year programme involved building out the largest public safety mobile communications network of its kind in Europe. In July 2005 O2 Airwave announced that it had been successful in its bid to provide a communications service to Ambulance Trusts in England and in November 2005 it was announced that O2 Airwave had been successful in its bid to equip all Fire and Rescue services throughout England with a new resilient and secure voice and data communications service.

Manx Telecom is unique within the Group, providing mobile, fixed line and internet services in the Isle of Man. Manx Telecom has run Europe's first superfast 3G trial, using HSDPA technology, which offers the possibility of communication speeds up to three times faster than current commercial UMTS services.

The Group's strategy

The combination of the O2 Group and Telefónica is expected to generate substantial synergies. The combined group expects to achieve these benefits in areas such as network cost efficiencies, handset and equipment purchasing and other cost savings. The combined group has estimated annual savings of €293 million (£199 million) by 2008, comprising €186 million (£127 million) of pre-tax operating cost savings and €107 million (£73 million) of capital expenditure savings. It is estimated that the net present value of these quantified synergies will be €3.3 billion (£2.2 billion).

The Group will continue to build on the momentum created by its successful brand. It has a number of specific growth opportunities including further investment in the Group's networks in Germany, improving the customer experience in the UK and Ireland, O2 Airwave moving into full operations and maximising the potential of key partnerships such as Tesco Mobile and Tchibo Mobilfunk.

Operating review

The operating reviews for the O2 businesses for the 10 months ended 31 January 2006 contain a discussion of the following metrics:

- Customer numbers – represent customers who are active. Customers are treated as being active if they have used the network in the preceding three months.

- ARPU – is calculated by dividing total service revenue from sales to customers for the preceding 12 months by the weighted average number of active customers for the same period. Total service revenue includes revenue from inbound roaming. ARPU is calculated using gross service revenue before deduction of wholesale discounts.

- Churn – is calculated by expressing the sum of disconnections for the preceding 12 months as a percentage of the weighted average number of active customers for the same period.

O2 UK

O2 UK's revenue for the 10 months ended 31 January 2006 was £3,544 million (year ended 31 March 2005: £3,923 million). O2 UK's service revenue for the 10 months ended 31 January 2006 was £3,144 million (year ended 31 March 2005: £3,507 million). O2 UK's operating profit for the 10 months ended 31 January 2006 was £430 million (year ended 31 March 2005: £520 million).

O2 UK's total customer base rose to 15.98 million at 31 December 2005, 1.60 million higher than at 31 March 2005. This excluded the Tesco Mobile customer base which reached one million customers at 31 December 2005.

A total of 590,000 net new contract customers and over one million net new pre-pay customers were added during the period from 1 April 2005 to 31 December 2005, driven by higher gross additions and lower churn. O2 UK's own channels accounted for more than 50 per cent of total gross connections.

In April 2005, O2 UK launched its "O2 Rewards" retention initiatives, offering pre-pay customers 10 per cent of top-ups back every 3 months and contract customers 50 per cent extra minutes and texts. The success of these programmes resulted in increased volumes of contract upgrades and a reduction in churn. 12 month rolling contract churn fell to 27 per cent compared to 30 per cent in December 2004, whilst pre-pay churn fell by 8 percentage points to 29 per cent.

O2 UK's blended ARPU of £272 at 31 December 2005 was £3 lower than the previous year reflecting the impact of the 30 per cent termination rate cut implemented in September 2004. Contract ARPU of £527 was also lower than December 2004 and pre-pay ARPU of £139 remained stable. Data ARPU increased to £78 at 31 December 2005 from £65 at 31 December 2004 driven by growth in both SMS
and non-SMS data. SMS volumes sent in the year to 31 December 2005 were 13.7 billion.

O2 Germany

O2 Germany's revenue for the 10 months ended 31 January 2006 was €2,705 million (year ended 31 March 2005: €2,736 million). O2 Germany's service revenue for the 10 months ended 31 January 2006 was €2,450 million (year ended 31 March 2005: €2,475 million). O2 Germany's operating loss for the 10 months ended 31 January 2006 was €197 million (year ended 31 March 2005: operating loss €133 million).

O2 plc
Directors' report (continued)

O2 Germany's total customer base rose to 9.77 million at 31 December 2005, 1.79 million higher than at 31 March 2005, and included 593,000 customers acquired through the Tchibo Mobilfunk joint-venture distribution channel. Contract customers comprised 51 per cent of the total base compared to 56 per cent at the same time last year.

Blended ARPU remained the highest in the German market, at €338 as at 31 December 2005, down from €370 last year. This trend reflected the approximately €15 impact of the termination rate cuts, the higher proportion of pre-pay customers in the total base, and the increasingly competitive market environment. Contract ARPU of €514 as at 31 December 2005 was €25 lower than the previous year which also reflected the impact of the termination rate cuts, as well as the introduction of new customer offers. Pre-pay ARPU of €135 at 31 December 2005 was €3 lower than 31 December 2004, mainly reflecting the impact of the termination rate cuts. Blended churn remained stable between 31 December 2005 and 31 December 2004.

O2 Ireland

The total customer base rose to 1,602 million customers as at 31 December 2005, 6 per cent higher than at the same time in the previous year. Blended ARPU of €572 as at 31 December 2005 was €8 higher than the previous year, reflecting the continuing strength of both voice and data usage trends. Contract ARPU increased by €49 from December 2004 and data ARPU also increased, to €128 at 31 December 2005 from €120 at 31 December 2004.

Mobile data

Quarterly data as a percentage of service revenue increased to 27 per cent as at 31 December 2005, from 24 per cent in the previous year. The total number of text messages sent by O2 customers grew by 32 per cent year-on-year, to 5.05 billion as at 31 December 2005. Quarterly non-SMS data accounted for 14 per cent of total data revenue and 4 per cent of total service revenue. The total number of non-SMS data users increased by 32 per cent in the year, with 40 per cent of O2's customers using these services.

O2 Airwave

O2 Airwave's revenue for the 10 months ended 31 January 2006 was £173 million (year ended 31 March 2005: £169 million) and operating loss for the 10 months ended 31 January 2006 was £4 million (year ended 31 March 2005: operating profit £17 million).

Financial performance of the Group for the 10 months ended 31 January 2006

The Group's revenues for the 10 months ended 31 January 2006 were £6,124 million compared to revenues of £6,575 million for the year ended 31 March 2005. Operating profit was £200 million for the 10 months ended 31 January 2006 and includes £320 million of operating exceptional charges. These exceptional charges included additional depreciation and amortisation of £151 million in the period related to a review of the useful lives of certain property, plant and equipment and software. Exceptional costs also include costs relating to the acquisition of the Group by Telefónica and include employee benefits of £75 million of which £41 million related to share based payments and professional and advisor fees and other costs of £58 million.

In the year ended 31 March 2005 the Group's operating profit was £533 million and included £45 million of operating exceptional charges. This exceptional operating charge related to the redeployment of resources within O2 UK into customer facing areas.

Profit for the period attributable to equity shareholders was £241 million for the 10 months ended 31 January 2006 (£493 million for the year ended 31 March 2005).

O2 plc
Directors' report (continued)

Financial position of the Group as at 31 January 2006

The net assets of the Group at 31 January 2006 were £10,168 million compared to £10,195 million at 31 March 2005. Details of the significant components of the Group's balance sheet and movements from 31 March 2005 are discussed below.

Non-current assets principally comprise property, plant and equipment, goodwill and UMTS licences.

The carrying value of property, plant and equipment has increased from £3,843 million at 31 March 2005 to £4,108 million at 31 January 2006 as a result of £956 million additions partly offset by depreciation charges of £682 million and net disposals of £8 million.

Goodwill has a carrying value of £3,210 million at 31 January 2006 (31 March 2005: £3,211 million). The movement during the period is a result of currency movements on Euro denominated goodwill when translated into sterling.

Other intangible assets comprise UMTS licences, software and other intangible assets. Their aggregate carrying value has fallen from £4,627 million at 31 March 2005 to £4,325 million at 31 January 2006. This is a result of amortisation charges of £198 million against UMTS licences, £237 million against software, £103 million against other intangibles and currency losses which arise on the retranslation of the Group's Euro denominated intangible assets into sterling. These charges are partially offset by additions of £244 million during the period.

Investments comprise the Group's investments in joint ventures and associates where the carrying value is positive.

Net current liabilities have changed from a net current asset position at 31 March 2005 of £617 million to a net current liability position of £242 million at 31 January 2006, primarily as a result of the reclassification of £693 million of the Euro medium–term notes from non-current to current during the period and an increase in trade and other payables of £164 million primarily due to the accrual of costs arising on the acquisition of the Group by Telefónica and an increase in deferred income.

Creditors falling due after more than one year comprise principally of the Group's long-term Euro medium-term notes and finance lease obligations. These have reduced from £2,126 million at 31 March 2005 to £1,234 million at 31 January 2006. This is primarily owing to the reclassification of a portion of the Euro medium term notes to current during the period of £693 million. Other factors that have reduced creditors due after more than one year include, a reduction in the deferred tax liability of £111 million due to recognition of deferred tax assets, a reduction in provisions of £36 million as a result of their utilisation during the period and a reduction in retirement benefit obligations of £36 million due to a one off pension scheme contribution of £81 million offset by an increase in pension liabilities.

Financial risk management objectives, policies and exposure

Details of the Group's approach to financial risk management are set out in the financial statements in note 31 "Financial instruments".

Risks and uncertainties

The Group faces increasing competition from new and existing providers of mobile services

The Group is competing increasingly with new mobile service providers, virtual network operators and resellers of mobile services. Also, competition from existing service providers may be more intense than anticipated, driving down prices. Failure to compete effectively could result in a decrease in customers, revenues and profitability.

The Group faces competing technologies

The Group faces competition from communications technologies that are under development or that will be developed in the future, including cordless technologies and private and shared radio networks. As a result of current trends in the telecommunications industry in Europe, such as the rapid convergence of technologies, the Group expects there to be further technological advances in the future. Failure to compete could result in a decrease in customers, revenues and profitability.

Alleged health risks associated with mobile telecommunications could lead to decreased usage of the Group's services and products, increased difficulty in obtaining transmitter sites or potential liability

Public concern about the alleged or perceived health risks of mobile communications could have a detrimental impact on the Group's business through negative customer perception of the Group's brand, services or products, difficulties in retaining or attracting customers, reduced usage times per customer of mobile telecommunications services or increased difficulty in obtaining transmitter sites. There can be no assurance that further medical research and studies will refute a link between the radio frequency emissions of wireless handsets and base stations and these health concerns. Government authorities could increase regulation of wireless handsets and base stations as a result of these health concerns, or wireless companies, including the Group, could be held liable for costs or damages associated with these concerns, which could have a negative impact on the Group's businesses.

In addition, regulators may reduce the prescribed limits for exposure to electromagnetic radiation in the countries in which the Group operates, which would mean that the exclusion areas around the Group's antennas in those countries may have to increase in some situations. In this event the Group may suffer additional costs associated with repositioning the Group's network equipment and the Group may experience delays in the roll-out of the Group's networks.

Failure to maintain the momentum necessary to achieve economic scale in Germany

If the Group's increased network investment fails to deliver a high-quality customer experience from the Group's own UMTS platform, this could have a significant negative impact on the profitability of the Group's business.

The Group may fail to achieve its strategic goal of earning revenues from more sophisticated data services

If the market for non-SMS data services does not grow as quickly as the Group currently anticipates and SMS yields fall faster than the Group currently anticipates and voice price erosion increases faster than the Group currently anticipates and, if the Group does not build the correct business model and capabilities to remain competitive in the data world, the Group could experience a negative impact on the Group's business and results of operations.

The Group may be disadvantaged by its UMTS offerings

The Group's UMTS offerings may suffer as a consequence of later launches. This could have a negative impact on the Group's business and results of operations.

Misuse of the Group's networks by the Group's customers through fraud or in a way that damages the Group's reputation

Certain customers may misuse the Group's networks in ways which damage the Group's reputation, for example using the network to make inappropriate contact with children, spamming or propagation of viruses. Certain customers may also misuse the Group's networks in ways which impact the Group's costs or revenues, including fraud. This could have a negative impact on the Group's business.

The Group may fail to positively differentiate the Group's customer experience and/or fail to implement the Group's customer plan

Slower implementation timetables, higher costs and poorer customer experience may undermine the value of the Group's brand and could limit the Group's ability to attract and retain high value customers, which in turn could have a negative impact on the Group's business and results of operation.

Competition Law and Regulatory Risks

The Group operates in highly regulated markets that limit its flexibility to manage its business

The Group must comply with an extensive range of requirements that regulate and supervise the licensing, construction and operation of its networks and the provision and pricing of its products and services in countries in which it operates. The Group must also co-operate with agencies or other governmental authorities that regulate and supervise the allocation of radio spectrum and which monitor and enforce regulation and competition laws which apply to the mobile telecommunications industry. The Group's business and results of operations could be materially adversely affected by changes in law, regulation or government policies directed at the mobile telecommunications markets in which it operates. In particular, decisions by regulators and competition authorities relating to the allocation of spectrum, tariffs, interconnection, the effects of expansion into new markets, or the accessibility of the Group's network to mobile virtual network operators and service providers could all have a negative impact on the Group's business and results of operations.

Action by the European Commission or regulators may result in fines and a decrease in roaming revenues

The European Commission is investigating whether O2 UK's charges for wholesale international roaming services were too high in the past, in breach of competition law. If the European Commission ultimately finds that O2 infringed the competition rules, it may fine the Group.

As a separate matter, the European Commission is currently consulting on a proposal to introduce new EU legislation to regulate the international roaming prices of European mobile operators.

Any fines or future regulation of roaming charges could have a negative impact on the Group's business and results of its operations.

Action by national regulators may result in a decrease in mobile termination revenues

New or more onerous regulatory obligations may be imposed on the Group in relation to call termination charges. The UK regulator (Ofcom) is currently reviewing the regulation of UK operators' termination charges for the period from April 2007, and the German regulator (BNetzA) expects to take a decision on the regulation of German operators' termination charges by the end of 2006. If call termination regulation is extended or becomes more onerous then this could have a negative impact on the Group's business and results of its operations.

The Group may be subject to new regulatory obligations

New or more onerous regulatory obligations may be imposed on the Group in Germany, the UK and Ireland, using the regulatory powers provided under the EU regulatory framework for the electronic communications sector (the EU Regulatory Framework). Depending upon the obligations imposed, this could have a significant effect on the profitability of the Group's businesses. The European Commission is currently conducting a review of the EU Regulatory Framework. If new regulatory obligations are imposed on the Group as a result of the review, this could also have a significant effect on the profitability of the Group's business.

Results

The audited financial statements are presented on pages 38 to 111.

Dividends

Two dividends were paid in the 10 months ended 31 January 2006. The Company paid an inaugural final dividend of 2.25 pence per share in respect of the financial year ended 31 March 2005 in August 2005 and an interim dividend of 1.54 pence per share in December 2005. The Directors do not recommend the payment of a final dividend for the 10 months ended 31 January 2006.

Directors

The names of the current Directors of O2 are shown below. All the Directors held office throughout the 10 months ended 31 January 2006 except where indicated otherwise.

	Appointed
César Alierta Izuel	23 January 2006
Sir David Arculus	
Peter Erskine	
David Finch	
Danuta Gray	23 January 2006
Rudolf Gröger	
Matthew Key	23 January 2006
Julio Linares Lopez	23 January 2006
Sohail Qadri	23 January 2006
Jaime Smith Basterra	23 January 2006
Andrew Sukawaty	
Antonio Viana-Baptista	23 January 2006

On 23 January 2006, David Chance, Judy Gibbons (appointed 1 September 2005), Stephen Hodge, Rudolf Lamprecht, Patrick Lupo and Kathleen O'Donovan resigned as non-executive Directors and Sir David Arculus stepped down as Chairman but remained on the Board as a non-executive Director. Peter Erskine became Executive Chairman from that date and remained as Chief Executive Officer.

Details of the Directors' service contracts, emoluments and share interests at 1 April 2005 and 31 January 2006 can be found in the report on directors' remuneration on pages 19 to 35.

Directors' liability insurance and indemnities

The Company maintains Directors' and Officers' Liability Insurance in respect of legal action that might be brought against its Directors. As stated in the Company's 2005 Annual Report and Financial Statements, following the enactment and implementation of the Companies (Audit, Investigations and Community Enterprise) Act 2004, which amended the Companies Act 1985 by permitting the grant of Qualifying Third Party Indemnity Provisions ("QTPIP") by a company to its directors, the Board on 13 May 2005 approved the granting of indemnities in the form permitted by the QTPIP. These indemnities were granted on 22 June 2005 to Directors on the Board at that time and to Judy Gibbons on 19 September 2005. The Company also granted an indemnity on 19 July 2005 in the form permitted by the QTPIP to directors appointed to subsidiary companies and Danuta Gray and Matthew Key are covered by this indemnity in respect of their directorships of subsidiary companies. The indemnities remained in place during the period from the date of grant to 31 January 2006 and continue until such time as any relevant limitation periods for bringing Claims (as defined in such indemnities) against the Director have expired, or for so long as the past Director, where relevant, remains liable for any Losses (as defined in such indemnities).

Re-election of directors

The Company's Articles of Association provide that Directors are required to retire by rotation every three years. Peter Erskine and Andrew Sukawaty will retire by rotation at the 2006 Annual General Meeting and are proposed for re-election at that meeting. In addition, any Director appointed during the year is required to retire and seek election by shareholders at the next Annual General Meeting. Accordingly, César Alierta Izuel, Danuta Gray, Matthew Key, Julio Linares Lopez, Sohail Qadri, Jaime Smith Basterra and Antonio Viana-Baptista will seek election at the forthcoming Annual General Meeting.

Share capital

Details of the authorised and issued share capital of the Company at 31 January 2006 and details of share allotments made during the 10 months ended 31 January 2006 are given in note 25 to the financial statements. Since 31 January 2006, additional shares have been allotted pursuant to the exercises of options and vesting of awards under the Company's employee share schemes *as a result of the Telefónica Offer going wholly unconditional and pursuant to the early exercises* of options under these schemes.

The authority given at last year's Annual General Meeting for the Company to purchase in the market 870,400,000 ordinary shares, representing approximately 10 per cent of the share capital in issue at 31 March 2005, was not utilised during the 10 month period ended 31 January 2006 and expires at the conclusion of the 2006 Annual General Meeting.

Interest of management in certain transactions

During and at the end of the 10 month period ended 31 January 2006, none of the Company's Directors had a significant interest in any material transaction in relation to the Group's business.

Employees

The Company has operated a number of employee share schemes, including savings-related option schemes, which encouraged regular saving and enabled employees to acquire options over shares in the Company, and an all-employee share ownership plan in the UK allowing employees to buy shares in the Company. These schemes have ceased to operate following the Company's acquisition by Telefónica.

O2 plc
Directors' report (continued)

The Company has a wide range of communication channels with employees including face-to-face meetings, team briefings, audio conferences and a comprehensive Company intranet that includes a regular newsletter. The aim of all these channels is to ensure employees fully understand the Group's objectives and its operational and financial performance. In addition, the Company conducts annual engagement surveys and maintains a constructive dialogue with unions, employee representative bodies and works councils.

The Company continues to be committed to the development of all people in the organisation and actively promotes this through many training and development initiatives. People are encouraged and supported in maintaining personal development plans. The Company has invested in e-learning technology to give people better access to a wide range of learning opportunities.

The Group is committed to employment policies that follow best practice, based on equal opportunities for all, and recognises that a diverse workforce is a strength in a competitive marketplace. The Company has a Diversity Champion at Board level and integrates equal opportunity into all its management processes. This approach extends to the fair treatment of people with disabilities in relation to their recruitment, training and development. Full consideration and every effort are given to the retention of people who become disabled during employment. O2 UK is a member of the Employers' Forum on Disability.

Corporate governance

Following the cancellation of the listing of the Company's shares on the London Stock Exchange on 7 March 2006, the Company is exempt from the requirement to produce a statement as to whether it has complied throughout the 10 months ended 31 January 2006 with the provisions set out in Section 1 of the Combined Code on Corporate Governance.

Notwithstanding this exemption, the Directors in their support of the highest standards of corporate governance confirm that the Company did fully comply with those provisions up until the Telefónica Offer became wholly unconditional, except that in the event of termination of Mr Gröger's employment within 12 months of a change of control of its German business, the employer was obliged to make a cash payment equal to two times his base salary and a payment equal to the bonus expected for an on-target performance.

At the time of de-listing of the Company's shares on 7 March 2006, the Company's audit, nomination and governance, and remuneration committees were dissolved and the responsibilities of these committees were subsumed into those of Telefónica, and, where appropriate, into new committees of the Company as referred to under the 'post balance sheet events' section of this report.

Community involvement

During the 10 months ended 31 January 2006, the O2 Group made cash donations to charitable and community organisations totalling £1,921,023 of which £765,400 was made from UK-based companies. As in previous years, no political donations were made. Further details regarding the Company's involvement in the community are set out in the corporate responsibility section of this report on pages 16 to 18.

The authority previously given by shareholders for political donations to be made by O2 plc and certain of its subsidiaries is due to expire on 23 July 2006. This authority will be renewed at the time of its expiry for a further four year period.

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Directors' report (continued)

Policy on the payment of suppliers

The Group aims to pay all of its creditors promptly. The payment terms for major contracts are agreed at the same time as other terms are negotiated with individual suppliers. It is the Group's policy to make payments for other purchases within 30 working days of the invoice date, provided that the relevant invoice is presented in a timely fashion and is complete.

The Group had 36 days' purchases outstanding as at 31 January 2006 (31 March 2005: 35 days) based on the average daily amount invoiced by suppliers during the 10 months ended 31 January 2006.

Auditors

PricewaterhouseCoopers LLP ("PwC") were the auditors of the Company during the 10 months period ended 31 January 2006. It is proposed that PwC resign as auditors at the conclusion of the audit of the financial statements of O2 plc and its subsidiaries and that Ernst & Young LLP will be appointed from that time.

So far as each Director is aware, there is no relevant audit information of which the Company's auditors were unaware. The Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By Order of the Board

Philip Bramwell
Company Secretary and General Counsel
29 June 2006
Registered Office: Wellington Street, Slough, Berkshire SL1 1YP
Registered number: 5310128

O2 plc
Statement of directors' responsibilities

Company law requires the Directors to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial period and of the profit or loss of the Group for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRS as adopted by the European Union; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

O2 plc
Corporate responsibility

We aim to engage with and improve the well-being of the communities in which we operate through active involvement and dialogue with them.

We also believe that corporate responsibility should be embedded in the way we work at O2. This helps us to continue to develop a sustainable business and create shareholder value.

The following paragraphs explain our approach to corporate responsibility and how we have performed in the last ten months.

Our approach

We are determined to take full account of the social, environmental and ethical ("SEE") impacts of our business. We approach this as a daily challenge, requiring processes, measurement and stretching performance targets. Our key SEE risks are covered in this section of the report and in more detail in our separate corporate responsibility report.

Our corporate responsibility achievements have received wide external recognition. During the ten months ended 31 January 2006 we were represented in the main sustainability indices and funds: the Dow Jones Sustainability Indexes, the Business in the Community Corporate Responsibility index as the highest scoring mobile operator and the FTSE4Good Index.

Governance and management of corporate responsibility issues

Dealing with constant change requires a commitment to risk management and we use it to identify, measure and control uncertain future events that could threaten the assets, revenue, brand, reputation of the Company.

We adhere to the Disclosure Guidelines on Social Responsibility set out by the Association of British Insurers to manage the significant SEE risks that may affect us. We manage these risks by assessing their potential impact, likelihood and our appetite to manage them, and develop strategies to mitigate them. We update an O2 Group-wide risk register every month with the key risks we face, supported by separate registers in each of our operating businesses. The Combined Code (Turnbull Guidance section) guides our risk management policy and procedures. Controls are scrutinised as part of a cyclical risk-based audit approach.

Our corporate responsibility activities are managed by full-time practitioners in each of our operating businesses. Their work is co-ordinated through the monthly Corporate Responsibility Forum – chaired by Corporate Affairs Director, Richard Poston. Significant issues are reported to our Executive Committee at least every quarter through scheduled corporate responsibility updates. An Executive Director or senior manager champions each key SEE aspect and reports regularly to the Group Board. Their remuneration is partly linked to their success in meeting key SEE objectives.

During the 10 months ended 31 January 2006, the Board was briefed on a range of SEE issues through the quarterly corporate responsibility reports as well as through specific six monthly reports on issues including community investment, health and safety, mast siting, privacy, content standards, child protection, environmental management, diversity and general employment issues. A summary report on our confidential help facility – set up to enable our employees to report ethical concerns, in confidence – was also presented at each Audit Committee meeting while it was in existence.

O2 plc
Corporate responsibility (continued)

Our environmental and health and safety practices are monitored through third party audits carried out by certification agencies for our ISO14001 and OHSAS 18001 registrations. An external party assesses all SEE risks through the Risk Review that also underpins our insurance arrangements. UK compliance to the industry-agreed Ten Commitments on responsible mast siting is independently reviewed by Deloitte & Touche LLP on behalf of the Mobile Operators Association. Assurance for our separate corporate responsibility report is provided by Ernst & Young. Assurance and verification of our community investment programme is provided by the Corporate Citizenship Company as part of the London Benchmarking Group assessment.

Business principles

We have developed our own set of Business Principles which dictate the high standards of behaviour we set ourselves as a company. Everyone within O2 is made aware of our Business Principles through communications materials, senior managers' communications and mandatory training. Everyone is encouraged to take responsibility for living by them in their work. Every employee can report any potential breaches of our principles in confidence and we maintain a register of any concerns.

Marketplace

New mobile services and devices make it increasingly possible for us to live our lives and communicate on the move. But the technology poses some important social challenges. Crucial among these is the protection of children and ethical sourcing.

We aim to proactively raise awareness about child protection and mobiles and have signed up to industry voluntary agreements on the responsible use of mobile services. We do not market mobile phones to under-16s, we monitor our chat rooms and offer call barring and age verification processes to ensure proper controls. We have published a series of consumer leaflets on the safe and responsible use of mobile services and taken part in a number of community activities that promote the responsible and sensible use of mobile phones.

We encourage our suppliers to adopt high-level working practices and materials sourcing, and refer to our Business Principles in all Group-wide contracts. We are working through the Global e-Sustainability Initiative to establish a common framework for supplier audits and to promote ethical practices across the industry and its supply chains.

Health

Although research has found no evidence of health risks from mobile technology operating below the scientifically based exposure guidelines, we respond to public concerns about handsets, masts and cell sites.

We are committed to funding independent research in this area, and help to fund the joint UK industry/government Mobile Telecommunications and Health Research programme, and the German Deutsches Mobilfunk Forschungsprogramm, as well as contributing to the World Health Organisation's International EMF Project on radio frequency emissions. We participate in and help fund a number of industry groups, including the UK Mobile Operators Association (MOA) and GSM Europe (GSME) within which we are chairing the Health and Environment Working Group. The MOA champions the Ten Commitments on responsible mast siting. O2 Airwave and O2 UK are working openly to meet these. Our other operating companies have committed to comply with similar guidelines by GSME.

We provide health and safety information to the public through our shops and online on www.o2.com/cr.

O2 plc
Corporate responsibility (continued)

Environment and sustainability

During the 10 months ended 31 January 2006 O2 established an environmental vision that has reaffirmed the strong ethos of environmental protection within the Company. We have set targets for each area of environmental impact, such as waste, pollution and energy use, which we describe in our separate corporate responsibility report.

All of our fully-owned operating businesses are registered to the international environmental standard ISO14001. We continue to review and control our environmental performance through the O2 Environmental Forum. Information on our environmental impact and performance can be found in the dedicated O2 Corporate Responsibility report on www.o2.com/cr. The report covering our operations between April 2005 and March 2006 will be published in July 2006.

Workplace

We believe it is important to offer a good working culture where people representing society as a whole can thrive. An important part of this commitment is to offer competitive rewards, opportunities for personal development and a modern working environment with flexible working arrangements.

The United Nations Universal Declaration of Human Rights and International Labour Organisation Declarations continue to guide our employment policies. The well-being of our employees is safeguarded by our Group-wide health and safety strategy promoted by our Group health, safety and environmental champion, Peter Richardson, O2 Airwave Managing Director. Well-being initiatives include stress awareness workshops, exercise, stop smoking initiatives and nutrition services.

Employee engagement levels are gauged at least annually by each of our businesses through our employee survey, Reflect O2. During the last financial year, 79 per cent of our employees took part in the survey, which gathers feedback on how people view their leaders, the way they are managed, the O2 spirit and O2's customer focus.

Diversity and inclusion remains a strong focus for the business, with a special emphasis on recruitment. The O2 Ability Awards in Ireland, which promote the recruitment and employment of people with disabilities, is one of the key sponsorships undertaken by O2.

We continued to negotiate with employees through trade unions, works councils or representative bodies.

Community

Investment in the communities we serve is an essential part of our approach to corporate responsibility. During the 10 months ended 31 January 2006, we made cash donations worth £1,921,023 to our chosen charities and community projects, of which £765,400 was made from UK-based companies.

In addition to company contributions O2 offers every employee the opportunity to apply for matched funding for any charitable fundraising that our employees undertake. Employees can also use the give-as-you-earn facility that allows for tax effective charitable giving directly through payroll.

In October 2005 we held the annual O2 Community Awards to recognise O2 employees who give their time and ideas to charity.

Further information can be found online in our independently verified corporate responsibility report in July 2006 at: www.o2.com/cr, or on request from the O2 plc Corporate Responsibility department cr@o2.com.

O2 plc
Report on directors' remuneration

This report has been prepared and approved by the Board of O2 plc (the Board).

Role

During the 10 months ended 31 January 2006 the O2 plc Remuneration Committee (the Committee) was responsible for determining policy on the remuneration and performance of the Chairman, executive Directors and the Senior Management Team (comprising the other members of the Executive Committee and the Company Secretary and General Counsel). It determined, within agreed terms of reference, specific remuneration packages for each of the roles above, including:

- service contracts;
- salaries;
- benefits;
- pension rights;
- any compensation payments; and
- the operation of the O2 Executive Share Portfolio.

Membership and meetings

The Committee consisted of independent non-executive Directors. No member of the Committee has any personal financial interest, other than as a shareholder, in the matters to be decided by the Committee.

The Committee comprised Patrick Lupo (resigned 23 January 2006), Stephen Hodge (resigned 23 January 2006), and Andrew Sukawaty. The Chairman and Chief Executive Officer were invited to attend meetings of the Committee, except when their own remuneration was discussed. The Committee had four scheduled meetings during the period and also met on three further occasions. The Committee was disbanded on the de-listing of the Company on 7 March 2006.

Advisers

The Committee took advice from both inside and outside the Group on a range of remuneration matters.

The Committee consulted the Chief Executive Officer on matters relating to the remuneration of the other executive Directors who report to him. The Chairman and Group HR Director were consulted in relation to the remuneration of all executive Directors.

O2 plc
Report on directors' remuneration (continued)

The advisers listed below provided services to the Committee in the 10 months ended 31 January 2006:

Adviser	Services provided	Other services provided to O2
Deloitte & Touche LLP	Appointed by the Committee to provide independent advice on executive remuneration matters.	Audit services in relation to the O2 Pension Plan and, specialist corporation tax, VAT, and expatriate services.
New Bridge Street Consultants LLP	Independently monitor and measure the Total Shareholder Return performance of the Company.	None.
Towers Perrin	Provision of market remuneration data.	Advice on benefits policy.
Freshfields Bruckhaus Deringer	Legal advice on long-term incentives matters.	Legal advice on certain corporate and Directors' service contracts.
Lane, Clark & Peacock	Provision of data for pension accounting and disclosures and advice in respect of executive pension provision.	Actuaries for the Group.
Hewitt, Bacon and Woodrow	Pensions advice in relation to the forthcoming changes in pensions legislation.	None.

Remuneration policy

This section of the report sets out the Group's policy on executive Directors' remuneration.

The Committee adopted the following principles:

- the Committee sets base salaries which reflect contribution, criticality to the business and general wage levels elsewhere in the Group. Decisions are made with reference to a range around the median of the relevant market for the individual although the Company may pay more to recruit a high-calibre executive;

- emphasis is placed on rewarding business performance, and therefore we seek to position the total compensation packages at upper quartile for superior performance; and

- performance-related incentives with stretching business performance targets to drive and reward superior performance from our executives.

These principles are applied to all employees to recruit, retain and motivate the highest calibre of employee throughout the business.

Certain aspects of the Company's future remuneration policy are likely to be altered as a result of Telefónica obtaining control of the Company on 23 January 2006. Interim incentive arrangements have been put in place, including the Retention Pool described below. Further, the Company has agreed that key executives will participate in long-term incentive arrangements at a level which is commensurate with their status in the Company.

Total reward approach

The Committee adopted a total reward approach which comprised a combined focus on base pay, short and long-term incentives, and pension and benefit provision. The Committee believed that total reward should encourage superior performance at all levels (Group, Operating Business and individual). In determining packages for the period being reported on, the Committee considered it vital to align the interests of the leadership team with those of shareholders, by linking a significant proportion of the package to the creation of shareholder value. On the basis of achievement of "on target" bonus and long-term incentives, the balance between fixed and performance-related pay was 41:59.

When determining total reward levels, the Committee took account of the UK market and looked wider than simply the telecoms sector. This approach allowed us to structure reward appropriately, with the right level of performance-related remuneration, rather than reflecting solely the remuneration practices adopted in our industry.

Elements of executive directors' remuneration

Base salary

Base pay is reviewed (but not necessarily increased) annually, with effect from 1 June.

Annual incentives

Annual incentive arrangements are based on a balance of KPIs that the Committee considers to be key drivers of shareholder value including EBITDA and EBIT (indicators of strong financial performance); net service revenue, data ARPU and customer satisfaction targets (crucial to future growth and profitability).

From 1 April 2005, annual bonus was delivered two-thirds in cash and one-third in deferred O2 shares (Deferred Shares). The Deferred Shares are held in trust for three years dependent on the *executive remaining in service. No further performance condition applies on vesting.*

Bonuses are not pensionable. The Chairman does not participate in annual incentive arrangements.

Long-term incentives

O2 had a long-term incentive portfolio (the O2 Executive Share Portfolio), the elements of which are listed below. All employees of the O2 Group were eligible to participate in long-term incentives at the discretion of the Committee. The Committee determined the appropriate performance targets and reviewed the extent to which they have been met. Awards and options are not pensionable.

Long-term incentives for 10 months ended 31 January 2006

The Committee recommended that the Performance Share Plan was the primary form of long-term incentive. The Committee made awards of performance shares linked to the Company's TSR performance for most executives as it believed that TSR was the most appropriate means of aligning the interests of executives with those of shareholders.

In the case of the CEO of O2 Germany and a small number of senior O2 Germany employees, performance share awards were made based solely on controllable EBIT margin and net service revenue growth of O2 Germany over a three-year performance period. For minimum performance achievement 30 per cent of the total award would vest. Below this level none of the award would vest. For achievement of the maximum performance level, 100 per cent of the award would vest. Both measures had to be achieved at maximum for the full award to vest. These measures were selected due to the major growth opportunity that the German mobile market represented for O2, with clear potential to increase shareholder value.

O2 plc
Report on directors' remuneration (continued)

O2 executive share portfolio

1. Performance Share Plan ("PSP")

In the 10 months ended 31 January 2006 performance shares were awarded to executive Directors and senior managers.

1.1 Performance measure

Aside from the small minority of awards based on O2 Germany performance as discussed above, vesting was subject to the Company's TSR performance against a comparator group over a fixed three-year period as set out below:

TSR Ranking	*% Performance Shares Vested*
Below median	0 per cent
Median	30 per cent
Upper Quartile	100 per cent

Vesting on a straight line basis between median and upper quartile performance.

The comparator group consisted of the constituents of the FTSEurofirst 300 Telecommunications Index at the time awards were made. This index was chosen by the Committee as it closely compares the Company with its business sector.

Awards only vest to the extent that the Committee is satisfied that the Company's TSR performance is a genuine reflection of the Company's underlying financial performance over the period.

There are no retesting opportunities.

2. Deferred Equity Incentive Plan ("DEIP")

The DEIP was not operated in the 10 months ended 31 January 2006.

For outstanding awards at 31 January 2006 the following performance condition applied:

2.1 Performance measure

2.1.1 Deferred award

Vesting subject only to continued employment.

2.1.2 Performance uplift

Comparator group - constituents of the FTSEurofirst 300 Telecommunications Index at the time awards were made.

Vesting schedule

TSR ranking	*% Performance Uplift Vesting*
Below median	0 per cent
Median	30 per cent
Upper quintile	100 per cent

Vesting on a straight line basis between median and upper quintile performance.

3. Share Option Plan

The Share Option Plan was not operated in the 10 months ended 31 January 2006.

For outstanding options at 31 January 2006 the following performance condition applied:

3.1 Performance measure

Comparator group - constituents of the FTSE 100 Index at the time options were granted.

TSR ranking	*% Options Exercisable*
Below median	0 per cent
Median	50 per cent
Upper quartile	*100 per cent*

Vesting on a straight line basis between median and upper quartile performance.

At 31 January 2006 TSR performance was such that all options had become exercisable.

4. Restricted Share Plan ("RSP")

In the 10 months ended 31 January 2006 restricted shares were not awarded to executive Directors.

4.1 Performance measure

In order for the restricted shares to vest in full, participants must personally build and maintain an equivalent number of O2 shares until the vesting date as well as remaining in employment with the O2 Group until this time. The awards vest on a pro rata basis if the participant builds up a lower personal investment.

Future long-term incentives

There are no plans to make any further awards under the O2 Executive Share Portfolio.

Treatment of dividends

In July 2005 and in the light of O2's emerging dividend policy, the Committee determined that existing share awards made under the DEIP, PSP, RSP and also Deferred Shares, would be adjusted on vesting so that participants receive additional shares representing the value of dividends that would have been paid on these shares during the performance period. This policy reflects market practice for dividend-paying companies in the FTSE 100.

Vesting under the O2 executive share portfolio as a result of Telefónica Offer

As a result of the offer from Telefónica, vesting levels for conditional share awards under the PSP and the DEIP (which are performance-related) required the exercise of discretion by the Remuneration Committee of O2 in relation to the offer. Aside from a small number of Performance Share Awards granted in July 2005 based on O2 Germany performance, awards were subject to O2's relative TSR performance which, over the period from each grant date to 31 December 2005, was such as to place the Company at first or second in the comparator group.

The Remuneration Committee of O2 considered the excellent performance to date against all of the measures and other relevant factors, and reached an indicative decision, which was confirmed at the Unconditional Date (23 January 2006), that:

- awards made in 2003 and 2004 would vest in full, and the O2 Shares under those awards would be released immediately; and

- awards made in 2005 will vest in full, but the offer proceeds for those O2 Shares would only be released on the first anniversary of the Unconditional Date subject to the participant (i) not having given notice to resign their employment, and (ii) not having been dismissed for cause in accordance with their service contract, in both cases prior to such first anniversary.

Sir David Arculus held a conditional share award over 292,397 O2 Shares, granted under the RSP, which would have normally vested in July 2007 provided he built up a personal holding of 350,877 O2 Shares by 29 July 2005 (which he had done). The terms of the award provided that, where Sir David becomes a director of an acquiring company following a change of control of O2, the award would be rolled over into an equivalent number of shares in the acquiring company and will vest in July 2007 provided he retained an equivalent coinvestment. The Remuneration Committee of O2 concluded that the above consequences would be inappropriate in the context of the agreed proposals (notably, Sir David's proposed appointment as a non-executive Director of Telefónica, and a cash offer for O2) and that the award should vest in respect of the full number of O2 Shares on the Unconditional Date.

The Remuneration Committee determined that other Restricted Share Awards should be released to the extent that personal shareholding requirements had been met, and replaced by a conditional entitlement to cash (the Conditional Cash Award) equivalent to the value of the Restricted Share Award at the Unconditional Date (i.e. 200p for every share under award). Payment of the Conditional Cash Award is subject to remaining in service with O2 until the vesting date.

In accordance with the terms of each arrangement, O2 Deferred Shares awarded in July 2005, and Deferred Awards made under the DEIP in July 2004, neither of which have performance conditions other than continuous employment, vested in full as a result of the change of control.

Retention pool

Under the Framework Agreement between Telefónica and O2, Telefónica has agreed that O2 will make available a pool of up to £17 million to fund retention payments to key managers including executive Directors.

Eligibility to receive these payments is conditional on the recipient waiving their right to any compensation in respect of share scheme rights which did not fully vest on the change of control of O2, to which they would otherwise be entitled under their service contracts if their employment was terminated in the twelve months following the Unconditional Date. Payments are generally conditional on the recipient (i) not having given notice to resign their employment and (ii) not having been dismissed summarily (i.e. without notice or any payment in lieu of notice) in accordance with their service contract, in both cases generally prior to the second anniversary of the Unconditional Date.

Pension benefits

There are pension arrangements in place in the main jurisdictions in which the O2 Group operates. Schemes vary in accordance with local market practices in each jurisdiction, and as such there are various arrangements in place for executive Directors and the Senior Management Team. Peter Erskine and David Finch are entitled to final salary related pension benefits up to the UK statutory earnings cap. In addition, they are entitled to supplementary pension benefits in respect of earnings above the statutory earnings cap (comprising unfunded final salary related benefits in the case of Peter Erskine and funded defined contribution benefits in the case of David Finch).

O2 plc
Report on directors' remuneration (continued)

Following a review of pension provision in the light of the changes in legislation under the Finance Act 2004, the Company's policy is to continue to provide for retirement benefits through the registered O2 Pension Plan (the 'Plan') in accordance with the existing Plan rules.

However, where executives are affected by the lifetime or annual allowances, the Company's policy is to offer a cash supplement in lieu of future pension entitlements under the Plan.

On that basis, Peter Erskine's pension arrangements were altered by a letter dated 12 September 2005. In light of the fundamental changes to the UK tax regime for pensions, with effect from 1 April 2006, Peter Erskine will be entitled to an annual cash supplement equal to 50 per cent of salary, in lieu of future pension accrual. The unfunded pension that Mr Erskine has accrued to 31 March 2006 will be satisfied by way of a fixed cash sum at retirement at an age between 54 and 60 (the amount of which has been derived on the basis of FRS17 accounting assumptions) in settlement for that accrual. The amount of the lump sum will depend on Mr Erskine's retirement date and will increase in the period up to his sixtieth birthday in accordance with an agreed schedule with a starting point as at 31 March 2006 of £4.60 million.

David Finch's pension arrangements provide for an annual accrual of 1/30 of the earnings cap within the O2 Pension Plan, subject to any restriction due to retained benefits. In addition, he is entitled to a supplementary defined contribution benefit, the level of which is determined on an annual basis. For the period ended 31 January 2006 this was equal to 32.5 per cent of basic salary per annum; 21 per cent was paid to a Funded Unapproved Retirement Benefit Scheme (FURBS) and 11.5 per cent was paid as a cash supplement.

Rudolf Gröger's pension arrangements provide for a pension at age 60 of 20 per cent of salary after the first three years of service and an annual pension accrual of 1.5 per cent of salary thereafter. The benefit is provided by the Company as an unfunded pension promise.

Matthew Key is a member of the defined contribution section of the O2 Pension Plan and receives a total pension contribution of 25 per cent of salary. For the period ended 31 January 2006, company contributions of 27 per cent of pensionable salary (subject to the earnings cap) were paid to the Plan with the remainder payable as a cash supplement.

Danuta Gray and Sohail Qadri are members of the defined benefit section of the O2 Pension Plan. Sohail Qadri's benefits in the O2 Pension Plan are limited by the earnings cap and so he earns benefits in excess of the earnings cap in an unfunded final salary arrangement.

Sir David Arculus's pension arrangements are described on page 29.

The pension arrangements for Peter Erskine, David Finch, Matthew Key, Danuta Gray and Sohail Qadri provide for life cover of four times salary. Rudolf Gröger was paid €7,500 to allow him to make his own life cover arrangements. Sir David Arculus is also provided with life cover of four times salary through an unapproved arrangement.

Details of pension arrangements within O2 are set out in note 22 to the financial statements.

Contracts and notice periods

It is general policy that executive Directors will have contracts and service agreements with similar provisions.

O2 plc
Report on directors' remuneration (continued)

The service contracts and notice periods for the executive Directors are set out below:

Director	Effective date of service agreement	Notice period
P Erskine [1]	23 January 2006	24 months until the second anniversary of the effective date, gradually reducing down to 12 months after the third anniversary.
D Finch [1]	23 January 2006	24 months until the second anniversary of the effective date, gradually reducing down to 12 months after the third anniversary.
D Gray [3]	23 January 2006	24 months until the second anniversary of the effective date, gradually reducing down to 12 months after the third anniversary.
R Gröger [2]	23 January 2006	Fixed term ending 22 January 2010.
M Key [4]	23 January 2006	24 months until the second anniversary of the effective date, gradually reducing down to 12 months after the third anniversary.
S Qadri [3]	23 January 2006	24 months until the second anniversary of the effective date, gradually reducing down to 12 months after the third anniversary.

Notes

1 Peter Erskine and David Finch are employed by O2 plc.
2 Rudolf Gröger's contract is with O2 (Germany) Management GmbH
3 Danuta Gray and Sohail Qadri are employed by O2 Holdings Limited. They were appointed to the O2 Board on 23 January 2006.
4 Matthew Key is employed by O2 (UK) Limited. He was appointed to the O2 Board on 23 January 2006.

The Company may in its discretion terminate without notice and make a payment in lieu of notice equal to the sum of the remaining notice, including the value of employers' pension contributions, benefits, and a bonus payment of not less than the previous year's bonus. This may be mitigated where the executive finds alternative employment (subject to a minimum salary level).

On termination of employment within 12 months following a change of control, the Company is obliged to make a payment equal to the base salary, the value of employer pension contributions and benefits for the proper notice period, plus additional payments generally equal to the maximum annual bonus potential for that year, and in respect of the loss of rights under long-term incentive schemes.

In the event of termination of Rudolf Gröger's employment within 12 months following a change of control of O2 or its German business, the employer is obliged to make a cash payment equal to two times his base salary and bonus. The amount of bonus payable will be that expected for on-target performance.

Sir David Arculus entered into a one-year fixed term agreement with the Company with effect from 7 March 2006. His time commitment is anticipated to be 18 days per year, and the annual fee is £300,000, part of which is, at his request, paid into personal pension arrangements. The agreement may be terminated at any time by the Company in accordance with the Company's Articles of Association or the Companies Act 1985, or upon Sir David's resignation. There is no entitlement to damages for loss of office and no fee is payable in respect of any unexpired portion of the term of the agreement.

O2 plc
Report on directors' remuneration (continued)

Chairman's remuneration

Sir David Arculus's remuneration for his tenure as Chairman for the 10 months ended 31 January 2006 was determined by the Committee. He received an annual fee of £355,000 as Chairman, of which £28,254 per annum is, at his request, paid into his personal pension arrangements. The Chairman does not participate in O2 plc annual incentive arrangements. The Chairman agreed to invest 15 per cent of his after-tax fee in the Company's shares, to be retained until his retirement as Chairman. This occurred on 23 January 2006 when he reverted to being a non-executive Director of O2 plc.

Remuneration of non-executive directors

With the exception of Andrew Sukawaty, the non-executive Directors of O2 resigned on 23 January 2006.

For the period ended 31 January 2006 the fees of non-executive Directors were determined by the Chairman and executive Directors who had access to independent advice.

Each non-executive Director agreed that a portion of their after-tax fee, equivalent to a minimum of 50 per cent and up to a maximum of 100 per cent, would be invested in shares. This arrangement was suspended for the period July 2005 to January 2006. Fees are paid quarterly in arrears and the shares are allotted on the same basis. The non-executive Directors do not participate in any of O2's pension or incentive arrangements and receive no benefits.

During the 10 months ended 31 January 2006, the following fee structure was in place:

a) the basic annual fee payable was £50,000 plus an additional fee of £7,500 for membership of the Audit and Remuneration Committees, £3,750 for the Nomination and Governance Committee and an additional fee of £7,500 per annum for chairmanship of a committee; and

b) the annual fee payable to the Deputy Chairman of the Company was £100,000.

Each non-executive Director had a letter of appointment with O2 plc covering, amongst other items, their terms of appointment and expected time commitment, together with a general statement of their role and duties. Non-executive Directors are appointed initially for three years unless otherwise terminated earlier by and at the discretion of either party upon one month's written notice.

With the exception of Andrew Sukawaty, the non-executive Directors employed by Telefónica who were appointed to the O2 Board on 23 January 2006 do not have contractual arrangements with O2. Andrew Sukawaty's appointment terms were varied with effect from 23 January 2006 to reflect a 12 month period which may be terminated by either party on three months' notice. The fee for the appointment is £75,000 per annum.

O2 plc
Report on directors' remuneration (continued)

Directors' remuneration (excluding pension arrangements) for the 10 months ended 31 January 2006

	Salary and fees		Annual bonus		Benefits excluding pensions[4]		Total[5]	
	2006[1]	2005[2]	**2006[3]**	2005[2]	**2006[1]**	2005[2]	**2006[1]**	2005[2]
	£	£	**£**	£	**£**	£	**£**	£
Current Directors								
C Alierta Izuel	-	-	-	-	-	-	-	-
Sir David Arculus	**286,124**	280,847	-	-	**31,288**	16,787	**317,412**	297,634
P Erskine [6]	**595,833**	665,833	**667,000**	568,404	**42,727**	35,241	**1,305,560**	1,269,478
D Finch	**378,333**	425,000	**423,200**	430,000	**24,320**	28,222	**825,853**	883,222
D Gray [7]	**5,730**	-	**5,365**	-	**1,196**	-	**12,291**	-
R Gröger [8]	**387,148**	439,992	**465,583**	534,847	**22,676**	25,146	**875,407**	999,985
M Key [7]	**7,538**	-	**9,509**	-	**1,624**	-	**18,671**	-
J Linares Lopez [7]	-	-	-	-	-	-	-	-
S Qadri [7]	**6,470**	-	**7,808**	-	**439**	-	**14,717**	-
J Smith Basterra [7]	-	-	-	-	-	-	-	-
A Sukawaty	**51,041**	87,000	-	-	-	-	**51,041**	87,000
A Viana-Baptista [7]	-	-	-	-	-	-	-	-
Former Directors								
D Chance[9, 11]	**56,145**	48,000	-	-	-	-	**56,145**	48,000
J Gibbons [10, 11]	**25,000**	-	-	-	-	-	**25,000**	
S Hodge[9, 11]	**91,667**	66,667	-	-	-	-	**91,667**	66,667
R Lamprecht[9, 11]	**46,102**	-	-	-	-	-	**46,102**	-
P Lupo[9, 11]	**59,583**	30,856	-	-	-	-	**59,583**	30,856
K O'Donovan[9,11]	**53,017**	-	-	-	-	-	**53,017**	-

The following people were appointed to the O2 Board as directors on 23 January 2006 but did not receive emoluments (nor pension rights) from O2 in respect of their O2 directorships: C Alierta Izuel, J Linares Lopez, and A Viana-Baptista (non-executive), and J Smith Basterra (executive).

Notes

1 Reflects 10 months ended 31 January 2006

2 Reflects year ended 31 March 2005

3 Reflects 12 months' worth of bonus, as performance was determined by the O2 Remuneration Committee prior to the period end (as set out in the offer document)

4 Benefits include car provision or cash allowance, health care, financial planning, dental care, home security and life cover

5 Certain Directors received pension supplements for the period ended 31 January 2006. Details of these can be found on page 29 below the pensions table

6 Highest paid Director

7 Appointed on 23 January 2006

8 Rudolf Gröger's remuneration has been converted from Euro to Sterling at an exchange rate of £1 = €1.46799 (year ended 31 March 2005: £1 = €1.45836)

9 Resigned from the Board on 23 January 2006

10 Appointed on 1 September 2005 and stepped down 23 January 2006

11 Includes one month's payment of fees in respect of loss of office in accordance with their letters of appointment as follows:

D Chance	£5,104
J Gibbons	£4,166
S Hodge	£8,333
R Lamprecht	£4,166
P Lupo	£5,416
K O'Donovan	£4,791

O2 plc
Report on directors' remuneration (continued)

Pensions

The table below includes the information required in relation to defined benefit schemes under the UKLA Listing Rules and Schedule 7A of the Companies Act 1985.

	Total accrued pension		Transfer value		Real increase in pension during year		Increase in accrued pension (incl. inflation)		Transfer value[7]		Increase in transfer value[8]	Directors' contri-butions
	At 31 Jan 2006	At 31 Mar 2005	At 31 Jan 2006	At 31 Mar 2005	2006	2005	2006	2005	2006	2005		
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
P Erskine												
O2 Pension Plan	**45**	41	**592**	490	**4**	3	**4**	4	**33**	25	**87**	**15**
Unfunded Plan	**281**	246	**5,756**	4,161	**31**	36	**35**	43	**644**	606	**1,595**	**0**
Total	**326**	287	**6,348**	4,651	**35**	39	**39**	47	**677**	631	**1,682**	**15**
D Finch	**16**	12	**151**	114	**3**	3	**4**	3	**31**	31	**37**	**0**
R Groger[4]	**104**	93	**3,032**	2,281	**10**	23	**11**	24	**286**	545	**751**	**0**
D Gray [5]	**70**	65	**756**	704	**4**	n/a	**5**	n/a	**29**	n/a	**39**	**13**
S Qadri [6]												
O2 Pension Plan	**39**	37	**297**	265	**2**	n/a	**2**	n/a	**2**	n/a	**17**	**15**
Unfunded Plan	**25**	20	**417**	269	**4**	n/a	**5**	n/a	**64**	n/a	**148**	**0**
Total	**64**	57	**714**	534	**6**	n/a	**7**	n/a	**66**	n/a	**165**	**15**

For the 10 months ended 31 January 2006, Sir David Arculus received employer's contributions of £23,545 (£28,254 per annum) into his personal pension arrangements. For the 10 months ended 31 January 2006, in respect of David Finch, £79,450 (£89,250 for the year ended 31 March 2005) was paid to a defined contribution Funded Unapproved Retirement Benefit Scheme (FURBS) and £43,508 (£48,875 for the year ended 31 March 2005) was paid as a cash supplement. For the 10 months ended 31 January 2006 Matthew Key received a cash allowance of £72,083 of which £23,760 was paid to the O2 Pension Plan.

Notes

1 The accrued annual pension represents the maximum defined benefit liability for O2. The amounts will be reduced by any retained benefits from previous employment

2 The transfer values have been calculated on the basis of actuarial advice. The transfer values of the Inland Revenue approved benefits have been calculated in accordance with Actuarial Guidance Note GN11 using the assumptions adopted by the O2 Pension Plan Actuary. The unapproved element of pension benefits has been valued using assumptions appropriate to the IAS19 accounting standard, which are consistent with GN11 principles

3 These figures represent liabilities of the Company and the O2 Pension Plan, not sums paid or due to the individual

4 The figures in £ sterling have been converted from Euros at an exchange rate of €1:£0.6843 as at 31 January 2006 and €1:£0.6803 as at 31 March 2005

5 Danuta Gray and Sohail Qadri were appointed to the Board on 23 January 2006

6 Danuta Gray has accrued a tax-free cash lump sum payment of £210,000, payable from retirement at age 60, as at 31 January 2006

7 Represents transfer value of real increase in accrued benefit (less Directors' contributions)

8 Represents increase in transfer value less Directors' contributions

O2 plc
Report on directors' remuneration (continued)

Directors' interests in the shares of the Company

Beneficial interests

The beneficial interests of the Directors and their immediate families in ordinary shares of 0.1p each in the Company as at 31 January 2006 are set out in the table below:

	As at 31 January 2006 Ordinary shares owned by director or immediate family	Shares held in trust in respect of vested share plans (total of RSP, DEIP, PSP and DBA vested on 23 January 2006)	As at 1 April 2005[1] Ordinary shares owned by director or immediate family
C Alierta Izuel	-	-	-
Sir David Arculus	-	292,397	338,281
P Erskine	-	3,972,819	965,910
D Finch	-	2,405,446	1,028,768
D Gray	-	1,296,380	2,580
R Gröger	-	2,942,496	63,944
M Key	-	1,024,919	-
J Linares Lopez	-	-	-
S Qadri	-	1,114,536	-
J Smith Basterra	-	-	-
A Sukawaty	-	-	83,576
A Viana-Baptista	-	-	-

[1] or at date of appointment if later

The shares held in trust in respect of share plans relate to awards that vested before the period end. However, these shares were not transferred out of the trust until after the period end, when they were assented to the Telefónica share offer in February 2006.

Following joining the board of Telefónica, Sir David Arculus and Mr P Erskine acquired 500 shares each in that company, which they continued to hold at 31 January 2006. As at that date, Mr A Sukawaty held 770 shares in Telefónica.

As at 31 December 2005, Mr C Alierta Izuel, Mr Linares Lopez and Mr A Viana-Baptista held 1,001,200, 26,487 and 22,873 shares respectively in Telefónica. The share interests in Telefónica of Mr C Alierta Izuel, Mr Linares Lopez and Mr A Viana-Baptista, who are also directors of that company, can be found in the Annual Report on Corporate Governance of Telefónica, S.A. for the year ended 31 December 2005. There was no movement in the shareholding of Mr C Alierta Izuel, Mr Linares Lopez and Mr A Viana-Baptista between 31 December 2005 and 31 January 2006. For further information on shareholdings of Mr C Alierta Izuel, Mr Linares Lopez and Mr A Viana-Baptista in Telefónica refer to Telefónica's website: http://www.telefonica.es/accionistaseinversores/. At 31 January 2006, Mr Smith Basterra held 3,910 shares in Telefónica. None of the remaining Directors of O2 plc had any interests in the share capital of Telefónica.

O2 plc
Report on directors' remuneration (continued)

Performance Share Plan

The table below shows the number of performance shares which remained outstanding to executive Directors as at 31 January 2006.

	Date of award	Number as at 1 April 2005	Granted during the 10 months ended 31 January 2006	Market price at date of grant	Vested	Lapsed	**Number as at 31 January 2006**	Vesting date
P Erskine	31/07/03	1,403,773	-		**1,403,773**[1]	-	**0**	23/01/06
	26/07/05	-	1,280,014	**142p**	**1,280,014**[2]	-	**0**	23/01/06
D Finch	31/07/03	905,660	-		**905,660**[1]	-	**0**	23/01/06
	26/07/05	-	649,717	**142p**	**649,717**[2]	-	**0**	23/01/06
D Gray	31/07/03	462,264	-		**462,264**[1]	-	**0**	23/01/06
	26/07/05	-	224,576	**142p**	**224,576**[2]	-	**0**	23/01/06
R Gröger	31/07/03	859,245	-		**859,245**[1]	-	**0**	23/01/06
	26/07/05	-	979,449	**142p**	**979,449**[2]	-	**0**	23/01/06
M Key	31/07/03	273,245			**273,245**[1]	-	**0**	23/01/06
	26/07/05	-	279,661	**142p**	**279,661**[2]	-	**0**	23/01/06
S Qadri	31/07/03	500,000	-		**500,000**[1]	-	**0**	23/01/06
	26/07/05	-	254,237	**142p**	**254,237**[2]	-	**0**	23/01/06

1 These awards vested early as a result of the acquisition by Telefónica (see page 23). However, the shares were not transferred out of the trust until after the period end and so formed part of the directors' beneficial interests in the shares of the company at 31 January 2006. The market price on the date of vesting was 200p.

2 Awards made in 2005 will vest in full, but the offer proceeds for these O2 Shares will only be released on the first anniversary of the Unconditional Date subject to the participant (i) not having given notice to resign their employment, and (ii) not having been dismissed for cause in accordance with their service contract, in both cases prior to such first anniversary

A summary of the performance condition can be found on page 22.

Deferred Equity Incentive Plan

The table below shows the number of deferred equity shares which remained outstanding to executive Directors as at 31 January 2006.

	Date of award	Number as at 1 April 2005	Granted during the 10 months ended 31 January 2006	Market price at date of grant	Vested [1]	Lapsed	**Number as at 31 January 2006**	Vesting date
P Erskine	29/07/04	989,824	-	85.5p	989,824	-	-	23/01/06
D Finch	29/07/04	638,595	-	85.5p	638,595	-	-	23/01/06
D Gray	29/07/04	491,718	-	85.5p	491,718	-	-	23/01/06
R Gröger	29/07/04	846,315	-	85.5p	846,315	-	-	23/01/06
M Key	29/07/04	233,743	-	85.5p	233,743	-	-	23/01/06
S Qadri	29/07/04	278,946	-	85.5p	278,946	-	-	23/01/06

1 These awards vested early as a result of the acquisition by Telefónica (see page 23). However, the shares were not transferred out of the trust until after the period end and so formed part of the directors' beneficial interests in the shares of the company at 31 January 2006. The market price on the date of vesting was 200p.

A summary of the performance condition can be found on page 22.

O2 plc
Report on directors' remuneration (continued)

Restricted Share Plan

The table below shows the number of restricted shares which remained outstanding to Directors as at 31 January 2006.

	Date of award	Number as at 1 April 2005	Granted during the 10 months ended 31 January 2006	Market price at date of grant	Vested	Lapsed	**Number as at 31 January 2006**	Vesting date
Sir David Arculus[1]	29/07/04	292,397	-	85.5p	292,397	-	-	29/07/07
M Key[2]	29/07/04	143,274	-	85.5p	143,274	-	-	29/07/07

1 The treatment of Sir David Arculus' Restricted Share Award is set out on page 24.

2 The personal shareholding requirement for Matthew Key was equal to the number of shares under award. The requirement had been met in full at the point that the takeover was announced. The Remuneration Committee determined that the Restricted Share Award should be released and replaced by a conditional entitlement to cash (the Conditional Cash Award) equivalent to the value of the Restricted Share Award at the Unconditional Date (i.e. 200p for every share under award). Payment of the Conditional Cash Award is subject to remaining in service with O2 until the vesting date of 29 July 2007.

Deferred Shares

The table below shows the number of deferred shares which remained outstanding to executive Directors as at 31 January 2006.

	Date of award	Number as at 1 April 2005	Granted during the 10 months ended 31 January 2006	Market price at date of grant	Vested[1]	Lapsed	**Number as at 31 January 2006**	Vesting date
P Erskine	26/07/05	-	200,707	142p	200,707	-	-	23/01/06
D Finch	26/07/05	-	151,836	142p	151,836	-	-	23/01/06
D Gray	26/07/05	-	85,682	142p	85,682	-	-	23/01/06
R Gröger	26/07/05	-	184,533	142p	184,533	-	-	23/01/06
M Key	26/07/05	-	69,587	142p	69,587	-	-	23/01/06
S Qadri	26/07/05	-	53,722	142p	53,722	-	-	23/01/06

1 These awards vested early as a result of the acquisition by Telefónica (see page 23). However, the shares were not transferred out of the trust until after the period end and so formed part of the directors' beneficial interests in the shares of the company at 31 January 2006. The market price on the date of vesting was 200p.

There is no performance condition attached to these awards other than continuous employment.

O2 plc
Report on directors' remuneration (continued)

Share Option Plan

The table below shows the number of executive share options which remained outstanding to Directors during the 10 months ended 31 January 2006.

	Date of award	Number as at 1 April 2005*	Granted during the 10 months ended 31 January 2006	Exercised	Lapsed	**Number as at 31 January 2006**	Option price	Price on date of exercise	Period exercisable
P Erskine	23/11/01	1,724,137	-	-	-	**1,724,137**	87p	-	23/11/04 – 23/03/06
	25/07/02	3,554,347	-	3,554,347	-	-	46p	141.5p	25/07/05 – 23/03/06
D Finch	23/11/01	1,206,896	-	-	-	**1,206,896**	87p	-	23/11/04 – 23/03/06
	25/07/02	2,445,652	-	2,445,652	-	-	46p	141.5p	25/07/05 – 23/03/06
D Gray	23/11/01	378,620	-	120,000	-	**258,620**	87p	141.5p	23/11/04 – 23/03/06
	25/07/02	1,304,347	-	1,304,347	-	-	46p	141.5p	25/07/05 – 23/03/06
R Gröger	23/11/01	162,544	-	-	-	**162,544**	87p	-	23/11/04 – 23/03/06
	25/07/02	1,763,373	-	1,763,373	-	-	46p	141.5p	25/07/05– 23/03/06
M Key	27/02/02	170,626	-	77,000	-	**93,626**	64p	196.5p	27/02/05 – 23/03/06
	25/07/02	931,304	-	931,304	-	-	46p	141.5p	25/07/05 – 23/03/06
S Qadri	23/11/01	793,103	-	586,895	-	**206,208**	87p	141.5p	23/11/04 – 23/03/06
	25/07/02	1,565,217	-	1,565,217	-	-	46p	141.5p	25/07/05 – 23/03/06

* or at date of appointment if later

Share options are subject to the TSR performance of the Company as set out on page 23. In the 10 months ended 31 January 2006, options granted in 2002/03 became exercisable in full as a result of O2's TSR ranking of 1st in the relevant comparator group at the first performance test (July 2005).

In addition, TSR performance was re-tested in respect of the remaining 26 per cent of options granted in 2001/02 and as a result of O2's TSR performance being above upper quartile, the 26 per cent also became exercisable from November 2005. All options were exercised in February 2006.

O2 plc
Report on directors' remuneration (continued)

Sharesave

The table below shows the sharesave options over ordinary shares in the Company held by Directors during the 10 months ended 31 January 2006.

	Grant Date	Number as at 1 April 2005*	Granted during the 10 months ended 31 January 2006	Exercised	Lapsed	**Number as at 31 January 2006**	Exercise price	Price on date of exercise	Period exercisable
P Erskine[1]	17/12/04	18,040	-	-	-	**18,040**	91.6p	-	23/01/06 - 23/03/06
D Finch[1]	17/12/04	10,343	-	-	-	**10,343**	91.6p	-	23/01/06 - 23/03/06
D Gray	20/12/02	21,477	-	-	-	**21,447**	44p	-	13/02/06 - 23/03/06
M Key	20/12/02	21,477	-	-	-	**21,447**	44p	-	13/02/06 - 23/03/06
S Qadri	20/12/02	21,477	-	-	-	**21,447**	44p	-	13/02/06 - 23/03/06

* or at date of appointment if later

[1] As a result of the acquisition by Telefónica, a portion of these options became exercisable and the remainder lapsed. Telefónica agreed under the Framework Agreement that O2 would pay compensation to participants in relation to lapsed options equal to the additional profit which the employees would have received had they continued to make savings under the Sharesave schemes to the bonus date of their savings contract.

Gains on exercise of share options

Gains on the exercise of share options by Directors for the 10 months ended 31 January 2006 are detailed in note 33 of the financial statements.

Share price

The closing market price of O2 plc shares at 31 January 2006 was 199.5p and the range from 1 April 2005 to that date was 114p to 209.25p.

Non-beneficial interests

At 31 January 2006, all executive Directors had a non-beneficial interest in 4,970,553 O2 plc ordinary shares held in trust by Hill Samuel Offshore Trust Company Limited as trustee of the O2 Restricted Share Plan, O2 Performance Share Plan, O2 Deferred Award and O2 Deferred Equity Incentive Plan.

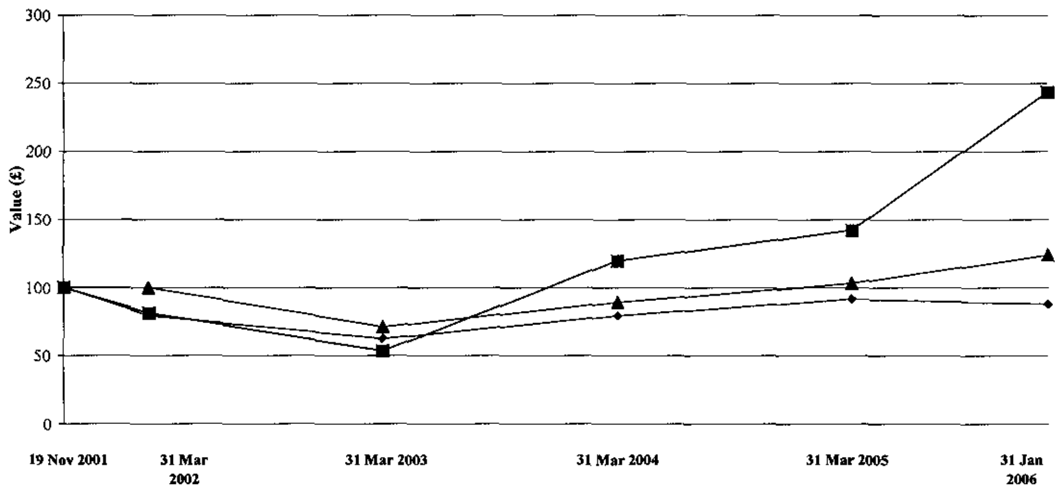
Performance graph

The performance graph illustrates the Company's TSR performance for the period from 19 November 2001 (when the Company was first listed following its demerger from BT) to 31 January 2006, compared to the FTSE 100 Index and the FTSEurofirst 300 Telecommunications Index. The FTSE 100 Index was selected by the Committee because it is recognised as an externally valid and robust comparator group of UK-based companies of similar size to the Company in terms of market capitalisation. The FTSEurofirst 300 Telecommunications Index was chosen because it more closely compares the Company within its sector. The graph relates to mmO2 plc's performance prior to 14 March 2005, and O2 plc's performance thereafter.

O2 plc
Report on directors' remuneration (continued)

The graph shows the growth in value of £100 invested on 19 November 2001 (including the reinvestment of dividends). It does not relate to the Company's TSR performance as reflected in O2 long-term incentives.

Total shareholder return
Source: Thomson Financial



This graph shows the value, by 31 January 2006, of £100 invested in mmO_2 on 19 November 2001 compared with the value of £100 invested in the FTSE 100 Index and in the FTSEurofirst300 Telecom Services Index. The other points plotted are the values at the intervening financial year-ends.

Policy on outside appointments

It is the Group's policy to support executive Directors and senior managers taking external directorships or similar roles where it is beneficial for both the individual concerned and the Group and does not detract from their responsibilities to the Group. The number of such appointments must not exceed two, only one of which may be with a FTSE 100 company. Appointments relating to executive Directors and Executive Committee members require the prior approval of the Board. Appointments relating to other senior executives require the prior approval of the Chairman. The Company permits the executive Director or senior executive concerned to retain any fees earned from such a position provided they are at a reasonable level. Danuta Gray is a Director of Irish Life & Permanent plc, for which she receives a fee of €62,500 per annum. Peter Erskine is a member of the University of Reading Business School Advisory Board, for which no fee is paid.

Compliance

This report complies with the Directors' Remuneration Report Regulations 2002 (the Regulations). The Regulations require the Group's auditors to report to shareholders on the auditable part of the report and to state whether, in their opinion, that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). The auditable sections of the report are the tables relating to Directors' remuneration, Directors' pensions and Directors' interests in share schemes on pages 28 to 34 and the accompanying footnotes. The Company's compliance with the Combined Code during the 10 months ended 31 January 2006 is set out in the Directors' Report.

By Order of the Board

Philip Bramwell
Company Secretary and General Counsel
29 June 2006

Independent auditors' report to the members of O2 plc

We have audited the Group and parent Company financial statements (the "financial statements") of O2 plc for the 10 months ended 31 January 2006 which comprise the consolidated income statement, the consolidated and parent Company balance sheets, the consolidated and parent Company cash flow statements, the consolidated and parent Company statements of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' report, the Corporate responsibility report and the unaudited part of the Directors' remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

Independent auditors' report to the members of O2 plc (continued)

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 January 2006 and of its profit and cash flows for the 10 month period then ended;

- the parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent Company's affairs as at 31 January 2006 and cash flows for the 10 month period then ended; and

- *the financial statements and the part of the Directors' remuneration report to be audited* have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
29 June 2006

O2 plc

Consolidated income statement
10 months ended 31 January 2006

	Note	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Revenue	2	**6,124**	6,575
Cost of sales		**(3,661)**	(3,691)
Gross profit		**2,463**	2,884
Administrative expenses		**(2,263)**	(2,351)
EBITDA[1]		**1,589**	1,760
Depreciation before exceptional items	9	**(619)**	(760)
UMTS licences amortisation	11	**(198)**	(169)
Other amortisation	11	**(252)**	(253)
Operating profit before exceptional items		**520**	578
Exceptional items	4	**(320)**	(45)
Operating profit	2,3	**200**	533
Share of post tax results of joint ventures and associates	18	**(5)**	(3)
Costs of capital reorganisation	4	**-**	(20)
Financial income	5	**74**	63
Financial expense	5	**(63)**	(73)
Profit before taxation		**206**	500
Taxation	6	**35**	(7)
Profit for the period attributable to equity shareholders		**241**	493
Basic earnings per share (pence)	8	**2.8**	5.7
Diluted earnings per share (pence)	8	**2.7**	5.6

The accompanying notes are an integral part of these financial statements.

[1]EBITDA is the Group's earnings before interest, tax, depreciation, amortisation and exceptional items, excluding the Group's share of operating profits and losses of its joint ventures and associates. Further discussion of EBITDA is provided in note 1 of these financial statements.

O2 plc

Consolidated statement of recognised income and expense
10 months ended 31 January 2006

	Note	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Exchange differences on translation of foreign operations	26	**(10)**	122
Net investment hedges of foreign operations	26	**-**	(54)
Actuarial losses on defined benefit pension plans	22	**(47)**	(19)
Deferred tax on amounts recognised in reserves	24	**63**	-
Net income recognised directly in reserves		**6**	49
Profit for the period attributable to equity shareholders		**241**	493
Total recognised income relating to the period	26	**247**	542

Company statement of recognised income and expense
10 months ended 31 January 2006

	Note	10 months ended 31 January 2006 £m	Period from incorporation on 10 December 2004 to 31 March 2005 £m
Actuarial losses on defined benefit pension plans	22	**(40)**	(16)
Deferred tax on defined pension liability	24	**38**	-
Net expense recognised directly in reserves		**(2)**	(16)
Loss for the period attributable to equity shareholders		**(42)**	-
Total recognised expense relating to the period	26	**(44)**	(16)

The accompanying notes are an integral part of these financial statements.

O2 plc

Consolidated balance sheet
As at 31 January 2006

	Note	31 January 2006 £m	31 March 2005 £m
Non-current assets			
Property, plant and equipment	9	**4,108**	3,843
Goodwill	10	**3,210**	3,211
Other intangible assets	11	**4,325**	4,627
Derivative financial instruments	17	**-**	21
Investments in joint ventures and associates	18	**1**	2
		11,644	11,704
Current assets			
Inventories	13	**133**	87
Trade and other receivables	14	**1,123**	1,029
Derivative financial instruments	17	**5**	28
Other financial assets	15	**324**	317
Cash and cash equivalents	16	**889**	1,009
		2,474	2,470
Current liabilities			
Borrowings	19	**(770)**	(71)
Trade and other payables	20	**(1,930)**	(1,766)
Current tax liabilities		**(15)**	(7)
Provisions	21	**(1)**	(9)
		(2,716)	(1,853)
Net current (liabilities)/assets		**(242)**	617
Total assets less current (liabilities)/assets		**11,402**	12,321
Non-current liabilities			
Borrowings	19	**(668)**	(1,370)
Retirement benefit obligations	22	**(90)**	(126)
Other payables	23	**(38)**	(45)
Deferred tax liabilities	24	**(378)**	(489)
Provisions	21	**(60)**	(96)
		(1,234)	(2,126)
Net assets		**10,168**	10,195
Equity			
Ordinary share capital	25	**9**	9
Share premium	26	**409**	375
Translation reserve	26	**1,450**	1,460
Other reserves	26	**2,305**	2,912
Retained earnings	26	**5,995**	5,439
Total equity		**10,168**	10,195

The accompanying notes are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 29 June 2006 and were signed on its behalf by:

Peter Erskine
Chairman and Chief Executive Officer

David Finch
Chief Financial Officer

O2 plc

Company balance sheet
As at 31 January 2006

	Note	31 January 2006 £m	31 March 2005 £m
Non-current assets			
Investments in subsidiary undertakings	12	**10,879**	10,879
Deferred tax assets	24	**38**	-
		10,917	10,879
Current assets			
Trade and other receivables	14	**107**	108
Current liabilities			
Borrowings	19	**(6)**	-
Trade and other payables	20	**(123)**	(21)
		(129)	(21)
Net current (liabilities)/assets		**(22)**	87
Total assets less current (liabilities)/assets		**10,895**	10,966
Non-current liabilities			
Borrowings	19	**(328)**	(14)
Retirement benefit obligations	22	**(60)**	(103)
		(388)	(117)
Net assets		**10,507**	10,849
Equity			
Ordinary share capital	25	**9**	9
Share premium	26	**409**	375
Other reserves	26	**3,767**	3,767
Retained earnings	26	**6,322**	6,698
Total equity		**10,507**	10,849

The accompanying notes are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 29 June 2006 and were signed on its behalf by:

Peter Erskine
Chairman and Chief Executive Officer

David Finch
Chief Financial Officer

O2 plc

Consolidated statement of cash flows
10 months ended 31 January 2006

	Note	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Operating profit		**200**	533
Depreciation and amortisation charges		**1,220**	1,188
Loss on disposal of non-current assets		**4**	2
Increase in inventory		**(46)**	(2)
Increase in trade and other receivables		**(99)**	(80)
Increase in trade and other payables		**121**	97
(Decrease)/increase in provisions		**(44)**	9
Income taxes paid		**(5)**	(15)
One-off contribution to defined benefit pension scheme	22	**(81)**	-
Other non-cash movements		**30**	8
Net cash from operating activities		**1,300**	1,740
Purchase of property, plant and equipment		**(917)**	(1,143)
Purchase of intangibles assets		**(256)**	(204)
Investment in joint ventures		**(1)**	(2)
Dividends received from associated undertakings		**-**	7
Proceeds from sale of property, plant and equipment		**7**	-
Net cash flow used in investing activities		**(1,167)**	(1,342)
Net proceeds from issue of ordinary share capital		**35**	24
Purchase of own shares		**(7)**	(1)
Settlement of cross currency swaps		**-**	22
Repayment of borrowings including finance leases		**(20)**	(21)
Settlement of forward foreign exchange contracts		**52**	(32)
Management of other financial assets		**-**	14
Interest paid		**(87)**	(68)
Interest received		**68**	30
Premium paid to shareholders in capital reorganisation		**-**	(15)
Costs of capital reorganisation		**-**	(15)
Dividends paid		**(332)**	-
Net cash flow used in financing activities		**(291)**	(62)
Net (decrease)/ increase in cash and cash equivalents		**(158)**	336
Cash and cash equivalents start of period	16	**1,009**	668
Exchange (losses)/gains on cash and cash equivalents		**(1)**	5
Cash and cash equivalents at end of period	16	**850**	1,009

The accompanying notes are an integral part of these financial statements.

O2 plc

Company statement of cash flows
10 months ended 31 January 2006

	10 months ended 31 January 2006 £m	Period from incorporation on 10 December 2004 to 31 March 2005 £m
Operating loss	**(39)**	(1)
Increase in trade and other payables	**20**	1
Net cash outflow from operating activities	**(19)**	-
Net proceeds from issue of ordinary share capital	**35**	-
Interest received	**2**	1
Premium paid to shareholders in capital reorganisation	**-**	(15)
Increase in borrowings from subsidiaries	**314**	14
Dividends paid	**(332)**	-
Net cash flow from financing activities	**19**	-
Net change in cash and cash equivalents	**-**	-
Cash and cash equivalents at start of period	**-**	-
Cash and cash equivalents at end of period	**-**	-

The accompanying notes are an integral part of these financial statements.

O2 plc

Consolidated statement of net debt
31 January 2006

	Note	**31 January 2006 £m**	31 March 2005 £m
Cash and cash equivalents	16	**889**	1,009
Other financial assets	15	**324**	317
		1,213	1,326
Euro medium-term notes	19	**(1,066)**	(1,078)
Non-current derivative financial instruments	17	**-**	21
Current derivative financial instruments	17	**4**	-
Bank overdraft	19	**(39)**	-
Obligations under finance leases	19	**(300)**	(308)
Other loans and borrowings	19	**(30)**	(40)
Net debt	27	**(218)**	(79)

The accompanying notes are an integral part of these financial statements.

O2 plc
Notes to the financial statements

1. Accounting policies

Basis of preparation

In accordance with European Union ("EU") Regulation 1606/2002, the O2 plc Group (the "Group") has adopted International Financial Reporting Standards ("IFRS") as its primary basis of accounting for the 10 months ended 31 January 2006 in place of UK Generally Accepted Accounting Principles ("UK GAAP"). Up to and including 31 March 2005, the Group has prepared and presented its financial statements in accordance with UK GAAP.

Reconciliations and descriptions of the effect of the transition from UK GAAP to IFRS on the Group's equity, net income and cash flows are provided in note 38.

These financial statements have been prepared in accordance with IFRS and International Financial Reporting Interpretations Committee ("IFRIC") interpretations as adopted for use in the EU. In addition the financial statements have been prepared in accordance with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The financial statements have been prepared using historical cost principles except that, as disclosed in the accounting policies below, certain items including derivative instruments are measured at fair value.

O2 plc (the "Company") and its subsidiaries have changed their accounting reference date from 31 March to 31 January to align the period end date more closely to the date on which Telefónica acquired the Group. Accordingly amounts presented for the current period are for the ten month period from 1 April 2005 to 31 January 2006. Comparative information is for the twelve months from 1 April 2004 to 31 March 2005.

The accounting policies of the Group applied in the preparation of these financial statements are set out below. The IFRS accounting policies have been applied consistently to all periods presented and in preparing an opening IFRS balance sheet at 1 April 2004 for the purposes of the transition to IFRS. Note 38 describes the transition date of the Group to IFRS.

O2 plc was incorporated on 10 December 2004 as part of the capital reorganisation described in note 25. The purpose of the capital reorganisation was to create distributable reserves in O2 plc to allow the implementation of the Group's distribution policy. On 14 March 2005, O2 plc was introduced as the new holding company of the mmO2 plc Group pursuant to a Scheme of Arrangement (the "Scheme") under section 425 of the Companies Act 1985, whereby O2 plc issued shares in return for the existing shares in mmO2 plc. Subsequently, O2 plc effected a reduction in its share capital to create distributable reserves. Shareholders were also offered the opportunity to realise, for cash, their shareholding in mmO2 plc in a cost effective manner.

The consolidated financial statements for the year ended 31 March 2005 comprise the results of O2 plc from incorporation to 31 March 2005 together with the results of the O2 plc group from the 14 March 2005 to the end of the financial year and the results of the mmO2 group from 1 April 2004 to 13 March 2005.

1. Accounting polices (continued)

Presentation of financial information

EBITDA

EBITDA is the Group's earnings before interest, tax, depreciation, amortisation and exceptional items, excluding the Group's share of operating profits and losses of its joint ventures and associates. EBITDA is not a measure of financial performance under IFRS and may not be comparable to similarly titled measures of other companies, because EBITDA is not uniformly defined. EBITDA should not be considered as an alternative to Group operating profit or profit before taxation as an indication of operating performance, or as an alternative to cash flow from operating activities as an indication of cash flows.

EBITDA is one of the key financial measures used by the Group for evaluating financial performance.

Exceptional items

Items of income or expense which require separate disclosure, owing to their size or incidence, are disclosed as "exceptional items" on the face of the income statement, as the Group believes such presentation is relevant to an understanding of financial performance.

Net debt

The Group defines "net debt" as its current and non-current borrowings together with the fair value of related derivatives, cash and cash equivalents and other financial assets, excluding liabilities relating to accrued interest on borrowings. Net debt is not a measure of the financial position of the Group under IFRS and may not be comparable to similarly titled measures of other companies, because net debt is not uniformly defined.

Basis of group accounting

Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities. The financial statements of all subsidiaries are included in the consolidated financial statements from the date that control commences until control ceases. All principal subsidiary undertakings' financial years are conterminous with those of O2 plc.

Joint ventures

Jointly controlled entities are those entities over whose activities the Group has joint control, established by a contractual agreement. The consolidated financial statements include the Group's share of the recognised income and expenses of joint ventures on an equity accounting basis. After the interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the Group has incurred legal or constructive obligations on behalf of the joint venture.

Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the income and expenses of associates on an equity accounting basis. The investment in associates includes goodwill arising on acquisition less accumulated impairment. After the interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the Group has incurred legal or constructive obligations on behalf of the associate.

1. Accounting polices (continued)

Transactions eliminated on consolidation

Intra-group balances and transactions are eliminated in preparing the consolidated financial statements.

Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation. The cost of property, plant and equipment includes directly attributable incremental costs incurred in its acquisition and installation. Subsequent costs are included in the assets' carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All borrowing costs are written off to the income statement as incurred and are not capitalised as part of any asset's carrying value.

Depreciation is provided on property, plant and equipment from the date they are brought into use over their estimated useful lives on a straight-line basis. The lives assigned to property, plant and equipment are:

Freehold buildings	40 years
Leasehold buildings	Unexpired portion of lease or 40 years, whichever is the shorter
Network assets	5 to 15 years
Computers and office equipment	2 to 6 years
Motor vehicles	5 years

The assets' useful lives and residual values are reviewed, and adjusted if appropriate, at each balance sheet date. No depreciation is provided on freehold land or assets in course of construction.

Goodwill

Goodwill, arising from the purchase of subsidiaries and associates, represents the excess of the cost of acquisition over the fair value of the Group's share of the net identifiable assets and liabilities acquired at the date of acquisition. Goodwill is reviewed annually for impairment and is carried at cost less accumulated impairment losses. Gains or losses arising on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Other intangible assets

Licences

Licence fees paid to Governments, which permit telecommunications activities to be operated for defined periods, are capitalised at cost less impairment losses and are amortised from the date of commercial launch of the service to the end of the licence period on a straight line basis. Their estimated useful lives are between 17 and 18 years.

Software

Software is capitalised and measured at the cost incurred to acquire and bring into use the specific software. These costs are amortised over their estimated useful lives of between 2 and 6 years on a straight line basis. Costs that are directly associated with the production of identifiable unique software products controlled by the Group, which are expected to generate economic benefits over a period of more than one year, are recognised as intangible assets. Computer software development costs recognised as intangible assets are amortised over their estimated useful lives not exceeding 6 years on a straight line basis.

1. **Accounting polices (continued)**

Other

Intangible assets classified as 'other' consist principally of amounts paid under a network sharing agreement in Germany. Such items recognised as intangible assets are amortised over their estimated useful lives not exceeding three years on a straight line basis.

Impairment of non financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows ("cash-generating units").

Revenue

Revenue, which excludes value added tax and other sales taxes, comprises the value of services provided, equipment sales and other revenue.

Mobile telecommunications service revenue includes revenue earned for usage of the Group's wireless network for voice and data transmission by the Group's customers, subscription fees, inbound roaming and interconnect revenue. Post-pay customers are billed in arrears based on usage and revenue is recognised when the service is rendered. Revenue for pre-pay customers is recorded as deferred revenue prior to commencement of services and is recognised as the pre-pay services are rendered. Inbound roaming revenue, earned from other mobile operators whose customers roam onto the O2 network, and outbound roaming revenue, earned from the Group's customers roaming outside their domestic coverage area, are recognised based upon usage. Subscription fees are recognised evenly throughout the periods to which they relate.

Hardware revenue principally consists of revenue from the sale of handsets. The revenue and related expenses associated with the sale of wireless handsets and accessories are recognised when the products are delivered and accepted by the customer. Other sales include connection charges which are deferred and recognised over the estimated customer relationship period.

Promotional offers and packages including different elements are assessed to determine whether it is necessary to separate out each component and apply a revenue recognition policy to each element. Total revenue is split among the identified elements based on their respective fair values.

Revenue is recognised on a gross basis where the Group's role is that of principal in a transaction. The gross basis represents the gross value of the billing to the customer after trade discounts, with any related costs being charged to operating expenses. Where the Group acts as agent in a transaction, the net revenue earned is recognised as revenue.

Deferred income, included in trade and other payables, includes the amount relating to purchases made by customers of prepaid cards that at the period end had still not been earned and recognised as revenue since the customers had not consumed the total amount of minutes relating to their cards.

Subscriber acquisition and loyalty programme costs

Subscriber acquisition and retention costs, other than loyalty programme costs, are recognised as an expense for the period in which they are incurred. Advertising, promotion, sponsoring, communication and brand marketing costs are also expensed as incurred. Loyalty programme costs are recorded as a reduction in revenues as earned. The consolidated balance sheet includes the related accrual based on estimates of the value of points accumulated at the year end under trade and other payables.

1. Accounting polices (continued)

Research and development

Expenditure on research activities is recognised in the income statement as an expense as incurred. Development expenditure is written off as incurred unless it meets the recognition criteria set out in IAS 38 "Intangible assets". Where the recognition criteria are met, intangible assets are capitalised and amortised over their useful economic lives.

Foreign currencies

Transactions denominated in foreign currencies are translated at the exchange rate on the day the transaction occurred to the functional currency of the entity. Monetary assets and liabilities denominated in foreign currencies are translated at the rates ruling at the balance sheet date.

Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency are translated at the foreign currency exchange rate ruling at the dates the non monetary assets and liabilities are recognised.

Net assets of foreign subsidiary undertakings, including related goodwill, are translated into sterling at the rates ruling at the balance sheet date. The profit or loss and cash flows for the year of foreign subsidiary undertakings are translated at the average rates of exchange for the year. Exchange adjustments arising on the translation into sterling of the opening net assets and profits or losses for the year retained by foreign subsidiary undertakings are recognised in reserves and reported in the consolidated statement of recognised income and expense. Exchange gains and losses arising on foreign currency net borrowings used to hedge the Group's foreign currency net investments are also recognised directly in reserves and reported in the consolidated statement of recognised income and expense.

Employee benefits

Employee benefits - Pension obligations

The Group operates both defined benefit and defined contribution plans. A defined benefit plan generally provides pensions based on the employee's length of service and their final pensionable salary. A defined contribution plan offers employees individual funds which are converted into pension benefits on retirement.

The assets of all schemes are held independently of the Group's finances.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Group has early adopted the amendment to IAS 19 "Employee Benefits", issued by the IASB on 16 December 2004 and applied it from 1 April 2004. Accordingly, on transition to IFRS the Group elected to recognise the full assets and liabilities of its defined benefit pension schemes on the consolidated balance sheet. Thereafter, the Group has elected to recognise actuarial gains and losses in full in the statement of recognised income and expense in the period in which they arise.

For defined contribution plans, the Group pays contributions to privately administered pension insurance plans on a contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

1. Accounting polices (continued)

Share based payments

The fair value of share awards and share options granted since 7 November 2002 and not vested at 1 January 2005 are recognised as an employee expense after taking into account the Groups' best estimate of the number of awards expected to vest. The fair values have been calculated using an adjusted Black-Scholes valuation model that takes into account the expected effect of performance conditions.

The Group recognises an expense for share based payments based on the fair value of the share awards or share options granted as compensation for the services rendered by the employee. The fair value is calculated at the grant date and excludes the impact of non-market conditions. Instead, the expense is adjusted for the effect of non-market conditions at each reporting date through the number of share awards or share options expected to be exercisable. The effect of market conditions is included in the fair value at the date of grant and is recognised as an expense irrespective of whether the market condition is satisfied. Any proceeds received are credited to share capital and share premium when the share option or award are exercised.

Taxation

The charge for current tax is based on the results for the period as adjusted for items which are non-assessable or disallowed.

Deferred income tax is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax and current tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

Own shares

Own shares which are held by a share ownership trust are consolidated into the Group's balance sheet. Where the trust purchases the Company's equity share capital, the consideration paid has been deducted from total shareholders' equity until such time as shares vested unconditionally to employees.

Cash and cash equivalents

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

Other financial assets

Other financial assets are carried in the balance sheet at cost. Other financial assets include deposits held in trust to meet hire purchase obligations and cash collateral for bank guarantees. These are not considered highly liquid investments and are not held for the purpose of meeting the Group's short-term cash commitments.

1. *Accounting polices (continued)*

Accounting for derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value at each reporting date. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

(1) hedges of the fair value of recognised assets or liabilities (fair value hedge);
(2) hedges of highly probable forecast transactions (cash flow hedges); or
(3) hedges of net investments in foreign operations.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of 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 hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, within financial expenses, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Hedges of net investments in foreign operations

Any gain or loss on the hedging instrument, which is used to hedge a net investment in a foreign operation, relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement within financial income. The ineffective portion relates to the forward points (comprising the interest rate differential between the currencies) excluded from the effectiveness testing which is completed on a spot to spot basis.

Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

Derivatives which are not designated as hedges

Derivative financial instrument which are used as economic hedges of foreign exchange exposures on recognised monetary assets or liabilities are not designated as hedges. In these circumstances, hedge accounting is not applied and gains or losses arising on the hedging instruments are recognised in the income statement and offset the movement in value of the monetary asset or liability also recognised in the income statement.

1. Accounting polices (continued)

Inventories

Inventories comprise mainly handsets and are stated at the lower of cost and net realisable value (which reflects the value to the business of the handset in the hands of the subscriber) on a first-in, first-out basis, after provisions for obsolescence. Cost comprises costs of purchase and costs incurred in bringing inventory to its current location and condition.

Trade and other receivables

Trade and other receivables are carried at original invoice amount less provision doubtful debts. A provision for doubtful debts is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Provisions are made based on an analysis of balances by age, previous losses experienced, disputes and ability to pay. The amount of the provision is the difference between the carrying *amount and the present value of estimated future cash flows. Changes in the provision against* receivables are recognised in the income statement within cost of goods sold.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable than an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made.

The Group recognises a provision for onerous contacts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. Restructuring provisions comprise employee termination payments, and these are recognised in the period in which the Group becomes legally or constructively committed to payment. A provision is made for the present value of the cost of restoration of mast sites at the date of acquisition of the site.

Borrowings

Borrowings are recognised initially at the proceeds received, less attributable transaction costs. Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between the cost and the redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis. Where borrowings are part of a fair value hedge relationship, an adjustment is made to the borrowing carrying value to reflect the hedged risk. Accrued interest on borrowings is included within the carrying value.

Leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Rentals under operating leases are charged to the income statement in equal annual instalments over the periods of the leases.

Leases which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Assets held under finance leases are capitalised at the lower of the present value of the minimum lease payments and the fair value of the asset at the inception of the leases and depreciated over the estimated useful economic lives of the assets. Finance charges are allocated over the period of the leases in proportion to the capital amount outstanding and are charged to the income statement.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividend distributions to the Company's shareholders are recognised in the Group's financial statements when paid.

1. Accounting polices (continued)

New accounting standards and IFRIC interpretations

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for accounting periods beginning on or after 1 January 2006 or later periods but which the Group has chosen not to early adopt. The new standards and interpretations which will be adopted by the Group in the periods beginning on or after 1 February 2006 are as follows:

Standards and amendments to standards		Effective date
IFRS 6	Exploration for and Evaluation of Mineral Assets	1 February 2006
IFRS 7	Financial Instruments: Disclosures	1 February 2007
Amendment to IAS 1	Presentation of Financial Statements – Capital Disclosures	1 February 2007
Amendment to IAS 21	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation	1 February 2006
Amendment to IAS 39	Financial Instruments: Recognition and Measurement – Fair Value Option	1 February 2006
Amendment to IAS 39	Financial Instruments – Recognition and Measurement – Cash Flow Hedges of Forecast Intra-group Transactions	1 February 2006
Amendment to IAS 39	Financial Instruments – Recognition and Measurement – Financial Guarantee Contracts	1 February 2006

Interpretations		Effective date
IFRIC 4	Determining Whether an Arrangement Contains a Lease	1 February 2006
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	1 February 2006
IFRIC 6	Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment	1 February 2006
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Information in Hyperinflationary Economies	1 February 2007
IFRIC 8	Scope of IFRS 2 Share-based Payment	1 February 2007
IFRIC 9	Reassessment of Embedded Derivatives	1 February 2007

The Group does not expect that the first-time adoption of these standards and interpretations will have a significant impact on its consolidated financial statements.

Critical accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the Group's accounting policies. A significant change in the facts and circumstances on which these estimates are based could have a material negative impact on the Group's earnings and financial position. The areas involving a higher degree of judgement or complexity and areas where assumptions and estimates are significant to the consolidated financial statements are discussed below.

1. Accounting polices (continued)

Property, plant and equipment and UMTS licences

Accounting for property, plant and equipment and UMTS licences involves the use of estimates and judgements for determining the useful lives over which they are to be depreciated or amortised and the existence and amount of any impairment.

Property, plant and equipment and UMTS licences are depreciated or amortised on a straight line basis over their estimated useful lives. When the Group estimates useful lives various factors are considered including expected technological obsolescence and the expected usage of the asset. The Directors regularly review these asset lives and change them as necessary to reflect the estimated current remaining lives in light of technological changes, future economic utilisation and physical condition of the assets concerned. A significant change in asset lives can have a significant change on depreciation and amortisation charges for the period.

It is not practicable to quantify the impact of changes in property, plant and equipment asset lives on an overall basis as asset lives are individually determined and there are a significant number of asset lives in use. The impact of changes in a small number of property, plant and equipment and software lives in the current period resulted in an exceptional charge of £151 million. The impact of any change would vary significantly depending on the individual changes in assets and the classes of assets impacted. A reduction in the estimated useful lives of the Group's UMTS licences from 17-18 years to 9 years at the start of the asset's life would have increased the UMTS licence amortisation charge for the 10 months ended 31 January 2006 by approximately £198 million.

The Group assesses the impairment of property, plant and equipment and UMTS licences whenever there is reason to believe that the carrying value may not exceed the fair value and where a permanent impairment in value is anticipated. The determination of whether the impairment of these assets is necessary, involves the use of estimates that includes, but are not limited to, the analysis of the cause of potential impairment in value, the timing of such potential impairment and an estimate of the amount of the impairment. The Group considers technological obsolescence, discontinuance of services and other changes in circumstances that indicate a need to perform an impairment test. A significant change in the facts and circumstances that were relied upon in making the estimates may trigger the requirement for recording an impairment and may have a material adverse impact on the operating results and financial condition of the Group.

Goodwill impairment

Goodwill is not subject to a regular amortisation charge and is instead tested annually to determine whether any impairment has arisen. This is completed by calculating the recoverable amount of cash-generating units ("CGUs") based on value in use calculations. These calculations require the use of estimates and judgements to calculate expected cash flows. Management make assumptions including, but not limited to, the discount rate to be applied, future technological evolution and revenue growth rates in calculating expected cash flow. A significant change in these facts and circumstances may have a material impact on the carrying value of goodwill. Based on the impairment review performed at 31 January 2006 (as disclosed in note 10), a 10% reduction in cash flows of each CGU, or a 1 percentage point increase in the discount rate, would not have led to the recognition of an impairment charge.

1. Accounting polices (continued)

Deferred tax assets and liabilities

The Group evaluates the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Group's ability to generate taxable earnings over the course of the period for which the deferred tax assets remain deductible. This analysis is based on the estimated reversal of deferred taxes as well as estimates of taxable earnings, which are sourced from internal projections and are updated to reflect the latest trends.

The appropriate classification of tax assets and liabilities depends on a series of factors, including estimates as to the timing and materialisation of deferred tax assets and the forecast tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

Provisions

Provisions are recognised when an event in the past gives rise to a current obligation for the Group, the settlement of which requires an outlay that is considered probable and can be estimated reliably. This obligation may be legal or constructive; deriving from regulations, contracts, normal practices or public commitments that lead third parties to reasonably expect that the Group will assume certain responsibilities. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, taking into account all available information.

No provision is recognised if the amount of liability cannot be estimated reliably. In this case, the relevant information is disclosed in the notes to the financial statements.

Given the uncertainties inherent in the estimates used to determine the amount of provision, actual outflows of resources may differ from the amounts recognised originally on the basis of the estimates.

Trade receivables provision for doubtful debts

The Group provides services to individuals and business customers on credit terms. The Group expects that some debts due will not be paid as a result of the default of a small number of customers. The Group uses estimates based on historical results and future expectations, the economic and competitive environment and other relevant factors to determine the provision for doubtful debts. A significant, unanticipated downturn in the major economies that the Group operates in or negative industry trends could require an increase in the estimated level of debts that will not be collected, which would negatively impact the operating results. The level of provision required is reviewed on an ongoing basis.

O2 plc
Notes to the financial statements

2. Segmental analysis

For day-to-day managerial and budgetary control, the Group's operations are divided along matrix lines as follows:

1) the supply of mobile telecommunications services and products in three geographical territories of operation; and
2) other businesses, comprising O2 Airwave, a secure national radio service business, and Manx Telecom, a fixed and mobile telecommunications business in the Isle of Man.

Inter-segment transactions are priced on an arms length basis.

	10 months ended 31 January 2006							
	O2 UK	O2 Germany	O2 Ireland	**Mobile telecomm-unications**	Other businesses UK	Central resources	Eliminations	**Total**
	£m	£m	£m	**£m**	£m	£m	£m	**£m**
Service revenue	3,144	1,669	512	5,325	18	-	(25)	**5,318**
Equipment and other revenue	400	174	32	606	200	-	-	**806**
Total revenue	**3,544**	**1,843**	**544**	**5,931**	**218**	-	**(25)**	**6,124**
Depreciation	(324)	(185)	(51)	(560)	(59)	-	-	**(619)**
Amortisation	(201)	(237)	(11)	(449)	-	(1)	-	**(450)**
Exceptional items	(50)	(84)	(5)	(139)	(19)	(162)	-	**(320)**
Other expenses	(2,539)	(1,471)	(348)	(4,358)	(130)	(72)	25	**(4,535)**
Operating profit/(loss) - segment result	**430**	**(134)**	**129**	**425**	**10**	**(235)[4]**	-	**200**
Share of post tax result of joint ventures and associates	(3)	(2)	-	(5)	-	-	–	**(5)**
Segment assets[1]	6,980	3,829	1,333	12,142	765	43	(50)	**12,900**
Segment liabilities[2]	(1,179)	(453)	(187)	(1,819)	(123)	(137)	50	**(2,029)**
	5,801	**3,376**	**1,146**	**10,323**	**642**	**(94)**	-	**10,871**
Capital expenditure[3]	448	596	91	1,135	63	2	-	**1,200**

[1]Segment assets comprise property, plant and equipment, goodwill, other intangible assets, inventories, trade and other receivables and investments accounted for under the equity method.

[2]Segment liabilities comprise current and non-current trade and other payables, provisions and investments in net liabilities accounted for under the equity method, and exclude borrowings and balances related to current and deferred tax.

[3]Capital expenditure comprises additions to property, plant and equipment and other intangible assets.

[4]Other non-cash expenses of £32 million are included within the central resources result.

2. *Segmental analysis (continued)*

Businesses within the mobile telecommunications services segment mainly derive their revenue from the calls made and received by their customers using mobile telephones, from subscription fees charged to their contract customers and from handset equipment sales.

	Year ended 31 March 2005							
	O2 UK	O2 Germany	O2 Ireland	**Mobile telecomm-unications**	Other businesses UK	Central resources	Eliminations	**Total**
	£m	£m	£m	**£m**	£m	£m	£m	**£m**
Service revenue	3,507	1,687	556	5,750	20	-	(20)	**5,750**
Equipment and other revenue	416	178	29	623	202	-	-	**825**
Total revenue	**3,923**	**1,865**	**585**	**6,373**	**222**	**-**	**(20)**	**6,575**
Depreciation	(462)	(177)	(59)	(698)	(61)	(1)	-	**(760)**
Amortisation	(155)	(253)	(8)	(416)	-	(6)	-	**(422)**
Exceptional items	(45)	-	-	(45)	-	-	-	**(45)**
Other expenses	(2,741)	(1,526)	(361)	(4,628)	(126)	(81)	20	**(4,815)**
Operating profit/(loss) - segment result	**520**	**(91)**	**157**	**586**	**35**	**(88)[1]**	-	**533**
Share of post tax result of joint ventures and associates	(1)	(2)	-	(3)	-	-	-	**(3)**
Segment assets	7,091	3,637	1,302	12,030	778	99	(108)	**12,799**
Segment liabilities	(1,161)	(446)	(174)	(1,781)	(139)	(104)	108	**(1,916)**
	5,930	**3,191**	**1,128**	**10,249**	**639**	**(5)**	-	**10,883**
Capital expenditure	638	445	100	1,183	228	4	-	**1,415**

[1]Other non cash expenses of £11 million are included within the central recourses result.

Included within the O2 UK segment liabilities at 31 January 2006 are investments in the net liabilities of joint ventures and associates of £6 million (31 March 2005: £3 million). Included within the O2 Germany segment assets at 31 January 2006 is an investment in the net assets of a joint venture of £1 million (31 March 2005: £2 million).

3. Operating profit

Group operating profit is stated after charging:	**10 months ended 31 January 2006 £m**	Year ended 31 March 2005 £m
Cost of inventories recognised as an expense included in cost of sales	**1,075**	895
Write downs of inventories recognised in the period	**14**	16
Total depreciation of property, plant, equipment:	**682**	766
- included in cost of sales	**558**	639
- included in administrative expense	**61**	121
- included in cost of sales (exceptional)	**60**	-
- included in administrative expenses (exceptional)	**3**	6
Amortisation of UMTS licences - included in administrative expenses	**198**	169
Total amortisation of other intangibles assets:	**340**	253
- included in cost of sales	**18**	23
- included in administrative expense	**234**	230
- included in administrative expenses (exceptional)	**88**	-
Operating lease rental payments	**209**	166
Trade receivables provision for doubtful debts	**38**	56
Employee benefit expense (note 34)	**581**	621

4. Exceptional items

In the 10 months ended 31 January 2006 the Group incurred an exceptional operating charge of £320 million. This included additional depreciation and amortisation of £151 million in the period related to a review of the useful lives of certain property, plant and equipment and software. Exceptional costs also include costs relating to the acquisition of the Group by Telefónica and include employee benefits of £75 million of which £41 million related to share based payments and professional and advisor fees and other costs of £58 million.

In the year ended 31 March 2005, the Group incurred an exceptional operating charge of £45 million and an exceptional non-operating charge of £20 million. The exceptional operating charge related to the redeployment of resources within O2 UK into customer facing areas and away from non-customer facing areas. This was in line with O2 UK's strategy of delivering an enhanced customer experience and increasing customer loyalty. The charge comprised redundancy and property costs. The exceptional non-operating charge related to the costs of the capital reorganisation is described in note 25.

5. Net financial income/(expense)

	10 months ended 31 January 2006 £m	Group Year ended 31 March 2005 £m
Interest income on cash, cash equivalents and other financial assets	41	33
Forward foreign exchange contracts (note 31)	26	24
Foreign exchange differences	5	2
Other financial income	2	4
Financial income	74	63
Interest payable on Euro medium-term notes	(50)	(57)
Losses on fair value hedges	(4)	-
Other financial costs	(9)	(16)
Financial expense	(63)	(73)
Net financial income/(expense)	11	(10)

6. *Taxation*

The analysis of (credit)/ charge for the period is as follows:

	10 months ended 31 January 2006 £m	Group Year ended 31 March 2005 £m
Current tax - non UK tax	14	14
Current tax – adjustments in respect of prior periods	(1)	(1)
Deferred tax - origination and reversal of temporary differences	(25)	(1)
Deferred tax - adjustments in respect of prior periods	(23)	(5)
Taxation – (credit)/charge for the period	(35)	7

6. Taxation (continued)

The tax assessed for the period varied from the amount computed by applying the weighted average tax rate to profit or loss on ordinary activities before taxation. The differences were attributable to the following factors:

	10 months ended 31 January 2006 £m	Group Year ended 31 March 2005 £m
Profit before taxation	**206**	500
Profit on ordinary activities multiplied by the rate of UK corporation tax of 30%	**62**	150
Adjustments to tax in respect of prior period	**(24)**	(6)
Expenses not deductible for tax purposes	**86**	65
Adjustments in respect of employee share based payments	**(17)**	-
Overseas tax suffered	**-**	(1)
Utilisation of previously unrecognised tax losses	**(123)**	(134)
Adjustments in respect of foreign tax rates	**(18)**	(35)
Temporary differences not recognised	**(1)**	(32)
Taxation – (credit)/charge for the period	**(35)**	7

7. Dividends

	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Final paid: 2.25 pence per share	**197**	-
Interim paid: 1.54 pence per share	**135**	-
	332	-

No final dividend has been declared by Directors for the 10 months ended 31 January 2006 (year ended 31 March 2005: 2.25 pence dividend per share declared).

8. Earnings per share

Earnings per share has been calculated for all periods by dividing the profit for the period by the weighted average number of ordinary shares in issue during that period, as follows:

	10 months ended 31 January 2006 £m	Group Year ended 31 March 2005 £m
Profit for the period attributable to equity shareholders	**241**	493
Basic weighted average share capital (number of shares, million)	**8,740**	8,681
Dilutive potential ordinary shares (number of shares, million)	**133**	120
Diluted weighted average share capital (number of shares, million)	**8,873**	8,801
Basic earnings per share (pence)	**2.8**	5.7
Diluted earnings per share (pence)	**2.7**	5.6

9. Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Assets in course of construction £m	Group Total £m
Cost				
At 1 April 2004	349	5,325	638	6,312
Additions	5	373	733	1,111
Transfers	24	960	(984)	-
Disposals	(7)	(190)	-	(197)
Currency movements	1	62	2	65
At 1 April 2005	372	6,530	389	7,291
Additions	8	477	471	956
Transfers	52	305	(357)	-
Disposals	(20)	(136)	-	(156)
Currency movements	-	(3)	-	(3)
At 31 January 2006	**412**	**7,173**	**503**	**8,088**
Depreciation				
At 1 April 2004	146	2,700	-	2,846
Charge for the year[1]	40	726	-	766
Disposals	(7)	(188)	-	(195)
Currency movements	-	31	-	31
At 1 April 2005	179	3,269	-	3,448
Charge for the period[1]	40	642	-	682
Disposals	(20)	(128)	-	(148)
Currency movements	-	(2)	-	(2)
At 31 January 2006	**199**	**3,781**	**-**	**3,980**
Net book value				
At 31 January 2006	**213**	**3,392**	**503**	**4,108**
At 31 March 2005	193	3,261	389	3,843

[1]The charge for the 10 months ended 31 January 2006 includes an exceptional charge of £63 million relating to additional depreciation arising from the review of useful lives described in note 4. The charge in the year ended 31 March 2005 includes an exceptional charge of £6 million relating to the reorganisation described in note 4.

Included within plant and equipment are finance leased assets with a net book value of £286 million (31 March 2005: £308 million).

10. Goodwill

	Group £m
Cost	
At 1 April 2004	3,189
Currency movements	22
At 1 April 2005	3,211
Currency movements	(1)
At 31 January 2006	**3,210**
Net book value	
At 31 January 2006	**3,210**
At 31 March 2005	3,211

Impairment testing

Goodwill arises in relation to two cash-generating units ("CGU's"), being O2 UK and O2 Ireland, as follows:

	Group	
	31 January 2006 £m	31 March 2005 £m
O2 UK	**2,347**	2,347
O2 Ireland	**863**	864
	3,210	3,211

The recoverable amount of each CGU is determined using value in use calculations. The value in use of each CGU is calculated with reference to the net present value of its future cash flows derived from the assets, using cash flow projections for the period up to 31 December 2014. These projections cover a 9-year period (year ended 31 March 2005: 10-year period), as management believe that throughout this period, the annual growth rate of the CGU's being assessed will differ from the average growth rates for the countries concerned. For the periods beyond 1 January 2015, the projections use a long term growth rate of 2.25%, being the nominal GDP growth rate of each territory.

The cashflow projections for the initial 9 year period (year ended 31 December 2005: 10 year period) are based on budgets and forecasts prepared by management for that period. The principal assumptions used in the projections are the number of subscribers, average revenues per user, customer acquisition costs, customer retention costs and capital expenditure. The assumptions are constructed based upon historic experience and management's best estimate of future trends and performance.

The discount rates applied to the projections are based on the pre-tax weighted average cost of capital for the Group. The effective pre-tax discount rate for each of the Group's territories range between 9.5 per cent and 10.9 per cent. (year ended 31 March 2005: 10.4 per cent and 11.5 per cent).

11. Other intangible assets

	UMTS licences £m	Software £m	Other £m	Assets in course of construction £m	Group Total £m
Cost					
At 1 April 2004	9,753	1,194	148	67	11,162
Additions	-	191	57	56	304
Disposals	-	(4)	-	-	(4)
Currency movements	164	10	1	-	175
At 1 April 2005	9,917	1,391	206	123	11,637
Additions	-	117	1	126	244
Disposals	-	(28)	-	-	(28)
Transfers	-	98	1	(99)	-
Currency movements	(11)	(2)	-	-	(13)
At 31 January 2006	**9,906**	**1,576**	**208**	**150**	**11,840**
Amortisation and impairment					
At 1 April 2004	5,751	725	4	-	6,480
Charge for the year	169	172	81	-	422
Disposals	-	(4)	-	-	(4)
Currency movements	103	9	-	-	112
At 1 April 2005	6,023	902	85	-	7,010
Charge for the period[1]	198	237	103	-	538
Disposals	-	(25)	-	-	(25)
Currency movements	(7)	(1)	-	-	(8)
At 31 January 2006	**6,214**	**1,113**	**188**	**-**	**7,515**
Net book value					
At 31 January 2006	**3,692**	**463**	**20**	**150**	**4,325**
At 31 March 2005	3,894	489	121	123	4,627

[1]The charge for the 10 months ended 31 January 2006 includes an exceptional charge of £88 million relating to additional amortisation arising from the review of software useful lives described in note 4.

Additions are mostly made through external acquisition and there are also small amounts of internally generated additions.

Included in software are assets held under finance lease with a net book value of £34 million (31 March 2005: £40 million).

UMTS licences includes a UK licence with a carrying value of £1,811 million (31 March 2005: £1,906 million) and a remaining useful life of 16 years (31 March 2005: 17 years). UMTS licences also includes a German licence with a carrying value of £1,804 million (31 March 2005: £1,908 million) and a remaining useful life of 15 years (31 March 2005: 16 years).

12. Investments in subsidiary undertakings

	Company Shares in subsidiary undertakings £m
Cost and net book value	
At 31 January 2006 and 31 March 2005	**10,879**

The Directors consider that disclosing full particulars of all subsidiary undertakings would lead to a statement of excessive length. A list of principal subsidiary undertakings is given in note 30.

13. Inventories

		Group
	31 January 2006 £m	31 March 2005 £m
Handsets	**133**	87

14. Trade and other receivables

		Group		Company
	31 January 2006 £m	31 March 2005 £m	**31 January 2006 £m**	31 March 2005 £m
Trade receivables	**691**	576	-	-
Other receivables	**17**	50	-	1
Amounts owed by subsidiaries	-	-	**107**	107
Amounts owed by other related parties (note 29)	**10**	14	-	-
Prepayments	**135**	112	-	-
Accrued income	**270**	277	-	-
	1,123	1,029	**107**	108

Trade receivables are stated net of provision for impairment of £222 million (2005: £183 million).

Amounts owed by subsidiaries represent receivables due from mmO2 plc.

15. Other financial assets

		Group
	31 January 2006 £m	31 March 2005 £m
Money market deposits	**324**	317

Included in other financial assets are restricted deposits of £278 million (31 March 2005: £275 million) held in trust to meet the O2 UK hire purchase obligations disclosed in note 19. A further USD 82 million (31 March 2005: USD 79 million) of other financial assets is restricted cash collateral for bank guarantees issued to cover specific risks under the same hire purchase obligations.

16. Cash and cash equivalents

	31 January 2006 £m	Group 31 March 2005 £m
Cash at bank and in hand	**56**	41
Short term deposits	**833**	968
Cash and cash equivalents	**889**	1,009
Bank overdraft included in borrowings (note 19)	**(39)**	-
Cash and cash equivalents per cash flow statement	**850**	1,009

Included in cash at bank and in hand are £3 million (31 March 2005: £3 million) of funds held by the O2 plc Share Ownership Trust ("The Trust"). These funds can only be used by the Trust to pay certain employee benefits.

17. Derivative financial instruments

	31 January 2006 £m	Group 31 March 2005 £m
Interest rate swaps – fair value hedges	**-**	24
Cross currency interest rate swaps – fair value hedges	**4**	-
Forward exchange contracts – net investment hedges[1]	**-**	25
Forward exchange contracts – monetary asset hedge	**1**	-
Total	**5**	49
Less non-current portion:		
Interest rate swaps – fair value hedges	**-**	21
Current portion	**5**	28

[1] At 31 January 2006 the Group had ceased all net investment hedges. Further detail of the Group's financial instruments are contained in note 31.

18. Investments in joint ventures and associates

	Interests in joint ventures £m	Interest in associate £m	Group Total £m
Cost			
At 1 April 2004	2	96	98
Additions	4	-	4
Dividend received from associate	-	(7)	(7)
(Loss)/profit retained for the year	(6)	3	(3)
Transfers[1]	2	1	3
At 1 April 2005	2	93	95
Additions	1	-	1
Loss retained for the period	(4)	(1)	(5)
Transfers[1]	2	1	3
At 31 January 2006	1	93	94
Impairment			
At 1 April 2004, 31 March 2005 and 31 January 2006	-	93	93
Net book value			
At 31 January 2006	**1**	**-**	**1**
At 31 March 2005	2	-	2

[1] Represents the reclassification of the Group's interest in the net liabilities of joint ventures and associates to trade and other payables.

18. Investments in joint ventures and associates (continued)

The Group's share of the summary financial information of its joint ventures is as follows:

	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Current assets	**30**	21
Current liabilities	**(32)**	(20)
Non-current liabilities	**(1)**	(1)
	(3)	-
Revenue	**54**	40
Expenses	**(58)**	(46)
Share of post tax losses of joint ventures	**(4)**	(6)

The financial summary of the Group's associate is as follows:

	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Assets	**88**	104
Liabilities	**(26)**	(17)
Net assets	**62**	87
Revenue	**267**	419
Retained (loss)/profit	**(2)**	7

19. Borrowings

	Group		Company	
	31 January 2006 £m	31 March 2005 £m	**31 January 2006 £m**	31 March 2005 £m
Current unsecured borrowings				
Euro medium-term notes[1]	**693**	15	**-**	-
Bank overdraft	**39**	-	**-**	-
Amounts owed to subsidiaries	**-**	-	**6**	-
Other loans and borrowings[1]	**16**	16	**-**	-
	748	31	**6**	-
Obligations under finance leases	**22**	40	**-**	-
	770	71	**6**	-
Non-current unsecured borrowings				
Euro medium-term notes	**374**	1,078	**-**	-
Amounts owed to subsidiaries	**-**	-	**328**	14
Other loans and borrowings	**16**	24	**-**	-
	390	1,102	**328**	14
Obligations under finance leases	**278**	268	**-**	-
	668	1,370	**328**	14

[1]The euro medium term notes include £1 million of accrued interest (31 March 2005: £15 million). Other loans and borrowings include £2 million of accrued interest (31 March 2005: nil). These amounts are excluded from net debt.

In January 2002 mmO2 plc issued two bonds under the Euro medium-term note programme in the form of a €1,000 million 6.375% fixed rate bond and a £375 million 7.625% fixed rate bond which have a five and ten year term respectively. Cross currency interest rate swaps convert the €1,000 million fixed rate bond to a sterling floating rate liability. Further details of these derivatives are included in note 17 and 31.

Loan notes of £132 million were issued by O2 UK Limited between March 1999 and April 2000 for the purchase of certain businesses. At 31 January 2006 loan notes totalling £6 million (31 March 2005: £7 million) were outstanding and repayable on demand.

Amounts owed to subsidiaries represents a sterling denominated loan from mmO2 plc with an effective interest rate of 5.6% (31 March 2005: 5.5%). Interest changes annually on 1 April and is based on 12 month Sterling LIBOR. The current portion relates to accrued interest on this loan.

The maturity of non-current borrowings (excluding finance leases) is as follows:

	Group		Company	
	31 January 2006 £m	31 March 2005 £m	**31 January 2006 £m**	31 March 2005 £m
Between one and five years	**16**	729	**328**	14
Over 5 years	**374**	373	**-**	-
	390	1,102	**328**	14

19. Borrowings (continued)

Borrowing facilities

On the acquisition of the Group by Telefónica on 23 January 2006, banks providing committed facilities for the undrawn £1 billion floating rate syndicated loan maturing 2009 had termination rights resulting from the change of control under the loan agreement. Subsequent to 31 January 2006 syndicate banks providing £720 million of the facility have waived their withdrawal rights under the facility and the balance of £280 million has now lapsed. Of the £280 million lapsed facility, £90 million is expected to be recommitted subject to formal documentation. Other than the reduction in the facility amount, the terms of the facility remain unchanged.

On 15 June 2006 the Group signed a Finance Credit Agreement of £90 million (or its equivalent in designated currencies). This credit facility expires in June 2008 and interest is based on LIBOR or EURIBOR set at the time the funds are drawn down plus a margin.

Obligations under finance leases

The Group's minimum lease payments under finance leases fall due as follows:

	Minimum lease payments 31 January 2006 £m	**Finance charges 31 January 2006 £m**	**Present value 31 January 2006 £m**	Minimum lease payments 31 March 2005 £m	Finance charges 31 March 2005 £m	Present value 31 March 2005 £m
Within one year	**37**	**(15)**	**22**	53	(13)	40
Between one and five years	**202**	**(49)**	**153**	153	(51)	102
After five years	**144**	**(19)**	**125**	192	(26)	166
	383	**(83)**	**300**	398	(90)	308

Obligations under finance leases and hire purchase contracts are mainly in respect of hire purchase agreements for plant and equipment. On 30 March 2001 and 9 April 2001 hire purchase financing contracts were signed between O2 UK and a number of US leasing trusts. Under the contracts O2 UK sold and repurchased material portions of its GSM radio and switching equipment. O2 UK has deposited sufficient funds with a trust company to meet the future hire purchase obligations. The deposit account is included in other financial assets. The hire purchase agreement is for 16 years with an early buy out option after 12 years. In accordance with the Separation Agreement signed on demerger, BT continues to guarantee all future hire purchase obligations of O2 UK which has provided a counter indemnity to BT for this guarantee.

Further details of the Group's financial instruments are contained in note 31.

20. Trade and other payables

	Group 31 January 2006 £m	Group 31 March 2005 £m	**Company 31 January 2006 £m**	Company 31 March 2005 £m
Trade payables	**613**	593	**-**	-
Amounts owed to group undertakings	**-**	-	**123**	21
Payables to other related parties (note 29)	**2**	5	**-**	-
Other taxation and social security	**56**	75	**-**	-
Other payables	**27**	25	**-**	-
Accrued expenses	**943**	841	**-**	-
Deferred income	**289**	227	**-**	-
	1,930	1,766	**123**	21

Amounts owed to group undertakings represent amounts owed to O2 Holdings Limited and balances arising on consolidation.

21. Provisions

A breakdown of the Group's current and non-current provisions is as follows:

	31 January 2006			31 March 2005		
	Restructuring £m	Other provisions £m	Total £m	Restructuring £m	Other provisions £m	Total £m
Current	1	-	1	-	9	9
Non-current	36	24	60	69	27	96
	37	24	61	69	36	105

	Restructuring £m	Other provisions £m	Total £m
At 1 April 2005	69	36	105
(Credit)/charge for the period	-	(10)	(10)
Utilised in the period	(32)	(2)	(34)
At 31 January 2006	**37**	**24**	**61**

Restructuring provision

The restructuring provision arose in respect of the exceptional operating charge recognised in the year ended 31 March 2005 and described in note 4. The provision mainly comprised of redundancy and onerous property lease costs. Redundancy and onerous lease costs have been paid during the period. The remaining provision is in relation to residual onerous lease commitments, after taking into account existing sub-lease arrangements. The payment dates of these restructuring costs are uncertain but are currently anticipated to be over the next 30 years.

Other provisions

Other provisions includes £18 million (31 March 2005: £16 million) in respect of asset retirement obligations. The Group has certain legal obligations relating to the restoration of leased property to its original condition at the end of the lease term. This obligation relates principally to mast sites. The provision is based on assumptions covering the discount rate, expected lease renewals and the expected cost of restoring the site. The payment dates of these asset retirement obligation costs are uncertain but are currently anticipated to be over the next 30 years.

Other provisions also include amounts provided for legal claims.

22. Pension costs

The Group operates a number of pension schemes in its businesses, being either defined benefit or defined contribution arrangements.

The total operating charge included in the income statement for all the Group's pension schemes is as follows:

	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
O2 Pensions Plan cost	18	22
Other defined benefit schemes	5	5
Defined contribution schemes	4	5
	27	32

22. Pension costs (continued)

The O2 Pension Plan

The O2 Pension Plan (O2 PP) provides the pension benefits for the majority of UK employees and is divided into defined contribution and defined benefit sections. Since 14 March 2005, the sponsoring employer of the scheme has been O2 plc. Prior to this the sponsoring employer was mmO2 plc.

The pension costs of the defined benefit sections of the O2 PP have been assessed in accordance with the advice of a qualified independent actuary using the projected unit method and taking assets at market value. The defined benefit sections of the O2 PP are closed to new entrants and therefore the current service cost is likely to increase as the members approach retirement.

Actuarial valuation

A full actuarial valuation of the defined benefit sections of the O2 PP was undertaken at 30 September 2005 by a professionally qualified independent actuary using the projected unit method. The purpose of this valuation was to design a future funding plan to ensure that contributions to the plan are sufficient to meet future liabilities. As at 30 September 2005 the assets of the O2 PP had a market value of £407 million and were sufficient to cover 83 per cent of the benefits accrued to members at that date on the ongoing funding measure. As a result of the valuation, the Group has increased the employer's regular contribution rate from 13.1 to 20.1 per cent of pensionable salaries with effect from 30 September 2005. The employee's contribution rate remains at 6 per cent of pensionable salary. In December 2005 a one-off cash contribution of £81 million was paid into the O2 PP to fund the deficit.

The main financial actuarial assumptions used in the valuation were as follows:

	%
Nominal rate of increase in salaries	4.90
Nominal rate of increase of pensions in payment	2.70-2.90
Investment return in the 10 year horizon period	4.30
Investment return after the 10 year horizon period	6.55
Inflation assumption	2.90

Other Group pension plans

The Group operates several other defined benefit pension schemes. In the Isle of Man benefits are provided by a funded defined benefit pension scheme that is closed to new entrants. The Group also operates an unfunded defined benefit scheme in the UK.

Until May 2001 the O2 Germany main scheme was unfunded. This scheme has changed to a funded arrangement with payments being made to provide for previously unfunded liabilities over the period to the active members' retirements. The vast majority of members of the O2 Germany main scheme are now accruing benefits under an insured arrangement. The other defined benefit schemes in Germany are also funded.

The Group operates defined contribution schemes in Ireland and the Isle of Man. The assets of these defined contribution arrangements are held separately from those of the Group in independently administered funds.

22. Pension costs (continued)

Defined benefit plans

The actuarial valuation of the O2 PP as at 30 September 2005 has been updated to 31 January 2006, and the actuarial valuation at 30 June 2003 was updated to 31 March 2005, by an independent qualified actuary in accordance with the requirements of IAS 19. In accordance with IAS 19, the defined benefit liabilities have been measured using the projected unit method. Plan assets are stated at fair value.

The main assumptions adopted for the O2 PP under IAS 19 are as follows:

	10 months ended 31 January 2006 %	Year ended 31 March 2005 %
Nominal rate of increase in salaries	**4.05-4.55**	4.15-4.65
Nominal rate of increase of pensions in payment:		
– Pension increases with inflation	**2.80**	2.90
– Pension increases with inflation limited to 5 per cent p.a.	**2.60**	2.70
Discount rate	**4.70**	5.50
Inflation assumption	**2.80**	2.90
Expected long-term return for:		
– Equities	**7.20**	7.70
– UK Government bonds	**3.90**	4.70
– Other bonds	**4.70**	5.50
– Other	**3.90**	4.70

Mortality assumptions are based on the '92 series' tables, issued by the Institute and Faculty of Actuaries, appropriate to the member's year of birth. The post-retirement mortality assumptions incorporate an additional allowance at 31 January 2006 for projected longevity improvements in line with the Continuous Mortality Investigation Bureau's 'medium cohort' tables.

The expected rate of return on pension plan assets is determined as management's best estimate of the long-term return on the relevant equities and bonds that constitute plan assets weighted by the actual allocation of assets among the categories at the measurement date.

The assumptions used for the Group's other defined benefit schemes are consistent with those used for the O2 PP.

The amounts recognised in the income statement and the statement of recognised income and expense in respect of defined benefit obligations are as follows:

	10 months ended 31 January 2006			Year ended 31 March 2005		
	O2 PP £m	**Other schemes £m**	**Total £m**	O2 PP £m	Other schemes £m	Total £m
Analysis of the amount charged to operating profit:						
Current service cost (employers)	**18**	**5**	**23**	20	5	25
Curtailment and settlement	**-**	**-**	**-**	(3)	-	(3)
Vested past service cost	**-**	**-**	**-**	5	-	5
Total operating charge	**18**	**5**	**23**	22	5	27
Analysis of the amount credited/(charged) to net interest:						
Expected return on pension plan assets	**22**	**2**	**24**	21	2	23
Interest on pension plan liabilities	**(21)**	**(2)**	**(23)**	(21)	(3)	(24)
Net interest income/(expense)	**1**	**-**	**1**	-	(1)	(1)
Analysis of the amount recognised in the statement of recognised income and expense:						
Actuarial losses	**(40)**	**(7)**	**(47)**	(16)	(3)	(19)

22. Pension costs (continued)

The amount included in the balance sheet arising from the Group's obligations in respect of its defined benefit schemes, as well as the analysis of scheme assets, is as follows:

	O2 PP £m	Other schemes £m	31 January 2006 Total £m	O2 PP £m	Other schemes £m	31 March 2005 Total £m
Fair value of assets comprises:						
– Equities	**482**	**17**	**499**	306	13	319
– UK Government bonds	**24**	**8**	**32**	17	7	24
– Other bonds	**23**	**2**	**25**	16	2	18
– Other	**4**	**22**	**26**	1	17	18
Fair value of assets	**533**	**49**	**582**	340	39	379
Present value of defined benefit obligations	**(593)**	**(79)**	**(672)**	(443)	(62)	(505)
Net liability recognised in balance sheet	**(60)**	**(30)**	**(90)**	(103)	(23)	(126)

Movements in the present value of defined benefit obligations in the current and preceding period were as follows:

	O2 PP £m	Other schemes £m	31 January 2006 Total £m	O2 PP £m	Other schem es £m	31 March 2005 Total £m
At start of period	**443**	**62**	**505**	362	48	410
Total current service cost	**24**	**5**	**29**	28	5	33
Curtailment	**-**	**-**	**-**	(3)	-	(3)
Vested past service cost	**-**	**-**	**-**	5	-	5
Interest cost	**21**	**2**	**23**	21	3	24
Actuarial losses	**106**	**11**	**117**	33	7	40
Benefits paid	**(1)**	**(1)**	**(2)**	(3)	(1)	(4)
At end of period	**593**	**79**	**672**	443	62	505

Of the defined benefit obligation relating to other schemes, £11 million (31 March 2005: £9 million) relates to unfunded schemes.

Movements in fair value of scheme assets in the current and preceding period were as follows:

	O2 PP £m	Other schemes £m	31 January 2006 Total £m	O2 PP £m	Other schemes £m	31 March 2005 Total £m
At start of period	**340**	**39**	**379**	277	28	305
Expected return on scheme assets	**22**	**2**	**24**	21	2	23
Actuarial gains	**66**	**4**	**70**	17	4	21
Employer contributions	**100**	**5**	**105**	20	6	26
Contributions from scheme members	**6**	**-**	**6**	8	-	8
Benefits paid	**(1)**	**(1)**	**(2)**	(3)	(1)	(4)
At end of period	**533**	**49**	**582**	340	39	379

22. Pension costs (continued)

The actual return on scheme assets was £94 million (year ended 31 March 2005: £44 million).

History of experience gains and losses	O2 PP £m	10 months ended 31 January 2006 Other schemes £m	O2 PP £m	Year ended 31 March 2005 Other schemes £m
Difference between the expected and actual return on plan assets:				
Amount - gain	**66**	**4**	17	4
Percentage of plan assets	**12%**	**8%**	5%	10%
Experience gains and losses on plan liabilities:				
Amount - gain/(loss)	**12**	**(1)**	-	(3)
Percentage of the present value of plan liabilities	**2%**	**(1%)**	-	(5%)
Total amount recognised in the statement of total recognised income and expense:				
Amount – (loss)	**(40)**	**(7)**	(16)	(3)
Percentage of the present value of plan liabilities	**(7%)**	**(9%)**	(4%)	(5%)

The total cumulative actuarial losses recognised in the statement of recognised income and expenses since transition to IFRS at 1 April 2004 is £66 million (31 March 2005: £19 million).

The estimated amount of contributions expected to be paid to the scheme during the year ended 31 January 2007 is £23 million.

The three year summarised history of the Group's defined benefit pension plans is as follows:

	31 January 2006 £m	31 March 2005 £m	1 April 2004 £m
Fair value of plan assets	**582**	379	305
Present value of defined benefit obligation	**(672)**	(505)	(410)
Net liability recognised in balance sheet	**(90)**	(126)	(105)

23. Other payables

	31 January 2006 £m	31 March 2005 £m
Long-term UMTS licence creditor	**38**	45

24. Deferred taxation

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

The total movement in the deferred tax liability during the period, taking into consideration the offsetting balances within the same tax jurisdiction, is as follows:

	Group £m
At 1 April 2004	(495)
Credit to the income statement	6
At 1 April 2005	(489)
Credit to the income statement	48
Credit to equity	63
At 31 January 2006	**(378)**

The movement in deferred tax liabilities and assets during the period, without taking into consideration the offsetting balances within the same tax jurisdiction, is as follows:

Deferred tax liabilities

	Roll over gain £m	Excess capital allowances £m	Other £m	**Group Total £m**
At 1 April 2004	(358)	(281)	(4)	**(643)**
Credit/(charge) to the income statement	-	87	(26)	**61**
At 31 March 2005	(358)	(194)	(30)	**(582)**
Credit/(charge) to the income statement	-	2	(43)	**(41)**
At 31 January 2006	(358)	(192)	(73)	**(623)**

Deferred tax assets

	Employee payments £m	Tax losses £m	Defined benefit pension liability £m	Other £m	**Group Total £m**
At 1 April 2004	-	122	-	26	**148**
(Charge) to the income statement	-	(55)	-	-	**(55)**
At 31 March 2005	-	67	-	26	**93**
Credit/(charge) to the income statement	5	86	-	(2)	**89**
Credit to equity	25	-	38	-	**63**
At 31 January 2006	30	153	38	24	**245**

Deferred tax assets in respect of certain other UK and German losses carried forward and other temporary differences totalling £5,229 million (31 March 2005: £5,185 million) have not been recognised due to insufficient certainty regarding the availability of appropriate future taxable profits. These tax losses have no expiry.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries as the earnings are not expected to be distributed in the foreseeable future, therefore no tax is expected to be payable on them. If the earnings were remitted at 31 January 2006, tax of £81 million would be payable (31 March 2005: £63 million).

24. *Deferred taxation (continued)*

The deferred income tax credited to equity during the period was as follows:

		Group
	10 months ended 31 January 2006	Year ended 31 March 2005
	£m	£m
Defined benefit pension liability	**38**	-
Employee share based payments	**25**	-
	63	-

The movement in deferred tax assets during the period in relation to the Company is as follows:

		Company
	Defined benefit pension liability	**Total £m**
At incorporation on 10 December 2004 and at 31 March 2005	-	-
Credit to equity	38	**38**
At 31 January 2006	38	**38**

25. Share capital

		31 January 2006		31 March 2005
	Number of shares	**£m**	Number of shares	£m
Authorised				
Ordinary shares of 0.1 pence each	**20,000,000,000**	**20**	20,000,000,000	20
Called up, allocated and fully paid				
Ordinary shares of 0.1 pence each	**8,772,973,922**	**9**	8,704,068,599	9

The Company has one class of authorised and issued share capital, comprising ordinary shares of 0.1 pence each. Subject to the Company's articles of association, and applicable law, the Company's ordinary shares confer on the holder, the right to receive notice of and vote at general meetings of the Company, the right to receive any surplus assets on a winding up of the Company and an entitlement to receive any dividend declared on ordinary shares.

	Number of shares	**£m**
Ordinary shares of 10 pence each on incorporation on 10 December 2004	2	-
Issue of ordinary shares of 10 pence	14	-
16 ordinary shares of 10 pence	16	-
Conversion of 10 pence ordinary shares to 80 pence ordinary shares	2	-
Cancellation on 14 March 2005 of 80 pence ordinary shares	(2)	-
Placement of ordinary shares 14 March 2005 of 0.1 pence each	299,500,644	-
Issue of ordinary shares on 14 March 2005 of 80 pence each reduced to 0.1 pence on 17 March 2005	8,403,362,095	9
Shares allotted under employee share option schemes	1,205,860	-
Ordinary shares of 0.1 pence each at 31 March 2005	**8,704,068,599**	**9**
Shares allotted under employee share option schemes	68,848,680	-
Shares allotted to non-executive directors	56,643	-
Ordinary shares of 0.1 pence each at 31 January 2006	**8,772,973,922**	**9**

25. Share capital (continued)

O2 plc was incorporated as a public limited company on 10 December 2004 with an authorised share capital of £51,000, comprising 10,000 ordinary shares of 10 pence each and 50,000 redeemable preference shares of £1 each. Of these shares, 2 ordinary shares of 10 pence each were taken up by the subscribers to the memorandum of association. By ordinary resolution passed on 21 December 2004, 50,000 non-voting redeemable preference shares of £1 each were issued and allotted at par. On 5 January 2005, a further 14 ordinary shares of 10 pence each were issued and allotted at par. By extraordinary general meeting on 5 January 2005, the ordinary shares of 10 pence each were consolidated at a ratio of 8 to 1 into ordinary shares of 80 pence each and the authorised share capital was increased from £51,000 to £16,000,050,000 by the creation of 19,999,998,750 additional ordinary shares of 80 pence each.

On 14 March 2005, pursuant to a Court approved scheme of arrangement under section 425 of the Companies Act 1985, the Company purchased mmO2 plc (mmO2) for share consideration. Certain mmO2 shareholders, holding 299,500,644 ordinary shares of mmO2, elected to receive the consideration for their shares in mmO2 in cash. All other shareholders, holding 8,403,362,095 ordinary shares of 0.1 pence each in mmO2, received the same number of new ordinary shares of 80 pence each in the Company as they previously held in mmO2. In order to fund the cash consideration the Company issued and allotted 299,500,644 ordinary shares in the Company via a placement with investors on the London Stock Exchange's market for listed securities on 17 March 2005. This placement raised £374,375,805. The remaining cash consideration of £14,975,032, representing a premium of five pence per share owing to shareholders electing to receive the cash, was funded by the Group.

Further, on 14 March 2005, the two 80 pence ordinary shares arising on the share consolidation on 5 January 2005 were transferred to the Company at par value and were cancelled in accordance with sections 146(1)(b) and 146(2)(a) of the Companies Act 1985.

On 16 March 2005, the share capital of the Company was reduced by cancelling paid up share capital to the extent of 79.9 pence on each issued ordinary share and reducing the nominal value of each such share from 80 pence to 0.1 pence; and reducing the nominal value of each unissued ordinary share of 80 pence to 0.1 pence. This created distributable reserves of £6,714,286,314.

On 17 March 2005, 50,000 £1 redeemable preference shares were redeemed at par.

The aggregate consideration received on the issue of the Company's ordinary shares under employee share option schemes was £34 million for the 10 months ended 31 January 2006. From the date of the Court Approved Scheme of arrangement on 14 March 2005 to 31 March 2005 £1 million was received on the issue of the Company's ordinary shares under employee share option schemes. During the period from 1 April 2004 to 13 March 2005 mmO2 plc issued 28.2 million ordinary shares of 0.1 pence each for a total cash consideration of £23 million under employee share option schemes.

Issue of ordinary shares after balance date

Under the Group's long-term incentive share option and share award plans for employees (including Directors) the Company issued 108 million ordinary 0.1 pence shares during February and March 2006 to satisfy the vesting and accelerated vesting of awards and options arising principally on the change of control of the Group. Details of the Group's share option and share award plans are contained in note 35.

26. Reconciliation of changes in equity

Group	Called up share capital £m	Share premium £m	Translation reserve £m	Other reserves £m	Retained earnings £m	Total equity £m
At 1 April 2004	**9**	**3**	**1,392**	**11,072**	**(2,840)**	**9,636**
Total recognised income for the year	-	-	68	-	474	**542**
Transfer to retained earnings	-	-	-	(1,099)	1,099	-
Transactions related to employee share schemes	-	24	-	-	7	**31**
Issue of shares in exchange for shares in mmO2 plc[1]	6,714	(26)	-	(7,062)	(15)	**(389)**
Placing of O2 plc shares on 17 March 2005[1]	-	374	-	-	-	**374**
Court approved capital reduction[1]	(6,714)	-	-	-	6,714	-
Transfers from cash flow hedge reserve	-	-	-	1	-	**1**
At 31 March 2005	**9**	**375**	**1,460**	**2,912**	**5,439**	**10,195**
Total recognised income for the period	-	-	(10)	-	257	**247**
Transfer to retained earnings	-	-	-	(607)	607	-
Transactions related to employee share schemes	-	34	-	-	24	**58**
Dividends	-	-	-	-	(332)	**(332)**
At 31 January 2006	**9**	**409**	**1,450**	**2,305**	**5,995**	**10,168**

[1] Transaction arising during the capital reorganisation described in note 25.

Other reserves

Other reserves mainly originally arose on the Group's demerger from British Telecommunications plc (BT). They relate to the difference between the carrying value of the Group held by BT prior to demerger (representing BT's investments and funding in the Group) and amounts settled with BT on demerger to acquire the assets and liabilities of the Group.

Also included in other reserves is a cash flow hedge reserve of £1 million at 31 January 2006 (31 March 2005: £1 million). This comprises the effective portion of the net change in the fair value of cash flow hedging instruments that are being amortised to the income statement over the life of the hedged item.

Included in the profit and loss account reserve are the Company's own ordinary shares of £8 million at 31 January 2006 (31 March 2005: £1 million) representing the cost of the Company's own shares held by the Group. At 31 January 2006 the Group held 5.0 million (31 March 2005: 1.0 million) of the Company's shares. These had a market value of £10 million (31 March 2005 : £1 million). These shares were acquired by the O2 plc Share Ownership Trust (the "Trust"). The Trust was established to encourage and facilitate the holding and distribution of shares and other benefits to certain Group employees.

Company	Ordinary share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total equity £m
On incorporation on 10 December 2004	-	-	-	-	-
Total recognised loss for the period	-	-	-	(16)	(16)
Shares issued on share scheme exercise	-	1	-	-	1
Issue of shares in exchange for shares in mmO2 plc[1]	6,723	-	3,767	-	10,490
Placing of O2 plc shares on 17 March 2005[1]	-	374	-	-	374
Court approved capital reduction[1]	(6,714)	-	-	6,714	-
At 31 March 2005	**9**	**375**	**3,767**	**6,698**	**10,849**
Total recognised loss for the period	-	-	-	(44)	**(44)**
Shares issued on share scheme exercises	-	34	-	-	**34**
Dividends	-	-	-	(332)	**(332)**
At 31 January 2006	**9**	**409**	**3,767**	**6,322**	**10,507**

[1] Transaction arising during the capital reorganisation described in note 25.

26. Reconciliation of changes in equity (continued)

Other reserves

Other reserves represent the difference between the nominal value of the investment held in mmO2 plc and market price on the date of purchase.

The Company has taken advantage of section 230 of the Companies Act 1985 not to present the Company's own income statement. The loss attributable to the shareholders of the Company for the 10 months ended 31 January 2006 was £42 million (from incorporation on 10 December 2004 to 31 March 2005: nil).

27. Reconciliation of movements in net debt

	At 1 April 2005 £m	Cash flow £m	Non-cash changes £m	Group At 31 January 2006 £m
Cash and cash equivalents	1,009	(159)	39	**889**
Other financial assets	317	-	7	**324**
	1,326	(159)	46	**1,213**
Non-current derivative financial instruments	21	-	(21)	**-**
Current derivative financial instruments	-	-	4	**4**
Debt due within one year	(56)	-	(711)	**(767)**
Debt due after one year	(1,370)	20	682	**(668)**
Net debt	(79)	(139)	-	**(218)**

	10 months ended 31 January 2006 £m	Group Year ended 31 March 2005 £m
Reconciliation of net cash flow to movements in net debt		
(Decrease)/ increase in cash and cash equivalents in the period	**(159)**	341
Management of other financial assets	**-**	(14)
Cash outflow from decrease in debt	**20**	21
Change in net debt resulting from cash flows	**(139)**	348
Other non-cash movements	**-**	(59)
(Decrease)/increase in net debt in the period	**(139)**	289
Net debt at start of period	**(79)**	(368)
Net debt at end of period	**(218)**	(79)

Non-cash changes relate principally to foreign exchange gains and losses arising items of net debt held in foreign currencies, the reclassification of debt due after one year to debt due within one year, and the reclassification of bank overdrafts to debt due within one year from cash and cash equivalents.

28. *Financial commitments and contingent liabilities*

Operating lease commitments

At 31 January 2006 the Group was committed to making the following payments in respect of operating leases:

	Group	
	31 January 2006 £m	31 March 2005 £m
Leases which expire		
Within one year	**208**	205
Between one and five years	**791**	666
After five years	**1,353**	1,060
	2,352	1,931

The Group leases various offices, shops, vehicles and mast sites under non-cancellable operating lease agreements. These leases have various terms and renewal rights.

The total future minimum sublease payments expected to be received by the Group under non-cancellable subleases at 31 January 2006 are £137 million (31 March 2005: £145 million).

Other commitments

	Group	
	31 January 2006 £m	31 March 2005 £m
Contracts placed for capital expenditure not provided in the accounts – property, plant and equipment	**449**	282
Contracts placed for capital expenditure not provided in the accounts – intangible assets	**131**	132
Contracts placed for non-capital expenditure not provided in the accounts	**248**	112
Total other commitments	**828**	526

mmO2 plc has provided a guarantee of all liabilities of Airwave O2 Limited under its contracts with the Police Information Technology Organisation (PITO) and the police force customers. O2 plc has guaranteed the performance of Airwave O2 Limited under its contract for the provision of certain radio network and associated services to HM Secretary of State for Health. O2 plc has also guaranteed the due and punctual performance of all services and all liabilities of Airwave O2 Limited under its contract with The First Secretary of State.

Other than as detailed in note 19, the Group has no contingent liabilities or guarantees on which material losses are expected. The Group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations.

The Group does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the Group.

29. Related party disclosures

Details of the nature of related party relationships are included in note 30 and 36.

During the 10 months ended 31 January 2006, the Group entered into sales and purchases with related parties as follows:

	10 month ended 31 January 2006 £m	Year ended 31 March 2005 £m
Revenue		
The Link Stores Limited	19	22
Tesco Mobile Limited	19	12
Tchibo Mobilfunk GmbH & Co. KG	2	-
Purchases		
The Link Stores Limited	(54)	(33)
Tchibo Mobilfunk GmbH & Co. KG	(11)	(4)
Total net transactions	(25)	(3)

At 31 January 2006 the Group had the following balances arising from sales and purchases with related parties.

	31 January 2006 £m	31 March 2005 £m
Receivables from related parties		
The Link Stores Limited	2	1
Tesco Mobile Limited	3	2
Tchibo Mobilfunk GmbH & Co. KG	2	9
Telefónica, S.A. and subsidiaries	1	-
	8	12
Payables to related parties		
The Link Stores Limited	-	(3)
Tchibo Mobilfunk GmbH & Co. KG	-	(1)
Telefónica S.A. and subsidaries	(1)	-
	(1)	(4)

In addition to the sales and purchases detailed above, during the 10 months ended 31 January 2006, the Group provided partly paid equity totalling £1 million (year ended 31 March 2005: £4 million) to Tchibo Mobilfunk GmbH & Co. KG. The balance outstanding at 31 January 2006 was £1 million (31 March 2005: £2 million).

During the 10 months ended 31 January 2006 the Group also provided other services to Tesco Mobile Limited with a value of £6 million (year ended 31 March 2005: £7 million) and equipment and other services to Tchibo Mobilfunk with a value of £10 million (year ended 31 March 2005: £15 million).

The Group has a committed interest free unsecured loan facility to Tesco Mobile Limited of £6 million (31 March 2005: £6 million) of which £1 million (31 March 2005: £1 million) has been drawn down. This facility expires in November 2007. The Group also has loan notes owing by Tesco Mobile Limited of £1 million (31 March 2005: £1 million).

Related party transactions with Directors and key management are detailed in note 33.

Company related party disclosures are contained in notes 14, 19 and 20.

30. Principal subsidiary undertakings, joint ventures and associates

The principal operating subsidiary undertakings are detailed below, all of which are included in the Group financial statements.

Name	Country of incorporation and operation	Activity	Portion of ordinary shares held %
mmO2 plc	England and Wales	Intermediate holding company	100
O2 Holdings Limited	England and Wales	Intermediate holding company	100
O2 (UK) Limited	England and Wales	Mobile cellular telephone system provider and operator	100
O2 (Germany) GmbH & Co. OHG	Germany	Mobile cellular telephone system provider and operator	100
O2 Communications (Ireland) Limited	Ireland	Mobile cellular telephone system provider and operator	100
Airwave O2 Limited	England and Wales	Secure digital radio service for public safety organisations	100
Manx Telecom Limited	Isle of Man	Telecommunication services supplier	100

The shares held in mmO2 plc are held directly by the Company. The shares in other operating companies are held by mmO2 plc or its wholly owned subsidiaries. The accounting reference date of the principal operating subsidiary undertakings is 31 January.

The Group also owns a 50 per cent stake in two joint ventures, Tesco Mobile Limited and Tchibo Mobilfunk GmbH & Co KG, and a 40 per cent stake in an associate, The Link Stores Limited.

Tesco Mobile Limited supplies mobile electronic communications and related services to consumers and is incorporated in England and Wales and operates throughout the United Kingdom. The financial year end of Tesco Mobile Limited is 28 February. The financial statements of Tesco Mobile Limited included in the Group financial statements of O2 plc on an equity accounting basis are those for the 10 months ended 31 December 2005 as those are the most recently available financial statements of Tesco Mobile.

Tchibo Mobilfunk is a telecommunications equipment retailer and is incorporated in and operates in Germany. The financial year end of Tchibo Mobilfunk is 31 December.

The Link Stores Limited is a telecommunications equipment retailer which is incorporated and operates in England and Wales. The financial year end of The Link Stores Limited is 30 April.

31. Financial instruments

Financial risk factors and management

On the 23 January 2006 the O2 Group was acquired by Telefónica. Following the acquisition of the Group by Telefónica, the financial risk management policies adopted by the Group have been amended to comply with those policies in place within the Telefónica Group. The most significant change to the application of the Group's policies since the acquisition has been the cessation of the net investment hedge. This is discussed further in the "Hedge of net investment in foreign entities" section below. The following discussion focuses on the historical financial risk management policies adopted by the Group during the periods covered by this annual report.

The Group's operations expose it to a variety of financial risks including currency risk, fair value interest rate risk, credit risk and liquidity risk. The Group's risk management policies focus on the unpredictability of financial markets and aimed to minimise potential adverse effects on the Group's financial performance and net assets.

31. Financial instruments (continued)

Financial risks are identified and managed by a centralised Group Treasury function. The role of Group Treasury has been to identify, monitor and manage financial risk within the framework of Board approved policies and delegated authorities.

The Group has held or issued financial instruments principally to finance its operations, for the temporary investment of short-term funds and to manage currency and interest rate risks arising from its operations. The Group has used derivative financial instruments to manage its exposure to market risks such as changes in interest rates and foreign exchange rates. The objective has been to match the profile and characteristics of Group funding of equity and debt to that of the assets funded and to mitigate foreign exchange risk. Treasury has not been permitted to add to the financial risks inherent in the business and cannot undertake speculative activity.

The principal financial risks of the Group and how the Group managed these risks are discussed below.

Credit risk

The Group's principal credit risks are attributable to its cash and cash equivalents, derivative financial instruments and trade receivables.

The Group has policies in place to mitigate credit risk to financial counter-parties through the application of strict counter-party limits. Counter-party limits are based on credit ratings issued by the main credit rating agencies and outstanding transactions are weighted according to potential risk to the Group. Counter-party limits are reviewed on a regular basis by Group Treasury.

Where appropriate, International Swap Dealer Association ("ISDA") master agreements permitting the netting of transactions in the event of counterparty failure are entered into with derivative counter parties.

Trade receivables as presented in the balance sheet are net of provision for doubtful debts, estimated by the Group's management based on prior experience and their assessment of the current economic environment. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis.

At the balance sheet date there were no significant concentrations of credit risk, with exposure spread over a large number of counter-parties and customers. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. The Group does not require collateral in respect of financial assets.

Liquidity risk

The Group manages liquidity risk by maintaining adequate committed borrowing facilities and holding its financial assets primarily in short-term, highly liquid investments that are readily convertible to known amounts of cash. Refinancing risk is managed by limiting the amount of borrowing that matures within a specific time period. These measures keep liquidity risk low.

Foreign currency risk

The Group operates in the United Kingdom, Ireland and Germany and is exposed to foreign exchange risk arising from various currency movements, primarily with respect to the Euro, USD and Pound Sterling. Foreign exchange risk arises from recognised assets and liabilities, where these are denominated in a currency that is not the entity's functional currency, net investments in foreign operations, where the overseas entity's functional currency is not the Group's functional currency, and transactional flows denominated in foreign currencies.

31. Financial instruments (continued)

Group policy was to hedge (primarily by the use of forward foreign exchange contracts) identified foreign exchange flows, although the current level of transaction risk exposure is low due to the fact that cash flows are primarily domestic in each Group company. The policy of the Group regarding foreign exchange translation risk has been to manage material risk on the translation of foreign currency assets and liabilities into Pounds Sterling through natural offsets, the use of currency debt, and forward foreign exchange contracts.

Recognised monetary assets

USD deposits of USD 82 million (31 March 2005: USD 79 million) are hedged by forward exchange contracts that create a USD obligation to offset the USD deposit assets. No hedge accounting is applied as fair value movements of the deposits and forward exchange contracts offset each other in the income statement within financial income and financial expenses.

The fair value of USD forward exchange contracts used as economic hedges of USD deposits at 31 January 2006 was £1 million (31 March 2005: nil) and these are recognised in the balance sheet as part of derivative financial instruments (see note 17). These had a notional contract amount of USD 82 million (31 March 2005: USD 79 million). All the forward contracts and deposits have maturities of less than one year after the balance sheet date.

Hedge of net investment in foreign entities

The Group is exposed to foreign currency risk arising from the consolidation of O2 Germany and O2 Ireland into the Group's reporting currency of Pounds Sterling. Management used certain derivative and non derivative instruments to minimise the impact of foreign currency fluctuations on net assets. The risk management policy required in all cases the level of net assets hedged to be lower than total net assets.

The Group's €1 billion Euro medium-term notes (see note 19) were designated as a hedge of the Group's investment in its subsidiaries in Germany and Ireland for the majority of the current financial period. On 25 January 2006 the use of the Euro medium-term notes as a net investment hedge ceased as Telefónica is a Euro denominated Company. Foreign exchange gains and losses up to 24 January 2006 have been treated as part of the net investment hedge and recognised in equity.

From 25 January 2006 all exchange gains and losses arising on the €1 billion Euro medium-term notes have been recognised in the income statement. The carrying amount of the €1 billion Euro medium-term notes at 31 January 2006 was £693 million (31 March 2005: £705 million), which includes the impact of changes in interest rates and currency. The €1 billion Euro medium-term notes mature on 25 January 2007.

A foreign exchange loss of £4 million (year ended 31 March 2005: £22 million) was recognised in equity within the consolidated statement of recognised income and expense on translation of the €1 billion Euro medium-loan notes from Euro to Pounds Sterling for the 10 months ended 31 January 2006.

The Group also hedged its investment in subsidiaries in Germany and Ireland using forward foreign exchange contracts for the majority of the current financial period. By the 27 January 2006 the use of forward exchange contracts to hedge Euro net investments ceased due to the acquisition of the Group by Telefónica. Foreign exchange gains and losses up to the date of settlement have been recognised as part of the net investment hedge and have been included in equity.

31. *Financial instruments (continued)*

The notional contract amounts of the outstanding forward foreign exchange contracts hedging net investments at 31 January 2006 were €900 million buy contracts offset by €900 million sell contracts (31 March 2005: €1,800 million buy contracts). At 31 January 2006 the fair value of the forward foreign exchange rate contracts was nil (31 March 2005: £25 million). A foreign exchange gain of £4 million (year ended 31 March 2005: loss of £32 million) was recognised in equity within the consolidated statement of recognised income and expense in relation to foreign exchange gains on the forward foreign exchange contracts for the 10 months ended 31 January 2006. All forward exchange contracts had maturities of less than one year after the balance sheet date. The forward exchange contracts were rolled over at maturity up to the cessation of the net investment hedge.

Interest rate risk

The Group's interest rate risk arises primarily from the effects of movements in interest rates on the value of the Group's long-term borrowings. The Euro medium-term notes issued at fixed rates expose the Group to fair value interest rate risk. During the period it was policy to fix or protect expected interest flows where Group profits or key financial ratios would be materially at risk from interest rate movements. Treasury maintained the proportion of fixed rate debt within a Board approved range of 25 to 75 per cent by the issuance of fixed rate debt and the use of derivative instruments (primarily interest rate swaps). As at 31 January 2006, and after taking into account the effect of derivative instruments, 35 per cent (31 March 2005: 38 per cent) of gross borrowings (excluding the QTE lease which is fully defeased) were fixed for a period of at least two years (31 March 2005: three years).

Fair value hedge

The Group classified the interest component of the cross currency interest rate swaps as a fair value hedge of its fixed rate €1 billion Euro medium-term note borrowing. The Group has entered into cross currency interest rate swaps with a notional contract amount of €1 billion Euro whereby the Group receives a fixed rate of 6.375 per cent and pays a variable interest rate based on 6 month Pound Sterling LIBOR plus a margin of 205 to 208 basis points. Prior to the 25 January 2006 these swaps converted the Euro fixed rate obligation to Euro floating rate based on 6 month EURIBOR.

The swaps mature in January 2007, matching the maturity of the related borrowing.

The fair value of these cross currency interest rate swaps at 31 January 2006 was £4 million (interest rate swaps at 31 March 2005: £24 million). The fair value of the Euro borrowing in relation to interest rate and currency risk at 31 January 2006 was £693 million (31 March 2005: £705 million). Movements in both the fair value of the cross currency interest rate swaps and Euro denominated borrowings are recognised in the income statement within financial expenses.

31. Financial instruments (continued)

Fair value of financial instruments

The carrying and fair value of the Group's financial assets and financial liabilities at 31 January 2006 are:

		31 January 2006		31 March 2005
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Liabilities				
Euro medium-term notes	**(1,067)**	**(1,127)**	(1,093)	(1,146)
Obligations under finance leases	**(300)**	**(300)**	(308)	(319)
Bank overdraft	**(39)**	**(39)**	-	-
Other loans and borrowings	**(32)**	**(32)**	(40)	(40)
Trade and other payables	**(1,930)**	**(1,930)**	(1,766)	(1,766)
Other payables	**(38)**	**(38)**	(45)	(45)
Total financial liabilities	**(3,406)**	**(3,466)**	(3,252)	(3,316)
Assets				
Derivative financial instruments	**5**	**5**	49	49
Trade and other receivables	**1,123**	**1,123**	1,029	1,029
Other financial assets	**324**	**328**	317	340
Cash and cash equivalents	**889**	**889**	1,009	1,009
Total financial assets	**2,341**	**2,345**	2,404	2,427

Fair value estimation

The fair value of interest rate swaps, cross currency interest rate swaps, and forward foreign exchange contracts is based on the market price of comparable instruments where available or, if not available, by the discounting of future cash flows to net present values using appropriate interest and currency rates.

The fair value of the trade and other receivables, trade and other payables, short-term deposits, money market funds, cash at bank and short-term borrowings approximates to the book carrying value due to the short-term or on demand maturity of these instruments. The fair value of the sterling and Euro denominated Euro medium-term notes for disclosure purposes have been estimated using quoted market prices. The fair value of other financial assets for disclosure purposes has been calculated using market values provided by third parties where available, or where not available, based on discounted cash flows. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar instruments.

Effective interest rates and repricing analysis

Financial assets consist of sterling and Euro denominated cash at bank, short-term money market deposits and investments in a AAA-rated money market fund. Money market deposits have a maturity profile between overnight and three months and earn interest at market rates. Investments in the money market fund can be called on either a same day or next day basis and yield income or interest on the basis of performance of the underlying assets measured against one-week and three-month LIBOR or EURIBOR benchmarks.

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they re-price or mature (whichever date is earlier). Accrued interest has been excluded from the analysis and all financial assets and liabilities bear interest at floating rates unless otherwise indicated.

31. Financial instruments (continued)

31 January 2006	Currency	Effective interest rate %	Total £m	One year or less £m	One to five years £m	Greater than five years £m
Other financial assets	USD	7.0	**324**	**75**	**145**	**104**
Cash and cash equivalents	Sterling	4.5	837	837	-	-
	Euro	2.2	40	40	-	-
	USD	1.9	12	12	-	-
Total cash and cash equivalents			**889**	**889**	-	-
Euro medium-term notes						
- Euro fixed rate	Euro	6.4	(692)	(692)	-	-
- Effect of cross currency interest rate swaps	Sterling	0.3	4	4	-	-
			(688)	(688)	-	-
-Sterling fixed rate	Sterling	7.6	(374)	-	-	(374)
Total Euro medium-term notes			**(1,062)**	**(688)**	-	**(374)**
Bank overdraft	Sterling	-	**(39)**	**(39)**	-	-
Finance lease obligations	Sterling	7.3	(12)	(7)	(5)	-
	USD	7.4	(288)	(15)	(148)	(125)
Total finance lease obligations			**(300)**	**(22)**	**(153)**	**(125)**
Other loans and borrowings	Sterling	7.4	**(30)**	**(14)**	**(16)**	-
Total			**(218)**	**201**	**(24)**	**(395)**

Included within other loans and borrowings are loans of £24 million which bear a fixed interest rate of 8%.

31 March 2005	Currency	Effective interest rate %	*Total* £m	*One year or less* £m	*One to five years* £m	Greater than five years £m
Other financial assets	USD	6.8	**317**	**69**	**136**	**112**
Cash and cash equivalents	Sterling	4.8	718	718	-	-
	Euro	3.0	281	281	-	-
	USD	1.0	10	10	-	-
Total cash and cash equivalents			**1,009**	**1,009**	-	-
Euro medium-term notes						
- Euro fixed rate	Euro	6.4	(705)	-	(705)	-
- Effect of interest rate swaps		(2.2)	21	21	-	-
			(684)	21	(705)	-
-Sterling fixed rate	Sterling	7.6	(373)	-	-	(373)
Total Euro medium-term notes			**(1,057)**	**21**	**(705)**	**(373)**
Finance lease obligations	Sterling	7.3	(22)	(12)	(10)	-
	USD	7.4	(286)	(15)	(130)	(141)
Total finance lease obligations			***(308)***	***(27)***	***(140)***	**(141)**
Other loans and borrowings	Sterling	7.5	**(40)**	**(16)**	**(24)**	-
Total			**(79)**	**1,056**	**(733)**	**(402)**

Included within other loans and borrowings are loans of £31 million which bear a fixed interest rate of 8%.

32. Auditors' remuneration

The aggregate fees paid to auditors during the year for audit and other services are analysed below:

	10 months ended 31 January 2006 £000	Year ended 31 March 2005 £000
Audit services:		
UK	**756**	665
Other countries	**541**	370
Total statutory audit fees	**1,297**	1,035
Audit-related regulatory reporting	**40**	32
Sarbanes-Oxley compliance reporting	**-**	279
International Financial Reporting Standards reporting	**226**	150
Total audit and audit-related fees	**1,563**	1,496
Non-audit fees:		
Other assurance services	**476**	869
Tax compliance	**123**	180
Tax advisory	**723**	338
Total non-audit fees	**1,322**	1,387

Other non-audit assurance services includes fees totalling £630,000 in the year ended 31 March 2005 in respect of the capital reorganisation described in note 4. Non-audit fees arising in the UK were £824,000 (year ended 31 March 2005: £991,000).

The audit fees for the Company were £10,000 (year ended 31 March 2005: £10,000) and were borne by another Group company.

33. Key management and director compensation

The compensation of key management for the 10 months ended 31 January 2006 was as follows:

	10 months ended 31 January 2006 £000	Year ended 31 March 2005 £000
Salaries and short-term employee benefits	**7,404**	7,493
Post-employment benefits	**865**	1,123
Share based payments	**8,367**	1,375
Total key management compensation	**16,636**	9,991

The key management compensation analysed above represents compensation earned by the Group's Executive Committee including Directors of the Company.

The emoluments of the Directors for the 10 months ended 31 January 2006 was, in summary, as follows:

	10 months ended 31 January 2006 £000	Year ended 31 March 2005 £000
Salaries	**1,667**	2,336
Performance related bonus	**1,578**	1,925
Other benefits	**124**	172
	3,369	4,433
Payments to non-executive directors	**382**	325
Total director emoluments	**3,751**	4,758

During the period, five directors (year ended 31 March 2005: three) accrued retirement benefits under a defined benefit pension plan. In addition, contributions of £107,962 (year ended 31 March 2005: £89,250) in respect of two directors (year ended 31 March 2005: one) were paid to a defined contribution pension plan. During the period, six directors (year ended 31 March 2005: five) exercised share options realising gains totalling £11,531,130 (year ended 31 March 2005: £1,214,442). During the period, seven directors (year ended 31 March 2005: three) realised gains on the vesting of long-term incentive plans totalling £25,465,440 (year ended 31 March 2005: £1,399,955).

The highest paid director had gains arising on the exercise of share options of £3,394,401 (year ended 31 March 2005: £7,000) and gains arising on long-term incentive plans of £7,748,636 (year ended 31 March 2005: £778,000).

More detailed information concerning directors' remuneration, shareholdings, pension entitlement, share options and long-term incentive plans is shown in the report on directors' remuneration.

34. Employees

	10 months ended 31 January 2006 No.	Year ended 31 March 2005 No.
Average number of full time employee equivalents (including executive Directors) by class of business:		
Mobile telecommunications	**14,530**	13,005
Other businesses	**973**	906
Total employees	**15,503**	13,911
Average number of full time employee equivalents (including executive Directors) by geographic area:		
UK	**9,640**	8,709
Germany	**4,260**	3,675
Ireland	**1,603**	1,527
Total employees	**15,503**	13,911

At 31 January 2006, the Group employed 16,205 (31 March 2005: 14,914) full time employee equivalents.

The benefit expense incurred in respect of these employees were:

	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Wages and salaries	**473**	514
Social security costs	**68**	64
Share based payments (note 35)	**13**	11
Pension costs (note 22)	**27**	32
Total employee benefit expense	**581**	621

In addition, included in exceptional costs in the current period are £22 million of wages and salaries, £12 million of social security costs and £41 million of share based payments (year ended 31 March 2005: £27 million of wages and salaries).

35. Share based payments

Group employees participated in a number of employee incentive schemes including a Sharesave Plan and various executive option and award schemes over shares in O2 plc. The report on directors' remuneration in this Annual Report contains full details of the directors' interests in these schemes.

The acquisition of the Company by Telefónica on 23 January 2006 has resulted in the early vesting of certain share option and share award schemes. The implications of this on the share option and share award schemes are discussed below.

The costs of share options and awards are charged to the income statement over the vesting period, based upon the fair value of the share award or option at the award date adjusted for the likelihood of vesting under the share award or option plan.

The amounts recognised in the income statement for share based payment transactions with employees for the 10 months ended 31 January 2006 was as follows:

	10 months ended 31 January 2006 £m	Year ended 31 March 2005 £m
Equity settled share based payments	**13**	11
Equity settled share based payments – included in exceptional costs (note 4)	**19**	-
Cash settled share based payments – included in exceptional costs (note 4)	**22**	-
Total share based payments	**54**	11

The amounts recognised in the income statement for Employers National Insurance on share based payments for the 10 months ended 31 January 2006 was £15 million (year ended 31 March 2005: £4 million) of which £13 million (year ended 31 March 2005: £4 million) related to equity settled share based payment transactions and £9 million related to the exceptional items as disclosed in note 4.

The liability recognised in the balance sheet for share based payments at 31 January 2006 totalled £38 million (31 March 2005: £5 million). The total intrinsic value of share based payment liabilities that have vested at 31 January 2006 was £38 million (31 March 2005: nil). At 31 January 2006 this related to Employer's National Insurance obligations and cash compensation due to Sharesave Plan members and at 31 March 2005 the liability solely related to Employer's National Insurance obligations.

Share option plans

The share option plans operated by the Group during the 10 months ended 31 January 2006 are:

O2 Sharesave Plan

The O2 Sharesave Plan was an Inland Revenue and Irish Revenue Commissioners approved savings related share option scheme available to all UK, Isle of Man and Irish employees. The scheme enabled employees to acquire shares in the Company at an agreed price through monthly savings at the end of a three or five year save as you earn ("SAYE") contract. A three year sharesave scheme also operated in Germany.

In the 10 months ended 31 January 2006 no options (year ended 31 March 2005: 9 million) were granted under the Sharesave Plan. Of the 9 million granted in the year ended 31 March 2005 7 million were granted under the three year plan and the remaining 2 million were granted under the five year plan.

35. Share based payments (continued)

O2 Share Option Plan

Executive Share Options have been granted to certain employees of the Group on terms such that they usually become exercisable on the third anniversary of grant subject to the achievement of certain performance criteria. The performance criteria is the Company's TSR performance against a comparator group over a fixed three year period as set out below:

TSR ranking	% of options exercisable
Below median	0%
Median	50%
Upper quartile	100%

Vesting occurs on a straight line basis between median and upper quartile performance.

If these criteria are not met on the third anniversary of grant, they are retested on the fourth and fifth anniversaries of grant, extending the length of the performance period at each test. The proportion of options that can be exercised will increase if the Company's TSR performance improves between the test dates any options not exercisable after the fifth anniversary lapse. The comparator group consisted of the constituents of the FTSE 100 Index at the time the options were granted.

All such options have an exercise price equal to the market value at grant date and have a life of ten years. Options under this plan were granted prior to 7 November 2002. The Group has elected not to apply IFRS 2 "Share based payments" to share based payments granted prior to 7 November 2002. Accordingly there is no fair value charge recognised in the income statement for this plan.

O2 Legacy Option Plan

Options over BT shares granted under BT Executive Share Option Plans were replaced with options over O2 shares, granted under the Legacy Option Plan, for those participants now employed by O2. The replacement options were granted on the same terms, and are exercisable between the same dates, as the options for which they were exchanged. The exercise price of these options equals the market value as at original grant date. Options are normally exercisable up until the tenth anniversary of the date of the original grant. There are no performance conditions relating to these options other than continued employment with the O2 Group.

Options under this plan were all granted prior to 7 November 2002. The Group has elected not to apply IFRS 2 to share based payments granted prior to 7 November 2002. Accordingly there is no fair value charge recognised in the income statement for this plan.

35. Share based payments (continued)

Options outstanding under the O2 Sharesave Plan, O2 Executive Share Option Plan and O2 Legacy Option Plan as at 31 January 2006, together with their exercise prices and vesting periods, are as follows:

	31 January 2006			31 March 2005		
	Number outstanding	Weighted average remaining contractual life[1]	Weighted-average exercise price	Number outstanding	Weighted average remaining contractual life	Weighted-average exercise price
Range of exercise prices	m	years	£	m	years	£
£0.44	**30**	-	**0.44**	32	1	0.44
£0.46	**12**	-	**0.46**	70	7	0.46
£0.48	**1**	-	**0.48**	1	8	0.48
£0.54	**12**	-	**0.54**	13	2	0.54
£0.64-0.69	**3**	-	**0.68**	4	7	0.68
£0.73	**2**	-	**0.73**	3	1	0.73
£0.87	**12**	-	**0.87**	18	7	0.87
£0.92	**8**	-	**0.92**	9	3	0.92
£1.16-1.93	**-**	-	**-**	1	6	1.61
	80	-	**0.59**	151	5	0.55

[1] A proportion of options outstanding at 31 January 2006 will be able to be exercised to 23 March 2006, after which they will lapse.

Options granted, exercised and lapsed during the 10 months ended 31 January 2006 and the year ended 31 March 2005 under these share option plans were as follows:

	Options over Ordinary shares			Options over ADS[1]	
	Savings-related share options[2]	Other share options	Weighted-average exercise price	Other share options	Weighted-Average Exercise Price
	m	m	£	m	£
Balance at 1 April 2004	55	111	0.57	2	0.93
Granted	9	-	0.92	-	-
Forfeited	(4)	-	0.60	(1)	0.82
Exercised	(3)	(17)	0.77	(1)	0.63
Outstanding at 31 March 2005	57	94	0.55	-	-
Forfeited	(2)	(2)	0.73	-	-
Exercised	(3)	(64)	0.50	-	-
Outstanding at 31 January 2006	**52**	**28**	**0.59**	-	-

[1] Share options over American Depositary Shares (ADSs) have exercise prices termed in US Dollars. For purposes of disclosure, these options' exercise prices have been translated into Sterling at the year end exchange rate. As each ADS represents ten ordinary shares, the number of options and exercise prices have been adjusted by this ratio to reflect the options on a like for like basis. As a consequence of the implementation of the capital reorganisation in March 2005, the mmO2 ADS programme was terminated, and all ADSs have been converted into either O2 plc ordinary shares or cash.

[2] As a result of the acquisition by Telefónica, a portion of these options became exercisable and the remainder lapsed. Telefónica agreed under the Framework Agreement that O2 would pay compensation to participants in relation to lapsed options equal to the additional profit which the employees would have received had they continued to make savings under the Sharesave Schemes to the bonus date of their savings contract.

There were 64 million options exercisable at 31 January 2006 (31 March 2005: 14 million) with a weighted average exercise price of £0.57 (31 March 2005: £0.83).

The weighted average share price at the date of exercise for share options exercised during the period was £1.47 (year ended 31 March 2005: £1.18).

35. Share based payments (continued)

Share award plans

The share award plans operated by the Group during the 10 months ended 31 January 2006 are:

O2 Restricted Share Plan ("RSP")

Restricted share awards were granted to a small group of senior executives on terms that they will normally only vest on the third anniversary of grant if the participant personally builds and maintains an equivalent number of O2 shares until the vesting date as well as remaining in employment with the Group until this time. The awards vest on a prorata basis if the participant builds up a lower personal investment. During the 10 months ended 31 January 2006 0.2 million shares under granted under the RSP (year ended 31 March 2005: 2 million).

The fair value of awards granted during the period in respect of the RSP was estimated using a Black-Scholes option pricing model with the following assumptions: weighted average share price of £1.43 (year ended 31 March 2005: £0.88), exercise price of nil (year ended 31 March 2005: nil), dividend yield of nil (year ended 31 March 2005: 3%), and an expected life of 2 years (year ended 31 March 2005: 3 years). The average fair value of RSP awards for the 10 months ended 31 January 2006 was £1.43 per share (year ended 31 March 2005: £0.80).The expected life used in the model is based on the contractual terms of the RSP. The expected outcome of meeting the matching criteria was estimated at 100% at grant date for all awards.

O2 Performance Share Plan ("PSP")

PSP awards vest on the third anniversary of grant if the Company meets certain performance criteria, and the participant remains in employment with the Group. The performance criteria is the Company's TSR performance against a comparator group over a fixed three-year period as set out below:

TSR ranking	% Performance Shares Vest
Below median	0%
Median	30%
Upper quartile	100%

Vesting occurs on a straight line basis between median and upper quartile performance.

The comparator group consists of the constituents of the FTSEurofirst 300 Telecommunications Index (formerly known as the FSE E300 Telecoms service Index) at the time awards are made.

During the 10 months ended 31 January 2006 16 million shares were granted under the PSP (year ended 31 March 2005: 12 million). During the 10 months ended 31 January 2006 2 million PSP shares granted do not have TSR performance conditions and instead have performance goals based solely on controllable EBIT margin and net service revenue growth over a three year performance period. For minimum performance achievement 30% of the total award would vest. Below this level none of the award would vest. For achievement of the maximum performance level, 100% of the award would vest. Both measures had to be achieved at the maximum for the full award to vest.

35. Share based payments (continued)

The fair value of awards granted during the period in respect of the PSP was estimated using an adjusted Black-Scholes option pricing model with the following assumptions: weighted average share price of £1.43 (year ended 31 March 2005: £0.88), exercise price of nil (year ended 31 March 2005: nil), dividend yield of nil (year ended 31 March 2005: 3%), and an expected life of 3 years (year ended 31 March 2005: 3 years). The model also contains assumptions about the Company's expected performance against the TSR comparator group. Share price volatility assumptions for O2 and the TSR comparator group as well as share price correlation assumptions are incorporated into this model. The fair value reflects the probability of market performance conditions being achieved.

For awards that do not have market based performance conditions (non TSR awards) an estimate was made of the likelihood of vesting. For the awards with non TSR conditions this was estimated at 80% at the grant date. The average fair value of shares allocated during the period was £0.71 per share for TSR based awards and £1.43 for awards with non market based performance conditions (year ended 31 March 2005: £0.26). The expected life used in the model is based on the contractual terms of the PSP. Expected departures at grant date were estimated at 10% (year ended 31 March 2005: 15%) spread evenly over the vesting period.

O2 Deferred Equity Incentive Plan ("DEIP")

These are two parts to the DEIP:

Deferred Award

The Deferred Award is an entitlement to shares equal in value to half of the annual bonus earned in respect of the preceding financial year. Vesting is subject to continued employment, but no further corporate performance condition.

Performance Uplift

The maximum Performance Uplift is equal to twice the Deferred Award. Vesting is subject to the long-term performance of the Company. Vesting of the Performance Uplift is subject to the Company's TSR performance against a comparator group over a fixed three-year period as set out below:

TSR ranking	% Performance Uplift Vesting
Below median	0%
Median	30%
Upper quintile (top 20%)	100%

Vesting occurs on a straight line basis between median and upper quintile performance.

The comparator group for Performance Uplift awards made in the year ended March 2005 consisted of the constituents of the FTSEurofirst 300 Telecommunications Index at the date of award. DEIP awards of 8 million have been granted to a small group of senior executives during the year ended 31 March 2005 and no awards were made in the 10 months ended to 31 January 2006. Of the 8 million awards granted in the year ended 31 March 2005, 3 million were granted under the Deferred Award part of the plan and 5 million were granted under the Performance Uplift part of the plan.

The fair value of awards granted during the year ended 31 March 2005 in respect of the DEIP was estimated using an adjusted Black-Scholes option pricing model with the following assumptions: weighted average share price £0.80, exercise price of nil, dividend yield of 3% and an expected life of 3 years. The model also contains assumptions about the Company's expected performance against the TSR comparator group. Share price volatility assumptions for O2 and the TSR comparator group as well as share price correlation assumptions are incorporated into this model. The fair value reflects the probability of market performance conditions being achieved. The average fair value of awards granted under the performance uplift part of the DEIP was £0.40 per share, under the Deferred Award part of the DEIP was £0.80 per share. The expected life used in the model is based on the contractual terms in the DEIP.

35. Share based payments (continued)

Deferred Award

The Deferred Award is an entitlement to shares based on the annual bonus earned in respect of the preceding financial year. The award vests three years after grant subject to continued employment with the Group. Two million Deferred Awards were granted to a small group of senior executives during the 10 months ended 31 January 2006 (year ended 31 March 2005: nil).

The fair value of awards granted during the 10 months ended 31 January 2006 was estimated using a Black-Scholes option pricing model with the following assumptions: weighted average share price of £1.43, exercise price of nil, dividend yield of nil and an expected life of 3 years. The average fair value of awards granted was £1.43 per share. The expected life used in the model is based on the contractual terms in the Deferred Award.

Implications for share option plans and share awards of acquisition by Telefónica

The acquisition of the Company by Telefónica on 23 January 2006 resulted in Sharesave options becoming exercisable to the extent that savings to that date permitted. After 23 March 2006 all outstanding, unexercised Sharesave options will lapse. Employees also received cash compensation equal to the additional profit which the employee would have received had they continued to make savings under the Sharesave schemes to the bonus date of their savings contracts (when they would have acquired the full number of shares under option). The O2 Share Option Plan awards were exercisable under their original terms and there were no changes to the awards on change of control. At 31 January 2006 TSR performance was such that all these had become exercisable.

As a result of the offer from Telefónica, vesting levels for conditional share awards under the PSP and DEIP (which are performance-related) were determined by the Remuneration Committee of O2 in relation to the offer. Aside from a small number of PSP awards granted in July 2005 that do not have TSR performance conditions, awards were subject to O2's relative TSR performance which, over the period from each grant date to 31 December 2005, was such as to place the Company at first or second in the comparator group.

The Remuneration Committee of O2 considered the performance to the offer date against all of the measures and other relevant factors, and reached an indicative decision, which was confirmed at the date that the offer became unconditional (23 January 2006), that:

- awards made in 2003 and 2004 would vest in full, and the O2 Shares under those awards would be released immediately; and
- awards made in 2005 will vest in full, but the offer proceeds for those O2 Shares would only be released on the first anniversary of the Unconditional Date subject to the participant (i) not having given notice to resign their employment, and (ii) not having been dismissed for cause in accordance with their service contract, in both cases prior to such first anniversary.

The Remuneration Committee determined that other RSP awards should be released to the extent that personal shareholding requirements had been met, and replaced by a conditional entitlement to cash (the Conditional Cash Award) equivalent to the value of the RSP awards at the Unconditional Date (being £2 for every share under award). Payment of the Conditional Cash Award is subject to remaining in service with O2 until the vesting date.

In accordance with the terms of each arrangement, Deferred Awards granted in July 2005, and Deferred Awards made under the DEIP in July 2004, neither of which have performance conditions other than continuous employment, vested in full as a result of the change of control.

35. Share based payments (continued)

Early vesting modification on Telefónica acquisition

The acquisition of the Company by Telefónica on 23 January 2006 has resulted in the modification of all share awards outstanding at that date, including the PSP, DEIP, RSP and the Deferred Award. The incremental fair value for the awards granted in 2004 was £0.06 and awards granted in 2005 were £0.36. This was calculated by isolating the change in fair value due to the modification to accelerate the vesting of the share award plans. The fair value was estimated using an adjusted Black-Scholes option pricing model with the following assumptions: weighted average share price of £2, exercise price of nil, dividend yield of 0%, and an expected life equal to the remaining original contractual term and the immediate vesting under the modified terms. The model just before the modification also contains assumptions about the Company's expected performance against the TSR comparator group. Share price volatility assumptions for O2 and the TSR comparator group as well as share price correlation assumptions are incorporated into this model just before the modification occurred.

Dividend modification

During the period the Remuneration Committee determined that all existing and future share awards made under the DEIP, PSP, RSP and Deferred Awards, would be adjusted on vesting so that participants receive additional shares representing the value of dividends that would have been paid on these shares during the performance period. The incremental fair value for each existing award was on average £0.03. This was calculated by isolating the change in fair value due to the modification to compensate employees in the share award plans for dividends during the vesting period. The fair value was estimated using an adjusted Black-Scholes option pricing model with the following assumptions: weighted average share price of £1.42, exercise price of nil, an expected life equal to the remaining original contractual term and a dividend yield of 2% just before the modification and 0% just after the modification.

36. Parent company and controlling party

On 31 October 2005, the Boards of Telefónica, and the Company jointly announced that they had agreed the terms of recommended cash offer to be made on behalf of Telefónica for the entire issued and to be issued share capital of O2. Shareholders were offered £2 cash or a loan note alternative for every one O2 share which they held in the Company. The Telefónica offer was declared wholly unconditional on 23 January 2006 at which time Telefónica became the Company's ultimate holding Company.

Therefore at 31 January 2006,, the immediate and ultimate parent company and controlling party was Telefónica, S.A., a company incorporated in Spain. Copies of the financial statements of Telefónica, S.A. may be obtained from Calle Gran Via 28, Madrid, Spain.

37. Subsequent events

Following the Telefónica Offer being declared wholly unconditional, Telefónica procured the Company to apply to the Financial Services Authority for the cancellation of the listing of its shares on the Official List and to the London Stock Exchange for the cancellation of the admission to trading of O2 shares on the London Stock Exchange's market for listed securities. The cancellation of the Company's listing and admission to trading became effective on 7 March 2006.

On 20 June 2006, O2 purchased the entire issued share capital of Be Un Limited for £50 million, thereby acquiring a leading broadband capability in the UK, and a platform for developing future converged services that integrate mobile and the internet.

On 21 June 2006, O2 announced that that it was in exclusive negotiations regarding the acquisition by O2 (UK) Limited of DSG Retail Limited's 60% stake in The Link Stores Limited, and had reached commercial agreement in principle, subject to agreement of legally binding documentation and other terms and conditions, for a cash sum of approximately £30 million.

38. Description of consolidated International Financial Reporting Standards adjustments

The Group is required, under European Union Regulation No. 1606/2002, to adopt International Financial Reporting Standards ("IFRS") as its primary basis of accounting for the 10 months ending 31 January 2006 in place of UK Generally Accepted Accounting Principles ("UK GAAP"). Up to and including 31 March 2005, the Group has prepared and presented its financial statements in accordance with UK GAAP. The following note describes the adjustments made to previous reported UK GAAP figures.

Transition date

The Group's transition date, being the beginning of the earliest period for which full comparative information is presented in accordance with IFRS, is 1 April 2004 in accordance with IFRS 1 "First time adoption of International Financial Reporting Standards".

IFRS 1 transition exemptions

IFRS 1 prescribes how the Group should apply IFRS for the first time in preparing its consolidated financial statements. In general, the accounting policies expected to be adopted by the Group at 31 January 2006 should be applied retrospectively in preparing the transition balance sheet at 1 April 2004 and in all subsequent periods.

IFRS 1 contains certain exemptions from the requirement to fully adopt IFRS in the opening balance sheet. The Group has applied the relevant exemptions as follows:

IFRS 3 – Business combinations	The Group has elected not to apply IFRS 3 retrospectively to business combinations occurring prior to the transition to IFRS on 1 April 2004. Accordingly the carrying value of the Group's goodwill under IFRS is £3,189 million, being the UK GAAP carrying value at 1 April 2004.
IAS 16 – Fair value or revaluation as deemed cost	The Group has elected to continue to recognise all property, plant and equipment ("PPE") at its historic UK GAAP carrying value and not to measure any item of PPE at fair value at 1 April 2004.
IAS 19 – Employee benefits	The Group has elected to recognise all cumulative actuarial gains and losses as at 1 April 2004 on the consolidated balance sheet.
IAS 21 – Cumulative translation differences	The Group will retain all existing translation differences arising on its foreign operations in reserves rather than utilise the exemption to set these translation differences to zero on transition to IFRS.
IAS 32 and IAS 39 - Financial instruments	The Group has applied IAS 39 from transition on 1 April 2004 and has not taken advantage of the exemption to apply IAS 39 from 1 April 2005.
IFRS 2 – Share-based payment transactions	The Group has elected not to apply IFRS 2 to share-based payments granted prior to 7 November 2002. The Group has not accounted for share-based payments granted prior to that date.

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Reconciliation of UK GAAP to IFRS retained profit for the year ended 31 March 2005, and equity for the transition balance sheet at 1 April 2004 and as at 31 March 2005.

Retained profit	Adjustment reference	Year ended 31 March 2005 £m
As reported under UK GAAP		105
Revenue recognition	1	-
Cessation of goodwill amortisation	2	200
Pensions	3	(7)
Share-based payments	4	(2)
Recognition of financial instruments	5	2
UMTS licence creditor	6	(1)
De-recognition of dividends	7	196
Restated under IFRS		493

Equity	Adjustment reference	As at 31 March 2005 £m	As at 1 April 2004 £m
As reported under UK GAAP		10,281	10,094
Cessation of goodwill amortisation	2	200	-
Pensions	3	(119)	(93)
Recognition of financial instruments	5	-	(3)
UMTS licence creditor	6	(3)	(2)
De-recognition of dividends	7	196	-
Deferred tax liability	8	(358)	(358)
Other employee benefits	9	(2)	(2)
Restated under IFRS		10,195	9,636

The major areas of difference between UK GAAP and IFRS which impact the Group's financial information comprise the following:

Adjustment 1 - Revenue recognition

O2 UK receives income and incurs a related expense on calls which are "ported" to another mobile operator. Porting arises when an O2 customer leaves O2 and joins another operator and takes ("ports") their existing mobile number to the new network. All calls received by that customer are still routed via the O2 network to the network of the new operator. For all incoming calls to the O2 network, O2 receives a termination fee per minute and is required to pass that termination fee to the new operator. The receiving operator pays O2 a small commission for conveying the call.

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Adjustment 1 - Revenue recognition (continued)

Under UK GAAP the Group recognised the termination fees on a gross basis and thus included these amounts in both revenue and cost of sales. The Group has reconsidered this policy under IAS 18, which states that in an agency relationship the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are therefore not revenue. Instead, revenue is the amount of commission. Accordingly under IFRS, the Group will recognise the termination payments on a net basis.

The impact of this adjustment on the income statement of the Group and O2 UK is as follows:

	Year ended 31 March 2005 £m
Revenue	(108)
Cost of sales	108
Gross profit	-

This adjustment reduces O2 UK's service revenue and cost of sales and is solely a reclassification which does not alter profit or cash flows. However, the reported EBITDA margin will rise and average revenue per user ("ARPU") has been restated downwards as a consequence of this adjustment.

The commission received by O2 from the receiving operator, described above, which totals £12 million for the year ended 31 March 2005, has been reclassified from service revenue to other revenue. This adjustment has no effect on the Group's total revenue.

Adjustment 2 - Goodwill amortisation

IFRS 3 "Business combinations" prohibits the annual amortisation of goodwill and instead subjects such goodwill to an annual impairment review. The carrying value of goodwill at the date of transition to IFRS is £3,189 million and the amortisation charge ceases from that date.

Accordingly, the impact on the income statement of the Group is as follows:

	Year ended 31 March 2005 £m
Goodwill amortisation	200

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Adjustment 3 – Pensions

In accordance with IAS 19 "Employee benefits", on transition to IFRS the Group has elected to recognise the net deficit of its defined benefit pension schemes on the consolidated balance sheet. Thereafter, the Group has elected to recognise actuarial gains and losses in full in the statement of recognised income and expense, rather than in the income statement, in the period in which they arise.

The impact on the Group's income statement of the adoption of IAS 19 is as follows:

	Year ended 31 March 2005 £m
Pension costs – administrative expenses	(6)
Pension costs – net financing costs	(1)
	(7)
Actuarial losses – in statement of total recognised income and expense	(19)

The pension deficit recognised on the consolidated balance sheet is as follows:

	At 31 March 2005 £m	At 1 April 2004 £m
Retirement benefit obligations	(126)	(105)

The operating charge included within administrative expenses under IAS 19 represents the current service cost, and the net financing charge represents the net of the expected return on scheme assets and the unwinding of the discount on the scheme liabilities. The actuarial losses arise on experience adjustments (being the effects of the differences between the previous actuarial assumptions and what has actually occurred) and the impact of changes in actuarial assumptions.

Adjustment 4 – Share-based payments

The Group has historically accounted for share scheme costs under UK GAAP using the intrinsic value. IFRS 2 "Share based payments" requires the value of all share based payments to be measured, and an expense recognised in the income statement, based on fair value. Additionally, under UK GAAP, Inland Revenue approved SAYE schemes are exempt from the requirement to recognise a charge whereas under IFRS there is no such exemption.

The impact on the Group's income statement of the adoption of IFRS 2 in accounting for share-based payments is as follows:

	Year ended 31 March 2005 £m
Administrative expenses	(2)

38. *Description of consolidated International Financial Reporting Standards adjustments (continued)*

Adjustment 5 - Financial instruments

The Group holds financial instruments principally to finance its operations, for the temporary investment of short term funds and to manage currency and interest rate risks arising from its operations. IAS 39 "Financial instruments: Recognition and measurement" addresses the accounting for financial instruments.

Since the transition to IFRS on 1 April 2004, the Group has prepared documentation and performed effectiveness testing procedures for certain derivative financial instruments which are designated as hedges. This permits the application of hedge accounting for these instruments

The impact on the Group's income statement of the adoption of IAS 39 is as follows:

	Year ended 31 March 2005
	£m
Net financing costs	2

The impact on the consolidated balance sheet of the adoption of IAS 39 is as follows:

	At 31 March 2005	At 1 April 2004
	£m	£m
Net assets	-	(3)

The Group's cash flow hedges and hedges of net investments in foreign operations do not give rise to significant adjustments under IAS 39.

The main components of the IAS 39 adjustments are:

Fair value hedges

The Group holds €1,000 million of interest rate swaps which hedge certain fixed rate borrowings by denominating them as floating rate. Under IAS 39, these interest rate swaps are a fair value hedge and are accounted for using hedge accounting. The interest rate swaps at 31 March 2005 result in the recognition of a non-current asset of £21 million (1 April 2004: £56 million) with a corresponding increase in the value of the Group's non-current borrowings. There is no impact on the Group's net assets.

Derivatives which are not designated as hedges

The Group uses forward foreign exchange contracts to hedge exchange rate movements on certain monetary assets. The overall effect of recognition of these derivatives is to increase current liabilities by £1 million at 1 April 2004, with no impact at 31 March 2005.

Other adjustments - accrued interest reclassification

IAS 39 requires all accrued interest on borrowings to be classified within the "borrowings" balance in the consolidated balance sheet. Accrued interest is also required to be recorded at its un-hedged rate if it has been hedged by an interest rate swap. Under UK GAAP, interest is accrued at the hedged rate and classified as an accrual rather than as part of the borrowings balance. At 31 March 2005, accrued interest totalling £13 million was reclassified from accruals to borrowings (1 April 2004: £14 million).

IAS 39 also requires accrued interest on cash and cash equivalents to be included within the cash balance reported in the consolidated balance sheet, although the impact is not significant.

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Adjustment 6 - UMTS licence creditor

In the year ended 31 March 2003, O2 Ireland purchased a UMTS "B" licence. The total licence fee was €114 million with payments phased over fifteen years. Under UK GAAP the asset and liability are recognised at their undiscounted value whereas under IFRS, the asset cost is recorded at the discounted present value of the payments and a corresponding creditor established.

The effect at 1 April 2004 is to reduce the carrying value of O2 Ireland's UMTS licence and creditor by £13 million and to recognise an interest cost of £1 million in the year ended 31 March 2005 representing the unwinding of the discount on the long-term liability.

The impact on the Group's income statement is as follows:

	Year ended 31 March 2005 £m
Net financing costs	(1)

The impact on the Group's consolidated balance sheet is as follows:

	At 31 March 2005 £m	At 1 April 2004 £m
Other intangible assets	(13)	(13)
Non-current liabilities: trade and other payables	10	11
Net assets	(3)	(2)

Adjustment 7 - Dividends

Under IAS 10 "Events after the balance sheet date", if an entity declares a dividend after the balance sheet date, the entity shall not recognise that dividend as a liability at the balance sheet date.

The dividend declared by the Group in May 2005 totalling £196 million is not recognised in the year ended 31 March 2005 under IFRS but is recognised under UK GAAP. The impact on the Group's consolidated balance sheet is as follows:

	At 31 March 2005 £m	At 1 April 2004 £m
Current liabilities: other payables	196	-

38. *Description of consolidated International Financial Reporting Standards adjustments (continued)*

Adjustment 8 - Taxation

IAS 12 "Income taxes" bases the calculation of the deferred tax assets and liabilities on the difference between tax carrying values and balance sheet carrying values, rather than the income statement approach required by FRS 19 "Deferred tax". As a result, the scope of IAS 12 is wider than that of FRS 19. IAS 12 requires a deferred tax liability in respect of rolled over gains to be recognised, irrespective of whether there is an expectation that the gain will crystallise.

The Group is required to recognise a deferred tax liability of £358 million on transition to IFRS relating to a gain arising prior to the Group's demerger from BT. The gain arose on BT's disposal of a non-mobile UK business which was rolled over into the goodwill relating to one of O2's operating businesses. This deferred tax liability is expected to reverse in the short to medium term as part of an internal reorganisation and, as a result, will be recognised as a credit in the tax line in the income statement of the Group in the corresponding period.

The other adjustments between UK GAAP and IFRS have no taxation effect as each adjustment either gives rise to a deferred tax asset in an entity where it is currently inappropriate to recognise further deferred tax assets or gives rise to a deferred tax liability in an entity which is already carrying unrecognised deferred tax assets such that a portion of that asset would be recognised to the extent *of the any liability.*

Adjustment 9 - Other employee benefits

The Group has recognised a liability of £2 million under IFRS on transition at 1 April 2004 in respect of holiday pay which under IAS 19 is defined as a short-term compensated absence.

Adjustment 10 - Software reclassification

Certain software, classified as tangible fixed assets under UK GAAP, has been assessed in accordance with IAS 38 and is reclassified to intangible assets under IFRS.

The impact on the Group's income statement is as follows:

	Year ended 31 March 2005 £m
Depreciation	171
Other amortisation	(171)
	-

The impact on the Group's consolidated balance sheet is as follows:

	At 31 March 2005 £m	At 1 April 2004 £m
Property, plant and equipment	(606)	(530)
Other intangible assets	606	530
	-	-

38. *Description of consolidated International Financial Reporting Standards adjustments (continued)*

Adjustment 11 - Joint ventures and associates

Under both UK GAAP and IFRS, the profits and losses of joint ventures and associates are recognised under the equity method of accounting. IFRS requires the Group's share of the post tax profits or losses to be included in one line in the income statement whereas under UK GAAP the Group's share of the interest and tax of associates are included under those headings in the profit and loss account.

The effect on the Group for the year ended 31 March 2005 is to reclassify a interest receivable of £1 million and a tax charge of £1 million to the "share of result of joint ventures and associates" line.

Adjustment 12 - Cash reclassification

IAS 7 "Cash flow statements" requires cash, which comprises cash on hand, demand deposits and cash equivalents to be reported in one line on the face of the balance sheet. Cash equivalents are defined as short term highly liquid investments that are readily convertible to known amounts of cash, UK GAAP does not recognise cash equivalents and such items are classified as current asset investments.

The impact on the Group's consolidated balance sheet is as follows:

	At 31 March 2005	At 1 April 2004
	£m	£m
Other financial assets	(968)	(645)
Cash and cash equivalents	968	645
	-	-

O2 plc
Notes to the financial statements

38. *Description of consolidated International Financial Reporting Standards adjustments (continued)*

Consolidated income statement – IFRS format
Year ended 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Revenue	**6,683**	**(108)**	**6,575**
Cost of sales	(3,799)	108	(3,691)
Gross profit	**2,884**	**-**	**2,884**
Administrative expenses	(2,543)	192	(2,351)
EBITDA	**1,768**	**(8)**	**1,760**
Depreciation before exceptional items	(931)	171	(760)
Goodwill amortisation	(200)	200	-
UMTS licences amortisation	(169)	-	(169)
Other amortisation	(82)	(171)	(253)
Operating profit before exceptional items	386	192	578
Exceptional items	(45)	-	(45)
Operating profit	**341**	**192**	**533**
Share of post tax result of joint ventures and associates	(3)	-	(3)
Costs of capital reorganisation	(20)	-	(20)
Finance income	63	-	63
Financial expense	(72)	(1)	(73)
Profit before taxation	**309**	**191**	**500**
Taxation	(8)	1	(7)
Profit for the year attributable to equity shareholders	**301**	**192**	**493**
Dividends	(196)	196	-
Retained profit for the year	**105**	**388**	**493**
Basic earnings per share (pence)	3.5	2.2	5.7
Diluted earnings per share (pence)	3.4	2.2	5.6

Consolidated statement of recognised income and expense – IFRS format
Year ended 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Exchange differences on translation of foreign operations	68	54	122
Net investment hedges of foreign operations	-	(54)	(54)
Actuarial losses on defined benefit pension plans	-	(19)	(19)
Net income recognised directly in reserves	**68**	**(19)**	**49**
Profit for the attributable to equity shareholders	301	192	493
Total recognised income relating to the year	**369**	**173**	**542**

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Consolidated balance sheet – IFRS format

As at 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Non-current assets			
Property, plant and equipment	4,449	(606)	3,843
Goodwill	3,011	200	3,211
Other intangible assets	4,034	593	4,627
Derivative financial instruments	-	21	21
Investments in joint ventures and associates	2	-	2
	11,496	**208**	**11,704**
Current assets			
Inventories	87	-	87
Trade and other receivables	1,035	(6)	1,029
Derivative financial instruments	25	3	28
Other financial assets	1,285	(968)	317
Cash and cash equivalents	41	968	1,009
	2,473	**(3)**	**2,470**
Current liabilities			
Borrowings	(56)	(15)	(71)
Trade and other payables	(1,968)	202	(1,766)
Current tax liabilities	(7)	-	(7)
Provisions	(9)	-	(9)
	(2,040)	**187**	**(1,853)**
Net current assets	**433**	**184**	**617**
Total assets less current liabilities	**11,929**	**392**	**12,321**
Non-current liabilities			
Borrowings	(1,348)	(22)	(1,370)
Retirement benefit obligations	(18)	(108)	(126)
Other payables	(55)	10	(45)
Deferred tax liabilities	(131)	(358)	(489)
Provisions	(96)	-	(96)
	(1,648)	**(478)**	**(2,126)**
Net assets	**10,281**	**(86)**	**10,195**
Equity			
Ordinary share capital	9	-	9
Share premium	375	-	375
Translation reserve	1,460	-	1,460
Other reserves	2,913	(1)	2,912
Retained earnings	5,524	(85)	5,439
Total equity	**10,281**	**(86)**	**10,195**

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Consolidated statement of cash flows – IFRS format
Year ended 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Operating profit	341	192	533
Depreciation and amortisation charges	1,388	(200)	1,188
Loss on disposal of non-current assets	2	-	2
Increase in inventory	(2)	-	(2)
Increase in trade and other receivables	(84)	4	(80)
Increase in trade and other payables	98	(1)	97
(Decrease)/increase in provisions	12	(3)	9
Income taxes paid	(15)	-	(15)
Other non-cash movements	-	8	8
Net cash from operating activities	**1,740**	-	**1,740**
Purchase of property, plant and equipment	(1,287)	144	(1,143)
Purchase of intangible assets	(60)	(144)	(204)
Investment in joint ventures	(2)	-	(2)
Dividends received from associated undertakings	7	-	7
Net cash used in investing activities	**(1,342)**	-	**(1,342)**
Net proceeds from issue of ordinary share capital	24	-	24
Purchase of own shares	(1)	-	(1)
Settlement of cross-currency swaps	22	-	22
Repayment of borrowings including finance leases	(21)	-	(21)
Settlement of forward foreign exchange contracts	(32)	-	(32)
Management of other financial assets	(302)	316	14
Interest paid	(68)	-	(68)
Interest received	28	2	30
Premium paid to shareholders in capital reorganisation	(15)	-	(15)
Costs of capital reorganisation	(15)	-	(15)
Net cash used in financing activities	**(380)**	**318**	**(62)**
Net increase in cash and cash equivalents	**18**	**318**	**336**
Cash and cash equivalents at start of year	23	645	668
Exchange gains on cash and cash equivalents	-	5	5
Cash and cash equivalents at end of year	**41**	**968**	**1,009**

The main IFRS transitional effects presented by the Group in its consolidated statement of cash flows for the year ended 31 March 2005 were:

- under UK GAAP "Management of financial assets " included deposits that under IFRS should be classified as part of "Cash and cash equivalents" because they form an integral part of the Group's cash management; and
- under IFRS certain cash outflows in relation to purchases of intangible assets have been reclassified from purchases of property, plant and equipment.

38. Description of consolidated International Financial Reporting Standards adjustments (continued)

Transition consolidated balance sheet – IFRS format
As at 1 April 2004

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Non-current assets			
Property, plant and equipment	3,996	(530)	3,466
Goodwill	3,189	-	3,189
Other intangible assets	4,165	517	4,682
Derivative financial instruments	-	56	56
Investments in joint ventures and associated undertakings	5	-	5
	11,355	43	11,398
Current assets			
Inventory	84	-	84
Trade and other receivables	943	(4)	939
Derivative financial instruments	-	2	2
Other financial assets	993	(645)	348
Cash and cash equivalents	23	645	668
	2,043	(2)	2,041
Current liabilities			
Borrowings	(53)	(16)	(69)
Derivative financial instruments	-	(1)	(1)
Trade and other payables	(1,616)	12	(1,604)
Current tax liabilities	(9)	-	(9)
Provisions	(26)	-	(26)
	(1,704)	(5)	(1,709)
Net current assets	339	(7)	332
Total assets less current liabilities	11,694	36	11,730
Non-current liabilities			
Borrowings	(1,328)	(58)	(1,386)
Retirement benefit obligations	(16)	(89)	(105)
Trade and other payables	(47)	11	(36)
Deferred tax liabilities	(137)	(358)	(495)
Provisions	(72)	-	(72)
	(1,600)	(494)	(2,094)
Net assets	10,094	(458)	9,636
Equity			
Ordinary share capital	9	-	9
Share premium	3	-	3
Other reserves	11,074	(2)	11,072
Translation reserve	1,392	-	1,392
Retained earnings	(2,384)	(456)	(2,840)
Total equity	10,094	(458)	9,636

39. Description of Company International Financial Reporting Standards adjustments

The Company has chosen adopt IFRS as its primary basis of accounting for the 10 months ending 31 January 2006 in place of UK GAAP. The financial statements for the period to 31 March 2005 were prepared and presented in accordance with UK GAAP. The following note describes the adjustments made to these previous reported UK GAAP figures.

Transition date

The Group's transition date, being the beginning of the earliest period for which full comparative information is presented in accordance with IFRS, is 1 April 2004 in accordance with IFRS 1 "First time adoption of International Financial Reporting Standards". As the Company was not incorporated at this date, no transitional balance sheet has been prepared. The first set of financial statements of the Company prepared were for the period from 10 December 2004 (the date of incorporation) to 31 March 2005 and accordingly the description of adjustments reconcile these previously reported financial statements only.

IFRS 1 transition exemptions

IFRS 1 prescribes how the Company should apply IFRS for the first time in preparing its consolidated financial statements. In general, the accounting policies expected to be adopted by the Company at 31 January 2006 should be applied retrospectively in preparing the transition balance sheet at 1 April 2004 and in all subsequent periods.

IFRS 1 contains certain exemptions from the requirements to fully adopt IFRS in the opening balance sheet. As the Company has not prepared a transitional balance sheet these exemptions are not relevant.

Reconciliation of UK GAAP to IFRS retained loss for the period ended 31 March 2005 and equity at 31 March 2005.

	Adjustment reference	From incorporation on 10 December 2004 to 31 March 2005 £m
Retained loss		
Retained loss reported under UK GAAP		(195)
Pensions	1	(1)
De-recognition of dividends	3	196
Loss for the period attributable to equity shareholders restated under IFRS		-
Equity	**Adjustment reference**	**As at 31 March 2005 £m**
As reported under UK GAAP		6,902
Restatement of investments to fair value	2	3,767
Pensions	1	(17)
De-recognition of employee benefit trust	4	1
De-recognition of dividends	3	196
Restated under IFRS		10,849

39. Description of Company International Financial Reporting Standards adjustments (continued)

The major areas of difference between UK GAAP and IFRS which impact the Company's retained loss and equity comprise the following:

Adjustment 1 – Pensions

In accordance with IAS 19 "Employee benefits", on transition to IFRS the Company has elected to recognise the net deficit of its defined benefit pension schemes on its balance sheet. Thereafter, the Company has elected to recognise actuarial gains and losses in full in the statement of recognised income and expense, rather than in the income statement, in the period in which they arise.

The impact on the Company's income statement of the adoption of IAS 19 is as follows:

	Year ended 31 March 2005 £m
Pension costs – administrative expenses	(1)
	(1)
Actuarial losses – in statement of total recognised income and expense	(16)

The operating charge included within administrative expenses under IAS 19 represents the current service cost. The actuarial losses arise on experience adjustments (being the effects of the differences between the previous actuarial assumptions and what has actually occurred) and the impact of changes in actuarial assumptions.

The pension deficit recognised on the Company's balance sheet is as follows:

	At 31 March 2005 £m
Retirement benefit obligations	(103)

As the Company became the sponsoring employer of the O2 PP Defined Benefit Scheme from 14 March 2005 the transfer of the pension deficit from the previous sponsoring employer (mmO2 plc) at this date generated the following balances:

	At 31 March 2005 £m
Trade and other receivables - amounts owed to subsidiary	107
Trade and other payables – other payables	(21)

39. Description of Company International Financial Reporting Standards adjustments (continued)

Adjustment 2 – Restatement of investments to fair value

Under IAS 27 ("Consolidated and Separate Financial statements") the total cost of the investment that the Company has in mmO2 plc is the fair value of the mmO2 plc shares at the date of purchase. Under UK GAAP, the Company's carrying value of the investment in mmO2 plc is based on the nominal value of the shares issued. Accordingly under IFRS the investment held in mmO2 plc is recorded at the market price on the purchase date of 125 pence per share rather than the nominal 80 pence per share under UK GAAP. This higher value results in a higher investment value under IFRS. The related credit is recorded within "other reserves".

	At 31 March 2005
	£m
Investments	3,767

Adjustment 3 - Dividends

Under IAS 10 "Events after the balance sheet date", if an entity declares a dividend after the balance sheet date, the entity shall not recognise that dividend as a liability at the balance sheet date.

The dividend declared by the Company in May 2005 totalling £196 million is not recognised in the period ended 31 March 2005 under IFRS but is recognised under UK GAAP. The impact on the Company's balance sheet is as follows:

	At 31 March 2005
	£m
Trade and other payables: other payables	196

Adjustment 4 – De-recognition of Employee Benefit Trust

The Company is the sponsoring employer of an Employee Benefit Trust ("the Trust"). UK GAAP requires consolidation of the Trust whereby the individual assets and liabilities of such a trust are treated as if they were assets and liabilities of the sponsoring employer itself. Under IFRS the Trust is consolidated as a separate entity into the Group results and not included in the Company results.

The following balance sheet amounts have been de-recognised under IFRS:

	At 31 March 2005
	£m
Own shares held by Trust	(1)
Investments – Trust investment	(4)
Cash and cash equivalents	(3)
Borrowings - owed to subsidiaries	4
Trade and other payables – owed to subsidiaries	4
	-

39. Description of Company International Financial Reporting Standards adjustments (continued)

Statement of recognised income and expense – IFRS format
From incorporation 10 December 2004 to 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Actuarial losses on defined benefit pension plans	-	(16)	(16)
Net expense recognised directly in reserves	-	**(16)**	**(16)**
Profit /(loss) for the period attributable to equity shareholders	1	(1)	-
Total recognised income/(losses) relating to the period	**1**	**(17)**	**(16)**

Balance sheet – IFRS format
As at 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Non-current assets			
Investments in subsidiary undertakings	7,116	3,763	10,879
Current assets			
Trade and other receivables	1	107	108
Cash and cash equivalents	3	(3)	-
	4	**104**	**108**
Current liabilities			
Trade and other payables	(200)	179	(21)
Net current (liabilities) / assets	**(196)**	**283**	**87**
Total assets less current (liabilities) / assets	**6,920**	**4,046**	**10,966**
Non-current liabilities			
Borrowings	(18)	4	(14)
Retirement benefit obligations	-	(103)	(103)
	(18)	**(99)**	**(117)**
Net assets	**6,902**	**3,947**	**10,849**
Equity			
Ordinary share capital	9	-	9
Share premium	375	-	375
Other reserves	-	3,767	3,767
Retained earnings	6,518	180	6,698
Total equity	**6,902**	**3,947**	**10,849**

O2 plc
Definitions

The following definitions apply throughout this document unless the context requires otherwise:

"Airwave"	A secure TETRA communications system for the emergency services and other Public Safety Users.
"ARPU"	Average Revenue Per User.
"GSM"	The Global System for Mobile communications. Originally defined as a pan-European standard for digital cellular telephone networks to support roaming, it is now one of the world's main digital mobile standards.
"HSDPA"	High Speed Downlink Packet Access, widely regarded as the next enhancement to 3G, also referred to as superfast 3G.
"IFRS"	International Financial Reporting Standards.
"Manx Telecom"	Manx Telecom Limited, a company incorporated in the Isle of Man with registered number 28059.
"mmO2"	mmO2 plc, a company incorporated in England and Wales with registered number 4190833.
"O2 Ordinary Shares", O2 shares" or "ordinary shares"	Ordinary shares of 0.1 pence each in the capital of O2 plc.
"O2"	O2 plc, a company incorporated in England and Wales with registered number 5310128 or, where the context requires, a reference to its subsidiaries or associated undertakings.
"O2 Group"	O2 plc and its subsidiary undertakings from time to time.
"O2 Airwave"	Airwave O2 Limited, a company incorporated in England and Wales with a registered number 3985643.
"O2 Germany"	O2 (Germany) GmbH & Co. OHG, a company incorporated in Germany.
"O2 Ireland"	O2 Communications (Ireland) Limited, a company incorporated in Ireland.
"O2 UK"	O2 (UK) Limited, a company incorporated in England and Wales with registered number 1743099.
"SAC"	Subscriber Acquisition Cost.
"SMS"	A service sometimes known as text messaging, which enables mobile telephone users to send and receive written messages on their handsets.
"Tchibo Mobilfunk"	Tchibo Mobilfunk GmbH & Co KG, a company incorporated in Germany.
"Telefónica"	Telefónica, S.A., a company incorporated in Spain.
"Telefónica Offer"	A recommended cash offer made on behalf of Telefónica for the entire issued and to be issued share capital of O2. Shareholders were offered £2 cash or a Loan Note Alternative for every one O2 Share which they held in the Company. The Telefónica Offer was declared wholly unconditional on 23 January 2006.

O2 plc
Definitions

"Tesco Mobile"	Tesco Mobile Limited, a company incorporated in England and Wales with registered number 4780736.
"TETRA"	Terrestrial Trunked Radio. Radio technology used in networks that require a high level of security and availability.
"UMTS"	Universal Mobile Telecommunications System. An international standard of third generation, or 3G, mobile telecommunications.
"we" or "us" or "our"	O2 and/or, if the context so requires, one or more members of the O2 Group.