Magyar Telekom Plc.
Form 6-K
April 18, 2011

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934

Report on Form 6-K dated April 18, 2011

Magyar Telekom Plc.

(Translation of registrant s name into English)

Budapest, 1013, Krisztina krt. 55, Hungary

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F x Form 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No x

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-

Magyar Telekom Telecommunications

Public Limited Company

Consolidated Annual Report

FOR THE YEAR ENDED DECEMBER 31, 2010

Magyar Telekom Telecommunications

Public Limited Company

Consolidated Financial Statements

FOR THE YEAR ENDED DECEMBER 31, 2010

Prepared in accordance with

International Financial Reporting Standards (IFRS)

MAGYAR TELEKOM

INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF MAGYAR TELEKOM PLC.

PricewaterhouseCoopers Kft.
H-1077 Budapest
Wesselényi u. 16.

H-1438 Budapest, P.O.Box 517
HUNGARY

Telephone: (36-1) 461-9100
Facsimile: (36-1) 461-9101
Internet: www.pwc.com/hu

INDEPENDENT AUDITOR S REPORT

To the Shareholders of Magyar Telekom Nyrt.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Magyar Telekom Nyrt. (the Company), which comprise the consolidated statement of financial position as of 31 December 2010 (in which total of statement of financial position is HUF 1,109,006 million and the total comprehensive income for the year is HUF 84,008 million) the consolidated statements of comprehensive income, consolidated statements of changes in equity, and the consolidated statements of cash flows, for the year then ended and the notes to the consolidated financial statements including a summary of the significant accounting policies and other explanatory information.

Management s Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor s Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Hungarian Standards on Auditing and with applicable laws and regulations in force in Hungary. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

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

Opinion

During our work we have audited the components and disclosures along with the underlying accounting records and supporting documentation in the consolidated financial statements of Magyar Telekom Nyrt. in accordance with Hungarian Standards on Auditing and, on the basis of our audit work, we have gained sufficient and appropriate evidence that the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. In our opinion, the accompanying financial statements give a true and fair view of the financial position of Magyar Telekom Nyrt. as of 31 December 2010, and of the results of its operation for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Other reporting requirements regarding the business report

We have examined the accompanying consolidated business report of Magyar Telekom Nyrt. (the Company) for the financial year of 2010.

Management is responsible for the preparation of the consolidated business report which is consistent with the consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU. Our responsibility is to assess whether or not the accounting information disclosed in the consolidated business report is consistent with that contained in the consolidated financial statements.

Our work in respect of the consolidated business report was limited to checking it within the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. In our opinion the 2010 consolidated business report is consistent with the disclosures in the consolidated financial statements as of 31 December 2010.

Budapest, March 7, 2011

/s/ Manfred Krawietz
Manfred Krawietz
Partner
PricewaterhouseCoopers Kft.
1077 Budapest, Wesselényi u. 16.
License Number: 001464

/s/ Hegedüsné Szücs Márta
Hegedüsné Szücs Márta
Statutory auditor
Licence number: 006838

Note:

Our report has been prepared in Hungarian and in English. In all matters of interpretation of information, views or opinions, the Hungarian version of our report takes precedence over the English version.

MAGYAR TELEKOM

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	At December 31, 2009	2010	2010 (Note 2.1)
		(in HUF millions)		(million USD)
ASSETS				
Current assets				
Cash and cash equivalents	6	34,270	15,841	76
Trade and other receivables	7	110,353	114,625	549
Other current financial assets	8.1	87,611	56,560	271
Current income lax receivable	9.1	4,075	1,804	9
Inventories	10	9,783	9,592	46
Non current assets held for sale	11	3,269	2,152	10
Total current assets		249,366	200,574	961
Non current assets				
Property, plant and equipment	12	550,745	549,752	2,635
Intangible assets	13	335,615	332,993	1,596
Investments in associates and joint ventures	14	186	77	
Deferred tax assets	9.4	1,890	913	4
Other non current financial assets	8.2	27,682	24,033	115
Other non current assets	15	893	664	3
Total non current assets		917,011	908,432	4,354
Total assets		1,166,377	1,109,006	5,315
LIABILITIES				
Current liabilities				
Financial liabilities to related parties	16	70,573	72,208	346
Other financial liabilities	17	36,332	46,647	224
Trade payables	18	85,874	86,613	425
Current income tax payable	9.1	624	661	3
Provisions	19	12,692	7,722	37
Other current liabilities	20	32,228	30,966	148
Total current liabilities		238,323	246,817	1,183
Non current liabilities				
Financial liabilities to related parties	16	266,998	234,164	1,122
Other financial liabilities	17	26,221	8,828	42
Deferred tax liabilities	9.4	18,594	10,924	52
Provisions	19	9,721	12,298	59
Other non current liabilities	21	1,100	1,263	6
Total non current liabilities		322,634	267,477	1,282
Total liabilities		560,957	514,294	2,465
EQUITY				
Equity of the owners of the parent				
Common stock		104,275	104,275	500
Additional paid in capital		27,379	27,379	131
Treasury stock		(1,179)	(307)	(1)

Retained earnings	398,250	385,283	1,847
Accumulated other comprehensive income	9,755	14,882	71
Total Equity of the owners of the parent	538,480	531,512	2,547
Non-controlling interests	66,940	63,200	303
Total equity	605,420	594,712	2,850
Total liabilities and equity	1,166,377	1,109,006	5315

These consolidated financial statements were authorized for issue by the Board of Directors on February 24, 2011 and signed on their behalf by:

Christopher Mattheisen Chairman and Chief Executive Officer	ThiloKusch Chief Financial Officer

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

MAGYAR TELEKOM

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Note	2008	2009	2010	2010 (Note 2.1) (million USD)
		For the year ended December 31, (in HUF millions, except per share amounts)			
Revenue	22	673,056	643,989	609,579	2,922
Expenses directly related to revenues	23	(167,558)	(160,576)	(157,427)	(755)
Employee related expenses	24	(100,320)	(101,918)	(93,884)	(450)
Depreciation and amortization		(106,120)	(101,920)	(100,872)	(483)
Other operating expenses	25	(141,049)	(135,305)	(148,750)	(713)
Operating expenses		(515,047)	(499,719)	(500,933)	(2,401)
Other operating income	26	4,249	2,863	3,448	17
Operating profit		162,258	147,133	112,094	537
Interest income	27	7,227	8,526	4,938	24
Interest expense	28	(33,188)	(33,465)	(23,784)	(114)
Other finance expense - net	29	(4,347)	(7,874)	(9,267)	(44)
Net financial result		(30,308)	(32,813)	(28,113)	(135)
Share of associates and joint ventures profits / (losses)	14	1,341	(109)	(27)	
Profit before income tax		133,291	114,211	83,954	402
Income tax expense	9.2	(27,698)	(20,958)	(6,583)	(32)
Profit for the year		105,593	93,253	77,371	371
Exchange differences on translating foreign operations		8,851	6,159	6,617	32
Revaluation of available-for-sale financial assets before tax		(348)	(6)	20	
Revaluation of available-for-sale financial assets tax effect		35			
Other comprehensive income for the year, net of tax		8,538	6,153	6,637	32
Total comprehensive income for the year		114,131	99,406	84,008	403
Profit attributable to:					
Owners of the parent		93,008	77,618	64,378	309
Non-controlling interests		12,585	15,635	12,993	62
		105,593	93,253	77,371	371
Total comprehensive income attributable to:					
Owners of the parent		99,316	81,586	69,505	333
Non-controlling interests		14,815	17,820	14,503	70
		114,131	99,406	84,008	403
Earnings per share (EPS) information:					
Profit attributable to the owners of the Company		93,008	77,618	64,378	309
		1,041,242	1,041,241	1,041,290	1,041,290

Weighted average number of common stock outstanding (thousands) used for basic and diluted EPS				
Basic and diluted earnings per share (HUF and USD)	89.32	74.54	61.83	0.30

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

MAGYAR TELEKOM

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Note	2008	2009	2010	2010 (Note 2.1)
		For the year ended December 31, (in HUF millions)			(million USD)
Cashflows from operating activities					
Profit for the year		105,593	93,253	77,371	371
Depreciation and amortization		106,120	101,920	100,872	483
Income tax expense		27,698	20,958	6,583	32
Net financial result		30,308	32,813	28,113	135
Share of associates and joint ventures profits / (losses)		(1,341)	109	27	
Change in assets carried as working capital		1,481	(1,427)	(8,364)	(40)
Change in provisions		(10,265)	(3,918)	(4,194)	(20)
Change in liabilities carried as working capital		1,886	(4,231)	(3,009)	(14)
Income tax paid		(20,768)	(16,053)	(11,419)	(55)
Dividend received		127	2,149	95	
Interest and other financial charges paid		(34,119)	(38,627)	(27,426)	(131)
Interest received		7,923	8,453	4,919	24
Other cashflows from operations		(4,354)	(1,604)	1,102	5
Net cash generated from operating activities		210,289	193,795	164,670	789
Cashflows from investing activities					
Purchase of property plant and equipment (PPE) and intangible assets	30	(116,039)	(110,228)	(87,300)	(418)
Purchase of subsidiaries and business units	31	(762)	(5,193)	(1,534)	(7)
Cash acquired through business combinations			460	6	
(Payments for) / Proceeds from other financial assets net		(4,075)	(18,547)	34,327	165
Proceeds from disposal of subsidiaries and associates	26	1,233	2,074	780	4
Proceeds from disposal of PPE and intangible assets		6,194	1,135	873	4
Net cash used in investing activities		(113,449)	(130,299)	(52,848)	(253)
Cashflows from financing activities					
Dividends paid to shareholders and Non-controlling interest		(95,343)	(93,640)	(91,819)	(440)
Proceeds from loans and other borrowings		143,014	190,617	190,797	914
Repayment of loans and other borrowings		(126,901)	(193,537)	(229,545)	(1,100)
Change in Non-Controlling interests				(22)	
Net cash used in financing activities		(79,230)	(96,560)	(130,589)	(626)
Exchange gains on cash and cash equivalents		1,404	654	338	2
Change in cash and cash equivalents		19,014	(32,410)	(18,429)	(88)
Cash and cash equivalents, beginning of year		47,666	66,680	34,270	164
Cash and cash equivalents, end of year	6	66,680	34,270	15,841	76

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

MAGYAR TELEKOM

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	pieces						**In HUF millions**				
	Shares of common stock (a)	**Common stock (a)**	**Additional paid in capital (b)**	**Treasury stock (c)**	**Retained earnings (d)**	**Cumulative translation adjustment (e)**	**Revaluation reserve for AFS financial assets net of tax (f)**	**Reserve for equity settled share based transactions (g)**	**Equity of the owners of the parent**	**Non-controlling interests (h)**	**To**
Balance at December 31, 2007	1,042,745,615	104,275	27,379	(1,179)	381,727	(688)	118	49	511,681	66,217	
Dividend (i)					(77,051)				(77,051)		
Dividend declared to Non-controlling interests (j)										(18,431)	
Total comprehensive income for the year					93,008	6,485	(177)		99,316	14,815	
Balance at December 31, 2008	1,042,745,615	104,275	27,379	(1,179)	397,684	5,797	(59)	49	533,946	62,601	
Dividend (i)					(77,052)				(77,052)		
Dividend declared to Non-controlling interests (j)										(13,481)	
Reduction in capital as a result of merger with T-Kábel and Dél-Vonal (k)	(3,072)										
Total comprehensive income for the year					77,618	3,971	(3)		81,586	17,820	
Balance at December 31, 2009	1,042,742,543	104,275	27,379	(1,179)	398,250	9,768	(62)	49	538,480	66,940	
Dividend (i)					(77,053)				(77,053)		
Dividend declared to Non-controlling interests (j)										(18,243)	
Share based compensation program (l)				872	(292)				580		

Total comprehensive income for the year					64,378	5,165	11	(49)	69,505	14,503
Balance at December 31, 2010	1,042,742,543	104,275	27,379	(307)	385,283	14,933	(51)		531,512	63,200
Of which treasury stock	(390,862)									
Shares of common stock outstanding at December 31, 2010	1,042,351,681									

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

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(a) The total amount of issued shares of common stock of 1,042,742,543 (each with a nominal value of HUF 100) is fully paid as at December 31, 2010. The number of authorized ordinary shares on December 31, 2010 is 1,042,742,543.

(b) Additional paid in capital represents the amount above the nominal value of the shares that was received by the Company during capital increases.

(c) Treasury stock represents the cost of the Company s own shares repurchased.

(d) Retained earnings include the accumulated and undistributed profit of the Group. The distributable reserves of the Company under Hungarian law at December 31, 2010 amounted to approximately HUF 253,793 million (HUF 266,149 million at December 31, 2009).

(e) Cumulative translation adjustment represents the foreign exchange differences arising on the consolidation of foreign subsidiaries.

(f) Revaluation reserve for available-for-sale (AFS) financial assets includes the unrealized gains and losses net of tax on available-for-sale financial assets.

(g) Reserve for equity settled share based transactions includes the compensation expenses accrued in this reserve related to share settled compensation programs. The December 31, 2009 balance of this reserve of HUF 49 million represented the amount reserved for the 103,530 options (granted in 2000) to Magyar Telekom s ex-CEO. Since these options lapsed unexercised in 2010, the balance of the reserve was released to Profit for the year in 2010 (Note 24.2).

(h) Non-controlling interests represent the Non-controlling shareholders share of the net assets of subsidiaries, in which the Group has less than 100% ownership.

(i) In 2010, 2009 and 2008 Magyar Telekom Plc. declared HUF 74 dividend per share.

(j) The amount of dividends declared to Non-controlling interests includes predominantly the dividends declared to the Non-controlling owners of Makedonski Telekom (MKT) and Crnogorski Telekom (CT), the Group s subsidiaries.

(k) In 2009 Magyar Telekom Plc. merged with T-Kábel and Dél-Vonal, its 100% subsidiaries. During the merger, the owners of 3,072 shares expressed their intention not to participate as owners in the merged Company. Consequently, the Company withdrew these shares and settled with these owners with a corresponding decrease in Common stock, Additional paid in capital and Retained earnings. These amounts did not exceed HUF 1 million. The merged Company was registered with 3,072 less shares as of September 30, 2009.

(l) In 2010 Magyar Telekom launched a share allocation program under which Magyar Telekom shares were awarded to the Company s selected employees. In total, 1,112,679 treasury shares were granted to employees for free in December 2010. (Note 24.3). The fair value of the treasury shares at the grant date was HUF 580 million, which was recognized as employee expense in 2010. The loss on the re-issuance of the treasury shares (measured as the difference between the original cost of re-acquisition and the grant date stock exchange price of the treasury shares) was recognized in Retained earnings in an amount of HUF 292 million.

Together with the approval of these financial statements for issue, the Board of the Company proposes a HUF 50 per share dividend distribution (in total HUF 52,118 million) to be approved by the Annual General Meeting of the Company in April 2011.

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

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 GENERAL INFORMATION

1.1 About the Company

Magyar Telekom Telecommunications Public Limited Company (the Company or Magyar Telekom Plc.) with its subsidiaries form Magyar Telekom Group (Magyar Telekom or the Group). Magyar Telekom is the principal supplier of telecommunications services in Hungary, Macedonia and Montenegro and alternative service provider in Bulgaria, Romania and in the Ukraine. These services are subject to various telecommunications regulations depending on the countries of operations (Note 1.3).

The Company was incorporated in Hungary on December 31, 1991 and commenced business on January 1, 1992. The Company s registered address is Krisztina körút 55, 1013 Budapest, Hungary.

Magyar Telekom Plc. is listed on the Budapest stock exchange and its shares are traded on the Budapest Stock Exchange. Magyar Telekom s American Depository Shares (ADSs) each representing five ordinary shares were also traded on the New York Stock Exchange until November 12, 2010, when the ADSs were delisted.

The immediate controlling shareholder of the Company is MagyarCom GmbH owning 59.21% of the issued shares, while the ultimate controlling parent of Magyar Telekom is Deutsche Telekom AG (DT or DTAG).

The consolidated financial statements are prepared and presented in millions of Hungarian Forints (HUF), unless stated otherwise.

These consolidated financial statements of the Company were approved for issue by the Company s Board of Directors (the Board), however, the Annual General Meeting (AGM) of the owners, authorized to accept these financials, has the right to require amendments before acceptance. As the controlling shareholders are represented in the Board of the Company that approved these financial statements for issuance, the probability of any potential change required by the AGM is extremely remote, and has never happened in the past.

On June 29, 2009, Magyar Telekom s Extraordinary General Meeting approved the merger of Magyar Telekom Plc., T-Kábel Kft. and Dél-Vonal Kft., two 100% subsidiaries of Magyar Telekom Plc. As the merger occurred between the parent company and its 100% owned subsidiaries, the transaction did not have any impact on the Consolidated financial position of the Group or its operating segments other than as disclosed in the notes to the Consolidated statements of changes in equity. The merger was registered by the Hungarian Court of Registration as of

September 30, 2009.

1.2 Investigation into certain consultancy contracts

In the course of conducting their audit of the Company s 2005 financial statements, PricewaterhouseCoopers, the Company s auditors, identified two contracts the nature and business purposes of which were not readily apparent to them. In February 2006, the Company s Audit Committee retained White & Case, as its independent legal counsel, to conduct an internal investigation into whether the Company had made payments under those, or other contracts, potentially prohibited by U.S. laws or regulations, including the U.S. Foreign Corrupt Practices Act (FCPA) or internal Company policy. The Company s Audit Committee also informed the United States Department of Justice (DOJ), the United States Securities and Exchange Commission (SEC) and the Hungarian Financial Supervisory Authority of the internal investigation.

Based on the documentation and other evidence obtained by it, White & Case preliminarily concluded that there was reason to believe that four consulting contracts entered into in 2005 were entered into to serve improper objectives, and further found that during 2006 certain employees had destroyed evidence that was relevant to the investigation. White & Case also identified several contracts at our Macedonian subsidiary that warranted further review. In February 2007, our Board of Directors determined that those contracts should be reviewed and expanded the scope of the internal investigation to cover these additional contracts and any related or similarly questionable contracts or payments.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

On December 2, 2009, the Audit Committee provided the Company s Board of Directors with a Report of Investigation to the Audit Committee of Magyar Telekom Plc. dated November 30, 2009 (the Final Report). The Audit Committee indicated that it considers that, with the delivery of the Final Report based on currently available facts, White & Case has completed its independent internal investigation.

The Final Report includes the following findings and conclusions, based upon the evidence available to the Audit Committee and its counsel:

• The information obtained by the Audit Committee and its counsel in the course of the investigation demonstrates intentional misconduct and a lack of commitment to compliance at the most senior levels of Magyar Telekom, TCG, and Makedonski Telekom during the period under investigation.

• As previously disclosed, with respect to Montenegrin contracts, there is insufficient evidence to establish that the approximately EUR 7 million in expenditures made pursuant to four consultancy contracts ... were made for legitimate business purposes , and there is affirmative evidence that these expenditures served improper purposes. These contracts were not appropriately recorded in the books and records of the Company and its relevant subsidiaries. As previously disclosed, the Company has already reclassified, in the Company s financial statements, the accounting treatment relating to certain of these contracts to more accurately account for these expenditures.

• As previously disclosed, there is evidence that certain former employees intentionally destroyed documents relating to activities undertaken in Macedonia by the Company and its affiliates.

• Between 2000 and 2006 a small group of former senior executives at the Company and the Company s Macedonian affiliates, authorized the expenditure of approximately EUR 24 million through over twenty suspect consultancy, lobbying, and other contracts (including certain contracts between the Company and its subsidiaries on one hand, and affiliates of a Cyprus-based consulting company on the other hand). The Final Report concludes that the available evidence does not establish that the contracts under which these expenditures were made were legitimate.

• The evidence shows that, contrary to their terms, a number of these contracts were undertaken to obtain specific regulatory and other benefits from the government of Macedonia. The Companies generally received the benefits sought and then made expenditures under one or more of the suspect contracts. There is evidence that the remaining contracts were also illegitimate and created a pool of funds available for purposes other than those stated on the face of the agreements.

• In entering into these contracts and approving expenditures under them, the former senior executives knowingly caused, structured, or approved transactions that shared most or all of the following characteristics:

• intentional circumvention of internal controls;

• false and misleading Company documents and records;

• lack of due diligence concerning, and failure to monitor performance of, contractors and agents in circumstances carrying a high risk of corruption;

• lack of evidence of performance; and

• expenditures that were not for the purposes stated in the contracts under which they were made, but rather were intended to obtain benefits for the Companies that could only be conferred by government action.

The Final Report states that the Investigation did not uncover evidence showing receipt of payments by any Macedonian government officials or political party officials. However, the Audit Committee s counsel did not have access to evidence that would allow it to identify the ultimate beneficiaries of these expenditures.

Nothing in the Final Report implicates any current senior executive or Board member of the Company in

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

connection with any wrongdoing.

As previously disclosed, the Company has taken remedial measures to address issues previously identified by the independent investigation. These measures included steps designed to revise and enhance the Company s internal controls as well as the establishment of the Corporate Compliance Program.

Due to these measures, no modifications to the Corporate Compliance Program were viewed as necessary in response to the Final Report. This conclusion has been discussed with the Audit Committee and the Audit Committee has not made recommendations either relating to the Company s compliance program or internal controls.

The Company is continuing to assess the nature and scope of potential legal remedies available to the Company against individuals or entities that may have caused harm to the Company.

As previously announced, the DOJ, the SEC and the Ministry of Interior of the Republic of Macedonia have commenced investigations into certain of the Company s activities that were the subject of the internal investigation. Further, in relation to certain activities that were the subject of the internal investigation, the Hungarian Central Investigating Chief Prosecutor s Office has commenced a criminal investigation into alleged corruption with the intention of violating obligations in international relations and other alleged criminal offenses. Also, as previously announced, the Hungarian National Bureau of Investigation (NBI) has begun a criminal investigation into alleged misappropriation of funds relating to payments made in connection with the Company s ongoing internal investigation and the possible misuse of personal data of employees in the context of the internal investigation. In addition, the Montenegrin Supreme State Prosecutor is also investigating the activities of the Company s Montenegrin subsidiary that were the subject of the internal investigation and has requested information from the Company s Montenegrin subsidiary in relation to the relevant contracts. These governmental investigations are continuing, and the Company continues to cooperate with these investigations.

As previously disclosed, the Company, through its external legal counsel, is engaged in discussions with the DOJ and the SEC regarding the possibility of resolving their respective investigations as to the Company through negotiated settlements. The Company has not reached any agreement with either the DOJ or the SEC regarding resolution of their respective investigations, and discussions with both agencies are continuing. We may be unable to reach a negotiated settlement with either agency. Any resolution of the investigations could result in criminal or civil sanctions, including monetary penalties and/or disgorgement, against the Company or its affiliates, which could have a material effect on the Company s financial position, results of operations or cash flows, as well as require additional changes to its business practices and compliance programs. The Company cannot predict or estimate whether or when a resolution of the DOJ or SEC investigations will occur, or the terms, conditions, or other parameters of any such resolution, including the size of any monetary penalties or disgorgement, the final outcome of these investigations, or any impact such resolution may have on its financial statements or results of operations. Consequently, the Company has not made any provisions in its financial statements as of December 31, 2010 with respect to the investigations.

1.3 Public service concession and license arrangements

Magyar Telekom s primary activities are the fixed line and mobile operations in Hungary, Macedonia and Montenegro. These services are in most cases regulated by these countries laws or other legislations. These services in most cases require the acquisition of a license or concession, which usually requires a one-off fee, which is capitalized and amortized over the original duration of license or concession, and also requires annual payments, which are recognized as Other operating expenses (included in Fees and levies) in the year the payment obligation refers to.

The most important features of the regulations of these services are described below.

1.3.1 Hungarian Fixed line

Magyar Telekom Plc. is the market leading fixed line telecom service provider in Hungary. Act C of 2003 on Electronic Communications (hereinafter: Communications Act), the latest act on the telecommunications sector, came

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

into effect on January 1, 2004. The National Media and Infocommunications Authority of Hungary (NMIAH) is the supreme supervisory body.

Universal services are basic communications services (including access to communication services at a fixed location, public payphones, directory and directory enquiry services) that should be available to all customers at an affordable price. Although Magyar Telekom Plc. was a universal service provider from 2002 to 2008, currently there is no universal service contract in effect and Magyar Telekom Plc. is not a universal service provider.

In the electronic communications field Magyar Telekom was designated as an SMP operator (a service provider with significant market power) on certain relevant markets. The current 7 relevant markets include retail and wholesale telephony and broadband services stipulated by the EU (according to the its second recommendation on the relevant markets). In 2008 the NMIAH has started the third round of market analysis. As a result of the third round market analysis, the NMIAH made a resolution on the Access to the public telephone network at a fixed location for residential and non-residential customers (Market 1) and published two draft resolutions concerning wholesale (physical) network infrastructure access (Market 4) and wholesale broadband access (Market 5).

Magyar Telekom Plc s retail tariffs are regulated in two ways: 1) there is price cap regulation based on SMP resolutions on retail residential and business markets which limits price increases of monthly fees and 2) price squeeze is prohibited as well (i.e. retail prices should be set in accordance with wholesale tariffs providing an acceptable level of retail margins).

Magyar Telekom is Hungary s leading fixed line broadband service provider in the wholesale market and one of the leading ones in the retail market. In 2005 the NMIAH designated the Company as an SMP operator on the wholesale broadband access market. In accordance with the effective resolution, all retail products shall be reproducible by competitors based on the wholesale service. Consequently, the full retail portfolio shall have a wholesale equivalent compliant to the pricing regulations (retail minus methodology) set forth by the NMIAH. The Company has a non-discrimination obligation, which means that the same terms and conditions shall be granted in terms of wholesale services to competitors under identical circumstances.

According to the Act on Electronic Communications, designated SMP operators are obliged to prepare reference offers for unbundled local loops (RUO) and to provide these services when there is a request for them by other telecommunications service providers. The reference offer of each SMP operator must be approved by the NMIAH. The pricing of these services has to be cost based and calculated according to the NMIAH resolution on the market of wholesale unbundled access to metallic loops published at the end of 2009 - by Long Run Incremental Costs (LRIC) method as opposed to using Fully Distributed Costs based on a 2003 Ministerial Decree. The SMP operators may refuse the offer for unbundling if there are technical or economic barriers or if the provision of access to the local loop or its broadband network access would endanger the integrity of the SMPs network.

SMPs are also obliged to prepare reference offers for interconnection (RIO), containing applicable fees, and to provide these services in accordance with the reference offer when there is a request for them by other telecommunications service providers. The reference offers of the

SMPs must be approved by the NMIAH, and prices have to be based on LRIC. Fees in the currently effective reference offers are applicable from April 1, 2009.

According to the Act on Electronic Communications, designated SMP operators are obliged to enable carrier selection to their subscribers. Consequently, voice telephony customers have the right to select different service providers for each call directions including Internet calls by dialing a pre-selected number or by using a call-by-call pre-fixed number. The requirements for carrier selection are set out in the RIO based interconnection agreements between the affected service providers.

Fixed line telecommunications service providers are obliged under the law to provide number portability on their networks starting January 1, 2004. This means that service providers must enable subscribers to change service provider without changing their fixed telephone numbers within the same geographical area.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1.3.2 Macedonian Fixed line

The Group is also present in the Macedonian fixed line telecommunications market through its subsidiary, Makedonski Telekom AD Skopje (MKT). MKT is the largest fixed line service provider in Macedonia. The Macedonian telecommunications sector is regulated by the Electronic Communications Law (ECL), enacted in March 2005. In December 2010 an update of the rulebooks was proposed according to the latest changes of the ECL from June 2010. Changes in Rulebook for content of data which operators of public communication networks and/or providers of public communication services are obliged to publish concerning general conditions for access and usage, prices and tariffs and parameters for quality of public communication services , and changes in the RUO and RIO rulebooks were also proposed according to changes in ECL and the new BEREC s NGN recommendation (Next Generation Network recommendation of the Body of European Regulators for Electronic Communications). On October 20, 2010 a new Rulebook for Universal service was enacted. According to the new rulebook Public call for express of interest was announced on December 1, 2010. MKT sent a letter of interest for all services in the scope of Universal service.

Based on the AEC analysis for the relevant markets 1-6 related to fixed voice retail services and the program of the Agency for Electronic Communications (Agency) for 2011, the Agency is planning to impose retail price regulation on MKT. The Agency introduced symmetrical termination rates for fixed operators and designation of Significant Market Power (SMP) for all alternative operators on market 9 for terminating calls in their networks. In the middle of 2010 the Agency introduced a Guideline for price squeeze testing. With such regulation, the Agency intends to have bigger impact on retail pricing schemes on all national operators and thus establish some basic rules regarding price squeeze issues. Regarding individual pricing offers, especially tenders, MKT is facing constant pressure from competitors and is under observation by Competition Authority and the Agency.

MKT has a cost based price obligation for the Regulated wholesale services, using Long Run Incremental Costs methodology (LRIC). During December 2010, the Agency published results from its own developed LRIC Bottom up costing model. If the results from the costing model are implemented at the beginning of 2011, it is possible that the monthly fee for Unbundled Local Loop (ULL) and interconnection rates (for origination, termination and transit), as well the monthly fees for interconnection links and collocation will have to be reduced.

Changes in by-law for bit-stream access made on June 7, 2010 resulted in decreased fees for bit-stream access and introduction of technical specifications for new services (IPTV, VoIP and VoD), therefore wholesale partners are more competitive on broadband market.

Also, new Rulebook on access and use of specific network assets was published by the Agency on December 7, 2010 according to which MKT has obligation to offer access to ducts and dark fiber.

1.3.3 Montenegrin Fixed line

The Group s Montenegrin subsidiary, Crnogorski Telekom (CT) is registered to provide fixed line telecommunications services in Montenegro as well as to provide domestic voice and data services as well as VOIP, leased line, IPTV, value added services, etc. The telecommunications sector in Montenegro is regulated by the Law on Electronic Communications (the Law) that came into force in August 2008. The Law is based on the 2002 regulatory framework of the EU. All regulations that are contrary to the Law became automatically invalid and new ones have been issued or will have to be issued.

In Montenegro, for the time being there is no obligation to introduce local loop unbundling, bit stream access or accounting separation. The Agency for Electronic Communications and Postal Services identified the relevant telecommunication markets in Montenegro identical to those defined by the EC recommendation 2007/879/EC and completed market analysis process in November 2010. As a result of the market analysis CT was recognized as an SMP operator at all seven markets, and local loop unbundling, bit stream access,wholesale leased line and carrier pre-selection are going to be introduced in Montenegro not earlier than March 2011. Carrier selection was already implemented by CT in 2008. Number portability will be introduced by the end of August 2011. RIO rates are determined by the Agency s Resolution based on benchmarks as there is no approved Cost Accounting Methodology prescribed in Montenegro.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

In December 2010 Montenegro obtained EU candidate status. In accordance with the previously signed Stabilization and Association Agreement with the EU, the harmonization of the telecommunications regulations with the regulatory framework of the EU should be completed within three years of the ratification of the Agreement that is in 2013.

1.3.4 Hungarian Mobile

The Company is also the market leader in the Hungarian mobile market through the brand T-Mobile (T-Mobile HU).

The initial duration of the concession regarding the GSM 900 public mobile radio telephone service was a period of 15 years starting from the execution of the concession agreement (November 4, 1993 to November 4, 2008). On October 7, 1999 an amended concession contract was signed between the Ministry of Transport, Communications and Water Management and T-Mobile HU extending T-Mobile HU s rights and obligations to also provide service in the 1800 MHz band in Hungary until October 7, 2014. The duration of the concession regarding the DCS 1800 public mobile radio telephone service is 15 years starting from the execution of the new concession agreement (October 7, 1999 to October 7, 2014). As stipulated in the concession contracts, the Minister is entitled to extend the concession period for both services upon their expiration for another 7.5 years without the invitation of a tender. On November 8, 2007, the Company signed the renewed Concession Contract along with the Cooperation Agreement with the Minister that is effective from November 2008. The new Concession Contract prolonged the duration of the 900 MHz frequency usage right until May 4, 2016.

On December 7, 2004, T-Mobile HU obtained the exclusive right of use of certain frequency blocks for the deployment and operation of an IMT2000/UMTS mobile telecommunications system (3G system). The duration of the frequency usage right is 15 years (until December 7, 2019) with an option to extend it for another 7.5 years. On August 26, 2005 T-Mobile HU started to provide 3G service and has been operating it in compliance with the license conditions.

T-Mobile HU is subject to number portability regulation since 2004, applicable only in case of other mobile operators.

In 2005 and 2006 the NMIAH designated T-Mobile HU as having significant market power in the mobile wholesale call termination market, and it is currently subject to regulatory obligations regarding the termination charge of calls into its network. In December 2008 the NMIAH designated T-Mobile HU as an SMP for the third time in a row and in its resolution reinforced the symmetric mobile termination fees applicable from January 1, 2009, and set out further reduction of tariffs until December 2010 based on a new glide path . The Company had appealed in court against the resolution.

Since June 30, 2007, an EU regulation has been regulating international roaming tariffs for wholesale and retail customers on the basis of a price cap system. The Regulation prescribed a glide-path that mandates further annual reductions of wholesale and retail prices in the forthcoming years. As of July 2009 the EU introduced regulated tariffs for SMS and data roaming similarly to the regulation of voice roaming.

It is expected that a tender will be issued for the 4th GSM/UMTS spectrum in the course of the implementation of the modified GSM Directive (2009/114/EC Directive, on the frequency bands to be reserved for the coordinated introduction of public pan-European cellular digital land-based mobile communications) in the second half of 2011. EU Member States had 6 months to transpose the modified GSM Directive into their national legislation by May 9, 2010. Due to the fact that Hungary did not implement the revised GSM Directive by the set deadline, the Commission sent a letter of formal notice on September 20, 2010 to the Hungarian Government calling for the transposition of the Directive.

T-Mobile HU won a tender for a spectrum usage right license for a 26 GHz block on April 30, 2009.

The negotiations with the Ministry/NMIAH on the full revision of the frequency usage fees for mobile radiotelephony frequency bands started in August 2010, and ended in September, aiming at introducing the band fee concept instead of the frequency usage proportional TRX-based frequency usage fees. The official publication of the modification of the frequency fee decree has not happened yet, but it is expected to be published soon.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1.3.5 Macedonian Mobile

T-Mobile Macedonia (T-Mobile MK), Magyar Telekom s subsidiary, is the leading mobile service provider in Macedonia. With the changes of the Electronic Communications Law (ECL) published on August 4, 2008, the existing Concession Contract of T-Mobile MK ceased to be valid as of August 5, 2008. On September 5, 2008 the Agency for Electronic Communications, ex officio, issued a notification to T-Mobile MK for those public electronic communication networks and/or services which have been allocated thereto under the Concession Contracts. The license for radiofrequencies used by T-Mobile MK with a bandwidth of 25 MHz in the GSM 900 band, was also issued in a form regulated in the ECL with a validity period until September 5, 2018, which can be renewed up to an additional 20 years in accordance with the ECL.

After the analysis of the market 16 Call termination services in public mobile communication networks the Agency on November 26, 2007 brought a decision by which T-Mobile MK and Cosmofon (competitor of T-Mobile MK, rebranded to ONE in November 2009) were designated with SMP status on Market 16. T-Mobile MK published a RIO with regulated termination rate effective from August 1, 2008. Second round analysis of Market 16 was concluded on May 14, 2010 and the third mobile operator VIP Operator (subsidiary of Mobilkom Austria) was designated as SMP on Market 16 on May 18, 2010.

Based on the second round analysis on Market 16 published by the Agency on May 14, 2010, on July 30, 2010 T-Mobile MK received a Decision for changing the RIO by which the mobile termination rate (MTR) has been defined with a glide path decrease in a four years time frame (until 2013). At the same time the Agency regulated the MTR s for ONE and VIP with a respective 4 year glide path but introducing asymmetry between all three mobile operators which will lead to equal termination rates in September 2013. In August 2010 T-Mobile MK initiated a procedure before the Administrative Court to dispute the decision of the Agency arguing against the lowering of the MTR as well as against unjustified asymmetry. The administrative procedure has not started yet.

On July 7, 2010 the Agency concluded market analysis on Market 15 (Service for access and call initiation in the public mobile communication networks) and on July 28, 2010 brought a decision by which T-Mobile MK was designated with SMP status on Market 15. As a result of the SMP designation, T-Mobile MK was obliged to prepare and publish Referent Access Offer (RAO). T-Mobile MK submitted the offer to the Agency on August 28, 2010 and it was approved on November 29, 2010. On August 30, 2010 T-Mobile MK initiated a procedure before the Administrative Court challenging this decision of the Agency for designating T-Mobile MK as SMP on Market 15. The administrative procedure has not started yet.

On September 2, 2008 a decision for granting three 3G licenses was published. T-Mobile MK started commercial operations of the 3G services on June 11, 2009. The validity of the license is 10 years i.e. December 17, 2018, with a possibility for extension for 20 years in accordance with the ECL.

In December 2010 four bylaws, for General terms, RIO provisions, LRIC calculation for mobile operators and for specific network elements, were published for public debate. The new provisions in the bylaws are not in favor of T-Mobile MK but they will be subject to public debate and possible revision by the Agency.

In January 2011 the Agency officially published the draft market analysis for SMS termination.

1.3.6 Montenegrin Mobile

Crnogorski Telekom, the Group s Montenegrin subsidiary is also providing mobile services under the T-Mobile brand (T-Mobile CG). CT is registered as one of three GSM/UMTS providers in Montenegro. T-Mobile CG, as the second mobile operator, was launched in 2000. The third mobile operator entered the market in 2007. T-Mobile CG started 3G operations in 2007.

As a result of the market analysis of the Agency (Note 1.3.3) T-Mobile CG is designated as an SMP in the market of termination of voice calls in its own network. Interconnect rates have been determined by the Regulator based on benchmarks. Number portability will be introduced by August 2011 also in the mobile the sector.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The new Mobile Country Code 297 (assigned to Montenegro after independence) has to be introduced by October 1, 2011 and consequently current SIM cards need to be changed. Montenegrin mobile operators have to register all prepaid customers by June 1, 2011.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The consolidated financial statements of Magyar Telekom have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU). All standards and interpretations issued by the International Accounting Standards Board (IASB) effective at the time of preparing the consolidated financial statements and applicable to Magyar Telekom have been endorsed by the EU. Therefore the consolidated financial statements currently also comply with IFRS as issued by the IASB and also comply with the Hungarian Accounting Law on consolidated financial statements, which refers to the IFRS as endorsed by the EU.

The consolidated financial statements are presented in millions of HUF. For the convenience of the reader, the consolidated Statement of financial position, Statement of comprehensive income and Statement of cash flows for the year 2010 are also presented in millions of U.S. dollars (USD) translated at a rate of HUF 208.65 to USD 1 (the official rate of the National Bank of Hungary at December 31, 2010). These translations are supplementary information, and are not in compliance with IFRS.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

2.1.1 Standards, amendments and interpretations effective and adopted by the Group in 2010

• IAS 27, IFRS 3 (amended). In January 2008 the IASB published the amended Standards IFRS 3 - Business Combinations and IAS 27 - Consolidated and Separate Financial Statements. The major changes compared to the previous version of the standards are summarized below:

• With respect to accounting for non-controlling interest an option is added to IFRS 3 to permit an entity to recognize 100% of the goodwill of the acquired entity, not just the acquiring entity s portion of the goodwill (full goodwill option) or to measure non-controlling interest at its fair value. This option may be elected on a transaction-by-transaction basis.

- In a step acquisition, the fair values of the acquired entity s assets and liabilities, including goodwill, are measured on the date when control is obtained. Accordingly, goodwill is measured as the difference at the acquisition date between the fair value of any investment the business held before the acquisition, the consideration transferred and the fair value of the net asset acquired. Even if the total ownership does not reach 100% as a result of the acquisition, the Group can elect to recognize 100% of the goodwill of the acquired entity, not just the Group s portion of the goodwill, consequently, the balance of the non-controlling interests can be measured at fair value at the acquisition date. Alternatively, the goodwill recognized may only represent the proportionate ownership acquired, consequently, the measurement of non-controlling interests at the acquisition date can exclude their share of the goodwill.

- A partial disposal of an investment in a subsidiary while control is retained is accounted for as an equity transaction with owners, and gain or loss is not recognized.

- A partial disposal of an investment in a subsidiary that results in loss of control triggers re-measurement of the residual interest to fair value. Any difference between fair value and carrying amount is a gain or loss on the disposal, recognized in profit or loss.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

- Acquisition related costs are accounted for separately from the business combination, and therefore, recognized as expenses rather than included in goodwill. An acquirer has to recognize at the acquisition date a liability for any contingent purchase consideration. If the amount of contingent consideration accounted for as a liability changes as a result of a post-acquisition event (such as meeting an earnings target), it is recognized in accordance with other applicable IFRSs, as appropriate rather than as an adjustment of goodwill.

- The revised standards require an entity to attribute their share of losses to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

- Effects resulting from an effective settlement of pre-existing relationships (relationships between acquirer and acquiree before the business combination) must not be included in the determination of the consideration.

- In contrast to the original IFRS 3, the amended version of this standard provides rules for rights that have been granted to the acquiree (e.g. to use its intellectual property) before the business combination and are re-acquired with the business combination.

- The revised IFRS 3 brings into scope business combinations involving only mutual entities and business combinations achieved by contracts alone.

The Group adopted the amended versions of IFRS 3 and IFRS 27 as of January 1, 2010. The amended standards did not have a significant impact on the Group s Statement of comprehensive income or Statement of financial position since the Group had no major investment transactions during the year.

- IFRS 2 (amended) Share-based Payment. The amendments related to Group Cash-settled Share-based Payment Transactions were published in June 2009. Previously effective IFRSs required attribution of group share-based payment transactions only if they were equity-settled. The amendments resolved diversity in practice regarding attribution of cash-settled share-based payment transactions and require an entity receiving goods or services in either an equity-settled or a cash-settled payment transaction to account for the transaction in its separate or individual financial statements. Amendments to IFRS 2 shall be applied retrospectively for annual periods beginning on or after January 1, 2010. The amendments also incorporate the guidance contained in IFRIC 8 (Scope of IFRS 2) and in IFRIC 11 (IFRS 2 - Group and Treasury Share Transactions). As a result, the Board withdrew IFRIC 8 and IFRIC 11. As the Group has no significant share based compensations, the amended standard did not have a significant effect on the financial statements of the Group.

• IFRIC 18 Transfers of Assets from Customers. The Interpretation clarifies the requirements of IFRSs for agreements in which an entity receives from a customer an item of property, plant and equipment (or cash to be used explicitly for the acquisition of property, plant and equipment) that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. The Interpretation is effective for annual periods beginning on or after July 1, 2009 and applies prospectively. However, limited retrospective application is permitted. The Group applied IFRIC 18 as of January 1, 2010. Since the applicable transactions of the Group are not material, the interpretation did not have a significant effect on the Group.

2.1.2 Standards, amendments and interpretations effective in 2010 but not relevant for the Group

• IAS 39 (amended) - The IASB published an amendment in August 2008 to IAS 39 with respect to hedge accounting. The amendment Eligible Hedged Items allows to designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable. The amendment of IAS 39 shall be applied retrospectively for annual periods beginning on or after July 1, 2009. The amendment did not have any impact on Magyar Telekom s accounts as the Group does not apply hedge accounting.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

• IFRS 1 The IASB amended IFRS 1 in July 2009. As the Group has been reporting according to IFRS for many years, neither the original standard, nor any revision to that is relevant for the Group.

• IFRIC 17 Distributions of Non-cash Assets to Owners. This interpretation issued in November 2008 refers to the issue when to recognize liabilities accounted for non-cash dividends payable (e.g. property, plant, and equipment) and how to measure them. In addition, the interpretation refers to the issue how to account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable. The interpretation shall be applied for annual periods beginning on or after July 1, 2009. As the Group does not distribute non-cash dividends, IFRIC 17 had no impact on the Group s financial statements.

• IFRS for Small and Medium-sized Entities. In July 2009 the IASB issued its IFRS for Small and Medium-sized Entities, which is not relevant for Magyar Telekom.

2.1.3 Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Group

• IAS 24 (revised). In November 2009, the IASB issued a revised version of IAS 24 Related Party Disclosures. Until now, if a government controlled, or significantly influenced, an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced by the same government. The revised standard still requires disclosures that are important to users of financial statements but eliminates requirements to disclose information that is costly to gather and of less value to users. It achieves this balance by requiring disclosure about these transactions only if they are individually or collectively significant. Furthermore the IASB has simplified the definition of related party and removed inconsistencies. The revised standard shall be applied retrospectively for annual periods beginning on or after January 1, 2011. Earlier application is permitted. We do not expect that the revised standard would have a significant impact on the disclosures in the Group s financial statements. The European Union has endorsed the revised standard.

• IFRS 9 Financial Instruments. The standard forms the first part of a three-phase project to replace IAS 39 (Financial Instruments: Recognition and Measurement) with a new standard, to be known as IFRS 9 Financial Instruments. IFRS 9 prescribes the classification and measurement of financial assets and liabilities. The remaining phases of this project, dealing with the impairment of financial instruments and hedge accounting, as well as a further project regarding derecognition, are in progress.

Financial assets - At initial recognition, IFRS 9 requires financial assets to be measured at fair value. After initial recognition, financial assets continue to be measured in accordance with their classification under IFRS 9. Where a financial asset is classified and measured at amortized cost, it is required to be tested for impairment in accordance with the impairment requirements in IAS 39. IFRS 9 defines the below rules for classification.

• IFRS 9 requires that financial assets are classified as subsequently measured at either amortized cost or fair value. There are two conditions needed to be satisfied to classify financial assets at amortized cost: (1) The objective of an entity s business model for managing financial assets has to be to hold assets in order to collect contractual cash flows; and (2) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Where either of these conditions is not satisfied, financial assets are classified at fair value.

• Fair Value Option: IFRS 9 permits an entity to designate an instrument, that would otherwise have been classified in the amortized cost category, to be at fair value through profit or loss if that designation eliminates or significantly reduces a measurement or recognition inconsistency (accounting mismatch).

• Equity instruments: The default category for equity instruments is at fair value through profit or

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

loss. However, the standard states that an entity can make an irrevocable election at initial recognition to present all fair value changes for equity investments not held for trading in other comprehensive income. These fair value gains or losses are not reported as part of a reporting entity s profit or loss, even when a gain or loss is realized. Only dividends received from these investments are reported in profit or loss.

- Embedded derivatives: The requirements in IAS 39 for embedded derivatives have been changed by no longer requiring that embedded derivatives be separated from financial asset host contracts.

- Reclassification: IFRS 9 requires reclassification between fair value and amortized cost when, and only when there is a change in the entity s business model. The tainting rules in IAS 39 have been eliminated.

Financial liabilities - IFRS 9 Financial Instruments sets the requirements on the accounting for financial liabilities and replaces the respective rules in IAS 39 Financial Instruments: Recognition and Measurement . The new pronouncement

- Carries forward the IAS 39 rules for the recognition and derecognition unchanged.
- Carries forward most of the requirements in IAS 39 for classification and measurement.
- Eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument.
- Changes the requirements related to the fair value option for financial liabilities to address own credit risk.

An entity shall apply IFRS 9 for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted. A reporting entity must apply IFRS 9 retrospectively. For entities that adopt IFRS 9 for periods before January 1, 2012 the IFRS provides transition relief from restating comparative information. The adoption of the new standard will likely result in changes in the financial statements of the Group, the exact extent of which we are currently analyzing. The European Union has not yet endorsed the standard.

- IFRS 7 (amended) - The IASB published an amendment to IFRS 7 Amendments to IFRS 7 Financial Instruments: Disclosures in October 2010. The amendment requires quantitative and qualitative disclosures regarding transfers of financial assets that do not result in entire derecognition, or that result in continuing involvement. This is intended to allow users of financial statements to improve their understanding of such transactions (for example, securitizations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of such transactions are undertaken around the end of a reporting period. The application of the amendment is required for annual periods beginning on or after July 1, 2011. An earlier application is permitted. We do not expect that the adoption of the amended standard would result in significant changes in the financial statements disclosures of the Group. The European Union has not yet endorsed the amended standard.

2.1.4 Standards, amendments and interpretations that are not yet effective and not relevant for the Group s operations

• IAS 12 (amended). In December 2010, the IASB issued published the pronouncement Deferred Tax: Recovery of Underlying Assets - Amendments to IAS 12 . The new pronouncement Deferred Tax: Recovery of Underlying Assets - Amendments to IAS 12 sets presumptions for the recovery (e.g. use or sale) of certain assets. This is relevant in cases where the type of recovery has different tax consequences. The pronouncement sets the rebuttable presumption that the carrying amount of investment property that is measured using the fair value model in IAS 40 will be recovered through sale. Moreover, the carrying amount of a non-depreciable asset measured using the revaluation model in IAS 16 is always deemed to be recovered through sale. The amendment supersedes SIC 21

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

and shall be applied for annual periods beginning on or after 1 January 2012. Earlier application is permitted. As Magyar Telekom does not have investment properties or non-depreciable asset measured using the revaluation model in IAS 16, the amended standard will not have any impact on the Group s financial statements. The European Union has not yet endorsed the amended standard.

• IAS 32 (amended) - The IASB published an amendment to IAS 32 Financial Instruments: Presentation in October 2009. The amendment clarifies the classification of rights issues as equity or liabilities for rights issues that are denominated in a currency other than the functional currency of the issuer. These rights issues are recorded as derivative liabilities before the amendment. The amendment requires that such right issues offered pro rata to all of an entity s existing shareholders are classified as equity. The classification is independent of the currency in which the exercise price is denominated. The application of the amendment is required for annual periods beginning on or after February 1, 2010. An earlier application is permitted. The amendment will have no impact on the Group s financial statements as Magyar Telekom has no such instruments. The European Union has also endorsed the amended standard.

• IFRS 1 The IASB amended IFRS 1 in January 2010 and in December 2010. As the Group has been reporting according to IFRS for many years, neither the original standard, nor any revision to that is relevant for the Group. The European Union has endorsed only the first amendment of the standard.

• IFRIC 14 (amended) IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. In November 2009, the IASB issued an amendment to IFRIC 14, which corrects an unintended consequence of IFRIC 14. Without the amendments, in some circumstances entities are not permitted to recognize some voluntary prepayments for minimum funding contributions as an asset. The amendment permits such an entity to treat the benefit of such an early payment as an asset. The amendments are effective for annual periods beginning January 1, 2011. The amendments must be applied retrospectively to the earliest comparative period presented. The amended interpretation is not applicable to Magyar Telekom as the Group has no funded defined post-retirement benefit schemes. The European Union has endorsed the amended interpretation.

• IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments. This interpretation issued in November 2009 clarifies the requirements of IFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity s shares or other equity instruments to settle the financial liability fully or partially. The interpretation is effective for annual periods beginning on or after July 1, 2010 with earlier application permitted. The interpretation shall be applied retrospectively. The interpretation will not have any impact on Magyar Telekom s financial statements as the Group does not extinguish any of its financial liabilities with equity instruments. The European Union has endorsed this interpretation.

2.2 Consolidation

2.2.1 Subsidiaries

Subsidiaries in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies as to obtain benefit from its activities, are consolidated.

The existence and effect of potential voting rights that are presently exercisable or presently convertible are also considered when assessing whether the Group controls another entity.

Subsidiaries are consolidated from the date on which control is transferred to the Group, and are no longer consolidated from the date control ceases. The acquisition method of accounting is used to account for business combinations. The cost of an acquisition is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition whereby costs directly attributable to the acquisition are expensed for transactions closed after January 1, 2010. The excess of the cost of acquisition over the fair value of the net assets and contingent liabilities of the subsidiary acquired is recorded as goodwill. If the cost of acquisition is less than the fair

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

value of the net assets of the subsidiary acquired, the difference is recognized directly in the Profit for the year (Other operating income).

If applicable, the Group recognizes at the acquisition date a liability for any contingent purchase consideration. If the amount of contingent consideration accounted for as a liability changes as a result of a post-acquisition event (such as meeting an earnings target), it is recognized in accordance with other applicable IFRSs, as appropriate rather than as an adjustment of goodwill for acquisitions concluded after January 1, 2010. For acquisitions concluded before, the difference between the contingent consideration recognized at the acquisition date and the actual contingent consideration paid was recognized as an adjustment to goodwill.

As for the measurement of non-controlling interest, from January 1, 2010, the Group may recognize 100% of the goodwill of the acquired entity, not just the Group s portion of the goodwill. This is elected on a transaction-by-transaction basis. Before that date, the Group could only recognize its own share of the goodwill. The Group attributes their share of losses to the non-controlling interests even if this results in the non-controlling interests having a deficit balance since January 1, 2010. Before that date, the balance of the Non controlling interests could not be a negative amount and thus these losses would be allocated to the Group.

In a step acquisition, the fair values of the acquired entity s assets and liabilities, including goodwill, are measured on the date when control is obtained. Accordingly, goodwill is measured as the difference at the acquisition date between the fair value of any investment the business held before the acquisition, the consideration transferred and the fair value of the net asset acquired and non-controlling interest is recorded at fair value when the Group elects the fair value option.

In case of acquisitions where the transaction takes place between companies under common control (i.e. with other Deutsche Telekom group companies), the transaction is recorded at the carrying amounts as recorded in the selling owner s accounts, and any gains, losses or differences between the carrying amount and the sale-purchase price are recognized in Retained earnings.

A partial disposal of an investment in a subsidiary while control is retained is accounted for as an equity transaction with owners, therefore gain or loss is not recognized in profit or loss for disposals concluded since January 1, 2010. Before that date, the gain or loss was recognized as a current year income.

A partial disposal of an investment in a subsidiary that results in loss of control triggers re-measurement of the residual interest to fair value. Any difference between fair value and carrying amount is a gain or loss on the disposal, recognized in profit or loss since January 1, 2010. Before that date, no such re-measurement took place.

Inter-company transactions, balances and unrealized gains on transactions between the Magyar Telekom Group companies are eliminated. Accounting policies of subsidiaries have been adjusted to ensure consistency with the policies adopted by the Group.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2010 and 2009 the principal operating subsidiaries of the Group were as follows:

	Group interest in capital as at December 31,		
Subsidiaries	**2009**	**2010**	**Activity**
Incorporated in Hungary:			
Dataplex	100.00%	100.00%	IT hardware co-location service provider
Origo	100.00%	100.00%	Internet and TV content provider
KFKI	100.00%	100.00%	System integration and IT services
IQSYS	100.00%	100.00%	System integration and IT services
Pro-M	100.00%	100.00%	Professional Mobile Radio (PMR) network operator
ISH	100.00%	100.00%	Integrated healthcare IT services
Telekom New Media	100.00%	100.00%	Interactive service provider of telecommunications applications
Incorporated in Macedonia:			
Makedonski Telekom (MKT)	56.67%	56.67%	Fixed line telecom service provider
T-Mobile Macedonia (T-Mobile MK)	56.67%	56.67%	Cellular telecom service provider
Stonebridge	100.00%	100.00%	Holding company
Incorporated in Montenegro:			
Crnogorski Telekom (CT)	76.53%	76.53%	Telecom service provider
Incorporated in Romania:			
Combridge	100.00%	100.00%	Wholesale telecommunications service provider
Incorporated in Bulgaria:			
Novatel BG	100.00%	100.00%	Wholesale telecommunications service provider
Orbitel	100.00%	(a)	Alternative telecommunications and internet service provider
Incorporated in the Ukraine:			
Novatel UA	100.00%	100.00%	Alternative telecommunications and internet service provider

(a) Orbitel was sold in January, 2010. See also Note 26.

The Group s interest in the capital of the above subsidiaries equals the voting rights therein.

2.2.2 Associates and joint ventures

Associates are all entities over which the Group has significant influence but not control, generally reflecting a shareholding of between 20% and 50% of the voting rights. Joint ventures are entities in which the Group has an ownership of 50% with and equivalent external partner holding the other 50% of the voting rights. Investments in associates and joint ventures are accounted for using the equity method of accounting and are initially recognized at cost. The Group s investment in associates and joint ventures includes goodwill arising on acquisitions, and net of any accumulated impairment loss.

The Group s share of its associates and joint ventures post-acquisition profits or losses is recognized in the Profit for the year (Share of associates and joint ventures profits). The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group s share of losses in an associate or joint venture equals or exceeds its interest in the company, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

Unrealized gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group s interest in the company. Accounting policies of associates and joint ventures have been adjusted

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

where necessary to ensure consistency with the policies adopted by the Group.

At December 31, 2010 and 2009 the Group had no significant associates or joint ventures

2.3 Foreign currency translation

2.3.1 Functional and presentation currency

Items included in the financial statements of each of the Group s entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency).

The consolidated financial statements are presented in millions of HUF, as the Group s presentation currency is the Hungarian Forint.

2.3.2 Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the Profit for the year (Other finance expense - net).

2.3.3 Group companies

The results and financial position of all of the Group s entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

• For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date are incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at the date of acquisition. The fair value adjustments resulting from the purchase price allocation and goodwill are accounted for in HUF for acquisitions before March 31, 2004, after which date these adjustments arising on consolidation are accounted for in the functional currency of the subsidiary.

• Assets and liabilities for each Statement of financial position presented are translated at the closing rate at the date of that Statement of financial position.

• Statements of comprehensive income are translated at cumulated average exchange rates.

• All resulting exchange differences are recognized directly in the consolidated equity (Cumulative translation adjustment). When a foreign operation is fully or partially disposed of, exchange differences that were recorded in equity are recognized in the Profit for the year as part of the gain or loss on sale.

2.4 Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets of the Group include cash and cash equivalents, equity instruments of another entity (available-for-sale) and contractual rights to receive cash (trade and other receivables) or another financial asset from another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity (derivatives).

Financial liabilities of the Group include liabilities that originate from contractual obligations to deliver cash or another financial asset to another entity (non-derivatives); or to exchange financial assets or financial liabilities with

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

another entity under conditions that are potentially unfavorable to the entity (derivatives).

Financial liabilities, in particular, include liabilities to banks and related parties, finance lease payables, trade payables and derivative financial liabilities.

Finance lease receivables and liabilities meet the criteria of a financial instrument, but these are recognized and measured according to IAS 17 Leases. See Note 2.17.

The fair value of traded financial instruments is determined by reference to their market prices at the end of the reporting period. This typically applies to available-for-sale (AFS) financial instruments.

The fair value of financial instruments that are not traded in an active market (e.g. derivative financial instruments) is determined by using discounted cash flow valuation technique. The fair value of forward foreign exchange contracts is determined using quoted spot exchange rates and appropriate interest rates at the end of the reporting period.

The fair value of other financial instruments is also determined by using discounted cash flow valuation technique. The expected quarterly cash inflows or outflows are discounted by market based interest rates interpolated from the official Budapest and EUR Interest Rate Swap.

The fair value of long term fixed-rate financial liabilities (Financial liabilities to related parties, Bank loans and Nonconvertible bonds and debentures) is also determined by using discounted cash flow valuation technique. The cash flows of the liabilities are discounted by interest rates, which are reasonable to the Group for similar financial instruments. The carrying amount of floating-rate financial liabilities or those expiring within one year approximate the fair values at the end of the reporting period.

Assumptions applied in the fair value calculations are subject to uncertainties. Changes in the assumptions applied in the calculations would have an impact on the carrying amounts, the fair values and/or the cash flows originating from the financial instruments. Sensitivity analyses related to the Group s financial instruments are provided in Note 3.

2.4.1 Financial assets

The Group classifies its financial assets in the following categories:

- at fair value through profit or loss
- loans and receivables
- available-for-sale (AFS)
- held-to-maturity

The classification depends on the purpose for which the financial asset was acquired. Management determines the classification of financial assets at their initial recognition.

Standard purchases and sales of financial assets are recognized on the trade-date, the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the Profit for the year.

The Group assesses at each financial statement date whether there is objective evidence that a financial asset is impaired. There is objective evidence of impairment if as a result of loss events that occurred after the initial recognition of the asset have an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Impairment losses of financial assets are recognized in the Profit for the year against allowance accounts to reduce the carrying amount until the derecognition of the financial asset, when the net carrying amount (including any allowance for impairment) is derecognized from the Statement of financial position. Any gains or losses on derecognition are calculated and recognized as the difference between the proceeds from disposal and the (net) carrying amount derecognized.

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

2.4.1.1 Financial assets at fair value through profit or loss

The financial assets at fair value through profit or loss measurement category includes the following financial assets:

- Financial assets that are designated as at fair value through profit or loss using the fair value option as per IAS 39
- Financial assets incurred for the purpose of selling immediately or in the near term and thus classified as held for trading
- Derivative financial assets are classified as held for trading

Assets in this category are classified as current assets (Other financial current assets). No reclassification between categories has been made in the past and no reclassifications are expected in the future.

Assets in this category are initially recognized and subsequently carried at fair value. Gains or losses arising from changes in the fair value and impairment losses or their reversals are recognized in the Profit for the year (Other finance expense - net) in the period in which they arise. The Group only classifies derivative financial instruments in this category.

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and their fair values are re-measured at subsequent financial statement dates. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the Profit for the year (Other finance expense - net).

2.4.1.2 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are included in current assets, except those with maturities over 12 months after the financial statement date. These are classified as Other non-current assets.

The following items are assigned to the loans and receivables measurement category.

- cash and cash equivalents,
- trade receivables,
- other receivables,
- employee loans,
- loans granted to related parties and third parties.

Loans and receivables are initially recognized at fair value and subsequently carried at amortized cost using the effective interest method, less any impairment.

The carrying amount of loans and receivables, which would otherwise be past due, whose terms have been renegotiated is not impaired if the collectability of the renegotiated cash flows are considered ensured.

(a) Cash and cash equivalents

Cash and cash equivalents include cash on hand and in banks, and all highly liquid deposits and securities with original maturities of three months or less, and exclude all overdrafts.

Should an impairment on cash and cash equivalents occur, it would be recognized in the Profit for the year (Other finance expense - net).

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(b) Trade and other receivables

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the underlying arrangement. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments as well as historical collections are considered indicators that the trade receivable is impaired.

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset s carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset s original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the Profit for the year (Other operating expenses Bad debt expense).

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, Magyar Telekom includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is recognized are not included in a collective assessment of impairment.

The Group s benchmark policy for collective assessment of impairment is based on the aging of the receivables due to the large number of relatively similar type of customers.

Individual valuation is carried out for customers under litigation; bankruptcy proceedings and for the total receivables of customers with overdue receivables. Itemized valuation is also performed in special circumstances, if there is an overdue receivable from any designated customer with different credit risk attributes.

When a trade or an other receivable is established to be uncollectible, it is written off against Other operating expenses in the Profit for the year (Bad debt expense) with a parallel release of cumulated impairment. Subsequent recoveries of amounts previously written off are credited against the same line of the Statement of comprehensive income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor s credit rating), the previously recognized impairment loss shall be reversed by adjusting the allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in the Profit for the year as a reduction to Other operating expenses (Bad debt expense).

Amounts due to, and receivable from, other network operators are shown net where a right of set-off exists and the amounts are settled on a net basis (such as interconnection receivables and payables).

(c) Employee loans

Employee loans are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less any impairment loss.

The difference between the nominal value of the loan granted and the initial fair value of the employee loan is recognized as prepaid employee benefits. Interest income on the loan granted calculated by using the effective interest method is recognized as Interest income, while the prepaid employee benefits are amortized to Employee related expenses evenly over the term of the loan.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Impairment losses on Employee loans are recognized in the Profit for the year (Employee related expenses).

(d) Loans granted to related parties and third parties

Loans granted to related parties and third parties include short term loans and deposits made with DTAG or other trading partners.

Impairment losses on Loans granted to related parties and third parties are accounted for in the Profit for the year (Other finance expense - net).

2.4.1.3 Available-for-sale (AFS) financial assets

AFS financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. They are included in other non current financial assets unless management intends to dispose of the investment within 12 months of the financial statement date. In this latter case they are included in current assets (Other financial assets).

The available-for-sale financial assets measurement category includes:

- listed equity instruments that are neither consolidated nor included using the equity method in the consolidated financial statements
- unlisted equity instruments that are neither consolidated nor included using the equity method in the consolidated financial statements
- debt instruments

AFS financial assets are initially recognized and also subsequently carried at fair value. The unrealized changes in the fair value of available-for-sale financial assets are recognized in equity (Revaluation reserve for AFS financial assets).

Interest on available-for-sale debt securities calculated using the effective interest method is recognized in the Profit for the year (Interest income). Dividends on available-for-sale equity instruments are recognized in the Profit for the year (Other finance expense - net) when the Group s right to receive payments is established.

The Group assesses at each financial statement date whether there is objective evidence that a financial asset is impaired. There is objective evidence of impairment if as a result of loss events that occurred after the initial recognition of the asset have an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If any such evidence exists for AFS financial assets, the cumulative unrealized gain (if any) is reclassified from Other comprehensive income to Profit for the year, and any remaining difference is also recognized in the Profit for the year (Other finance expense - net). Impairment losses recognized on equity instruments are not reversed through the Profit for the year, while impairment losses recognized on debt instruments are reversed through the Profit for the year.

When AFS financial assets are sold or redeemed, therefore derecognized, the fair value adjustments accumulated in equity are reclassified from Other comprehensive income to Profit for the year (Other finance expense - net).

2.4.1.4 Held-to-maturity investments

This category includes non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity. The Group does not classify any of its financial instruments in this category.

2.4.2 Financial liabilities

There are two measurement categories for financial liabilities used by the Group:

- Financial liabilities carried at amortized cost

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

- Financial liabilities at fair value through profit or loss

No reclassification between categories has been made in the past and no reclassifications are expected in the future. Both types of financial liabilities are initially recognized at fair value, while subsequent measurements are different (see below). We remove a financial liability (or a part of a financial liability) from the Statement of financial position when, and only when, it is extinguished i.e. when the obligation specified in the contract is discharged, cancelled or expired.

2.4.2.1 Financial liabilities carried at amortized cost

The measurement category for financial liabilities measured at amortized cost includes all financial liabilities not classified as at fair value through profit or loss .

(a) Loans and other borrowings

Borrowings are recognized initially at fair value less transaction costs, and subsequently measured at amortized costs using the effective interest rate method. The effective interest is recognized in the Profit for the year (Interest expense) over the period of the borrowings.

(b) Trade and other payables

Trade and other payables (including accruals) are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method. The carrying values of trade and other payables approximate their fair values due to their short maturity.

2.4.2.2 Financial liabilities at fair value through profit or loss

Since the Group currently has no intention of measuring non-derivative financial liabilities at fair value, generally only derivative financial instruments are assigned to this category.

The Group does not designate any derivatives as hedging instruments, therefore, all derivatives are classified as held for trading .

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and their fair values are re-measured at subsequent financial statement dates. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the Profit for the year (Other finance expense - net).

The Group considers only those contracts as a separable host contract and an embedded derivative which are denominated neither in the functional currency of either of the contracting parties nor in a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g. a relatively stable and liquid currency that is commonly used in local business transactions or external trade). The Group has identified EUR and USD (except Montenegro) as currencies commonly used in the Group s operating area.

2.5 Inventories

Inventories are stated at the lower of cost or net realizable value using the historical cost method of accounting, and are valued on a weighted average basis. The cost of inventories comprises all costs of purchase, cost of construction and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Phone sets are often sold for less than cost in connection with promotions to obtain new subscribers with minimum commitment periods (Note 4.6). Such loss on the sale of equipment is only recorded when the sale occurs if

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

the normal resale value is higher than the cost of the phone set. If the normal resale value is lower than costs, the difference is recognized as impairment immediately.

Impairment losses on Inventories are recognized in Other operating expenses (Materials, maintenance and service fees).

2.6 Non current assets held for sale

An asset is classified as held for sale if it is no longer needed for the future operations of the Group, and has been identified for sale, which is highly probable and expected to take place within 12 months. These assets are accounted for at the lower of carrying value or fair value less cost to sell. Depreciation is discontinued from the date of designation to the held for sale status. When an asset is designated for sale, and the fair value is determined to be lower than the carrying amount, the difference is recognized in the Profit for the year (Depreciation and amortization) as an impairment loss.

2.7 Property, plant and equipment (PPE)

Property, plant and equipment are stated at historical cost less accumulated depreciation and impairment losses.

The cost of an item of PPE comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located is also included in the costs if the obligation incurred can be recognized as a provision according to IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Government grants relating to the purchase of PPE are deducted from the original cost of the items and are recognized in the Profit for the year through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects (Note 9.5) are also recognized in this manner.

Cost in the case of telecommunications equipment comprises of all expenditures including the cabling within customers premises and borrowing costs of related loans.

Subsequent expenditure on an asset that meets the recognition criteria to be recognized as an asset or an addition to an asset is capitalized, while maintenance and repairs are charged to expense when incurred.

When assets are scrapped, the cost and accumulated depreciation are removed from the accounts and the loss is recognized in the Profit for the year as depreciation expense.

When assets are sold, the cost and accumulated depreciation are removed from the accounts and any related gain or loss is recognized in the Profit for the year (Other operating income).

Depreciation is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. On an annual basis, Magyar Telekom reviews the useful lives and residual values for consistency with current development plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 12. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

2.8 Intangible assets

Intangible assets are stated at historical cost less accumulated amortization and impairment losses.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use. These costs are amortized over the estimated useful life of the software. Costs associated with developing or maintaining computer software programs are generally recognized as an expense as incurred. Costs directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets. Direct costs include the software development employee related costs and an appropriate portion of relevant overhead. Computer software development costs recognized as assets are amortized over their estimated useful lives. As these assets represent an immaterial portion of all software, these are not disclosed separately.

Costs associated with the acquisition of long term frequency licenses are capitalized including any related borrowing costs. The useful lives of concessions and licenses are determined based on the underlying agreements and are amortized on a straight line basis over the period from availability of the frequency for commercial use until the end of the initial concession or license term. No renewal periods are considered in the determination of useful life.

Amortization is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. On an annual basis, Magyar Telekom reviews the useful lives for consistency with current development and replacement plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 13. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group s share of the net assets and contingent liabilities of the acquired subsidiary or business at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses. Impairment testing is carried out on an annual basis for all goodwill in the last quarter of the year based on the carrying values as at September 30 of the year. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill relating to the entity or business sold.

In determining whether an asset that incorporates both intangible and tangible elements should be treated under IAS 16 - Property, Plant and Equipment or as an intangible asset under IAS 38 Intangible Assets, management uses judgment to assess which element is more significant and recognizes the assets accordingly.

2.9 Impairment of PPE and intangible assets

Assets that are subject to amortization or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the assets fair value less costs to sell and its 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 - CGUs).

The fair values of the individual tangible and intangible assets of the Group in most cases cannot be determined as individual assets do not generate cash flows. Instead, the Group determines CGUs to which the individual assets are allocated and the fair values can only be determined at CGU level, primarily by using discounted cash flow analyses. See also Note 4.3. Corporate assets which have the distinctive characteristics of not generating cash inflows independently of other assets or groups of assets are allocated to CGUs when conducting impairment tests.

Goodwill is tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred. When conducting the impairment tests, Magyar Telekom allocates goodwill to its cash generating units or groups of cash generating units, which, in the vast majority of the cases, are determined at the operating segment level. See also Note 4.2. Operating segments may include one clearly identifiable company or a group of companies, or components of one company and other companies as well.

For the subsidiaries included in the operating segments the Group establishes the subsidiaries recoverable amounts by determining their fair value less cost to sell by using valuation techniques. These include the use of recent

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

arm s length transactions, reference to other instruments that are substantially the same, discounted cash flow analyses and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. The fair values determined as described above are used as a basis when establishing the need for an impairment of any goodwill allocated to the CGUs or group of CGUs (usually the operating segments). See also Note 4.2. If the calculated fair value less cost to sell is lower than the carrying amount of the operating segment, goodwill is impaired.

The impairment losses of PPE and intangible assets are accounted for in the Depreciation and amortization line of the Statement of comprehensive income.

2.10 Provisions and contingent liabilities

Provisions are recognized when Magyar Telekom has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions are measured and recorded as the best estimate of the expenditure required to settle the present obligation at the financial statement date.

Provisions for obligations expected to fall due after 12 months are generally recognized at their present value and are accreted (against Interest expense) until utilization or reversal.

No provision is recognized for contingent liabilities. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability.

2.11 Treasury stock

When the Company or its subsidiaries purchase the Company s equity shares, the consideration transferred including any attributable incremental external costs are deducted from the Equity of the owners of the parent as Treasury stock until they are re-sold or cancelled. When such shares are subsequently sold, the treasury share balance decreases by the original cost of the shares, thereby increasing equity, while any gains or losses are also recognized in equity (Retained earnings). Treasury stock transactions are recorded on the transaction date.

2.12 Revenues

Revenues for all services and equipment sales (Note 22) are shown net of VAT, discounts and excluding sales within the Group. Revenue is recognized when the amount of the revenue can be reliably measured, and when it is probable that future economic benefits will flow to the Group and all other specific recognition criteria of IAS 18 on the sale of goods and rendering of services are met for the provision of each of the Group s services and sale of goods.

Customers of the Group are granted loyalty awards (credit points) based on their usage of the Group s services including timely payment of their invoices. Loyalty awards can be accumulated and redeemed to obtain future benefits (e.g. call credits, handset discounts, etc.) from the operators of the Group. When customers earn their credit points, the fair value of the credit points earned are deducted from the revenue invoiced to the customer, and recognized as Other liabilities (deferred revenue). On redemption (or expiry) of the points, the deferred revenue is released to revenue as the customer collected (or waived) the undelivered element of the deemed bundle.

Revenues from operating leases are recognized on a straight line basis over the period the services are provided. Operating lease revenues are primarily included in the System integration and IT revenues.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2.12.1 Fixed line and mobile telecommunications revenues

Revenue is primarily derived from services provided to Magyar Telekom s customer subscribers and other third parties using Magyar Telekom s telecommunications network, and equipment sales.

Customer subscriber arrangements typically include an equipment sale, subscription fee and charge for the actual voice, internet, data or multimedia services used. The Group considers the various elements of these arrangements to be separate earnings processes and classifies the revenue for each of the deliverables into the categories as disclosed in Note 22 using the residual method for each of the elements. These units are identified and separated, since they have value on a standalone basis and are sold not only in a bundle, but separately as well. Therefore the Group recognizes revenues for all of these elements using the residual method that is the amount of consideration allocated to the delivered elements of the arrangements equals the total consideration less the fair value of the undelivered elements.

The Group provides customers with narrow and broadband access to its fixed, mobile and TV distribution networks. Service revenues are recognized when the services are provided in accordance with contractual terms and conditions. Airtime revenue is recognized based upon minutes of use and contracted fees less credits and adjustments for discounts, while subscription and flat rate revenues are recognized in the period they relate to.

Revenue and expenses associated with the sale of telecommunications equipment and accessories are recognized when the products are delivered, provided that there are no unfulfilled obligations that affect the customer s final acceptance of the arrangement.

Advertising revenues are recognized in the period that the advertisements are exhibited.

Revenues from premium rate services (Voice and non-voice) are recognized on a gross basis when the delivery of the service over Magyar Telekom s network is the responsibility of the Group, the Group establishes the prices of these services and bears substantial risks of these services, otherwise these revenues are presented on a net basis.

Customers may also purchase prepaid mobile, public phone and internet credits (cards) which allow those customers to use Magyar Telekom s telecommunications network for a selected amount of time. Customers must pay for such services at the date when the card is purchased. Revenues from the sale of cards are recognized when used by the customers or when the credits expire with unused traffic.

Third parties using Magyar Telekom s telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on Magyar Telekom s network. These wholesale (incoming) traffic revenues included in Voice and Non-voice (Data and Internet) revenues are recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where applicable. The revenues and costs of these transit calls are stated gross in the Financial statements as the Group is the principal supplier of these services using its own network freely defining the pricing of the services, and recognized in the period of related usage.

2.12.2 System integration and IT revenues

Contracts for network services, which consist of the installation and operation of communication networks for customers, have an average duration of 2-3 years. Revenues for voice and data services are recognized under such contracts when used by the customer.

Revenue from outsourcing contracts reflects the extent of actual services delivered in the period in accordance with the terms of the contract. The contracts are analyzed based on the requirements of IFRIC 4 - Determining whether an Arrangement contains a Lease, and if they include embedded lease elements, the revenues attributable to these are recognized according to IAS 17 - Leases as described in Note 2.17.

Revenue from system integration contracts requiring the delivery of customized products and/or services is generally covered by one of the following types of contracts: fixed-price or time and material-based. For fixed-price contracts, revenue is generally recognized based on percentage of completion taking into account the proportion that

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

contract costs incurred for work performed to date bear to the estimated total contract costs. In the case of contracts billed on the basis of time and material, revenue is recognized as the services are rendered.

Revenue from maintenance services (generally fixed fee per month) is recognized over the contractual period or as the services are provided. Revenue from repairs, which are not part of the maintenance contract, billed on the basis of time and material used is recognized as the services are provided.

Revenue from hardware and software sales or sales-type leases is recognized when the risk of ownership is substantially transferred to the customer, provided there are no unfulfilled obligations that affect the customer s final acceptance of the arrangement. Any costs of these obligations are recognized when the corresponding revenue is recognized.

Revenues from construction contracts are accounted for using the percentage-of-completion method. The stage of completion is determined on the basis of the costs incurred to date as a proportion of the estimated total costs. Receivables from construction contracts are classified in the Statement of financial position as Trade receivables. If the total actual and estimated expenses exceed revenues for a particular contract, the loss is recognized immediately (in Expenses directly related to revenues).

2.13 Employee benefits

2.13.1 Short term employee benefits

Short term employee benefits are recognized as a current expense in the period when employees render their services. These include wages, social security contributions, bonuses, paid holidays, discounted telephone bills, meal and holiday contributions and other fringe benefits and the tax charges thereon.

Payments to defined contribution pension and other welfare plans are recognized as an expense in the period in which they are earned by the employees.

Magyar Telekom does not have significant post-employment defined benefit schemes.

2.13.2 Share based compensation

Magyar Telekom recognizes the costs of services received from its employees in a share based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in its equity reserves (Reserve for equity settled share based transactions) if the services are received in an equity-settled share based payment transaction. When the share based compensation program is completed, i.e. the shares are transferred to the employees ownership or the share options have forfeited, the respective reserve is transferred to Retained earnings. If the services are received in a cash-settled share based payment transaction, the Group recognizes the expense against a liability, re-measured at each financial statement date.

Fair values are determined using option pricing models (such as Black-Scholes and Monte Carlo simulation) and other relevant techniques. As Magyar Telekom Plc. is listed and actively traded on the Budapest Stock Exchange, the share price and its history is readily available as a basis for fair value calculations.

Bonuses tied to the long term performance of the Magyar Telekom share are recognized in the Profit for the year at their time-proportioned fair value (Note 24.1) against an accumulating balance in Provisions.

2.13.3 Termination benefits

Termination benefits are payable whenever an employee s employment is terminated before the nominal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either terminate the employment of current employees according to a detailed formal plan without the possibility of withdrawal or to provide termination benefits as a result of an offer made to encourage voluntary redundancy.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2.14 Research and Marketing expenses

Research as well as marketing costs are expensed as incurred. Research costs are not material, while marketing expenses are disclosed in Note 25.

2.15 Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense. Borrowing costs include interest and other costs that the Group incurs in connection with the borrowing of funds. The borrowing costs eligible for capitalization are capitalized applying the weighted average of the borrowing costs applicable to the general borrowings of the Group that are outstanding during the period. A qualifying asset is an asset that necessarily takes a substantial period of time, in general over 12 months, to get ready for its intended use.

2.16 Income taxes

2.16.1 Corporate income taxes

Corporate income taxes are payable to the central tax authorities of the countries in which the Group s consolidated entities operate. The basis of the tax is the taxable entities accounting profit adjusted for non-deductible and non-taxable items. The nominal tax rates and the determination of the tax base vary among the countries in which the Group operates.

2.16.2 Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies net margins, determined at a substantially higher level than the corporate tax base, but applying a significantly lower tax rate.

2.16.3 Deferred taxes

Deferred tax is recognized applying the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit. Deferred tax is determined using income tax rates that have been enacted or substantially enacted by the financial statement date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit (or reversing deferred tax liabilities) will be available against which the temporary differences can be utilized.

Deferred tax is also provided on taxable temporary differences arising on investments in subsidiaries and associates and joint ventures, 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.

2.17 Leases

2.17.1 Operating lease Group as lessor

Assets leased to customers under operating leases are included in Property, plant and equipment in the Statement of financial position. They are depreciated over their expected useful lives on a basis consistent with similar assets. Rental income is recognized as revenue on a straight-line basis over the lease term.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2.17.2 Finance lease Group as lessor

Leases of assets where Magyar Telekom transfers substantially all the benefits and risks of ownership are recognized and disclosed as revenue against a finance lease receivable. The revenue equals the estimated present value of the future minimum lease payments receivable and any unguaranteed residual value (net investment in the lease). The cost of the asset sold in a finance lease transaction is recognized at the inception of the lease. Each lease receipt is then allocated between the receivable and interest income so as to achieve a constant rate of return on the finance receivable balance outstanding. The interest element of the lease receipt is recognized in Interest income.

2.17.3 Operating lease Group as lessee

Costs in respect of operating leases are charged to the Profit for the year on a straight-line basis over the lease term.

2.17.4 Finance lease Group as lessee

Leases of property, plant and equipment where Magyar Telekom assumes substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the fair value of the asset or if lower, at the estimated present value of the future minimum lease payments against a finance lease payable. Each lease payment is allocated between the finance liability and interest expense so as to achieve a constant rate of interest on the outstanding finance balance payable. The finance lease obligations, net of finance charges, are included in the Statement of financial position (Other financial liabilities). The interest element of the lease payments is charged to the Profit for the year (Interest expense) over the lease period. Property, plant and equipment acquired under finance lease contracts are depreciated over the shorter of the lease term or the useful life of the asset.

2.17.5 Sale and leaseback transactions

Sale and leaseback transactions involve the sale of an asset by Magyar Telekom and the leasing of the same asset or part of it back to Magyar Telekom. When sale and leaseback transactions qualify as finance leases any gain on the sale is deferred and recognized in the Profit for the year over the lease term through lower depreciation expense. If the leaseback qualifies as an operating lease, any gains or losses on the sale are recognized in the Profit for the year (Other operating income) at the time of the sale as the sales price reflects the fair value of the asset, while the lease payments are recognized in the Profit for the year (Other operating expenses) on a straight line basis over the period of the lease.

2.18 Earnings per share

Basic earnings per share is calculated by dividing profit attributable to the owners of the Company for the period by the weighted average number of common stocks outstanding. Diluted earnings per share is calculated considering the weighted average number of diluting share options (if any) in addition to the number of common stocks outstanding.

2.19 Dividends

Dividends payable to the Company s shareholders and to Non-controlling shareholders of the Group s subsidiaries are recorded as a liability and debited against equity (Retained earnings or Non-controlling interests) in the Group s financial statements in the period in which the dividends are approved by the shareholders.

2.20 Segments

In the Financial statements, the Group s segments are reported in a manner consistent with the internal reporting provided to the chief operating decision makers, the members of the Management Committee (MC) of Magyar Telekom Plc. The MC is responsible for allocating resources to, and assessing the performance of, the operating

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

segments on a monthly basis. The accounting policies and measurement principles of the operating segments are very similar to those applied for the Group described in the previous sub-notes of the Summary of significant accounting policies. The differences primarily originate from the fact that the operating segments annual results are determined and closed at an earlier stage, around January 10-12 each year, than these Financial statements. Any items discovered and requiring adjustment between the closing date of the segment results and the approval date of the Financial statements are reflected in the next year s segment results.

The operating segments revenues include revenues from external customers as well as the internal revenues generated from other segments for telecommunications and, to a lesser extent, from inter-segment support services. In order to concentrate on real performance achieved on third party transactions, the number of inter-segment cross-charges applied within the organizations of Magyar Telekom Plc. operating in different segments is fairly limited. These cross-charges are not meant to allocate all the actual costs to the operating segment which are in fact incurred for the operation of the particular segment. Consequently, regardless of the costs incurred for the operation of another segment, the supporting organizations of the operating segments do not charge revenues for the services delivered within Magyar Telekom Plc., the largest legal entity of the Group.

The operating segments results are monitored by the MC down to EBITDA (Earnings before interest, tax, depreciation and amortization) level, which is defined by the Group as Operating profit without Depreciation and amortization expense.

The MC does not monitor the assets and liabilities at the segment level.

Another important KPI monitored at segment level is capital expenditure (Capex), which is determined as the gross additions to PPE and Intangible assets, excluding those due to business combinations.

2.21 Comparative information

In order to maintain consistency with the current year presentation in the Financial statements and the Notes thereto, certain items may have been reclassified for comparative purposes. Material changes in disclosures, if any, are described in detail in the relevant Notes. In 2010 certain reclassifications impacted the disclosure of the financial results as described in Notes 27-29. As the changes in the disclosures did not impact the statements of financial position of any year, we did not extend the statements of financial position to include further comparative years.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

Magyar Telekom is primarily exposed to credit risks related to its financial assets. In addition, the Group is also exposed to risks from movements in exchange rates, interest rates that affect the fair value and/or the cash flows arising from financial assets and liabilities.

Financial risk management aims to limit these risks through ongoing operational and finance activities. Selected derivative and non-derivative hedging instruments are also used for this purpose, depending on the risk assessment. Magyar Telekom only hedges the risks that affect the Group s cash flows, no hedges are concluded to hedge fair values. Derivatives are exclusively used as hedging instruments, i.e., not for trading or other speculative purposes. To reduce the counterparty risk, hedging transactions are generally only concluded with Deutsche Telekom or leading Hungarian financial institutions. Nevertheless, hedge accounting is not applied to such transactions, considering that not all the criteria in IAS 39 are met.

The detailed descriptions of risks, the management thereof as well as sensitivity analyses are provided below. These sensitivity analyses calculate with reasonably possible changes in the relevant risk variables and their impact on profit before tax. The impacts disclosed below are subject to an average effective income tax rate of approximately 10% in the Group, i.e. the impact on Profit for the year would be approximately 90% of the pre tax amount. The potential impacts disclosed (less tax) would be the same on the Group s Equity.

There were no major changes in these risks compared to the previous reporting period.

3.1.1 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

The fundamentals of Magyar Telekom s financing strategy are established each year by the Board of Directors. The Group s policy is to borrow centrally using a balanced combination of medium term and short term loans, and fixed and floating interest rates on those loans. The Board of Directors has approved two debt protection ratio limits, and monitors their fulfillment annually. At the end of 2009 and 2010 Magyar Telekom fulfilled both criteria; Total Debt to EBITDA ratio of 1.70 in 2010 (2009: 1.61), the allowed maximum of which would be 2.5 and EBITDA to

Interest Expense ratio of 7.58 in 2010, (2009: 7.59), the allowed minimum of which would be 3.0. The Group s Treasury department is responsible for implementing the finance policy and for ongoing risk management. The details of foreign exchange, liquidity and counterparty risk management guidelines are determined and monitored by the Group Treasurer continuously.

Magyar Telekom is exposed to interest and foreign exchange (FX) rate risk associated with its interest bearing assets and liabilities and anticipated transactions. As the vast majority of the revenues and expenses of the Hungarian entities arise in HUF, the functional currency of Magyar Telekom is HUF. Consequently, Magyar Telekom s objective is to minimize the level of its financial risk in HUF terms.

For the presentation of market risks, we also provided sensitivity analyses that show the effects of hypothetical changes of relevant risk variables on Profit before tax. These hypothetical changes were modeled to present a reasonably possible change in the relevant risk variables. The periodic effects are determined by relating the hypothetical changes in the risk variables to the balance of financial instruments at the end of the latest reporting period (2010) and the preceding reporting period (2009). The balances at the end of the reporting period are usually representative for the year as a whole, therefore the impacts are calculated using the year end balances as though the balances had been constant throughout the reporting period. As the global economic situation has not changed significantly compared to the end of the previous reporting period, the methods and assumptions used in the sensitivity calculations did not change significantly. As a result of the still rather volatile international capital and securities markets, a higher fluctuations of the FX and interest rates are also possible.

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3.1.1.1 Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in FX rates. Currency risks primarily arise on financial instruments being denominated in a currency that is not the functional currency of the given operating segment of the Group. Differences resulting from the translation of the foreign subsidiaries financial statements into the Group s presentation currency are not taken into consideration. Relevant risk variables are generally all non-functional currencies in which Magyar Telekom has financial instruments.

Due to the free-float of the HUF introduced in 2008, the Group is exposed to FX risk in case of FX denominated financial instruments of the Hungarian entities to a higher degree than before. In order to mitigate this risk, Magyar Telekom minimized its foreign currency borrowings in the past years, or covered them with derivative instruments to substantially reduce FX risk.

(a) FX risks arising on loans from DTIF and related swaps with DT AG

In the past few years, all related party loans payable of Magyar Telekom were denominated in HUF. In agreement with Deutsche Telekom, the related party loans taken to finance general corporate needs from the financing vehicle of Deutsche Telekom, Deutsche Telekom International Finance B.V. (DTIF) from June 2009 are denominated in EUR, while, at the same time, cross-currency interest rate swaps are concluded with Deutsche Telekom AG to fix the actual cash flows of Magyar Telekom in HUF for the whole nominal amount and interest payments of these loans. Even though the Group does not apply hedge accounting, the change in the HUF/EUR exchange rate has no significant (net) impact on Profit before tax related to the hedged loans and the swaps together.

(b) FX risks arising on third party loans and related swaps

Magyar Telekom also has third party loans denominated in EUR, for the majority of which we also concluded cross-currency interest rate swap agreements with one of the substantial Hungarian banks to eliminate FX risk in connection with these loans and hedge the whole foreign currency denominated cash flows of these loans. Even though the Group does not apply hedge accounting, the change in the HUF/EUR exchange rate has no significant (net) impact on Profit before tax related to the hedged loans and the swaps together.

(c) Other FX exposure

The remaining FX exposure of Magyar Telekom is mostly related to (i) holding foreign currency cash balances in its subsidiaries in the Southern and Eastern Europe region, and (ii) operating activities through revenues from, and payments to, international telecommunications carriers as well as capital expenditure contracted with vendors in foreign currency. In line with currency hedging policy, the Company holds sufficient amounts of foreign currencies on its bank accounts, the amounts of which are determined considering the balance of FX denominated trade and leases payables and trade receivables in order to hedge the currency risk arising in connection with those assets and liabilities. The Group s foreign currency denominated assets (primarily held by the Group s foreign subsidiaries), however, exceed the Group s foreign currency denominated liabilities (other than the above described loans), therefore changes of the functional currencies exchange rates would have significant impact on the profit of the Group. Compared to the spot FX rates as of December 31, 2010, a 10% weaker functional currency HUF against the EUR and USD would have caused an unrealized loss of less than HUF 0.1billion on this net balance (2009: HUF 0.1 billion loss). The same amount of gain would have been caused by a 10% stronger functional currency HUF against the EUR and USD. Compared to the spot FX rates as of December 31, 2010, a 20% weaker functional currency MKD against the EUR and USD would have caused HUF 5.2 billion unrealized gain on this net balance (2009: HUF 4.4 billion gain). The same amount of loss would have been caused by a 20% stronger functional currency MKD against the EUR and USD.

In order to reduce the above exposure, Magyar Telekom occasionally enters into derivative contracts. The fair value of the open short term forward positions was HUF -666 million (liability) as of December 31, 2010 (2009: HUF -502 million (liability)). These positions were opened to hedge the FX risks of future FX payments exceeding FX incomes. Compared to the spot FX rates as of December 31, 2010, a 10% weaker functional currency HUF against the EUR and USD would have caused HUF 2.8 billion unrealized gain on this net balance while a 10% stronger HUF

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

against the EUR and USD would have caused HUF 4.2 billion unrealized loss.

As a result of the volatile international capital and securities markets, even a more than 10% fluctuation of the functional currency HUF and a more than 20% fluctuation of the functional currency MKD against the EUR and USD is possible as extraordinary market conditions may cause extreme volatility on FX markets.

3.1.1.2 Interest rate risk

Magyar Telekom is also exposed to interest rate fluctuations. This is due to the fact that changing interest rates affect the fair value of the fixed rate instruments and also affect the cash flows through the floating rate instruments.

Changes in the market interest rates of non-derivative financial instruments with fixed interest rates only affect income if these are measured at their fair value. On the other hand, all financial instruments with fixed interest rates (which are carried at amortized cost) are not subject to cash flow interest rate risk.

Changes in the market interest rate of interest rate derivatives (interest rate swaps, cross-currency swaps) that are not part of a hedging relationship as set out in IAS 39 affect financial income or expense (net gain/ loss from re-measurement of the financial assets to fair value).

Changes in market interest rates affect the interest income or expense of non-derivative floating-interest financial instruments for which no cash flow hedges are in place.

(a) Financial assets

Excess cash of the Group s Hungarian operations is primarily used to repay loans, however, significant amount of cash of the Group s Macedonian and Montenegrin subsidiaries are held in local banks. These amounts are deposited primarily on fixed interest rate terms in order to minimize exposure to market changes that would potentially adversely change the cash flows from these instruments.

The Group had no significant HUF denominated bank deposits at the end of 2010 (2009: HUF 6.5 billion).

The Group s MKD denominated bank deposits amounted to HUF 15.7 billion at the end of 2010 (2009: HUF 32.7 billion). A 5 percentage point higher interest rate throughout 2010 (assuming the year-end 2010 balance throughout 2010) would have resulted in HUF 0.8 billion higher interest income in 2010 (2009: HUF 1.6 billion). The interest income would be lower by a smaller amount as interest rates are usually lower than 5%.

The Group s EUR denominated bank deposits amounted to HUF 38.0 billion at the end of 2010 (2009: HUF 37.0 billion). A 1 percentage point higher interest rate throughout 2010 (assuming the year-end 2010 balance throughout 2010) would have resulted in HUF 0.4 billion higher interest income in 2010 (2009: HUF 0.4 billion). The interest income would be lower by a smaller amount as interest rates are usually lower than 1%.

As a result of the volatile international capital and securities markets, a higher fluctuation of the interest rates is also possible, the exposure to which is mitigated by the balanced portfolio of fixed and floating interest rate deposits (see above). Sensitivities have been disclosed for a movement of 5 percentage points for MKD and 1 percentage point for EUR, but extraordinary market conditions may cause extreme volatility on money markets, which can result in even higher percentage point change in interest rates.

(b) Financial liabilities

Financial liabilities exposed to interest rate risk are primarily the related party (DTIF) and third party loans and the related swap agreements in place. These loans are almost exclusively taken by the Company as the financing of the Group is managed centrally. The analysis below describes the Group s net exposure to the net interest rate risks related to the loans and the related swap agreements.

As the vast majority of debt portfolio is denominated in HUF, or swap agreements are in place so that the loans payable are exposed to changes in HUF interest rates, the Group is mostly exposed to the HUF interest rate

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

fluctuations for its financial liabilities. To control this interest rate risk, a combination of fixed and floating rate debt is used. Fixed interest-bearing debts (including loans swapped to fixed interest and excluding loans swapped to floating interest) made up 63% of the Group s total debt as of December 31, 2010 (2009: 56%).

In addition, some of the Group s loan agreements with Deutsche Telekom include a fixed interest rate that in fact may change in case of downgrading the credit rating of Deutsche Telekom by specific international rating agencies below the level of credit rating BBB+. Such rating downgrades from the current grade would have caused additional annual interest payments of approximately HUF 0.2 billion (assuming the year-end 2010 balance and rating throughout 2010) on top of the pre-fixed amount of interest (2009: HUF 0.2 billion). On the other hand, such rating upgrades above the level of the credit rating A would have caused HUF 0.2 billion lower interest expense for 2010 (2009: HUF 0.3 billion).

Floating interest-bearing debts (including loans swapped to floating interest and excluding loans swapped to fixed interest) made up 37% of the Group s total debt as of December 31, 2010 (2009: 44%). A 1 percentage point higher interest rate throughout 2010 (assuming the year-end 2010 balance throughout 2010) would have resulted in HUF 1.3 billion higher interest expense in 2010, while the same decrease of interest rates would cause the same decrease in interest payments (2009: HUF 1.7 billion).

3.1.1.3 Other price risk

As of the end of the reporting periods, Magyar Telekom did not hold any material investments, which could be affected by risk variables such as stock exchange prices or other indices, therefore, the Group s exposure to such price changes is very limited. See also Note 8.2.

3.1.2 Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The maximum exposure to credit risk as at the financial statement dates are represented by the carrying amounts of the financial assets in the Statement of financial position. Guarantee agreements reducing the maximum exposure to credit risk as at the end of the reporting period are described later in this section.

The following table represents Magyar Telekom s maximum exposure to credit risk as at December 31, 2009 and 2010.

In HUF millions	At December 31, 2009	2010
Cash and cash equivalents	34,270	15,841
Bank deposits with original maturities over 3 months	50,660	47,798
Trade receivables	100,524	106,732
Loans to Deutsche Telekom Group companies	29,587	
Finance lease receivables	23,531	20,385
Employee loans	4,870	4,704
Derivative financial instruments	1,285	1,305
Trade receivables over one year	1,487	1,524
Loans to third parties	580	947
Financial assets available for sale	276	296
RDC receivables	839	715
Other current	1,626	2,400
Other non-current	552	519
	250,087	203,166

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The vast majority of credit risks may arise in respect of Cash and cash equivalents, Bank deposits with original maturities over 3 months and Trade receivables, and to a lesser extent, of Finance lease receivables. Cash and cash equivalents, Bank deposits with original maturities over 3 months and Trade receivables have short term maturities, which represent the vast majority of the Group s financial assets.

According to the Group s risk management policy Magyar Telekom Group companies deposit the excess cash only in banks rated at least BBB+ (or equivalent), or make efforts to get guarantees for the deposits from banks rated at least BBB+. Moreover, Magyar Telekom prefers to deposit in banks which grants loans for Magyar Telekom to make possible the compensation of debts and loans in case of the default of the bank.

Cash and cash equivalents and Bank deposits with maturities over 3 months held in Hungary are primarily denominated in HUF and concentrations of credit risk are limited as Magyar Telekom places its cash in Hungary with substantial credit institutions. Further, excess HUF cash is also used for repayment of the HUF denominated loans and borrowings, or is deposited at partner banks which grant loans for Magyar Telekom, therefore, the credit risk related to cash held in HUF is very limited.

Cash and cash equivalents and Bank deposits with maturities over 3 months held in Macedonia are primarily denominated in MKD and EUR, while the Cash and cash equivalents and Bank deposits with maturities over 3 months held in Montenegro are primarily denominated in EUR. Cash and cash equivalents and Bank deposits with maturities over 3 months deposited in these countries run higher counterparty risk, due to the small amount of internationally substantial financial institutions in those countries. The bank deposits in Montenegro of HUF 10.1 billion as at December 31, 2010 (2009: HUF 12.2 billion) and those in Macedonia of HUF 43.7 billion as at December 31, 2010 (2009: HUF 57.5 billion) are fully covered with bank guarantees issued by international financial institutions rated at BBB+ or above, or Magyar Telekom has the right to net the deposits with loans taken from the guarantor, in case of default of the bank. Credit risk related to bank deposits is further limited by the diversification of the deposits among several independent credit institutions determinant on the local market.

Finance lease receivables, in most cases, are legally embedded in service contracts also requiring to provide assets related to the services, which are legally in the Group s ownership. Should the customers fail to pay their bills, we are entitled to discontinue the services and take the assets back to the Group s locations. As these assets are rarely customer specific, we can utilize these assets in other ways as well, therefore, the credit risk related to finance leases is in fact rather limited.

Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising the Group s customer base and their dispersion across many different geographic areas and industries.

No financial assets other than trade and other receivables had to be impaired in the reported years, as they are neither past due nor are there any signs of impairment.

The following table contains the carrying amount of trade receivables broken down by country of operation.

In HUF millions	At December 31, 2009	2010
Hungary	82,333	88,099
Macedonia	12,061	12,852
Montenegro	4,763	4,792
Other	1,367	989
	100,524	106,732

The amounts in the table above are shown net of provisions for impairment losses of HUF 34.5 billion as at December 31, 2010 (2009: HUF 29.7 billion). The annual bad debt expense of the Group had been under 1% of the consolidated revenues before 2009, when it started to increase (1.4% in 2009). In 2010, the ratio reached 1.6%. Further changes in customer payment behavior in the future, however, may result in higher impairment losses. Each additional 1 percentage point of uncollectible revenue would result in additional impairment charges of HUF 6.1 billion in 2010 (2009: HUF 6.4 billion).

MAGYAR TELEKOM

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Hungary

There are varying credit checking practices applied across the members of the Group. The majority of customers are located in Hungary. For these customers the Company follows the practice described below.

Credit checking at the time of the service request is carried out automatically by the credit checking application of the Sales Department. A variety of checks including checking the bankruptcy list, the internal database of risky installation locations, the collection history of the past 6 months, the outstanding debt and the joint database of debtors of the Hungarian mobile operators are performed depending on the service to be used. The Fraud Detecting System monitors extreme usage and fraudulent behavior of customers for mobile, fixed-line and Internet services. In case of business customers, account managers check if the customer has outstanding debts.

Dunning procedures are run automatically by the billing systems and include various reminder tools like SMS, telephone calls, reminder letters, restricted service, termination letters and disconnections. Over a minimum overdue amount we apply varying and customized reminder procedures with specific deadlines to the different customer groups. After the termination of the contract and depending on the expected success of the process, we combine the different collection steps of involving external partners, selling the outstanding debt or initiating legal proceedings. All parts of the process are regulated by internal directives.

Macedonia

The process of managing the credit risk from operating activities includes preventive measures such as credibility checking and prevention barring, corrective measures during legal relationship (reminding and disconnection activities), collaboration with collection agencies and collection after legal relationship as litigation process, court proceedings and involvement of the executive unit. The overdue payments are monitored through a debt escalation procedure based on customer type, credit class and amount of debt. The credit risk is controlled through credibility checking which determines that the customer is not indebted and the customers credit worthiness and through preventive barring which determines the credit limit based on the usual level of the customer s consumption. There s no concentration of risk in Macedonia either with any single customer or group of customers with similar characteristics. The procedures in Macedonia ensure on a permanent basis that sales are made to customers with an appropriate credit history and that an acceptable level of credit exposure is not exceeded.

Montenegro

In Montenegro, receivables management and credit risk control were focus points of the efficiency program in the finance area in 2010. Through organizational change, Customer Finance department has been formed, with the goal of reducing bad debt expenses. Most of the processes have been changed in 2010: reminder processes were changed and tuned to different customer segments; additional debt collection agencies have been included into the process, to increase competition, drive provision fees down and to increase their collection rates; the credit checking processes for new and existing customers have been redesigned. All of these activities resulted in sharp decline of bad debt expenses, despite the economic crisis in Montenegro.

3.1.3 Liquidity risk

Liquidity risk is the risk that an entity may encounter difficulty in meeting obligations associated with financial liabilities.

Prudent liquidity risk management implies maintaining sufficient Cash and cash equivalents and Bank deposits as well as available funding through adequate amount of committed credit lines. The Group Treasury s management aims at maintaining flexibility in funding by keeping committed credit lines available. The undrawn credit lines amounted to 54.6 billion as at December 31, 2010 (2009: HUF 50.5 billion), and the Company also had uncommitted credit lines from several Hungarian Banks as at December 31, 2010. In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom Group s budgeted financing needs until the end of June 2012.