Registered Number: 1743099

Telefónica UK Limited

Annual Report and Financial Statements
Year ended 31 December 2016

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Directors and advisers

Directors

Mark Evans
Patricia Cobian

Secretary

O2 Secretaries Limited

Registered office

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Slough
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Auditor

Ernst & Young LLP
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Strategic report

Strategy

Telefonica UK Limited ("The Company") is a wholly owned subsidiary within the Telefonica Group of Companies, The ultimate parent company is Telefonica SA a company incorporated in Spain and primarily listed on the Spanish stock exchange.

The Company is a leading UK mobile network operator whose primary business is providing mobile telecommunication and related services to more than 25 million customers. The Company pursues a customer-led, mobile-first strategy focused on delivering an excellent customer experience and helping customers get the most out of mobile connectivity. The Company's commitment to this strategy has helped to generate high customer loyalty, with the Company consistently achieving the market leading post-pay churn rates in the UK mobile telecommunication market in recent years. The Company, trading under the brand O2 ("O2"), has been ranked by the Office of Communications ("Ofcom"), as the number one network for customer service satisfaction for seven consecutive times and was also awarded the best network coverage in the uSwitch Mobile Awards 2016 which is a major award voted by customers, for two consecutive times.

The customer-led, mobile-first strategy ensures that the Company focuses entirely on customer needs, using mobile technologies as the key enabler. The Company aspires to deliver an excellent and differentiated customer experience through a customer centric approach. The O2 brand is not only the leading brand in the UK mobile market, but also one of the strongest brands in the UK overall, driving high consideration and appeal by customers. The Company has also built a proven track record of innovation since its inception and has been leading the market through innovations such as O2 Refresh, O2 Priority and Business Essentials. In order to meet changing customer behaviour better, the Company has implemented best-in-class distribution channel capabilities allowing customers to interact across online, voice and stores. The Company has also built an award-winning customer service to ensure outstanding customer satisfaction. The Company's strategy has been instrumental in helping the Company to establish a leading position in the UK mobile telecommunications market underpinned by high customer loyalty.

Under its premium O2 brand, the Company offers a full range of mobile services and products to consumer and business customers, including mobile voice, messaging and data services and sales of handsets and other hardware. In addition, the Company offers a wide range of value-added services and products including Wi-Fi services, security services, cloud services, digital payment services, certain fixed-line services for businesses and insurance products for handsets and automobiles. The Company has continued to develop innovative value-added services and products, including services and products relating to the internet of things, big-data & insights, advertising and digital identity & authentication services for businesses.

Customer Experience

The Company intends to continue to give customers more reasons to choose and stay with O2 with the aim of continuing to offer a leading, differentiated customer experience and to improve customer engagement.

Through its digital loyalty programme, O2 Priority, the Company offers O2 customers a range of exclusive deals and perks. The Company continues to invest in O2 Priority to offer increasingly personalised perks and rewards to customers.

Also, in an effort to build on the success of the O2 Refresh proposition and to bring more flexible device ownership models to customers, the Company recently launched propositions such as O2 Recycle (which allows customers to sell their old device to the Company in exchange for cash and has become one of the largest mobile recycling programme by a mobile operator in Europe), and an Annual Upgrade Program (which enables customers to get the newest device every year) and Like New (which offers customers a choice of quality-assured pre-owned handsets). For business customers, the Company intends to continue to develop offerings targeted at the needs of specific

Strategic Report (continued)

Customer Experience (continued)

customer segments, including consumers and small-to-medium enterprises.

The Company prides itself on delivering excellent customer service and has sought to innovate to improve the customer service experience. The Company provides its customers with best-in-class service experience through self-serve channels such as My O2 and other channels, while partnering with NSPCC to provide further materials to help educate families about online safety for children. The Company's O2 Guru Service provides customers with advice and expert technical support for complex issues. In 2016, there were over 8 million interactions between O2 Gurus and customers; in store, online and over the phone.

The Company has prioritised mobile connectivity in its offerings, while also remaining flexible and utilising other technologies to deliver the best connectivity in every condition (e.g. O2 Wi-Fi, O2 Wi-Fi Extra, TU Go and certain fixed-line services for businesses).

Customer Relationship

The Company actively seeks opportunities to grow the value of its customer relationships by offering, and cross-selling and up-selling to its customers, additional services and products. For example, the Company's insurance offerings (including O2 Drive for automobiles), mobile broadband services, data bolt-on products and accessories (including premium headphones and smart-tech products such as fitness trackers and other wearables). In the Business segment the Company also offers customers additional products and services such as app offerings (including both third-party apps and apps developed by the Company), fixed-line offerings and O2 Wi-Fi. By understanding customer needs, this is part of the Company's strategy to deepen and strengthen its customer relationships.

Network Coverage

The Company follows an efficient approach to build a competitive network designed around what matters the most to the customers. As at 31 December 2016, the Company operated 2G, 3G and 4G mobile networks providing outdoor reception coverage to approximately 99%, 98% and 95%, respectively, of the UK population. The Company is committed to delivering a market leading mobile network and is in the process of rolling out the next generation 4G Network which will aim to provide 98% population coverage by the end of 2017.

Wholesale Provision

The Company also acts or has agreed to act as a wholesale provider in connection with mobile virtual network operator (MVNO) offerings by a range of third parties, including Lycamobile, Sky, TalkTalk and Truphone. The Company is the leading wholesale provider in the United Kingdom in terms of the number of MVNO subscribers (including Tesco Mobile, a joint venture). While the Company is focused on its customer-led, mobile-first strategy, the Directors believe that the Company's wholesale agreements with fixed-line operators will allow the Company to benefit from any trend in the consumer segment toward "multi-play" offerings (i.e. the bundling of mobile telecommunication services together with one or more of fixed-line telephony, fixed-line broadband internet and television content). Also, with respect to business customers where converged offerings are more established, the Company offers fixed-line services through partners and via O2 Gateway, which combines mobile, Wi-Fi and fixed-line services.

Strategic report (continued)

Smart Metering Implementation Programme

The Company, is the communications service provider for two of the three regions (Central and South) of the UK government's smart metering implementation programme which aims to roll out approximately 53 million gas and electricity smart meters across the UK by 1 January 2021. The Company has responsibility for the supply of communications hubs which link smart meters and in-home displays across a home area network and link smart meters to the data Communications Company and energy company systems.

Sustainability

The Company constantly aims to be a UK sustainability leader and believes that its technology can help customers and people live smarter and more sustainable lives.

The Company's sustainability strategy was re-launched in 2016 and is targeted at helping 20 million people to live better with technology by 2020. The Company aims to create digital products and services that help customers change their lives for the better, help society as a whole and grow social and environmental influence through the Company's partnerships. An example is the Company's continuing Partnership with the NSPCC to help parents and guardians understand the digital world their children live in with an aim to keep children safe online.

Performance and Development

The Company's revenue for the year ended 31 December 2016 was £5,241 million (2015: £5,393 million). The Company's operating profit for the year ended 31 December 2016 was £554 million (2015: loss of £3,689m primarily due to impairment of investments prior to the group reorganisation).

The Company's total comprehensive income for the year ended 31 December 2016 was £372 million (2015: £1,326 million). There was a decrease in revenue which was countered by a decrease in cost of sales and administrative expenses. In 2016 no dividends were received (2015: £5,111 million) and no investments were impaired in 2016 (£4,145 million impairment of investments in 2015).

The net assets of the Company as at 31 December 2016 were £1,835 million compared to £1,988 million at 31 December 2015 primarily due to a dividend paid in 2016 of £525m and the total comprehensive income of £374m.

The operating review of the Company's operating business for the year ended 31 December 2016 contain a discussion of relevant key performance measures including:

- Customer numbers – in line with industry convention postpay customers are counted if they have used the network in the preceding month whereas prepay customers are counted if they have used the network in the preceding three months.
- ARPU – Average revenue per user is calculated by dividing total monthly service revenue (excluding inbound roaming) from sales to customers for the preceding 12 months by the weighted average number of active customers for the same period. ARPU is calculated using gross service revenue before deduction of wholesale discounts. Total ARPU is a combination ratio incorporating both pre-pay and post-pay revenues.
- Churn – This represents the percentage of average accesses which have been disconnected in a period. It is calculated by dividing monthly disconnections (excluding migrations) by the monthly average customers.

Strategic Report (continued)

Performance and Development (continued)

At the end of 2016, the key operating performance highlights of the Company are:

Customer numbers – The Company's total mobile customer base increased to reach 25.5 million (+1.8% year-on-year), driven by continued growth in the contract segment of +9.0% year-on-year. The prepay base declined 8.1% year-on-year to 9.7 million. Mobile net additions stood at +444,000 in 2016, which was driven by the strong net additions in postpay of +584,000 offset by prepay net additions of -140,000. At the end of 2016, contract customers represented 61.9% of the base (+4.1 percentage points year-on-year).

4G network deployment reached 95% outdoor population coverage at 31 December 2016, with 4G enabled customers representing 47% of the mobile customer base.

Average revenue per user ("ARPU") – Total ARPU was down 1.1% year-on-year to £13.90.

Churn – Churn totalled 1.9% in 2016 (up 0.1 percentage points year-on-year), and contract churn remained market leading and improved to 0.9% for the year (down 0.1% year-on-year).

Principal risks and uncertainties

The Company has a comprehensive risk management framework in place, which is aligned with best practice in Internal Control (COSO1 II Report and ISO31000:2009 Principles and Guidelines for Risk Management).

The framework is designed to identify, assess, manage, monitor and mitigate significant risks that could adversely affect the future success of the Company through a well-established network of risk champions throughout the Company. The framework gives the Board a high awareness of key risks and the capacity to assign the most effective resources at the optimal moment to control and respond to the risks and opportunities identified.

Topical risk workshops and forums are held regularly in order to discuss and evaluate key emerging and horizon risks to the Company such as climate change and the environment, data fraud and the withdrawal of the UK from the European Union ('Brexit'). However the Company's most significant risks and uncertainties are as follows:

Risk	**Mitigation**
Data Privacy	
The Company has an obligation to manage its customer's data sensitively and within the relevant permissions, making it very clear and transparent to customers how their private data is being used and shared. In the event that The Company shared customer data without permission or where that permission had not been clearly understood, it would be at risk of fines, loss of reputation, loss of customer and employee trust, increased churn and loss of revenue	The Company has a Digital Confidence programme in place to address this risk. Each operating division has been asked to review their current products and services for compliance with internally set Data Governance on Customer Data Principles and permissions. The programme also reviews compliance against the EU General Data Protection Regulation, which came in to law in April 2016.

Strategic report (continued)

Breach of Data Security

Due to the way in which data is electronically stored and transmitted, there is a risk that a breach of security could occur and lead to the accidental or unlawful destruction, loss, alteration, unauthorised disclosure of, or access to that data. This could result in fines, loss of reputation, loss of customer and employee trust, increased churn and loss of revenue.	The Company carried out a review to identify the principal areas where data breaches could occur and mitigating controls are in place where relevant.

Network Spectrum/Capacity

The Company's mobile operations rely on the availability of spectrum and following the 2013 Spectrum auction, The Company has the lowest amount of spectrum per customer, aligned with a data growth rate of 100% year on year. To redress this, the Company needs to successfully acquire additional capacity in an upcoming auction.	The Company is preparing for the upcoming spectrum auction and has also taken learnings from around the World in alternative radio technology and infrastructure.

Fraud Management

Fraudulent activity by customers, suppliers, and sales channels may lead to the Company suffering financial loss due to being unable to recover revenue from products and services already provided. Examples could include identity fraud, card payment fraud and the fraudulent takeover of genuine customer accounts.	The Company remains ever-vigilant to the constantly changing threat environment and numerous defences are in place to defend its products and services, including dynamic and technological security solutions.

Network Coverage

The Company has an obligation in its 800MHz spectrum license to provide indoor coverage to 98% of the UK population (and 95% of the populations of each of England, Wales, Scotland and Northern Ireland) and an obligation in its 900/1800MHz spectrum licence to provide voice and text services to 90% of the UK landmass, both by the end of 2017, to be maintained, thereafter. Inherent with these obligations is a risk of the Company not meeting the required targets.	The Company is actively working towards mitigating the risk through the increased investment of capital expenditure in an infrastructure improvement programme, upgrading its 2G and 3G Networks and continued roll-out of our 4G Network.

Strategic report (continued)

Child Protection

The Company provides mobile and online services and due to the ever-increasing penetration of WiFi and Smartphone use amongst young people there is a risk of corporate reputation and brand damage or regulatory intervention flowing from a failure to protect children from inappropriate content, contact or conduct.

The Company has a robust network of 'SHIELD' controls in place to protect young people on our network from inappropriate content and contact. The Company also works with the NSPCC to raise awareness of online safety and share advice with parents and children.

Cyber Security Threat

The Company provides its consumer facing services through the internet via its online estate. Consequently, it must ensure that the estate is maintained to an acceptable and secure level so that customers are protected when using its services.

The Company is engaged in reviewing the front facing domains and has identified a number of items as needing redress to ensure provision of the best possible security against the physical estate. Mitigation elements are being introduced across systems gradually and the risk value will be reviewed at each significant step.

Significant event

On March 24, 2015, Telefónica, S.A. ("Telefonica") reached an agreement with Hutchison Whampoa Company for the acquisition of Telefónica's operations in the UK (the "Proposed Transaction").

On May 11, 2016 the European Commission made public its decision to prohibit the Proposed Transaction. Following this decision, the Board of Directors of Telefónica at its meeting on June 29, 2016 agreed that Telefónica will continue to explore different strategic alternatives for its UK operations, to be implemented when market conditions are deemed appropriate.

Post year end event

On 23 February 2017, Telefonica UK Limited (O2), announced that it had signed a new agreement with Anschutz Entertainment Group (AEG) for a further ten years securing the naming rights for the world's most successful music and entertainment venue, The O2 (the "Partnership") . The Partnership reaffirms O2's commitment to its customers to provide countless benefits through Priority and unforgettable live experiences.

The Strategic report was approved by the Board on 27 September 2017.

By Order of the Board

Robert Harwood
for and on behalf of O2 Secretaries Limited
Company Secretary

Directors' report

Legal form

Telefónica UK Limited ("the Company") is a private limited company registered in England and Wales under the number 1743099. The registered address is 260 Bath Road, Slough, SL1 4DX. The Company wholly owned subsidiary of Telefónica Europe plc, its ultimate UK parent, incorporated in England and Wales, which is itself a wholly owned subsidiary of Telefónica, S.A. ("Telefónica"), a company incorporated in Spain. The Company also trades under the brand name "O2".

Directors and secretary

The Directors who held office during the year were as follows:

Ronan Dunne (resigned 1 August 2016)
Mark Evans
Patricia Cobian (appointed 1 August 2016)

The Secretary who held office during the year was O2 Secretaries Limited.

Directors' liability insurance and indemnities

Telefónica Europe plc, the Company's ultimate UK parent company, has granted an indemnity in the form permitted by UK Company Law to Directors appointed to subsidiary companies. This indemnity remains in place and continues until such time as any relevant limitation periods for bringing claims (as defined in the indemnity) against the Director has expired, or for so long as the past Director, where relevant, remains liable for any losses (as defined in the indemnity).

Governance

The Company has set up a number of committees to consider specific matters within the framework of the Telefonica Group Operating Model and Delegated Authorities. The principal committees and their main responsibilities are as follows:

> The Operating Committee which monitors the operating and financial performance of the UK businesses as a whole and assesses risk. This committee has sub-committees reporting to it in relation to investment matters, commercial and digital operations.
>
> The Strategy Committee which monitors the external market and competitive forces in the UK, develops strategy, and monitors key strategic projects.
>
> The Assurance Forum which supports the internal control framework and assists the Board in fulfilling its oversight responsibilities for governance, risk and compliance.
>
> The Pensions Committee which considers matters relating to the Telefonica UK Pension Plan of which Telefonica Europe plc is the Principal Employer.
>
> The Sustainability and Responsibility Council which considers matters related to the delivery of the Company's sustainability and responsibility strategy.

Dividends

During the year ended 31 December 2016 the Company paid an interim dividend of £525 million (year ended 31 December 2015: £11,705 million).

Directors' Report (continued)

Political donations

The Company made no political donations during the year ended 31 December 2016 (2015: £nil).

Employment Policies

The Directors believe that diversity of thinking is critical to a successful consumer business, as the Company aims to understand the points of view and needs of its more than 25 million customers.

The Company is committed to employment policies that follow good practice based on equal opportunities for all, and recognise diversity, including fair treatment of people with disabilities in relation to their recruitment, training and development.

The Company also invests in researching age, gender and disability diversity across the organisation, seeking to support all employees and their career development at every level of the organisation.

The Company supports the health and wellbeing of its employees and, specifically, is committed to making improvements to the issue of mental health in the workplace as well as providing a range of occupational health and employee support services to employees.

To support employees the Company is a member of the Business Disability Forum which provides pragmatic support by sharing expertise, giving advice, providing training and facilitating networking opportunities. This helps organisations become fully accessible to disabled customers and employees.

The Company's policies on *Diversity & Inclusion* and *Reasonable Adjustments* detail the importance placed on providing an inclusive workplace for all, including disabled employees.

These policies include guidance for line managers and employees including:

Recruitment processes and additional arrangements which can be made as required due to any disability, such as:

- Reasonable adjustments and practical considerations relating to disabilities.
- Increasing the accessibility of our services making them more inclusive for disabled people.
- Importance of diversity and ensuring that discrimination does not occur.
- Importance of focussing on what people can do rather than what they cannot and challenging stereotypes about people with disabilities.
- E-learning which is available to all Company employees to highlight the legal and behavioural aspects of Diversity & Inclusion.

Employee engagement

The Company's employees are key to its business and culture. The Company aims to achieve high levels of employee engagement in order to achieve high levels of performance. The Company aims to do this in the following ways:

Engagement: the Company has a wide range of communication channels with employees, including face-to-face meetings, team briefings, digital live streaming conferences, interactive microsites and a comprehensive intranet with tailored content dependent on employee segmentation. The Company aims to ensure employees understand the Company's objectives and its operational and financial performance as well as its latest products and services. The Company

Directors' Report (continued)

Employment Engagement (continued)

conducts a biannual engagement survey, in which the Directors believe the Company consistently scores above average in comparison to other comparable UK organisations. The Company aims to maintain a constructive dialogue with unions, employee representative bodies and works councils.

Employee development: the Company is committed to the development of all employees and actively promotes this through learning and development initiatives including the provision of digital learning. The Company aims to maintain robust succession plans for senior roles and invests in developing high-potential leaders through tailored development programmes to improve stability in its leadership population. Employees are encouraged and supported in maintaining personal development plans.

Diversity: the Directors believe that diversity of thinking is critical to a successful consumer business, as the Company aims to understand the points of view and needs of its more than 25 million customers. The Company is committed to employment policies that follow good practice based on equal opportunities for all, and recognise diversity, including fair treatment of people with disabilities in relation to their recruitment, training and development. The Company has also invested in researching age, gender and disability diversity across the organisation, seeking to support all employees and their career development at every level of the organisation. The Company supports the health and wellbeing of its employees and, specifically, is committed to making improvements to the issue of mental health in the workplace as well as providing a range of occupational health and employee support services to employees.

Incentives: the Company aims to create a high performing culture by targeting and rewarding employees based on both personal and company performance, through annual bonuses and financial incentives for the Company reaching specific targets.

Financial risk management objectives, policies and exposure

Details of the Company's approach to financial risk management are set out in the financial statements in note 21 "Financial instruments".

Going concern

The Company's business activities together with the factors likely to affect the future development, performance and position are set out in the Strategic Report.

The financial position of the Company is described in the Strategic Report. In addition, note 21 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk. As a consequence, the Directors believe that the Company is well placed to manage its business risk successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future, and thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Directors' Report (continued)

Statement as to disclosure to auditor

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

The Directors' Report has been approved by the Board on 27 September 2017.

By Order of the Board

Robert Harwood
for and on behalf of O2 Secretaries Limited
Company Secretary

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, International Accounting Standard 1 requires that the directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance;
- make an assessment of the company's ability to continue as a going concern;
- make judgements and estimates that are reasonable and prudent; and
- state that applicable accounting standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Year ended 31 December 2016

Independent auditor's report to the members of Telefonica UK Limited

We have audited the financial statements of Telefonica UK Limited for the year ended 31 December 2016 which comprise the Statement of Financial Position, the Statement of Comprehensive Income, the Statement of changes in equity, Statement of Cash Flows and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement on page 12, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit;

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

Year ended 31 December 2016

Independent auditor's report to the members of Telefonica UK Limited (continued)

Matters on which we are required to report by exception

In light of the knowledge and understanding of the Company and its environment obtained in the course of audit, we have identified no material misstatements in the Strategic report or Directors' Report.

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Ernst & Young LLP

Marcus Butler (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading

28/04/2017

Statement of comprehensive income
For the year ended 31 December 2016

	Note	**2016** **£m**	2015 Restated* £m
Revenue	29	**5,241**	5,393
Cost of sales		**(2,882)**	(2,950)
Gross profit		**2,359**	2,443
Administrative expenses		**(1,805)**	(1,987)
Non recurring expenses - impairment charge	7	**-**	(4,145)
Operating Profit/(Loss)	2	**554**	(3,689)
Financial income	3	**23**	5,131
Financial expense	3	**(32)**	(37)
Profit before taxation		**545**	1,405
Taxation	4	**(173)**	(79)
Profit for the year attributable to equity shareholders		**372**	1,326
Total comprehensive income for the year		**372**	1,326

The accompanying notes on pages 20 to 57 are an integral part of these financial statements.
* The prior year comparatives have been restated. Refer to note 1 of the financial statements for further details.

Statement of financial position
As at 31 December 2016

	Note	31 December 2016 £m	31 December 2015 Restated* £m
Non-current assets			
Property, plant and equipment	5	**2,459**	2,367
Intangible assets	6	**1,319**	1,430
Investments	7	**21**	21
Deferred tax assets	16	**3**	1
Trade and other receivables	9	**188**	245
Other financial assets	10	**22**	16
		4,012	4,080
Current assets			
Inventories		**84**	66
Trade and other receivables	9	**1,385**	1,493
Other financial assets	10	**72**	64
Cash and cash equivalents	11	**58**	266
		1,599	1,889
Current liabilities			
Borrowings	12	**(305)**	(272)
Trade and other payables	13	**(2,593)**	(2,893)
Current tax liabilities		**(126)**	(88)
Provisions	14	**(34)**	(37)
		(3,058)	(3,290)
Net current liabilities		**(1,459)**	(1,401)
Total assets less current liabilities		**2,553**	2,679
Non-current liabilities			
Borrowings	12	**(590)**	(590)
Deferred income		**(9)**	-
Deferred tax liabilities	16	**(39)**	(36)
Provisions	14	**(80)**	(65)
		(718)	(691)
Net assets		**1,835**	1,988
Equity			
Ordinary share capital	17	**10**	10
Retained earnings	18	**1,825**	1,978
Total equity		**1,835**	1,988

The accompanying notes on pages 20 to 57 are an integral part of these financial statements.
* The prior year comparatives have been restated. Refer to note 1 of the financial statements for further details.

These financial statements were approved by the Board of Directors on 27 September 2017 and were signed on its behalf by:

Patricia Cobian
Director

Statement of changes in equity
Year ended 31 December 2016

	Ordinary share capital Note 17 £m	Share premium £m	Retained earnings Note 18 £m	Total equity £m
At 1 January 2015	**10**	**8,799**	**3,558**	**12,367**
Total comprehensive income for the year	**-**	**-**	**1,326**	**1,326**
Share premium transferred to reserves	**-**	**(8,799)**	**8,799**	**-**
Dividends paid	**-**	**-**	**(11,705)**	**(11,705)**
At 31 December 2015	**10**	**-**	**1,978**	**1,988**
Total comprehensive income for the year	**-**	**-**	**372**	**372**
Dividends paid	**-**	**-**	**(525)**	**(525)**
At 31 December 2016	**10**	**-**	**1,825**	**1,835**

The accompanying notes on pages 20 to 57 are an integral part of these financial statements.

Statement of cash flows
Year ended 31 December 2016

	Note	2016 £m	2015 £m
Profit before taxation		**545**	**1,405**
Adjustments to reconcile profit before tax to net cash flows:			
Depreciation and amortisation charges	5,6	773	744
Impairment of investment in subsidiaries	7	-	4,145
Dividend income	3	-	(5,111)
Increase/(Decrease) in other provisions		(3)	1
Increase in bad debt provision	9	(22)	17
Share based payments expense		-	2
Net foreign exchange differences		(2)	19
Net financial expenses/(income)		14	17
Operating profit before adjustments for working capital changes		**1,305**	**1,239**
(Increase)/Decrease in inventories		(18)	(16)
Decrease/(Increase) in trade and other receivables		187	6,660
(Decrease)/Increase in trade and other payables		45	(106)
Other non cash movements	(a)	1	(6,601)
Corporation tax paid		(60)	(18)
Net cash flow from operating activities		**1,460**	**1,158**
Investment in group companies	7	-	-
Repayment in other financial assets		59	75
Investment in financial assets		(73)	-
Dividends received		-	543
Interest received		7	1
Purchase of property, plant and equipment		(748)	(663)
Net cash flow used in investing activities		**(755)**	**(44)**
Dividends paid		(525)	(598)
Interest paid		(20)	(28)
Repayment of borrowings		(368)	(197)
Net cash flow used in financing activities		**(913)**	**(823)**
Net increase/(decrease) in cash and cash equivalents		**(208)**	**291**
Cash and cash equivalents at 1 January		**266**	**(53)**
Cash and cash equivalents at 31 December	11	**58**	**238**

Statement of cash flows (continued)
Year ended 31 December 2016

Note (a) – Major Non Cash Transactions

	2016	2015
	£m	£m
Distribution in Specie paid	-	(11,106)
Distribution in Specie received	-	4,568
Intercompany debtors impairments	-	(72)
Other non cash transactions	1	9
Other non cash movements	**1**	**(6,601)**

The accompanying notes on pages 20 to 57 are an integral part of these financial statements.

1. Accounting policies

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations, as adopted for use in the EU. In addition the financial statements have been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared using historical cost principles except that, as disclosed in the accounting policies below, certain items including derivative instruments are measured at fair value.

The principal accounting policies of the Company applied in the preparation of these financial statements are set out below. The IFRS accounting policies have been applied consistently to all periods presented.

In accordance with s400 of the Companies Act 2006, consolidated financial statements have not been prepared as the Company and its subsidiaries are included in the Company financial statements of Telefonica S.A, the ultimate parent company, for the year ended 31 December 2016.

Presentation of financial information

Operating items in the statement of comprehensive income are derived from the primary operations of the Company as a telecommunications provider. Items in the statement of comprehensive income recognised below operating profit represent activities that are not directly attributable to the Company's primary operations.

Basis of accounting

These financial statements comprise the financial statements of the company and its share of jointly controlled entities as at 31 December 2016.

Joint arrangements

IFRS11 establishes principles for the financial reporting of parties to joint arrangements. It defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when the decisions about the relevant activities require the unanimous consent of the parties sharing control. Joint arrangements that meet the definition of a joint venture are accounted for using the equity method, while joint arrangements that meet the definition of joint operations are accounted for by integrating assets and liabilities, and the related revenues and expenses, in proportion to the joint operator's interest in the arrangement.

The Company holds a 50% interest in Cornerstone Telecommunications Infrastructure Limited, which is engaged in maintaining and managing the non-radio (passive) assets supporting the mobile wireless network of Vodafone Limited and Telefonica UK Limited. This is accounted for as a joint operation by integrating the assets and liabilities and the related revenues and expenses in proportion to the Company's interest in the joint operation.

Under the equity method, the investment in an associate or a joint venture is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Company's share of net assets of the associate or joint venture since the acquisition date. The statement of comprehensive income reflects the Company's share of the results of operations of the associate or joint venture.

Investments

Investments are stated at cost less provision for impairment. An impairment loss is recognised for the amount by which the investment's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an investment's fair value less costs to sell and value in use.

1. Accounting policies (continued)

Disposal of subsidiaries to entities under common control

In the absence of specific IFRS literature in relation to transactions under common control, the Company has applied the requirements of IAS 8.10 – 12, in its financial statements, and has selected an appropriate accounting policy, not contradicting other IFRS's. The Company has chosen to recognise the transactions at the consideration agreed between the parties (being the amount of cash paid). Recognition of the transaction on the basis of the consideration agreed may result in a gain or loss based on the difference between the consideration received and the carrying value of the business disposed.

Functional currency

For the purpose of the financial statements, the results and financial position of the Company are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for the financial statements.

In preparing the financial statements, transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on the dates of the transactions. At each reporting date, the monetary assets and liabilities that are denominated in foreign currencies are retranslated at rates prevailing at each reporting date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, an on the retranslation of monetary items, are included in the profit of loss for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss of the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity.

Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. The cost of property, plant and equipment includes directly attributable incremental costs incurred in their acquisition and installation. Subsequent costs are included in the assets' carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

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

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

The assets' useful lives and residual values are reviewed, and adjusted if appropriate, at each statement of financial position date.

1. Accounting policies (continued)

Property, plant and equipment (continued)

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income when the asset is derecognised.

Intangible assets

Radiocommunications Licences

Licence fees paid to the Government, which permit telecommunications activities to be operated for defined periods, are capitalised at cost less impairment losses and are amortised from the date of commercial launch of the service over the initial 20 year term of the licence on a straight line basis. The remaining useful lives of the "3G" and "4G" licences are 5 years and 16 years respectively.

Software

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

Impairment of non-financial assets

Assets with a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and 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.

Revenue

Revenue, which excludes value added tax and other sales taxes, comprises mobile service revenue and hardware and other revenue (each as described in more detail below).
Promotional offers and packages including different elements are assessed to determine whether it is necessary to separate out each component and apply a revenue recognition policy to each element. Total revenue is split among the identified elements based on their respective fair values.
Revenue is recognised on a gross basis where the Company's role is that of principal in a transaction. The gross basis represents the gross value of the billing to the customer after trade discounts, with any related costs being charged to cost of sales or administrative expenses, as relevant. Where the Company acts as agent in a transaction, revenue is presented net of direct attributable expenses.

Mobile service revenue includes revenue earned for usage of the Company's wireless network for voice, text message and data transmission by the Company's customers, subscription fees (including those earned from the Company's MVNO partners), inbound roaming (earned from foreign mobile operators whose customers roam onto the Company's network), outbound roaming (earned from the Company's customers roaming outside their domestic coverage area) and interconnect revenue (earned from other telecommunication operators whose customers terminate calls on the Company's network).

1. Accounting policies (continued)

Revenue (continued)

Mobile service revenue, relating to both customers connected by indirect distribution channels and direct customers who are not under the Refresh proposition, will include the full amount charged to the customer and this revenue is not separated between mobile service and handset element, with the monthly bills of relevant post-pay customers reflecting a single tariff for both the cost of the airtime and the mobile device. The O2 Refresh proposition was introduced in 2013 and separates the sale of mobile devices from the sale of mobile telecommunication services by the customer signing separate contracts: a device plan (paid in monthly instalments) and an airtime plan.

Bills issued to post-pay customers include monthly subscription fees charged in advance and calls and other usage charged in arrears. Revenue is recognised when the service is rendered with deferred revenue recognised on the statement of financial position to the extent of services paid for but not yet used or until expiry at the end of the subscription period. Revenue is accrued and recognised on the statement of financial position if the services are delivered in advance of customer billing. Revenue for pre-pay customers is recorded as deferred revenue prior to commencement of services and is recognised as the pre-pay services are rendered. Inbound roaming revenue, earned from foreign mobile operators whose customers roam onto the network, and outbound roaming revenue, earned from the Company's customers roaming outside their domestic coverage area, is recognised based upon usage. Subscription fees are recognised evenly throughout the periods to which they relate.

Interconnect revenue earned from other telecommunications operators whose customers terminate calls on the Company's network, is recognised based on usage.

Hardware revenue principally consists of revenue from the sale of mobile devices, including smartphones and other mobile handsets sold through the Company's direct distribution channels under the Refresh proposition, where hardware is recognised as a separate deliverable, as well as the sale of tablets, smart-tech (e.g. smart watches and fitness devices) and accessories (e.g. mobile phone cases, screen protectors, chargers, cables, portable batteries, headphones and speakers). Hardware revenue is recognised when the products are delivered to the customer.

Other revenue principally consists of revenue from the Company's integrated mobile, Wi-Fi and fixed-line offerings to business customers and related business offerings, insurance sales and smart metering. These revenues are recognised on the provision of both goods and services, with revenue recognition on delivery of the goods or services to the customer.

Supplies principally consists of interconnection and roaming costs incurred in connecting the Company's customers to other mobile networks, costs associated with hardware procurement (such as handsets, tablets, SIM cards and accessories), indirect distribution channel sales costs and costs associated with providing connectivity to consumer and business customers (such as transmission line rental costs and costs associated with the Company's integrated mobile, Wi-Fi and fixed-line offerings to business customers and related business offerings), comprising wholesale costs with other network and service providers and related hardware.

Personnel expenses

Personnel expenses comprise wages and salaries and related direct employment costs for permanent employees, adjusted for own work capitalised.

1. Accounting policies (continued)

Administrative expenses

Administrative expenses principally consists of commissions paid to dealers, network and non-network accommodation costs in relation to the Company's properties, network maintenance costs, customer service costs, IT and system support costs, marketing costs and bad debt expenses. Subscriber acquisition and retention costs, other than loyalty programme costs, are recognised as an expense for the period in which they are incurred. Advertising, promotion, sponsoring, communication and brand marketing costs are also expensed as incurred.

Employee benefits

Pension obligations
The Company operates both defined benefit and defined contribution plans. A defined benefit plan is a pension plan that sets the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the Company pays fixed contributions on behalf of employees and under which there is no legal or constructive obligation to pay further contributions for employees' service in the current and prior periods.

The Company participates in the Telefonica UK Pension Plan ("Plan"), a scheme sponsored by Telefonica Europe plc that provides benefits for the majority of UK employees in the Telefonica Europe plc Group. During the period presented, the Plan had both defined benefit and defined contribution sections. On 28 February 2013 the defined benefit sections of the Plan closed to further benefit accrual.

In its capacity as a participating employer of the defined contribution section of the Plan, the Company pays contributions into the Plan on behalf of employees. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

The Company accounts for the defined benefit section of the Plan as though it were a defined contribution plan as there is no arrangement for charging out the net defined benefit cost between participating employers. The net defined benefit cost of the defined benefit sections, as assessed in accordance with the advice of a qualified, independent actuary measuring actual liabilities using the projected unit method and taking assets at market value, is recognised by the sponsoring employer. Accordingly the defined benefit deficit of the Plan is not recognised on the statement of financial position of the Company because the sponsoring employer is Telefónica Europe plc. Disclosures over the defined benefit sections of the Plan are provided in note 25.

Share based payments

The Company recognises an expense for share awards and share options, which are both equity and cash settled, based on the fair value of the share awards or share options granted as compensation for the services rendered by employees. The fair value is calculated at the grant date using an adjusted statistical model and excludes the impact of non-market conditions. Instead, the expense is adjusted for the effect of non-market conditions at each reporting date through the number of share awards or share options expected to be exercisable.

The effect of market and non-vesting conditions is included in the fair value at the date of grant and is recognised as an expense irrespective of whether the market or non-vesting condition is satisfied. Any proceeds received are credited to share capital and share premium when the share option or award is exercised. In addition, for cash-settled share based payment transactions, the Company measures the services received and the liability incurred at the fair value of the liability. Until the liability is settled, the Company re-measures the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognised in the consolidated statement of comprehensive income for the period.

1. Accounting policies (continued)

Financial income and expense

Financial income principally consists of interest income on Company deposits, interest income from balances with other group companies and gains arising from foreign exchange rate hedging instruments. Financial expense principally consists of interest expense on Company borrowings and losses arising from foreign exchange rate hedging instruments. The Company utilises foreign exchange rate hedging instruments to hedge foreign exchange rate exposure principally in respect of Euro and US dollar payments with regard to roaming agreements and not for speculative purposes.

Taxation

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

Deferred income tax is provided in full, using the statement of financial position liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable future taxable profits will be available against which deductible temporary differences can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

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

Income tax relating to items recognised in other comprehensive income or in equity is also recognised directly in other comprehensive income or in equity respectively.

Cash and cash equivalents

Cash and cash equivalents are carried in the statement of financial position at cost. Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and short term deposits repayable on demand with Telefonica Finanzas S.A and Telfisa Global B.V., both of which are related parties. Bank overdrafts are shown within borrowings in current liabilities on the statement of financial position.

Other financial assets

Other financial assets are non-monetary financial assets, including hire purchase contract balances and other financial receivables. These are carried in the statement of financial position at amortised cost. Other financial assets are held in trust to meet hire purchase obligations. These are not considered highly liquid investments and are not held for the purpose of meeting the Company's short-term cash commitments.

Inventories

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

1. Accounting policies (continued)

Trade and other receivables

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

Provisions and contingent liabilities

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Restructuring provisions could comprise, amongst other items, employee termination payments, and these are recognised in the period in which the Company becomes legally or constructively committed to payment. A provision is made for the present value of the cost of restoration of mast sites at the date of acquisition of the site.

Borrowings

Borrowings are recognised initially at fair value. Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between the cost and the redemption value being recognised in the statement of comprehensive income over the period of the borrowings on an effective interest basis. Accrued interest on borrowings is included within the carrying value.

Leases

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

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

Accounting for derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value at each reporting date.

Derivatives which are not designated as hedges

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

1. Accounting policies (continued)

Dividends

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

Income is recognised when the company's rights to receive the payment is established. Dividends received from subsidiary companies are recognised as finance income in the Company's financial statements in the period in which the dividends are received.

Capital management

The Company's capital comprises share capital and retained earnings.

The Company's objectives when managing capital are to safeguard the Company's ability to continue to operate as a going concern, to maintain optimal capital structure commensurate with risk and return and to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Company may pay dividends to its shareholder, return capital to its shareholder, issue new shares or sell assets to reduce debt or draw down more debt.

Financial risk factors and management

The Company's principal financial liabilities, other than derivatives, comprise bank overdrafts, other loans, finance leases and trade and other payables. The purpose of these financial liabilities is to raise finance for the Company's operations. The Company has various financial assets such as trade receivables, cash and short term deposits.

The main sources of risk arising from the Company's financial instruments are currency risk, interest rate risk, credit risk and liquidity risk. Management of the Company's financial risks is achieved mostly through being a part of the larger Telefónica group, which operates group wide policies in each area and is able to hedge positions on a group basis.

The Company's operations expose it to a variety of financial risks including currency risk, credit risk and liquidity risk, sensitivity analysis of these risks has not been considered as the Company mitigates efficiently against these risks. The principal financial risks of the Company and how the Company manages these risks are discussed below.

Credit risk

Credit risk is the risk that a counterparty will not meet its obligation under a financial instrument or customer contract, leading to a financial loss.

The Company's principal credit risks are attributable to its trade receivables. Trade receivables as presented in the statement of financial position are net of provision for doubtful debts, estimated by the Company's management based on prior experience and their assessment of the current economic environment. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis.

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

1. Accounting policies (continued)

Liquidity risk

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

Management of the Company's liquidity risk is achieved mostly through being a part of the larger Telefónica group, which operates group wide policies in this area. The Company holds financial assets primarily in short-term deposits with a central Telefónica group company that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

Foreign currency risk

The Company operates mainly in the United Kingdom. The Company is exposed to transactional foreign exchange risks arising from various currency movements, primarily with respect to the Euro and US dollar that can affect its results and financial position.

The Company also has a small amount of transactional exposure. Such exposure arises from revenues and purchases by an operating unit that is in currencies other than the unit's functional currency. Significant exposures are managed through the use of foreign exchange contracts and the Telefónica group managing positions on a group wide basis.

Interest rate risk

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company's interest rate risk arises primarily from the effects of movements in interest rates on the value of the Company's long-term borrowings and interest received on cash and cash equivalents. The Company's long term borrowings and other financial assets are at fixed interest rates. The majority of the Company's cash and cash equivalents are deposited with a central Telefónica group company that pays interest at variable market rates.

New standards and IFRIC interpretations not applied

The following IFRS and IFRIC interpretations, which may have an impact on the Company's financial information, have been issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee (IFRIC). The Company intends to adopt these standards and interpretations when they become effective:

1. Accounting policies (continued)

IAS/IFRS standards	Effective for accounting periods beginning on or after
Amendments to IAS 12 (January 2016) *Recognition of Deferred Tax Assets for Unrealised Losses*	1 January 2017[1]
Amendment to IAS 7 *Disclosure Initiative*	1 January 2017[1]
IFRS 9 *Financial Instruments*	1 January 2018[1]
IFRS 15 *Revenues from Contracts with Customers*	1 January 2018[1]
IFRS 16 *Leases*	1 January 2019[1]
Amendments to IFRS 10 and IAS 28 (September 2014) *Sales or Contribution of Assets between and Investor and its Associate of Joint Venture*)	See below[2]

1. Accounting policies (continued)

New standards and IFRIC interpretations not applied (continued)

[1] The mandatory adoption under EU applying regulations has not yet been confirmed.

[2] The IASB has acknowledged a conflict between these amendments and IAS 28 Investments in Associates and Joint Ventures. In December 2015 the IASB published and amendment to IFRS 10 and IAS 28, deferring the effective date of these amendments indefinitely.

The Company do not anticipate the adoption of these other standards will have a material impact on the Company's accounts in the period of initial application other than the following:

IFRS 9 may impact the measurement and disclosure of the Company's financial instruments.

IFRS 15 will require the Company to identify deliverables in contracts with customers that qualify as 'performance obligations'; the transaction price receivable from customers must be allocated between the Company's performance obligations under the contracts on a relative stand-alone selling basis. The main impact of this will see the amount of revenue allocated to equipment and recognised when control of the device passes to the customer increase with a decrease in revenue recognised as services. Where additional up-front unbilled revenue is recorded for the sale of devices, this will be reflected in the balance sheet as a contract asset.

Under IFRS 15 certain incremental costs incurred in acquiring a contract with a customer will be deferred on the balance sheet and amortised as revenue under the related contract. This will generally lead to the later recognition of charges for commissions payable to third parties and employees.

Following an initial impact assessment, the Company has established a transition plan to deliver the required business change together with an implementation timetable. The changes highlighted above will have a material impact on the consolidated statement of comprehensive income and the consolidated statement of financial position after the Company adopts IFRS 15 on 1 January 2018.

When IFRS 15 is adopted it can be applied either on a fully retrospective basis, requiring the restatement of comparative periods presented in the financial statements, or with the cumulative restatement impact of IFRS 15 applied as an adjustment to equity on the date of adoption; when the latter approach is applied it is necessary to disclose the impact of IFRS 15 on each line item in the financial statements in the reporting period.

IFRS 16 is expected to result in a material increase to both assets and liabilities of the Company and will reduce operating costs and increase finance costs.

Adoption of new and revised standards

The accounting policies adopted are consistent with those of the previous financial year except for a number of new and revised Standards and Interpretations which have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported.

Critical accounting estimates and judgements

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

1. Accounting policies (continued)

Property, plant and equipment and licences

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

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

It is not practicable to quantify the impact of changes in property, plant and equipment asset lives on an overall basis as asset lives are individually determined and there is a significant number of assets in use. The impact of any change would vary significantly depending on the individual changes in assets and the classes of assets impacted.

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

The carrying amount of property plant and equipment and licences for each reporting period is set out in Notes 5 and 6 respectively.

Deferred tax assets and liabilities

The Company evaluates the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the course of the period for which the deferred tax assets remain deductible.

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

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

The carrying amount of deferred tax assets and liabilities for each reporting period is set out in Note 16.

Trade receivables provision for doubtful debts

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

1. Accounting policies (continued)

Trade receivables provision for doubtful debts (continued)

which would negatively impact the operating results. The level of provision required is reviewed on an ongoing basis.

The carrying amount of doubtful debt provision for each reporting period is set out in Note 9.

Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. This obligation may be legal or constructive deriving from regulations, contracts, normal practices or public commitments that lead third parties to reasonably expect that the Company will assume certain responsibilities. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, taking into account all available information.

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

The ARO provision is based on assumptions covering the discount rate, expected lease renewals and the expected cost of restoring the sites. The payment dates of these asset retirement obligation costs are uncertain but are currently anticipated to be over the next 23 years.

The carrying amount of provisions for each reporting period is set out in Note 14.

Pension benefits

The cost of the defined benefit pension plan and the present value of the pension obligation are determined using an actuarial valuation. An actuarial valuation involves making various assumptions. These include the discount rate, future salary increases, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long term nature, a defined benefit obligation is highly sensitive to changes in these assumptions and its long term nature, a defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of corporate bonds with at least an AA rating, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. The mortality rate is based on publically available mortality tables.

Future salary increases and pension increases are based in expected future inflation rates.

Further details about the assumptions are given in Note 15.

Prior period adjustments

Trade and other receivables

In the current year it was determined that the non-current element of a prepayment could be reliably estimated. A similar non-current prepayment existed in the prior year, and the comparative has therefore been restated for consistency. This has resulted in an understatement of non-current prepayments that was offset by an equal and opposite overstatement of current prepayments.

The adjustment has been made to reclassify prepayments from trade and other receivables included within current assets to trade and other receivables included within Non-current assets by £77m.

The Company has also reclassified £168m of non-current trade receivables previously included in other financial assets to trade and other receivables for effective presentation of the financial position of the Company.

The change did not have an impact on statement of changes in equity, statement of comprehensive income or cash flows.

1. Accounting policies (continued)

Fixed assets reclassification

Following a review of non-current assets, the Company has identified historical misclassifications of fixed assets. This has resulted in an understatement of intangible assets that was offset by an equal and opposite overstatement of Property Plant and Equipment ("PPE"). The classification error has been corrected by restating each of the affected financial statements line items for the prior period.

The balances as of 1st January 2015 have been adjusted to reclassify £59m from PPE to intangible assets. The comparative balances as of 31 December 2015 have been adjusted to reclassify £85m from PPE to intangible assets.

The change did not have an impact on statement of changes in equity, statement of comprehensive income or the cash flow statement.

Tax charge

As a result of the fixed asset reclassification explained above, the tax charge for the prior year was reviewed and recalculated. The 2015 opening balances reflect an increase in current tax payable of £9m (£14m to £23m) and a decrease in the deferred tax liability of £8m (£48m to £40m). The charge for 2015 reflects an increase in corporation tax of £4m (£75m to £79m) comprising £3m of current tax and £1m of deferred tax. The statement of financial position was similarly changed to reflect the above.

2. Operating profit/(loss)

The following items have been included in arriving at operating profit/(loss):

	2016 £m	2015 £m
Depreciation of property, plant and equipment (note 5)	518	539
Amortisation of intangible assets (note 6)	255	205
Impairment of investments	-	4,154
Loss on disposal of property, plant and equipment	1	-
Staff costs (note 24)	384	454
Auditor's remuneration (note 22)		
Audit	0.7	0.7
Other audit related fees	2.4	0.3
Inventories		
Cost of inventories recognised as an expense (included in cost of sales)	1,123	1,146
Net write downs of inventories recognised in the year	-	(2)
Operating lease rentals payable	168	168
Restructuring costs (note 14)	32	(2)
Provision for doubtful debts	76	88
Bad debt retirements	(14)	(21)
Movement in provision for amounts owed by Group companies	(2)	(32)
Joint operation operating costs	20	16

3. Net financial income

	2016 £m	2015 £m
Financial income		
Interest income on cash, cash equivalents and other financial assets	**11**	19
Interest income from other group companies	**12**	1
Dividends received	**-**	5,111
Total financial income	**23**	5,131
Interest payable to other group companies	**(22)**	(35)
Other financial costs	**(10)**	(2)
Total financial expense	**(32)**	(37)
Net financial (expense)/income	**(9)**	5,094

4. Taxation

Analysis of charge in the year

	2016 £m	2015 Restated* £m
Current tax - current year	**114**	105
Current tax - adjustment in respect of prior years	**58**	(21)
Deferred tax - current year (note 16)	**4**	(4)
Deferred tax - adjustment in respect of prior years (note 16)	**(2)**	4
Effect of change in tax rate (note 16)	**(1)**	(5)
Taxation	**173**	79

The tax assessed for the year varied from the amount computed by applying the corporation tax standard rate to profit on ordinary activities before taxation. The difference was attributable to the following factors:

	2016 £m	2015 Restated* £m
Profit before taxation	**545**	**1,405**
Profit before taxation multiplied by rate of corporation tax in the UK of 20% (2015: 20.25%)	**109**	**285**
Effects of:		
Expenses not deductible for tax purposes	**17**	**897**
Non-taxable income	**(7)**	**(1,081)**
UK-UK transfer pricing adjustment	**(1)**	**-**
Effect of change in tax rate	**(1)**	**(5)**
Adjustments in respect of prior years	**56**	**(17)**
Total taxation	**173**	**79**

The Finance Act 2013 reduced the main rate of corporation tax to 21%, with effect from 1 April 2014, with a further reduction to 20%, with effect from 1 April 2015.

The prior period balances have been restated to update the tax balances for the impact of the fixed assets reclassification. See note 1 for more information.

5. Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
Cost				
At 1 January 2015	312	5,706	453	6,471
Additions	-	-	544	544
Reclassifications	22	485	(507)	-
Disposals	(3)	(122)	-	(125)
At 31 December 2015	**331**	**6,069**	**490**	**6,890**
Additions	-	-	613	613
Reclassifications	11	609	(620)	-
Disposals	(1)	(230)	-	(231)
At 31 December 2016	**341**	**6,448**	**483**	**7,272**
Depreciation				
At 1 January 2015	212	3,890	-	4,102
Charge for the year	23	516	-	539
Disposals	(3)	(115)	-	(118)
At 31 December 2015	**232**	**4,291**	**-**	**4,523**
Charge for the year	23	495	-	518
Disposals	(1)	(227)	-	(228)
At 31 December 2016	**254**	**4,559**	**-**	**4,813**
Net book value				
At 31 December 2016	**87**	**1,889**	**483**	**2,459**
At 31 December 2015	**99**	**1,778**	**490**	**2,367**

The prior period balances have been restated to include a reclassification between intangible assets and plant, property and equipment. See note 1 for more information.

6. Intangible assets

	Licences £m	Software £m	Assets in the course of construction £m	Total £m
Cost				
At 1 January 2015	4,641	1,332	36	6,009
Additions	-	-	105	105
Disposals	-	(1)	-	(1)
Reclassifications	-	64	(64)	-
At 31 December 2015	4,641	1,395	77	6,113
Additions	-	-	145	145
Disposals	-	(8)	-	(8)
Reclassifications	-	123	(123)	-
At 31 December 2016	**4,641**	**1,510**	**99**	**6,250**
Amortisation				
At 1 January 2015	3,276	1,204	-	4,480
Charge for the year	145	60	-	205
Disposals	-	(1)	-	(1)
At 31 December 2015	3,421	1,263	-	4,684
Charge for the year	145	110	-	255
Disposals	-	(8)	-	(8)
At 31 December 2016	**3,566**	**1,365**	**-**	**4,931**
Net book value				
At 31 December 2016	**1,075**	**145**	**99**	**1,319**
At 31 December 2015	1,220	132	77	1,430

The licences are assets permitting the Company to operate both its "3G" and "4G" networks in the UK. On 19 February 2013 the Company successfully secured the licence to 20Mhz of 800Mhz spectrum which has been used by the Company to build a 4G mobile network in the UK. The Company paid a total of £550m for two separate lots of the auction; one of these lots has a coverage obligation attached, under which the Company is obliged to provide a mobile broadband service for indoor reception to at least 98% of the UK population (expected to cover at least 99% when outdoors) and at least 95% of the population of each of the UK nations – England, Northern Ireland, Scotland and Wales – by the end of 2017 at the latest.

The prior period balances have been restated to include a reclassification between intangible assets and plant, property and equipment. See note 1 for more information.

7. *Investments*

	Shares in subsidiary undertakings £m	Shares in joint ventures £m	Total Shares in investments £m
Cost			
At 1 January 2015	**4,149**	**15**	**4,164**
Additions	17	-	17
Disposals	(4,145)	(15)	(4,160)
At 31 December 2015	21	-	21
Additions/Disposals in year	-	-	-
At 31 December 2016	**21**	**-**	**21**
Amortisation and impairment			
At 1 January 2015	-	-	-
Impairment	(4,145)		(4,145)
Disposals	4,145	-	4,145
At 31 December 2015	-	-	-
Additions/Disposals in year	-	-	-
At 31 December 2016	**-**	**-**	**-**
Net book value			
At 31 December 2016	**21**	**-**	**21**
At 31 December 2015	21	-	21

Investments in subsidiaries are held at historical cost less any provisions for impairment.

The subsidiary undertakings and joint arrangements as at 31 December 2016 are detailed below, all of which are included in the Telefonica Group Financial Statements:

Name	Country of incorporation and operation	Activity	Portion of ordinary shares held %
O2 Unify Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	IT and communications solutions	100%
giffgaff Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Mobile communications network	100%
Weve Ltd 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Mobile marketing and commerce services	100%
Digital Mobile Spectrum Ltd 83 Baker Street, London, W1U 6AG	England & Wales	Provision of services in relation to spectrum auction obligations	25%
Cellular Radio Ltd 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Active non trading company	100%
The Mobile Phone Store Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Dormant entity	100%
DX Communications Limited The Ca'D'Ore, 45 Gordon Street, Glasgow, G1 3PE	Scotland	Dormant entity	100%

7. Investments (continued)

Name	Country of incorporation and operation	Activity	Portion of ordinary shares held %
O2 Redwood Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Dormant entity	100%

Cornerstone Telecommunications Infrastructure Limited ("CTIL") is a company owned 50:50 by Telefónica Group ("TEF") and Vodafone, and was formed as part of the network sharing agreement signed between these parties in 2012 which is accounted for by TEF as a joint operation under IFRS 11.

The 50% interest of TEF in CTIL is legally held by O2 Cedar Limited (10%) and O2 Networks Limited (40%). However, the Company, as the main operating entity of the TEF group in UK, has the beneficial rights and obligations relating to TEF's interest in assets, liabilities, revenues and costs of this joint operation, and consequently TEF's interest in the joint operation has been integrated into these separate financial statements.

8. Inventories

	2016 **£m**	2015 £m
Handsets held for resale	**84**	66

In the opinion of the Directors there is no material difference between the balance sheet value of inventories and their replacement cost.

9. Trade and other receivables

Non-current:	**2016** **£m**	2015 Restated* £m
Trade receivables	**113**	168
Prepayments	**75**	77
	188	245

Current:	**2016** **£m**	2015 Restated* £m
Trade receivables	**671**	785
Amounts owed by other group companies	**155**	174
Amounts owed by associates	**16**	19
Prepayments	**409**	375
Accrued income	**134**	140
	1,385	1,493

Amounts owed by other group companies relate to trading activities are unsecured, interest free and repayable on demand.

As at the year ended 31 December 2016, the Company had recorded a provision of £4 million relating to amounts owed by other group companies (2015: £38 million). This assessment is undertaken each financial year through an examination of the financial position of the related party.

9. Trade and other receivables (continued)

The nature and impact of the prior year reclassification is explained further in note 1.

In accordance with IFRS 7 "Financial Instruments: Disclosures", the following disclosures are presented regarding the trade receivable balances:

	Carrying Amount £m	Neither impaired nor overdue at the reporting date £m	Not impaired but overdue on the reporting date: Less than 90 days £m	Between 90 to 180 days £m	Between 180 to 360 days £m	Over 360 days £m
Trade receivables as at 31 December 2016	**784**	**668**	**59**	**17**	**10**	**30**
Trade receivables as at 31 December 2015	**953**	**814**	**59**	**21**	**22**	**37**

Amounts above are presented including VAT, which is reclaimable from Her Majesty's Revenue and Customs ("HMRC") upon write off of the underlying trade receivable.

For the debtors which are not impaired and which are overdue at the reporting date, there has been no indication that their payment obligations will not be met.

The movement in the trade receivables provision for doubtful debts during the year is as follows:

	£m
Doubtful debt provision at 1 January 2015	171
Additions	200
Reductions / amount paid	(183)
Doubtful debt provision at 31 December 2015	**188**
Additions	187
Reductions / amounts paid	(200)
Doubtful debt provision at 31 December 2016	**175**

Additions and reductions in the provision are recognised in administrative expenses within the statement of comprehensive income.

10. Other financial assets

	2016 £m	2015 Restated* £m
Current other financial assets		
Other financial assets	**72**	64
	72	64

	2016 £m	2015 £m
Non-current other financial assets		
Other financial assets	**22**	16
	22	16

Other assets related to hire purchase contracts total £3 million (2015: £6 million) which is classified under Other financial assets in the above table. They mature at various dates during 2016. The nature and impact of the prior year reclassification is explained further in note 1.

11. Cash and cash equivalents

	2016 £m	2015 £m
Short term deposits	**58**	**266**
Cash and cash equivalents	**58**	**266**
Bank overdraft included in borrowings (note 12)	**-**	**(28)**
	58	**238**

12. Borrowings

	2016 £m	2015 £m
Current unsecured borrowings		
Bank overdrafts	**-**	28
Amounts owed to other group companies	**302**	238
	302	266
Obligations under finance leases	**3**	6
	305	272
Non-current unsecured borrowings		
Amounts owed to other group companies	**590**	590
	590	590

The current amounts owed to other group companies were granted to fund general trading activities and are unsecured, interest free and repayable on demand with the exception of an amount of £63m that bore an effective rate of interest of 1.47%. The non-current amount owed to other group companies bears an effective rate of interest of 3.29% (2015: 3.29%) and has a maturity date of 30 June 2018; the purpose of the loan was to assist with the acquisition of 4G spectrum.

Obligations under finance leases

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

	Minimum lease payments 2016 £m	**Finance charges 2016 £m**	**Present value 2016 £m**	Minimum lease payments 2015 £m	Finance charges 2015 £m	Present value 2015 £m
Within one year	**3**	**-**	**3**	6	-	6
Between one and five years	**-**	**-**	**-**	-	-	-
	3	**-**	**3**	6	-	6

Obligations under finance leases at 31 December 2016 are in respect of the device lease proposition for business customers (2015: £6 million).

13. Trade and other payables

	2016 £m	2015 £m
Trade payables	**452**	431
Amounts owed to other group companies	**545**	532
Amounts owed to other related parties	**66**	376
Other taxation and social security	**296**	303
Other payables	**231**	243
Accrued expenses	**766**	778
Deferred income	**237**	230
	2,593	2,893

13. Trade and other payables (continued)

Amounts owed to other group companies relate to trading activities (including tax loss transfers) are unsecured, interest free and repayable on demand.

14. Provisions

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

	31 December 2016				31 December 2015			
	Restructuring £m	**Asset retirement obligation £m**	**Other provisions £m**	**Total £m**	Restructuring £m	Asset retirement obligation £m	Other provisions £m	Total £m
Current	**30**	**3**	**1**	**34**	1	5	31	37
Non-current	**2**	**78**	**-**	**80**	-	62	3	65
	32	**81**	**1**	**114**	1	67	34	102

	Restructuring £m	**Asset retirement obligation £m**	**Other provisions £m**	**Total £m**
At 1 January 2015	**4**	**81**	**7**	**92**
Charge/(credit) for the year	(2)	(14)	29	13
Utilised in the period	(1)	-	(2)	(3)
At 31 December 2015	**1**	**67**	**34**	**102**
Charge for the year	32	20	-	**52**
Utilised in the period	(1)	(6)	(2)	**(9)**
Amounts released to the income statement	-	-	(31)	**(31)**
At 31 December 2016	**32**	**81**	**1**	**114**

Restructuring provisions

Restructuring provisions include the full costs of planned business restructuring programmes, entered into during the year.

Asset retirement obligation provision

The Group has certain legal obligations relating to the restoration of leased property to its original condition at the end of the lease term. This obligation relates principally to the Group's share of obligation for assets held in Cornerstone Telecommunications Infrastructure Ltd, and to mast sites.

The provision is based on assumptions covering the discount rate, expected lease renewals and the expected cost of restoring the sites. The payment dates of these asset retirement obligation costs are uncertain but are currently anticipated to be over the next 23 years.

Other provisions

Other provisions relate to various commercial disputes and other liabilities arising from on-going trading activities.

15. Pension costs

The Company participates in the Telefónica UK Pension Plan ("the Plan"). Telefónica Europe plc (the Company's ultimate UK parent company) acts as Sponsor and Principal Employer of the Plan, and the Plan is divided into defined contributions and defined benefit sections.

The net defined benefit cost of the defined benefit scheme, as assessed in accordance with the advice of a qualified, independent actuary, measuring actuarial liabilities using the projected unit method and taking assets at market value, is recognised by the sponsoring employer, Telefonica Europe plc. Accordingly the defined benefit liability and assets of the Plan are not recognised on the statement of financial position of the Company, but are instead reported by Telefónica Europe plc as the Plan's Sponsor.

The Plan provides the pension benefits for the majority of Telefónica's UK employees, including those the Company. Participating companies whose employees are members are the Plan account for the defined benefit sections of the plan as though it were a defined contribution plan as there is no contractual arrangement or stated policy for charging out the net defined benefit cost between participating employers. The Company therefore expenses any contributions payable to the defined benefit sections of the plan.

The total charge included in the Company's statement of comprehensive income of Telefónica UK for the Plan are as follows:

	2016 £m	2015 £m
Defined benefit scheme contributions expensed	-	80
Defined contribution scheme contributions expensed	35	35
Total pension costs	35	115

With effect from 28 February 2013 the defined benefit sections of the Plan closed to further benefit accrual. Members' defined benefit pensions will continue to be increased in deferment by reference to the Consumer Prices Index but will not retain the link to any future increases in salary. Upon closure, members of the defined benefit scheme of the Plan were given the option to become members of the defined contribution scheme of the Plan. The defined contribution scheme of the Plan remain open to new entrants and further contributions. The assets of the Plan are held independently of the Sponsor's finances.

Actuarial valuation

A full valuation of the defined benefit scheme of the Plan was undertaken as at 30 September 2014 by a suitably qualified independent actuary. The valuation used the projected unit method.

The full valuation was completed in line with the current investment strategy of the Plan which is predominantly a corporate bond basis initiated following the 2008 valuation.

No payment was made to the defined benefit scheme in the year ended 31 December 2016 (2015: £80m).

The initial results of the actuarial valuation of the Plan as at 30 September 2014 have been updated to 31 December 2016 by third party qualified actuary in accordance with the requirements of IAS 19. The defined benefit liabilities have been measured using the projected unit credit method. Plan assets are stated at fair value.

15. Pension costs (continued)

The Telefónica Pension Plan (continued)

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

	2016 £m	2015 £m
Life expectancy (male currently age 40 / 60)	88.7/87.2 years	88.6/87.1 years
Nominal rate of increase of pensions in payment (RPI max 5%)	3.15%	3.15%
Discount rate	2.60%	3.80%
Inflation assumption (RPI/CPI)	3.35% / 2.35%	3.35% / 2.35%

80% of the assets are invested in sterling-denominated bonds with 20% invested in synthetic global equities.

Plan assets are valued by reference to quoted market prices in active markets. No assets of Telefonica Europe plc are held by the Plan.

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

	2016	2015
Funded and unfunded	£m	£m
Nominal rate of increase in salaries	N/A	N/A
Nominal rate of increase of pensions in payment:		
Pension increases with inflation	3.35%	3.35%
Pension increases with inflation limited to 5% p.a.	3.15%	3.15%
Discount rate	2.60%	3.80%
Inflation assumption:		
RPI	3.35%	3.35%
CPI	2.35%	2.35%
Life expectancy:		
Male (current age 40)	88.7 years	88.6 years
Male (current age 60)	87.2 years	87.1 years
Female (current age 40)	91.0 years	90.9 years
Female (current age 60)	89.5 years	89.4 years

At 31 December 2016, the weighted average duration of the defined benefit obligation of the funded plan was 23 years (2015: 23 years).

The position and results reported are subject to the accuracy of the assumptions used.

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

15. Pension costs (continued)

The Telefónica Pension Plan (continued)

	2016	2015
	£m	£m
Present Value Movements of Defined Benefit Obligations:		
At start of year	**1,180**	**1,183**
Interest expense	44	44
Actuarial gains on demographic assumptions	-	(8)
Actuarial losses on financial assumptions	382	8
Actuarial gains on experience adjustments	(20)	(28)
Benefits paid	(21)	(19)
At end of year	1,565	1,180

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

	2016	2015
	£m	£m
At start of year	1,286	1,220
Interest income	48	45
Return on plan assets in excess of interest income	110	(38)
Employer contributions	-	80
Scheme expenses paid	(1)	(2)
Benefits paid	(21)	(19)
At end of year	1,422	1,286

The amount included in the consolidated statement of financial position arising from obligations in respect of the defined benefit scheme of the Plan, as well as the analysis of the Plan's assets, is as follows:

	2016	2015
	£m	£m
Fair value of assets comprises:		
Equities	306	257
Corporate bonds	1,117	949
Cash and net current assets	(1)	80
Fair value of assets	1,422	1,286
Present value of defined benefit obligations	(1,565)	(1,180)
Net (obligation)/asset recognised in statement of financial position	(103)	106

A reduction in the discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the discount rate will have an opposite effect of similar magnitude.

15. Pension costs (continued)

The Telefónica Pension Plan (continued)

An increase in the inflation rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A reduction in the inflation rate will have an opposite effect of similar magnitude.

There is also uncertainty around the future life expectancy of the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

The following table summarises the estimated sensitivity of the disclosed liability value to changes in the principal assumptions that have been used in the calculations:

Charge by assumption	Liabilities increase by:
Decrease discount rate by 0.25%	£105 million
Increase inflation rate by 0.25%	£90 million
Increase life expectancy by 1 year	£37 million

16. Deferred taxation

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 17.5% (2015: 18%).

The movement on the deferred tax account is as shown below:

	£m
At 1 January 2015	(40)
Prior year charge to statement of comprehensive income	(4)
Current year credit to statement of comprehensive income	4
Effect of change in tax rate	5
At 31 December 2015	(35)
Prior year charge to statement of comprehensive income	2
Current year charge to statement of comprehensive income	(4)
Effect of change in tax rate	1
At 31 December 2016	**(36)**

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

Deferred tax liabilities	**Accelerated tax depreciation** £m	**Other** £m	**Total** £m
At 1 January 2015	(23)	(19)	(42)
Current year credit to statement of comprehensive income	3	1	4
Prior year charge to statement of comprehensive income	(2)	(1)	(3)
Effect of change in tax rate	3	2	5
At 31 December 2015	(19)	(17)	(36)
Current year (charge)/credit to statement of comprehensive income	(6)	1	(5)
Prior year (charge)/credit to statement of comprehensive income	1	-	1
Effect of change in tax rate	-	1	1
At 31 December 2016	**(24)**	**(15)**	**(39)**

16. Deferred taxation (continued)

Deferred tax assets	Employee share based payments	Other	Total
	£m	£m	£m
At 1 January 2015	1	1	2
Prior year charge to statement of comprehensive income	-	(1)	(1)
At 31 December 2015	1	-	1
Credit to statement of comprehensive income	-	2	2
At 31 December 2016	**1**	**2**	**3**

Net deferred tax liability	£m
At 31 December 2016	**(36)**
At 31 December 2015	(35)

Finance (No.2) Act 2015 provides that the rate of corporation tax from 1 April 2017 will be 19% and that the rate from 1 April 2020 will be 17%. As a result the estimate of deferred tax has been calculated at a blended rate of 17.5%, with no significant impact on these financial statements.

The prior period balances have been restated to update the tax balances for the impact of the fixed assets reclassification. See note 1 for more information.

17. Ordinary share capital

	Number of shares	31 December 2016 £	Number of shares	31 December 2015 £
Share capital				
Called up, allotted and fully paid				
Ordinary A shares of 20 pence each				
At end of year	**10,001,100**	**2,000,220**	10,001,100	2,000,200
Ordinary B shares of 20 pence each				
At end of year	**40,004,400**	**8,000,880**	40,004,400	8,000,800
Total shares	**50,005,500**	**10,001,100**	50,005,500	10,001,000

The Company has two classes of issued share capital comprising Ordinary A and Ordinary B shares of 20 pence each. Each share class ranks pari passu. Subject to the Company's Articles of Association and applicable law, the Company's shares confer on the holder the right to receive notice of and vote at General Meetings, the right to receive surplus assets on a winding up of the Company, and an entitlement to receive any dividend declared on ordinary shares.

18. Reconciliation of retained earnings to distributable reserves

On the transfer of the UMTS licence (3G) from O2 Third Generation in July 2003, the Directors revalued the UMTS licence by way of an impairment and considered the value of all of the other fixed assets of the Company to confirm that they were satisfied that the aggregate value of the fixed assets was not less than the aggregate amount at which they were stated. In these accounts the Directors have reconsidered the value of all of the fixed assets without actually revaluing those fixed assets and are satisfied that their aggregate value is not less than the aggregate amount at which they are stated. In accordance with Section 841 of the Companies Act 2006 the Company's provision against the UMTS licence is not classified as a realised loss to the extent that the UMTS licence has not been amortised. The distributable reserves of the Company are as analysed below:

	2016	2015 *Restated
	£m	£m
Retained earnings*	1,825	1,978
Less: Retained earnings attributable to inclusion of Joint Operations	(324)	(284)
Retained earnings from Operations of Telefónica UK Ltd	1,501	1,694
Provision against intangible fixed asset	2,068	2,068
Realisation of provision against intangible fixed assets	(1,468)	(1,115)
Distributable reserves	2,101	2,647

* Includes share of accumulated reserves of Joint Operations under IFRS 11. These are not readily available for distribution by Teléfonica UK Limited.

19. Financial commitments and contingent liabilities

Operating lease commitments

At 31 December 2016 the Company was committed to making the following total future lease payments in respect of operating leases for each of the following periods:

	2016	2015
	£m	£m
Lease payments		
Within one year	118	95
Between one and five years	176	261
After five years	93	161
	387	517

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

The total future minimum sublease payments expected to be received under non-cancellable subleases at the 31 December 2016 are £17 million (2015: £44 million).

19. Financial commitments and contingent liabilities (continued)

Other commitments

Contracts placed for capital expenditure not provided in the accounts are as follows:

	2016 £m	2015 £m
Contractual commitments placed for expenditure not provided in the accounts	2,151	2,417
Total other commitments	**2,151**	2,417

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

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

20. Related party disclosures

During the year the Company entered into transactions with related parties as follows:

	2016 £m	2015 £m
Revenue		
Group companies	165	44
Other related parties	163	144
Total Revenue	**328**	188
Purchases		
Group companies	(130)	(77)
Other related parties	(143)	(136)
Total Purchases	**(273)**	(213)
Other		
Dividends received	-	5,111
Dividends paid	(525)	(11,705)
Total Other	**(525)**	(6,594)
Total net transactions	**(470)**	(6,619)

All related party transactions relate to regular trading activities of the Company on an arm's length basis.

Related parties include group companies, associates where the Company has a direct interest but not control and other related parties being associates of other Group companies.

Additional related party transactions are detailed in notes 3, 9, 12 and 13.

Related party transactions with Directors and key management are detailed in note 23.

21. Financial instruments

Financial risk factors and management

The Company's principal financial liabilities comprise bank overdrafts, finance leases and trade and other payables. The purpose of these financial liabilities is to raise finance for the Company's operations. The Company has various financial assets such as trade receivables and cash. The purpose of the Company's risk management policy is to manage the interest rate risk and currency risk that arise from the Company's operations and sources of finance.

The main sources or risk arising from the Company's financial instruments are currency risk, interest rate risk, credit risk and liquidity risk. Management of the Company's financial risks is achieved mostly through being a part of the larger Telefónica group, which operates group wide policies in each area and is able to hedge positions on a group basis.

Credit risk

Credit risk is the risk that a counterparty will not meet its obligation under a financial instrument or customer contract, leading to a financial loss.

The Company's principal credit risks are attributable to its trade receivables. Trade receivables as presented in the statement of financial position are net of provision for doubtful debts, estimated by the Company's management based on prior experience and their assessment of the current economic environment. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. At the statement of financial position date there were no significant concentrations of credit risk, with exposure spread over a large number of counter-parties and customers. The maximum exposure to credit risk is represented by the carrying amount of trade receivables as disclosed in note 9.

With respect to credit risk arising from other financial assets of the Company, which mostly comprise cash and cash equivalents, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

The Company does not require collateral in respect of financial assets.

Liquidity risk

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

Management of the Company's liquidity risk is achieved mostly through being a part of the larger Telefónica group. The Company holds financial assets primarily in short-term deposits with a central Telefónica group company that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

21. Financial instruments (continued)

Liquidity risk (continued)

The following tables set out contractual undiscounted cash outflows of financial liabilities, including interest payments:

31 December 2016	On demand	< 1 year	1 – 2 years	2 – 5 years	> 5 years	Total
	£m	£m	£m	£m	£m	£m
Obligations under finance leases	-	3	-	-	-	3
Borrowings	-	302	590	-	-	892
Trade and other payables	-	2,528	-	-	-	2,528
	-	2,833	590	-	-	3,423

31 December 2015	On demand	< 1 year	1 – 2 years	2 – 5 years	> 5 years	Total
	£m	£m	£m	£m	£m	£m
Bank overdrafts	28	-	-	-	-	28
Obligations under finance leases	-	7	-	-	-	7
Borrowings	-	238	-	590	-	828
Trade and other payables	-	2,804	-	-	-	2,804
	28	3,049	-	590	-	3,667

Foreign currency risk

Foreign currency risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Company operates in the United Kingdom. The Company is exposed to foreign exchange risk arising from various currency movements, primarily with respect to the Euro and US dollar that can affect its results and statement of financial position.

The Company has a limited exposure to foreign currency risk. Such exposure arises from revenues and purchases by an operating unit that is in currencies other than the unit's functional currency. Significant exposures are managed through the use of foreign exchange contracts and the Telefónica group managing positions on a group wide basis.

Interest rate risk

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company's interest rate risk arises primarily from the interest received on cash and cash equivalents. The majority of the Company's cash and cash equivalents are deposited with a central Telefónica group company that pays interest at variable market rates.

21. Financial instruments (continued)

Fair value of financial instruments

The carrying and fair value of the Company's financial assets and financial liabilities at 31 December are:

	Carrying value £m	31 December 2016 Fair value £m	Carrying value* £m	31 December 2015 Fair value £m
Liabilities				
Bank overdrafts	-	-	(28)	(28)
Obligations under finance leases	(3)	(3)	(7)	(7)
Other loans and borrowings	(892)	(892)	(596)	(596)
Trade and other payables	(2,472)	(2,472)	(2,804)	(2,804)
Total financial liabilities	(3,367)	(3,367)	(3,407)	(3,407)
Assets				
Cash and cash equivalents	58	58	266	266
Other financial assets	94	94	80	80
Trade and other receivables	1,089	1,089	1,286	1,286
Total financial assets	1,241	1,241	1,632	1,632

Fair value estimation

The fair value of the trade and other receivables, trade and other payables and cash and cash equivalents approximates to the book carrying value due to the short-term or on demand maturity of these instruments. The fair value of other financial assets for disclosure purposes has been calculated using market values provided by third parties and converted to Sterling where applicable.

The following tables set out the maturity analysis of financial assets that are held to manage liquidity risk:

31 December 2016	On demand £m	< 1 Year £m	1 – 2 Years £m	2 – 5 years £m	> 5 years £m	Total £m
Cash and cash equivalents	58	-	-	-	-	58
Other financial assets	-	72	22	-	-	94
Trade and other receivables	-	976	113	-	-	1,089
	58	1,048	135	-	-	1,241

31 December 2015	On demand £m	< 1 year £m	1 – 2 Years £m	2 – 5 years £m	> 5 years £m	Total £m
Cash and cash equivalents	266	-	-	-	-	266
Other financial assets	-	64	16	-	-	80
Trade and other receivables	-	1,118	168	-	-	1,286
	266	1,182	184	-	-	1,632

22. Auditor's remuneration

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

	2016	2015
	£'000	£'000
Audit services:		
UK audit fees	731	729
Other assurance services	2,406	252
Total audit and audit-related fees	3,137	981

The fees in the current and previous year were paid to Ernst & Young LLP.

23. Key management and Directors' compensation

Directors of the Company are part of the key management of the Group. Compensation for services to the Group for the period were as follows:

	2016	2015
	£000	£000
Salaries and short-term employee benefits	10,109	2,433
Long term incentive plans	77	717
Post-employment benefits	68	63
Total key management compensation	10,254	3,213

Following a 2016 strategic review the key management has been redefined to be the Operating Committee of the Company. Previously, the key management was considered to be the same as the Directors of the Company.

The emoluments of the Directors for the year ended 31 December 2016 was as follows:

	2016	2015
	£000	£000
Aggregate emoluments in respect of qualifying services	4,886	2,433
Aggregate amounts paid under long term incentive plans	-	717
Aggregate amount of company contributions paid to a pension scheme	32	63
	4,918	3,213

During the current year, no directors accrued retirement benefits under a defined benefit pension plan. Two Directors (2015: Two) accrued retirement benefits under a defined contribution pension plan during the year. None of the Directors were entitled to receive shares in respect of qualifying service under long-term incentive plans (2015: three).

In respect of the highest paid Director:

	2016	2015
	£000	£000
Aggregate emoluments in respect of qualifying services	2,386	1,525
Aggregate amounts paid under long term incentive plans	-	482
Aggregate amount of company contributions paid to a pension scheme	-	-
	2,386	2,007

The highest paid Director is a member of the Telefónica UK Pension Plan.

24. Employees

	2016 No.	2015 No.
Average number of full time employee equivalents (including executive Directors):		
Technology	**1,366**	1,242
Customer operations	**3,112**	3,406
Administration	**2,010**	2,017
Total average employees	**6,488**	6,665

The benefits expense incurred in respect of these employees were:

	2016 £m	2015 £m
Wages and salaries	**312**	303
Social security costs	**35**	33
Pension costs (note 14)	**35**	35
Further pension costs (note 14)	**-**	80
Share based payments (note 25)	**2**	3
Total employee benefits expense	**384**	454

The Company's employees and Directors participated in a number of employee incentive share schemes operated by Telefónica S.A (see note 25 for further details).

25. Share based payments

The main share-based payment plans in place during the period are as follows:

Telefónica Performance Investment Share Plan 2011-2016

At the General Shareholders' Meeting held on 18 May 2011, a long-term share-based incentive plan called "Performance and Investment Plan" was approved for Telefónica Group directors and executive officers.

Under this plan, a certain number of shares of Telefónica, S.A. would be delivered to plan participants selected by the Company who decided to participate on compliance with stated requirements and conditions.

The plan lasted five years and was divided into three independent three-year phases (i.e. delivery of the shares for each three-year phase three years after the start date). The first phase began on 1 July 2011 (with the delivery of the related shares from 1 July 2014). The second phase began on 1 July 2012 (with delivery of the related shares from 1 July 2015). The third phase began on 1 July 2013 (with delivery of the related shares from 1 July 2016).

The specific number of Telefónica, S.A. shares deliverable within the maximum amount established to each member at the end of each phase would be contingent and based on the Total Shareholder Return ("**TSR**") of Telefónica, S.A. shares (from the reference value) throughout the duration of each phase compared to the TSRs of the companies included in the Dow Jones Global Sector Titans Telecommunications Index. For the purposes of this plan, these companies made up the comparison group ("**Comparison Group**").

The TSR was the indicator used to determine the Telefónica Group's medium- and long-term value generation, measuring the return on investment for each shareholder of Telefónica S.A.. For the purposes of this plan, the return on investment of each phase was defined as the sum of the increase or decrease in the Telefónica, S.A. share price and dividends or other similar items received by the shareholders during the phase in question.

At the beginning of each phase, each participant was allocated a notional number of shares.

25. Share based payments (continued)

According to the plan, the number of shares to be delivered would range from:

- 30% of the number of notional shares if Telefónica, S.A.'s TSR was at least equal to the median of the Comparison Group;
- 100% if Telefónica S.A's TSR was within the third quartile or higher than that of the Comparison Group. The percentage was calculated using linear interpolation when it fell between the median and third quartile; and
- No shares would be delivered if Telefónica, S.A's TSR was below the Comparison Group's median.

The plan included an additional condition regarding compliance by all or part of the participants with a target investment and holding period of Telefónica, S.A. shares through each phase ("**Co-Investment**"), to be determined for each participant, as appropriate, by the Board of Directors based on a report by the Nominating, Compensation and Corporate Governance Committee. Participants meeting the co-investment requirement would receive an additional number of shares, provided the rest of the requirements established in the plan were met.

In addition, and independently of any other conditions or requirements that could be established, in order to be entitled to receive the corresponding shares, each participant had to be a Telefónica Group employee at the delivery date for each phase, except in special cases as deemed appropriate.

Shares would be delivered at the end of each phase (in 2014, 2015, and 2016, respectively). The specific delivery date was determined by the Board of Directors or the committee or individual entrusted by the Board to do so.

The first phase expired on 30 June 2014. Delivery of the shares was not required at the end of the phase according to the general conditions of the plan; therefore managers did not receive any shares. The second phase expired on 30 June 2015. Delivery of the shares took place at the end of the phase according to the general conditions of the plan to the value of £2.2 million.

The third phase expired on 30 June 2016. Delivery of the shares was not required according to the general conditions of the plan; therefore management did not receive any shares.

The period of the three independent three-year phases of the 2011-2016 plan came to an end on 30 June 2016.

Telefónica Performance Investment Share Plan 2014-2019

The Telefónica, S.A. General Shareholders' Meeting on 30 May 2014 approved a new instalment of the long-term share-based incentive "Performance and Investment Plan" for certain senior executives and members of the management team of the Telefónica Group, to be operational on completion of the first Performance and Investment Plan.

Like its predecessor, the term of the new plan covers a period of five years divided into three phases. No shares were granted in the third and final phase of the scheme in 2016. Shares are to be delivered at the end of each of the first two phases (in 2017 and 2018 respectively).

The initial share allocation took place on 1 October 2014, and the second phase began on 1 October 2015.

Phase	No. Shares assigned	Unit fair value	End date
1st phase October 2014	302,189	€6.82	30 September 2017
2nd phase October 2015	301,213	€6.46	30 September 2018
3rd phase October 2016	-	-	-

Talent for the future Share Plan (TFSP) 2014-2019

The TFSP is a long-term programme aimed to recognise and reward employees with consistent outstanding performance, with high potential and key skills.

25. Share based payments (continued)

The plan lasts five years and is divided into three independent three-year phases (i.e. delivery of the shares for each three-year phase three years after the start date). The first phase began on 1 October 2014 (with the delivery of the related shares from 30 September 2017). The second phase began on 1 October 2015 (with delivery of the related shares from 30 September 2018). There was no allocation of shares in the third and final phase of the plan.

The specific number of Telefónica, S.A. shares deliverable within the maximum amount established to each member at the end of each phase will be contingent and based on the Total Shareholder Return ("**TSR**") of Telefónica, S.A. shares (from the reference value) throughout the duration of each phase compared to the TSRs of the companies included in Comparison Group.

The TSR is the indicator used to determine the Telefónica Group's medium- and long-term value generation, measuring the return on investment for each shareholder. For the purposes of this plan, the return on investment of each phase is defined as the sum of the increase or decrease in the Telefónica, S.A. share price and dividends or other similar items received by the shareholder during the phase in question.

At the beginning of each phase, each participant was allocated a notional number of shares. According to the plan, the number of shares to be delivered will range from:

Talent for the future Share Plan (TFSP) 2014-2019

- 30% of the number of notional shares if Telefónica, S.A.'s TSR is just above the TSR of the companies making up 50th percentile of the Comparison Group, and
- 100% of the number of notional shares if Telefónica S.A's exceeds the TSR of the companies making up the 50th percentile of the Comparison Group.
- Where Telefónica S.A.'s TSR is between the 50th percentile and the 75th percentile of the Comparison Group, the percentage of notional shares to be received will be determined on a straight-line basis.
- No shares will be delivered if Telefónica, S.A's TSR is below the TSR of the companies making up 50th percentile of the Comparison Group.

In addition, and independently of any other conditions or requirements that may be established, in order to be entitled to receive the corresponding shares, each participant must be a Telefónica Group employee at the delivery date for each phase, except in special cases as deemed appropriate.

Shares will be delivered at the end of each phase (in 2017, 2018, and 2019 respectively).

The initial and second share allocation took place on 1 October 2014 and 2015 respectively. There was no share grant in the third and final phase.

Phase	No. Shares assigned	Unit fair value	End date
1st phase October 2014	33,862	€6.82	30 September 2017
2nd phase October 2015	-	€6.46	30 September 2018
3rd phase October 2016	-	-	-

Cash-settled share-based payments

Telefónica Performance Cash Plan

This plan mirrored the conditions of the Telefónica Performance Investment Share Plan and awarded employees a given number of notional shares in Telefónica, S.A. These notional shares entitled the beneficiary to a cash payment equivalent to their market value on vesting.

25. Share based payments (continued)

Telefónica Performance Cash Plan (continued)

The plan expired on 30 June 2014. Delivery of shares was not required at the end of the phase according to the general conditions of the plan; therefore managers did not receive any shares.

There were no new cash-settled share-based plans approved during the period.

Other share-based payment plans

Global Employee Share Plan 2015

At 30 May 2014 General Shareholders' Meeting of Telefónica, S.A., the shareholders approved the introduction of a new Telefónica, S.A. share incentive plan for all employees of the Telefónica Group worldwide. Under the plan the possibility of acquiring shares of Telefónica S.A. was offered with the commitment of the latter to allot free of charge to the participants in the plan a certain number of shares of Telefónica S.A., provided certain requirements are met.

The total term of the plan was 2 years. Employees joining the plan could acquire Telefónica, S.A. shares through maximum monthly instalments of €150 (or the local currency equivalent), up to a maximum of €1,800 over a period of 12 months (acquisition period) and the minimum contribution to be made by each participant would be 25 euros. Shares were delivered upon vesting of the plan, as from 31 July 2017, subject to a number of conditions:

- The beneficiary must have continued to work for the company throughout the two-year duration of the plan (consolidation period), subject to certain special conditions related to departures.
- The actual number of shares to be delivered at the end of the consolidation period depended on the number of shares acquired and retained by each employee. Each employee who was a member of the plan and remained a Company employee, and retained the shares acquired for an additional twelve-month period after the acquisition date, was entitled to receive one free share per share acquired and retained at the end of the consolidation period.

The plan's shareholding period came to an end in July 2017. At the vesting date (31 July 2017), 910 employees adhered to the plan and received free matching shares. This plan was equity-settled via the delivery of shares to the employees in August 2017.

26. Parent company and controlling party

The Company's immediate parent company is O2 Holdings Limited.

At the end of the year the ultimate parent company and controlling party was Telefónica, S.A., a company incorporated in Spain. Copies of the consolidated financial statements of Telefónica, S.A. may be obtained from Gran Via 28, 28013, Madrid, Spain.

27. Significant events

On March 24, 2015, Telefónica, S.A. ("Telefonica") reached an agreement with Hutchison Whampoa Group for the acquisition of Telefónica's operations in the UK (the "Proposed Transaction").

On May 11, 2016 the European Commission made public its decision to prohibit the Proposed Transaction. Following this decision, the Board of Directors of Telefónica at its meeting on June 29, 2016 agreed that Telefónica will continue to explore different strategic alternatives for its UK operations, to be implemented when market conditions are deemed appropriate.

28. Contingent Liabilities

The company has been addressing a request for disclosure made by governmental authorities which is related to possible violations of anti-bribery laws and regulations.

The company is co-operating with the governmental authorities' investigation in to this matter, which is ongoing, and is also conducting its own internal investigation. The company intends to co-operate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

29. Revenue

The total revenue for the Group and significant revenue streams for the period are detailed below:

	2016	2015
	£m	£m
Mobile service revenue	**4,079**	4,133
Non-mobile	**1,162**	1,260
Total revenue	**5,241**	5,393
Financial income (note 3)	**23**	5,131
Total revenue as defined by IAS 18	**5,264**	10,524