

## SUPPLEMENTAL DISCLOSURES

The following information has been prepared to present supplemental disclosures required under US GAAP and SEC regulations applicable to France Telecom.

### Convenience translation

The financial information expressed in US dollars is presented solely for the convenience of the reader and is translated from Euro at the Noon Buying rate in New York on June 30, 2003, which was € 0.8694 for each US dollar. No representation is made that the Euro amounts could have been, or could be, converted to US dollars at that rate on June 30, 2003 or at any other rate.

## 1-SUMMARY OF DIFFERENCES BETWEEN ACCOUNTING POLICIES GENERALLY ACCEPTED IN THE UNITED STATES AND FRANCE

The Consolidated Financial Statements of France Telecom have been prepared in accordance with French accounting principles that differ in certain respects from generally accepted accounting principles in the United States. The most significant differences are generated by consolidation rules, the measurement of certain assets and liabilities at fair value, the measurement and impairment of goodwill, transfers of financial assets, and timing differences in the recognition of certain gains and losses. The principal differences between French GAAP and US GAAP as they relate to France Telecom are discussed in further detail below.

### Stock-based compensation (A)

As noted in Note 24 to these consolidated financial statements, certain France Telecom subsidiaries (Equant, Orange and Wanadoo) have various stock-based compensation plans, which issue options in their own shares. In addition, France Telecom effected a stock subscription plan which was made available to all eligible employees of France Telecom.

In accordance with French GAAP, France Telecom does not record any compensation charges when stock options are granted. If France Telecom's subsidiaries issue new shares to satisfy the exercise of the options, then the difference between the par value and the exercise price is recorded as an addition to additional paid-in capital. If France Telecom's subsidiaries repurchase shares on the open market or issues shares held in treasury, then the difference between the repurchase price of the shares and the exercise price of the option is recorded as a compensation charge in the consolidated statement of operations.

Effective January 1, 2002, France Telecom adopted the fair value recognition provisions of SFAS 123, *Accounting for Stock-Based Compensation*. Under the modified prospective method of adoption selected by France Telecom under the provisions of SFAS 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, compensation cost recognized in 2002 is the same as that which would have been recognized had the recognition provisions of Statement 123 been applied from its original effective date. Given that the 2002 compensation charge was recorded as of December 31, 2002, the interim financial statements as of June 30, 2002 did not reflect in earnings a SFAS 123 compensation charge. Therefore, the following table illustrates the pro-forma effect on net income (loss) and earnings (loss) per share for the six months ended June 30, 2002, as if the fair value based method had been applied at the beginning of the period.

(In millions, except per share data)	<b>Six months ended June 30,</b>		
	<b>2002</b> €	<b>2003</b> €	<b>2003</b> \$
Net income (loss), as reported, US GAAP	(30,857)	3,505	4,031
Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects	19	-	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(58)	-	-
Pro forma net income (loss), US GAAP	<u>(30,896)</u>	<u>3,505</u>	<u>4,031</u>
Earnings per share:			
Basic—as reported	(24.36)	2.10	2.42
Basic—pro forma	(24.39)	2.10	2.42
Diluted—as reported	(24.36)	1.98	2.28
Diluted—pro forma	(24.39)	1.98	2.28

The weighted-average fair values at date of grant for France Telecom's subsidiaries common stock options granted during the six-month periods ended 2002 and 2003 were €2.79 and €3.42, respectively, and were estimated using the Black-Scholes option-pricing model. The weighted-average risk-free interest rates applied for 2002 and 2003 were 4.25% and 3.03%, respectively. The following weighted-average assumptions were applied for 2002 and 2003, respectively: (i) expected volatility rates of 45.2% and 52.8%, (ii) expected lives of 4.8 years in 2002 and 5.0 years in 2003, and (iii) expected dividend yields of 0% for all periods presented.

In addition, as noted in Note 31 to these consolidated financial statements, France Telecom effected a stock subscription plan which was made available to all eligible employees of France Telecom. Due to the preferential terms of the plan in the form of a discounted exercise price relative to the market price at the date of grant, along with the offering of an additional free share of France Telecom stock for every three shares purchased, the plan is considered compensatory under US GAAP. Therefore, France Telecom recognized €60 million in compensation expense based on the fair value of the shares subscribed. All such compensation expense was recognized immediately upon the date of grant in June 2003.

Furthermore, under US GAAP, France Telecom has recorded a receivable for amounts due from employees having signed a stock subscription agreement as of June 30, 2003; accordingly, the amounts due from employees for subscribed shares are included as a receivable from shareholders in the statement of shareholders' equity offset against additional paid-in capital as of June 30, 2003. Under US GAAP, the net impact to shareholders' equity is nil.

Under French GAAP, no compensation expense or receivable from shareholder was recognized in conjunction with the stock subscription plan. The capital increase will be recognized when the shares are issued.

## **Business combinations**

The following paragraph details differences between French and US GAAP in relation to accounting for business combinations.

The accounting for goodwill differs from French to US GAAP for various reasons which include but are not limited to the following: (i) a different measurement date used in valuing the securities issued in purchase transactions: typically under US GAAP the date of the signed agreement and under French GAAP the date of the closing, (ii) the recognition in purchase accounting under US GAAP of deferred tax liabilities in connection with certain intangible assets such as brand names, trademarks or customers lists, which increases the amount of goodwill under US GAAP, (iii) the inclusion of certain put and call arrangements considered as contingent consideration under French GAAP and recorded as an equity transaction under US GAAP, (iv) the amortization of goodwill which is required under French GAAP but ceased under US GAAP upon adoption of SFAS 142

*Goodwill and Other Intangible Assets*, on January 1, 2002 and (v) differing methods of the measurement of goodwill impairment.

### **Accounting for goodwill—non amortization and impairment (B)**

France Telecom adopted SFAS 141 *Business Combinations* which requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination completed after June 30, 2001.

Effective January 1, 2002, France Telecom adopted SFAS 142, *Goodwill and Other Intangible Assets*. SFAS 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives, and requires that goodwill and indefinite lived intangible assets included in the carrying value of equity method investments no longer be amortized. Intangible assets that have finite useful lives will continue to be amortized over their useful lives. Amortization periods for intangible assets with finite lives are no longer limited to 40 years. Our tradenames are considered as indefinite-lived assets, as defined in SFAS 142, and therefore are not subject to amortization beginning in January 2002. Additionally, changes in the useful lives of intangible assets with finite lives as well as reclassifications from or to goodwill, combined with the effect of ceasing amortization of goodwill as of the date of adoption, have resulted in an approximate positive impact on operations of €1.6 billion and 1 billion (€ 1.5 billion and 0.9 billion relating to goodwill, and € 0.2 billion and 0.1 billion relating to other intangibles, respectively) before tax, and before impairment of goodwill, for the six-month periods ended June 30, 2002 and 2003, respectively.

SFAS 142 requires that goodwill and intangible assets of consolidated entities with indefinite useful lives be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Intangible assets with indefinite lives are required to be tested for impairment by comparing the carrying value of the assets to their fair value. If the carrying value is determined to be in excess of fair value, the asset is considered impaired. Goodwill is tested using a prescribed two-step process following allocation of goodwill to the France Telecom's reporting units. The first step screens for potential impairment by comparing the carrying value of each reporting unit to its fair value. If the carrying value is determined to be in excess of the fair value, then a second step is performed to quantify the amount of goodwill impairment, if any. The second step is performed by estimating the fair values of the assets and liabilities of the reporting unit, including recognized and unrecognized intangible assets, to estimate the implied fair value of the reporting unit's goodwill. To the extent that the carrying value of the reporting unit's goodwill is in excess of the implied fair value, it is considered impaired.

France Telecom identified the following reporting units, which contain the most significant portions of the outstanding balance of goodwill: Orange, Equant, Wanadoo-Internet, and Wanadoo-Directories. As required under SFAS 142, France Telecom estimates fair value for Orange and Equant using the quoted market prices adjusted for an appropriate control premium. For Wanadoo-Internet and Wanadoo-Directories, the fair value is based on market comparables. In preparation for the adoption of Statement 142, France Telecom had performed the first of the required impairment tests of goodwill and indefinite lived intangible assets as of January 1, 2002. Based on those tests, no significant impairment was recorded at January 1, 2002 as a cumulative effect of change in accounting principle. Due to the decreasing trends in the reporting units' stock prices in the first half of 2002, France Telecom performed interim goodwill impairment tests on the Orange and Equant reporting units as of June 30, 2002 and recognized significant goodwill impairment charges totaling €20.8 billion or €(16.41) loss per basic and diluted share, in connection with SFAS 142 due to the considerable decrease in the reporting units' market values. There is no further requirement to perform the annual goodwill impairment test for the Equant reporting unit given that all its goodwill has been written-off. France Telecom performed the annual goodwill impairment tests for the Orange, Wanadoo-Internet, and Wanadoo-Directories reporting units as of November 30, 2002. Based on those tests, France Telecom recorded no additional goodwill impairment charges. The application of this new accounting principle, subsequent to its first application on January 1, 2002, has resulted in material differences between net income and shareholders' deficit presented under US GAAP and those presented under French GAAP, according to which France Telecom's individual and consolidated accounts are prepared as required by French law.

Under French GAAP, France Telecom recorded goodwill impairment charges totaling approximately €0.9 billion relating to Orange Communications SA which is part of the Orange reporting unit as of December 31, 2002. Given that under US GAAP, the Orange reporting unit goodwill is reviewed for impairment under SFAS 142 which resulted in a €19.7 billion impairment charge recorded during the first half of 2002, France Telecom reversed, for reconciliation purposes to US GAAP, the €0.9 billion goodwill impairment charge recorded under French GAAP.

Under French and US GAAP, France Telecom recorded goodwill impairment charges totaling approximately €0.1 billion relating to its investment in JTC-Jordan as of December 31, 2002. That impairment is reflected in the "Impairment losses" line item in the goodwill table below under the column "other".

At June 30, 2003, France Telecom has reviewed its reporting units for impairment indicators for the following reporting units, which contain the most significant portions of the outstanding balance of goodwill: Orange, Wanadoo-Internet, and Wanadoo-Directories. Based on reporting units identified under US GAAP, no additional impairment testing was required to be performed as of June 30, 2003. France Telecom is expecting to perform its annual impairment testing in the fourth quarter of the year ended December 31, 2003.

Under French and US GAAP, France Telecom recorded goodwill impairment charges totaling approximately €0.2 billion relating to its investment in Mauritius Telecom as of June 30, 2003. That impairment is reflected in the “Impairment losses” line item in the goodwill table below under the column “other”.

At June 30, 2003, under French GAAP, France Telecom also recorded goodwill impairment charges totaling approximately €0.4 billion and €0.1 billion respectively for Freeserve and QDQ Media. These last two entities belong to the Wanadoo-Internet and Wanadoo-Directories reporting units for which a goodwill review under SFAS 142 was not required. Consequently, at June 30, 2003 and for reconciliation purposes to US GAAP, France Telecom reversed the impairment charges (including related tax effects) related to Freeserve and QDQ Media, which were recorded under French GAAP.

The carrying values of goodwill under US GAAP for the reporting units noted above are as follows:

(€ in billions)	<b>Orange</b>	<b>Equant</b>	<b>Wanadoo- Internet</b>	<b>Wanadoo- Directories</b>	<b>Other</b>	<b>Total</b>
Balance as of January 1, 2002	29.5	1.2	2.7	0.6	1.3	35.3
Goodwill acquired during period	—	—	0.3	—	—	0.3
Impairment losses	(19.7)	(1.1)	—	—	(0.1)	(20.9)
Other	0.2	—	—	—	(0.6)	(0.4)
Currency translation effect on goodwill	(1.7)	(0.1)	(0.1)	—	(0.1)	(2.0)
<b>Balance as of December 31, 2002</b>	<b>8.3</b>	<b>—</b>	<b>2.9</b>	<b>0.6</b>	<b>0.5</b>	<b>12.3</b>
Goodwill acquired during period	—	—	—	—	—	—
Impairment losses	—	—	—	—	(0.2)	(0.2)
Currency translation effect on goodwill	(0.5)	—	(0.2)	—	—	(0.7)
<b>Balance as of June 30, 2003</b>	<b>7.8</b>	<b>—</b>	<b>2.7</b>	<b>0.6</b>	<b>0.3</b>	<b>11.4</b>

The above goodwill amounts relating to non-euro operations reflect the translation to the Euro.

#### **Amortization of intangible assets (C)**

Under French GAAP, certain acquired intangible assets such as brand names, trademarks and customer relationships are not amortized.

As mentioned above, under US GAAP, brand names and trademarks with indefinite lives are no longer amortized, beginning on January 1, 2002. The major intangible assets held and amortized are customer relationships (average life of 5 years) and licenses. Licenses currently in use are amortized over an average life of 15 years – corresponding to the terms of the licenses, whereas licenses in preparation for use (representing approximately 86% of all licenses), are not currently amortized.

The aggregate intangible assets amortization expense for the six month periods ended June 30, 2002 and 2003 were €469 million and €400 million, respectively.

The estimated intangible assets amortization expense for each of the following 5 years is presented below:

<b>Estimated Amortization Expense:</b>	(€ in millions )
Period from July 1, 2003 to June 30, 2004	692
Period from July 1, 2004 to June 30, 2005	481
Period from July 1, 2005 to June 30, 2006	187
Period from July 1, 2006 to June 30, 2007	137
Period from July 1, 2007 to June 30, 2008	134

Excluded from the estimated amortization expense table above, is the future amortization of certain UMTS licenses currently being prepared for use. The carrying amount of these UMTS licenses totaled €7.9 billion as of June 30, 2003. These licenses have an estimated useful life of between 15 and 20 years. The table below summarizes the estimated annual amortization expense for each of the next five years, based on anticipated dates for putting in use the UMTS licenses, as of June 30, 2003.

<b>Estimated Amortization Expense:</b>	(€ in millions )
2004	401
2005	411
2006	481
2007	481
2008	481

#### **Step acquisitions (D)**

Under French GAAP, an additional interest in an equity method investment triggers a revaluation of the historical investment prior to the acquisition of this additional interest on the basis of the fair value of the net assets of the equity investee at the time the additional interest is acquired. This revaluation is recorded through equity.

Under US GAAP, the interest's historical carrying value prior to the acquisition of the additional interest remains unchanged.

#### **Adjustment on Orange plc acquisition cost (E)**

Under French GAAP, the settlement of the put and call arrangement with Vodafone on February 28, 2001, has been reflected as contingent consideration and the purchase price of Orange Plc has been reduced accordingly.

Under US GAAP, the settlement of the put and call arrangement is considered as an equity transaction and accordingly, there is no adjustment to the purchase price of Orange Plc.

#### **Purchase of additional Orange shares held by E.On**

Under French GAAP, upon settlement of the E.On put option on shares of Orange SA in June 2002, France Telecom recorded the additional investment in Orange at the amount of consideration paid.

Under US GAAP, the additional investment in Orange SA was recorded at market value upon settlement of the E.On put option. The put option had been accounted for at fair value under SFAS 133 with changes in fair value being recorded through earnings. (see Note J).

#### **Acquisition of Freeserve (F)**

Under French GAAP, the value of the Wanadoo shares issued to Freeserve's shareholders was derived from the weighted average price of Wanadoo shares during the exchange period, which occurred in February 2001.

Under US GAAP, the first date on which the number of Freeserve shares becomes fixed without subsequent revision is the measurement date. Since the ratio of exchange was fixed at the date the agreement was signed (December 6, 2000), a period of several days before and after such agreement was signed was used to measure the value of the Freeserve shares. Consequently under US GAAP, the resulting cost of acquisition, goodwill, and gain from the sale of the newly issued Wanadoo shares were higher as compared to French GAAP.

## **Equant – CVR and impairment of long-lived assets (G)**

### *Accounting for CVR*

Under French GAAP, in the determination of the purchase price, no value is ascribed to the Contingent Value Right (“CVR”) until the CVR is eventually paid. However, given movements in CVR market values in 2001 and early 2002, France Telecom considered that the probable payment of the CVR would not be recoverable based on the value in use of the Equant investment as derived from its business plan and consequently recorded a provision of €2,077 million at December 31, 2001, representing the maximum payment to be made by France Telecom at maturity.

Under US GAAP, the value ascribed to the CVR is part of the purchase consideration and was determined at the date the agreement was signed (November 19, 2000) using an option-pricing model. Any subsequent changes to the value of the CVR are reflected in earnings. France Telecom reversed the provision noted above under French GAAP since the CVR’s changes in value since November 19, 2000 have been reflected in earnings. Additional charges of €73 million and €134 million related to changes in the value of the CVR was recognized under US GAAP for the six month periods ended June 30, 2002 and 2003, respectively.

### *Accounting for long-lived assets*

Under French GAAP, as of December 31, 2001 France Telecom reviewed the recoverability of long-lived assets of Equant in accordance with the method described in Note 2 to these consolidated financial statements. That review did not cause an impairment on tangible and intangible assets to be recorded under French GAAP. As of December 31, 2001, considering the difference between the net book value of Equant’s long-lived assets which was materially higher under US GAAP than under French GAAP, mainly due to the amount attributable to the CVRs and the higher value for the France Telecom shares contributed to SITA, an impairment review of Equant long-lived assets had been carried out in accordance with US GAAP. That review resulted in an impairment write-down based on Equant’s market value at December 31, 2001 amounting to €7,940 million.

Under French GAAP, France Telecom recorded impairment charges as of December 31, 2002 for the write-down of goodwill and other long-lived assets totaling €4,244 million relating to its investment in Equant. Given that under US GAAP, Equant’s goodwill and other long-lived assets had been written down in 2001, for reconciliation purposes to US GAAP, France Telecom reversed the €4,244 million impairment charge recorded under French GAAP.

## **Sale of TDF (H)**

Under French GAAP, as described in Note 3 to these consolidated financial statements, a €486 million gain was recognized to the extent of the 63.8% ownership interest in TDF disposed. Of the total gain on the sale of TDF, 36.2% was deferred as a result of the simultaneous investment by France Telecom in Tower Participation SAS, TDF’s new parent company.

Under US GAAP, to the extent of the sale to third parties, a €495 million pre-tax gain was recognized., to the extent of the sale to CDC, a party under common control with France Telecom, a €350 million gain was recognized through equity as additional paid-in capital, and the related investment in Tower Participation SAS was carried over from TDF’s historical carrying value.

## **Investment in NTL (I)**

Under French GAAP as of June 30, 2002 an additional provision of €1.7 billion was recorded to reduce the remaining carrying values of the NTL ordinary shares, preferred shares and convertible notes to zero.

Under US GAAP, France Telecom’s investment in NTL’s common shares was carried under the equity method. Given the amount of NTL’s accumulated net losses, all NTL common shares, convertible notes, and preferred shares held by France Telecom and by financial institutions (which were parties to put and call options with France Telecom) had been fully provided for in 2001, in order of seniority by the excess equity losses incurred. Consequently, given that no additional obligations existed, no additional losses were required to be recorded in 2002 under US GAAP relating to the NTL investment, and the € 1.7 billion provision recorded under French GAAP, as noted above, was reversed for US GAAP purposes.

As a result, no resulting reconciling item remained in the reconciliation of shareholders’ equity to US GAAP as of December 31, 2002 and June 30, 2003.

## Financial instruments

### *Derivative Instruments and Hedging Activities (J)*

The French GAAP accounting for derivative and hedging instruments is disclosed in Note 2 to these consolidated financial statements.

Under US GAAP, all derivative instruments (including certain derivative instruments embedded in other contracts) are recognized in the balance sheet at their fair values. Changes in fair value of derivative instruments that are not designated as hedges are recognized in earnings. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in Other Comprehensive Income (“OCI”) and are recognized in the income statements when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings immediately.

For the six-month period ended June 30, 2002, France Telecom recorded a net loss before tax of €61 million (€117 million after tax) pursuant to the provisions of SFAS 133, comprising:

- €60 million profit mostly relating to exchange gains incurred in connection with debt instruments denominated in foreign currencies. These instruments, designated under French GAAP as foreign currency hedges of certain investments held by the France Telecom group, did not qualify as hedges under the provisions of SFAS 133.
- €276 million gain which included both the changes in fair value of certain interest rate swaps and other derivative instruments not designated as hedges under the provisions of SFAS 133, along with the impact of the ineffectiveness of certain derivative instruments designated as hedges under SFAS 133.
- €397 million loss from settlement of the put & call options held by E.On on Orange shares (102.7 million shares).

For the six months ended June 30, 2003, France Telecom recorded a profit before tax of €27 million (€19 million after tax) pursuant to the provisions of SFAS 133, which includes both the changes in fair value of certain interest rate swaps and other derivative instruments not designated as hedges under the provisions of SFAS 133, along with the impact of accounting for certain embedded derivatives under SFAS 133

For the six month periods ended June 30, 2002 and June 30, 2003, France Telecom recorded a decrease in OCI of €26 million (€19 million after tax), and an increase in OCI of €39 million (€26 million after tax), respectively, comprised of changes in fair values of instruments designated as cash flow hedges and the impact of reallocating certain foreign currency hedges.

For the year ended December 31, 2002, France Telecom recorded a decrease in OCI of €12 million (€11 million after tax), comprising of changes in fair values of instruments designated as cash flow hedges and the impact of reallocating certain foreign currency hedges.

As of December 31, 2002 and June 30, 2003, total accumulated OCI comprising of accumulated losses before tax relating to derivative instruments and hedging activities amounted to €141 million and €102 million, respectively (€93 million and €67 million accumulated losses after tax, respectively). France Telecom estimates that €21 million of net derivative losses included in OCI as of June 30, 2003 will be reclassified into earnings within the next twelve months.

As of December 31, 2002 and June 30, 2003, derivative instruments recorded as assets at fair value totaled €433 million and €399 million, respectively, while derivative instruments recorded as liabilities at fair value totaled €1,844 million and €1,653 million, respectively.

### *Valuation of marketable securities and investment securities (K)*

In accordance with French GAAP, France Telecom's policy is to value marketable securities at the lower of aggregated cost and market value. Investment securities are stated at cost and an allowance is recorded when recoverable value, based upon management's analysis of the specific nature of each investment, appears to be permanently less than carrying value. Allowances can be subsequently reversed if the value in use of the investment increases. Unrealized gains on marketable securities and investment securities are not recognized.

Under US GAAP (SFAS 115), marketable securities and investment securities are divided into three categories: trading (used as part of a company's cash management activities), held-to-maturity (company has positive intent and ability to hold the securities to maturity) and available-for-sale (all other securities). For the third category, to which substantially all France Telecom's investments in marketable securities belong, unrealized gains and unrealized losses, measured by comparison with the market value, that are temporary are recorded as a separate component of shareholders' equity. Unrealized losses that are other than temporary are charged to income and any write-down is considered permanent. The remainder of France Telecom's marketable securities belong to the first category, trading securities, which are recorded at market value, and adjustments to market value are recorded in earnings. Valuations for publicly traded marketable securities and investment securities must be conducted by comparison with the market value as of the reporting period end. France Telecom has no held-to-maturity securities.

### **Investment in Wind (L)**

As of December 31, 2002, a provision of €1,324 million relating to its investment in Wind Infostrada was recorded through income under French GAAP. Under US GAAP given that the carrying value of the investment in Wind Infostrada was higher than under French GAAP, an additional €61 million impairment charge was recorded for US GAAP purposes.

As of June 30, 2003, a reversal of provision of €270 million relating to its investment in Wind Infostrada was recorded through income under French GAAP. Under US GAAP, this reversal of provision was decreased by €26 million.

See also Notes 11 and 31 to these consolidated financial statements.

### **Transfers of financial assets**

#### *Sale of carry back (M)*

Under French GAAP, France Telecom sold its 2000 and 2001 anticipated carry back receivables to a bank. This transaction was recognized as a transfer of financial assets.

Under US GAAP, such transaction did not meet all the requirements for a transfer of financial assets and was accounted for as a secured borrowing.

#### *Defeasance of finance leases*

Under French GAAP, deposits and lease obligations recognized under the defeased leases entered into by Orange in 1995, 1996 and 1999 have been netted.

Under US GAAP, such deposits and lease obligations are shown gross in the balance sheet.

#### *Sale of future receivables from the French State*

Under French GAAP, the compensation that France Telecom is entitled to receive as consideration for supplying services to the French State has been sold to a bank and an accrued liability reflecting future services was recognized. On December 31, 2002, as described in Note 2 to these consolidated financial statements, this transaction has been accounted for as a secured borrowing.

Under US GAAP, this transaction is accounted for as a secured borrowing for all periods presented.

### *Sale and leaseback of real estate (N)*

Under French GAAP, sales and leasebacks under operating leases of real estate properties (mainly office and technical buildings) have been reflected as disposals with a related net gain recorded as of December 31, 2001.

Under US GAAP, this transaction was not consummated in 2001 and consequently, no gain had been recognized as of December 31, 2001. During 2002, upon the legal transfer of property, those assets qualifying for sale-leaseback accounting under US GAAP (mainly office buildings) have been recorded as sales with the resulting gains deferred and amortized over the remaining operating lease terms. The transactions not qualifying for sale-leaseback accounting were recorded as financings.

In June 2002, a second set of sales and leasebacks under operating leases of real estate properties (mainly office and technical buildings) was initiated and effected during the six-month period ended June 30, 2003. Under French GAAP, such sales and leasebacks were reflected as disposals with a related net gain of €30 million recognized for the six months ended June 30, 2003.

Under US GAAP, those assets qualifying for sale-leaseback accounting (mainly office buildings) have been recorded as sales in the six months ended June 30, 2003 with the resulting gains being deferred and amortized over the remaining operating lease terms. The transactions not qualifying for sale-leaseback accounting were recorded as financings.

### **Capitalization of interests – mobile telecommunication licenses (O)**

Under French GAAP, interest costs incurred in connection with mobile telecommunication licenses such as UMTS licenses are expensed as incurred by France Telecom.

Under US GAAP, these interest costs are capitalized along with the interest costs related to other capital expenditures incurred in order for telecommunications networks to be ready for their intended use.

### **Adjustments relating to the 1996 quasi-reorganization and change of status (P)**

Assets transferred from the French State on January 1, 1991, upon the creation of France Telecom as a public sector operator, were recorded at values determined in accordance with the Opening Balance Sheet jointly approved by the Telecommunications Ministry and the Ministry of the Economy and Finance rather than at historical cost, which is required by US GAAP. France Telecom has not been able to quantify the effect of the difference in this accounting treatment since, prior to France Telecom becoming a public sector operator effective January 1, 1991, sufficiently detailed historical-cost asset records were not maintained.

The enactment of the FT Law and the LRT which, amongst other developments in 1996, changed France Telecom's corporate status, liberalized the telecommunications industry and changed the legal status of assets previously classified as within the public domain, together with rapidly changing technology and a widespread decline in French real estate market values, led France Telecom to review the carrying values of its long-lived assets and resulted in the recognition of certain impairment losses. Under French GAAP, the estimation of undiscounted cash flows, compared with asset carrying values in order to ascertain the need for write-down, was made based upon asset groupings used by France Telecom to manage its operations.

Under US GAAP, effective December 31, 1996, France Telecom effected a quasi-reorganization for financial reporting purposes, which resulted in the write-down of certain property, plant and equipment, as well as, identifiable intangible assets, and the increase in the book value of debt instruments to fair value. In addition, France Telecom recorded provisions for the early retirement plan, and for post-retirement benefits. Those adjustments were recorded directly against additional paid-in capital, and continue to be reflected as a reconciling item on the French to US statement of shareholders' equity.

## Income Taxes (Q)

### *Deferred taxes*

For French GAAP purposes, deferred tax assets related to the France Telecom SA tax group in France have been recognized considering expected future taxable income over the next eight years. Additionally, consistent with French GAAP, France Telecom records deferred tax balances on a present value basis for the portion of deferred tax assets for which the timing of reversal is determinable.

Under US GAAP, measurement of deferred tax on a present value basis is not allowed and the related allowance has been reversed accordingly. Further, considering their specific timing of reversal and in compliance with US practice, certain deferred tax assets were provided for.

## Consolidation methods

The principles covering the scope of consolidation under French GAAP are set forth in Note 2 to the consolidated financial statements. Under this policy, companies in which France Telecom and other shareholders have agreed to exercise joint control over significant financial operating policies are accounted for using the proportionate consolidation method.

For US GAAP purposes, companies in which France Telecom holds the majority of the voting rights directly or indirectly, are fully consolidated, and less than majority-owned companies over which France Telecom is deemed to exercise significant influence (generally 20% or more of voting interests), including those companies accounted for using the proportionate consolidation method under French GAAP, are included in the consolidated financial statements using the equity method pursuant to APB No. 18.

This difference in accounting policy has no effect on either net income or shareholders' equity.

### *TP Group*

Under French GAAP, and as noted in Note 3 to these consolidated financial statements, the TP Group (TP S.A. and its subsidiaries, or TPSA) was fully consolidated in the France Telecom financial statements beginning on April 1, 2002. France Telecom's share of the TP Group results, as noted in the table below, is primarily impacted by the goodwill amortization in French GAAP.

Under US GAAP, France Telecom's investment in TPSA (representing approximately 33.93% of TPSA's voting common stock) is accounted for as an equity investment under APB 18. France Telecom also holds a 34% investment directly in PTK, an entity held at 66% by TPSA and consolidated by TPSA.

The approximate effects on the reported France Telecom consolidated balance sheet, statement of income, and cash flows from consolidating TPSA are presented below (French GAAP).

(€ millions)	As of	
	December 31, 2002	June 30, 2003
<b>Balance sheet data</b>		
Current assets	1,102	1,027
Long-term assets	10,810	9,559
Current liabilities	1,720	1,308
Long-term liabilities	3,550	3,300
Net assets	6,642	5,978
France Telecom's share of net assets (including equity method excess basis)	3,806	3,399

	<b>For the interim period from April 1, 2002 to June 30, 2002</b>	<b>For the six months ended June 30, 2003</b>
<b>Statement of income data</b>		
Sales	1,191	2,121
Operating income	241	451
Financial charges	(40)	(128)
Net income before minority interest	(9)	50
	<hr/>	<hr/>
France Telecom's share of net income (including equity method excess basis)	(22)	(25)
	<hr/> <hr/>	<hr/> <hr/>
<b>Statement of cash flows data</b>		
Cash flows provided by operating activities	88	642
Cash flows used in investing activities	17	(449)
Cash flows used in financing activities	11	(122)
	<hr/> <hr/>	<hr/> <hr/>

The Stock market value of France Telecom's investment in TP Group was approximately €1.4 billion as of June 30, 2003.

For the six months ended June 30, 2003, the approximate effects on the consolidated financial statements from applying the proportionate consolidation method of accounting to other investments that would be accounted for under the equity method under US GAAP, have resulted in an impact on the French GAAP consolidated assets of €1,268 million (or 1.20%), revenues of €291 million (or 1.27%), operating income of €83 million (or 1.79%), and on operating cashflows of €140 million (or 3.13%).

#### **Put arrangements with Kulczyk Holding (R)**

As noted in Note 28.2 to these consolidated financial statements, France Telecom entered into several arrangements with Kulczyk Holding (Kulczyk) and its banks, which involved the issuance of put and call options among the parties on TPSA shares held by Kulczyk.

For the six months ended June 30, 2002, Under US GAAP, a € 300 million contingent loss provision was recorded representing the difference between the commitments relating to the put options and the recoverable value of the shares of TPSA to be received, as estimated by management. Under French GAAP, a similar contingent loss provision of €300 million was recorded, and was included as part of goodwill amortization. Such amortization was reversed under US GAAP.

#### **Variable interest entities : BlueBirds**

As discussed in Note 11 to these consolidated financial statements, France Telecom holds a 20% interest in BlueBirds, which is accounted for under the equity method under both French GAAP and US GAAP. For the purposes of US GAAP, BlueBirds is also considered a variable interest entity pursuant to the guidance in FIN 46 "Consolidation of Variable Interest Entities". However, France Telecom is not the primary beneficiary and therefore does not consolidate BlueBirds.

#### **Earnings per share (S)**

Under French GAAP, when computing earnings per share (EPS), stock dividends are treated on a pro-rata basis similarly to capital increases.

Under US GAAP, the stock dividend issued in June 2002 is fully included in the computation of basic and diluted earnings (loss) per share. The basic and diluted earnings (loss) per share for the prior periods presented have to be adjusted to reflect the effect of the stock dividend. In addition, as discussed in Note 26 to these consolidated financial statements, the rights issue whose exercise price at issuance was less than the market value of France Telecom' common stock contained a bonus element similar to a stock dividend. Accordingly, basic and diluted earnings (loss) per share for prior periods have been adjusted retroactively to reflect such bonus element.

Diluted earnings per share is also adjusted to reflect the exercise of less than 100% owned consolidated subsidiary stock options, so long as such exercise is not anti-dilutive. Dilutive earnings per share also reflects the dilutive effect of any debt convertible into shares of France Telecom common stock.

Below is a reconciliation of basic and diluted earnings per share under US GAAP :

<b>For the six months ended</b>						
(millions, except per share amounts)	<b>June 30, 2002</b>			<b>June 30, 2003</b>		
	Net loss	Weighted average shares outstanding	Earnings per share	Net income	Weighted average shares outstanding	Earnings per share
	<i>Numerator</i>	<i>Denominator</i>		<i>Numerator</i>	<i>Denominator</i>	
<b>Basic EPS</b>	(€ 30,857)	1,267	(€ 24.36)	€ 3,505	1,669	€ 2.10
<i>Effect of dilutive securities</i>	anti dilutive	anti dilutive		148	179	
<b>Diluted EPS</b>	(€ 30,857)	1,267	(€ 24.36)	€ 3,653	1,848	€ 1.98

#### **Accounting for perpetual bonds redeemable only in shares of France Telecom (TDIRA)**

Under French GAAP, the TDIRA, issued on March 3, 2003, is reflected under a mezzanine caption (“refundable funds & equivalents”) between equity and liabilities and the related return owed to their holders is recorded through the income statement.

Under US GAAP, the TDIRA is reflected as debt at the same fair value as under French GAAP which approximates the nominal value at the issuance date and the related return owed to their holders is recorded as interest expense through the income statement. The non-detachable conversion feature embedded in the TDIRA will be reflected if it becomes beneficial based on its intrinsic value as additional paid-in capital under equity and, given that the conversion feature would be exercisable at any time by the holder, it would be amortized immediately as interest expense.

## Reconciliation of net income and comprehensive income to US GAAP

In accordance with SFAS 130, *Reporting Comprehensive Income*, France Telecom reports comprehensive income in the reconciliation table of net income from French to US GAAP and in the components of shareholders' equity for US GAAP purposes.

The following is a reconciliation of net income (loss) as reported in the consolidated statements of income to net income (loss) and comprehensive income as adjusted for the approximate effects of the application of US GAAP for the six month periods ending June 30, 2002 and 2003:

		<b>Six months ended June 30,</b>		
		<b>2002</b>	<b>2003</b>	<b>2003</b>
		<b>€</b>	<b>€</b>	<b>\$</b>
(In millions, except per share data)				
	<i>Notes</i>			
Net income (loss) as reported in the consolidated statement of income		(12,176)	2,522	2,901
<i>Adjustments to conform to US GAAP</i>				
Stock-based compensation	A	(18)	(66)	(76)
Capital increase reserved to employees	A	—	(60)	(69)
Impairment of goodwill	B	(20,793)	415	477
Amortization of goodwill	B	1,419	705	811
Amortization of intangible assets	C	(299)	(269)	(309)
Equant CVR	G	(73)	(134)	(154)
Investment in NTL	I	1,663	—	—
Derivative instruments and hedging activities	J	(61)	27	31
Valuation of marketable securities and investment securities	K	(42)	45	52
Investment in Wind	L	—	(26)	(30)
Sale of carry back	M	(37)	(40)	(46)
Sale and leaseback of real estate	N	(25)	(14)	(16)
Capitalization of interest - mobile telecommunication licenses	O	153	105	120
Adjustments relating to the 1996 quasi reorganization and change of status	P	362	42	48
Put arrangements with Kulczyk Holding	R	(300)	—	—
Income taxes (including effect on the above adjustments)	Q	(630)	253	291
<b>Net income (loss) as adjusted for US GAAP</b>		<b>(30,857)</b>	<b>3,505</b>	<b>4,031</b>
Earnings (loss) per share as adjusted for US GAAP				
— Basic	S	(24.36)	2.10	2.42
— Diluted	S	(24.36)	1.98	2.28
Net income (loss) as adjusted for US GAAP		(30,857)	3,505	4,031
<i>Other Comprehensive Income</i>				
Unrealized gains (losses) on securities (net of related taxes)		(1,019)	10	11
Reclassification adjustment for gains realized in income		—	—	—
Unrealized losses on derivative instruments and hedging activities		(32)	26	30
Minimum pension liability adjustment (net of taxes)		—	(3)	(3)
Foreign currency translation adjustment (net of taxes)		(3,834)	(2,089)	(2,403)
<b>Comprehensive income (loss)</b>		<b>(35,742)</b>	<b>1,449</b>	<b>1,666</b>

Certain elements of the consolidated statement of income are classified as non-operating expenses and would have been considered as operating expenses under US GAAP. The reclassification of these expenses which include employee profit sharing, the effect of discounting the early retirement liability, restructuring provisions and write-down of investments, as well as, the amortization and impairment of goodwill, would have reduced operating income under US GAAP. In addition, certain US GAAP adjustments such as the impairment of goodwill and other long-lived assets, the amortization of other intangible assets, the accounting for stock-based compensation, and the carving out of the TP Group as a consolidated subsidiary under French GAAP for presentation as an equity investment under US GAAP, would have impacted operating income under US GAAP.

Reclassifications and adjustments to conform operating income to US GAAP are summarized as follows:

(In millions)	<b>Six months ended June 30,</b>		
	<b>2002</b>	<b>2003</b>	<b>2003</b>
	<b>€</b>	<b>€</b>	<b>\$</b>
Operating income as reported in the consolidated statement of income	3,182	4,645	5,343
<i>Reclassifications and adjustments to conform to US GAAP</i>			
Goodwill impairment	(20,793)	(467)	(537)
Goodwill amortization – amortization of intangible assets	(297)	(248)	(285)
Employee profit sharing	(51)	(72)	(83)
Stock-based compensation and capital increase reserved to employees	—	(119)	(137)
Consolidation of TP Group under French GAAP	(241)	(451)	(519)
Orange SA restructuring charges	—	(110)	(127)
Other US GAAP reclassifications and adjustments	(72)	(208)	(239)
	<u>(18,272)</u>	<u>2,970</u>	<u>3,416</u>
Operating income (loss) under US GAAP			

### Major assets and liabilities under US GAAP

Following the quasi-reorganization in 1996, the equity accounting of TP Group, and other US GAAP adjustments described above, the major assets and liabilities captions which differ under US GAAP from those reported in the consolidated balance sheets at December 31, 2002 and June 30, 2003 are as follows:

(in millions)	<b>December 31, 2002</b>		<b>As of June 30, 2003</b>		
	<b>As Reported</b>	<b>US GAAP</b>	<b>As Reported</b>	<b>US GAAP</b>	<b>US GAAP</b>
	<b>€</b>	<b>€</b>	<b>€</b>	<b>€</b>	<b>\$</b>
<i>Assets</i>					
Goodwill, net	27,675	12,276	24,355	11,379	13,088
Other intangible assets	18,411	15,336	17,230	14,195	16,237
Property, plant and equipment	36,268	30,232	32,227	27,428	31,548
Investment securities	1,418	1,393	1,335	1,328	1,527
Net deferred tax assets (current and long term)	3,920	116	7,332	3,896	4,481
<i>Liabilities</i>					
Bank overdrafts and other short term borrowings	10,490	10,278	2,661	2,775	3,192
Long-term debt (including current portion)	60,393	59,790	56,236	61,984	71,295

Indefeasible rights of use (IRUs) totaling €215 million and €254 million as of December 31, 2002 and June 30, 2003, respectively, classified under French GAAP as intangible assets, have been reclassified as tangible assets in the US GAAP balance sheets presented above.

As of December 31, 2002 and June 30, 2003, the impact of consolidating the TP Group under French GAAP has been eliminated in the US GAAP columns above to reflect the TP Group as an equity investment accounted for under APB18.

As described before, the TDIRA's are classified as long-term debt under US GAAP. The amount of these financial instruments totaled €6,073 million as of June 30, 2003.

#### Major cash flow items under US GAAP

The following table discloses significant differences in cash flow line items from French GAAP to US GAAP for the six month periods ended June 30, 2002 and 2003:

(In millions)	Six months ended June 30, 2002		Six months ended June 30, 2003		
	As reported	US GAAP	As reported	US GAAP	US GAAP
	€	€	€	€	\$
Net cash provided by operating activities	4,814	3,781	4,474	3,938	4,530
Net cash used in investing activities	(7,103)	(1,194)	(4,007)	(3,668)	(4,219)
Net cash provided by (used in) financing activities	1,575	(3,417)	3,581	3,707	4,264
Effect of changes in exchange rates on cash and cash equivalents	59	75	(107)	(90)	(104)
Cash and cash equivalents at beginning of period	2,943	2,943	2,819	2,654	3,053
Cash and cash equivalents at end of period	2,288	2,188	6,760	6,541	7,524

The major differences noted in the above consolidated cash flow statements for the six month period ended June 30, 2002 relate to reclassifying the repurchase of own shares from Vodafone in connection with the Orange plc acquisition for €4,974 million from investing to financing activities under US GAAP. In addition, approximately €1,111 million in cash provided by the sale of investments, was reclassified from operating to investing activities under US GAAP.

## Reconciliation of shareholders' equity to US GAAP

The following is a reconciliation of shareholders' equity (deficit) as reported in the consolidated balance sheet as adjusted for the approximate effects of the application of US GAAP as of December 31, 2002 and June 30, 2003:

(In millions)	Notes	At December 31,	At June 30, 2003	
		2002 €	2003 €	2003 \$
Shareholders' equity (deficit) as reported in the consolidated balance sheet		(9,951)	4,652	5,351
<i>Adjustments to conform to US GAAP</i>				
Stock-based compensation	A	30	12	14
Impairment of goodwill	B	(19,983)	(18,330)	(21,084)
Amortization of goodwill	B	1,957	2,530	2,910
Amortization of intangible assets	C	(1,700)	(1,861)	(2,141)
Step acquisitions	D	109	95	109
Adjustment on Orange plc acquisition cost	E	3,439	3,227	3,712
Acquisition of Freeserve	F	261	245	282
Equant – CVR and impairment of long-lived assets	G	345	(25)	(29)
Sale of TDF	H	313	313	360
Derivative instruments and hedging activities	J	38	99	113
Valuation of marketable securities and investment securities	K	(9)	48	55
Investment in Wind	L	(61)	(87)	(100)
Sale of carry back	M	272	232	267
Sale and leaseback of real estate	N	(547)	(561)	(645)
Capitalization of interest - mobile telecommunication licenses	O	653	723	832
Adjustments relating to the 1996 quasi reorganization and change of status	P	(289)	(247)	(284)
Other		(6)	(10)	(11)
Income taxes (including effect on the above adjustments)	Q	(1,622)	(1,382)	(1,589)
<b>Shareholders' equity (deficit) as adjusted for US GAAP</b>		<b>(26,751)</b>	<b>(10,327)</b>	<b>(11,878)</b>

Currency translation effects between French and US GAAP are included in the individual reconciliation line items above.

The components of shareholders' equity for US GAAP purposes as of December 31, 2002 and June 30, 2003 are as follows:

(in millions)	At December 31,	At June 30, 2003	
	2002 €	2003 €	2003 \$
Share capital	4,761	8,897	10,233
Additional paid-in capital	27,537	38,165	43,898
Receivable from shareholders	—	(86)	(99)
Retained earnings	(46,397)	(42,907)	(49,352)
Own shares including those bought back from Vodafone	(9,977)	(9,665)	(11,117)
<b>Accumulated Other Comprehensive Income</b>			
<i>Net unrealized gains on securities (net of related taxes)</i>	—	10	11
<i>Unrealized gains and losses on cash flow hedges</i>	(93)	(67)	(77)
<i>Minimum pension liability adjustment</i>	(7)	(10)	(11)
<i>Foreign currency translation adjustment</i>	(2,575)	(4,664)	(5,364)
<i>Accumulated Other Comprehensive Income</i>	(2,675)	(4,731)	(5,441)
<b>Total shareholders' equity (deficit) as adjusted for US GAAP</b>	(26,751)	(10,327)	(11,878)

A capital increase of €14,852 million was recorded in the first half-year for 2003 for respectively €4,148 million in share capital and €10,704 million in additional paid-in capital.

In addition, as noted in Note 26 and pursuant to the May 27, 2003 shareholders' meeting, it was decided to allocate the 2002 France Telecom's statutory net loss of € 22,776 million from retained earnings to additional paid in capital. Under US GAAP, this allocation has been reclassified back to retained earnings.

#### Other SEC disclosures

Details of asset valuation allowances under French GAAP recorded for the year ended December 31, 2002 and the six-months ended June 30, 2003 are as follows:

(in millions)	Balance at beginning of period €	Net additions (deductions) charged to costs and expenses €	Other changes <sup>(1)</sup> €	Balance at end of period €
<b>Year ended December 31, 2002</b>				
Valuation allowances relating to:				
Marketable securities	2	1	1	4
Trade accounts receivable	1,475	63	87	1,625
Inventories	213	(11)	(61)	141
Investment securities	6,433	2,785	(37)	9,181
Deferred tax assets	3,772	3,800	(70)	7,502
Other assets	1,093	768	130	1,991
<b>Six months ended June 30, 2003</b>				
Valuation allowances relating to:				
Marketable securities	4	—	(1)	3
Trade accounts receivable	1,625	(42)	(2)	1,581
Inventories	141	1	(3)	139
Investment securities	9,181	(8,196)	403	1,388
Deferred tax assets	7,502	(853)	(145)	6,504
Other assets	1,991	(1,613)	11	389

(1) Mainly includes translation adjustments and effect of acquisitions and divestitures.

## 2-RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002, the Emerging Issues Task Force reached consensus on EITF Issue 00-21 Accounting for Revenue Arrangements with Multiple Deliverables. This Issue addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. In some arrangements, the different revenue-generating activities (deliverables) are sufficiently separable, and there exists sufficient evidence of their fair values to separately account for some or all of the deliverables (that is, there are separate units of accounting). In other arrangements, some or all of the deliverables are not independently functional, or there is not sufficient evidence of their fair values to account for them separately. This Issue addresses when and, if so, how an arrangement involving multiple deliverables should be divided into separate units of accounting. This Issue does not change otherwise applicable revenue recognition criteria. However, this Issue does provide guidance with respect to the effect of certain customer rights due to vendor nonperformance on the recognition of revenue allocated to delivered units of accounting. This Issue also addresses the impact on the measurement and/or allocation of arrangement consideration of customer cancellation provisions and consideration that varies as a result of future actions of the customer or the vendor. Finally, this Issue provides guidance with respect to the recognition of the cost of certain deliverables that are excluded from the revenue accounting for an arrangement. The provisions of this Issue become effective for France Telecom beginning on January 1, 2004. France Telecom is currently reviewing this Issue to measure the potential impact on its results of operations and financial position.

In January 2003, the Financial Accounting Standards Board announced the issuance of Interpretation No. 46, Consolidation of Variable Interest Entities (an interpretation of ARB 51). As a result of increasing transactions involving variable interest entities, and given the fragmented and incomplete accounting literature available, Interpretation 46 addresses consolidation of certain types of variable interest entities by business enterprises considered to be the primary beneficiaries of the variable interest entities. The primary beneficiary of a variable interest entity is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests, which are the ownership, contractual, or other pecuniary interests in an entity. Consolidation of variable interest entities is no longer determined solely on the majority of voting interests approach, but instead on identifying the enterprise holding the controlling financial interests in the variable interest entity. A primary beneficiary holds the controlling financial interests in a variable interest entity and is required to consolidate the assets, liabilities, and results of the activities of the variable interest entity in the primary beneficiary's consolidated financial statements. Interpretation 46 requires additional disclosures relating to transactions involving variable interest entities to be made by primary beneficiaries and enterprises holding significant variable interests in variable interest entities. This Interpretation applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. For variable interests acquired by France Telecom before February 1, 2003, this Interpretation becomes applicable beginning on January 1, 2004.

France Telecom assessed its involvement with variable interest entities modified or created after January 31, 2003 and determined whether France Telecom is the primary beneficiary. Such assessment did not result in France Telecom as being identified as a primary beneficiary of such variable interest entities. In addition, France Telecom is currently investigating other variable interest entities created prior to February 1, 2003, and completing the assessment, when applicable, of whether France Telecom should be considered the primary beneficiary of such variable interest entities under this Interpretation. At this time, Tele-Invest and Tele-Invest II (see Note 28) have been identified as variable interest entities modified or created prior to February 1, 2003. France Telecom has not yet determined whether such variable interest entities will be required to be consolidated under the Interpretation beginning January 1, 2004.

In April 2003 the Financial Accounting Standards Board issued SFAS 149-Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This Statement amends Statement 133 for decisions made: (1) as part of the Derivatives Implementation Group process that effectively required amendments to Statement 133, (2) in connection with other Board projects dealing with financial instruments, and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative, in particular, the meaning of an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, the meaning of underlying, and the characteristics of a derivative that contains financing components. SFAS 149 is effective for contracts entered into or modified, and for hedging relationships designated, after June 30, 2003. France Telecom is currently reviewing this Statement to measure the potential impact on its results of operations and financial position.

In May 2003 the Financial Accounting Standards Board issued SFAS 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability. The changes in this statement will result in a more complete depiction of an entity's liabilities and equity and will, thereby,

assist investors and creditors in assessing the amount, timing, and likelihood of potential future cash outflows and equity share issuances. The majority of the instruments within the scope of SFAS 150 are to be measured initially and on a continuous basis at fair value, with offsets being charged to the statement of operations. SFAS 150 is effective for financial instruments issued or modified after March 31, 2003. No such instruments within the scope of this Statement were issued or modified by France Telecom since March 31, 2003 and until June 30, 2003. Financial instruments existing before March 31, 2003 are subject to this Statement beginning on January 1, 2004 for France Telecom. France Telecom is currently reviewing this Statement to measure the potential impact on its results of operations and financial position for financial instruments existing before March 31, 2003.

In May 2003, the EITF reached a consensus on EITF 01-8 Determining Whether an Arrangement Contains a Lease, relating to new requirements on identifying leases contained in contracts or other arrangements that sell or purchase products or services. The evaluation of whether an arrangement contains a lease within the scope of SFAS No. 13 Accounting for Leases, should be based on the evaluation of whether an arrangement conveys the right to use property, plant and equipment. This consensus is effective prospectively for contracts entered into or significantly modified after January 1, 2004. France Telecom is currently reviewing this Issue to measure the potential impact on its results of operations and financial position.

### **3- ADDITIONAL SUBSEQUENT EVENTS (SINCE SEPTEMBER 1, 2003)**

#### **TDIRAs**

On September 1, 2003, France Telecom repurchased a portion of its TDIRAs, issued on March 3, 2003, for approximately € 750 million by means of a competitive auction process. Of that amount, approximately €725 million nominal value of TDIRAs issued under the “Bank Tranche” were repurchased at an average price equivalent to 99.24 % of the nominal value, excluding accrued interest. The remaining € 25 million nominal value were TDIRAs issued under the “Vendor Tranche” and were repurchased at an average price equivalent to 99.19% of the nominal value, excluding accrued interest.

#### **Sale of Holdings in Argentina and El Salvador**

On September 9, 2003, France Telecom signed an agreement relating to the sale of its indirect interests in Telecom Argentina to W de Argentina, an affiliate of the Los W group, a leading Argentinean investment company, for \$125 million.

France Telecom and Telecom Italia each hold approximately 34% of the voting rights and 25.5% in economic interest in Nortel Inversora (“Nortel”), the holding company which owns 54.7% of Telecom Argentina’s share capital. Prior to the sale, it was agreed that France Telecom and Telecom Italia will contribute their stakes in Nortel to a company created for this purpose, co-owned on a 50-50 basis by France Telecom and Telecom Italia. France Telecom will then sell 48% of this company’s stock to W de Argentina, together with an option for the purchase of the remaining 2%. The option is exercisable by W de Argentina at any time between 31 January 2008 and 31 December 2013.

The total consideration for this transaction, including the option price, is \$125 million.

The closing of the transaction will take place as soon as all necessary authorizations are obtained, in particular regulatory and governmental authorizations.

On the same day, France Telecom signed an agreement with America Movil for the sale of its 26% indirect interest in the El Salvadoran operator, CTE Salvador, for a net amount of \$217 million.

The transaction provides for the sale of 100% of the stock of Estel, a consortium owning 51% of CTE Salvador and owned 51% by France Telecom and 49% by CAC (a group of private Salvadoran partners), for an amount of \$417 million.

The closing of the transaction occurred on October 22, 2003.

#### **Debt rating**

On September, 11, 2003, Moody's changed the outlook to positive from stable for the Baa3 long-term debt ratings of France Telecom S.A (FT) and its subsidiary Orange.

#### **Acquisition of Orange shares**

On 1 September, 2003, France Telecom announced its intent to acquire the remaining Orange shares not already held by France Telecom by way of a public exchange offer (“ Exchange Offer”). France Telecom irrevocably offered to exchange Orange ordinary shares, with a nominal value of one euro each, held by Orange shareholders, for existing or to be issued France Telecom ordinary shares, with a nominal value of four euros, at an exchange rate of 11 France Telecom shares for 25 Orange shares. The Board of Directors of Orange recommended to Orange’s shareholders that they tender their shares in the Offer. No public offer was made in the United States, Canada or Japan.

As a result of the exchange offer, as announced on October 16, 2003, France Telecom held 4,758,984,293 Orange shares, amounting to approximately 98.78% of Orange’s share capital.

The settlement and delivery date of the offer and the first listing of the newly issued France Telecom shares occurred on October 24, 2003. On that date, pursuant to the terms of the Exchange Offer, France Telecom remitted for the Orange shares tendered in the Exchange Offer approximately 95.4 million existing France Telecom shares and issued approximately 170.6 million new shares.

On October 16, 2003, France Telecom announced its intention, after complying with certain French regulatory steps, to acquire all remaining shares of Orange by means of a compulsory buy-out, the legal process under French law which permits a shareholder with more than 95% of the shares of a corporation, after taking certain intermediate steps, to compel the transfer of all remaining shares held by minority shareholders. The price of the compulsory buy-out is 9.50 euro per Orange share. The transaction was approved by the *Conseil des Marchés Financiers* and the *Commission des Opérations de Bourse*. Following completion of the proposed transaction, France Telecom will hold 100% of Orange shares and the Orange shares will be de-listed from Euronext Paris and the London Stock Exchange. This transaction will entail a maximum net cash outflow for the France Telecom group amounting to approximately € 1 019 million on the basis of the number of Orange shares outstanding at October 7, 2003 and of stock options that may be exercised prior to the closing of the Tender Offer.