

**Hrvatski Telekom d.d.**

**Consolidated financial statements**

**31 December 2011**

## Contents

	<i>Page</i>
Responsibility for the consolidated financial statements	2
Independent Auditor's Report	3
Consolidated statement of comprehensive income	5
Consolidated statement of financial position	6
Consolidated statement of cash flows	8
Consolidated statement of changes in equity	9
Notes to the consolidated financial statements	10

## Responsibility for the consolidated financial statements

Pursuant to the Croatian Accounting Act in force, the Board is responsible for ensuring that consolidated financial statements are prepared for each financial year in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) which give a true and fair view of the financial position and results of the Group for that period.

The Board has a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing the consolidated financial statements.

In preparing those consolidated financial statements, the responsibilities of the Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable accounting standards are followed; and
- the consolidated financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

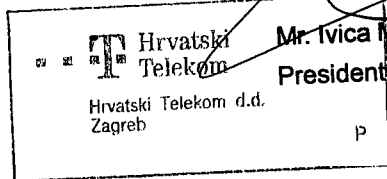
The Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the consolidated financial position of the Group and must also ensure that the consolidated financial statements comply with the Croatian Accounting Act in force. The Board is also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The accompanying consolidated financial statements were approved for issuance by the Management Board on 6 February 2012.

Hrvatski Telekom d.d.  
Savska cesta 32  
10000 Zagreb  
Republic of Croatia

6 February 2012

On behalf of the Group,



Mr. Ivica Mudrinić  
President of the Management Board (CEO)



## **Independent auditor's report**

To the shareholders and Board of directors of Hrvatski Telekom d.d.

We have audited the accompanying consolidated financial statements of Hrvatski Telekom d.d. and its subsidiaries (the 'Group') which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### *Management's responsibility for the consolidated financial statements*

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

### *Auditor's responsibility*

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

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

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

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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*PricewaterhouseCoopers d.o.o., Alexandera von Humboldta 4, 10000 Zagreb, Croatia*  
T: +385 (1) 6328 888, F: +385 (1) 6111 556, [www.pwc.com/hr](http://www.pwc.com/hr)



*Emphasis of matter*

Without qualifying our opinion, we draw attention to Notes 11 and 27 b) to the consolidated financial statements, which describe the uncertainty related to the ownership of distributive telecommunications infrastructure (DTI) of which the net book value recognised as assets by the Group as at 31 December 2011 is HRK 885 million. Efforts are being undertaken by the Group to obtain certain legal documents and registrations necessary to fully evidence the Group's ownership of these assets. The Group is defending a lawsuit claiming ownership of DTI in the city of Zagreb together with a demand for payment of HRK 390 million plus interest in respect of the Group's use of these assets in prior years. The Group has not recognised any adjustments to its assets and liabilities in respect of these matters due to the uncertainty as to their outcome and their impact on the financial statements.


*PricewaterhouseCoopers d.o.o.*

PricewaterhouseCoopers d.o.o.  
Zagreb, 6 February 2012



PricewaterhouseCoopers d.o.o.\*  
za reviziju i konzalting  
Zagreb, Alexandera von Humboldta 4

John Mathias Gasparac  
Procurator

  
Tamara Mačašović  
Certified Auditor

# Consolidated statement of comprehensive income

For the year ended 31 December 2011

	Notes	2011 HRK millions	2010 HRK millions
Rendering of services		7,765	8,155
Sale of goods		302	217
Revenue	3	8,067	8,372
Other operating income		301	240
Merchandise, material and energy expenses		(1,034)	(1,044)
Service expenses	4	(1,141)	(1,281)
Employee benefits expenses	6	(1,296)	(1,198)
Work performed by the Group and capitalised		81	105
Depreciation, amortization and impairment of non-current assets	5	(1,414)	(1,415)
Other expenses	7	(1,359)	(1,533)
Total operating costs		(6,163)	(6,366)
Operating profit	3	2,205	2,246
Interest income		83	71
Financial costs		(48)	(55)
Net financial income		35	16
Net share in investments in associate and joint venture	12,13	15	13
Profit before income tax		2,255	2,275
Income tax expense	8	(444)	(444)
Profit for the year		1,811	1,831
Other comprehensive income for the year			
Change in value of available for sale financial assets		(2)	2
Actuarial gains and other income (expense)		19	(3)
Other comprehensive income for the year, net of tax		17	(1)
Total comprehensive income for the year, net of tax		1,828	1,830
Earnings per share			
- basic and diluted, for profit for the year attributable to ordinary equity holders of the Company	9	HRK 22.12	HRK 22.36

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

# Consolidated statement of financial position

As at 31 December 2011

	Notes	31 December 2011 HRK millions	31 December 2010 HRK millions
<b>ASSETS</b>			
<b>Non-current assets</b>			
Intangible assets	10	999	1,162
Property, plant and equipment	11	5,953	6,336
Investments in associate and joint venture	12,13	395	380
Available-for-sale financial assets	14	39	42
Other non-current receivables		23	24
Deferred income tax assets	8	52	64
<b>Total non-current assets</b>		<b>7,461</b>	<b>8,008</b>
<b>Current assets</b>			
Inventories	15	175	216
Trade and other receivables	16	1,307	1,423
Prepayments and accrued income		126	110
Income tax prepayments		-	25
Available-for-sale financial assets	14	323	463
Time deposits	17 b)	40	2
Cash and cash equivalents	17 a)	3,704	3,282
<b>Total current assets</b>		<b>5,675</b>	<b>5,521</b>
<b>TOTAL ASSETS</b>		<b>13,136</b>	<b>13,529</b>

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

Consolidated statement of financial position (continued)  
As at 31 December 2011

	Notes	31 December 2011 HRK millions	31 December 2010 HRK millions
<b>EQUITY AND LIABILITIES</b>			
<b>Issued capital and reserves</b>			
Issued share capital	22	8,189	8,189
Legal reserves	23	409	409
Fair value reserves		(3)	(1)
Retained earnings	24	2,424	2,457
<b>Total issued capital and reserves</b>		<b>11,019</b>	<b>11,054</b>
<b>Non-current liabilities</b>			
Provisions for legal claims and other provisions	21	114	101
Employee benefit obligations	19	157	192
Deferred income	20	2	74
Other long-term liabilities		32	43
<b>Total non-current liabilities</b>		<b>305</b>	<b>410</b>
<b>Current liabilities</b>			
Trade and other payables	18	1,347	1,473
Provisions for redundancy	6	169	133
Other accruals	25	116	196
Income tax payable		20	-
Deferred income	20	151	250
Short term borrowings		9	13
<b>Total current liabilities</b>		<b>1,812</b>	<b>2,065</b>
<b>Total liabilities</b>		<b>2,117</b>	<b>2,475</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>13,136</b>	<b>13,529</b>

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

Signed on behalf of HT Group on 6 February 2012:

Mr. Ivica Mudrić  
President of the Management Board (CEO)

Mr. Dino Ivan Dogan, Ph. D.  
Member of the Management Board and Chief Financial Officer (CFO)

Consolidated statement of cash flows  
For the period ended 31 December 2011

	Notes	2011 HRK millions	2010 HRK millions
<b>Operating activities</b>			
Profit before income tax		2,255	2,275
Depreciation, amortization and impairment of non-current assets	5	1,414	1,415
Interest income		(34)	(8)
Loss on disposal of assets		6	2
Share of profit in joint venture	13	(15)	(11)
Decrease in inventories		41	39
Decrease/(Increase) in receivables and prepayments		65	(48)
(Decrease)/Increase in payables and accruals		(375)	73
(Decrease)/Increase in employee benefit obligations	19	(35)	-
Increase/(Decrease) in provisions		49	(2)
Other non-cash items		7	6
Cash generated from operations		3,378	3,741
Interest paid		(2)	(9)
Income tax paid		(388)	(466)
<b>Net cash flows from operating activities</b>		2,988	3,266
<b>Investing activities</b>			
Purchase of non-current assets	10,11	(877)	(1,153)
Proceeds from sale of non-current assets		3	12
Purchase of available-for-sale financial assets		(944)	(807)
Proceeds from sale of available-for-sale financial assets		1,065	698
Interest received		57	31
Dividend received		-	6
Acquisition of subsidiary, net of cash acquired		-	(176)
<b>Net cash flows used in investing activities</b>		(696)	(1,389)
<b>Financing activities</b>			
Repayment of lease liability and borrowings		(11)	(4)
Dividends paid	24	(1,863)	(2,788)
<b>Net cash flows used in financing activities</b>		(1,874)	(2,792)
Net increase/(decrease) in cash and cash equivalents		418	(915)
Exchange gains on cash and cash equivalents		4	2
Cash and cash equivalents at 1 January		3,282	4,195
Cash and cash equivalents at 31 December	17 a)	3,704	3,282

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

# Consolidated statement of changes in equity

## For the year ended 31 December 2011

	Issued capital HRK millions (Note 22)	Legal reserves HRK millions (Note 23)	Fair value reserves HRK millions	Retained earnings HRK millions (Note 24)	Total HRK millions
Balance as at 1 January 2010	8,189	409	(3)	3,417	12,012
Profit for the year	-	-	-	1,831	1,831
Other comprehensive income for the year	-	-	2	(3)	(1)
Total comprehensive income for the year	-	-	2	1,828	1,830
Dividends paid to equity holders of the Company	-	-	-	(2,788)	(2,788)
Balance as at 31 December 2010	8,189	409	(1)	2,457	11,054
Profit for the year	-	-	-	1,811	1,811
Other comprehensive income for the year	-	-	(2)	19	17
Total comprehensive income for the year	-	-	(2)	1,830	1,828
Dividends paid to equity holders of the Company	-	-	-	(1,863)	(1,863)
Balance as at 31 December 2011	8,189	409	(3)	2,424	11,019

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

# Notes to the consolidated financial statements

## For the year ended 31 December 2011

### 1 Corporate information

Hrvatski Telekom d.d. ("HT d.d.", "HT" or the "Company") is a joint stock company whose majority shareholder is Deutsche Telekom AG ("DTAG") (51%). DTAG is also ultimate controlling parent.

The registered office address of the Company is Savska cesta 32, Zagreb, Croatia.

The total number of employees of the Group as at 31 December 2011 was 6,239 (31 December 2010: 6,519).

The principal activities of the Group are described in Note 3.

The consolidated financial statements of Hrvatski Telekom d.d. for the financial year ended 31 December 2011 were authorised for issue in accordance with a resolution of the Management Board on 6 February 2012. These consolidated financial statements are subject to approval of the Supervisory Board as required by the Croatian Company Act.

#### 2.1. Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets (Note 14), as disclosed in the accounting policies hereafter.

The Group's consolidated financial statements are presented in Croatian Kuna (HRK). All amounts disclosed in the consolidated financial statements are presented in millions of HRK if not otherwise stated.

The consolidated financial statements include the financial statements of Hrvatski Telekom d.d. and the following subsidiaries comprise together HT Group:

Entity	Country of Business	Ownership Interest	
		31 December 2011	31 December 2010
Combis d.o.o.	Republic of Croatia	100%	100%
Iskon Internet d.d.	Republic of Croatia	100%	100%
KDS d.o.o.	Republic of Croatia	100%	100%

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.2. Changes in accounting policies and disclosures

The accounting policies adopted are consistent with those of the previous financial year.

The Group has adopted the following new and amended IFRS and IFRIC interpretations during the year. When the adoption of the standard or interpretation is deemed to have an impact on the financial statements or performance of the Group, its impact is described below.

*Amendment to IAS 32 Financial Instruments: Presentation – Classification of Rights Issues (effective for financial years beginning on or after 1 February 2010)*

The amendment allows rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency to be classified as equity instruments provided the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. The adoption of the amendment did not have any impact on the financial position and performance of the Group, as the Group does not have such instruments.

*IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective for financial years beginning on or after 1 July 2010)*

The interpretation clarifies the requirements of IFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially. The adoption of the interpretation did not have any impact on the financial statements as the Group does not negotiate such terms with its creditors.

*Amendment to IFRS 1 First time adoption – Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (effective for financial years beginning on or after 1 July 2010)*

The amendment clarifies that first time adopters do not need to provide comparative disclosures as introduced by the IFRS 7 amendment issued in March 2009. The adoption of the amendment did not affect the financial statements of the Group.

*Amendments to IAS 24 Related Party Disclosures (effective for financial years beginning on or after 1 January 2011)*

The amendments simplify the definition of a related party and modify certain related-party disclosure requirements for government-related entities. The implementation of these amendments did not have any impact on the financial position and performance of the Group and the related parties' disclosures.

*Amendment to IFRIC 14 The Limit On A Defined Benefit Assets, Minimum Funding Requirements And Their Interaction (effective for financial years beginning on or after 1 January 2011)*

Removes unintended consequences arising from the treatment of pre-payments where there is a minimum funding requirement. Results in pre-payments of contributions in certain circumstances being recognized as an asset rather than an expense. The Group is not subject of minimum funding requirements; therefore the amendment of the interpretation did not have any effect on the financial position and performance of the Group.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2011

### 2.2. Changes in accounting policies and disclosures (continued)

#### *Improvements to IFRSs (issued in May 2010)*

The IASB issued improvements to IFRSs, an omnibus of amendments to its IFRS standards. The adopted amendments resulting from improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Group:

#### *IFRS 1 First-Time Adoption of IFRS (effective for annual periods beginning after 1 January 2011)*

- (a) *Accounting policy changes in the year of adoption* - Clarifies that, if a first-time adopter changes its accounting policies or its use of the exemptions in IFRS 1 after it has published an interim financial report in accordance with *IAS 34 Interim financial reporting* it should explain those changes and update the reconciliations between previous GAAP and IFRS.
- (b) *Revaluation basis as deemed cost* - Allows first-time adopters to use an event-driven fair value as deemed cost, even if the event occurs after the date of transition but before the first IFRS financial statements are issued. When such remeasurement occurs after the date of transition to IFRSs but during the period covered by its first IFRS financial statements, any subsequent adjustment to that event-driven fair value is recognized in equity.
- (c) *Use of deemed cost for operations subject to rate regulation* - Entities subject to rate regulation are allowed to use previous GAAP carrying amounts of property, plant and equipment or intangible assets as deemed cost on an item-by-item basis. Entities that use this exemption are required to test each item for impairment under IAS 36 at the date of transition.

#### *IFRS 3 Business Combinations (effective for annual periods beginning on or after 1 July 2010)*

- (a) *Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS* - Clarifies that the amendments to *IFRS 7 Financial instruments: Disclosures*, *IAS 32 Financial instruments: Presentation*, and *IAS 39 Financial instruments: Recognition and measurement*, that eliminate the exemption for contingent consideration, do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of IFRS 3 (as revised in 2008).
- (b) *Measurement of non-controlling interests* - The choice of measuring non-controlling interests at fair value or at the proportionate share of the acquiree's net assets applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by IFRS.
- (c) *Un-replaced and voluntarily replaced share-based payment awards* - The application guidance in IFRS 3 applies to all sharebased payment transactions that are part of a business combination, including un-replaced and voluntarily replaced share-based payment awards.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.2. Changes in accounting policies and disclosures (continued)

##### *Improvements to IFRSs (issued in May 2010) (continued)*

*IFRS 7 Financial Instruments* - Emphasises the interaction between quantitative and qualitative disclosures about the nature and extent of risks associated with financial instruments.

*IAS 1 Presentation of Financial Statements* - Clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements.

*IAS 27 Consolidated and Separate Financial Statements* - Clarifies that the consequential amendments from IAS 27 made to *IAS 21 The effect of changes in foreign exchange rates*, *IAS 28 Investments in associates*, and *IAS 31 Interests in joint ventures*, apply prospectively for annual periods beginning on or after 1 July 2009, or earlier when IAS 27 is applied earlier.

*IAS 34 Interim Financial Reporting* - Provide guidance to illustrate how to apply disclosure principles in IAS 34 and add disclosure requirements around: The circumstances likely to affect fair values of financial instruments and their classification; Transfers of financial instruments between different levels of the fair value hierarchy; Changes in classification of financial assets; and Changes in contingent liabilities and assets.

*IFRIC 13 Customer Loyalty Programmes* - The meaning of 'fair value' is clarified in the context of measuring award credits under customer loyalty programmes.

##### *Standards and interpretations issued but not yet effective*

Standards and interpretations that have been issued and are effective for period after 1 January 2011 are listed below:

##### *Amendments to IFRS 7 Financial Instruments: Disclosures on Derecognition (effective for annual periods beginning on or after 1 July 2011)*

This amendment will promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets. The amendment affects disclosure only and has no impact on the Group's financial position or performance. The Group plans to adopt this amendment on its effective date.

##### *Amendments to IFRS 1 First Time Adoption: Fixed Dates and Hyperinflation (effective for annual periods beginning on or after 1 July 2011)*

These amendments include two changes to *IFRS 1 First-time adoption of IFRS*. The first replaces references to a fixed date of 1 January 2004 with 'the date of transition to IFRSs', thus eliminating the need for entities adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. The amendments will not have any impact on the Group's financial position or performance because the Group is not first time adopter.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.2. Changes in accounting policies and disclosures (continued)

##### *Standards and interpretations issued but not yet effective (continued)*

##### *IAS 12 Income Taxes – Deferred Taxes (effective for annual periods beginning on or after 1 January 2012)*

IAS 12 *Income taxes*, currently requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 *Investment property*. This amendment therefore introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC 21 *Income taxes - recovery of revalued non-depreciable assets*, will no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is withdrawn. The Group does not expect that amended IAS 12 will have an impact on the financial statements of the Group as the Group currently does not have any investment property or non-depreciable asset which is measured using the revaluation model.

##### *Amendment to IAS 1 Financial Statement Presentation Regarding Other Comprehensive Income (effective for annual periods beginning on or after 1 July 2012)*

The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The amendment affects presentation only and therefore is not expected to have an impact on the Group's financial position or performance.

##### *Amendment to IAS 19 Employee Benefits (effective for annual periods beginning on or after 1 January 2013)*

These amendments eliminate the corridor approach and calculate finance costs on a net funding basis. The amendment could have an impact on the Group's financial position or performance.

##### *IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2013)*

IFRS 9 is the first standard issued as part of a wider project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortised cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply. The Group does not expect IFRS 9 to have an impact on the financial statements. The Group plans to adopt this new standard on its effective date.

##### *IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after 1 January 2013)*

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entity (an entity that controls one or more other entities) to present consolidated financial statements. Defines the principle of control, and establishes controls as the basis for consolidation. Set out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. Sets out the accounting requirements for the preparation of consolidated financial statements. The Group is currently assessing the impact that IFRS10 will have on financial statements. The Group plans to adopt this new standard on its effective date.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.2. Changes in accounting policies and disclosures (continued)

##### *Standards and interpretations issued but not yet effective (continued)*

##### *IFRS 11 Joint Arrangements (effective for annual periods beginning on or after 1 January 2013)*

IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Group expects IFRS 11 could have an impact on the financial statements and is currently assessing the impact. The Group plans to adopt this new standard on its effective date.

##### *IFRS 12 Disclosures of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2013)*

IFRS 12 includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Group is currently assessing the impact of IFRS12 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IFRS 13 Fair Value Measurement (effective for annual periods beginning on or after 1 January 2013)*

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Group is currently assessing the impact of IFRS13 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IAS 27 (revised 2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2013)*

IAS 27 (revised 2011) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Group is currently assessing the impact of IAS 27 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IAS 28 (revised 2011) Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2013)*

IAS 28 (revised 2011) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Group is currently assessing the impact of IAS 28 on financial statements. The Group plans to adopt this new standard on its effective date.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2011

### 2.2. Changes in accounting policies and disclosures (continued)

#### *Standards and interpretations issued but not yet effective (continued)*

*IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013)*

The interpretation clarifies that benefits from the stripping activity are accounted for in accordance with the principles of IAS 2 *Inventories* to the extent that they are realised in the form of inventory produced. To the extent the benefits represent improved access to ore, the entity should recognize these costs as a 'stripping activity asset' within non-current assets, subject to certain criteria being met. This amendment is not relevant to the Group's operations.

*Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014)*

The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment and the impact on the Group.

*Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013)*

The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

### 2.3. Significant accounting judgments, estimates and assumptions

The preparation of the Group's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, during the reporting period or at the reporting date respectively. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. The key assumptions concerning the future and other key sources of estimation uncertainty at the statement of financial position date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

#### *Provisions and contingencies*

The Group is exposed to a number of legal cases and regulatory proceedings and ownership dispute over distributive telecommunication infrastructure that may result in significant outflow of economic resources or derecognition of related assets. The Group uses internal and external legal experts to assess outcome of each case and makes judgments if and what amount needs to be provided for in the financial statements as more explained in Notes 21 and 27. Changes in these judgments could have a significant impact on the segments of the Group.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.3. Significant accounting judgments, estimates and assumptions (continued)

##### *Impairment of non-financial assets*

Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. Value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for the next ten years and do not include restructuring activities that the Group is not yet committed to or significant future investments that will enhance the asset's performance of the cash generating unit being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used for extrapolation purposes. Non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. Further details including carrying values and effects on the result of the period are given in Notes 10 and 11.

##### *Change in estimated life of customers relationship*

The Group recognizes revenue from activation (connection fee) on a straight line basis through future periods depending on an average life of a single customer relationship. In 2011, based on the changes in market such as mergers between competitors and new regulations which demand introducing standalone broadband connection without fixed telephone line attached if a customer requests it, it was estimated that useful life has changed from 10 to 3 years, which resulted in increased revenue of HRK 73 million.

##### *Useful lives of assets*

The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that this is a critical accounting estimate since it involves assumptions about technological development in an innovative industry and heavily dependent on the investment plans of the Group. Further, due to the significant weight of depreciable assets in our total assets, the impact of significant changes in these assumptions could be material to our financial position, and results of operations.

##### *Tax payable on mobile revenues*

In 2009, the Croatian Parliament introduced a 6% tax payable on SMS, MMS and voice revenues. Based on an analysis of the nature of this tax (including factors such as the calculation basis and economic substance of the tax), the Group presented the tax net of revenue (similar to a sales tax) rather than as an operating expense. Due to the significant magnitude of this tax, a change in the Group's assumptions could have a material impact on total revenues, but would not have an impact on results of operations.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies

##### a) *Operating profit*

Operating profit is defined as the result before income taxes and finance items. Finance items comprise interest revenue on cash balances in the bank, deposits, treasury bills, interest bearing available for sale financial assets, dividend income from associate and joint venture, interest expense on borrowings, gains and losses on the sale of available for sale financial assets and foreign exchange gains and losses on all monetary assets and liabilities denominated in foreign currency.

##### b) *Business Combinations and Goodwill*

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through the statement of comprehensive income.

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 either in statement of comprehensive income or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in the statement of comprehensive income. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognized in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *c) Investment in associate*

In the Group's financial statements, investment in associated company (generally a shareholding of between 20% and 50% of voting rights) where significant influence is exercised by the Group are accounted for using the equity method less any impairment in value. Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. An assessment of investment in associate is performed when there is an indication that the asset has been impaired or that the impairment losses recognized in previous years no longer exist.

When the Group's share of losses in an associate equals or exceeds its interest in the company, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associate are eliminated to the extent of the Group's interest in the company.

##### *d) Investment in joint venture*

The Group has an interest in a joint venture which is a jointly controlled entity, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The Group recognizes its interest in the joint venture using equity method of accounting. The financial statements of the joint venture are prepared for the same reporting period as the parent company.

Adjustments are made where necessary to bring the accounting policies into line with those of the Group. Adjustments are made in the Group's financial statements to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its jointly controlled entity. Losses on transactions are recognized immediately if the loss provides evidence of a reduction in the net realisable value of current assets or an impairment loss. Interest in the joint venture is derecognized at the date on which the Group ceases to have joint control over the joint venture.

When the Group's share of losses in a joint venture equals or exceeds its interest in the company, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the joint venture.

Unrealized gains/losses on transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the company.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### e) *Intangible assets*

Intangible assets are measured initially at cost. Intangible assets are recognized in the event that the future economic benefits that are attributable to the assets will flow to the Group, and that the cost of the asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. Intangible assets are amortised on a straight-line basis over the best estimate of their useful life. There are no intangible assets that are assessed to have an indefinite useful life. The amortization method is reviewed annually at each financial year-end.

Amortization of the UMTS licence has started when operations for the UMTS network started its commercial use, the amortization period is the term of the licence.

Useful lives of intangible assets are as follows:

##### Licences and concessions

UMTS licences	20 years
Patents and concessions	5 – 10 years
Right of servitude for Distributive Telecommunication Infrastructure DTI)	30 years

##### Software and other assets

2 – 5 years

Assets under construction are not amortised.

Goodwill arises on the acquisition of subsidiaries. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash generating units, or groups of cash generating units, that are expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount, based on value in use estimations, of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (group of cash-generating units) to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods. The Group performs its annual impairment test of goodwill as at 31 December. Please see Note 10 for more details.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *f) Property, plant and equipment*

An item of property, plant and equipment that qualifies for recognition as an asset is measured at its cost. The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

In addition to directly attributable costs, the costs of internally constructed assets include proportionate indirect material and labour costs, as well as administrative expenses relating to production or the provision of services.

After recognition as an asset, an item of property, plant and equipment is measured at cost less accumulated depreciation and any accumulated impairment losses.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

Depreciation is computed on a straight-line basis.

Useful lives of newly acquired assets are as follows:

Buildings	10 – 50 years
Telecom plant and machinery	
Cables	8 – 18 years
Cable ducts and tubes	30 years
Other	2 – 15 years
Tools, vehicles, IT, office and other equipment	4 – 15 years

Land and assets under construction are not depreciated.

The useful life, depreciation method and residual values are reviewed at each financial year-end, and if expectations differ from previous estimates, the change(s) are accounted for as a change in an accounting estimate.

Construction-in-progress represents plant and properties under construction and is stated at cost.

Depreciation of an asset begins when it is available for use.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *g) Impairment of assets*

###### *Impairment of non-financial assets*

The determination of impairment of assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on the large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of services, current replacement costs, prices paid in comparable transactions and other changes in circumstances that indicate an impairment exists. The recoverable amount and the fair values are typically determined using the discounted cash flow method which incorporates reasonable market participant assumptions. The identification of impairment indicators, as well as the estimation of future cash flows and the determination of fair values for assets (or groups of assets) require management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. Specifically, the estimation of cash flows underlying the fair values of the business considers the continued investment in network infrastructure required to generate future revenue growth through the offering of new data products and services, for which only limited historical information on customer demand is available. If the demand for those products and services does not materialize as expected, this would result in less revenue, less cash flow and potential impairment to write down these investments to their fair values, which could adversely affect future operating results.

###### *Impairment of trade receivables*

A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the underlying arrangement. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments as well as historical collections are considered indicators that the trade receivable is impaired. Individual valuation is carried out for customers under litigation; bankruptcy proceedings and for the total receivables of customers with overdue receivables. When a trade or another receivable is established to be uncollectible, it is written off.

###### *Impairment of available-for-sale financial assets*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the statement of comprehensive income, is transferred from equity to the statement of comprehensive income. Reversals in respect of equity instruments classified as available for sale are not recognized in the statement of comprehensive income. Reversals of impairment losses on debt instruments are reversed through the statement of comprehensive income if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in the statement of comprehensive income.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *h) Inventories*

Inventories are valued at the lower of cost and net realisable value, after provision for obsolete items. Net realisable value is the selling price in the ordinary course of business, less the costs necessary to make the sale. Cost is determined on the basis of weighted average cost.

Phone sets are often sold for less than cost in connection with promotions to obtain new and/or retain existing subscribers with minimum commitment periods. Such loss on the sale of equipment is only recorded when the sale occurs if the normal resale value is higher than the cost of the phone set. If the normal resale value is lower than costs, the difference is recognized as an impairment immediately.

##### *i) Receivables*

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Receivables are stated at the fair value of the consideration given and are carried at amortised cost, after provision for impairment.

##### *j) Foreign currencies*

Transactions denominated in foreign currencies are translated into local currency at the middle exchange rates of the Croatian National Bank prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into local currency at the middle exchange rates of the Croatian National Bank prevailing at the statement of financial position date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included in the statement of comprehensive income within financial income or financial expense, respectively.

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

(a) assets and liabilities for each statement of financial position presented are translated at the middle exchange rates of the Croatian National Bank prevailing at the statement of financial position date;

(b) income and expenses for each statement of comprehensive income are translated at average exchange rates of the Croatian National Bank; and

(c) all resulting exchange differences are recognized in statement of other comprehensive income.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *k) Leases*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance lease. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charge. The corresponding rental obligations, net of finance charges, are included in borrowings. The interest element of the finance cost is charged to the statement of comprehensive income over the lease period so as to produce constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance lease is depreciated over the shorter of the useful life of the assets and the lease term.

##### *l) Taxation*

The income tax charge is based on profit for the year and includes deferred taxes. Deferred taxes are calculated using the liability method.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes at the reporting date.

Deferred tax is determined using income tax rates that have been enacted or substantially enacted by the financial statement date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would arise from the manner in which the enterprise expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

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

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and liabilities in the statement of financial position. Deferred tax assets are recognized when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised.

Current tax and deferred tax are charged or credited in other comprehensive income if the tax relates to items that are credited or charged, in the same or a different period in other comprehensive income.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *m) Employee benefit obligations*

The Group provides other long-term employee benefits (see Note 19). These benefits include retirement and jubilee (length of service) payments, and are determined using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation.

Past service costs are recognized in other comprehensive income immediately in the period in which they occur. Gains or losses on the curtailment or settlement of benefit plans are recognized when the curtailment or settlement occurs. The benefit obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest rate on government bonds where the currency and terms of the government bonds are consistent with the currency and estimated terms of the benefit obligation. Gains and losses resulting from changes in actuarial assumptions are recognized in other comprehensive income in the period in which they occur.

The Group provides death in service short term benefits which are recognized as an expense of the period in which it incurred.

##### *n) Revenue recognition*

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and sales taxes or duty. The Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Group has concluded that it is acting as a principal in all of its revenue arrangements with the exception of the provision of its telecommunications infrastructure to third parties that offer value added services to its customer. In these cases, the Group is acting as an agent.

Revenue from fixed telephony includes revenue from activation, monthly fees, calls placed by fixed line subscribers and revenue from additional services in fixed telephony. Revenue from activation (connection fees) is recognized on a straight-line basis throughout future periods depending on an average useful life of a single customer line. Estimated life changed from 10 years in 2010 to 3 years in 2011.

Revenue from wholesale services includes interconnection services for domestic and international carriers.

Revenue from mobile telephony includes revenue from monthly fee and call charges for "post-paid" mobile customers, call charges for "pre-paid" mobile customers, call charges for customers of international mobile operators when roaming on the Group's mobile network, sale of mobile handsets and domestic interconnection revenues related to mobile network.

Revenue from unused tariff packages and prepaid vouchers is recognized when they are realised. Before their realisation, they are recorded as deferred revenues.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *n) Revenue recognition (continued)*

The Group offers certain multiple-element arrangements (bundled product offers) arrangements. For multiple-element arrangements, revenue recognition for each of the units of accounting (elements) identified must be determined separately. Total arrangement consideration relating to the bundled contract is allocated among the different elements based on their relative fair values (i.e., a ratio of the fair value of each element to the aggregated fair value of the bundled deliverables is generated). The relative fair value of an individual element is limited by the proportion of the total arrangement consideration to be provided by the customer, the payment of which does not depend on the delivery of additional elements. If the fair value of the delivered elements cannot be determined reliably but the fair value of the undelivered elements can be determined reliably, the total arrangement consideration provided by the customer is allocated by determining the fair value of the delivered elements as the difference between the total arrangement consideration and the fair value of the undelivered elements.

Revenue from Internet and data services includes revenue from leased lines, frame relay, ATM, Ethernet services, ADSL subscription and traffic, fixed line access, WEB hosting, VPN online, internet traffic to T-Com call number, Multimedia services, IP phone (access and traffic) and IPTV. Service revenues are recognized when the services are provided in accordance with contractual terms and conditions.

Revenues from the provision of its network to the provider of value added services are reported on a net basis. Revenues are exclusively the amount of the commission received.

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

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

Revenue from dividends is recognized when the Group's right to receive the payment is established.

Interest revenue is recognized as interest accrues (using the effective interest rate that is the rate that exactly discounts receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

The Group maintains a loyalty point's programme, T-Club. In accordance with IFRIC 13, customer loyalty credits are accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to the award credits and deferred. This is then recognized as revenue over the period that the award credits are redeemed.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### *o) Cash and cash equivalents*

Cash and cash equivalents comprise cash on hand, demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and which are subject to an insignificant risk of change in value.

##### *p) Borrowings*

Borrowing costs, which include interest and other costs incurred in connection with the borrowing of funds, including exchange differences arising from foreign currency borrowings, are expensed in the period in which they are incurred, except those which directly attributable to the acquisition, construction or production of qualifying assets and are capitalised.

Borrowings are initially recognized in the amount of the proceeds received net of transaction costs.

##### *q) Financial assets*

All investments, other than loans and receivables originated by the Group, are classified as available-for-sale.

Available-for-sale financial assets are classified as current assets if management intends to realise them within 12 months after the statement of financial position date. All purchases and sales of investments are recognized on the settlement date.

Financial assets are initially measured at cost, which is the fair value of the consideration given for them, including transaction costs.

Available-for-sale financial assets and trading financial assets are subsequently carried at fair value without any deduction for transaction costs by reference to their quoted market price at the statement of financial position date. Gains or losses on measurement to the fair value of available-for-sale financial assets are recognized in other comprehensive income, until the investment is sold or otherwise disposed of, or until it is determined to be impaired, at which time the cumulative gain or loss previously recognized in other comprehensive income is included in the net profit or loss for the period.

Financial instruments are generally recognized as soon as the Group becomes a party to the contractual regulations of the financial instrument. However, in the case of regular way purchase or sale (purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the marketplace concerned), the settlement date is relevant for the initial recognition and derecognition. A financial asset is derecognized when the cash is collected or the rights to receive cash from the assets have expired. A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### r) Provisions

A provision is recognized when, and only when, the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each statement of financial position date and adjusted to reflect the current best estimate.

Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation. When discounting is used, the increase in provision reflecting the passage of time is recognized as interest expense.

Provisions for termination benefits are recognized when the Group is demonstrably committed to a termination of employment contracts, that is when the Group has a detailed formal plan for the termination which is without realistic possibility of withdrawal. Provisions for termination benefits are computed based on amounts paid or expected to be paid in redundancy programs.

##### s) Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognized in the financial statements but is disclosed when an inflow of economic benefits is probable.

##### t) Share-based payments

The cost of cash-settled transactions is measured initially at fair value at the grant date using a binomial model, further details of which are given in Note 32. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is remeasured to fair value at each statement of financial position date up to and including the settlement date with changes in fair value recognized in the statement of comprehensive income.

##### u) Events after reporting period

Post-year-end events that provide additional information about the Group's position at the statement of financial position date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

##### v) Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 2.4. Summary of accounting policies (continued)

##### w) Dividend distribution

Dividend distribution to the Group's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Group's shareholders.

##### x) Earnings per share

Earnings per share are calculated by dividing the profit attributable to equity holders of the Group by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Group and held as treasury shares.

##### y) Reclassifications

In order to reconcile the presentation of comparable period data with data presented in 2011, following positions in the financial statements for the year ended 31 December 2010 were reclassified:

- Statement of financial position

<i>Position</i>	<i>HRK millions</i>
Trade and other receivables	(56)
Trade and other payables	(56)
Other non-current receivables	(7)
Deferred income tax assets	7

- Statement of comprehensive income

<i>Position</i>	<i>HRK millions</i>
Rendering of services	8
Sale of goods	(11)
Other operating income	3

The above reclassifications affecting the statement of financial position are not considered material, and therefore no opening statement of financial position is presented.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 3 Segment information

In contrast to previous reporting period, business reporting format is determined to be Residential, Business and Network and Support Function segments as the Group's risks and rates of return are affected predominantly by differences in the market and customers. The segments are organised and managed separately according to the nature of the customers and markets that the services rendered, with each segment representing a strategic business unit that offers different products and services.

The Residential Segment includes marketing, sales and customer services, focused on providing mobile, fixed line telecommunications and TV distribution services to residential customers.

The Business Segment includes marketing, sales and customer services, focused on providing mobile and fixed line telecommunications and systems integration services to corporate customers, small- and medium-sized businesses and the public sector. The Business Segment is also responsible for the wholesale business in both fixed and mobile services.

The Network and Support Functions performs cross-segment management and support functions, and includes the Technology, Procurement, Accounting, Treasury, Legal and other central functions. The Network and Support Functions is included in segment information as a voluntary disclosure since it does meet the criteria for an operating segment.

Management Board as chief operating decision maker monitors the operating results of business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on contribution margin II (as calculated in the table below).

The Group's geographical disclosures are based on the geographical location of its customers.

Fully owned subsidiaries Iskon Internet, Combis and KDS are consolidated within the respective operating segments.

Management of the Group does not monitor assets and liabilities by segments and therefore this information has not been disclosed.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**3 Segment information (continued)**

*Residential and Business segments*

The following tables present revenue and direct cost information regarding the Group's segments:

Year ended 31 December 2010	Residential HRK millions	Business HRK millions	Network & Support functions HRK millions	Total HRK millions
<i>Segment revenue</i>	4,638	3,734	-	8,372
Service revenues	4,432	3,509	-	7,941
Terminal equipment	189	64	-	253
Other	17	161	-	178
<i>Usage related direct costs</i>	(440)	(566)	-	(1,006)
<i>Income and losses on accounts receivable</i>	(75)	(38)	-	(113)
Contribution margin I	4,123	3,130	-	7,253
<i>Non-usage related direct costs</i>	(729)	(410)	-	(1,139)
Segment result	3,394	2,720	-	6,114
Other income	-	-	240	240
Other operating expenses	(399)	(292)	(2,002)	(2,693)
Depreciation, amortization and impairment of non-current assets	-	-	(1,415)	(1,415)
Operating profit	2,995	2,428	(3,177)	2,246
Capital expenditure	258	69	826	1,153

Year ended 31 December 2011

<i>Segment revenue</i>	4,432	3,635	-	8,067
Service revenues	4,263	3,465	-	7,728
Terminal equipment	153	60	-	213
Other	16	110	-	126
<i>Usage related direct costs</i>	(367)	(459)	-	(826)
<i>Income and losses on accounts receivable</i>	(17)	(41)	-	(58)
Contribution margin I	4,048	3,135	-	7,183
<i>Non-usage related direct costs</i>	(632)	(521)	-	(1,153)
Segment result	3,416	2,614	-	6,030
Other income	-	-	301	301
Other operating expenses	(391)	(327)	(1,994)	(2,712)
Depreciation, amortization and impairment of non-current assets	-	-	(1,414)	(1,414)
Operating profit	3,025	2,287	(3,107)	2,205
Capital expenditure	330	86	461	877

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**3 Segment information (continued)**

*Revenue – by geographical area*

	2011 HRK millions	2010 HRK millions
Republic of Croatia	7,411	7,661
Rest of the World	656	711
	<u>8,067</u>	<u>8,372</u>

The majority of Group's assets (2011: 94%; 2010: 93%) are located in Croatia.

None of the Group's external customers represent a significant source of revenue.

**4 Service expenses**

	2011 HRK millions	2010 HRK millions
Domestic interconnection	445	555
International interconnection	382	451
Other services	314	275
	<u>1,141</u>	<u>1,281</u>

**5 Depreciation, amortization and impairment of non-current assets**

	2011 HRK millions	2010 HRK millions
Depreciation	1,029	1,006
Amortization	336	344
	<u>1,365</u>	<u>1,350</u>
Impairment loss	49	65
	<u>1,414</u>	<u>1,415</u>

Notes 10 and 11 disclose further details on amortization and depreciation expense and impairment loss.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**6 Employee benefits expenses**

	2011 HRK millions	2010 HRK millions
Gross salaries	881	904
Taxes, contribution and other payroll expenses	253	258
Redundancy expenses	162	31
Long-term employee benefits (Note 19)	-	5
	<u>1,296</u>	<u>1,198</u>

The movements of redundancy provision are as follows:

	2011 HRK millions	2010 HRK millions
Provision at 1 January – current	133	7
Provision at 1 January - non current	-	113
Total provision for redundancy 1 January	<u>133</u>	<u>120</u>
Interest costs recognized in the statement of comprehensive income	-	20
Additions charged to the statement of comprehensive income	162	31
Utilisation	<u>(126)</u>	<u>(38)</u>
Total provision for redundancy 31 December	<u>169</u>	<u>133</u>
Of that – current	169	133

Redundancy expenses and provisions include the amount of gross severance payments and other related costs for employees whose employment contracts will be involuntary terminated after 31 December 2011 due to business reasons.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**7 Other expenses**

	2011 HRK millions	2010 HRK millions
Maintenance services	271	349
Rent (Note 26)	178	165
Advertising	163	192
Licence cost	163	155
Selling commission	128	139
Postal expenses	95	103
Provision of trade receivables	59	112
Call centre and customer care support	56	56
Non-income taxes and contribution	51	60
Contract workers	23	45
Daily allowances and other costs of business trips	22	23
Education and consulting	18	23
Insurance	13	14
Provision for charges and risks	10	16
Write down of inventories	8	2
Loss on disposal of fixed assets	2	4
Other operating charges	99	75
	<hr/>	<hr/>
	1,359	1,533
	<hr/>	<hr/>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**8 Income tax expense**

*a) Tax on profit*

	2011 HRK millions	2010 HRK millions
Current tax expense	435	455
Deferred tax expense/(income)	9	(11)
<b>Taxation</b>	<b>444</b>	<b>444</b>

*b) Reconciliation of the taxation charge to the income tax rate*

	2011 HRK millions	2010 HRK millions
Profit before taxes	2,255	2,275
Income tax at 20% (domestic rate)	451	455
Dividends received and incentives	(1)	(2)
Tax for previous years	(14)	(12)
Entertainment expenses and car usage	2	3
Other	6	0
<b>Taxation</b>	<b>444</b>	<b>444</b>
<b>Effective tax rate</b>	<b>19.69%</b>	<b>19.52%</b>

## For the year ended 31 December 2011

## 8 Income tax expense (continued)

Components and movements of deferred tax assets and liabilities are as follows:

	31 December 2011	Charge to statement of comprehensive income HRK millions	31 December 2010	Charge to statement of comprehensive income HRK millions	31 December 2009
<i>Deferred tax asset</i>					
Non-tax deductible value adjustments	22	3	19	7	12
Property, plant and equipment write down	9	(3)	12	(4)	16
Accrued interest on legal cases	6	0	6	6	-
Deferred revenue from connection fees	-	(11)	11	(4)	15
Other	11	2	9	6	3
	<u>48</u>	<u>(9)</u>	<u>57</u>	<u>11</u>	<u>46</u>
Deferred tax assets					

Actuarial gains and losses	4	(3)	7	1	6
Total deferred tax assets	52	(12)	64	12	52

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2011

### 8 Income tax expense (continued)

The deferred tax asset of the Group arises on the property, plant and equipment impairment as a result of the fact that HRK 395 million of the impairment reported in 2001 was not tax deductible in that year. Of this amount, HRK 348 million became tax deductible in the period from 2002 to 2011, and the remaining HRK 47 million will be tax deductible in future periods.

The Group has recognized deferred tax assets based on temporary differences coming out of revenue recognition of connection fees in previous periods when the tax on those revenues was paid, and due to deferring these fees for the period of useful life of providing services to the customers for reporting purposes. Due to changes in estimate of customer relationship useful life, in 2011 the total amount of deferred revenue from this period is transferred to income. This resulted in the release of the total amount of deferred taxes, and tax expense on this basis amounts to HRK 11 million.

There are no formal procedures in the Republic of Croatia to agree the final level of tax charge upon submission of the declaration for corporate tax and VAT. However, such tax settlements may be subject to review by the relevant tax authorities during the limitation period of three years. The limitation period of three years starts with the year that follows the year of submission of tax declarations, i.e. 2013 for the 2011 tax liability. The counting of three years starts again with any action of tax authorities with the purpose to collect tax, interest or fines until the absolute statute of limitation of 6 years expires.

### 9 Earnings per share

Basic earnings per share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the Group by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are equal to basic earnings per share since there are no dilutive potential ordinary shares or share options.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2011	2010
Profit for the year attributable to ordinary equity holders of the Company in HRK millions	1,811	1,831
Weighted average number of ordinary shares for basic earnings per share	81,888,535	81,888,535

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**10 Intangible assets**

	Licences and concessions	Software	Goodwill	Assets under construction and other assets	Total
	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions
<b>At 1 January 2010</b>					
Cost	677	1,811	77	200	2,765
Accumulated amortization	(419)	(1,204)	-	(44)	(1,667)
<b>Net book value</b>	<b>258</b>	<b>607</b>	<b>77</b>	<b>156</b>	<b>1,098</b>
<b>Year ended 31 December 2010</b>					
Opening net book value	258	607	77	156	1,098
Acquisition of a subsidiary	-	-	85	74	159
Additions	6	149	-	95	250
Transfers	(81)	191	-	(110)	-
Disposals	-	(1)	-	-	(1)
Amortization charge	(45)	(267)	-	(32)	(344)
<b>Net book value</b>	<b>138</b>	<b>679</b>	<b>162</b>	<b>183</b>	<b>1,162</b>
<b>At 31 December 2010</b>					
Cost	281	2,509	162	251	3,203
Accumulated amortization	(143)	(1,830)	-	(68)	(2,041)
<b>Net book value</b>	<b>138</b>	<b>679</b>	<b>162</b>	<b>183</b>	<b>1,162</b>
<b>Year ended 31 December 2011</b>					
Opening net book value	138	679	162	183	1,162
Additions	-	154	-	27	181
Transfers	2	55	-	(57)	-
Transfers from PPE	-	2	-	-	2
Amortization charge	(10)	(295)	-	(31)	(336)
Impairment loss	-	(2)	-	(8)	(10)
<b>Net book value</b>	<b>130</b>	<b>593</b>	<b>162</b>	<b>114</b>	<b>999</b>
<b>At 31 December 2011</b>					
Cost	281	2,660	162	217	3,320
Accumulated amortization	(151)	(2,067)	-	(103)	(2,321)
<b>Net book value</b>	<b>130</b>	<b>593</b>	<b>162</b>	<b>114</b>	<b>999</b>

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 10 Intangible assets (continued)

The intangible assets of the Group as of 31 December 2011 include the UMTS licence with the carrying value of HRK 88 million (31 December 2010: HRK 94 million). The UMTS licence is amortised over a period of 20 years (starting from June 2005) according to Concession contract.

Net book value of total assets under construction amounts to HRK 27 million (2010: HRK 69 million) and primarily relates to software and the various licences for the use of software.

##### *Additions of intangible assets*

Major additions in the reporting period relate to applicative, system and network technology software and user licences in the amount of HRK 170 million.

##### *Impairment loss*

During 2011, the Group recognized impairment loss of intangible assets of HRK 10 million (2010: nil).

##### *Impairment testing of goodwill*

For impairment testing, goodwill acquired through business combinations has been allocated to cash-generating units. Goodwill arising from the Iskon acquisition has been allocated mainly to the Residential operating segment, while the goodwill arising from the Combis acquisition has been allocated to a separate cash-generating unit at a level lower than the operating segments.

The recoverable amount of the cash-generating units has been determined based on the value in use calculation using cash flow projections from financial budgets covering a ten-year period. The post-tax discount rate applied to all cash flow projections is 9.6% (2010: 11.0%) and cash flows beyond the ten-year period are extrapolated using a 2.0% growth rate (2010: 2.0%).

The calculation of value-in-use is most sensitive to the assumptions on market penetration, market share, regulation and discount rate.

With regard to the assessment of value-in-use, management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of the cash-generating units to materially exceed its recoverable amount.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**11 Property, plant and equipment**

	Land and and buildings	Telecom plant and machinery	Tools, vehicles, IT and office equipment	Assets under construction	Total
	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions
<b>At 1 January 2010</b>					
Cost	1,938	11,088	1,000	478	14,504
Accumulated amortization	(822)	(6,493)	(677)	(5)	(7,997)
<b>Net book value</b>	<b>1,116</b>	<b>4,595</b>	<b>323</b>	<b>473</b>	<b>6,507</b>
<b>Year ended 31 December 2010</b>					
Opening net book value	1,116	4,595	323	473	6,507
Acquisition of a subsidiary	-	-	7	1	8
Additions	62	515	50	276	903
Transfers	100	152	85	(337)	-
Disposals	(1)	(4)	(3)	(3)	(11)
Amortization charge	(103)	(774)	(129)	-	(1,006)
Impairment loss	-	(46)	(4)	(15)	(65)
<b>Net book value</b>	<b>1,174</b>	<b>4,438</b>	<b>329</b>	<b>395</b>	<b>6,336</b>
<b>At 31 December 2010</b>					
Cost	2,098	11,330	1,176	411	15,015
Accumulated amortization	(924)	(6,892)	(847)	(16)	(8,679)
<b>Net book value</b>	<b>1,174</b>	<b>4,438</b>	<b>329</b>	<b>395</b>	<b>6,336</b>
<b>Year ended 31 December 2011</b>					
Opening net book value	1,174	4,438	329	395	6,336
Additions	39	436	58	163	696
Transfers	25	257	28	(310)	-
Transfers to intangible assets	-	(2)	-	-	(2)
Disposals	(6)	(1)	(1)	(1)	(9)
Amortization charge	(105)	(796)	(128)	-	(1,029)
Impairment loss	(5)	(12)	-	(22)	(39)
<b>Net book value</b>	<b>1,122</b>	<b>4,320</b>	<b>286</b>	<b>225</b>	<b>5,953</b>
<b>At 31 December 2011</b>					
Cost	2,152	11,428	1,122	248	14,950
Accumulated amortization	(1,030)	(7,108)	(836)	(23)	(8,997)
<b>Net book value</b>	<b>1,122</b>	<b>4,320</b>	<b>286</b>	<b>225</b>	<b>5,953</b>

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 11 Property, plant and equipment (continued)

Included within assets under construction of the Group are major spare parts of HRK 27 million (31 December 2010: HRK 53 million), net of a provision of HRK 1 million (31 December 2010: HRK 10 million).

Beginning in 2001, the Group has performed additional procedures which have provided support for the existence of legal title to land and buildings transferred from HPT s.p.o. under the Separation Act of 10 July 1998. The Group is still in the process of formally registering this legal title.

The Group does not have any material property, plant and equipment held for disposal, nor does it have any material idle property, plant and equipment.

##### *Impairment loss*

In 2011, the Group recognized an impairment loss of property, plant and equipment of HRK 39 million (2010: HRK 65 million) due to transfer to the newer technology. The recoverable amount of that equipment is its fair value less costs to sell, which is based on the best information available to reflect the amount that the Group could obtain, at the statement of financial position date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal.

##### *Disposal of property, plant and equipment*

The disposal of the property, plant and equipment primarily relates to the disposal of telecom machinery, old tools, IT, office equipment and vehicles of HRK 300 million and disposal of technical equipment for mobile voice services of HRK 380 million (all values stated as gross book values).

##### *Ownership over ducts*

Although the assets (including the ducts as a part of the infrastructure) were transferred from the legal predecessor of the Company, HPT Public Company by virtue of the "Law on Separation of Croatian Post and Telecommunication" and contributed by the Republic of Croatia ("RoC") to the share capital at the foundation of the Company on 1 January 1999, according to other Croatian legislation, part of HT's infrastructure that may be considered as a real estate which is also known as Distributive Telecommunication Infrastructure (DTI, TI or ducts) - does not have all the necessary documents (building, use permits etc.) and the major part is not registered in the land registry, which may be relevant to the issue of proving the ownership towards third parties. Intrusions in HT's ducts by other competitors and some requirements of ownership over these assets by the local authorities (the City of Zagreb and City of Split present the majority of problems), may have a material effect on the financial statements in the case that HT will not be able to prove its ownership rights for some ducts.

The Company formed the Technical Infrastructure Contractual Relation Management Work Unit that is responsible to assure that all network technology related assets are properly legalised, documented and that this documentation is available to all relevant departments and authorities. The overall process is slow and complex since the registration depends not only on HT but also on local and state authorities. Since the year 2006 the actions of HT have been concentrated on the conclusion of "right of servitude" contracts with local municipalities and "right of use" contracts with Croatian and County Roads.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 11 Property, plant and equipment (continued)

##### *Ownership over ducts (continued)*

In connection with the offer for sale of ordinary shares held by the Government of Republic of Croatia (RoC) in 2007, the Government of RoC, the Company and Deutsche Telekom AG have entered into a Memorandum of Understanding on how the various issues relating to the Initial Public Offering, including DTI infrastructure should be resolved. Inter alia this provides the underlying principles under which right of way charges and shared usage issues will be based.

The Government of the Republic of Croatia has committed, within the limits of its authority, to use its reasonable efforts to provide for the appropriate legislation and regulations under the Croatian legal system as soon as practicably possible.

In accordance with Ordinance on Manner and Conditions for Access and Joint Use of Electronic Communications Infrastructure and Related Equipment (Official Gazette No. 154/08 effective as at 6 January 2009) and Ordinance on Certificate and Fees for the Right of Way (Official Gazette No. 31/09 effective as of 19 March 2009) the Croatian Post and Electronic Communications Agency started issuing certificates for the rights of way for certain routes in the city of Zagreb to HT. The Company believes that the issued certificates for the rights of way might help HT in the lawsuit filed by Zagrebački Holding Zagrebački Digitalni Grad (ZHSDG) (Note 27).

The legalization process is to be speeded up due to Law on Electronic Communications which obliges local municipality and other owners of the land used for the construction of telecommunication infrastructure to give HT "right of way" if other solutions were not agreed.

The Group assessed and declared the existence of the risks thereon, including obtaining legal opinions with respect to certain of the issues involved; however, due to the fact that these issues are very complex so far the Group has not yet been able to determine the possible outcome and whether it will result in any impairment of the DTI assets concerned due to any inability to prove title or as a result of the additional right of way charges that may be imposed, which could have a retrospective effect. Therefore, no adjustments were made to these financial statements in respect of this matter.

The net book value of all the Group's ducts as at 31 December 2011 is HRK 885 million (31 December 2010: HRK 889 million).

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**12 Investment in associate**

The net book value of investments in associate comprises:

	31 December 2011 HRK millions	31 December 2010 HRK millions
HP d.o.o. Mostar	2	2
	<u>2</u>	<u>2</u>

HT d.d. has an ownership interest of 30.29% in its associate HP d.o.o. Mostar which is incorporated in the Republic of Bosnia and Herzegovina. The principal activity of the associate is provision of postal services.

The movement in investments in associates of the Group during the year ended 31 December 2011 and during the year ended 31 December 2010 was as follows:

	2011 HRK millions	2010 HRK millions
<i>Net book value</i>		
At 1 January	2	2
Share of profits	0	2
Impairment of investments	0	(2)
At 31 December	<u>2</u>	<u>2</u>

Summarisation of the Group's share in aggregated financial information of associate is as follows:

	31 December 2011 Unaudited HRK millions	31 December 2010 Audited HRK millions
<i>Share of the associates statements of financial position:</i>		
Current assets	15	17
Non-current assets	18	19
Current liabilities	(3)	(6)
Non-current liabilities	0	(1)
Net assets	<u>30</u>	<u>29</u>

	2011 Unaudited	2010 Audited
<i>Share of the associate revenue and profit:</i>		
Revenue	29	31
Profit	<u>0</u>	<u>2</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**13 Investment in joint venture**

The net book value of investments in joint venture comprises:

	31 December 2011 HRK millions	31 December 2010 HRK millions
HT d.d. Mostar	393	378
	<u>393</u>	<u>378</u>

HT d.d. has an ownership interest of 39.1% in its joint venture HT d.d. Mostar which is incorporated in the Republic of Bosnia and Herzegovina. The principal activity of this company is provision of telecommunication services.

All decisions made by the Management Board and all decisions made by the Supervisory Board have to be approved by both of the majority shareholders. Therefore investment is classified as a jointly controlled entity. The rest of the company is mainly owned by Federation of Bosnia and Herzegovina (50.10%).

The Group's share in HT d.d. Mostar unaudited profit for the year ended 31 December 2011, is recognized in the statement of comprehensive income in the amount of HRK 15 million (2010: HRK 11 million of profit was recognized based on unaudited results of profit for the year ended 31 December 2010 which was later confirmed by the audit report).

During 2011, HT did not receive a dividend of from HT d.d. Mostar (2010: HRK 6 million).

	31 December 2011 Unaudited HRK millions	31 December 2010 Audited HRK millions
<i>Share of the jointly controlled entity assets and liabilities:</i>		
Current assets	124	102
Non-current assets	568	585
Current liabilities	(143)	(132)
Non-current liabilities	(59)	(83)
Net assets	<u>490</u>	<u>472</u>
	2011 Unaudited	2010 Audited
<i>Share of the jointly controlled entity revenue and profit:</i>		
Revenue	370	346
Profit	<u>15</u>	<u>11</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**14 Available-for-sale financial assets**

Non-current available-for-sale financial assets include the following bonds:

<i>Issuer</i>	<i>Currency</i>	<i>Interest rate</i>	<i>Maturity</i>	31 December 2011 HRK millions	31 December 2010 HRK millions
Government of Croatia	HRK	4.75%	8 February 2017	31	32
Other equity securities	HRK			8	10
				<u>39</u>	<u>42</u>

Current available-for-sale financial assets include the following:

				31 December 2011 HRK millions	31 December 2010 HRK millions
<i>Unit holdings in money market funds:</i>				22	20
<i>Bonds:</i>					
Government of Germany	EUR	1.25%	11 March 2011	-	74
<i>Foreign treasury bills:</i>					
Government of France	EUR	1.00%	9 February 2012	75	-
Government of Germany	EUR	1.00%	15 February 2012	76	-
Government of France	EUR	1.00%	22 March 2012	75	-
Government of France	EUR	1.00%	23 August 2012	75	-
Government of France	EUR	1.00%	21 April 2011	-	96
Government of France	EUR	1.00%	24 March 2011	-	74
Government of France	EUR	1.00%	19 May 2011	-	88
Government of France	EUR	1.00%	5 May 2011	-	37
Government of Germany	EUR	1.00%	23 February 2011	-	37
Government of Germany	EUR	1.00%	11 May 2011	-	37
				<u>323</u>	<u>463</u>

The estimated fair value of investments in treasury bills and bonds at 31 December 2011 is determined by reference to their market value offered on the secondary capital market which is an active market at the statement of financial position date and belong to the first financial instruments hierarchy category. There were no changes among financial instruments hierarchy categories in 2011.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

15 Inventories

	31 December 2011 HRK millions	31 December 2010 HRK millions
Inventories and spare parts	84	103
Merchandise	91	113
	<u>175</u>	<u>216</u>

16 Trade and other receivables

	31 December 2011 HRK millions	31 December 2010 HRK millions
Trade receivables	1,233	1,328
Other receivables	74	95
	<u>1,307</u>	<u>1,423</u>

The aging analysis of trade receivables is as follows:

	Total HRK millions	Neither past due nor impaired HRK millions	Past due but not impaired				
			< 30 days HRK millions	31-60 days HRK millions	61-90 days HRK millions	91-120 days HRK millions	>120 days HRK millions
31 December 2011	1,233	896	192	71	48	19	7
31 December 2010	1,328	883	242	97	38	22	46

Provisions are made for all outstanding receivables older than 120 days, except for receivables for international settlement for which provisions are made according to the collection estimate. International settlement account for the majority of past due but not impaired receivables older than 120 days.

As at 31 December 2011, trade receivables with a nominal value of HRK 1,047 million (31 December 2010: HRK 1,028 million) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows:

	2011 HRK millions	2010 HRK millions
At 1 January	1,028	946
Charge for the year	163	211
Unused amounts reversed	(144)	(129)
At 31 December	<u>1,047</u>	<u>1,028</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**17 Cash and cash equivalents and time deposits**

*a) Cash and cash equivalents*

Cash and cash equivalents comprise the following amounts:

	31 December 2011	31 December 2010
	HRK millions	HRK millions
Cash on hand and balances with banks	1,937	494
Time deposits with maturity less than 3 months	1,767	2,788
Cash and cash equivalents	<u>3,704</u>	<u>3,282</u>

*b) Time deposits with maturities more than 3 months*

	31 December 2011	31 December 2010
	HRK millions	HRK millions
Splitska banka d.d.	38	-
Zagrebačka banka d.d.	2	2
	<u>40</u>	<u>2</u>

*c) Currency breakdown of cash and cash equivalents and time deposits:*

	31 December 2011	31 December 2010
	HRK millions	HRK millions
HRK	2,828	2,693
EUR	874	557
USD	42	34
	<u>3,744</u>	<u>3,284</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**18 Trade and other payables**

	31 December 2011 HRK millions	31 December 2010 HRK millions
Trade payables	1,173	1,314
Payroll and payroll taxes	82	75
VAT and other taxes payable	62	40
Other creditors	30	44
	<u>1,347</u>	<u>1,473</u>

**19 Employee benefit obligations**

Long-term employee benefits include retirement and jubilee (length of service) payments. One off retirement benefits are dependent on employees fulfilling the required conditions to enter retirement and are determined in the amount of six average monthly salaries paid to employees in the preceding month. Jubilee benefits are paid in the fixed amount depending on the number of years of service in the Group.

Long-term employee benefits are determined using the projected unit credit method. Gains and losses resulting from changes in actuarial assumptions are recognized as other comprehensive income/expense in the period in which they occur.

The movement in the liability recognized in the statement of financial position was as follows:

	2011 HRK millions	2010 HRK millions
At 1 January	192	192
Service costs recognized in the statement of comprehensive income	-	5
Interest costs recognized in the statement of comprehensive income	10	12
Payments made under scheme	(13)	(15)
Change in calculation parameters effect recognized in the statement of comprehensive income	(12)	-
Actuarial gains	<u>(20)</u>	<u>(2)</u>
At 31 December	<u>157</u>	<u>192</u>

The principal actuarial assumptions used to determine retirement benefit obligations as at 31 December were as follows:

	2011 %	2010 %
Discount rate (annually)	6.5	6.5
Wage and salary increases (annually)	2.0	4.5

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**20 Deferred income**

	31 December 2011 HRK millions	31 December 2010 HRK millions
Connection fee	2	74
Deferred income – non current	2	74
Prepaid vouchers	72	97
Connection fee	4	32
Customer loyalty programme	49	95
Other	26	26
Deferred income – current	151	250
	153	324

The connection fee is recognized on a straight-line basis over future periods depending on the average useful life of a single customer line relationship. In 2011, average useful life in fixed telephony has been decreased from 10 to 3 years which resulted in of increased revenue in the amount of HRK 73 million.

**21 Provisions for legal cases and other provisions**

	2011 HRK millions	2010 HRK millions
At 1 January	101	116
Additions	11	3
Reversal	-	(3)
Interest cost	5	-
Utilisation	(3)	(15)
At 31 December	114	101

As at 31 December 2011 the Group has provided estimated amounts for several legal actions and claims that management has assessed as probable to be result in outflow of resources of the Group.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**22 Issued capital**

*Authorised, issued, fully paid and registered share capital*

	31 December 2011 HRK millions	31 December 2010 HRK millions
81,888,535 ordinary shares of HRK 100 each	8,189	8,189

The number of shares in issue remained unchanged between 1 January 1999 and 31 December 2011.

**23 Legal reserves**

Legal reserves represent reserves prescribed by the Company Act in the amount of 5% of the net profit for the year, until these reserves amount to 5% of the issued capital. Legal reserves that do not exceed the above amount can only be used to cover current year or prior year losses. If the legal reserves exceed 5% of the issued capital they can also be used to increase the issued capital of the Group.

**24 Retained earnings**

In 2011 the Group paid a dividend of HRK 1,863 million (2010: HRK 2,788 million), respectively HRK 22.75 per share (2010: HRK 34.05).

**25 Other accruals**

	31 December 2011 HRK millions	31 December 2010 HRK millions
Variable salary to employees	86	94
Handset budget programme	-	63
Unused vacation	30	39
	116	196

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**26 Commitments**

*a) Operating lease commitments*

The Group has operating lease commitments in respect of buildings, land, equipment and cars.

Operating lease charges:

	2011 HRK millions	2010 HRK millions
Current year expense (Note 7)	<u>178</u>	<u>165</u>

Future minimum lease payments under non-cancellable operating leases were as follows:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Within one year	227	164
Between 1 and 5 years	524	558
Greater than 5 years	<u>466</u>	<u>485</u>
	<u>1,217</u>	<u>1,207</u>

The contracts relate primarily to property leases and car leases.

*b) Capital commitments*

The Group was committed under contractual agreements to capital expenditure as follows:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Intangible assets	14	86
Property, plant and equipment	<u>64</u>	<u>123</u>
	<u>78</u>	<u>209</u>

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 27 Contingencies

At the time of preparation of these consolidated financial statements, there are a number of claims outstanding against the Group. In the opinion of the management, the settlement of these cases will not have a material adverse effect on the financial position of the Group, except for certain claims for which a provision was established (see Note 21).

##### a) *Competition / Regulatory matters*

HT vigorously defends all of the below competition / regulatory situations. There is no history of significant settlements in Croatia under either the Competition Law or imposed by misdemeanour courts. Due to the lack of relevant practice and due to the fact that the proceedings are still in progress, the Group is not able to determine the possible outcome of these cases, however management believes that any settlement will be significantly less than the maximum penalties outlined below.

##### *Vipnet complaint in front of the Croatian Competition Agency and Optima claim in front of Croatian Post and Electronic Communications Agency (HAKOM)*

VIPnet d.o.o. complained to the Competition Agency regarding Frame Agreements that HT and T-Mobile Croatia d.o.o. signed with our key and large business clients that allegedly contain anti competitive clauses. The Agency has initiated administrative proceedings for assessing whether the Company and T-Mobile Croatia d.o.o. have abused their dominant position by conclusion of the Frame Agreements.

The potential penalty for violations of the Law on Protection of Market Competition could amount up to 10% of the annual Company turnover of the financial year proceeding the year in which the infringement was committed. The first instance procedure of the misdemeanour proceedings against HT was finished in December 2011 and the verdict could be reached in 2012.

A similar complaint regarding Frame Agreements has been addressed by fixed competitor OT - Optima Telekom d.o.o. to HAKOM in June 2006. It should be pointed out that the penalty for violations of the Law on Telecommunications could amount to between 1% and 5% of the annual turnover of the fixed operations. A penalty based on 1% of the turnover for the relevant period would amount to HRK 50 million.

##### *Croatian Post and Electronic Communications Agency's (HAKOM's) supervision on Bitstream Standard offer*

On 17 July 2009, HAKOM passed decision regarding the analysis of the wholesale bitstream access service by which HT is designated as an operator having significant market power on the relevant market, through which certain regulatory obligations have been defined, including the obligation to publish a Bitstream Standard Offer within the transparency obligation.

HAKOM initiated a supervision relating to distinction between "existing" and "new" end-users in HT's Bitstream Standard Offer, claiming that such distinction is contrary to HAKOM's decisions, in which percentage of discount for all users has been determined in the amount of 40%.

HT received Misdemeanour Indictment in which HAKOM proposed that HT should be fined with penalty in the amount of 1% of yearly turnover gained by providing electronic communication networks and services in the year preceding the year in which the offence was committed. On the basis of the results for 2008, 1% of the turnover would amount to HRK 88 million.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2011

### 27 Contingencies (continued)

#### a) Competition / Regulatory matters (continued)

##### *Wholesale Line Rental case*

According to HAKOM's Council decision from 6 April 2011 on the analysis of market on access to the public telephone network at a fixed location for residential and non-residential customers, on 1 July 2011 HT published Reference Offer for wholesale line rental (WLR) and accordingly changed the Reference Offer for Interconnection (RIO).

HAKOM's supervisor passed two decisions stating that by such publishing, HT breached its regulatory obligations and ordered HT several changes of Reference Offers that HT accordingly made. HT challenged these supervisor's decisions by submitting several lawsuits to the Administrative Court.

In October 2011, HT was informed that HAKOM has submitted two indictments to the Misdemeanour Court against HT because of HT's alleged breach of its regulatory obligations. HT has not yet officially received these indictments.

HAKOM has demanded from the Misdemeanour court to fine HT in the amount of 3% of HT's annual gross income in each of the two proceedings. On the basis of the results for 2010, 3% of the turnover would amount to HRK 250 million in each of the two proceedings. It can be expected that the Misdemeanour Court will soon deliver these indictments to HT for stating its objections.

##### *Denial of ULL access to Amis and Metronet*

In 2009 HT received two lawsuits filed by Metronet Telekomunikacije d.d. Zagreb (hereinafter: Metronet) and Amis Telekom d.o.o. Zagreb against HT. They claim that HT was late in setting up the collocation and providing an access to unbundled local loop and that access to unbundled local loop was conditioned with conclusion of the Contract on lease of DTI contrary to the Standard offer of HT for unbundled local loop. In addition, Metronet requests for the annulment of the Contract on lease of DTI from 22 July 2005. Total claim demanded in Metronet and Amis Telekom lawsuits amount to HRK 37 and 30 million HRK plus interest, retrospectively. Our attorneys in these cases are of a firm belief that they cannot succeed with their claim.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**27 Contingencies (continued)**

*b) Ownership claim of Distributive Telecommunication Infrastructure (DTI) by the City of Zagreb*

With respect to the ducts issue mentioned under Property, plant and equipment (Note 11), on 16 September 2008 the Company received a lawsuit filed by the Zagreb Digital City Ltd. branch of Zagreb Holding Ltd. (hereinafter: ZHZDG) against the Company. ZHZDG is claiming the ownership of the City of Zagreb over DTI on the area of the City of Zagreb and demanding a payment in the range from HRK 120 to 390 million plus interest.

The suit is based on the legal acts adopted by the Administration and Assembly of the City of Zagreb in the years 2006 and 2007 by which DTI has been declared a communal infrastructure owned by the City of Zagreb that are challenged by the Company and the suit was filled.

The Company's attorney is of the firm belief that ZHZDG cannot succeed with its claim if the court decision will be based on the positive legislation of the RoC.

As a result, management concluded that no provision is required to be recognized in the consolidated financial statements for this case.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**28 Balances and transactions with related parties**

The transactions disclosed below primarily relate to transactions with the companies owned by Deutsche Telekom AG (DTAG). The Group enters into transactions in the normal course of business on an arm's length basis. These transactions included the sending and receiving of international traffic to/from these companies during 2011 and 2010. Further, DTAG provided technical assistance to the Group of HRK 10 million (2010: HRK 13 million).

The main transactions with related parties during 2011 and 2010 were as follows:

	Sales		Purchases	
	2011	2010	2011	2010
<i>Related party:</i>	HRK millions	HRK millions	HRK millions	HRK millions
<i>Immediate parent</i>				
Deutsche Telekom AG, Germany	21	26	48	58
<i>Joint venture</i>				
HT Mostar, Bosnia and Herzegovina	34	37	53	71
<i>Subsidiaries of immediate parent</i>				
Telekom Deutschland, Germany	27	27	7	12
T-Mobile Austria, Austria	10	13	5	9
T-Systems International, Germany	-	-	6	5
Others	49	48	17	24
<b>Total</b>	<b>141</b>	<b>151</b>	<b>136</b>	<b>179</b>

The statement of financial position includes the following balances resulting from transactions with related parties:

	Receivables		Payables	
	31 December 2011	31 December 2010	31 December 2011	31 December 2010
<i>Related party:</i>	HRK millions	HRK millions	HRK millions	HRK millions
<i>Immediate parent</i>				
Deutsche Telekom AG, Germany	3	-	14	34
<i>Joint venture</i>				
HT Mostar, Bosnia and Herzegovina	-	-	6	20
<i>Subsidiaries of immediate parent</i>				
Telekom Deutschland, Germany	-	-	44	46
T-Mobile Austria, Austria	-	-	16	16
Everything Everywhere Ltd., UK	-	-	16	1
T-Systems International, Germany	-	-	-	1
Others	2	6	69	45
<b>Total</b>	<b>5</b>	<b>6</b>	<b>165</b>	<b>163</b>

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2011

### 28 Balances and transactions with related parties (continued)

#### *Compensation of the Supervisory Board*

The chairman of the Supervisory Board receives remuneration in the amount of 1.5 of the average net salary of the employees of the Company paid in the preceding month. To the deputy chairman, the amount of 1.25 of the average net salary of the employees of the Company paid in the preceding month is paid, while any other member receives the amount of one average net salary of the employees of the Company paid in the preceding month. To a member of the Supervisory Board who is in the same time the Chairman of the Audit Committee of the Supervisory Board in the amount of 1.5 of the average monthly net salary of the employees of the company paid in the preceding month. To a member of the Supervisory Board who is in the same time a Member of the Audit Committee of the Supervisory Board in the amount of 1.25 of the average monthly net salary of the employees of the company paid in the preceding month. To a member of the Supervisory Board who is in the same time a Member of the Compensation and Nomination Committee of the Supervisory Board in the amount of 1.25 of the average monthly net salary of the employees of the company paid in the preceding month. DTAG representatives do not receive any remuneration for the membership in the Supervisory Board due to a respective policy of DTAG.

In 2011, Group paid a total amount of HRK 0.7 million (2010: HRK 0.6 million) to the members of its Supervisory Board. No loans were granted to the members of the Supervisory Board.

#### *Compensation to key management personnel*

In 2011 the total compensation paid to key management personnel of the Group amounted to HRK 46 million (2010: HRK 40 million). Key management personnel include members of the Management Boards of the Company and its subsidiaries and the operating directors of the Company, who are employed by the Group. Compensation paid to key management personnel includes:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Short term benefits	44	39
Share based payments	2	1
	<u>46</u>	<u>40</u>

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2011

### 29 Financial risk management objectives and policies

The Group is exposed to international service-based markets. As a result, the Group can be affected by changes in foreign exchange rates. The Group also extends credit terms to its customers and is exposed to a risk of default. The significant risks, together with the methods used to manage these risks, are described below. The Group does not use derivative instruments either to manage risk or for speculative purposes.

#### a) Credit risk

The Group has no significant concentration of credit risk with any single counter party or group of counterparties with similar characteristics. The Group procedures are in force to ensure on a permanent basis that sales are made to customers with an appropriate credit history and do not exceed an acceptable credit exposure limit.

The Group does not guarantee obligations of other parties.

The Group considers that its maximum exposure is reflected by the amount of debtors (see Note 16) net of provisions for impairment recognized at the statement of financial position date.

Additionally, the Group is exposed to risk through cash deposits in the banks. As at 31 December 2011 the Group had business transactions with thirteen banks (2010: eight banks). The Group held cash and deposits in five banks almost exclusively. For those five domestic banks with foreign ownership the Group received guarantees for deposits given from parent banks which have a minimum rating of BBB+. The management of this risk is focused on dealing with the most reputable banks in foreign and domestic ownership at the domestic and foreign markets and on contacts with the banks on a daily basis.

The credit quality of financial assets that are neither past due nor impaired can be assessed by historical information about counterparty default rates:

	31 December 2011	31 December 2010
	HRK millions	HRK millions
Trade receivables for rendered telecom services to domestic customers	775	794
Trade receivables for rendered telecom services to foreign customers	30	20
Other trade receivables	91	69
	<u>896</u>	<u>883</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**29 Financial risk management objectives and policies (continued)**

*b) Liquidity risk*

The Group policy is to maintain sufficient cash and cash equivalents or to have available funding through an adequate amount of committed credit facilities to meet its commitments for the foreseeable future.

Any excess cash is invested mostly in available-for-sale financial assets.

Trade and other payables all amounts in HRK millions	Due in 0-30 days	Due in 31-60 days	Due in 61-90 days	Due in 91-120 days	Due in >120 days	Total
Year ended 31 December 2011	1,226	73	13	5	30	1,347
Year ended 31 December 2010	1,392	26	24	5	26	1,473

Other long-term liabilities all amounts in HRK millions	1 to 3 years	3 to 5 years	> 5 years	Total
Year ended 31 December 2011	5	7	20	32
Year ended 31 December 2010	18	6	19	43

*c) Interest rate risk*

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's available-for-sale financial assets, cash, cash equivalents and time deposits.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit post tax (through the impact on floating rate investments).

	Increase/decrease in basis points	Effect on profit post tax HRK millions
Year ended 31 December 2011		
Croatian Kuna	+100	6
	-100	(6)
Euro	+100	10
	-100	(10)
Year ended 31 December 2010		
Croatian Kuna	+100	6
	-100	(6)
Euro	+100	6
	-100	(6)

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2011

### 29 Financial risk management objectives and policies (continued)

#### d) Foreign currency risk

The Group's functional currency is the Croatian Kuna (HRK). Certain assets and liabilities are denominated in foreign currencies which are translated at the valid middle exchange rate of the Croatian National Bank at each statement of financial position date. The resulting differences are charged or credited to the statement of comprehensive income but do not affect short-term cash flows.

A significant amount of deposits in the banks, available for sale financial assets and cash equivalents are made in foreign currency, primarily in Euro. The purpose of these deposits is to hedge foreign currency denominated liabilities and liabilities indexed to foreign currencies from changes in the exchange rate. The following table demonstrates the sensitivity to a reasonably possible change in the Euro exchange rate, with all other variables held constant, of the Group's profit post tax due to changes in the fair value of monetary assets and liabilities.

	Increase/decrease in Euro rate	Effect on profit post tax HRK millions
Year ended 31 December 2011	+3%	28
	-3%	(28)
Year ended 31 December 2010	+3%	19
	-3%	(19)

#### e) Fair value estimation

The fair value of securities included in available-for-sale financial assets is estimated by reference to their quoted market price at the statement of financial position date. The Group's principal financial instruments not carried at fair value are trade receivables, other receivables, long-term receivables, trade and other payables. The historical cost carrying amounts of receivables and payables, including provisions, which are all subject to normal trade credit terms, approximate their fair values.

#### f) Capital management

The primary objective of the Group's capital management is to ensure that it supports its business and maximise shareholder value. The capital structure of the Group consists of equity attributable to shareholders, comprising issued capital, reserves and retained earnings and totals HRK 11,019 million as at 31 December 2011 (2010: HRK 11,054 million).

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2011 and 31 December 2010 (see Notes 22 and 24).

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2011

**30 Financial instruments**

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments:

	Carrying amount		Fair value	
	31 December 2011 HRK millions	31 December 2010 HRK millions	31 December 2011 HRK millions	31 December 2010 HRK millions
<i>Financial assets</i>				
Cash and cash equivalents	3,704	3,282	3,704	3,282
Time deposits	40	2	40	2
Available-for-sale assets, non-current	39	42	39	42
Available-for-sale assets, current	323	463	323	463
<i>Financial liabilities</i>				
Interest-bearing loans	32	22	32	22

Market values have been used to determine the fair value of listed available-for-sale financial assets. The fair value of loans has been calculated by discounting the expected future cash flows at prevailing interest rates.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2011

### 31 Authorization for Services and Applicable Fees

The Company is party to the following Authorization for Services, none of which are within the scope of IFRIC 12:

#### a) *Service authorization for the performance of electronic communications services in a fixed and mobile network*

On 1 July 2008 a new Law on Electronic Communications entered into force and introduced general authorization for all electronic communications services and networks. On 10 August 2011 Law on amendments to the Law on Electronic Communications, in compliance with EU framework, entered into force Pursuant to Article 32 of the Law on Electronic Communications the Company is entitled to provide the following electronic communication services based on the general authorisation which has been lastly updated on 15 November 2010:

- Publicly available telephone service in the fixed electronic communications network;
- Publicly available telephone service in the mobile electronic communications network;
- Lease of electronic communication network and/or lines;
- Transmission of image, voice and sound through electronic communication networks (which excludes services of radio diffusion);
- Value added services;
- Internet access services;
- Voice over Internet protocol services;
- Granting access and shared use of electronic communications infrastructure and associated facilities;
- Satellite services;
- Providing of information about the numbers of all subscribers of publicly available telephony services in the Republic of Croatia;
- Issuing of comprehensive publicly available directory of all subscribers of publicly available telephone services in the Republic of Croatia;
- Other services.

Upon the merger of T-Mobile Croatia d.o.o. to the Company as of 1 January 2010, T-Mobile Croatia d.o.o. ceased to exist as a separate company and thus was erased from the list of the operators.

In accordance with HAKOM's decision of 28 November 2005 the Company was designated as the Universal services provider for a period of five years i.e. till 29 November 2010. Due to expiration of the 5-year period, on 27 October 2010 HAKOM adopted a new decision thereby designating the Company as the operator of the following universal services in the territory of the Republic of Croatia for the next 5-year period starting from 29 November 2010:

- access to the public telephone network and publicly available telephone services at a fixed location, allowing end-users to make and receive local, national and international telephone calls, facsimile communications and data communications, at data rates that are sufficient to permit functional Internet access, taking into account prevailing technologies used by the majority of subscribers and technological feasibility;
- access for end-users, including users of public pay telephones, to a telephone directory enquiry service;
- setting up of public pay telephones on public places accessible at any time, in accordance with the reasonable needs of end-users in terms of the geographical coverage, the quality of services, the number of public pay telephones and the accessibility of such telephones for disabled persons;
- special measures for disabled persons, including access to emergency services, telephone directory enquiry services and directories, equivalent to that enjoyed by other end-users;
- special pricing systems adjusted to the needs of the socially disadvantaged groups of end-users.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2011

### 31 Authorization for Services and Applicable Fees (continued)

*a) Service authorization for the performance of electronic communications services in a fixed and mobile network (continued)*

Following the later decision of HAKOM, the Company is no longer designated as universal service operator for service access for end-users to at least one comprehensive directory of all subscribers of publicly available telephone services, however, shall continue to provide the service on commercial basis.

*b) Service authorization for provision of public telecommunications services with the usage of radio frequency spectrum in the global mobile network system – GSM and with the usage of radio frequency spectrum in third generation mobile network system UMTS*

Upon the merger of T-Mobile Croatia d.o.o. to the Company as of 1 January 2010 all rights and licences for use of addresses and numbers and for the use of radiofrequency spectrum (GSM and UMTS and others) that were granted to T-Mobile Croatia d.o.o. until 31 December 2009 were transferred to the Company.

In 2010 upon the Company's request HAKOM issued following licenses to the Company:

- on 20 January 2010 received new technology neutral licences issued by HAKOM for use of radiofrequency spectrum in 900 MHz and 1800 MHz frequency bands (GSM licence) and for the use of radiofrequency spectrum in 2100 MHz frequency band (UMTS license); Both licences have been issued with the validity until 18 October 2024.
- on 13 September 2010 HAKOM issued licences for the use of radiofrequency spectrum for satellite services (DTH services);

In 2011 the Company submitted two requests to HAKOM for the assignment of additional radiofrequency spectrum in 1800 MHz frequency band. Based on these requests, after conducted assignment procedure, HAKOM issued the following licences:

- on 20 April 2011 new technology neutral licences for use of radiofrequency spectrum in 900 MHz and 1800 MHz frequency bands, which replaced the licence received on 20 January 2010
- on 16 November 2011 new technology neutral licence for use of radiofrequency spectrum in 900 MHz and 1800 MHz frequency bands, which replaced the licence issued on 20 April 2011.

In addition during 2011 based on temporary licences HAKOM made possible the use of radiofrequency spectrum in 1800 MHz frequency band for the purpose of the Company's technical testing and exploration of LTE technology for non-commercial purposes.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 31 Authorization for Services and Applicable Fees (continued)

##### *c) Fees for providing electronic communications services*

Pursuant to the Law on Electronic Communications, the Company is obliged to pay the fees for the use of addresses and numbers, radiofrequency spectrum and for the performance of other tasks of HAKOM pursuant to the ordinances of HAKOM and Ministry of the sea, transport and infrastructure. The said regulations prescribe the calculation and the amount of fees. These fees are paid for the current year or one year in advance (in case of fees for usage of radiofrequency spectrum).

In 2011 the Company paid the following fees:

- the fees for the use of addresses, numbers and radiofrequency spectrum pursuant to the ordinance passed by the Ministry of the sea, transport and infrastructure (in favour of State budget, Official Gazette 154/08, 28/09, 97/10) and
- the fees for use of addresses, numbers and radiofrequency spectrum and for the performance of other tasks of HAKOM. Pursuant to the ordinance passed by HAKOM (in favour of HAKOM's budget, Official Gazette, 144/10).

##### *d) Audiovisual and electronic media services*

Pursuant to the Law on Audio-visual Services, which entered into force on 31 July 2007, the Company is obliged to pay the fee of 1% of the annual gross revenues realized from the provision of audio-visual services, to the state budget of the Republic of Croatia as a contribution to the funding of National Programme for Promotion of Audio-visual Works.

Pursuant to the Law on Electronic Media, which entered into force on 29 December 2009, the Company is obliged to pay upon the request the fee of 0,5% of the annual gross revenues realized from the provision of audiovisual media services and the electronic publication services.

##### *e) Electronic communications infrastructure and associated facilities*

The Company as the infrastructure operator is obligated to pay fees for the right of way in accordance with the Law on Electronic Communications. The fees for the right of way are defined by the Ordinance on right of way certificate and fee (Official Gazette, 31/09, 89/10) passed by HAKOM. This Ordinance is replaced by the new Ordinance on Certificate and Fees for the Right of Way (Official Gazette 152/2011) that was adopted by HAKOM in December 2011. The new Ordinance is effective as of 4 January, 2012. The fee is calculated according to the area of land used for the installation of electronic communications infrastructure and associated facilities.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 32 Share-based and non share-based payment transactions

Various mid-term (MTIP 2009, MTIP 2010 and MTIP 2011) and long-term incentive plan (LTIP - Variable II 2011) exist at Group level to ensure competitive total compensation for members of the Management Board, senior executives and other beneficiaries. The plans promote the medium and long-term value enhancement of the Group, thus aligning the interests of management and shareholders. First HT's MTIP was introduced in 2008.

MTIP is generally set up as a cash-based plan linked to two equally weighted, share-based performance parameters – one absolute and one relative. If both performance targets are achieved, then the total amount earmarked as an award to the beneficiaries by the respective employers is paid out; if one performance target is achieved, 50 percent of the amount is paid out, and if neither performance target is achieved, no payment is made.

All MTIPs cover period of three years (i.e. MTIP 2008 covers the period from 1 January 2008 to 31 December 2010) and LTIP- Variable II 2011 covers period of four years. The payment of the awarded sum is subject to the achievement of two share value based performance targets. Upon expiry of the term of the plan, the Supervisory Board of the Company shall determine whether each of the targets has been achieved. Based on the findings of the Supervisory Board, the Management Board shall determine and announce the level of target achievement.

All MTIPs have two targets which are equally weighted and cannot be changed during the MTIP duration. The first target is based on the increase of the share price by a certain percentage; the second target is related to the share price movement compared to the complex return index.

The incentives themselves consist of 20 percent or 30 percent of the participants' individual annual salary as contracted on the beginning of each MTIP depending on the management level of the participant and according to the Supervisory Board decision. Participants' individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100 percent target achievement.

Based on decision of the Supervisory Board it was established that one MTIP 2008 target out of two has been achieved. The rewards for participants of MTIP 2008 were paid out in March 2011. In accordance with targets achievements, payment of 50% of the total amount was made.

LTIP – Variable II 2011 is new cash-based plan with four equally weighted performance parameters and cannot be changed during plan duration. Two targets are financial KPIs, Earnings Per Share (EPS) and adjusted operating Return On Capital Employed (ROCE), third and forth targets are customer and employee satisfaction.

According to LTIP – Variable II 2011, the amounts awarded for International Business Leaders (BLT's) is fixed sum specified in the individual employment contract and for other participant is 30% or 20% of the participants' individual annual salary as contracted on the beginning of the plan depending on the management level of the participant and according to the Supervisory Board decision. Participants' individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100 percent target achievement.

In contrast to the former MTIP structure, Variable II offers the option of exceeding the amounts earmarked for award, limited to 150% of the award volume per parameter. The parameters are independent of each other, hence each parameter is assessed separately. Both potential excesses and shortfalls in relation to targets are accounted for on a graded basis per target parameter (departure from the principle of "all or nothing").

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2011

#### 32 Share-based and non share-based payment transactions (continued)

All gains and expenses resulting from changes of the related provisions for all MTIP plans recognized for employee services received during the year are shown in the following table:

	2011 HRK millions	2010 HRK millions
Expenses for providing for cash-settled share-based and non share-based payment transactions	3	4
Gains arising from cancellation of provision for cash-settled share-based and non-share based payment transactions	-	1
	<hr/>	<hr/>

#### 33 Auditor's fees

The statutory auditors of the Group's financial statements have rendered services of HRK 6 million in 2011 (2010: HRK 7 million). Services rendered in 2011 and 2010 relate to the audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes and audit of SAP transformation project.

#### 34 Events after reporting period

No other events or transactions have occurred since 31 December 2011 or are pending that would have a material effect on the financial statements at that date or for the period then ended, or that are of such significance in relation to the Group's affairs to require disclosure in the financial statements.