

**Hrvatski Telekom d.d.**

Consolidated financial statements

31 December 2012

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## Responsibility for the consolidated financial statements

Pursuant to the Croatian Accounting Act in force, the Management 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 (Hrvatski Telekom d.d. and its subsidiaries) for that period.

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

In preparing those consolidated financial statements, the responsibilities of the Management 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 Management 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 Management 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 5 February 2013.

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

On behalf of the Group,

5 February 2013

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

  
Hrvatski Telekom d.d.  
Zagreb

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## **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 2012 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 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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*Emphasis of matter*

Without qualifying our opinion, we draw attention to Notes 11 and 28 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 2012 is HRK 855 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, 5 February 2013

  
John Mathias Gasparac  
Procurator

  
PricewaterhouseCoopers d.o.o.<sup>3</sup>  
za reviziju i konzalting  
Zagreb, Aleksandra von Humboldta 4

  
Tamara Mačašović  
Certified Auditor

Consolidated statement of comprehensive income  
For the year ended 31 December 2012

	Notes	2012 HRK millions	2011 HRK millions Restated
Rendering of services		7,152	7,765
Sale of goods		304	302
Revenue	3	<u>7,456</u>	<u>8,067</u>
Other operating income		259	204
Merchandise, material and energy expenses		(872)	(1,013)
Service expenses	4	(1,042)	(1,091)
Employee benefits expenses	6	(1,208)	(1,283)
Work performed by the Group and capitalised		85	81
Depreciation, amortization and impairment of non-current assets	5	(1,326)	(1,447)
Other expenses	7	<u>(1,302)</u>	<u>(1,296)</u>
Total operating costs		<u>(5,665)</u>	<u>(6,049)</u>
<b>Operating profit</b>	3	<u>2,050</u>	<u>2,222</u>
Finance income		78	83
Finance costs		<u>(63)</u>	<u>(65)</u>
Net finance income		15	18
Net share in investments in associate and joint venture	12,13	<u>27</u>	<u>15</u>
<b>Profit before income tax</b>		<u>2,092</u>	<u>2,255</u>
Income tax expense	8	<u>(396)</u>	<u>(444)</u>
<b>Profit for the year</b>		<u>1,696</u>	<u>1,811</u>
<b>Other comprehensive income for the year</b>			
Change in value of available for sale financial assets		2	(2)
Actuarial (losses)/gains and other (expense)/income		<u>(5)</u>	<u>19</u>
<b>Other comprehensive (loss)/income for the year, net of tax</b>		<u>(3)</u>	<u>17</u>
<b>Total comprehensive income for the year, net of tax</b>		<u>1,693</u>	<u>1,828</u>
Earnings per share			
- basic and diluted, for profit for the year attributable to ordinary equity holders of the Company	9	HRK 20.71	HRK 22.12

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

Consolidated statement of financial position  
As at 31 December 2012

	Notes	31 December 2012 HRK millions	31 December 2011 HRK millions Restated	1 January 2011 HRK millions Restated
<b>ASSETS</b>				
<b>Non-current assets</b>				
Intangible assets	10	1,142	1,087	1,222
Property, plant and equipment	11	5,733	5,953	6,336
Investments in associate and joint venture	12,13	398	395	380
Available-for-sale financial assets	14	499	39	42
Other non-current receivables		21	23	24
Deferred income tax assets	8	65	52	64
<b>Total non-current assets</b>		<u>7,858</u>	<u>7,549</u>	<u>8,068</u>
<b>Current assets</b>				
Inventories	16	155	175	216
Trade and other receivables	17	1,215	1,307	1,423
Prepayments and accrued income		149	126	110
Income tax prepayments		4	-	25
Available-for-sale financial assets	14	86	323	463
Loans to banks	15	239	-	-
Time deposits	18 b)	261	40	2
Cash and cash equivalents	18 a)	3,146	3,704	3,282
<b>Total current assets</b>		<u>5,255</u>	<u>5,675</u>	<u>5,521</u>
<b>TOTAL ASSETS</b>		<u>13,113</u>	<u>13,224</u>	<u>13,589</u>

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

# Consolidated statement of financial position (continued)

As at 31 December 2012

	Notes	31 December 2012 HRK millions	31 December 2011 HRK millions Restated	1 January 2011 HRK millions Restated
<b>EQUITY AND LIABILITIES</b>				
<b>Issued capital and reserves</b>				
Issued share capital	23	8,189	8,189	8,189
Legal reserves	24	409	409	409
Fair value reserves		(1)	(3)	(1)
Retained earnings	25	2,302	2,424	2,457
<b>Total issued capital and reserves</b>		<b>10,899</b>	<b>11,019</b>	<b>11,054</b>
<b>Non-current liabilities</b>				
Provisions for legal claims and other provisions	22	87	113	101
Employee benefit obligations	20	140	158	192
Deferred income	21	2	2	74
Other non-current liabilities		50	49	44
<b>Total non-current liabilities</b>		<b>279</b>	<b>322</b>	<b>411</b>
<b>Current liabilities</b>				
Trade and other payables	19	1,577	1,418	1,532
Provisions for redundancy	6	146	169	133
Other accruals	26	84	116	196
Income tax payable		-	20	-
Deferred income	21	122	151	250
Short-term borrowings		6	9	13
<b>Total current liabilities</b>		<b>1,935</b>	<b>1,883</b>	<b>2,124</b>
<b>Total liabilities</b>		<b>2,214</b>	<b>2,205</b>	<b>2,535</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>13,113</b>	<b>13,224</b>	<b>13,589</b>

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

Signed on behalf of the Group on 5 February 2013:

Mr. Ivica Mudrinić

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 2012

	Notes	2012 HRK millions	2011 HRK millions Restated
<b>Operating activities</b>			
Profit before income tax		2,092	2,255
Depreciation, amortization and impairment of non-current assets	5	1,326	1,447
Interest income		(54)	(34)
(Gain)/Loss on disposal of assets		(58)	6
Share of profit in joint venture	13	(27)	(15)
Decrease in inventories		20	41
Decrease in receivables and prepayments		89	65
Increase/(Decrease) in payables and accruals		104	(347)
Decrease in employee benefit obligations	20	(18)	(34)
(Decrease)/Increase in provisions		(50)	48
Other non-cash items		(9)	7
Cash generated from operations		<u>3,415</u>	<u>3,439</u>
Interest paid		(0)	(2)
Income tax paid		<u>(433)</u>	<u>(388)</u>
<b>Net cash flows from operating activities</b>		<u>2,982</u>	<u>3,049</u>
<b>Investing activities</b>			
Purchase of non-current assets	10,11	(1,180)	(938)
Proceeds from sale of non-current assets		64	3
Purchase of available-for-sale financial assets		(1,481)	(944)
Proceeds from sale of available-for-sale financial assets		1,045	1,065
Purchase of reverse REPO arrangements	15	(634)	-
Proceeds from reverse REPO arrangements	15	395	-
Interest received		48	57
Dividend received	13	25	-
<b>Net cash flows used in investing activities</b>		<u>(1,718)</u>	<u>(757)</u>
<b>Financing activities</b>			
Repayment of lease liability and borrowings		(12)	(11)
Dividends paid	25	<u>(1,813)</u>	<u>(1,863)</u>
<b>Net cash flows used in financing activities</b>		<u>(1,825)</u>	<u>(1,874)</u>
Net (decrease)/increase in cash and cash equivalents		(561)	418
Exchange gains on cash and cash equivalents		3	4
Cash and cash equivalents at 1 January		<u>3,704</u>	<u>3,282</u>
Cash and cash equivalents at 31 December	18 a)	<u>3,146</u>	<u>3,704</u>

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 2012

	Issued share capital HRK millions (Note 23)	Legal reserves HRK millions (Note 24)	Fair value reserves HRK millions	Retained earnings HRK millions (Note 25)	Total HRK millions
Balance as at 1 January 2011	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
Profit for the year	-	-	-	1,696	1,696
Other comprehensive income for the year	-	-	2	(5)	(3)
Total comprehensive income for the year	-	-	2	1,691	1,693
Dividends paid to equity holders of the Company	-	-	-	(1,813)	(1,813)
Balance as at 31 December 2012	8,189	409	(1)	2,302	10,899

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 2012

### 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 2012 was 5,999 (31 December 2011: 6,239).

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 2012 were authorized for issue in accordance with a resolution of the Management Board on 5 February 2013. 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 2012	31 December 2011
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 2012

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

The accounting policies adopted are consistent with those of the previous financial year except as is disclosed at the end of this Note.

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.

*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 Group adopted this amendment that affects disclosure only and did not impact on the Group's financial position or performance.

*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 do not have any impact on the Group's financial position or performance because the Group is not first time adopter.

*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. Amended IAS 12 does not 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.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

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

*Standards and interpretations issued but not yet effective:*

*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 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.

*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 IFRS 12 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 2012

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

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

*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 IFRS 13 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.

*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 recognise 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.

*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. The Group is considering the implications of the amendment and the impact on the Group.

*Amendment to IFRS 1 First time adoption on government loans (effective for annual periods beginning on or after 1 January 2013).*

This amendment addresses how a first-time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRS. It also adds an exception to the retrospective application of IFRS, which provides the same relief to first-time adopters granted to existing preparers of IFRS financial statements when the requirement was incorporated into IAS 20 in 2008. This amendment is not relevant to the Group's operations.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

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

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

*Amendment to IFRSs 10, 11 and 12 on transition guidance (effective for annual periods beginning on or after 1 January 2013).*

These amendments provide additional transition relief to IFRSs 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The Group is considering the implications of the amendments and the impact on the Group.

*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.

*IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2015)*

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.

*Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014)*

The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary. The Group is currently assessing the impact of the amendments on its financial statements.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

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

*Annual improvements 2011 (effective for annual periods beginning on or after 1 January 2013)*

These annual improvements, address six issues in the 2009-2011 reporting cycle. It includes changes to:

- IFRS 1, 'First time adoption'
- IAS 1, 'Financial statement presentation'
- IAS 16, 'Property plant and equipment'
- IAS 32, 'Financial instruments; Presentation'
- IAS 34, 'Interim financial reporting'

The Group is considering the implications of the improvements and the impact on the Group.

#### *Voluntary accounting policy change*

In 2012, the Group voluntarily changed its accounting policy for the treatment of content provider cost. Previously, the Group expensed content provider costs in the period in which they occurred. The Group now recognizes these costs as an intangible asset at the inception of related contract. The Group determined that the following conditions have to be met for capitalization of content provider contracts: contract duration must be longer than one year, cost must be determined or determinable, contracted rights must be continuous and costs under the contract are unavoidable. Assets recognized under these contracts will be amortized over the contract period. The Group believes that recognizing the content provider costs as intangible assets results in better presentation of the financial position and provides more relevant information. The accounting treatment of content provider costs varies within the media and telecommunication industry, but the Group believes the current accounting policy is more appropriate as it is aligned better with industry best practices and the policies followed by Deutsche Telekom AG.

The change in accounting policy has been accounted for retrospectively, and the Group restated the comparative amounts for each prior period presented as if the new accounting policy had always been applied. The effects of the accounting policy change on financial information for 2011 and 2010 are as follows:

- Statement of comprehensive income

<i>Position</i>	2011 As reported HRK millions	Impact on change HRK millions	2011 Restated HRK millions
Service expenses	(1,141)	50	(1,091)
Depreciation, amortization and impairment of non-current assets	(1,414)	(33)	(1,447)
Financial costs	(48)	(17)	(65)



Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

2.2. Changes in accounting policies and disclosures (continued)

Voluntary accounting policy change (continued)

- Statement of financial position

	1 January 2011 As reported HRK millions	Impact on change HRK millions	1 January 2011 Restated HRK millions
<i>Position</i>			
Intangible assets	1,162	60	1,222
Other non-current liabilities	43	1	44
Trade and other payables	1,473	59	1,532

	31 December 2011 As reported HRK millions	Impact on change HRK millions	31 December 2011 Restated HRK millions
<i>Position</i>			
Intangible assets	999	88	1,087
Other non-current liabilities	32	17	49
Trade and other payables	1,347	71	1,418

- Statement of cash flows

	2011 As reported HRK millions	Impact on change HRK millions	2011 Restated HRK millions
<i>Position</i>			
Depreciation, amortization and impairment of non-current assets	1,414	33	1,447
Decrease in payables and accruals	(375)	28	(347)
Purchase of non-current assets	877	61	938

There was no any effect on earnings per share related to the restatement in 2011.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

### 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 the 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 22 and 28. Changes in these judgments could have a significant impact on the segments of the Group.

#### *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 a 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.

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. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the financial plan covering a mid-term period. The cash flows beyond the planning period are extrapolated using appropriate growth rates given in Note 10. 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. Further details including carrying values and effects on the result of the period are given in Notes 10 and 11.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

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

#### *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 is 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.

In 2012, the Group reassessed useful life of customer premises equipment (CPE) which was increased from 3 and 5 to 7 years. The effect is reduced annual depreciation cost by HRK 59 million. The change was made based on lower replaced malfunctioned devices during the time that passed since the initial useful life was estimated and due to new purchases of higher quality equipment.

The following table demonstrates the sensitivity to a reasonably possible change in useful life on amortization and depreciation, with all other variables held constant, on the Group's profit post tax:

	Increase/ decrease in %	Effect on profit post tax HRK millions
Year ended 31 December 2012	+10	(34)
	-10	148

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 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 2012

#### 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 2012

### 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 rights	
UMTS licence	20 years
LTE licence (digital dividend)	12 years
GSM licence	15 years
Right of servitude for Distributive Telecommunication Infrastructure (DTI)	30 years
Software, content 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 2012

### 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
Customer premises equipment (CPE)	7 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 2012

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

#### g) *Impairment of assets*

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

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

##### *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.

#### 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 inventory impairment immediately.



## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2012

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

##### *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, the receivables 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.

##### *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.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

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

#### *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.

#### *m) Employee benefit obligations*

The Group provides other long-term employee benefits (see Note 20). 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.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2012

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

##### *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 is 3 years in 2012.

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, domestic interconnection revenues related to mobile network, revenues for short and multimedia messages and data traffic revenues.

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

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.

Revenue from ICT includes revenue from restructuring business processes services, application management services, technology infrastructure and system maintenance and the design and development of complex IT systems to a client's specifications (design and build).

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

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

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

Revenues from application management services, technology infrastructure and system maintenance are recognised on a straight line basis over the term of the contract. Revenues from time and material contracts are recognised based on contracted prices and direct cost incurred. Revenue from product maintenance contracts are recognized on a straight-line basis over the delivery period.

Revenues and expenses from fixed-price design and build contracts where the outcome can be estimated reliably are recognised under percentage-of completion (POC) method. Estimates are revised and can result in decrease or an increase of estimated revenues and expenses and are included in statement of comprehensive income in the year in which circumstances that give rise to the revision become known to management.

Revenues from one-time-charge licensed software are recognized at the inception of licence term all revenue recognition criteria have been met. Revenues from monthly licence charges are recognised on a subscription basis over the period that the client is entitled to use the licence. Revenues for maintenance, unspecified upgrades and technical support are recognised over the period such items are delivered.

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 2012

#### 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.

Securities purchased under agreements to resell ('reverse REPOs') are recorded as loans to banks and cash equivalents, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

## Notes to the consolidated financial statements (continued)

### For the year ended 31 December 2012

#### 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 and equity-settled transactions is measured initially at fair value at the grant date using a binomial model, further details of which are given in Note 33. 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.

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

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

#### 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.

#### 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 2012, following positions in the financial statements for the year ended 31 December 2011 were reclassified:

- Statement of comprehensive income

<i>Position</i>	2011 HRK millions
Other expenses	(63)
Employee benefits expenses	(13)
Merchandise, material and energy expenses	(21)
Other operating income	(97)

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 3 Segment information

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 not meet the criteria for an operating segment.

The Management Board, as the 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 or segment results (as calculated in the table below).

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

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

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



Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**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 2011	Residential HRK millions	Business HRK millions	Network & Support functions HRK millions	Total HRK millions
<i>Segment revenue</i>	4,432	3,635	-	8,067
Service revenues	4,263	3,466	-	7,729
Terminal equipment	153	60	-	213
Other	16	109	-	125
<i>Usage related direct costs</i>	(324)	(502)	-	(826)
<i>Income and losses on accounts receivable</i>	(17)	(41)	-	(58)
Contribution margin I	4,091	3,092	-	7,183
<i>Non-usage related direct costs, restated</i>	(569)	(513)	-	(1,082)
Segment result, restated	3,522	2,579	-	6,101
Other income	-	-	204	204
Other operating expenses	(409)	(288)	(1,939)	(2,636)
Depreciation, amortization and impairment of non-current assets, restated	-	-	(1,447)	(1,447)
Operating profit, restated	3,113	2,291	(3,182)	2,222
Capital expenditures	386	91	461	938
Year ended 31 December 2012				
<i>Segment revenue</i>	4,099	3,357	-	7,456
Service revenues	3,947	3,180	-	7,127
Terminal equipment	134	49	-	183
Other	18	128	-	146
<i>Usage related direct costs</i>	(318)	(458)	-	(776)
<i>Income and losses on accounts receivable</i>	(8)	(59)	-	(67)
Contribution margin I	3,773	2,840	-	6,613
<i>Non-usage related direct costs</i>	(533)	(424)	-	(957)
Segment result	3,240	2,416	-	5,656
Other income	-	-	259	259
Other operating expenses	(401)	(349)	(1,789)	(2,539)
Depreciation, amortization and impairment of non-current assets	-	-	(1,326)	(1,326)
Operating profit	2,839	2,067	(2,856)	2,050
Capital expenditures	391	141	648	1,180

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**3 Segment information (continued)**

*Revenue – by geographical area*

	2012	2011
	HRK millions	HRK millions
Republic of Croatia	6,829	7,411
Rest of the World	627	656
	<u>7,456</u>	<u>8,067</u>

The majority of Group's assets are located in Croatia (2012: 99.99%; 2011: 99.99%).

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

**4 Service expenses**

	2012	2011
	HRK millions	HRK millions
Domestic interconnection	442	445
International interconnection	334	382
Other services	266	264
	<u>1,042</u>	<u>1,091</u>

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

	2012	2011
	HRK millions	HRK millions
Depreciation	912	1,029
Amortization	356	369
	<u>1,268</u>	<u>1,398</u>
Impairment loss	58	49
	<u>1,326</u>	<u>1,447</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 2012

**6 Employee benefits expenses**

	2012	2011
	HRK millions	HRK millions
Gross salaries	849	881
Taxes, contribution and other payroll expenses	231	252
Redundancy expenses	144	162
Long-term employee benefits (Note 20)	<u>(16)</u>	<u>(12)</u>
	<u>1,208</u>	<u>1,283</u>

The movements of redundancy provision are as follows:

	2012	2011
	HRK millions	HRK millions
Provision at 1 January – current	<u>169</u>	<u>133</u>
Additions charged to the statement of comprehensive income	144	162
Utilisation	<u>(167)</u>	<u>(126)</u>
Total provision for redundancy 31 December	<u>146</u>	<u>169</u>
Of that – current	146	169

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 2012 due to business reasons.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**7 Other expenses**

	2012	2011
	HRK millions	HRK millions
Maintenance services	265	271
Rent (Note 27)	185	178
Licence cost	165	163
Advertising	121	163
Selling commission	120	128
Postal expenses	69	95
Provision of trade receivables	68	59
Call centre and customer care support	50	56
Non-income taxes and contribution	45	51
Contract workers	35	23
Daily allowances and other costs of business trips	21	22
Write down of inventories	21	8
Education and consulting	18	18
Insurance	14	13
Loss on disposal of fixed assets	1	2
Other operating charges	104	46
	<u>1,302</u>	<u>1,296</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**8 Income tax expense**

a) *Tax on profit*

	2012 HRK millions	2011 HRK millions
Current tax expense	409	435
Deferred tax (income)/expense	(13)	9
Taxation	<u>396</u>	<u>444</u>

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

	2012 HRK millions	2011 HRK millions
Profit before taxes	<u>2,092</u>	<u>2,255</u>
Income tax at 20% (domestic rate)	418	451
Dividends received and incentives	(16)	(1)
Tax for previous years	(11)	(14)
Entertainment expenses and car usage	2	2
Tax effects of tax loss carry forward	(1)	-
Other	4	6
Taxation	<u>396</u>	<u>444</u>
Effective tax rate	<u>18.93%</u>	<u>19.69%</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**8 Income tax expense (continued)**

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

	31 December 2012	Charged/ (credited) in 2012	31 December 2011	Charged/ (credited) in 2011	31 December 2010
	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions
<i>Deferred tax asset recognized in statement of comprehensive income</i>					
Non-tax deductible value adjustments	23	1	22	3	19
Property, plant and equipment write down	16	7	9	(3)	12
Accrued interest on legal cases	7	1	6	0	6
Deferred revenue from connection fees	-	-	-	(11)	11
Other	15	4	11	2	9
<i>Deferred tax asset recognized in statement of other comprehensive income</i>					
Actuarial gains and losses	4	0	4	(3)	7
Total deferred tax assets	<u>65</u>	<u>13</u>	<u>52</u>	<u>(12)</u>	<u>64</u>

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 8 Income tax expense (continued)

A deferred tax asset has been recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets have not been discounted.

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 359 million became tax deductible in the period from 2002 to 2012, and the remaining HRK 36 million will be tax deductible in future periods.

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. 2014 for the 2012 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.

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable in the amount of HRK 1 million. The Group did not recognise deferred income tax assets of HRK 28 million in respect of losses amounting to HRK 141 million that can be carried forward against future taxable income.

Losses expires in:	HRK million
2013	38
2014	45
2015	38
2016	27
	<hr/>
	148

## 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:

	2012	2011 Restated
Profit for the year attributable to ordinary equity holders of the Company in HRK millions	<hr/> 1,696	<hr/> 1,811
Weighted average number of ordinary shares for basic earnings per share	<hr/> 81,887,256	<hr/> 81,888,535

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**10 Intangible assets**

	Licences	Software	Goodwill	Assets under construction and other assets	Total
	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions
<b>At 1 January 2011</b>					
Cost	281	2,509	162	340	3,292
Accumulated amortization	(143)	(1,830)	-	(97)	(2,070)
<b>Net book value</b>	<b>138</b>	<b>679</b>	<b>162</b>	<b>243</b>	<b>1,222</b>
<b>Year ended 31 December 2011</b>					
Opening net book value	138	679	162	243	1,222
Additions	-	154	-	88	242
Transfers	2	55	-	(57)	-
Transfers from PPE	-	2	-	-	2
Amortization charge	(10)	(295)	-	(64)	(369)
Impairment loss	-	(2)	-	(8)	(10)
<b>Net book value</b>	<b>130</b>	<b>593</b>	<b>162</b>	<b>202</b>	<b>1,087</b>
<b>At 31 December 2011</b>					
Cost	281	2,660	162	367	3,470
Accumulated amortization	(151)	(2,067)	-	(165)	(2,383)
<b>Net book value</b>	<b>130</b>	<b>593</b>	<b>162</b>	<b>202</b>	<b>1,087</b>
<b>Year ended 31 December 2012</b>					
Opening net book value	130	593	162	202	1,087
Additions	150	186	-	81	417
Transfers	-	39	-	(39)	-
Amortization charge	(12)	(264)	-	(80)	(356)
Impairment loss	-	(6)	-	-	(6)
<b>Net book value</b>	<b>268</b>	<b>548</b>	<b>162</b>	<b>164</b>	<b>1,142</b>
<b>At 31 December 2012</b>					
Cost	432	2,767	162	366	3,727
Accumulated amortization	(164)	(2,219)	-	(202)	(2,585)
<b>Net book value</b>	<b>268</b>	<b>548</b>	<b>162</b>	<b>164</b>	<b>1,142</b>



# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 10 Intangible assets (continued)

The intangible assets of the Group as of 31 December 2012 include the UMTS licence with the carrying value of HRK 81 million (31 December 2011: HRK 88 million). The UMTS licence is amortised over a period of 20 years (starting from June 2005) according to Concession contract.

Assets under construction primarily relate 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 179 million and licence for use of the radio frequency spectrum in 800 MHz band (digital dividend) in the amount of HRK 150 million. The LTE licence is amortized over a period of 12 years (starting from November 2012) according to licence granted.

### *Impairment loss*

During 2012, the Group recognized impairment loss of intangible assets of HRK 6 million (2011: HRK 10 million).

### *Impairment testing of goodwill*

Goodwill is allocated to the Group's cash-generating units (CGUs) identified according to operating segment. An operating segment-level summary of the goodwill allocation is presented below:

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Residential	55	55
Business	107	107
	<u>162</u>	<u>162</u>

The key assumptions used for value-in-use calculations are as follows:

	Residential		Business	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
Growth rate	2.0%	2.0%	2.0%	2.0%
Discount rate	9.6%	9.6%	9.6%	9.6%

The recoverable amount of a CGU is determined based on value in use calculations. The key assumptions on which the determination of CGUs value in use is based reflect past experience and expectations of market development, in particular: development of revenue, market share, customer acquisition and retention cost, capital expenditures, growth rate. The growth rate does not exceed the long-term average growth rate for the industry in which the CGU operates. The weighted average growth rate is used to extrapolate cash flows beyond the budgeted period and post-tax discount rate is applied to the cash flow projections.

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 2012

**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 2011</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>
<b>Year ended 31 December 2012</b>					
Opening net book value	1,122	4,320	286	225	5,953
Additions	29	291	39	404	763
Transfers	7	98	14	(119)	-
Disposals	(16)	-	(2)	(1)	(19)
Amortization charge	(104)	(709)	(99)	-	(912)
Impairment loss	-	(49)	-	(3)	(52)
<b>Net book value</b>	<b>1,038</b>	<b>3,951</b>	<b>238</b>	<b>506</b>	<b>5,733</b>
<b>At 31 December 2012</b>					
Cost	2,160	11,420	1,139	509	15,228
Accumulated amortization	(1,122)	(7,469)	(901)	(3)	(9,495)
<b>Net book value</b>	<b>1,038</b>	<b>3,951</b>	<b>238</b>	<b>506</b>	<b>5,733</b>

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 11 Property, plant and equipment (continued)

Included within assets under construction of the Group are major spare parts of HRK 19 million (31 December 2011: HRK 27 million), net of a provision of HRK 1 million (31 December 2011: HRK 1 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 2012, the Group recognized an impairment loss of property, plant and equipment of HRK 52 million (2011: HRK 39 million) due to transfer to the newer technology. The recoverable amount of that equipment is its estimated 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 in the gross amount of HRK 420 million.

### *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 the Company'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 portion of these assets are 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 Group 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 2012

### 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 Group 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 28 b).

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 2012 is HRK 855 million (31 December 2011: HRK 885 million).

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**12 Investment in associate**

The net book value of investments in associate comprises:

	31 December 2012	31 December 2011
	HRK millions	HRK millions
HP d.o.o. Mostar	<u>2</u>	<u>2</u>
	<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 2012 and during the year ended 31 December 2011 was as follows:

	2012	2011
	HRK millions	HRK millions
<i>Net book value</i>		
At 1 January	2	2
Share of profits	0	0
Impairment of investments	<u>(0)</u>	<u>(0)</u>
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 2012	31 December 2011
	Unaudited	Audited
	HRK millions	HRK millions
<i>Share of the associates statements of financial position:</i>		
Current assets	14	15
Non-current assets	17	17
Current liabilities	(3)	(3)
Non-current liabilities	<u>0</u>	<u>0</u>
Net assets	<u>28</u>	<u>29</u>
	2012	2011
	Unaudited	Audited
<i>Share of the associate revenue and loss</i>		
Revenue	28	29
Loss	<u>(2)</u>	<u>0</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**13 Investment in joint venture**

The net book value of investments in joint venture comprises:

	31 December 2012	31 December 2011
	HRK millions	HRK millions
HT d.d. Mostar	396	393
	<u>396</u>	<u>393</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, the 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 2012, is recognized in the statement of comprehensive income in the amount of HRK 27 million (2011: HRK 15 million of profit was recognized based on unaudited results of profit for the year ended 31 December 2011 which was later confirmed by the audit report).

In 2012, HT received a dividend of HRK 25 millions from HT d.d. Mostar (2011: nil).

	31 December 2012	31 December 2011
	Unaudited	Audited
	HRK millions	HRK millions
<i>Share of the jointly controlled entity assets and liabilities:</i>		
Current assets	124	135
Non-current assets	563	554
Current liabilities	(129)	(139)
Non-current liabilities	(42)	(60)
Net assets	<u>516</u>	<u>490</u>
	2012	2011
	Unaudited	Audited
<i>Share of the jointly controlled entity revenue and profit:</i>		
Revenue	393	370
Profit	<u>27</u>	<u>15</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

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

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

<i>Issuer</i>	<i>Currency</i>	<i>Maturity</i>	31 December 2012 HRK millions	31 December 2011 HRK millions
<i>Domestic bond:</i>				
Government of Croatia	HRK	8 February 2017	35	31
<i>Foreign bonds:</i>				
Government of France	EUR	25 September 2014	153	-
Government of Germany	EUR	12 September 2014	151	-
Government of Germany	EUR	13 July 2014	75	-
Government of Netherland	EUR	15 April 2015	77	-
Other equity securities	HRK		8	8
			<u>499</u>	<u>39</u>

Interest rate on domestic bond is 4.75%. Interest rates on foreign bonds are up to 0.75%.

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

			31 December 2012 HRK millions	31 December 2011 HRK millions
<i>Unit holdings in money market funds:</i>			11	22
<i>Foreign bond:</i>				
Government of France	EUR	12 January 2013	75	-
<i>Foreign treasury bills:</i>				
Government of France	EUR	9 February 2012	-	75
Government of Germany	EUR	15 February 2012	-	76
Government of France	EUR	22 March 2012	-	75
Government of France	EUR	23 August 2012	-	75
			<u>86</u>	<u>323</u>

Interest rate on foreign bond is 3.75%. Interest rates on foreign treasury bills were up to 1.00%.

The estimated fair value of investments in treasury bills and bonds at 31 December 2012 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 2012.

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**15 Loans to banks**

<i>Issuer</i>	<i>Currency</i>	<i>Maturity</i>	31 December 2012 HRK millions	31 December 2011 HRK millions
<i>Reverse REPO agreements (Note 30 g):</i>				
Erste Steiermärkische Bank d.d.	HRK	23 January 2013	86	-
Erste Steiermärkische Bank d.d.	HRK	27 February 2013	79	-
Privredna banka Zagreb d.d.	HRK	29 March 2013	74	-
			<u>239</u>	<u>-</u>

Interest rates on reverse REPO agreements are up to 1.00%.

**16 Inventories**

	31 December 2012 HRK millions	31 December 2011 HRK millions
Inventories and spare parts	78	84
Merchandise	77	91
	<u>155</u>	<u>175</u>



Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**17 Trade and other receivables**

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Trade receivables	1,146	1,233
Other receivables	69	74
	<u>1,215</u>	<u>1,307</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 2012	1,146	823	176	73	30	29	15
31 December 2011	1,233	896	192	71	48	19	7

Value adjustment is done for outstanding domestic receivables older than 120 days, and for outstanding foreign receivables that are due more than 150 days. Value adjustment for receivables from subsidiaries, domestic telecommunication operators, receivables for the international settlement and key customers under extraordinary collection method value adjustment is done according to the collection estimate.

Short-term receivables are written-off in the case when the debtor is liquidated or ceased its business activities; when the legal case is lost by the final court decision or in the case of lapse of receivables.

As at 31 December 2012, trade receivables with a nominal value of HRK 1,085 million (31 December 2011: HRK 1,047 million) were deemed impaired and fully provided for.

Movements in the provision for impairment of receivables were as follows:

	2012 HRK millions	2011 HRK millions
At 1 January	1,047	1,028
Charge for the year	151	143
Unused amounts reversed	(83)	(91)
Receivables written-off	(30)	(33)
At 31 December	<u>1,085</u>	<u>1,047</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**18 Cash and cash equivalents and time deposits**

*a) Cash and cash equivalents*

Cash and cash equivalents comprise the following amounts:

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Cash on hand and balances with banks	741	1,937
Time deposits with maturity less than 3 months	1,857	1,767
Reverse REPO agreements affairs with maturity less than 3 months	548	-
	<u>3,146</u>	<u>3,704</u>

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

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Foreign bank	259	-
Domestic banks	2	40
	<u>261</u>	<u>40</u>

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

	31 December 2012	31 December 2011
	HRK millions	HRK millions
HRK	2,659	2,828
EUR	723	874
USD	25	42
	<u>3,407</u>	<u>3,744</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**19 Trade and other payables**

	31 December 2012	31 December 2011	1 January 2011
	HRK millions	HRK millions Restated	HRK millions Restated
Trade payables	1,428	1,244	1,373
Payroll and payroll taxes	81	82	75
VAT and other taxes payable	38	62	40
Other creditors	30	30	44
	<u>1,577</u>	<u>1,418</u>	<u>1,532</u>

**20 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:

	2012	2011
	HRK millions	HRK millions
At 1 January	158	192
LTIP – Variable II (Notes 6 and 33)	1	1
Service costs (Note 6)	11	13
Interest costs	8	10
Amortization losses/(gains) (Note 6)	(1)	(23)
Benefit paid	(13)	(12)
Curtailments (Note 6)	(27)	(3)
Actuarial losses/(gains)	3	(20)
At 31 December	<u>140</u>	<u>158</u>

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

	2012	2011
	%	%
Discount rate (annually)	6.5	6.5
Wage and salary increases (annually)	2.0	2.0

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**21 Deferred income**

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Connection fee	<u>2</u>	<u>2</u>
Deferred income – non current	<u>2</u>	<u>2</u>
Prepaid vouchers	66	72
Customer loyalty programme	34	49
Connection fee	2	4
Other	<u>20</u>	<u>26</u>
Deferred income – current	<u>122</u>	<u>151</u>
	<u>124</u>	<u>153</u>

**22 Provisions for legal claims and other provisions**

	2012	2011
	HRK millions	HRK millions
At 1 January	113	101
Additions	25	10
Reversals	(24)	-
Interest cost	2	5
Utilisation	<u>(29)</u>	<u>(3)</u>
At 31 December	<u>87</u>	<u>113</u>

As at 31 December 2012, 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 2012

**23 Issued share capital**

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

	31 December 2012	31 December 2011
	HRK millions	HRK millions
81,888,535 ordinary shares of HRK 100 each	<u>8,189</u>	<u>8,189</u>

The number of shares in issue remained unchanged between 1 January 1999 and 31 December 2012.

In 2012, the Group acquired 1,931 of its own shares and are held as 'treasury shares' (2011: nil).

**24 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.

**25 Retained earnings**

In 2012, the Group paid a dividend of HRK 1,813 million (2011: HRK 1,863 million), respectively HRK 22.14 per share (2011: HRK 22.75).

**26 Other accruals**

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Variable salary to employees	69	86
Unused vacation	<u>15</u>	<u>30</u>
	<u>84</u>	<u>116</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**27 Commitments**

*a) Operating lease commitments*

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

Operating lease charges:

	2012	2011
	HRK millions	HRK millions
Current year expense (Note 7)	<u>185</u>	<u>178</u>

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

	31 December 2012	31 December 2011
	HRK millions	HRK millions
Within one year	174	227
Between 1 and 5 years	573	524
Greater than 5 years	<u>428</u>	<u>466</u>
	<u>1,175</u>	<u>1,217</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 2012	31 December 2011
	HRK millions	HRK millions
Intangible assets	63	60
Property, plant and equipment	<u>869</u>	<u>864</u>
	<u>932</u>	<u>924</u>

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 28 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 22).

### a) *Competition / Regulatory matters*

The Group 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*

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.

In January 2012 Misdemeanour Court rendered a decision in which it has suspended the proceedings against HT. Against this decision in HT's favour, the Competition Agency filed appeal in March 2012. 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 preceding the year in which the infringement was committed.

#### *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 55 million.

In addition, on 24 October 2012 HT received an additional Misdemeanour Indictment Proposal as a result of the expert supervisions that HAKOM had undertaken in October 2009 and January 2010, HAKOM submitted to the Misdemeanour Court the Indictment Proposal against HT and a responsible person, claiming that HT proceeded in its Bitstream Standard Offer contrary to the regulatory obligations regarding the price calculation and publication of the offer VoIP and IPTV special virtual channels, as defined in the wholesale bitstream access market analysis conducted by HAKOM within its decision dated of 17 July 2009.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

### 28 Contingencies (continued)

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

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

Thereby proposing the 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 28.6 million.

#### *Access to 064/069 numbers case*

Pursuant to Metronet notification from 2010, HAKOM initiated supervision and in April 2010 issued a decision that HT shouldn't have conditioned network access with the changed numbering of VAS services with the contract annex, but should have provided the service directly instead. Pursuant to this decision, HT in June 2012, received a Misdemeanour Indictment based on HAKOM's decision from 2010 proposing 1% fine on the T-Com business annual gross revenue from the year 2008. On the basis of the results for 2008, 1% of the gross revenue would amount to HRK 48 million. HT submitted written defence and proposed suspension of the procedure until the Constitutional Court of RoC decides on HT's Request on conformity assessment of the Law on electronic communications.

#### 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 up 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.

On 10 December 2012, the Company received the partial interlocutory judgement and partial judgement by which it is determined that HT is obliged to pay to ZHZDG the fee for usage of the DTI system, and that until the legal validity of this partial interlocutory judgment, litigation will be stopped regarding the amount of the claim. Furthermore, the claim in the part concerning the establishment of the ownership of the City of Zagreb over DTI and other communal infrastructure for laying telecommunication installations on the area of the City of Zagreb for the purpose of communication-information systems and services is rejected. Decision on the litigation costs is left for the later judgment. On 21 December 2012, the Company submitted the appeal against this judgment.

Since the plaintiff was rejected with the main part of his claim, and since the interlocutory partial judgement defines that the amount of the claim shall be discussed only after legal validity of the judgement, management concluded that no provision is required to be recognised in the financial statements for this case.



## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

### 29 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 2012 and 2011. Further, DTAG provided technical assistance to the Group of HRK 13 million (2011: HRK 10 million).

The main transactions with related parties during 2012 and 2011 were as follows:

	Sales		Purchases	
	2012	2011	2012	2011
<i>Related party:</i>	HRK millions	HRK millions	HRK millions	HRK millions
<i>Immediate parent</i>				
Deutsche Telekom AG, Germany	30	21	59	48
<i>Joint venture</i>				
HT Mostar, Bosnia and Herzegovina	32	34	53	53
<i>Subsidiaries of immediate parent</i>				
Telekom Deutschland, Germany	19	27	8	7
T-Mobile Austria, Austria	5	10	3	5
T-Systems International, Germany	3	-	6	6
Others	22	49	8	17
<b>Total</b>	<b>111</b>	<b>141</b>	<b>137</b>	<b>136</b>

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

	Receivables		Payables	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
<i>Related party:</i>	HRK millions	HRK millions	HRK millions	HRK millions
<i>Immediate parent</i>				
Deutsche Telekom AG, Germany	4	3	48	26
<i>Joint venture</i>				
HT Mostar, Bosnia and Herzegovina	-	-	3	6
<i>Subsidiaries of immediate parent</i>				
Telekom Deutschland, Germany	-	-	80	44
T-Mobile Austria, Austria	-	-	18	16
T-Mobile Czech, Czech Republic	-	-	16	13
T-Systems International, Germany	-	-	2	-
Others	3	2	68	60
<b>Total</b>	<b>7</b>	<b>5</b>	<b>235</b>	<b>165</b>

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

### 29 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 2012, the Group paid a total amount of HRK 0.7 million (2011: HRK 0.7 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 2012 the total compensation paid to key management personnel of the Group amounted to HRK 45 million (2011: HRK 46 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 2012	31 December 2011
	HRK millions	HRK millions
Short-term benefits	42	44
Share-based payments	3	2
	<hr/>	<hr/>
	45	46
	<hr/>	<hr/>

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

## 30 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 17) 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 2012, the Group had business transactions with fourteen banks (2011: thirteen banks). The Group held cash and deposits in six banks almost exclusively. For those six domestic banks with foreign ownership, the Group received guarantees for deposits given from parent banks which have a minimum rating of BBB+ or guarantees in form of low-risk government securities. 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 2012	31 December 2011
	HRK millions	HRK millions
Trade receivables for rendered telecom services to domestic customers	726	775
Trade receivables for rendered telecom services to foreign customers	34	30
Other trade receivables	63	91
	<u>823</u>	<u>896</u>

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

**30 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.

all amounts in HRK millions	Trade and other payables			Other non-current liabilities			Total
	Less than 3 months	3 to 12 months	Total	1 to 3 years	3 to 5 years	> 5 years	
Year ended 31 December 2012	1,526	51	1,577	32	6	12	50
Year ended 31 December 2011	1,331	87	1,418	25	5	19	49
Year ended 31 December 2010	1,457	75	1,532	19	6	19	44

*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 2012		
Croatian Kuna	+100	13
	-100	(13)
Euro	+100	9
	-100	(9)
Year ended 31 December 2011		
Croatian Kuna	+100	6
	-100	(6)
Euro	+100	10
	-100	(10)

# Notes to the consolidated financial statements (continued)

## For the year ended 31 December 2012

### 30 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 2012	+3%	27
	-3%	(27)
Year ended 31 December 2011	+3%	29
	-3%	(29)

#### 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, non-current 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 10,899 million as at 31 December 2012 (31 December 2011: HRK 11,019 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 2012 and 31 December 2011 (see Notes 23 and 25).

Notes to the consolidated financial statements (continued)  
For the year ended 31 December 2012

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

*g) Accepted collaterals*

Accepted collaterals for reverse REPO affairs include:

	31 December 2012 HRK million	31 December 2011 HRK million
<i>Foreign bonds:</i>		
Government of Austria	581	-
Government of France	75	-
<i>Foreign treasury bills:</i>		
Government of Germany	150	-
	<u>806</u>	<u>-</u>

All above stated values are fair market values. Neither of accepted collaterals is currently sold nor repledged. There are no specific terms and conditions related to the use of collaterals.

**31 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 2012 HRK millions	31 December 2011 HRK millions	31 December 2012 HRK millions	31 December 2011 HRK millions
<i>Financial assets</i>				
Cash and cash equivalents	3,146	3,704	3,146	3,704
Time deposits	261	40	261	40
Available-for-sale assets, non-current	499	39	499	39
Available-for-sale assets, current	86	323	86	323
Loans to banks	239	-	239	-
<i>Financial liabilities</i>				
Interest-bearing loans	17	22	17	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 2012

### 32 Authorization for Services and Applicable Fees

The Group 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. In the meantime, two Amendments to the Law on Electronic Communications entered into force on 10 August 2011 and on 3 December 2012. 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 was last 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 2012

#### **32 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) Authorization for usage of radio frequency spectrum*

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, the Company 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, HAKOM issued 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, HAKOM issued 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.

After the conducted public call procedure for granting licences for use of the radio frequency spectrum for public mobile electronic communications networks in the territory of Republic of Croatia, a licence for use of the radio frequency spectrum in 800 MHz band (digital dividend) was issued to the Company in November 2012.



## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2012

### 32 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 maritime affairs, 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 2012, 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 maritime affairs, transport and infrastructure (in favour of State budget, Official Gazette 154/08, 28/09, 97/10, 92/12) 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, 133/11).

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

Pursuant amendment of the Law on audiovisual activities, which entered into the force in July 2011, the Company is obliged to pay the fee in the amount of 2% of the total annual gross income generated from the performing of audiovisual activities on demand for the purpose of the implementation of the National Programme.

Also, the Company (as the operator of public communication network) is obliged to pay a fee in the amount of 0,8% of the total annual gross income generated in previous calendar year by performing transmission and/or retransmission of audiovisual programmes and their parts through public communication network, including internet and cable distribution for the purpose of the implementation of the National Programme.

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 was replaced by the new Ordinance on Certificate and Fees for the Right of Way (Official Gazette 152/11) 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 2012

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

Various mid-term (MTIP 2010 and Transition MTIP 2011) and long-term incentive plans (LTIP – HT Variable II 2011 and HT Variable II 2012) 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.

MTIP is set up as a cash-based plan linked to achievement of two equally weighted, share-based performance parameters, related to the value of HT share – 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% of the amount is paid out, and if neither performance target is achieved, no payment is made.

MTIP targets 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.

All MTIPs cover period of three years (i.e. MTIP 2010 covers the period from 1 January 2010 to 31 December 2012). Upon expiry of the term of the plan, the Supervisory Board 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.

The incentives themselves consist of 20% or 30% 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% target achievement.

The rewards for participants of MTIP 2009 were paid out in February 2012. Based on decision of the Supervisory Board it was established that one MTIP 2009 target out of two has been achieved. 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 fourth 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% 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 2012

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

Along with introduction of LTIP – Variable II 2011, a new compensation model for International Business Leaders (BLT's) was introduced. It consists of Variable I (Share Matching Plan - SMP) and Variable II. The SMP is program under which the participant can receive HT shares on expiry of a four-year period. The participant is obliged to invest an amount from 10% to a maximum 33.33% of the paid out gross annual variable salary - to HT shares. The participant is granted one additional HT share for each share, under condition that he/she held them continuously for a period of at least four years from the date of purchase (vesting period). Employee services are recognized as expenses on a pro rata basis over the vesting period. The Group is measuring value of employee services, indirectly, by reference to the fair value of the equity instruments granted. The fair value of the equity instruments granted is measured at grant date by using observable market price.

HT Variable II was introduced in beginning of 2012.

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

	2012 HRK millions	2011 HRK millions
Expenses for providing for cash-settled share-based and non share-based payment transactions	1	3
Gains arising from cancellation of provision for cash-settled share-based and non-share based payment transactions	3	-
	<hr/>	<hr/>

#### 34 Auditor's fees

The auditors of the Group's financial statements have rendered services of HRK 5 million in 2012 (2011: HRK 6 million). Services rendered in 2012 mainly relate to audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes, audit of sustainability report and upgrade of Cost and Profitability Calculation tool. Services rendered in 2011 relate to the audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes and audit of SAP transformation project.

#### 35 Events after reporting period

No other events or transactions have occurred since 31 December 2012 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.