

Hrvatski Telekom d.d.

Financial statements

31 December 2011

Contents

| | <i>Page</i> |
|---|-------------|
| Responsibility for the financial statements | 3 |
| Independent Auditor's Report | 4 |
| Statement of comprehensive income | 6 |
| Statement of financial position | 7 |
| Statement of cash flows | 9 |
| Statement of changes in equity | 10 |
| Notes to the financial statements | 11 |

Supervisory Board

The members of the Supervisory Board who served during 2011 and subsequently are as follows:

| | | |
|----------------------|---------------------------------|---------------------------------|
| Guido Kerkhoff | Chairman | Until 31 March 2011 |
| Andreas Moelich | Chairman | From 4 May 2011 |
| Ivica Mišetić, Ph.D. | Deputy chairman | Member from 21 April 2008 |
| | | Deputy chairman from 8 May 2008 |
| Steffen Roehn | Member | Until 4 May 2011 |
| Oliver Morbach | Member | From 4 May 2011 |
| Dr. Lutz Schade | Member | From 21 April 2010 |
| Andreas Hesse | Member | From 21 April 2010 |
| Dr. Ralph Rentschler | Member | From 15 December 2003 |
| Kathryn Walt Hall | Member | From 21 April 2008 |
| Slavko Leban | Member | From 21 April 2008 |
| Juko Cikojević | Member, workers' representative | From 1 January 2011 |

Management Board

The members of the Management Board who served during 2011 and subsequently are as follows:

| | | |
|---------------------|-----------|---------------------|
| Ivica Mudrinić | President | From 1 January 1999 |
| Jürgen P. Czapran | Member | Until 31 March 2011 |
| Dino Ivan Dogan | Member | From 1 April 2011 |
| Božidar Poldrugač | Member | From 15 March 2007 |
| Irena Jolić Šimović | Member | From 1 August 2006 |
| Johan Busé | Member | From 1 April 2010 |
| Branka Skaramuča | Member | From 1 October 2008 |

Responsibility for the financial statements

Pursuant to the Croatian Accounting Act in force, the Board is responsible for ensuring that 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 Company for that period.

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

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

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

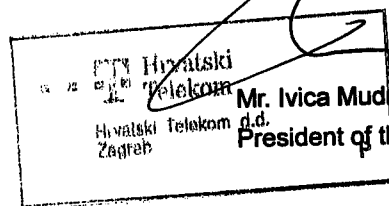
The Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and must also ensure that the financial statements comply with the Croatian Accounting Act in force. The Board is also responsible for safeguarding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

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

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

6 February 2012

On behalf of the Company,



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



Independent auditor's report

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

We have audited the accompanying financial statements of Hrvatski Telekom d.d. (the 'Company') which comprise the statement of financial position as at 31 December 2011 and the 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 financial statements

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of Hrvatski Telekom d.d. as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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Commercial Court in Zagreb, TI-99/7257-2, Reg. No.: 080238978; Company ID No.: 81744835353; Founding capital: HRK 1,810,000.00, paid in full; Management Board: F. Matelaer, President, I. Bijelic, Member; Giro-Account: Raiffeisenbank Austria d.d., Petrinjska 59, Zagreb, giro account no.: 2484008-1105514875.





Emphasis of matter

Without qualifying our opinion, we draw attention to Notes 11 and 28 b) to the 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 Company as at 31 December 2011 is HRK 885 million. Efforts are being undertaken by the Company to obtain certain legal documents and registrations necessary to fully evidence the Company's ownership of these assets. The Company 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 Company's use of these assets in prior years. The Company has not recognised any adjustments to its assets and liabilities in respect of these matters due to the uncertainty as to their outcome and their impact on the financial statements.

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


John Mathias Gasparac
Procurement


pwc
PricewaterhouseCoopers d.o.o.⁹
za reviziju i konzalting
Zagreb, Alexandra von Humboldta 4


Tamara Mačašović
Certified Auditor

Statement of comprehensive income
For the year ended 31 December 2011

| | Notes | 2011 HRK millions | 2010 HRK millions |
|---|-------|----------------------|----------------------|
| Rendering of services | | 7,391 | 7,922 |
| Sale of goods | | 85 | 86 |
| Revenue | 3 | <u>7,476</u> | <u>8,008</u> |
| Other operating income | | 283 | 233 |
| Merchandise, material and energy expenses | | (710) | (873) |
| Service expenses | 4 | (1,075) | (1,236) |
| Employee benefits expenses | 6 | (1,184) | (1,113) |
| Work performed by the Company and capitalised | | 76 | 103 |
| Depreciation, amortisation and impairment of non-current assets | 5 | (1,355) | (1,366) |
| Other expenses | 7 | (1,303) | (1,488) |
| Total operating costs | | <u>(5,551)</u> | <u>(5,973)</u> |
| Operating profit | 3 | <u>2,208</u> | <u>2,268</u> |
| Interest income | | 80 | 79 |
| Financial costs | | (37) | (48) |
| Net financial income | | <u>43</u> | <u>31</u> |
| Income from investment in joint venture | | - | 6 |
| Profit before income tax | | <u>2,251</u> | <u>2,305</u> |
| Income tax expense | 8 | (438) | (441) |
| Profit for the year | | <u>1,813</u> | <u>1,864</u> |
| Other comprehensive income for the year | | | |
| Changes in value of available for sale financial assets | | (2) | 2 |
| Actuarial gains and other income (expense) | | 17 | (3) |
| Other comprehensive income for the year, net of tax | | <u>15</u> | <u>(1)</u> |
| Total comprehensive income for the year, net of tax | | <u>1,828</u> | <u>1,863</u> |
| Earnings per share | | | |
| - basic and diluted, for profit for the year attributable to ordinary equity holders of the Company | 9 | HRK 22.14 | HRK 22.76 |

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

Statement of financial position
As at 31 December 2011

| | Notes | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|--|-------|-------------------------------------|-------------------------------------|
| ASSETS | | | |
| Non-current assets | | | |
| Intangible assets | 10 | 773 | 924 |
| Property, plant and equipment | 11 | 5,840 | 6,236 |
| Investment in subsidiaries | 12 | 522 | 291 |
| Investments in associate and joint venture | 13,14 | 337 | 337 |
| Available-for-sale financial assets | 15 | 39 | 42 |
| Non-current loans given to subsidiary | | 94 | 277 |
| Other non-current receivables | | 21 | 24 |
| Deferred income tax assets | 8 | 52 | 64 |
| Total non-current assets | | <u>7,678</u> | <u>8,195</u> |
| Current assets | | | |
| Inventories | 16 | 154 | 203 |
| Trade and other receivables | 17 | 1,144 | 1,306 |
| Receivables from subsidiaries | | 22 | 22 |
| Prepayments and accrued income | | 109 | 96 |
| Income tax prepayments | | - | 23 |
| Available-for-sale financial assets | 15 | 301 | 443 |
| Time deposits | 18 b) | 40 | 2 |
| Cash and cash equivalents | 18 a) | 3,665 | 3,245 |
| Total current assets | | <u>5,435</u> | <u>5,340</u> |
| TOTAL ASSETS | | <u>13,113</u> | <u>13,535</u> |

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

Statement of financial position (continued)
As at 31 December 2011

| | Notes | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|--|-------|-------------------------------------|-------------------------------------|
| EQUITY AND LIABILITIES | | | |
| Issued capital and reserves | | | |
| Issued share capital | 23 | 8,189 | 8,189 |
| Legal reserves | 24 | 409 | 409 |
| Fair value reserves | | (3) | (1) |
| Retained earnings | 25 | 2,568 | 2,601 |
| Total issued capital and reserves | | 11,163 | 11,198 |
| Non-current liabilities | | | |
| Provisions for legal claims and other provisions | 22 | 114 | 101 |
| Employee benefit obligations | 20 | 157 | 192 |
| Deferred income | 21 | 2 | 74 |
| Other long-term liabilities | | 24 | 30 |
| Total non-current liabilities | | 297 | 397 |
| Current liabilities | | | |
| Trade and other payables | 19 | 1,187 | 1,348 |
| Provisions for redundancy | 6 | 169 | 133 |
| Other accruals | 26 | 113 | 194 |
| Payables to subsidiaries | | 22 | 20 |
| Income tax payables | | 17 | - |
| Deferred income | 21 | 145 | 245 |
| Total current liabilities | | 1,653 | 1,940 |
| Total liabilities | | 1,950 | 2,337 |
| TOTAL EQUITY AND LIABILITIES | | 13,113 | 13,535 |

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

Signed on behalf of HT d.d. on 6 February 2012:

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)

Statement of cash flows
For the year ended 31 December 2011

| | Notes | 2011 HRK millions | 2010 HRK millions |
|---|-------|----------------------|----------------------|
| Operating activities | | | |
| Profit before income tax | | 2,251 | 2,305 |
| Depreciation, amortisation and impairment of non-current assets | 5 | 1,355 | 1,366 |
| Interest income | | (41) | (49) |
| Loss on disposal of assets | | 6 | 2 |
| Share of profit in joint venture | | - | (6) |
| Decrease/(Increase) in inventories | | 49 | (10) |
| Decrease/(Increase) in receivables and prepayments | | 122 | (574) |
| (Decrease)/Increase in payables and accruals | | (417) | 663 |
| (Decrease)/Increase in employee benefit obligations | 20 | (35) | 24 |
| Increase in provisions | | 49 | 7 |
| Other non-cash items | | 8 | - |
| Cash generated from operations | | <u>3,347</u> | <u>3,728</u> |
| Taxes paid | | <u>(385)</u> | <u>(463)</u> |
| Net cash flows from operating activities | | <u>2,962</u> | <u>3,265</u> |
| Investing activities | | | |
| Purchase of non-current assets | 10,11 | (817) | (1,105) |
| Proceeds from sale of non-current assets | | 3 | 12 |
| Purchase of available-for-sale financial assets | | (943) | (804) |
| Proceeds from sale of available-for-sale financial assets | | 1,065 | 687 |
| Interest received | | 57 | 34 |
| Purchase of subsidiary | | - | (189) |
| Non-current loans given to subsidiary | | (48) | (50) |
| Dividend received | | - | 6 |
| Net cash flows used in investing activities | | <u>(683)</u> | <u>(1,409)</u> |
| Financing activities | | | |
| Dividends paid | 25 | <u>(1,863)</u> | <u>(2,788)</u> |
| Net cash flows used in financing activities | | <u>(1,863)</u> | <u>(2,788)</u> |
| Net increase/(decrease) in cash and cash equivalents | | 416 | (932) |
| Exchange gains on cash and cash equivalents | | 4 | 2 |
| Cash and cash equivalents at 1 January | | 3,245 | 1,713 |
| Merging of subsidiary | | - | 2,462 |
| Cash and cash equivalents at 31 December | 18 a) | <u>3,665</u> | <u>3,245</u> |

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

Statement of changes in equity
For the year ended 31 December 2011

| | Issued 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 2010 | <u>8,189</u> | <u>409</u> | <u>(3)</u> | <u>3,528</u> | <u>12,123</u> |
| Profit for the year | - | - | - | 1,864 | 1,864 |
| Other comprehensive income for the year | - | - | 2 | (3) | (1) |
| Total comprehensive income for the year | - | - | 2 | 1,861 | 1,863 |
| Dividends paid to equity holders of the Company | - | - | - | (2,788) | (2,788) |
| Balance as at 31 December 2010 | <u>8,189</u> | <u>409</u> | <u>(1)</u> | <u>2,601</u> | <u>11,198</u> |
| Profit for the year | - | - | - | 1,813 | 1,813 |
| Other comprehensive income for the year | - | - | (2) | 17 | 15 |
| 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 | <u>8,189</u> | <u>409</u> | <u>(3)</u> | <u>2,568</u> | <u>11,163</u> |

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

Notes to the financial statements

For the year ended 31 December 2011

1 Corporate information

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

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

The total number of employees of the Company as at 31 December 2011 was 5,724 (31 December 2010: 6,028).

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

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

2.1. Basis of preparation

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

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets (Note 15), as disclosed in the accounting policies hereafter.

The Company's financial statements are presented in Croatian Kuna (HRK) which is the HT's functional currency. All amounts disclosed in the financial statements are presented in millions of HRK if not otherwise stated.

The Company has also prepared consolidated financial statements in accordance with IFRS for the Company and its subsidiaries (the Group), which were approved by the Management Board on 7 February 2012. In the consolidated financial statements, subsidiary undertakings (listed in Note 12) have been fully consolidated. Users of these separate financial statements should read them together with the Group's consolidated financial statements as at and for the year ended 31 December 2011 in order to obtain full information on the financial position, results of operations and changes in the financial position of the Group as a whole.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.2. Changes in accounting policies and disclosures

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

The Company 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 Company, its impact is described below.

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.2. Changes in accounting policies and disclosures (continued)

Improvements to IFRSs (issued in May 2010)

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

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

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

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.2. Changes in accounting policies and disclosures (continued)

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

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

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

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

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

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

Standards and interpretations issued but not yet effective

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

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

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

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.2. Changes in accounting policies and disclosures (continued)

Standards and interpretations issued but not yet effective (continued)

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

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

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

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

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

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

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.2. Changes in accounting policies and disclosures (continued)

Standards and interpretations issued but not yet effective (continued)

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

IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Company expects IFRS 11 could have an impact on the financial statements and is currently assessing the impact. The Company 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 Company is currently assessing the impact of IFRS12 on financial statements. The Company plans to adopt this new standard on its effective date.

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

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Company is currently assessing the impact of IFRS13 on financial statements. The Company 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 Company is currently assessing the impact of IAS 27 on financial statements. The Company 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 Company is currently assessing the impact of IAS 28 on financial statements. The Company plans to adopt this new standard on its effective date.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.2. Changes in accounting policies and disclosures (continued)

Standards and interpretations issued but not yet effective (continued)

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

The interpretation clarifies that benefits from the stripping activity are accounted for in accordance with the principles of IAS 2, Inventories, to the extent that they are realised in the form of inventory produced. To the extent the benefits represent improved access to ore, the entity should 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 Company's operations.

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

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

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

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

2.3. Significant accounting judgments, estimates and assumptions

The preparation of the Company'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 Company 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 Company uses internal and external legal experts to assess outcome of each case and makes judgments if and what amount needs to be provided for in the financial statements as more explained in Notes 22 and 28. Changes in these judgments could have a significant impact on the segments of the Company.

Notes to the financial statements (continued)

For the year ended 31 December 2011

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

Impairment of non-financial assets

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

Change in estimated life of customers relationship

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

Useful lives of assets

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

Tax payable on mobile revenues

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies

a) Operating profit

Operating profit is defined as the result before income taxes and finance items. Finance items comprise interest revenue on cash balances in the bank, deposits, treasury bills, interest bearing available for sale financial assets, dividend income from associate, subsidiaries 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) Intangible assets

Intangible assets are measured initially at cost. Intangible assets are recognised in the event that the future economic benefits that are attributable to the assets will flow to the Company, and that the cost of the asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortisation 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 amortisation method is reviewed annually at each financial year-end.

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

Useful lives of intangible assets are as follows:

| | |
|--|--------------|
| Licences and concessions | 20 years |
| UMTS licences | 5 – 10 years |
| Patents and concessions | 30 years |
| Right of servitude for Distributive Telecommunication Infrastructure (DTI) | 2 – 5 years |
| Software and other assets | |

Assets under construction are not amortised.

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

2.4. Summary of accounting policies (continued)

c) *Property, plant and equipment*

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

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

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

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

Depreciation is computed on a straight-line basis.

Useful lives of newly acquired assets are as follows:

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

Land and assets under construction are not depreciated.

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

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

d) *Impairment of assets*

Impairment of non-financial assets

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

Impairment of trade receivables

A provision for impairment of trade and other receivables is established when there is objective evidence that the Company 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 amortisation) and its current fair value, less any impairment loss previously recognised 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 recognised 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 recognised in the statement of comprehensive income.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

e) *Inventories*

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

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

f) *Receivables*

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

g) *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.

h) *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.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

i) 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 recognised 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.

j) Employee benefit obligations

The Company 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 recognised in other comprehensive income immediately in the period in which they occur. Gains or losses on the curtailment or settlement of benefit plans are recognised 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 recognised in other comprehensive income in the period in which they occur.

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

k) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company 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 Company assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Company 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 Company is acting as an agent.

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

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

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

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

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

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

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

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

2.4. Summary of accounting policies (continued)

k) *Revenue recognition (continued)*

Third parties using the Company's telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on the Company'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 Company 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 recognised when the Company's right to receive the payment is established.

Interest revenue is recognised 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 Company 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.

l) *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.

m) *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 recognised in the amount of the proceeds received net of transaction costs.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

n) *Financial assets*

All investments, other than loans and receivables originated by the Company, 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 recognised 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 recognised 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 recognised in other comprehensive income is included in the net profit or loss for the period.

Financial instruments are generally recognised as soon as the Company 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 derecognised when the cash is collected or the rights to receive cash from the assets have expired. A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

o) *Provisions*

A provision is recognised when, and only when, the Company 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 recognised as interest expense.

Provisions for termination benefits are recognised when the Company is demonstrably committed to a termination of employment contracts, that is when the Company 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.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

p) Contingencies

Contingent liabilities are not recognised 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 recognised in the financial statements but is disclosed when an inflow of economic benefits is probable.

q) Share-based payments

The cost of cash-settled transactions is measured initially at fair value at the grant date using a binomial model, further details of which are given in Note 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 recognised in the statement of comprehensive income.

r) Events after reporting period

Post-year-end events that provide additional information about the Company'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.

s) 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.

t) Dividend distribution

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

u) Investment in subsidiaries

Subsidiaries are all entities over which the Company 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 Company controls another entity. Investments in subsidiaries are measured at cost less any impairment in value.

Notes to the financial statements (continued)

For the year ended 31 December 2011

2.4. Summary of accounting policies (continued)

v) *Investment in associate*

In the Company's financial statements, investments in associated companies (generally a shareholding of between 20% and 50% of voting rights) where significant influence is exercised by the Company are measured at cost less any impairment in value. An assessment of investments in associates is performed when there is an indication that the asset has been impaired or that the impairment losses recognised in previous years no longer exist.

w) *Investment in joint ventures*

The Company 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. These investments are measured at cost less any impairment in value. An assessment of investments in joint ventures is performed when there is an indication that the asset has been impaired or that the impairment losses recognised in previous years no longer exist.

x) *Earnings per share*

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

y) *Reclassifications*

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

- Statement of financial position

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

- Statement of comprehensive income

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

3 Segment information

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

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

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

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

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

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

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

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

3 Segment information

Residential and Business segments

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

| Year ended 31 December 2010 | Residential HRK millions | Business HRK millions | Network & Support functions HRK millions | Total HRK millions |
|---|-----------------------------|--------------------------|---|-----------------------|
| <i>Segment revenue</i> | 4,546 | 3,462 | - | 8,008 |
| Service revenues | 4,342 | 3,238 | - | 7,580 |
| Terminal equipment | 190 | 64 | - | 254 |
| Other | 14 | 160 | - | 174 |
| <i>Usage related direct costs</i> | (393) | (578) | - | (971) |
| <i>Income and losses on accounts receivable</i> | (72) | (35) | - | (107) |
| Contribution margin I | 4,081 | 2,849 | - | 6,930 |
| <i>Non-usage related direct costs</i> | (720) | (259) | - | (979) |
| Segment result | 3,361 | 2,590 | - | 5,951 |
| Other income | - | - | 233 | 233 |
| Other operating expenses | (396) | (230) | (1,924) | (2,550) |
| Depreciation, amortisation and impairment of non-current assets | - | - | (1,366) | (1,366) |
| Operating profit | 2,965 | 2,360 | (3,057) | 2,268 |
| Capital expenditure | 239 | 63 | 803 | 1,105 |
| Year ended 31 December 2011 | | | | |
| <i>Segment revenue</i> | 4,302 | 3,174 | - | 7,476 |
| Service revenues | 4,139 | 3,003 | - | 7,142 |
| Terminal equipment | 151 | 61 | - | 212 |
| Other | 12 | 110 | - | 122 |
| <i>Usage related direct costs</i> | (306) | (476) | - | (782) |
| <i>Income and losses on accounts receivable</i> | (14) | (40) | - | (54) |
| Contribution margin I | 3,982 | 2,658 | - | 6,640 |
| <i>Non-usage related direct costs</i> | (609) | (227) | - | (836) |
| Segment result | 3,373 | 2,431 | - | 5,804 |
| Other income | - | - | 283 | 283 |
| Other operating expenses | (381) | (229) | (1,914) | (2,524) |
| Depreciation, amortisation and impairment of non-current assets | - | - | (1,355) | (1,355) |
| Operating profit | 2,992 | 2,202 | (2,986) | 2,208 |
| Capital expenditure | 307 | 74 | 436 | 817 |

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

3 Segment information (continued)

Revenue by geographical area

| | 2011 HRK millions | 2010 HRK millions |
|---------------------|----------------------|----------------------|
| Republic of Croatia | 6,908 | 7,335 |
| Rest of the World | 568 | 673 |
| | <u>7,476</u> | <u>8,008</u> |

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

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

4 Service expenses

| | 2011 HRK millions | 2010 HRK millions |
|-------------------------------|----------------------|----------------------|
| Domestic interconnection | 400 | 519 |
| International interconnection | 382 | 451 |
| Other services | 293 | 266 |
| | <u>1,075</u> | <u>1,236</u> |

5 Depreciation, amortisation and impairment of non-current assets

| | 2011 HRK millions | 2010 HRK millions |
|-----------------|----------------------|----------------------|
| Depreciation | 990 | 976 |
| Amortisation | 316 | 325 |
| | <u>1,306</u> | <u>1,301</u> |
| Impairment loss | 49 | 65 |
| | <u>1,355</u> | <u>1,366</u> |

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

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

6 Employee benefits expenses

| | 2011 HRK millions | 2010 HRK millions |
|--|----------------------|----------------------|
| Gross salaries | 790 | 829 |
| Taxes, contributions and other payroll costs | 232 | 248 |
| Redundancy expenses | 162 | 31 |
| Long-term employee benefits (Note 20) | - | 5 |
| | <u>1,184</u> | <u>1,113</u> |

The movements of redundancy provision are as follows:

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

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

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

7 Other expenses

| | 2011 | 2010 |
|--|--------------|--------------|
| | HRK millions | HRK millions |
| Maintenance services | 283 | 358 |
| Rent (Note 27) | 167 | 156 |
| Licence cost | 158 | 150 |
| Advertising | 153 | 183 |
| Selling commission | 117 | 135 |
| Postal expenses | 92 | 101 |
| Provision of trade receivables | 55 | 108 |
| Non-income taxes and contribution | 50 | 59 |
| Call centre and customer care support | 49 | 50 |
| Contract workers | 20 | 42 |
| Daily allowances and other costs of business trips | 18 | 20 |
| Education and consulting | 17 | 22 |
| Insurance | 12 | 13 |
| Provision for charges and risks | 10 | 16 |
| Write down of inventories | 8 | 1 |
| Loss on disposal of fixed assets | 2 | 4 |
| Other operating charges | 92 | 70 |
| | <u>1,303</u> | <u>1,488</u> |

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

8 Income tax expense

a) Tax on profit

| | 2011 HRK millions | 2010 HRK millions |
|-------------------------------|----------------------|----------------------|
| Current tax expense | 429 | 452 |
| Deferred tax expense/(income) | 9 | (11) |
| Taxation | 438 | 441 |

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

| | 2011 HRK millions | 2010 HRK millions |
|--------------------------------------|----------------------|----------------------|
| Profit before taxes | 2,251 | 2,305 |
| Income tax at 20% (domestic rate) | 450 | 461 |
| Dividends received and incentives | (1) | (2) |
| Tax for previous years | (14) | (12) |
| Entertainment expenses and car usage | 2 | 3 |
| Other | 1 | (9) |
| Taxation | 438 | 441 |
| Effective tax rate | 19.46% | 19.13% |

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

8 Income tax expense (continued)

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

| | 31 December 2011 | Charge to statement of comprehensive income | 31 December 2010 | Charge to statement of comprehensive income | 31 December 2009 |
|--|---------------------|--|---------------------|--|---------------------|
| | HRK millions | HRK millions | HRK millions | HRK millions | HRK millions |
| <i>Deferred tax asset</i> | | | | | |
| Non-tax deductible value adjustments | 22 | 3 | 19 | 7 | 12 |
| Property, plant and equipment write down | 9 | (3) | 12 | (4) | 16 |
| Accrued interest on legal cases | 6 | 0 | 6 | 6 | - |
| Deferred revenue from connection fees | - | (11) | 11 | (4) | 15 |
| Other | 11 | 2 | 9 | 6 | 3 |
| | <u>48</u> | <u>(9)</u> | <u>57</u> | <u>11</u> | <u>46</u> |
| <i>Deferred tax assets</i> | | | | | |
| | | <i>Charge to other comprehensive income</i> | | | |
| | | HRK millions | | | |
| Actuarial gains and losses | 4 | (3) | 7 | 1 | 6 |
| Total deferred tax assets | <u>52</u> | <u>(12)</u> | <u>64</u> | <u>12</u> | <u>52</u> |

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

8 Income tax expense (continued)

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

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

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

9 Earnings per share

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

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

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

| | 2011 | 2010 |
|---|------------|------------|
| Profit for the year attributable to ordinary equity holders of the Company in HRK millions | 1,813 | 1,864 |
| Weighted average number of ordinary shares for basic earnings per share | 81,888,535 | 81,888,535 |

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

10 Intangible assets

| | Licences and concessions HRK millions | Software HRK millions | Other assets HRK millions | Assets under construction HRK millions | Total HRK millions |
|------------------------------------|---|--------------------------|---------------------------------|--|-----------------------|
| At 1 January 2010 | | | | | |
| Cost | 676 | 1,789 | 111 | 88 | 2,664 |
| Accumulated amortisation | (418) | (1,196) | (45) | - | (1,659) |
| Net book value | 258 | 593 | 66 | 88 | 1,005 |
| Year ended 31 December 2010 | | | | | |
| Opening net book value | 258 | 593 | 66 | 88 | 1,005 |
| Additions | 6 | 144 | 4 | 90 | 244 |
| Transfers | (81) | 190 | 1 | (110) | - |
| Amortisation charge | (45) | (262) | (18) | - | (325) |
| Net book value | 138 | 665 | 53 | 68 | 924 |
| At 31 December 2010 | | | | | |
| Cost | 281 | 2,482 | 108 | 68 | 2,939 |
| Accumulated amortisation | (143) | (1,817) | (55) | - | (2,015) |
| Net book value | 138 | 665 | 53 | 68 | 924 |
| Year ended 31 December 2011 | | | | | |
| Opening net book value | 138 | 665 | 53 | 68 | 924 |
| Additions | - | 147 | 1 | 25 | 173 |
| Transfers | 2 | 54 | 2 | (58) | - |
| Transfers from PPE | - | 2 | - | - | 2 |
| Amortisation charge | (10) | (289) | (17) | - | (316) |
| Impairment loss | - | (2) | - | (8) | (10) |
| Net book value | 130 | 577 | 39 | 27 | 773 |
| At 31 December 2011 | | | | | |
| Cost | 281 | 2,628 | 107 | 35 | 3,051 |
| Accumulated amortisation | (151) | (2,051) | (68) | (8) | (2,278) |
| Net book value | 130 | 577 | 39 | 27 | 773 |

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

10 Intangible assets (continued)

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

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 170 million.

Impairment loss

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

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

11 Property, plant and equipment

| | Land and and buildings | Telecom plant and machinery | Tools, vehicles, IT and office equipment | Assets under construction | Total |
|------------------------------------|------------------------------|-----------------------------------|---|------------------------------|--------------|
| | HRK millions | HRK millions | HRK millions | HRK millions | HRK millions |
| At 1 January 2010 | | | | | |
| Cost | 1,938 | 10,979 | 989 | 471 | 14,377 |
| Accumulated amortisation | (819) | (6,454) | (673) | (4) | (7,950) |
| Net book value | 1,119 | 4,525 | 316 | 467 | 6,427 |
| Year ended 31 December 2010 | | | | | |
| Opening net book value | 1,119 | 4,525 | 316 | 467 | 6,427 |
| Additions | 62 | 509 | 47 | 243 | 861 |
| Transfers | 100 | 125 | 84 | (309) | - |
| Disposals | (1) | (4) | (3) | (3) | (11) |
| Amortisation charge | (103) | (749) | (124) | - | (976) |
| Impairment loss | - | (46) | (4) | (15) | (65) |
| Net book value | 1,177 | 4,360 | 316 | 383 | 6,236 |
| At 31 December 2010 | | | | | |
| Cost | 2,098 | 11,192 | 1,161 | 398 | 14,849 |
| Accumulated amortisation | (921) | (6,832) | (845) | (15) | (8,613) |
| Net book value | 1,177 | 4,360 | 316 | 383 | 6,236 |
| Year ended 31 December 2011 | | | | | |
| Opening net book value | 1,177 | 4,360 | 316 | 383 | 6,236 |
| Additions | 39 | 427 | 48 | 130 | 644 |
| Transfers | 21 | 226 | 27 | (274) | - |
| Transfers to intangible assets | - | (2) | - | - | (2) |
| Disposals | (6) | (1) | (1) | (1) | (9) |
| Amortisation charge | (105) | (763) | (122) | - | (990) |
| Impairment loss | (5) | (12) | - | (22) | (39) |
| Net book value | 1,121 | 4,235 | 268 | 216 | 5,840 |
| At 31 December 2011 | | | | | |
| Cost | 2,151 | 11,254 | 1,092 | 239 | 14,736 |
| Accumulated amortisation | (1,030) | (7,019) | (824) | (23) | (8,896) |
| Net book value | 1,121 | 4,235 | 268 | 216 | 5,840 |

Notes to the financial statements (continued)

For the year ended 31 December 2011

11 Property, plant and equipment (continued)

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

Beginning in 2001, the Company 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 Company is still in the process of formally registering this legal title.

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

Impairment loss

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

Disposal of property, plant and equipment

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

Ownership over ducts

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

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

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

11 Property, plant and equipment (continued)

Ownership over ducts (continued)

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

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

In accordance with Ordinance on Manner and Conditions for Access and Joint Use of Electronic Communications Infrastructure and Related Equipment (Official Gazette No. 154/08 effective as at 6 January 2009) and Ordinance on Certificate and Fees for the Right of Way (Official Gazette No. 31/09 effective as of 19 March 2009) the Croatian Post and Electronic Communications Agency started issuing certificates for the rights of way for certain routes in the city of Zagreb to HT. The Company believes that the issued certificates for the rights of way might help HT in the lawsuit filed by Zagrebački Holding Zagrebački Digitalni Grad (ZHSDG) (Note 28).

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 Company 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 Company has not yet been able to determine 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 Company's ducts as at 31 December 2011 is HRK 885 million (31 December 2010: HRK 889 million).

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

12 Investment in subsidiaries

The net book value of investments in subsidiaries comprises:

| | 31 December 2011 | 31 December 2010 |
|---------------------|---------------------|---------------------|
| | HRK millions | HRK millions |
| Combis d.o.o. | 189 | 189 |
| Iskon Internet d.d. | 330 | 99 |
| KDS d.o.o. | 3 | 3 |
| | <u>522</u> | <u>291</u> |

During 2011, investment in Iskon Internet d.d. is increased in the amount of HRK 231 million, and relates to converting of loan receivables into share capital of Iskon Internet d.d..

Hrvatski Telekom d.d. has the following subsidiaries in the Republic of Croatia:

| <i>Company</i> | <i>Country of Business</i> | <i>Principal Activities</i> | <i>Ownership Interest</i> |
|---------------------|----------------------------|---|-------------------------------|
| Combis d.o.o. | Republic of Croatia | Provision of IT services | 100% |
| Iskon Internet d.d. | Republic of Croatia | Provision of Internet and data services | 100% |
| KDS d.o.o. | Republic of Croatia | Provision of cable TV services | 100% |

13 Investment in associate

The net book value of investments in associate comprises:

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

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

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

14 Investment in joint venture

The net book value of investments in joint venture comprises:

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|----------------|-------------------------------------|-------------------------------------|
| HT d.d. Mostar | <u>335</u> | <u>335</u> |
| | <u>335</u> | <u>335</u> |

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

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

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

15 Available-for-sale financial assets

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

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

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

| | | | | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|--------------------------------|-----|-------|------------------|-------------------------------------|-------------------------------------|
| <i>Bonds:</i> | | | | | |
| Government of Germany | EUR | 1.25% | 11 March 2011 | - | 74 |
| <i>Foreign treasury bills:</i> | | | | | |
| Government of France | EUR | 1.00% | 9 February 2012 | 75 | - |
| Government of Germany | EUR | 1.00% | 15 February 2012 | 76 | - |
| Government of France | EUR | 1.00% | 22 March 2012 | 75 | - |
| Government of France | EUR | 1.00% | 23 August 2012 | 75 | - |
| Government of France | EUR | 1.00% | 21 April 2011 | - | 96 |
| Government of France | EUR | 1.00% | 24 March 2011 | - | 74 |
| Government of France | EUR | 1.00% | 19 May 2011 | - | 88 |
| Government of France | EUR | 1.00% | 5 May 2011 | - | 37 |
| Government of Germany | EUR | 1.00% | 23 February 2011 | - | 37 |
| Government of Germany | EUR | 1.00% | 11 May 2011 | - | 37 |
| | | | | <u>301</u> | <u>443</u> |

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

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

16 Inventories

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|-----------------------------|-------------------------------------|-------------------------------------|
| Inventories and spare parts | 83 | 102 |
| Merchandise | 71 | 101 |
| | <u>154</u> | <u>203</u> |

17 Trade and other receivables

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|-------------------|-------------------------------------|-------------------------------------|
| Trade receivables | 1,073 | 1,213 |
| Other receivables | 71 | 93 |
| | <u>1,144</u> | <u>1,306</u> |

The aging analysis of trade receivables is as follows:

| | Total HRK millions | Neither past due nor impaired HRK millions | Past due but not impaired | | | | |
|------------------|-----------------------|---|---------------------------|----------------------------|----------------------------|-----------------------------|---------------------------|
| | | | < 30 days HRK millions | 31-60 days HRK millions | 61-90 days HRK millions | 91-120 days HRK millions | >120 days HRK millions |
| 31 December 2011 | 1,073 | 767 | 171 | 68 | 45 | 18 | 4 |
| 31 December 2010 | 1,213 | 788 | 231 | 94 | 35 | 22 | 43 |

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

As at 31 December 2011, trade receivables with a nominal value of HRK 1,036 million (31 December 2010: HRK 1,019 million) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows:

| | 2011 HRK millions | 2010 HRK millions |
|-------------------------|----------------------|----------------------|
| At 1 January | 1,019 | 946 |
| Charge for the year | 160 | 202 |
| Unused amounts reversed | (143) | (129) |
| At 31 December | <u>1,036</u> | <u>1,019</u> |

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

18 Cash and cash equivalents and time deposits

a) Cash and cash equivalents

Cash and cash equivalents comprise the following amounts:

| | 31 December 2011 | 31 December 2010 |
|--|---------------------|---------------------|
| | HRK millions | HRK millions |
| Cash on hand and balances with banks | 1,919 | 472 |
| Time deposits with maturity less than 3 months | 1,746 | 2,773 |
| Cash and cash equivalents | <u>3,665</u> | <u>3,245</u> |

b) Time deposits with maturities more than 3 months

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

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

| | 31 December 2011 | 31 December 2010 |
|-----|---------------------|---------------------|
| | HRK millions | HRK millions |
| HRK | 2,802 | 2,656 |
| EUR | 868 | 557 |
| USD | 35 | 34 |
| | <u>3,705</u> | <u>3,247</u> |

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

19 Trade and other payables

| | 31 December 2011 | 31 December 2010 |
|-----------------------------|---------------------|---------------------|
| | HRK millions | HRK millions |
| Trade payables | 1,032 | 1,212 |
| Payroll and payroll taxes | 67 | 68 |
| VAT and other taxes payable | 63 | 43 |
| Other creditors | 25 | 25 |
| | <u>1,187</u> | <u>1,348</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 Company.

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 recognised in the statement of financial position was as follows:

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

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

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

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

21 Deferred income

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|-------------------------------|-------------------------------------|-------------------------------------|
| Connection fee | 2 | 74 |
| Deferred income – non current | <u>2</u> | <u>74</u> |
| Prepaid vouchers | 72 | 97 |
| Customer loyalty programme | 49 | 95 |
| Connection fee | 4 | 32 |
| Other | 20 | 21 |
| Deferred income – current | <u>145</u> | <u>245</u> |
| | <u>147</u> | <u>319</u> |

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

22 Provisions for legal cases and other provisions

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

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

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

23 Issued capital

Authorised, issued, fully paid and registered share capital

| | 31 December 2011 | 31 December 2010 |
|--|---------------------|---------------------|
| | 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 2011.

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 Company. These reserves are not distributable.

25 Retained earnings

In 2011 the Company paid a dividend of HRK 1,863 million (2010: HRK 2,788 million), respectively HRK 22.72 per share (2010: HRK 34.05).

26 Other accruals

| | 31 December 2011 | 31 December 2010 |
|------------------------------|---------------------|---------------------|
| | HRK millions | HRK millions |
| Variable salary to employees | 86 | 94 |
| Handset budget programme | - | 63 |
| Unused vacation | <u>27</u> | <u>37</u> |
| | <u>113</u> | <u>194</u> |

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

27 Commitments

a) Operating lease commitments

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

Operating lease charges:

| | 2011 HRK millions | 2010 HRK millions |
|-------------------------------|----------------------|----------------------|
| Current year expense (Note 7) | <u>167</u> | <u>156</u> |

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

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|-----------------------|-------------------------------------|-------------------------------------|
| Within one year | 227 | 164 |
| Between 1 and 5 years | 523 | 558 |
| Greater than 5 years | 466 | 485 |
| | <u>1,216</u> | <u>1,207</u> |

The contracts relate primarily to property leases and car leases.

b) Capital commitments

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

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

28 Contingencies

At the time of preparation of these financial statements, there are a number of claims outstanding against the Company. In the opinion of the management, the settlement of these cases will not have a material adverse effect on the financial position of the Company, except for certain claims for which a provision was established (see Note 22).

a) *Competition / Regulatory matters*

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

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

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

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

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

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

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

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

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

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

28 Contingencies (continued)

a) Competition / Regulatory matters (continued)

Wholesale Line Rental case

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

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

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

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

Denial of ULL access to Amis and Metronet

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

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

28 Contingencies (continued)

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

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

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

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

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

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

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 Company enters into transactions in the normal course of business on an arm's length basis. These transactions included the sending and receiving of international traffic to/from these companies during 2011 and 2010. Further, DTAG provided technical assistance to the Company of HRK 10 million (2010: HRK 13 million).

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

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

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

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

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

29 Balances and transactions with related parties (continued)

The Company had the following balances on transactions with its subsidiaries excluding loans in the amount of HRK 94 million (2010: HRK 277 million):

| <i>Subsidiaries:</i> | Sales HRK millions | Purchases HRK millions | Receivables HRK millions | Payables HRK millions |
|-------------------------|-----------------------|---------------------------|-----------------------------|--------------------------|
| 2011 / 31 December 2011 | 78 | 85 | 22 | 22 |
| 2010 / 31 December 2010 | 80 | 53 | 22 | 20 |

Compensation of the Supervisory Board

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

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

Compensation to key management personnel

In 2011 the total compensation paid to key management personnel of the Company amounted to HRK 32 million (2010: HRK 29 million). Key management personnel include members of the Management Boards of the Company and the operating directors of the Company, who are employed by the Company.

Compensation paid to key management personnel includes:

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|----------------------|-------------------------------------|-------------------------------------|
| Short term benefits | 30 | 28 |
| Share based payments | 2 | 1 |
| | <u>32</u> | <u>29</u> |

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

30 Financial risk management objectives and policies

The Company is exposed to international service-based markets. As a result, the Company can be affected by changes in foreign exchange rates. The Company 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 Company does not use derivative instruments either to manage risk or for speculative purposes.

a) Credit risk

The Company has no significant concentration of credit risk with any single counter party or group of counterparties with similar characteristics. Company 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 Company has issued guarantees for obligations of its subsidiary in total amount of EUR 9.3 million (currency clause).

The Company considers that its maximum exposure is reflected by the amount of debtors (see Note 17) net of provisions for impairment recognised at the statement of financial position date.

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

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

| | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
|---|-------------------------------------|-------------------------------------|
| Trade receivables for rendered telecom services to domestic customers | 747 | 769 |
| Trade receivables for rendered telecom services to foreign customers | 20 | 19 |
| | <u>767</u> | <u>788</u> |

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

30 Financial risk management objectives and policies (continued)

b) *Liquidity risk*

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

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

| Trade and other payables all amounts in HRK millions | Due in 0-30 days | Due in 31-60 days | Due in 61-90 days | Due in 91-120 days | Due in > 120 days | Total |
|---|------------------------|-------------------------|-------------------------|--------------------------|-------------------------|-------|
| Year ended 31 December 2011 | 1,118 | 33 | 4 | 2 | 30 | 1,187 |
| Year ended 31 December 2010 | 1,275 | 20 | 23 | 5 | 25 | 1,348 |

| Other long-term liabilities all amounts in HRK millions | 1 to 3 years | 3 to 5 years | > 5 years | Total |
|--|-----------------|-----------------|--------------|-------|
| Year ended 31 December 2011 | 2 | 3 | 19 | 24 |
| Year ended 31 December 2010 | 8 | 3 | 19 | 30 |

c) *Interest rate risk*

The Company's exposure to the risk of changes in market interest rates relates primarily to the Company'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 Company's profit post tax (through the impact on floating rate investments).

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

Notes to the financial statements (continued)

For the year ended 31 December 2011

30 Financial risk management objectives and policies (continued)

d) Foreign currency risk

The Company'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 Company's profit before tax due to changes in the fair value of monetary assets and liabilities.

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

e) Fair value estimation

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

f) Capital management

The primary objective of the Company's capital management is to ensure that it supports its business and maximise shareholder value. The capital structure of the Company consists of equity attributable to shareholders, comprising issued capital, reserves and retained earnings and totals HRK 11,163 million as at 31 December 2011 (2010: HRK 11,198 million).

The Company manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2011 and 31 December 2010 (see Note 23 and 25).

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

31 Financial instruments

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

| | Carrying amount | | Fair value | |
|--|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| | 31 December 2011 HRK millions | 31 December 2010 HRK millions | 31 December 2011 HRK millions | 31 December 2010 HRK millions |
| <i>Financial assets</i> | | | | |
| Cash and cash equivalents | 3,665 | 3,245 | 3,665 | 3,245 |
| Time deposits | 40 | 2 | 40 | 2 |
| Available-for-sale assets, non-current | 39 | 42 | 39 | 42 |
| Available-for-sale assets, current | 301 | 443 | 301 | 443 |
| <i>Financial liabilities</i> | | | | |
| Interest-bearing loans | 14 | 15 | 14 | 15 |

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 financial statements (continued)

For the year ended 31 December 2011

32 Authorization for Services and Applicable Fees

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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 sea, transport and infrastructure. The said regulations prescribe the calculation and the amount of fees. These fees are paid for the current year or one year in advance (in case of fees for usage of radiofrequency spectrum).

In 2011 the Company paid the following fees:

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

d) Audiovisual and electronic media services

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

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

e) Electronic communications infrastructure and associated facilities

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

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

33 Share-based and non share-based payment transactions

Various mid-term (MTIP 2009, MTIP 2010 and MTIP 2011) and long-term incentive plan (LTIP - Variable II 2011) exist at Company 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 Company, thus aligning the interests of management and shareholders. First HT's MTIP was introduced in 2008.

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

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

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

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

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

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

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

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

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

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

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

34 Auditor's fees

The statutory auditors of the Company's financial statements have rendered services of HRK 5.2 million in 2011 (2010: HRK 6.5 million). Services rendered in 2011 and 2010 relate to the audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes and audit of SAP transformation project.

35 Events after reporting period

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